

# Participant Handbook

Sector  
**BFSI**

Sub-Sector  
**Lending**

Occupation  
**Finance and Accounts**

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**Accounts  
Assistant**

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**Shri Narendra Modi**  
Prime Minister of India

“ Skilling is building a better India.  
If we have to move India towards  
development then Skill Development  
should be our mission. ”



## Certificate

### COMPLIANCE TO QUALIFICATION PACK – NATIONAL OCCUPATIONAL STANDARDS

is hereby issued by the

**BFSI SECTOR SKILL COUNCIL OF INDIA**

for

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The preparation of this guide would not have been possible without the banking sector's support. Industry feedback has been extremely beneficial since inception to conclusion, and it is with their guidance that we have tried to bridge the existing skill gaps in the industry. This facilitator guide is dedicated to the aspiring youth, who desire to achieve special skills that will be a long-term asset for their future pursuits.

## About this Guide

Learning is limitless and is an ongoing process. In order to be knowledgeable and skilled in professional domains, we have to constantly try to keep ourselves updated with new changes or best practices in industry and the role we work for, or aspire to work for.

This handbook attempts to impart knowledge to participants who aspire to become accountants, consultants etc. in the finance industry. The participant will be able to study GST along with its important concepts. This handbook is a great tool to learn about concepts, practices and methods that helps them to understand GST, its role in the economy and the advantages & disadvantages. They will also learn about the softwares used in the industry. We recommend that experienced professionals refer to a more detailed manual. The content of this handbook is primarily meant for beginners or freshers. We strongly recommend that users of this handbook seek detailed explanation if they need more information about any topic covered in this handbook.

### Vocational Education and Skill Development

The current education system does not focus on training young people in employable skills that can provide them with employment opportunities. Today, a large section of India's labour force has outdated skills. The Government is therefore strongly emphasizing on upgrading people's skills by providing vocational education and training to them. It has formulated the National Policy on Skill Development and set a target of providing skills to 50 Crore people by 2022.

The National Skill Development Mission has been developed to create convergence across sectors and States in terms of skill training activities. Further, to achieve the vision of 'Skilled India', the National Skill Development Mission would not only consolidate and coordinate skilling efforts, but also expedite decision making across sectors to achieve skilling at scale with speed and standards. It will be implemented through streamlined institutional mechanism driven by the Ministry of Skill Development and Entrepreneurship (MSDE).

### About the National Skill Development Corporation of India (NSDC)

The National Skill Development Corporation (NSDC) is a one-of-its-kind, Public Private Partnership in India, under the Ministry of Skill Development & Entrepreneurship (MSDE). It aims to promote skill development by catalyzing the creation of large, quality and for-profit vocational institutions.

The NSDC facilitates or catalyzes initiatives that can potentially have a multiplier effect as opposed to being an actual operator in this space. In doing so, it strives to involve the industry in all aspects of Skill Development. NSDC focuses primarily on supplementary skill development and strive to create seamless tracks within the education system.

National Skill Development Corporation (NSDC) has been in close contact with the BFSI Sector Skill Council as we partner to address Skill Development needs in a large, highly segmented industry which is characterized by accelerated growth. The progress of the BFSI industry has significant impact on the progress of our nation and the issue of Skill Development is one that the industry holds to be of great importance.

### About BFSI Sector Skill Council of India

The BFSI Sector Skill Council of India is set up to bring leading organizations of the BFSI industry together to create strategies and operational plans that will create standardized skill requirements for the various job roles in the industry. The skill council will also accredit well equipped service providers who will partner to disseminate the training.

The skill council is seen by its stakeholders and partners as a nation-building activity with far reaching implications for social development and empowerment through financial inclusion. Great care is being taken to appropriately address the needs of the various industry verticals as well as the geographical regions of the country.

Based on the evaluation of the content submitted by the training partners by our panel of subject matter experts (SME) and instructional designers and the feedback received from various stakeholders, we identified that there were many instances of inconsistencies in the content coverage and alignment to the QP/NOS. To address this gap we have worked with this publishing house to create QP/NOS aligned content.

## Symbols Used



Key Learning  
Outcomes



Unit  
Objectives



Exercise



Notes



Practical

## Table of Contents

| S. No. | Modules and Units                                                                                                                                                                                                                                                                                                                                                                                                                        | Page No. |
|--------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| 1.     | <b>Conceptual Frame Work</b><br>Unit 1.1 - Standard Body Setting & Hierarchy<br>Unit 1.2 - Overview of financial Reporting<br>Unit 1.3 - Elements of Financial Statement<br>Unit 1.4 - Objectives of Financial Statement<br>Unit 1.5 - Qualitative Characteristics of Financial Statement<br>Unit 1.6 - Fundamental Assumptions and Principles<br>Unit 1.7 - Accounting Process or Accounting Cycle<br>Unit 1.8 - Accounting Terminology | 1        |
| 2.     | <b>Financial Statement</b><br>Unit 2.1 - Introduction to Financial Statement<br>Unit 2.2 - Advantages of Financial Statement<br>Unit 2.3 - Types of Financial Statement<br>Unit 2.4 - Trading and Profit & Loss account/ Income Statement/ Revenue Statement<br>Unit 2.5 - Performa of Trading and Profit & loss Account<br>Unit 2.6 - Elements of the Statement of Earnings<br>Unit 2.7 - Cause Study                                   |          |
| 3.     | <b>Preparation of Balance Sheet</b><br>Unit 3.1 - Introduction<br>Unit 3.2 - Order of Permanence<br>Unit 3.3 - Order of Liquidity<br>Unit 3.4 - Elements of Balance Sheet<br>Unit 3.5 - Cause Study                                                                                                                                                                                                                                      |          |
| 4.     | <b>Cash Flow Statement</b><br>Unit 4.1 - Basic Concept and Meaning<br>Unit 4.2 - Types of Adjustment for Reconciling<br>Unit 4.3 - Preparation of Bank Reconciliation Statement<br>Unit 4.4 - Case Study                                                                                                                                                                                                                                 |          |



## Table of Contents

| S. No. | Modules and Units                                                                                                                                                                                                                                                                                                         | Page No. |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| 5.     | <b>Bank Reconciliation</b><br>Unit 5.1 - Basic Concept and Meaning<br>Unit 5.2 - Types of Adjustment for Reconciling<br>Unit 5.3 - Preparation of Bank Reconciliation Statement<br>Unit 5.4 - Cause Study                                                                                                                 | 1        |
| 6.     | <b>Preparation of Financial Statement of Non-Profit Organization</b><br>Unit 6.1 - Non-Profit Organization<br>Unit 6.2 - Financial Statement<br>Unit 6.3 - Treatment in Non-Profit Organization<br>Unit 6.4 - Receipt and Payment Account<br>Unit 6.5 - Case Study                                                        |          |
| 7.     | <b>Government Accounting</b><br>Unit 7.1 - Introduction<br>Unit 7.2 - Important Features of Government Accounting<br>Unit 7.3 - Difference between Government Account & Commercial Accounting<br>Unit 7.4 - IFRS (International Financial Reporting Standard)<br>Unit 7.5 - NFRA (National Financial Reporting Authority) |          |





## Table of Contents

| S. No. | Modules and Units                                                                          | Page No. |
|--------|--------------------------------------------------------------------------------------------|----------|
| 8.     | <b>The Employees State Insurance Act, 1948</b>                                             | 1        |
|        | Unit 8.1 - Employee State Insurance Act 1948                                               |          |
|        | Unit 8.2 - Objective of the ESI Act                                                        |          |
|        | Unit 8.3 - Important Definitions                                                           |          |
|        | Unit 8.4 - Applicability                                                                   |          |
|        | Unit 8.5 - Contribution                                                                    |          |
|        | Unit 8.6 - Fundamental Assumptions and Principles                                          |          |
|        | Unit 8.7 - Rights and Obligations                                                          |          |
|        | Unit 8.8 - Interest and Penalty                                                            |          |
|        | Unit 8.9 - Registration                                                                    |          |
| 9.     | <b>Employees Provident Fund Organization</b>                                               |          |
|        | Unit 9.1 - Introduction                                                                    |          |
|        | Unit 9.2 - The Employees Provident Fund Organization (EPFO)                                |          |
|        | Unit 9.3 - Applicability of Employees Provident Fund<br>Miscellaneous Provisions Act, 1952 |          |
|        | Unit 9.4 - Non-Applicability of this Act                                                   |          |
|        | Unit 9.5 - Important Terms and Definitions                                                 |          |
|        | Unit 9.6 - Benefits of EPF                                                                 |          |
|        | Unit 9.7 - Employees' Provident Fund Scheme (Section 5)                                    |          |
|        | Unit 9.8 - Contributions                                                                   |          |
|        | Unit 9.9 - Withdrawal from the fund                                                        |          |
|        | Unit 9.10 - Advances From The Fund                                                         |          |
|        | Unit 9.11 - Types of EPF                                                                   |          |
|        | Unit 9.12 - Employees' Pension Scheme- Section 6A                                          |          |
|        | Unit 9.13 - III. Employees' Deposit Linked Insurance Scheme - Section 6C                   |          |
|        | Unit 9.14 - General Provisions                                                             |          |
|        | Unit 9.15 - EPF – Registration Process                                                     |          |



## Table of Contents

| S. No. | Modules and Units                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Page No. |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| 10     | <b>Introduction To Income Tax</b><br>Units 10.1 - Overview Income Tax<br>Units 10.3 - Components of Income Tax Laws<br>Units 10.4 - Important definitions<br>Units 10.5 - Residential status<br>Units 10.6 - Heads of Income<br>Units 10.7 - Deduction from Gross Total Income<br>Units 10.8 - Income [Section 2(24)]<br>Units 10.9 - India [Section 2(25A)]<br>Units 10.10 - Rates of Tax                                                                                                                                                                                                                                                                                                  |          |
| 11     | <b>Residential Status And Taxability</b><br>Units 11.1 - Overview<br>Units 11.2 - Residential status (section 6)<br>Units 11.2 - Scope of Total Income<br>Units 11.3 - Income Received and Deemed to be Received                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |          |
| 12     | <b>Salaries</b><br>Unit 12.1 - Introduction<br>Units 12.2 - Basic Elements of Salary<br>Units 12.3 - Definition of Salary [Sec. 17(1)]<br>Units 12.4 - Basis of Charge [Sec. 15]<br>Units 12.5 - Allowances<br>Units 12.6 - Pension<br>Units 12.7 - Gratuity<br>Units 12.8 - Fees, commission, perquisites, or profits in lieu of or in addition to any salary or wages<br>Units 12.9 - Leave Salary or Leave Encashment:<br>Units 12.10 - Provident fund<br>Units 12.11 - Profits in lieu of salary [Section 17(3)]<br>Units 12.12 - Retrenchment compensation [Section 10(10B)]<br>Units 12.13 - Voluntary Retirement Receipts [Section 10(10c)]<br>Units 12.14 - Perquisites [Sec 17(2)] |          |



## Table of Contents

|             |                                       |
|-------------|---------------------------------------|
| Units 12.15 | Specified Employees [Sec. 17(2)(iii)] |
| Units 12.16 | Leave Travel Concession [Sec. 10(5)]  |
| Units 12.17 | Deductions from Salary                |
| Units 12.18 | Relief Under Section 89 (1)           |

### 13 Income From House Property

- Units 13.1 - Chargeability [Sec. 22]
- Units 13.2 - Conditions for Chargeability
- Units 13.3 - Composite Rent
- Units 13.4 - Income from House Property Situated Outside India
- Units 13.5 - Exempted House Properties
- Units 13.6 - Determination of Annual Value
- Units 13.7 - Deductions from Annual Value [Section 24]
- Units 13.8 - Arrears of Rent and Unrealized Rent Received Subsequently [Section 25A]
- Units 13.9 - Treatment of Income from Co-Owned Property [Section 26]
- Units 13.10 - Deemed Ownership [Section 27]

## 14 Profits And Gains of Business or Profession (PGBP)

- Units 14.1 - Introduction
- Units 14.2 - Method of Accounting [Section 145]
- Units 14.3 - Income Chargeable Under This Head [Section 28]
- Units 14.4 - Computation of Profits and Gains from Business or Profession [Section 29]
- Units 14.5 - Admissible Deductions [Section 30 To 37]
- Units 14.6 - Inadmissible Deductions [Section 40]
- Units 14.7 - Expenses or Payment Not Deductible in Certain Circumstances [Section 40A]
- Units 14.8 - Profits Chargeable to Tax [Section 41]
- Units 14.9 - Changes in The Rate of Exchange of Currency [Section 43A]
- Units 14.10 - Certain Deductions to Be Allowed Only on Actual Payment [Section 43B]
- Units 14.11 - Stamp Duty Value of Land and Building to Be Taken as The Full Value of Consideration in Respect of Transfer, Even if the Same Are Held by The Transferor as Stock- In-Trade [Section 43CA]
- Units 14.12 - Compulsory Maintenance of Accounts [Section 44AA]
- Units 14.13 - Audit of Accounts of Certain Persons Carrying on Business or Profession [Section 44ab]
- Units 14.14 - Special Provisions for Computing Profits and Gains of Business on Presumptive Basis [Sections 44AD/ 44ADA/ 44AE]



## Table of Contents

| S. No. | Modules and Units | Page No. |
|--------|-------------------|----------|
|--------|-------------------|----------|

### 15

#### Capital Gains

- Units 15.1 - Capital Asset [Sec 2(14)]
- Units 15.2 - Short Term and Long-Term Capital Assets
- Units 15.3 - Transfer [Section 2(47)]
- Units 15.4 - Scope and Year of Chargeability [Section 45]
- Units 15.5 - Capital Gains on Distribution of Assets by Companies in Liquidation [Section 46]
- Units 15.6 - Capital Gains on Buyback of Shares or Specified Securities [Section 46a]
- Units 15.7 - Transactions Not Regarded as Transfer [Section 47]
- Units 15.8 - Computation of Capital Gains [Sec. 48]
- Units 15.9 - Ascertainment of Cost in Specified Circumstances [Section 49]
- Units 15.10 - Cost of Acquisition [Section 55(2)]
- Units 15.11 - Cost of Improvement [Section 55(1)]
- Units 15.12 - Advance Money Received [Section 51]
- Units 15.13 - Computation of Capital Gains in Case of Depreciable Assets [Sections 50 & 50A]
- Units 15.14 - Capital Gains in Respect of Slump Sale Section 50B]
- Units 15.15 - Exemption of Capital Gains
- Units 15.16 - Reference to Valuation Officer [Section 55A]
- Units 15.17 - Tax on Short Term Capital Gains in Respect of Equity Shares/Units of an Equity Oriented Fund [Section 111A]
- Units 15.18 - Tax on Long Term Capital Gains [Section 112]
- Units 15.19 - Tax on Long Term Capital Gains on Certain Assets [Section 112A]

### 16

#### Income From Other Sources

- Units 16.1 - Dividend income
- Units 16.2 - Deemed Dividend
- Units 16.3 - Casual Income
- Units 16.4 - Income by way of interest on securities
- Units 16.5 - Income from hiring of machinery, etc
- Units 16.6 - Hiring out of building with machinery etc. [Section 56(2)(iii)]
- Units 16.7 - Share premiums in excess of the fair market value to be treated as income
- Units 16.8 - Income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be chargeable to tax under income from other sources. [Section 56(2) (viii)]
- Units 16.9 - Advance money received
- Units 16.10 - Any sum of money or value of property received without consideration or for inadequate consideration to be subject to tax in the hands of the recipient [Section 56(2)(x)]
- Units 16.11 - Immovable property [Land or building or both]:



## Table of Contents

| S. No.    | Modules and Units                                                                                                             | Page No. |
|-----------|-------------------------------------------------------------------------------------------------------------------------------|----------|
|           | Units 16.12 - Movable Property [Property, other than immovable property]                                                      |          |
|           | Units 16.13 - Compensation or any other payment received in connection with termination of his employment [Section 56(2)(xi)] |          |
|           | Units 16.14 - Keyman Insurance Policy                                                                                         |          |
|           | Units 16.15 - Residual Income:                                                                                                |          |
|           | Units 16.16 - Deductions Allowable [Section 57]                                                                               |          |
|           | Units 16.17 - Deductions Not Allowable [Section 58]                                                                           |          |
| <b>17</b> | <b>Aggregation Of Income; Set-Off, Or Carry Forward And Set-Off Of Losses</b>                                                 |          |
|           | Units 17.1 - Aggregation of Income                                                                                            |          |
|           | Units 17.2 Set Off and Carry Forward                                                                                          |          |
|           | Units 17.3 - Inter Source Adjustment (Section 70)                                                                             |          |
|           | Units 17.4 - Inter Head Adjustment                                                                                            |          |
|           | Units 17.5 Carry Forward & Set-Off of Loss from House Property [Section 71B]                                                  |          |
|           | Units 17.6 Carry Forward and Set-Off of Business Losses [Sections 72]                                                         |          |
|           | Units 17.7 - Losses in Speculation Business [Section 73]                                                                      |          |
|           | Units 17.8 Carry Forward & Set Off of Losses of Specified Businesses [Section 73a]                                            |          |
|           | Units 17.9 - Losses Under the Head 'Capital Gains' [Section 74]                                                               |          |
|           | Units 17.10 - Losses from the Activity of Owning and Maintaining Race Horses [Section 74A (3)]                                |          |
|           | Units 17.11 - Order of Set-Off of Losses                                                                                      |          |
|           | Units 17.12 - Submission Of Return of Losses [SECTION 80]                                                                     |          |
| <b>18</b> | <b>Computation Of Total Income And Tax Liability Of Individuals</b>                                                           |          |
|           | Units 18.1 - Meaning of Total Income                                                                                          |          |
|           | Units 18.2 - Income to be Considered While Computing Total Income of Individuals Unit                                         |          |
|           | 18.3 - Computation of Total Income and Tax Liability of Individuals                                                           |          |
| <b>19</b> | <b>Advance Tax, TDS And TCS</b>                                                                                               |          |
|           | Units 19.1 - Deduction of Tax at Source and Advance Payment [Section 190]                                                     |          |
|           | Units 19.2 - Direct Payment [Section 191]                                                                                     |          |
|           | Units 19.3 - Consequences of Failure To Deduct Or Pay [Section 201]                                                           |          |
|           | Units 19.4 - Due Date of Depositing Deducted Tds                                                                              |          |
|           | Units 19.5 - Liability for Payment of Advance Tax                                                                             |          |





## Table of Contents

| S. No. | Modules and Units | Page No. |
|--------|-------------------|----------|
|--------|-------------------|----------|

- Units 19.6 - Computation of Advance Tax
- Units 19.7 - Instalments of Advance Tax and Due Dates
- Units 19.8 - Interest For Non-Payment Or Short-Payment Of Advance Tax [Section 234B]
- Units 19.9 - Interest Payable for Deferment of Advance Tax [Section 234C]
- Units 19.10 - Tax Collection At Source – Basic Concept
- Units 19.11 - Rate of Tcs In Case of Collection by an Authorized Dealer
- Units 19.12 - Higher Rate Of Tcs For Non-Furnishers Of Pan [Section 206CC]

### 20 **Employability Skills (DGT/VSQ/N0102) (60 hrs.)**

Employability Skills is available at the following location :

<https://www.skillindiadigital.gov.in/content/list>

Scan the QR code below to access the ebook





# 1. Conceptual Frame Work

- Unit 1.1 - Standard body setting & hierarchy
- Unit 1.2 - Overview of financial Reporting
- Unit 1.3 - Elements of Financial Statement
- Unit 1.4 - Objectives of Financial Statement
- Unit 1.5 - Qualitative Characteristics of financial Statement
- Unit 1.6 - Fundamental Assumptions and Principles
- Unit 1.7 - Accounting Process or Accounting Cycle
- Unit 1.8 - Accounting Terminology



## Key Learning Outcomes



- Understand Standard Setting Bodies and Hierarchy
- Gain an Overview of Financial Reporting
- Identify and Explain the Elements of Financial Statements
- Understand the Objectives of Financial Statements
- Recognize the Qualitative Characteristics of Financial Statements
- Understand Fundamental Assumptions and Principles
- Comprehend the Accounting Process or Accounting Cycle
- Familiarize with Accounting Terminology

## Unit 1 - Conceptual Frame Work

### Unit Objectives

- Concepts of Financial Accounting
- Understand the Fundamentals and Principles of a Financial Statement
- Structural Overview of an Accounting Cycle
- Knowledge of Various Financial Statements of Accounting
- Familiarise with Accounting Terminology



## Unit 1.1 - Standard Setting Body & Hierarchy

Accounting can be defined as the language of trade and the rhythm of all business standards. To ensure fair accounting, there exists a worldwide standard-setting authority body. Some of the most important authority bodies include NFRA, FASB and IASB. These bodies were established to ensure improved quality and standard of corporate financial reporting worldwide.

- **NFRA** (National Financial Reporting Authority) – IND AS (Indian Accounting standards)
- **FASB** (Financial Accounting Standard Board) – US GAAP (Generally Accepted Accounting Principles)
- **IASB** (International Accounting Standard Board) – IFRS (International Financial Reporting Standard)

## Unit 1.2 - Overview of Financial Accounting & Reporting

A public corporation is expected to send an annual report to its shareholders, showing a detailed overview of the corporation's activities and finances. The front part of the report includes a mix of illustrations, images, and narration for the same, all chronologically portraying the activities of the organisation over the previous year. The back part of the report includes extensive details on corporation finance and activities. Financial accounting is the process of recording, summarizing, and reporting a company's business transactions with the help of financial statements, which include, the income statement, the balance sheet, the cash flow statement, and the statement of retained earnings.

How does accounting generate financial information?



Fig 1.1

- **Purpose of an Annual Report**

The aim of an annual report submitted to shareholders and other parties is to publicize the business operations of the company over the previous financial year. The report submitted helps determine the financial performance of the company.

Given below is the information that constitutes an annual report:

1. General corporate details
2. Financial and operating highlights
3. Letter to shareholders from the CEO
4. Management's discussion and analysis (MD&A)
5. The narrative document, charts, and images
6. Financial Statements
7. Auditors Report
8. Accounting Policies



Fig 1.2

## Unit 1.3 - Elements of Financial Statement

### Financial Statement

|                                        |                     |
|----------------------------------------|---------------------|
| Statement of Financial Position ( B/S) | Balance Sheet       |
| Statement of Earnings (I/S)            | Income Statement    |
| Statement of Cash Flow (C/S)           | Cash Flow statement |
| Statement of Equity (S/E)              | Statement of Equity |

### Elements

Ten core elements define a financial statement. Understanding these elements can help an individual construct a basic financial statement.

The ten elements are given below:

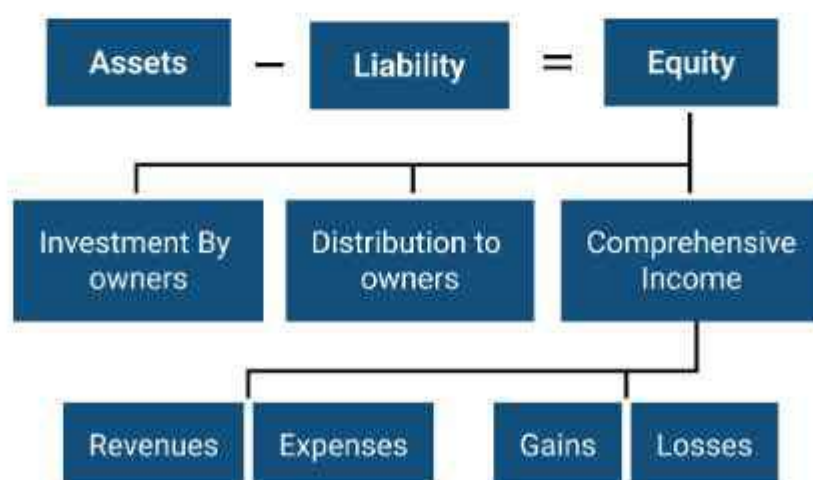


Fig 1.3

## Points to Remember

|                        |                                                                                                                                                                                     |
|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Assets                 | <ul style="list-style-type: none"> <li>• Probable future economic benefit</li> <li>• Owned and controlled today</li> <li>• Result of past transaction</li> </ul>                    |
| Liability              | <ul style="list-style-type: none"> <li>• Probable future economic sacrifices</li> <li>• Owned today</li> <li>• Result of a past transaction</li> </ul>                              |
| Equity                 | <ul style="list-style-type: none"> <li>• Ownership interest calculated as the residual interest in the assets after deducting liabilities</li> </ul>                                |
| Investment by owners   | <ul style="list-style-type: none"> <li>• Increase in equity</li> <li>• Result of transfers from owners</li> </ul>                                                                   |
| Distribution to owners | <ul style="list-style-type: none"> <li>• Decrease in equity</li> <li>• Result of transfers to owners</li> </ul>                                                                     |
| Comprehensive Income   | <ul style="list-style-type: none"> <li>• Change in equity during a reporting period from transactions and tother events/circumstances</li> <li>• From non-owners sources</li> </ul> |
| Revenues               | <ul style="list-style-type: none"> <li>• Inflow (Assets Increase / Liability Decrease)</li> <li>• From ongoing major or central operations</li> </ul>                               |
| Expenses               | <ul style="list-style-type: none"> <li>• Outflow (Assets Decrease / Liability Increase)</li> <li>• From ongoing major or central operations</li> </ul>                              |
| Gains                  | <ul style="list-style-type: none"> <li>• Increase in equity</li> <li>• From peripheral or incidental sources except investment from owners</li> </ul>                               |
| Losses                 | <ul style="list-style-type: none"> <li>• Decrease in equity</li> <li>• From peripheral or incidental sources except distribution to owners</li> </ul>                               |



## Unit 1.4 - Objectives of Financial Statement

### • Providing Information to the users for Decision-Making

The primary objective of accounting is to provide useful information for decision-making to stakeholders such as owners, management, creditors, and investors.



Fig 1.4

### • Systematic Recording of Transactions

The basic objective of accounting is to systematically record financial transactions.

These recorded transactions are later classified and summarized logically for the analysis, interpretation, and preparation of financial statements.

### • Ascertainment of Result of Transactions

Profit and loss accounts are prepared to analyse the result of a business operation for a particular period. If the revenue is higher than the expenses, the business can be deemed profitable. But if the expenses exceed the revenue, then the business is likely to be running at loss. The profit and loss account helps the management and stakeholders take rational decisions.

### • Ascertainment of the Financial Position of the Business

A balance sheet or a financial position statement is prepared by an accountant.

The balance sheet is a statement of the assets and liabilities of a business at a given point in time. This also helps in understanding the financial health of the business.

## Unit 1.5 - Qualitative Characteristics of Financial Statement

- **Predictive Value:** It's a key concept that helps forecast future outcomes.
- **Confirmatory Value:** This feature clarifies the prior evaluations.
- **Materiality:** The concept to measure the degree to which certain elements or factors are important for a firm.
- **Error free:** The statement should be free of any errors and omissions.
- **Neutrality:** The content of a statement must be unbiased.
- **Completeness:** The intended content must be portrayed as a whole.
- **Comparability:** The prepared statement must be comparable and measurable to the previous statement.
- **Understandability:** The concept featured in the statement must be clear and concise.
- **Timeliness:** The statement must be up to date.
- **Verifiability:** Every function provided must hold proof or evidence.
- **Cost is less than Benefits:** While there should be a balance between cost and benefits, it must be ensured that benefits are prioritised over the cost.

## Unit 1.6 - Fundamental Assumptions and Principles

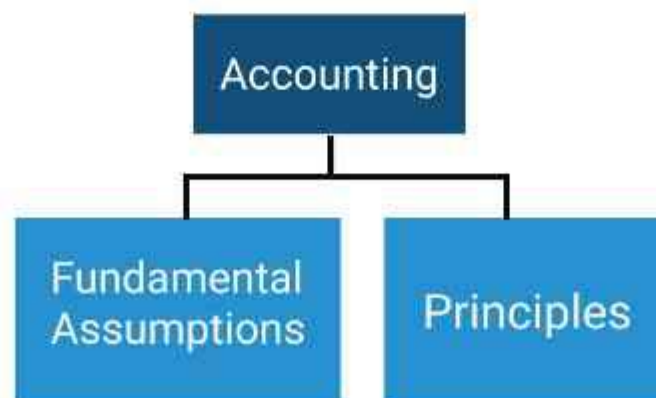


Fig 1.5

### • Fundamental Assumptions

Accounting should begin with a set of assumptions and some of them are explained below:

- **Business Entity Concept:**

A business is treated as a separate entity, distinct from its owner, which means that the business and the owner must be treated separately. Thus, when an individual invests in a business, the invested amount will fall under the liability of the business. The concept of a separate entity applies to all forms of business.

- **Going Concern Concept:**

This concept states that the business is in for the long run and that there is no intention to liquidate the business at any time in the immediate future.

- **Money Measurement concept:**



Fig 1.6

Monetary transactions alone can find a place in books of accounts. This means that any transactions with no monetary value will not be recorded.

- **Accounting Period Concept:**

According to this assumption, the life of a business is divided into different periods for preparing financial statements. Generally, a business concern adopts twelve months for measuring the income of the concern. This time interval is known as the accounting period.

### • Principles

The financial statement created follows a certain standard in accounting. The principles to follow while creating a statement are mentioned below:

#### Historical cost

The information displayed in the statement must be the information based on the original cost and not the current market value, except for when it comes to inventory.

Earned

+

Realized/Realizable

=

Revenue Recognition

- **Realization :**

Realization states the revenue is recognized when goods and services are sold.

The receipt or the advanced payment received on an order cannot be considered for the realization of revenue.

- **Dual Aspect:**

According to this concept, every transaction has two aspects, they namely are receiving and giving. The base of this principle is that, for every debit, there is an equal and corresponding credit.



Fig 1.8

- **Matching Principles :**

According to this Principle, revenue earned, and expenses incurred should be matched and reported in the same accounting period.

- **Conservatism :**

According to this principle, an accountant must exercise a high degree of verification and use solutions that reduce the amount of loss in an uncertain event.

- **Full disclosure:**

The accounting convention of full disclosure implies that accounts must be honest, and unbiased, and all material information must be disclosed.

## Unit 1.7- Accounting Process/Accounting Cycle

The accepting, recording, classifying and crediting of payments made and received inside a business over a specific accounting period is known as the accounting process/cycle.



- Remember the 3 Golden Rules of Accounting

| Real Account                                     | Personal account                            | Nominal Account                                                   |
|--------------------------------------------------|---------------------------------------------|-------------------------------------------------------------------|
| Debit What Comes in<br>&<br>Credit What goes out | Debit the Receiver<br>&<br>Credit the Giver | Debit the Expenses and Loses<br>&<br>Credit the Incomes and Gains |

Fig 1.9

- STEP: 1** Record transaction Journal entries
- STEP: 2** Post Transaction Journal entries to the General Ledger
- STEP: 3** Prepare unadjusted Trial Balance
- STEP: 4** Record Adjusting Journal entries
  - Accrual Type Journal Entries** (e.g., Account Receivable, Accounts payable, Other Payables / receivables)
    - » Adjusting Journal Entries first
    - » Cash journal Entries later
  - Deferral Type Journal Entries** (e.g., Depreciation, Prepaid Expenses, Unearned revenues)
    - » Cash journal Entries first
- STEP: 5** Post Adjusting journal entries to the General Ledger
- STEP: 6** Prepare Adjusted Trail Balance
- STEP: 7** Prepare Financial Statement & Notes to account

**The various financial statement of the accounting are:**

- Balance sheet
- Income statement
- Statement of Shareholders' Equity
- Cashflow statement

**STEP: 8** Prepare Closing Entries

**Explanations:**

• **Journal**

Journals are original entry books where transactions are noted in chronological order as they occur. The primary record of company transactions is a journal.

The journal is sub divided in to the following subsidiary books:

- **Cash Book:** For recording all cash transactions
- **Purchases Book:** For recording credit purchases of goods
- **Sales Book:** For recording credit sales
- **Purchase Returns Books:** For recording the goods returned by the trader to the supplier
- **Sales Returns Book:** For recording the goods returned to the trader by his customer
- **Bills Receivable Books:** For recording all bills received by the trader from his customer
- **Bills Payable Book:** For recording all the bills given or accepted by the suppliers
- **Journal Proper:** For all transactions that do not find a place in any of the above books



### • The concept of DEBIT & CREDIT

Typically, an account is expressed as a statement in form of the English letter 'T'. It has two sides. The left-hand side is called the "Debit" side and the right-hand side is called the "Credit" side. The debit is denoted as 'Dr' and the credit as 'Cr'.

Please refer to the following image for illustration:

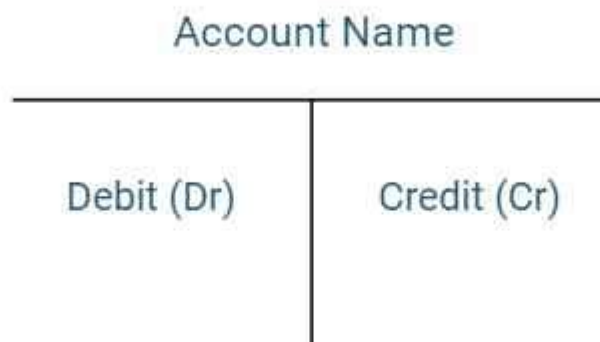


Fig 1.10

### • Rules of accounting

The Golden Rules will guide us on whether the account is to be debited or credited.

There is a different rule for each basic type of account i.e., real, personal, and nominal.

**Real Account:** Real accounts are accounts that are associated with assets or property. Real accounts include things like money, furniture, equipment, stock-in-trade, receivable bills, etc. The rule for a real account is Debit what comes in, Credit what goes out.

**Personal accounts:** These include the account of the person with whom the business deals are carried out. Natural personal accounts (e.g., - Raja's accounts, Gupta's accounts etc.,). Artificial personal accounts (corporate bodies or institutions), Representative personal accounts (salary due, rent outstanding etc.,) are examples of a personal account. The rule of a personal account is Debit the receiver, Credit the giver.

**Nominal accounts:** Nominal accounts are those that deal with expenses and losses as well as income and gains. Examples include salary accounts, commission accounts, interest received, dividends received, sale of goods and so on. The rule of Nominal account is, Debit all expenses and losses, Credit all incomes and gains.

#### • Ledger

A ledger is a book, which contains various accounts, it is said to be a secondary books of account. A ledger is defined as "a book in which all the personal, real, and nominal accounts of business are kept for permanent records so that up-to-date statement of an account can be easily known".

#### • Trial Balance

Trial balance is a statement containing the various ledger balances on a particular date. This

statement is prepared to check the correctness of ledger posting and balancing of accounts. If the total of the debit balances is equal to the credit balances, it is implied that the posting and balancing of accounts are correct.

Specimen of trial balance is given below:

• **Type of Adjusting Entries**

An adjusting entry means adjustment made by the books to make financial statements more accurate. Adjusting entries are made at the end of the accounting period.

The following are Adjusting Entries:

• **Profit and Loss Account/Income statement**

Profit and loss account or income statement is prepared to ascertain the net profit or net loss of the business for an accounting period. If credit side is more than the debit side, the difference is net profit

Specimen of profit and loss Account is given below:

TRAIL BALANCE AS PER LEDGER ACCOUNTS

| Particular        | Dr.  | Cr.  |
|-------------------|------|------|
| Opening inventory | XX   |      |
| Sales             |      | XX   |
| Wages             | XX   |      |
| Salary            | XX   |      |
| Purchase return   |      | XX   |
| Sales return      | XX   |      |
| Machinery         | XX   |      |
| Land & Building   | xx   |      |
| Sunday Debtors    | XX   |      |
| Sunday Creditors  |      | XX   |
| Bills Payable     |      | XX   |
| Bills Receivable  | XX   |      |
| Cash in Hand      | XX   |      |
| Share Capital     |      | XX   |
| Secured Loan      |      | XX   |
| Capital Reserve   |      | XX   |
|                   | XXXX | XXXX |

• **Type of adjusting entries**

An adjusting entry means, adjustments made by the books to make financial statements more accurate. Adjusting entries are made at the end of the accounting period.

The following are Adjusting Entries:

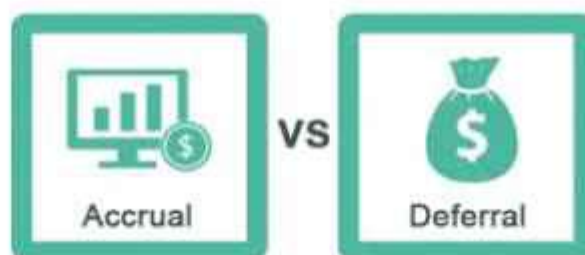


Fig 1.12

|                   | Now                    | Later                  |
|-------------------|------------------------|------------------------|
| Accrued Revenue   | Revenue is Recognized  | Cash is Received       |
| Accrued Expenses  | Expenses is Recognized | Cash is paid           |
| Deferred Revenue  | Cash is Received       | Revenue is Recognized  |
| Deferred Expenses | Cash is paid           | Expenses is Recognized |

Fig 1.13

- Profit and loss account/income statement

A profit and loss account or income statement is prepared to ascertain the net profit or net loss of the business for an accounting period. If the credit side is more than the debit side, the difference is net profit.

Specimen of profit and loss Account is given below

| Income /Profit/Loss Statement               |        |        |
|---------------------------------------------|--------|--------|
| Sales                                       | Amount | Amount |
| Less: OGS (Cost of goods sold)              | -----  | -----  |
| Gross Margin                                | -----  | -----  |
| Less: Operating Expenses                    | -----  | -----  |
| Operating Income                            | -----  | -----  |
| Add: Other Revenues & Gains                 | -----  | -----  |
| Less: Others Expenses & Losses              | -----  | -----  |
| Income from Continuing Operation before Tax | -----  | -----  |
| Less: Tax                                   | -----  | -----  |
| Income from Continuing Operation            | -----  | -----  |
| Net Income/ Earnings                        | -----  | -----  |

Fig 1.14

**Sales/Net Sales**

**Net Sales = Gross sales – Sales Return – Sales Discount**

**COGS (Cost of goods Sold)**

Beginning Inventory

Add: Cost of goods purchased (Net Purchase + Direct Expenses )

Add: Direct Manufacturing Cost (Factory overhead, Depreciation on plant,  
cost of goods available for sale)

Less: Ending Inventory

-----

Cost of Goods Sold (COGS)

**Operating Expenses**

General & Administrative Expenses

Selling Expenses

Other Indirect expenses

**Non- Operating Items**

Interest

Commission Received

Dividend

- **Balance sheet**

Balance sheet is a statement showing the assets and liabilities of a business on a particular date. It reveals the financial position of a business. Hence it is also known as position statement.

Specimen of Balance sheet is given below:

| Liability             | Assets              |
|-----------------------|---------------------|
| Equity                | Non- Current Assets |
| Non-Current Liability | Current Assets      |
| Current Liability     |                     |



## Unit 1.8 Accounting Terminology

- **Assets:** An asset is something that contains economic value and is for future benefit. An asset can often generate cash flow in the future.

### Non-Current Assets



### Current Assets



Fig 1.15

#### • Current Assets

The assets that can be converted to cash within the next 1 year is called as Current Assets. Balance sheet preparation is done within the end of an year that's why it is called the asset that can be converted in the next 1 year

#### • Non- Current Assets

The assets that cannot be converted to cash within the next 1 year are called as Non-Current Assets

- **Liability:** A liability is something a person or company owes, usually a sum of money. Liabilities are settled over time through the transfer of economic benefits including money, goods or services.

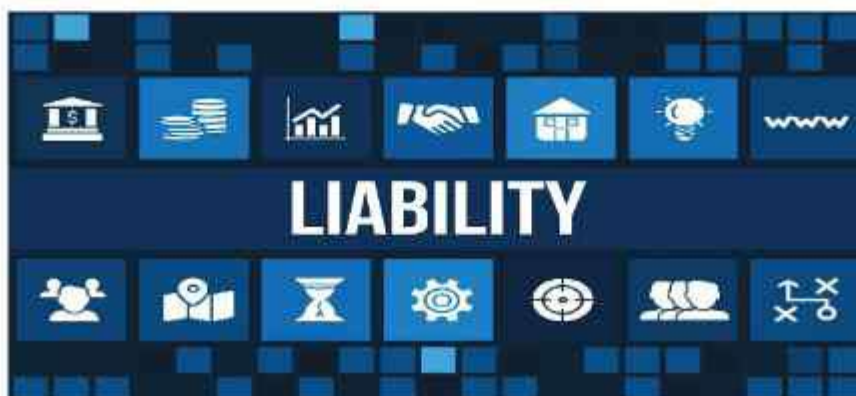


Fig 1.16

- **Current Liability**

The liability that has to be returned within the next 1 year is known as Current Liability.

- **Non-Current Liability**

The liability that cannot be returned back within the next 1 year is known as Non-current Liability.

- **Equity:** Generally, refers to the amount invested in the enterprises by its owners. This is a vital source of financing across all types of businesses because companies need these resources in order to operate. Businesses raise capital by issuing stocks and bonds to investors who purchase these financial instruments with cash or other assets.

### **Current Assets – Current liability = Working Capital**

**Reserve:** Reserves are a part of profits or gains that has been allotted for a specific purpose. Reserves are usually set up to buy fixed assets, pay bonuses, pay an expected legal settlement, pay for repairs & maintenance and pay off debt.

- **Opening, Closing and Adjusting Entries:** Opening entries are passed at the beginning of an accounting period. At the end of every accounting period, all revenue items are closed by transferring to trading and profit and loss account, such entries are known as closing entries. In the Accrual system of accounting, various adjustments are made to accounts, to show the correct figure for the current year. The entries that are passed for adjusting the incomes, expenses etc., are called adjusting entries.

Following are the examples of adjusting entries:

- **Prepaid Expenses (Asset)**
- **Unpaid Expenses (Liability)**
- **Unearned Income (Liability)**
- **Bad & doubtful debt (Expenses)**
- **Depreciation (Expenses)**

- **Treatment of Certain Adjusting Items:**

1. **Closing Stock:** Closing stock refers to the goods that remain unsold at the end of the accounting year. If it is given in the adjustment it is shown on the credit side of the trading account, also shown on the assets side of the balance sheet. If it is only given in the trial balance, it should be shown only in the debit side of the trading account and profit & loss account termed as opening stock.



Fig 1.17

2. **Outstanding Expenses** :These are expenses which remain unpaid at the end of the accounting period.If it is given in the adjustment, it should be added to the concerned expenses on the debit side of the trading account and profit & loss account and it should also be shown in the balance sheet as a liability

#### • Prepaid Expenses

Prepaid expenses are payments made in the current year but related to the next accounting year. Prepaid expenses are also known as expenses paid in advance or unexpired expenses. If it is given in the adjustment, it should be deducted from the concerned expenses on the debit side of trading accounting or profit and loss account and it should also be shown on the asset side of the balance sheet.

#### • Accrued Income

The income which has already been received by the business before it's been earned is known as unearned income or income received in advance. This income belongs to the next accounting period. If it is given in the adjustment, it should be deducted from the concerned income on the credit side of the profit and loss account and it should also be shown on the liability side of the balance sheet.

#### • Income Received in Advance

The income which has already been received by the business before it's been earned is known as unearned income or income received in advance. This income belongs to the next accounting period. If it is given in the adjustment, it's should be deducted from the concerned income on the credit side of the profit and loss account and it should also be shown on the liability side of balance sheet.

#### • Depreciation & Amortisation

The monetary value of an asset decreases over some time due to use, wear and tear or obsolescence. This decrease is measured as Depreciation. Amortization is an accounting technique used to periodically lower the book value of an intangible asset over a set period. If it is given in the adjustment, it should be shown on the debit side of the profit and loss account and deducted from the concerned asset on the balance sheet.

#### • Bad Debts

When an amount due from debtors is irrecoverable it is called bad debt. It is a loss to the business. If it is given in the adjustment, it should be taken on the debit side of the profit and loss account by adding to the bad debt, and it should also be deducted from debtors on the asset side.



## Summary

Financial reporting is guided by a framework established by standard-setting bodies, which ensures consistency and transparency in financial statements. These reports comprise key elements such as assets, liabilities, equity, revenue, and expenses, which together provide a snapshot of a company's financial health. The objectives of financial statements are to offer relevant and reliable information to users like investors and creditors, helping them make informed decisions. This is supported by qualitative characteristics such as comparability, reliability, and understandability. Underpinning this process are fundamental accounting assumptions and principles, like the going concern and accrual basis, which guide the recording and reporting of financial transactions through the accounting cycle. A strong grasp of accounting terminology is essential for interpreting these statements accurately. Together, these components form the backbone of effective financial management and reporting.



## Exercise

Which of the following is a key element of financial statements?

- a) Marketing Strategy
- b) Assets
- c) Product Design
- d) Customer Satisfaction
- Answer: b) Assets

What is the primary purpose of financial statements?

- a) To attract new customers
- b) To provide useful financial information to stakeholders
- c) To promote products
- d) To assess market trends
- Answer: b) To provide useful financial information to stakeholders

Which qualitative characteristic ensures that financial information is presented in a manner that is clear and easy to understand?

- a) Relevance
- b) Understandability
- c) Reliability
- d) Comparability
- Answer: b) Understandability

What is the fundamental assumption that a business will continue its operations in the foreseeable future?

- a) Materiality
- b) Going Concern
- c) Consistency
- d) Accrual Basis
- Answer: b) Going Concern

Which step in the accounting cycle involves recording financial transactions as they occur?

- a) Preparing the financial statements
- b) Making journal entries
- c) Posting to the ledger
- d) Adjusting entries
- Answer: b) Making journal entries

Which of the following is NOT a qualitative characteristic of financial statements?

- a) Relevance
- b) Profitability
- c) Reliability
- d) Comparability
- Answer: b) Profitability

Which principle requires transactions to be recorded when they occur, rather than when cash is received or paid?

- a) Consistency
- b) Accrual Basis

- c) Materiality
- d) Going Concern
- Answer: b) Accrual Basis

What does the term 'liabilities' refer to in financial statements?

- a) Company profits
- b) Company debts or obligations
- c) Company assets
- d) Company revenue
- Answer: b) Company debts or obligations

Which characteristic of financial statements ensures that information is dependable and free from material error?

- a) Reliability
- b) Relevance
- c) Comparability
- d) Understandability
- Answer: a) Reliability

Why is standardized accounting terminology important?

- a) To increase company profits
- b) To ensure clarity and consistency in financial reporting
- c) To promote brand awareness
- d) To simplify tax calculations
- Answer: b) To ensure clarity and consistency in financial reporting

[illegible]



## 2. Financial Statement

- Unit 2.1 - Introduction to Financial Statement
- Unit 2.2 - Advanatages of Financial Statement
- Unit 2.3 - Types of Financial Statement
- Unit 2.4 - Trading and Profit & Loss account/ income statement/  
revenue statement
- Unit 2.5 - Performa of Trading and Profit & Loss Account
- Unit 2.6 - Elements of the statement of Earnings
- Unit 2.7 - Case Study





## Key Learning Outcomes



- Understand the Purpose and Importance of Financial Statements
- Identify Different Types of Financial Statements
- Analyze the Components of an Income Statement
- Prepare a Trading and Profit & Loss Account
- Evaluate the Elements of the Statement of Earnings
- Apply Knowledge through Case Studies

## Unit 2 - Financial Statement

### Unit Objectives

After studying this module, the students shall be able to ;

- Understand the concept of financial statement
  - Knowledge of various types of financial statement
  - Overview of different elements of statement of earnings
- Learn to work on financial statement problems

## Unit 2 .1- Introduction to financial Statement

Financial statements are formal records of the financial activities and position of a business, person, or other entity. Relevant financial information is presented in a structured and easy-to-understand manner.

## Unit 2.2 - Advantages of Financial Statement

- To determine the ability of a business to generate cash, sources, and utilization of the generated cash.
- To determine whether a business can pay back debt.
- To track financial results on a trend line to spot any looming profitability issues.
- To derive financial ratios from the statements that can indicate the condition of the business.
- To investigate the details of certain business transactions, as outlined in the disclosures that accompany the statements.
- To use as the basis for an annual report, which is distributed to a company's investors and the investment community

## Unit 2.3 - Types of financial statements



Fig 2.1

## Unit 2.4 Trading and Profit & Loss account / income statement / Revenue Statement

Every business requires to know the income earned and expenses incurred during a particular period, usually at the end of the year. Profit & loss statement/account shows the profit/loss earned/incurred by a business for a month or a year. Businesses use profit & loss statement and others such as sole traders and partnership firms use "T Account".

Profit & loss statement/account is prepared for two prime reasons.

- To know the financial performance over a period via accrual accounting
- Statutory requirements
- Traditionally, there were two steps to knowing the profit/loss. It meant, the preparation of:
  - Trading account
  - Profit and loss account



Fig 2.2



## Unit 2.5 - Performa Of Trading and Profit & Loss Account

No specific profit & loss account format is given for the sole traders and partnership firms. They shall prepare the P&L account in any form. However, it should reflect the gross profit & net profit separately.

Usually, such firms prefer a "T-shaped form" for preparing a P&L account.

| OUR CO. LTD TRADING, PROFIT & LOSS ACCOUNT<br>FOR THE YEAR ENDED DD/MM/YY |     |                        |      |
|---------------------------------------------------------------------------|-----|------------------------|------|
| DR                                                                        |     | CR                     |      |
| Opening inventory                                                         | SXX | Sales                  | SXXX |
| Add Purchases                                                             | XX  | Less Returns Inward    | (XX) |
| Add Carriage inwards                                                      | XX  |                        |      |
| Cost of Goods Available                                                   | XXX |                        |      |
| Less Returns outwards                                                     | (X) |                        |      |
| Less Closing inventory                                                    | (X) |                        |      |
| Cost of Goods Sold                                                        | XX  |                        |      |
| Gross Profit c/d                                                          | XX  |                        |      |
|                                                                           | XXX |                        | XXX  |
| Less Opening inventory                                                    | X   | Gross Profit b/d       | XX   |
| Insurance                                                                 | X   | Add other incomes;     |      |
| Transport                                                                 | X   | 1. Interest on deposit | XX   |
| Rent Expense                                                              | X   | 2. Discount Received   | XX   |
| Carriage Outward                                                          | X   | 3. Commission Received | XX   |
| Salary                                                                    | X   | 4. Bad Debt Recovered  | XX   |
| Advertisement                                                             | X   |                        |      |
| Depreciation                                                              | X   |                        |      |
| Discount Allowed                                                          | X   |                        |      |
| Bad Debts Written Off                                                     | X   |                        |      |
| Net Profit c/d                                                            | XX  |                        |      |
|                                                                           | XXX |                        | XXX  |
|                                                                           |     | Net Profit b/d         | SXX  |

Fig 2.3

- Performa of income statement /revenue statement

Companies shall prepare the profit & loss account as per schedule III of the companies act, 2013.

| Income /Profit/Loss Statement               |        |        |
|---------------------------------------------|--------|--------|
| Sales                                       | Amount | Amount |
| Less: OGS (Cost of goods sold)              | -----  | -----  |
| Gross Margin                                | -----  | -----  |
| Less: Operating Expenses                    | -----  | -----  |
| Operating Income                            | -----  | -----  |
| Add: Other Revenues & Gains                 | -----  | -----  |
| Less: Others Expenses & Losses              | -----  | -----  |
| Income from Continuing Operation before Tax | -----  | -----  |
| Less: Tax                                   | -----  | -----  |
| Income from Continuing Operation            | -----  | -----  |
| Net Income/ Earnings                        | -----  | -----  |

Fig 2.4

## Unit 2.6 - Elements of the Statement of Earnings

### Sales

A sale is a transaction between two or more parties that involves the exchange of tangible or intangible goods, services, or assets for money. In some cases, assets other than cash are paid to a seller.

$$\text{Net Sales} = \text{Gross sales} - \text{sales return} - \text{sales Discount}$$

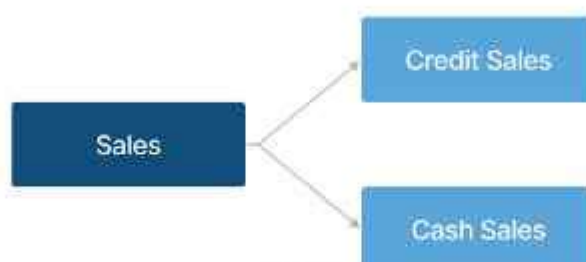


Fig 2.5

### Credit sales

Credit sales are payments that are usually not made until several days or weeks since a product has been delivered.

Journal:-

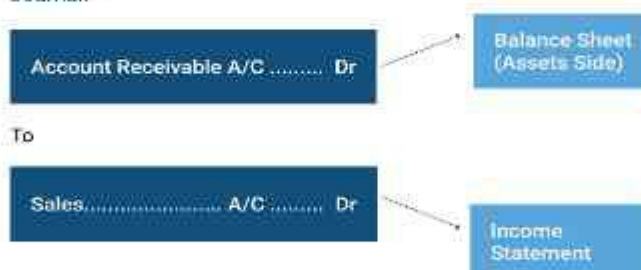


Fig 2.6

### Cash Sales

Cash sales are sales in which the payment obligation of the buyer is settled at once. Cash sales are considered to include bills, coins, checks, credit cards, and money orders as forms of payment. A cash sale eliminates the need for the seller to extend credit to a customer. Therefore, it eliminates any risk of bad debt.

Journal:-

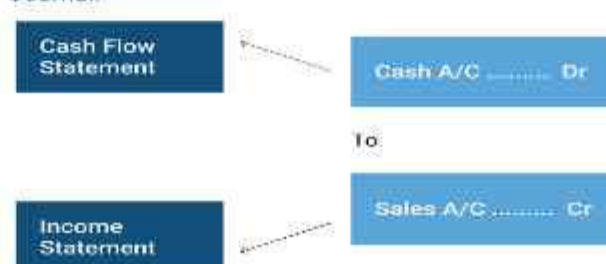


Fig 2.7

### Purchase

A purchase involves the acquisition of goods or services in exchange for a payment of some kind. The payment is usually in cash or credit (to be paid later).

$$\text{Net Sales} = \text{Gross sales} - \text{sales return} - \text{sales Discount}$$

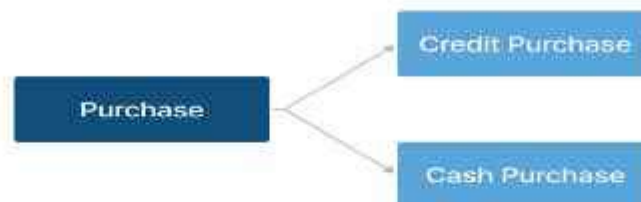


Fig 2.8

### Credit Purchase

Credit purchases are something through which one could buy products on loan. Precisely, one could buy products and could pay them back shortly

Journal: -

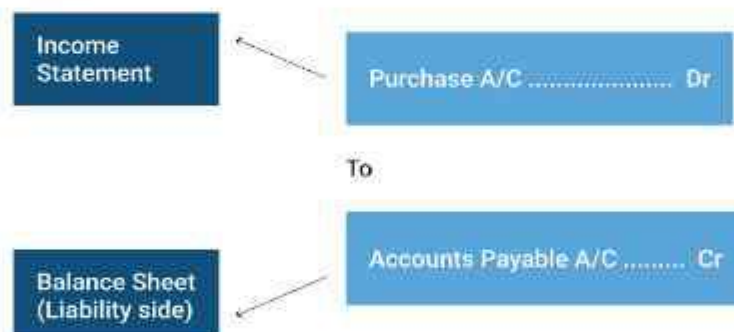


Fig 2.9

### Cash Purchase

A cash purchase occurs when a business pays for goods or services immediately upon ordering or delivery

Journal: -

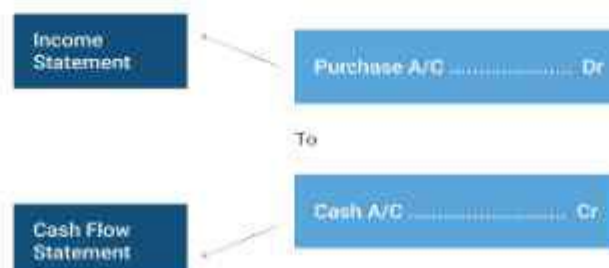


Fig 2.10

• **COGS (Cost of goods sold)**

Cost of goods sold (COGS) is the direct cost of manufacturing products, sold by any business

**Beginning Inventory**

Add: Cost Of Goods Purchased ( Net Purchase + Inward )

Add: Direct Manufacturing Cost ( For Manufacturing Entities;  
Includes Factory Overhead, Depreciation On Path )

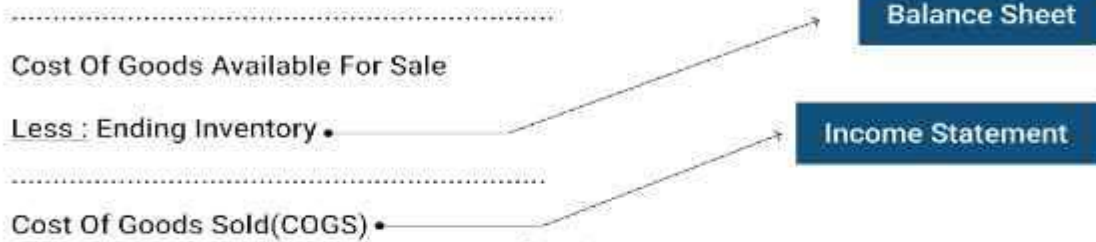


Fig 2.11

• **Operating expenses / indirect expenses**

Indirect expenses are those expenses that are incurred to operate a business as a whole or a segment of a business, and so cannot be directly associated with a cost object, such as a product, or service. For e.g., selling, general & administrative expenses

Journal: -

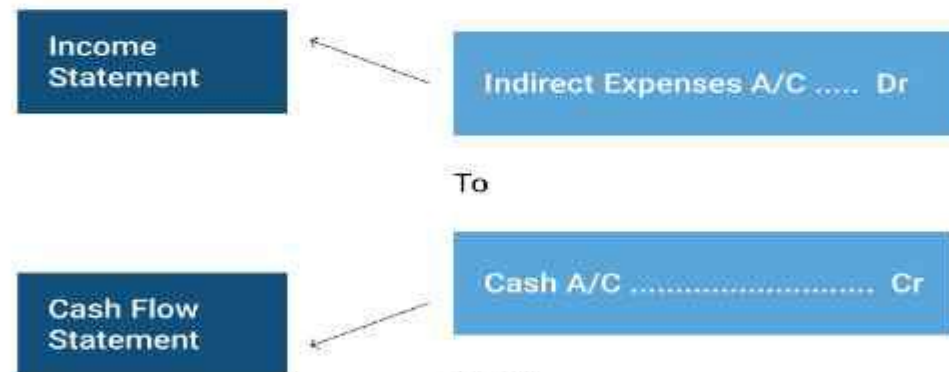


Fig 2.12



Fig 2.13



- **Non-operating income / indirect expenses**

The income earned from the non-operational activities of the business is known as indirect income, for e.g., interest, dividend, commission etc.

Journal: -

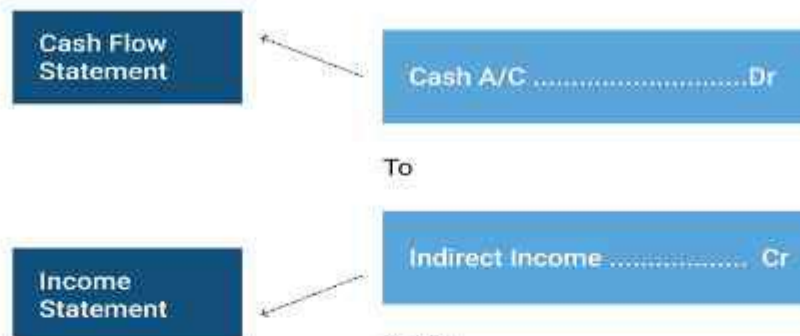


Fig 2.14

- **Direct expenses**

Direct expenses are those expenses that are incurred since the time of purchase to manufacture the goods. Such expenses include freight inward, octroi, wages etc. Such expenses shall be debited to the trading account.

Journal: -

Trading A/c Dr.XXX  
 To Carriage inward XXX  
 To Freight Inward XXX  
 To Wages XXX

- **Depreciation**

Depreciation can be defined as the process of decreasing the value of the asset. It is an accounting technique for spreading out the expense of a tangible item over the course of its useful life. How much of an asset's value has been used is shown through depreciation. It enables businesses to purchase assets over a predetermined length of time and generate income from those assets. For instance, the product "X" and its value shall gradually decline, and its worth shall be determined based on the money already spent and the money that shall be spent on it in the future

Depreciation allocates the cost of an asset to the period benefited in line with the matching concept.

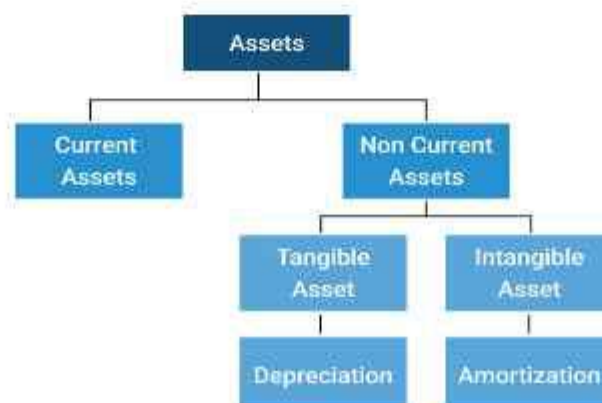


Fig 2.15

Journal:-

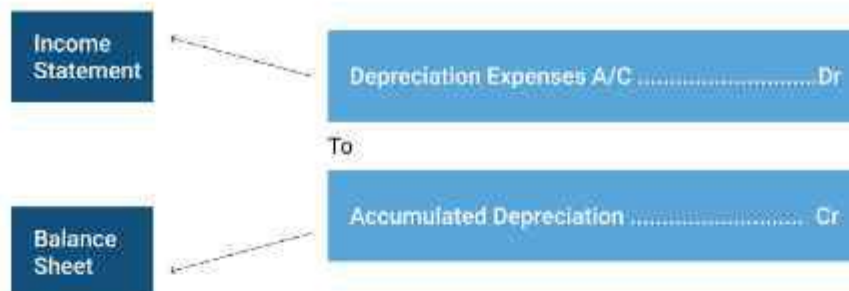


Fig 2.16

Reasons for depreciation:



Fig 2.17

#### Methods for Depreciation

The 4 main types of depreciation are shown below, and an individual or businesses can choose the one that best matches their needs based on the assets and type of individual or business.

- Fixed/equal installment or straight-line method
- A fixed portion of the cost of the fixed asset is allocated and charged as periodic depreciation.
- Such depreciation becomes an equal amount in each period.

The formula for the calculation of depreciation is

Cost of Assets - Residual value or the expected scrap value of the asset

Estimated life of the asset

Reducing / diminishing balance method or written down value method

- Depreciation is calculated at a fixed percentage on the original cost in the first year. But in subsequent years it is calculated at the same percentage on the written down values gradually reducing during the expected working life of the asset.
- The rate of allocation is constant (usually a fixed percentage) but the amount allocated yearly gradually decreases.

#### Illustration 1

Calculate the amount of depreciation under the straight-line method (SLM) in each of the following: -

| Machine No. | Cost of Machine | Expenses incurred at the time of purchase | Estimated Residual Value | Expected Useful Life in years |
|-------------|-----------------|-------------------------------------------|--------------------------|-------------------------------|
| 1           | 90,000          | 10,000                                    | 20,000                   | 8                             |
| 2           | 24,000          | 7,000                                     | 3,100                    | 6                             |
| 3           | 1,05,000        | 20,000                                    | 12,500                   | 5                             |
| 4           | 2,60,000        | 30,000                                    | 56,000                   | 10                            |

Solution:

| Machine No. | Cost of Machine | Expenses incurred at the time of purchase | Total Cost of Asset = (B+C) | Estimated Residual Value | Expected Useful Life in years | Depreciation = (D-E)/F |
|-------------|-----------------|-------------------------------------------|-----------------------------|--------------------------|-------------------------------|------------------------|
| A           | B               | C                                         | D                           | E                        | F                             | G                      |
| 1           | 90,000          | 10,000                                    | 1,00,000                    | 20,000                   | 8                             | 10,000                 |
| 2           | 24,000          | 7,000                                     | 31,000                      | 3,100                    | 6                             | 4650                   |
| 3           | 1,05,000        | 20,000                                    | 1,25,000                    | 12,500                   | 5                             | 22,500                 |
| 4           | 2,60,000        | 30,000                                    | 2,90,000                    | 56,000                   | 10                            | 23,400                 |

**Illustration 2**

On 01.04.2019 a machine was purchased for ₹ 6,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on the reducing balance method, calculate the amount of depreciation up to 31.03.2022

**Solution:**

| Year | Opening Book value | Rate | Depreciation | Closing Book value |
|------|--------------------|------|--------------|--------------------|
| 1    | 6,50,000           | 10%  | 65,000       | 5,85,000           |
| 2    | 5,85,000           | 10%  | 58,500       | 5,26,500           |
| 3    | 5,26,500           | 10%  | 52,650       | 4,73,850           |

Amount of depreciation up to 31.03.2022 = (65000 + 58500 + 52650) = 1,76,150

**Double declining balance method**

The double declining balance (DDB) depreciation method is an approach to accounting that involves depreciating certain assets at twice the rate outlined under straight-line depreciation. This results in depreciation being the highest in the first year of ownership and declining over time.

$$\text{Double Declining Balance Method} = 2 \times \frac{\text{Asset Cost} - \text{Accumulated Depreciation}}{\text{Useful Life of Asset}}$$

Fig 2.18

**Units of production method**

Depreciation expense for a given year is calculated by dividing the original cost of the equipment less its salvage value, by the expected number of units the asset shall produce given its useful life.

$$\text{Unit of Production Method} = \frac{\text{Asset Cost} - \text{Residual Value}}{\text{Life-Time Production}} \times \text{Units Produce}$$

Fig 2.19



- **Discount**

A discount is the reduction of either the monetary amount or a percentage of the normal selling price of a product or service.

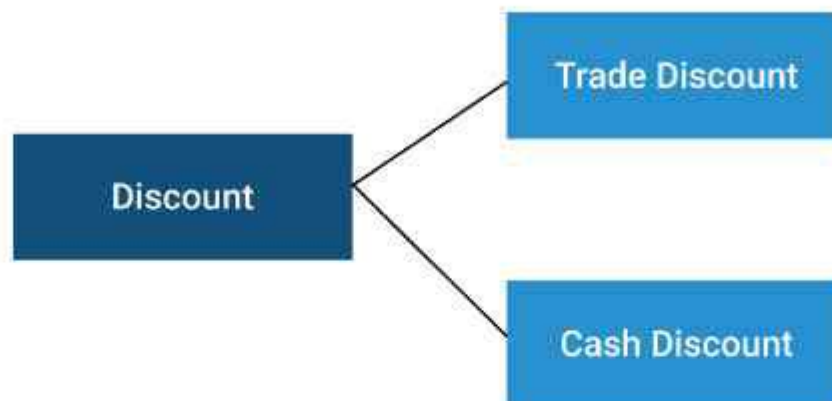


Fig 2.20

- **Trade Discount**

Manufacturers often prepare product catalogues for wholesalers, retailers, and other resellers. These product catalogues will contain the listed prices of the products. However, when a reseller offers to buy the product in bulk, the manufacturer reduces the listed price of the product. This is called a trade discount.

- **Cash Discount**

Cash discounts refer to an incentive that a seller offers to a buyer in return for paying a bill before the scheduled due date. In a cash discount, the seller shall usually reduce the amount that the buyer owes by either a small percentage or a set amount.



Fig 2.21

Journal (discount allowed): -

Discount allowed is a reduction in the price of goods or services allowed by a seller to a buyer and is an expense for the seller.



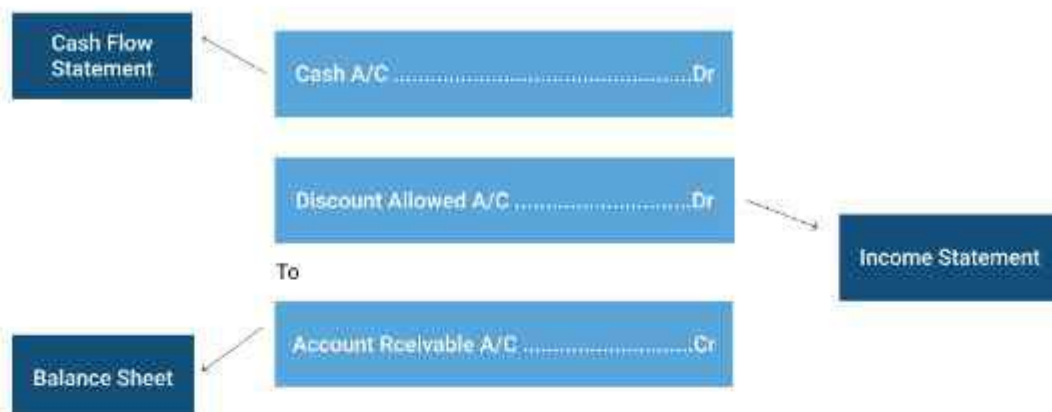


Fig 2.22

Journal (discount received): -

Discount received is the concession in the price received by the buyer of the goods and services from the seller and is an income for the buyer

Journal: -

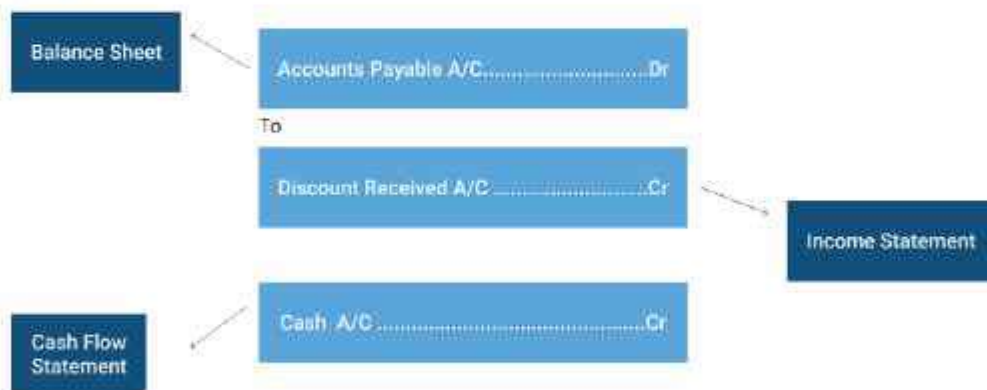


Fig 2.23

- **Abnormal losses**

Abnormal loss is referred to as the loss that is faced by a business which is beyond the normal loss threshold. Abnormal items are debited in profit and loss a/c.

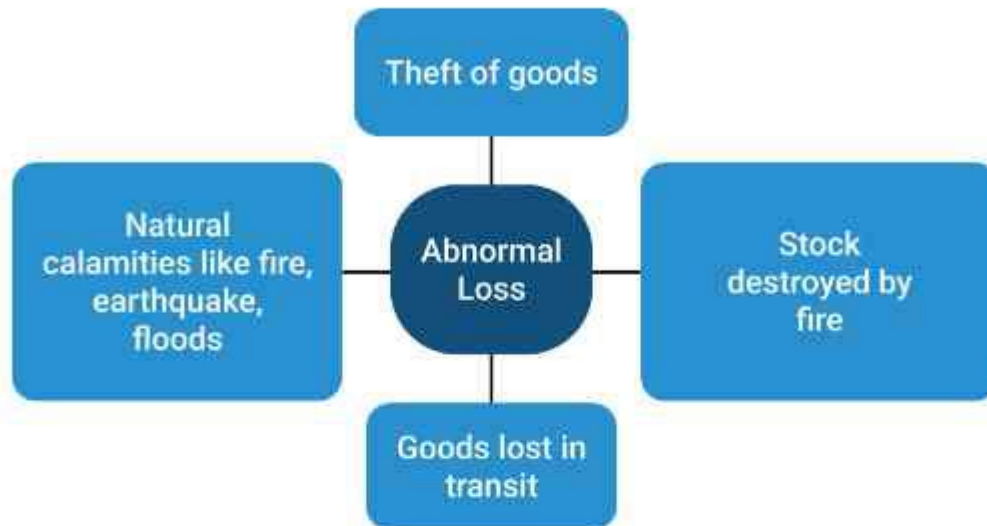


Fig 2.24

The entry shall be recorded in the profit & loss account:

Profit & Loss A/c Dr. XXX

To Abnormal Loss A/c XXX

## Unit 2.7 - Case Study

**Illustration: 1**

Following is the trial balance of Ram & sons. Prepare final accounts for the year ended on 31st March 2021.

Dr.

Cr.

| Particulars            | Amount           | Particulars       | Amount           |
|------------------------|------------------|-------------------|------------------|
| Stock as on 01-04-2020 | 2,00,000         | Sales             | 30,00,000        |
| Purchases              | 22,00,000        | purchase Returns  | 50,000           |
| Sales Returns          | 1,00,000         | Creditors         | 3,00,000         |
| Bills receivable       | 50,000           | Discount Received | 5,000            |
| Carriage Inwards       | 50,000           | Capital           | 5,00,000         |
| Debtors                | 2,00,000         |                   |                  |
| Discount Allowed       | 5,000            |                   |                  |
| Carriage Outwards      | 40,000           |                   |                  |
| Salaries               | 2,20,000         |                   |                  |
| Insurance              | 60,000           |                   |                  |
| Rent                   | 60,000           |                   |                  |
| Wages                  | 80,000           |                   |                  |
| Bad debt               | 10,000           |                   |                  |
| Furniture              | 4,00,000         |                   |                  |
| Drawings               | 70,000           |                   |                  |
| Advertising            | 50,000           |                   |                  |
| Cash in Bank           | 45,000           |                   |                  |
| Cash at hand           | 5,000            |                   |                  |
| Commission paid        | 10,000           |                   |                  |
|                        | <b>38,55,000</b> |                   | <b>38,55,000</b> |

**Adjustments:**

- Stock on 31st March was valued at a cost price ₹4,20,000 and market price ₹4,00,000.
- Depreciate furniture @ 10% p.a.
- Rent of ₹5,000 was paid in advance.
- Salaries due but not paid ₹30,000.
- Make a provision for doubtful debts @ 5% on debtors.

Solution:

Dr. Trading and profit &amp; loss a/c for the year ended 31st March 2021 Cr.

| Particulars                   | Amount    | Particulars              | Amount    |
|-------------------------------|-----------|--------------------------|-----------|
| To;                           |           | By;                      |           |
| Opening Stock                 | 2,00,000  | sales : 30,00,000        | 29,00,000 |
| Purchase: 22,00,000           |           | (less) Return : 1,00,000 | 4,00,000  |
| (less) Return: 50,000         | 21,50,000 | Closing Stock            |           |
| Carriage inward               | 50,000    |                          |           |
| Wages                         | 80,000    |                          |           |
| Gross Profit c/d              | 8,20,000  |                          |           |
|                               | 33,00,000 |                          | 33,00,000 |
| To;                           |           | By Gross Profit b/d      |           |
| Salaries : 2,20,000           | 2,50,000  | Discount received        |           |
| (Add) Not paid : 30,000       |           |                          |           |
| Depreciation on furniture     | 40,000    |                          |           |
| Insurance                     | 60,000    |                          | 8,20,000  |
| Rent: 60,000                  | 55,000    |                          |           |
| (less) Paid in advance: 5,000 |           |                          |           |
| Advertising                   | 50,000    |                          |           |
| Carriage Outwards             | 40,000    |                          |           |
| Discounts Allowed             | 5,000     |                          |           |
| Bad debts                     | 10,000    |                          | 5,000     |
| Commission Paid               | 10,000    |                          |           |
| Provision for doubtful debts  |           |                          |           |
|                               | 2,95,000  |                          |           |
| Net Profit                    |           |                          |           |
|                               | 8,25,000  |                          | 8,25,000  |

**Working Notes: -**

- Closing stock is valued at market price or cost price whichever is lower

## Summary

Financial statements are essential documents that provide a comprehensive overview of a company's financial performance and position. They offer several advantages, including helping stakeholders make informed decisions, assessing the financial health of an organization, and ensuring transparency in financial reporting. There are different types of financial statements, such as the balance sheet, cash flow statement, and income statement (or Trading and Profit & Loss account). The income statement specifically details the company's revenues and expenses over a specific period, showing the net profit or loss. The performance of the Trading and Profit & Loss account outlines the structure and format in which this information is presented, typically including key elements like gross profit, operating expenses, and net earnings. The elements of the statement of earnings further break down the components of income, such as sales revenue, cost of goods sold, and various operating expenses, providing a detailed look at how a company's profit is generated. Together, these topics form the foundation of financial analysis and reporting.



## Exercise

What is the primary purpose of financial statements?

- A) To advertise the company's products
- B) To provide a comprehensive overview of a company's financial performance and position
- C) To detail the company's employee structure
- D) To outline the company's future goals
- Answer: B

Which of the following is NOT a type of financial statement?

- A) Balance Sheet
- B) Cash Flow Statement
- C) Income Statement
- D) Employee Performance Review
- Answer: D

What does the Income Statement primarily show?

- A) The total assets and liabilities of a company
- B) The cash inflows and outflows
- C) The net profit or loss over a specific period
- D) The number of employees in the company
- Answer: C

What term is synonymous with the Income Statement?

- A) Equity Statement
- B) Trading and Profit & Loss Account
- C) Liability Ledger
- D) Asset Overview
- Answer: B

What is typically included at the top of the Income Statement?

- A) Net Earnings
- B) Gross Profit
- C) Operating Expenses
- D) Total Equity
- Answer: B

What does 'gross profit' account for on the Income Statement?

- A) Expenses from operations
- B) Revenue minus cost of goods sold
- C) Net profit after taxes
- D) Dividend payments
- Answer: B

Which component is crucial for assessing a company's financial health through financial statements?

- A) Advertising costs
- B) Employee benefits
- C) Operating expenses

- D) Market analysis
- Answer: C

What role do financial statements play for stakeholders?

- A) They provide entertainment
- B) They help in making informed decisions
- C) They list new products
- D) They detail company outings
- Answer: B

What aspect of financial statements ensures transparency in financial reporting?

- A) Marketing strategies
- B) Social media presence
- C) Detailed financial information
- D) Employee interviews
- Answer: C

Which statement details how a company's profit is generated?

- A) Statement of Earnings
- B) Balance Sheet
- C) Cash Flow Statement
- D) Statement of Employee Roles
- Answer: A

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins or other markings on the paper.

## 3. Preparation of Balance Sheet

- Unit 3.1 - Introduction
- Unit 3.2 - Order of Permanence
- Unit 3.3 - Order of Liquidity
- Unit 3.4 - Elements of Balance Sheet
- Unit 3.5 - Case Study



## Key Learning Outcomes



- Understand the Purpose and Structure of a Balance Sheet
- Differentiate Between Order of Permanence and Order of Liquidity
- Identify and Classify the Elements of a Balance Sheet
- Prepare a Balance Sheet
- Analyze and Interpret Balance Sheet Data
- Apply Knowledge through Case Studies



## Unit 3 - Preparation of Balance Sheet

### Unit Objectives

- Concepts of balance sheet
- Provide knowledge of assets in a balance sheet
- Familiarise with important balance sheet elements preparation and
- Presentation of Balance Sheet

## Unit 3.1 - Introduction

The balance sheet is prepared on the last day of the accounting period. It has assets and liabilities, prepared based on accounting equations. The assets are shown on the right-hand side and liabilities and capital are shown on the left-hand side. There is no prescribed form of the balance sheet for a proprietary and partnership firm. However, every company shall follow schedule III part of the I of the companies act. In a balance sheet the assets and liabilities are arranged either in the order of permanence or liquidity. Most of the companies follow order of permanence.

## Unit 3.2 - Order of Permanence

Under this method, while preparing a balance sheet a company's assets are listed according to their permanency. Permanent assets are shown at first and then temporary assets are shown later. The fixed or long-term liabilities are shown first under the order of permanence method, and the current liabilities are listed afterward. On the liabilities side, we start from capital, reserve and surplus, long-term loans, and end with outstanding expenses.

The following is the format of the Balance sheet in order of permanence:

**Specimen of Balance sheet: - (In case other than company)**

**Balance sheet as on 31st March ....**

| Liabilities          | Amount | Assets                | Amount | Permanency<br>Decrease |
|----------------------|--------|-----------------------|--------|------------------------|
| Capital              | XXX    | Goodwill              | XXX    |                        |
| Reserve & Surplus    | XXX    | Land & Building       | XXX    |                        |
| Loans                | XXX    | Plant & Machinery     | XXX    |                        |
| Trade creditors      | XXX    | Furniture             | XXX    |                        |
| Bills Payable        | XXX    | Stock                 | XXX    |                        |
| Outstanding Expenses | XXX    | Sundry Debtors        | XXX    |                        |
|                      |        | Bill receivable       | XXX    |                        |
|                      |        | Other Investment      | XXX    |                        |
|                      |        | Government Securities | XXX    |                        |
|                      |        | Cash in Bank          | XXX    |                        |
|                      |        | Cash in Hand          | XXX    |                        |

## Unit 3.3 - Order of Liquidity

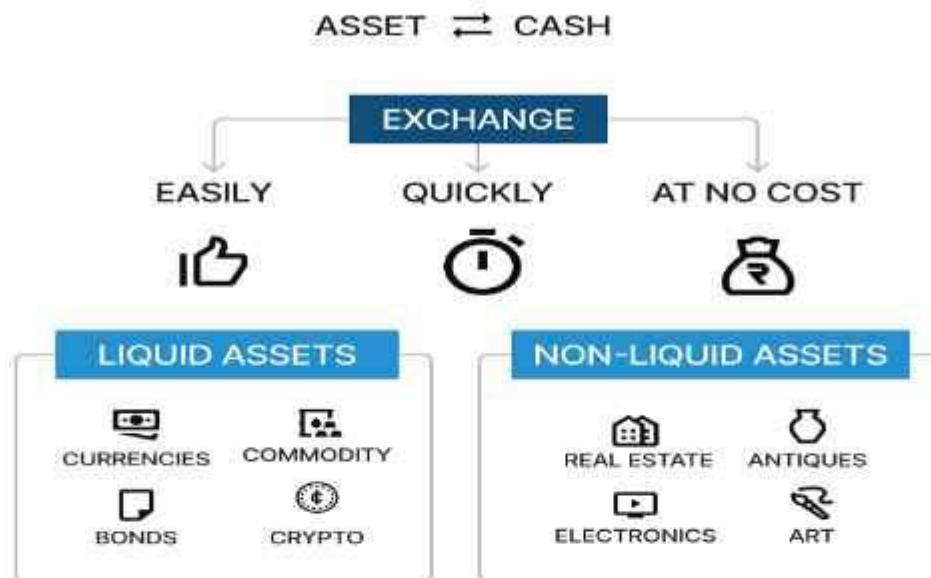


Fig 3.1

Under this method, a company organizes current and fixed assets in the balance sheet in order of liquidity. These are presented according to their ability to convert into cash. On the asset side, we shall write most liquid assets at first. Liabilities are presented based on the order of urgency of payment. On the liabilities side, we start from short-term liabilities. In the end, we write capital adjusted with net profit and drawings if any. This approach is generally used by sole traders and partnership firms.

The following is the format of the Balance sheet in order of liquidity:

Specimen of Balance sheet: - (In case other than Company)  
Balance sheet as on 31st March ....

| Liabilities          | Amount | Assets                | Amount |              |
|----------------------|--------|-----------------------|--------|--------------|
| Outstanding Expenses | XXX    | Cash in Bank          | XXX    | Most Liquid  |
| Bills Payable        | XXX    | Government Securities | XXX    |              |
| Trade creditors      | XXX    | Other Investment      | XXX    |              |
| Loans                | XXX    | Bill receivable       | XXX    |              |
| Reserve & Surplus    | XXX    | Sundry Debtors        | XXX    |              |
| Capital              | XXX    | Stock                 | XXX    |              |
|                      |        | Furniture             | XXX    | Least Liquid |
|                      |        | Plant & Machinery     | XXX    |              |
|                      |        | Land & Building       | XXX    |              |
|                      |        | Goodwill              | XXX    |              |
|                      | XXX    |                       | XXX    |              |

Specimen of schedule III Balance sheet: - (In the case of company)  
Balance sheet as on 31st March ....

| Particulars                      | Note No | Amount      |
|----------------------------------|---------|-------------|
| • <b>EQUITY AND LIABILITIES</b>  |         | XXX         |
| □ Shareholder's funds:           |         | XXX         |
| ⑩ Share capital                  |         | XXX         |
| ⑪ Reserves and surplus           |         | XXX         |
| □ Non-current liabilities:       |         | XXX         |
| ⑩ Long-term borrowings           |         | XXX         |
| ⑪ Deferred tax liabilities (Net) |         | XXX         |
| ⑫ Other long-term liabilities    |         | XXX         |
| ⑬ Long-term provisions           |         | XXX         |
| □ Current liabilities:           |         | XXX         |
| ⑩ Short-term borrowings          |         | XXX         |
| ⑪ Trade payables                 |         | XXX         |
| ⑫ Other current liabilities      |         | XXX         |
| ⑬ Short-term provisions          |         | XXX         |
| <b>TOTAL</b>                     |         | <b>XXXX</b> |
| • <b>ASSETS</b>                  |         |             |
| □ Non-current assets:            |         | XXX         |
| ⑩ Fixed assets                   |         | XXX         |
| ③ Tangible assets                |         | XXX         |
| ④ Intangible assets              |         | XXX         |
| ⑪ Non-current investments        |         | XXX         |
| ⑫ Deferred tax assets (Net)      |         | XXX         |
| ⑬ Long-term loans and advances   |         | XXX         |
| □ Current assets:                |         | XXX         |
| ⑩ Current investments            |         | XXX         |
| ⑪ Inventories                    |         | XXX         |
| ⑫ Trade receivables              |         | XXX         |
| ⑬ Cash and cash equivalents      |         | XXX         |
| ⑭ Short-term loans and advances  |         | XXX         |
| <b>TOTAL</b>                     |         | <b>XXX</b>  |

"The old format of the balance sheet, as shown in figure 1(a & b) is known as T-shaped or horizontal format. The new format of the balance sheet of a company is known as the vertical format (Figure 2). In this format, equities and liabilities are at the top along while assets are at the bottom. "Every company are following schedule III Balance sheet format

## Unit 3.4 - Elements of Balance Sheet

### • Share Capital

Share capital means getting investment for the business from natural or artificial person by issuing share of ownership of the business.



Fig 3.2

Journal entry for introducing capital into business

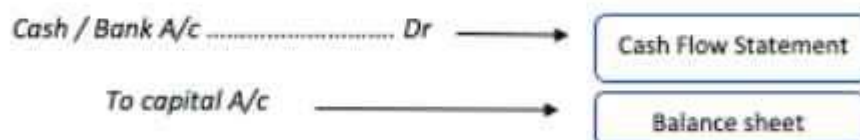


Fig 3.3



Required disclosure for share capital: -

**The Number and Amount of Shares Authorized**

**The Number of shares issued, subscribed and Fully Paid and Subscribed but not fully Paid**

**Par value Per Share**

**Calls Unpaid and Forfeited Shares**

**Reconciliation of the number of shares outstanding at the beginning and at the ending of the reporting Period.**

Fig 3.4

When the share of a company is issued more than its nominal value, (face value) the excess amount is called share premium. Share premium a/c is a reserve a/c. It can be used to pay the excess of issuing equity and issuing bonus shares to shareholders. Share premium cannot be used for distributing dividends.

#### • Reserves and Surplus

Reserve and surplus are created from undistributed profits for a specific purpose and the cumulative amounts of retained earnings are recorded as a part of the shareholder's equity.

Journal entry for creating reserve from retained earnings.

Cash/ Bank A/C.....Dr



**Cash Flow Statements**

To Capitale A/C



**Balance Sheet**

Fig 3.5

Reserves shall be classified as;



Fig 3.6

- If Revenue exceeds the total expenditure Income statement shows surplus. If total expenditure exceeds the revenue Income statement shows Deficit. "The balance in the income statement must be shown in the balance sheet if it is surplus or deficit"

Debit balance of statement of profit and loss (Debit balance in the profit and loss account is a loss because expenses are more than revenue) shall be shown as a negative figure under the head "Surplus". Similarly, the balance of "Reserves and Surplus", after adjusting the negative balance of surplus (i.e., deficit) shall be shown under the head "Reserves and Surplus" even if the resulting figure is negative.

### • Long-Term Borrowings

Long Term borrowing is classified as a non-current liability on the balance sheet, which simply means it is due in more than 12 months. Terms of the repayment of term loans and other loans shall be stated

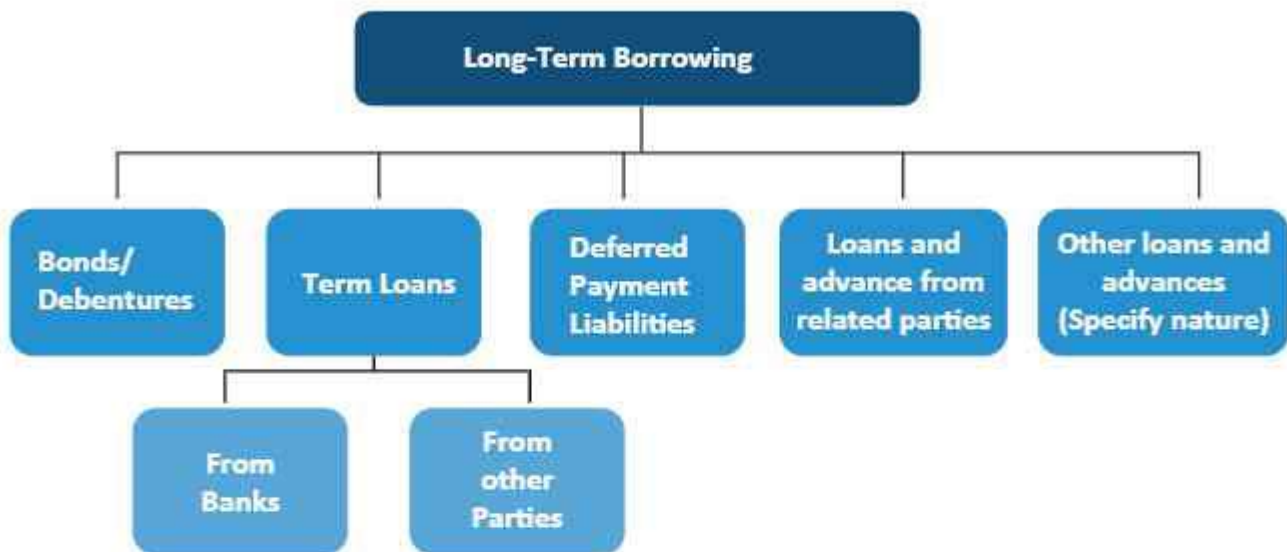


Fig 3.7

Journal entry for money is borrowed (Loan taken)

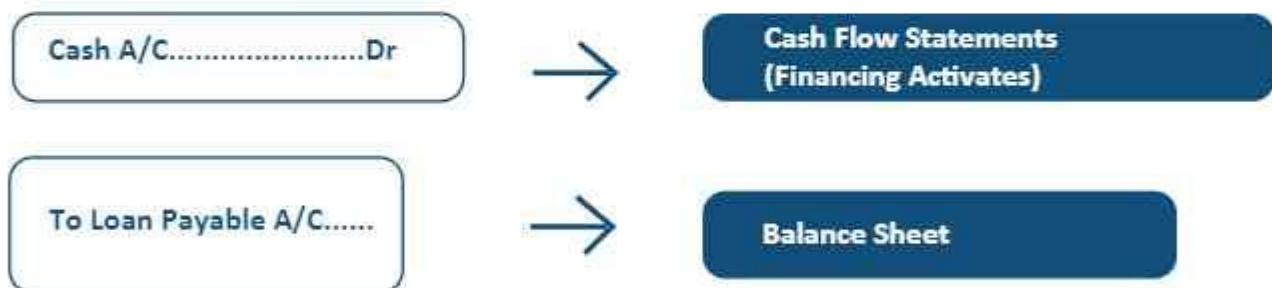


Fig 3.8

Journal entry for Loan amount is paid.



Fig 3.9

### • Other Long-term Liabilities

Trade payables:

When a business makes any credit purchase of a goods or service, the payment on its account is yet to be made. In this condition, the account holder from whom the credit purchase was made, shall be addressed as a creditor of the firm. The closing balance of creditors a/c denoted in balance sheet as trade payable or trade creditors.



Fig 3.10

Journal entry for goods purchased on credit.

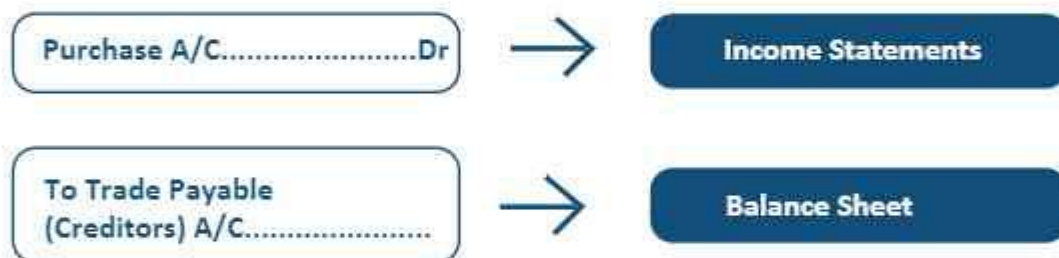


Fig 3.11

Journal entry for cash paid against goods purchased on credit

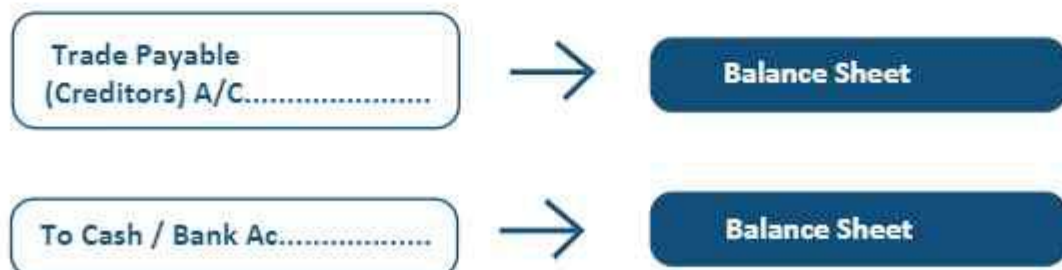


Fig 3.12

Journal entry for assets purchased on credit

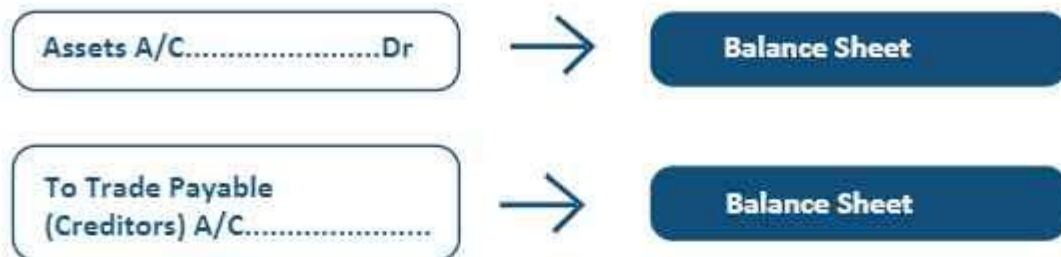


Fig 3.13

Journal entry for cash paid against goods purchased on credit.

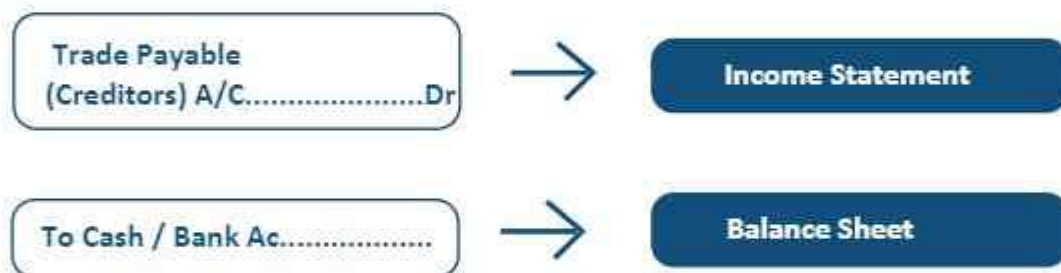


Fig 3.14

**Note:** All the credit purchase of goods are recorded in purchase book, but both cash, as well as credit purchases of goods, are recorded in purchase a/c..

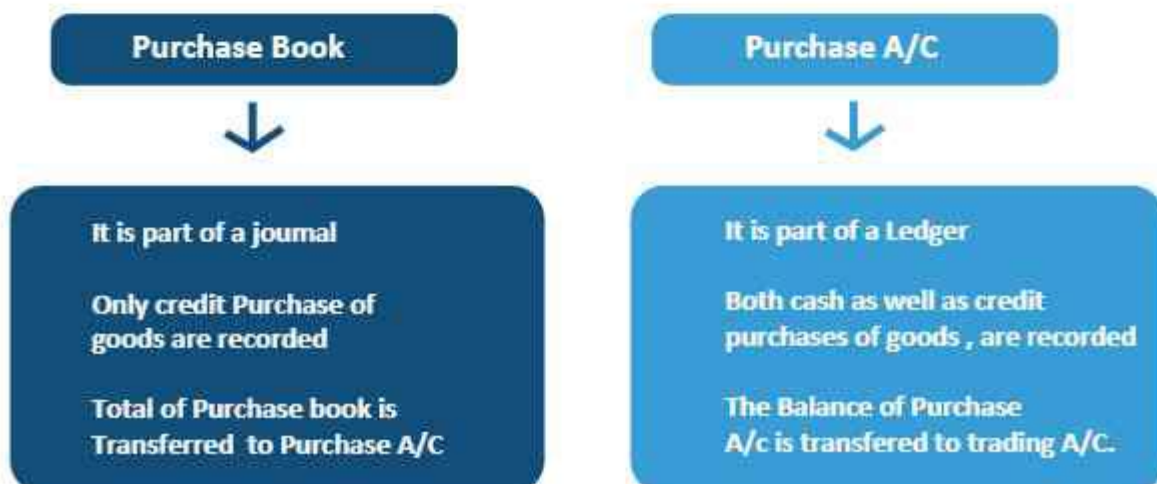


Fig 3.15



### • Long-term provisions

A provision is termed as the cash amount, which is set aside from the business profits and the specific amount is used to cover a probable future expense or reduction in the value of an asset of the business.

Following are the examples:

- Provision for employee benefits (gratuity, leave encashment, provident funds)
- Provision for depreciation
- Provision for Tax
- Others (specify nature)

Journal entry for making provisions for income tax

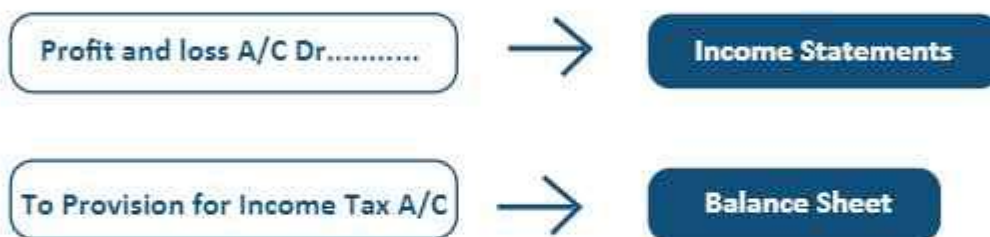


Fig 3.16

### • Short-term borrowings

Short-term debt, also called current liabilities, is a firm's financial obligations that are expected to be paid off within a year. Period and amount of repayment of loans and interest shall be specified separately

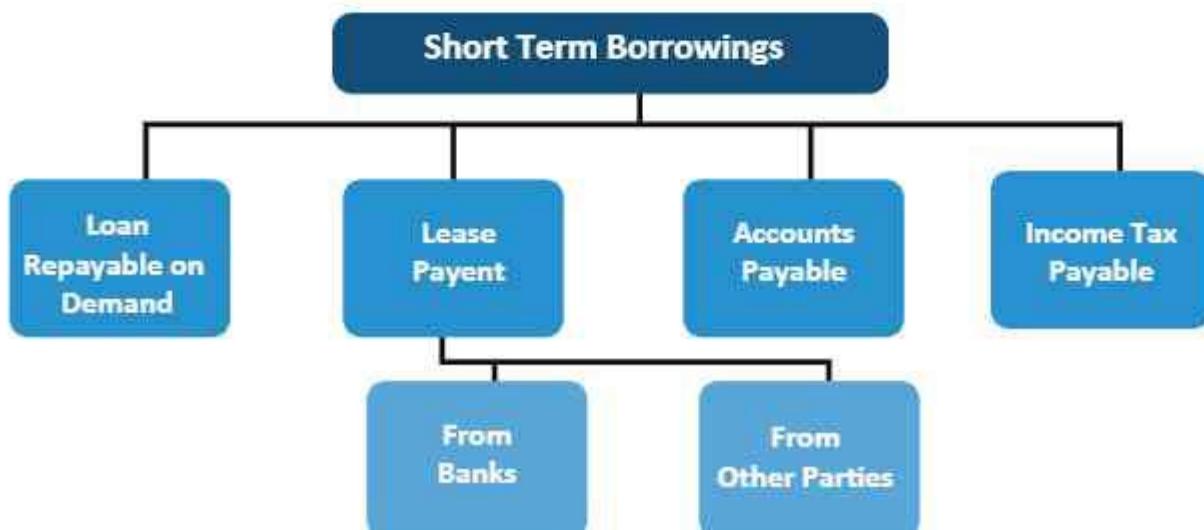


Fig 3.17

### • Other Current Liabilities

The amounts shall be classified as:

- Interest accrued and due on borrowings
- Income received in advance
- Unpaid dividends
- Other payables (specify nature)

Journal entry for outstanding expenses:

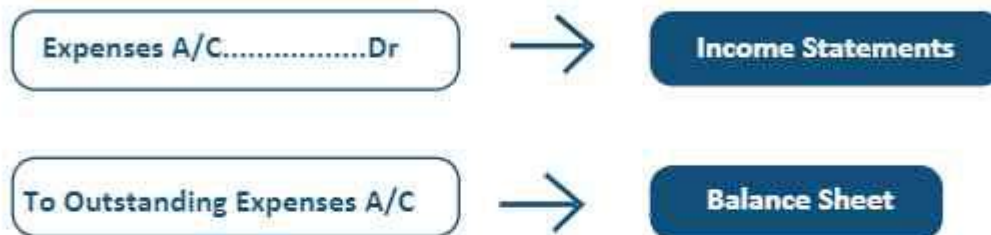


Fig 3.18

**Note;** The outstanding expenses a/c appears on the liabilities side of the Balance Sheet. While preparing the Trading and Profit and Loss a/c we need to add the amount of outstanding expenses to that particular expense.

Journal entry to record income received in advance is:

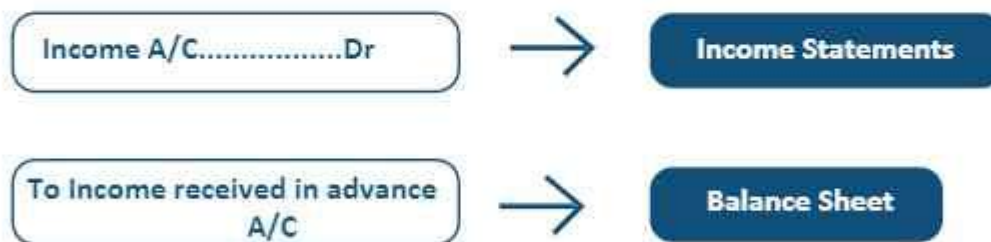


Fig 3.19

**Note:** The Income Received in Advance A/c appears on the liabilities side of the Balance Sheet. While preparing the Trading and Profit and Loss A/c we need to deduct the amount of income received in advance from that particular income.

### • Short-term provisions

The short-term provisions mean that the provision is created to meet the short obligations/payments.

The amounts shall be classified as:

- Provision for tax
- Provision for doubtful debts
- Provision for discount on debtors
- Others (specify nature)

### • Tangible asset

Tangible assets are physical and measurable assets that are used in a company's operations.

- Classification shall be given as:



Fig 3.20

Following are disclosed separately:

- Assets under the lease.
- Reconciliation of Gross or Net carrying amount of assets at the beginning and end of the reporting period. (i.e., showing additions, disposals, acquisitions, written off on a reduction of capital, revaluation assets)
- Depreciation and impairment losses.

Journal: -

Journal entry for purchase of Assets for cash:

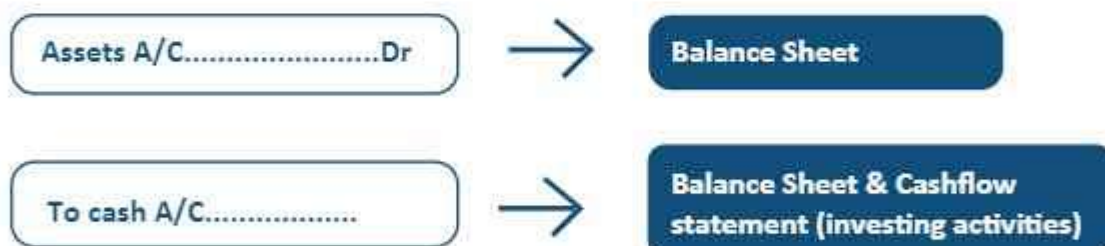


Fig 3.21

Journal entry for purchase of Assets for credit:

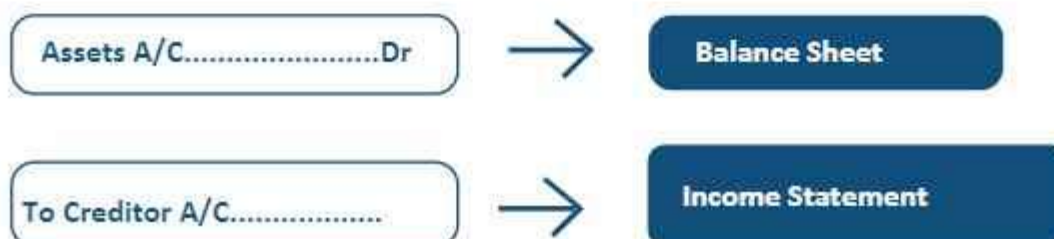


Fig 3.22

Journal entry for depreciation is charged on Assets.

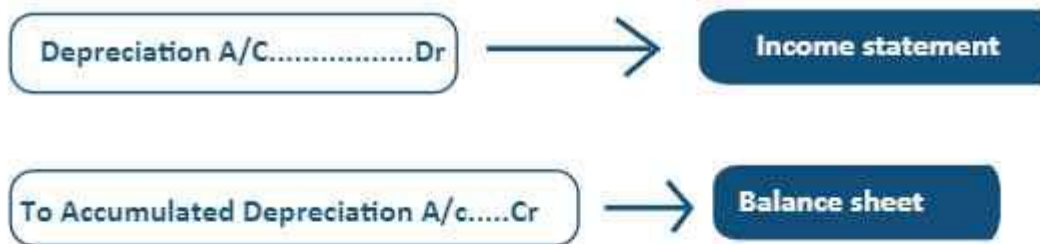


Fig 3.23

Accumulated depreciation is the total amount an asset has been depreciated.

- **Intangible assets**

An intangible asset is an asset that is not physical in nature.

Classification shall be given as:



Fig 3.24

Following are disclosed separately:

- Reconciliation of gross or net carrying amount of assets at the beginning and end of the reporting period. (i.e., showing additions, disposals, acquisitions, written off on a reduction of capital, revaluation assets)
- Amortization and impairment losses.

#### **Non-current investments**

Noncurrent assets are a company's long-term investments. The full value of such investment will not be realized within a period of one year. The liquidity of this investment is relatively low, as it cannot easily be converted into cash.



Non-current investments shall be classified as trade investments and other investments are:



Fig 3.25

#### Long-term loans and advances

When a business firm gives any loan to its employees or its subsidiaries or to its directors, then this loan is shown on the asset side of the balance sheet because it is recoverable in the future.

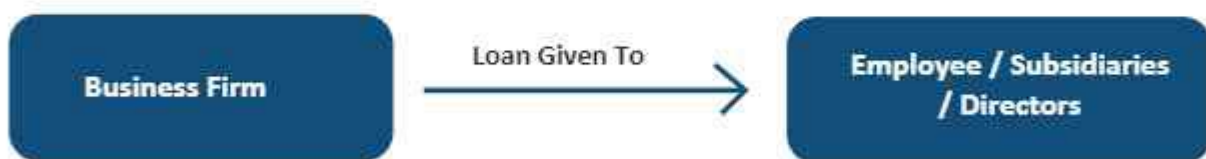


Fig 3.26

Advances are not loans. Advances are given for particular purposes against which either goods or services are to be received by the company in near future.

Long-term loans and advances shall be classified as:

- Capital advances
- Security deposits
- Loans and advances (specify nature)



- **Other non-current asset**

Other non-current assets shall be classified as:

- Long-term Trade Receivables
- Others (specify nature)

### **Current Investments**

Current investments are investments that are intended to be held for less than a year from the date when such investment is done.

### **Inventories**

Inventories shall be classified as:



Fig 3.27

FIFO (First In, First Out), LIFO (Last In, First Out), and WAC (Weighted Average Cost) are different methods of inventory valuation. (Detailed study in Cost Accounting)

Inventory Adjustment:

Trading and Profit and Loss A/c (Income Statement)



Fig 3.28

Notes: Closing stock is represented on the asset side of the balance sheet. Then, this is adjusted with the purchases amount which may be taken to the debit side of the trading account and the closing stock appears on the asset side of the balance sheet.

- **Cash and cash equivalents**

Cash and cash equivalents are the most liquid current assets found on a business's balance sheet. Cash equivalents can be converted into cash immediately.

Following are the examples of Cash and cash equivalent:

| Cash                    | Cash equivalent       |
|-------------------------|-----------------------|
| Coins & Currencies      | Commercial paper      |
| Cash in savings account | Marketable Securities |
| Bank Overdraft          | Money market fund     |
| Money orders            | Treasury bills        |
| Petty Cash              | Short term govt Bonds |

Bank deposits with more than twelve months' maturity shall be disclosed separately. Cash and cash equivalents are recorded on the balance sheet as a current asset. Its value changes each time that the business either receives or spends cash and cash equivalents. Such changes are called cash flows and are described in transactions recorded on the accounting ledger.

|                                              |
|----------------------------------------------|
| Net Cash Flows from Operating Activities     |
| (+) Net Cash Flows from Investing Activities |
| (+) Net Cash Flows from Financing Activities |
| Net Increase in Cash and Cash Equivalents    |

|                                                               |                      |
|---------------------------------------------------------------|----------------------|
| Net increase in cash and cash equivalents                     |                      |
| Add: Cash and cash equivalents at the beginning of the period |                      |
| Cash and cash equivalents at the end of the period            | <b>Balance Sheet</b> |

**“Cash and cash equivalents are consolidated into a single line item on a company's balance sheet”.**

**A summary of all adjustments**

| No | Adjustments                | If given in trial Balance       | If given in trial Balance                                                                                                                                               |
|----|----------------------------|---------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1  | Closing stock              | Balance sheet- Asset Side       | <ul style="list-style-type: none"> <li>Trading A/c- Credit side</li> <li>Balance sheet- Assets Side</li> </ul>                                                          |
| 2  | Prepaid Expenses           | Balance sheet- Asset Side       | <ul style="list-style-type: none"> <li>Trading / Profit &amp; Loss A/c - Debit side (Deduct from the concerned expenses)</li> <li>Balance sheet- Assets Side</li> </ul> |
| 3  | Outstanding Expenses       | Balance sheet- Li-ability Side  | <ul style="list-style-type: none"> <li>Trading / Profit &amp; Loss A/c- Debit side (Add to the concerned expenses)</li> <li>Balance sheet- Liability Side</li> </ul>    |
| 4  | Income Outstanding         | Balance sheet- As- set Side     | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Credit side (Add to the concerned income)</li> <li>Balance sheet- Assets Side</li> </ul>                 |
| 5  | Income received in advance | Balance sheet- Li-ability Side  | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Credit side (Deduct from concerned income)</li> <li>Balance sheet- Liability Side</li> </ul>             |
| 6  | Depreciation               | Profit & Loss A/c – Debit side  | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Debit side</li> <li>Balance sheet- Assets Side (Deduct from the respective asset)</li> </ul>             |
| 7  | Bad debt                   | Profit & Loss A/c – Debit side  | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Debit side</li> <li>Balance sheet- Assets Side (Deduct from debtors)</li> </ul>                          |
| 8  | Provision for bad debt     | Profit & Loss A/c – Debit side  | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Debit side</li> <li>Balance sheet- Assets Side (Deduct from debtors)</li> </ul>                          |
| 9  | Interest on capital        | Profit & Loss A/c – Debit side  | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Debit side</li> <li>Balance sheet- Liability Side (Add to capital)</li> </ul>                            |
| 10 | Interest on Drawings       | Profit & Loss A/c – Credit side | <ul style="list-style-type: none"> <li>Profit &amp; Loss A/c - Credit side</li> <li>Balance sheet- Liability Side (Deducted from capital)</li> </ul>                    |

## Unit 3.5 - Case Study

### Illustration: 1

Following is the Trial Balance of Ram & Sons.

Prepare final accounts for the year ended on 31st March 2021

Dr.

Cr.

| Particulars            | Amount    | Particulars       | Amount    |
|------------------------|-----------|-------------------|-----------|
| Stock as on 01-04-2020 | 3,00,000  | Sales             | 32,00,000 |
| Purchases              | 23,00,000 | purchase Returns  | 40,000    |
| Sales Returns          | 1,00,000  | Creditors         | 2,50,000  |
| Bills receivable       | 50,000    | Discount Received | 6,000     |
| Carriage Inwards       | 35,000    | Capital           | 5,80,000  |
| Debtors                | 1,95,000  | Rent              | 70,000    |
| Discount Allowed       | 5,000     |                   |           |
| Carriage Outwards      | 38,000    |                   |           |
| Salaries               | 2,90,000  |                   |           |
| Insurance              | 60,000    |                   |           |
| Electricity charges    | 72,000    |                   |           |
| Wages                  | 80,000    |                   |           |
| Bad debt               | 10,000    |                   |           |
| Furniture              | 4,00,000  |                   |           |
| Drawings               | 73,000    |                   |           |
| Advertising            | 50,000    |                   |           |
| Cash in Bank           | 70,000    |                   |           |
| Cash at hand           | 8,000     |                   |           |
| Commission paid        | 10,000    |                   |           |
|                        | 41,46,000 |                   | 41,46,000 |

### Adjustments:

- Stock on 31st March was valued at Cost price ₹ 3,80,000 and market price ₹ 420,000.
- Depreciate furniture @ 10% p.a.
- Rent of ₹ 8,000 was received in advance.
- Salaries due but not paid ₹ 33,000.
- Create a provision for doubtful debts @ 6% on debtors.
- Insurance of ₹ 12,000 was paid in advance.



Solution:

Dr. Trading And Profit &amp; Loss A/c for the year ended 31st March 2021

Cr.

| Particulars                           | Amount           | Particulars                              | Amount           |
|---------------------------------------|------------------|------------------------------------------|------------------|
| To;                                   |                  | By;                                      |                  |
| Opening Stock                         | 3,00,000         | sales : 32,00,000                        |                  |
| Purchase: 23,00,000                   |                  | (less) Return : <u>1,00,000</u>          | 31,00,000        |
| (less) Return: <u>40,000</u>          | 22,60,000        | Closing Stock                            | 3,80,000         |
| Carriage inward                       | 35,000           |                                          |                  |
| Wages                                 | 8,000            |                                          |                  |
| Gross Profit c/d                      | 8,05,000         |                                          |                  |
|                                       | <u>34,80,000</u> |                                          | <u>34,80,000</u> |
| To;                                   |                  | By Gross Profit b/d                      | 8,05,000         |
| Discounts Allowed                     | 5,000            | Discount received                        |                  |
| Carriage Outwards                     | 38,000           | Rent : 70,000                            | 6,000            |
| Salaries : 2,90,000                   |                  | (less) Received in advance : <u>8000</u> | 62,000           |
| (Add) Not paid : <u>33,000</u>        | 3,23,000         |                                          |                  |
| Insurance 60,000                      |                  |                                          |                  |
| (less) Paid in advance: <u>12,000</u> | 48,000           |                                          |                  |
| Electricity charges                   | 72,000           |                                          |                  |
| Bad debts                             | 10,000           |                                          |                  |
| Depreciation on furniture             | 40,000           |                                          |                  |
| Advertising                           | 50,000           |                                          |                  |
| Commission Paid                       | 10,000           |                                          |                  |
| Provision for doubtful debts          | 11,700           |                                          |                  |
| Net Profit                            | 2,65,300         |                                          |                  |
|                                       | <u>8,73,000</u>  |                                          | <u>8,73,000</u>  |

## Balance Sheet as on 31st March 2021

| Particulars                       | Note No | Amount           |
|-----------------------------------|---------|------------------|
| <b>I. EQUITY AND LIABILITIES</b>  |         |                  |
| (1) Shareholder's funds:          |         |                  |
| (a) Share capital                 | 1       | 5,07,000         |
| (b) Reserves and surplus          |         | 2,65,300         |
| (2) Current Liabilities:          |         |                  |
| (a) Trade Payable<br>(Creditors)  |         | 2,50,000         |
| (3) Other current liabilities:    | 2       | 41,000           |
| <b>TOTAL</b>                      |         | <b>10,63,300</b> |
| <b>II. ASSETS</b>                 |         |                  |
| (1)                               |         |                  |
| (a) Fixed Assets:                 | 3       |                  |
| (i) Tangible assets               |         | 3,60,000         |
| (2) Current assets:               |         |                  |
| (a) Inventories                   |         | 3,80,000         |
| (b) Trade receivables             |         | 2,33,300         |
| (c) Cash and cash equivalents     |         | 78,000           |
| (d) Short-term loans and advances |         | 12,000           |
| <b>TOTAL</b>                      |         | <b>10,63,300</b> |

## Notes to Accounts

| Particulars                          | Amount   |
|--------------------------------------|----------|
| <b>1. Share capital:</b>             |          |
| Capital : 5,80,000                   | 5,07,000 |
| (Less) Drawings : 73,000             |          |
| <b>2. Other current liabilities:</b> |          |
| Outstanding salary : 33,000          | 41,000   |
| Rent received in advance : 8,000     |          |
| <b>3. Fixed Assets:</b>              |          |
| Furniture : 4,00,000                 | 3,60,000 |
| (Less): Depreciation : 40,000        |          |

|                                         |            |          |
|-----------------------------------------|------------|----------|
| <b>4. Trade receivables</b>             |            |          |
| Sundry debtors                          | : 1,95,000 |          |
| (Less): Provision for doubtful debts :  | 11,700     | 2,33,300 |
| (Add): Bills receivable                 | : 50,000   |          |
| <b>5. Cash and cash equivalents</b>     |            |          |
| Cash in Bank                            | : 70,000   | 78,000   |
| Cash in Hand                            | : 8,000    |          |
| <b>6. Short-term loans and advances</b> |            |          |
| Prepaid insurance                       |            | 12,000   |

- Closing stock is valued at market price or cost price whichever is lower.

## Summary

The balance sheet, a cornerstone of financial reporting, provides a snapshot of a company's financial position at a specific point in time. Its structure is governed by key principles such as the Order of Permanence and the Order of Liquidity, which dictate the arrangement of assets and liabilities. The Order of Permanence prioritizes long-term stability, listing assets and liabilities in descending order of their permanence or expected longevity in the business. Conversely, the Order of Liquidity arranges items based on their closeness to cash, with the most liquid assets (like cash itself and receivables) listed first, followed by less liquid assets such as inventory and fixed assets. The balance sheet is divided into distinct elements: assets, liabilities, and shareholders' equity. Assets and liabilities are further broken down into current and non-current categories, enhancing clarity and providing insights into the company's liquidity and financial health. Together, these elements and organizing principles offer a comprehensive view of the organizational resources, obligations, and the equity held by shareholders.

## Exercise

What does a balance sheet primarily provide?

- A) A detailed profit forecast
- B) A snapshot of a company's financial position at a specific point in time
- C) A record of the company's annual sales
- D) An analysis of market trends
- Answer: B

Which principle on the balance sheet prioritizes long-term stability?

- A) Order of Liquidity
- B) Order of Permanence
- C) Order of Profitability
- D) Order of Solvency
- Answer: B

What does the Order of Liquidity dictate?

- A) The arrangement of items based on their profitability
- B) The arrangement of items based on their expected life span
- C) The arrangement of items based on their closeness to cash
- D) The arrangement of items based on their market value
- Answer: C

Which type of assets are listed first under the Order of Liquidity?

- A) Fixed assets
- B) Long-term investments
- C) Most liquid assets
- D) Intangible assets
- Answer: C

What are the main sections into which a balance sheet is divided?

- A) Assets, Liabilities, and Shareholders' Equity
- B) Revenues, Expenses, and Profits
- C) Departments, Teams, and Offices
- D) Markets, Products, and Strategies
- Answer: A

Under which category would cash and receivables fall in a balance sheet?

- A) Fixed assets
- B) Current assets
- C) Non-current liabilities
- D) Long-term liabilities
- Answer: B

How are liabilities typically classified on the balance sheet?

- A) Current and non-current
- B) Solvent and insolvent
- C) Permeable and impermeable
- D) Profitable and non-profitable
- Answer: A



Which assets would be listed last in the Order of Liquidity?

- A) Cash
- B) Inventory
- C) Receivables
- D) Fixed assets
- Answer: D

• What aspect does shareholders' equity represent on the balance sheet?

- A) The total debt owed to creditors
- B) The equity held by shareholders in the company
- C) The operational expenses of the company
- D) The total inventory held by the company
- Answer: B

• Which principle helps in understanding a company's liquidity through the balance sheet?

- A) Order of Permanence
- B) Order of Profitability
- C) Order of Liquidity
- D) Order of Stability
- Answer: C

## Notes

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.[illegible]



## 4. Cash Flow Statement

- Unit 4.1 - Overview of cash flow statement
- Unit 4.2 - Sources and uses of the cash
- Unit 4.3 - Categories of activities in the statement of cash flow
- Unit 4.4 - Summary of cash flow classification of common Transactions
- Unit 4.5 - Treatment of certain important items
- Unit 4.6 - Cash flow from operating activities - direct vs indirect method
- Unit 4.7 - Case study



## Key Learning Outcomes



- Understand the Overview of the Cash Flow Statement
- Identify Sources and Uses of Cash
- Differentiate Categories of Activities in the Statement of Cash Flow
- Summarize Cash Flow Classification of Common Transactions
- Understand the Treatment of Certain Important Items
- Analyze Cash Flow from Operating Activities - Direct vs Indirect Method
- Apply Knowledge through Case Studies

## Unit 4 - Cash Flow Statement

### Unit Objectives

- Knowledge of the cashflow statement.
- Understand the concept of cashflow from operating activities. Learn about the methods under cashflow statement.



## Unit 4.1 - Overview of Cash Flow Statement

A cash flow statement is an important tool for managing finances since it tracks a business's cash flow. This statement is one of three major reports that assists in determining a business's performance (together with the income statement and the balance sheet).

## Unit 4.2 - Sources and Uses of The Cash

According to the balance sheet, the concept of a cash flow statement shall be defined as the shift in cash flow from the start to the end of the year.

| Balance Sheet | Amount | Assets                 | Amount |
|---------------|--------|------------------------|--------|
| Liability     |        | Cash & cash equivalent | ***    |

A cash flow statement summarizes the amount of inflow and outflow of cash and cash equivalents coming in and moving out of the business. It provides aggregate data about all cash inflows (that a business receives from its ongoing operations and external investment sources) and cash outflows (that pay for business activities and investments during a given period).

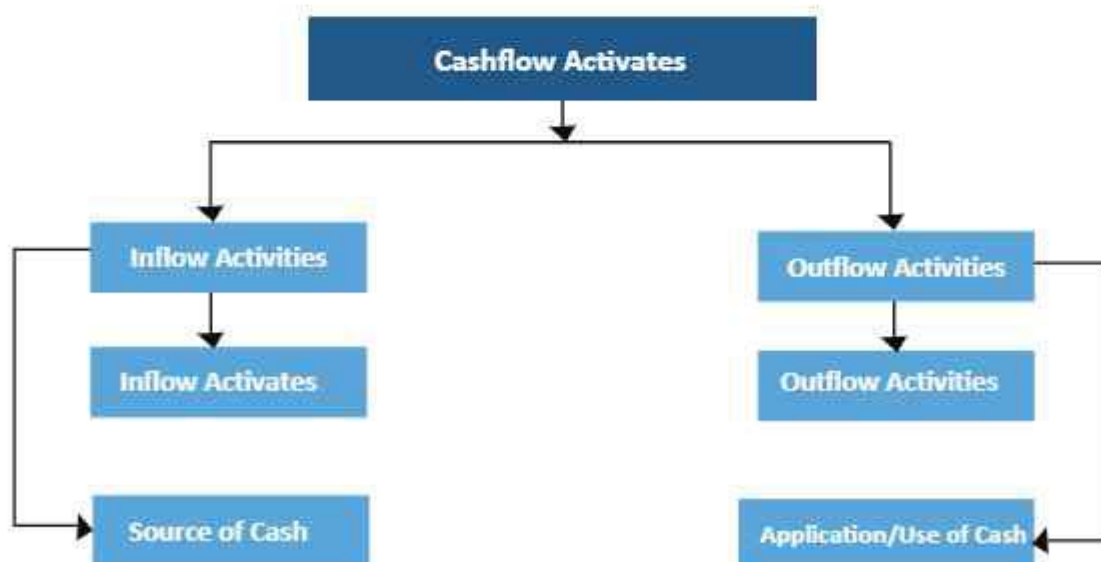


Fig 4.1

Cashflow statements are prepared to explain the cash difference between two points in time.

- Sources of cash (cash inflows):
  - Issuance of shares and debentures
  - Raising long-term loans
  - Sale of investments and fixed assets
  - Cash from operations (net operating expenses)
- Uses of cash (cash outflows):
  - Purchase of investments and other fixed assets
  - Payment of dividend and tax
  - Loss of operation (net operating loss)
  - Redemption of preferred shares and debentures
  - Repayment of a long-term loan

- **Income statement is accrual basis of accounting**
- **Cashflow Statement is the cash basis of accounting**

## Unit 4.3 - Categories of Activities In The Statement of Cash Flow



Fig 4.2

|                                            | Dr  | Cr  | Change |
|--------------------------------------------|-----|-----|--------|
| Cash flow from operating activities        | *** | *** | ***    |
| Cash flow from investing activities        | *** | *** | ***    |
| Cash flow from <b>financing</b> activities | *** | *** | ***    |
| Net increase / decrease in cash            | *** | *** | ***    |
| + Beginning cash balance                   | *** | *** | ***    |
| Ending cash balance                        | *** | *** | ***    |

### Operating Activities



Fig 4.3

$$\text{Operating activities} = \text{Income statement items} + \text{Current assets} + \text{Current liability}$$

All the income statement items, most of the current asset items and current liability items falls under the operating activities section of the cash flow statement. Accounting laws do not cover this statement.

Sources & uses of cash from operating activities

- Cash collection of sales
- Cash payments for COGS & SG&A
- Interest received and interest paid
- Dividend received
- Tax Paid

### Investing Activities



Fig 4.4

$$\text{Investing activities} = \text{non-current assets}$$

Most of the non-current items go to investment activities of a cashflow statement.

Sources & uses of cash from investing activities:

- Loans to others
- Invest in debt, security, bonds
- Purchase PP&E and intangibles
- Gain and loss from the sale of PP&E

#### • Financing Activities



Fig 4.5

**Financing activities = Non-Current Liability + Equity**

Most of the items in non-current liability and equity shall go to financing activities of the cash flow statement.

Sources & uses of cash from financing activities:

- Loans borrowed
- Issuing bonds
- Equity
- Dividend paid

## Unit 4.4 - Summary of Cash flow Classification of Common Transactions

| Transactions                                                               | Operating cash flow | Investing cash flow | Financing cash flow | No net cash flow |
|----------------------------------------------------------------------------|---------------------|---------------------|---------------------|------------------|
| Sale of goods & services/<br>collection of receivables                     | ***                 |                     |                     |                  |
| Purchase of supplies &<br>services/payment to vendors                      | ***                 |                     |                     |                  |
| Payment of taxes                                                           | ***                 |                     |                     |                  |
| Purchase/sale of trading<br>securities                                     | ***                 |                     |                     |                  |
| Purchase/sale of PP&E,<br>intangibles, or long-term<br>investments of cash |                     | ***                 |                     |                  |
| Depreciation, amortisation,<br>or depletion                                |                     |                     |                     | ***              |
| Interest income received                                                   | ***                 |                     |                     |                  |
| Dividend income received                                                   | ***                 |                     |                     |                  |
| Dividend paid                                                              |                     |                     | ***                 |                  |
| Income from equity method<br>affiliates                                    |                     |                     |                     | ***              |
| Borrowing funds                                                            |                     |                     | ***                 |                  |
| Payment of interest on debt                                                | ***                 |                     |                     |                  |
| Payment of principal on debt                                               |                     |                     | ***                 |                  |
| Issue of common or preferred<br>stock                                      |                     |                     | ***                 |                  |
| Payment on dividends on<br>common or preferred stock                       |                     |                     | ***                 |                  |



## Unit 4.5 - Treatment of Certain Important Items

### • Extraordinary items

Extraordinary items are not a regular phenomenon; they are non-recurring in nature. e.g., loss due to theft or earthquake, or flood. Such items are disclosed separately as arising from operating, investing, or financing activities.

### • Interest and dividend

In the case of a financial enterprise  
(whose main business is lending and borrowing)

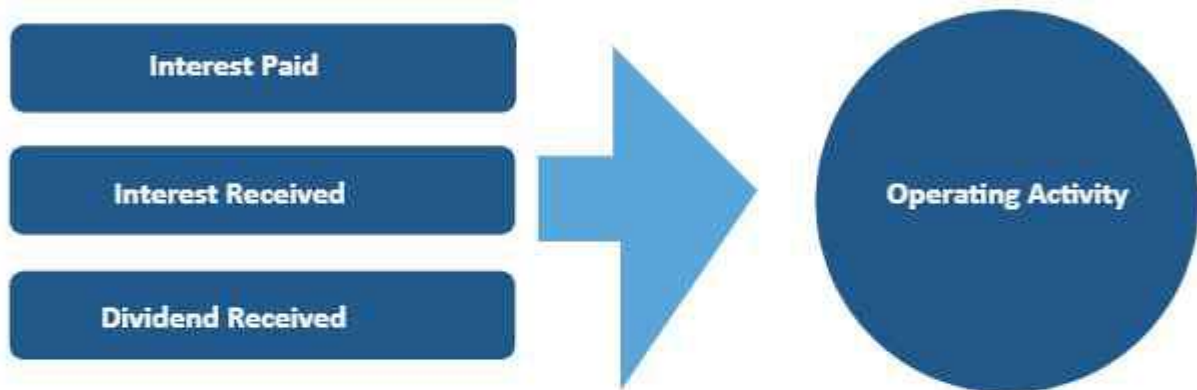


Fig 4.6

In the case of a non-financial enterprise, as per as 3



Fig 4.7

### Taxes on Incomes and Gains

Cash flows arising from taxes on income should be disclosed separately. (Unless they can be specifically identified with financing and investing activities).

Tax on operating profit → Operating cash flows.

Dividend tax (tax paid on dividend) → Financing activity along with dividend paid.

Capital gains tax (paid on the sale of fixed assets) → Investing activities.

### • Non-cash Transactions

Investment and financial transactions that do not require the use of cash or cash equivalents shall be excluded from a cash flow statement.

**Example:** Assets acquired through the issuance of shares, the redemption of debentures and by the issuance of equity shares shall not be disclosed in cash flow statements, because they are non-cash transactions.

## Unit 4.6 - Cash flow from operating activities - Direct vs Indirect Method

The direct and the indirect method are the two approaches that can be used to create a cash flow statement.

### • Direct Method

The direct method represents the summary of cash flow, and all the uses and sources are directly related to such activities. Also, these methods are applicable only to operating activities. In financing and investing activi-

| Direct method                                                                                                                            | Indirect / Reconciliation method                                         |
|------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Operating activities</li> <li>• Investing Activities</li> <li>• Financing activities</li> </ul> | <ul style="list-style-type: none"> <li>• Operating activities</li> </ul> |

ties only direct method can be used.

The direct method uses only the cash transactions, i.e., cash spent, and cash received to produce the cash flow statement. All non-cash transactions like depreciation are ignored. Compared to the indirect method, they are only a very few companies that use this method.

**PROFORMA OF CASH FLOW STATEMENT**  
Under Direct method.

| Particulars                                                                       | Amount |
|-----------------------------------------------------------------------------------|--------|
| <b><u>A. Cash flows from operating activities:</u></b>                            |        |
| Cash receipts from customers                                                      |        |
| Less: Cash paid to suppliers and employees                                        |        |
| : Cash generated from operation                                                   |        |
| Less : Income tax paid                                                            |        |
| : Cash flows from operation before extraordinary items                            |        |
| Add : Proceeds from any disaster settlement                                       |        |
| <b>Net cash flow from operating activities</b>                                    |        |
| <b><u>B. Cash flows from investing activities:</u></b>                            |        |
| Proceeds from the sale of fixed assets including investments                      |        |
| Less: Purchase of fixed assets including investments                              |        |
| Add: Interest received                                                            |        |
| : Dividends received                                                              |        |
| <b>Net Cash flow from investing activities</b>                                    |        |
| <b><u>C. Cash flows from financing activities:</u></b>                            |        |
| Proceeds from issuance of share capital                                           |        |
| Proceeds from Long-term borrowings                                                |        |
| Less: Repayment of long-term borrowings including redemption of preference shares |        |
| : Interest paid                                                                   |        |
| : Dividend paid                                                                   |        |
| <b>Net cash flow from financing activity</b>                                      |        |
| Net increase in cash and cash equivalents                                         |        |
| Add: Cash and cash equivalents at the beginning of the period                     |        |
| <b>Cash and cash equivalents at the end of the period</b>                         |        |

• **Indirect/reconciliation method**

The indirect method uses net income as a base and adds non-cash expenses like depreciation, and deducts non-cash incomes like profit on the sale of scraps, and net adjustments between current assets and liabilities to produce the overall cash flow statement. Net income is automatically converted into cash flow. Many businesses predominantly use this method.

## PROFORMA OF CASH FLOW STATEMENT

Under the Indirect method:

| Particulars                                                     | Amount |
|-----------------------------------------------------------------|--------|
| <b>A. Cash flows from operating activities:</b>                 |        |
| Net profit for the period before taxation & extraordinary items |        |
| Add: Adjustment for non-current and non-operating Items         |        |
| : Depreciation                                                  |        |
| : Interest paid                                                 |        |
| : Foreign exchange loss                                         |        |
| : Loss on sale of fixed assets & investments                    |        |
| Less: Adjustment for non-current and non-operating items        |        |
| : Interest earned                                               |        |
| : Dividend earned                                               |        |
| : Profit on sale of fixed & investments                         |        |
| <b>Operating profit before</b>                                  |        |
| Working capital changes;                                        |        |
| Add: Increase in current liabilities                            |        |
| : Decrease in current assets                                    |        |
| Less: Increase in operating current assets                      |        |
| : Decrease in operating current liabilities                     |        |
| : Cash generated from operation                                 |        |
| Less: Income tax paid                                           |        |
| Add: Proceeds from any disaster settlement                      |        |
| <b>Net cash flow from operating activities</b>                  |        |

## Unit 4.7 - Case study

**Illustration no: 1**

Star Ltd a non-financial company has the following entries in its bank account. It has sought your advice on the treatment of preparing the cash flow statement.

- I. Dividend paid for the year.
- II. Investment made in subsidiary Smart Ltd. and dividend received.
- III. TDS on interest income earned for investments made.
- IV. TDS on interest earned for advance given to suppliers.
- V. Insurance claim received against loss of fixed asset by fire.
- VI. Loans and advances given to the following and interest earned on them;
  - a. to suppliers
  - b. to employees
  - c. its subsidiaries' companies



**Solution :**

I. Dividend paid for the year.

: Financing cash outflow

II. Investment made in subsidiary Smart Ltd. and dividend received.

: Investing cash flow

III. TDS on interest income earned for investments made.

: Investing cash outflow

IV. TDS on interest earned for advance given to suppliers.

: Operating cash outflow

V. Insurance claim received against loss of fixed asset by fire.

: Extraordinary items are to be shown under a separate heading as 'Cash inflow from investing activities'

VI. Loans and advances given to the following, and interest earned

(1) to suppliers Operating cash flow

(2) to employees Operating cash flow

(3) to its subsidiary companies Investing cash flow

**Illustration no: 2**

From the following information, calculate cash flow from operating activities under the direct method.

Summary of cash account of Winners Ltd for the year ended 31st march 2021

| Particulars            | Amount   | Particulars                  | Amount   |
|------------------------|----------|------------------------------|----------|
| To Balance b/d         | 1,00,000 | By Cash purchases            | 1,30,000 |
| To Cash sales          | 1,50,000 | By Trade payables            | 1,55,000 |
| To Trade receivables   | 1,75,000 | By Office & selling expenses | 75,000   |
| To Trade commission    | 50,000   | By Income tax                | 25,000   |
| To Sale of investment  | 33,000   | By Investment                | 35,000   |
| To Loan from bank      | 1,00,000 | By Repayment of loan         | 75,000   |
| To Interest & dividend | 5,000    | By Interest on loan          | 15,000   |
|                        |          | By Balance c/d               | 1,03,000 |
|                        | 6,13,000 |                              | 6,13,000 |



**Solution:**

Cash flow statement of Winners Ltd for the year ended 31st March 2021

| Particulars                                | Amount   | Amount     |
|--------------------------------------------|----------|------------|
| Operating activities:                      |          |            |
| Cash received from sale of goods           | 1,50,000 |            |
| Cash received from Trade receivables       | 1,75,000 |            |
| Trade commission received                  | 50,000   | 3,75,000   |
| Less: Payment for cash purchases           | 1,30,000 |            |
| Payment to trade payables                  | 1,55,000 |            |
| Office and selling expenses                | 75,000   |            |
| Payment for income tax                     | 25,000   | (3,85,000) |
| Net cash flow used in operating activities |          | (10,000)   |

**Illustration 3**

Prepare cash flow statement from the following profit and loss account in the indirect method as of 31st March 2021.

| Revenue                           | Amount     |
|-----------------------------------|------------|
| Sales                             | 4,150      |
| Interest and dividend             | 100        |
| Stock adjustment                  | 20         |
| Total                             | 4,270      |
| Expenditure                       |            |
| Purchases                         | 2,400      |
| Wages and salaries                | 800        |
| Other expenses                    | 200        |
| Interest                          | 60         |
| Depreciation                      | 100        |
| Total                             | 3,560      |
| Profit before tax                 | 710        |
| Tax Provision                     | 200        |
| <b>Profit after tax</b>           | <b>510</b> |
| Balance of Profit & Loss Account  | 50         |
| Profit available for distribution | 560        |

**Solution:**

Calculation of cash flow under the indirect method.

Cash flow statement as of 31st March 2021

| Particulars                                                      | Amount     |
|------------------------------------------------------------------|------------|
| Profit before tax                                                | 710        |
| Adjustment for Non-cash and Non-operating Items                  |            |
| Add: Non-cash items: Depreciation                                | 100        |
| Add: Interest (Financing cash outflow)                           | 60         |
| Less: Interest and Dividend (Investment Cash inflow)             | (100)      |
| <b>Operating profit before adjusting working capital changes</b> | <b>770</b> |
| Adjustment for Non-cash and Non-operating Items:                 |            |
| Increase in Debtors (250-400)                                    | (150)      |
| Increase in Inventories (180-200)                                | (20)       |
| Increase in Creditors (250-230)                                  | 20         |
| Increase in Outstanding wages (50-40)                            | 10         |
| Increase in Outstanding expenses (20-10)                         | 10         |
| Cash generated from operations                                   | 640        |
| Less: Tax paid                                                   | (195)      |
| Cash Flow from Operating Activities                              | 445        |

## Summary

The cash flow statement is a crucial financial document that outlines the inflows and outflows of cash within a company, serving as a bridge between the balance sheet and income statement by explaining the changes in cash and cash equivalents. It highlights the basic concept of monitoring liquidity and operational efficiency. The preparation of a cash flow statement involves various adjustments for reconciling starting and ending balances of cash, including adjustments for non-cash transactions, deferred taxes, and changes in working capital. Another related but distinct financial practice is the preparation of a Bank Reconciliation Statement, which is vital for comparing the company's cash records against those reported by the bank to identify discrepancies like outstanding checks or deposits in transit. This process helps ensure that the cash records are accurate and reflects actual available funds, crucial for effective financial management. Together, these tools enhance transparency and accuracy in financial reporting and operational assessment.

## Exercise

What is the primary purpose of the cash flow statement?

- A) To track the company's profit margins
- B) To outline the company's employee structure
- C) To explain changes in cash and cash equivalents
- D) To showcase the company's investment portfolio
- Answer: C

What does the cash flow statement connect?

- A) Balance Sheet and Income Statement
- B) Income Statement and Employee Performance
- C) Marketing strategies and financial outcomes
- D) Customer engagement and sales figures
- Answer: A

Which aspect of a company does the cash flow statement specifically highlight?

- A) Market share
- B) Liquidity and operational efficiency
- C) Annual growth rate
- D) Employee satisfaction
- Answer: B

What types of adjustments are made when preparing a cash flow statement?

- A) Adjustments for CEO salary
- B) Adjustments for market expansion
- C) Adjustments for non-cash transactions and changes in working capital
- D) Adjustments for new product launches
- Answer: C

What is the main purpose of preparing a Bank Reconciliation Statement?

- A) To compare company's records with bank reports
- B) To calculate annual profits
- C) To evaluate employee performance
- D) To plan future marketing strategies
- Answer: A

What kind of discrepancies might a Bank Reconciliation Statement reveal?

- A) Differences in product quality
- B) Discrepancies like outstanding checks or deposits in transit
- C) Variations in employee attendance
- D) Inconsistencies in management reports
- Answer: B

How does a cash flow statement aid in financial management?

- A) By determining product pricing
- B) By tracking cash inflows and outflows
- C) By assessing employee productivity
- D) By analysing customer feedback
- Answer: B

What is a non-cash transaction adjustment in a cash flow statement?

- A) Adjusting for cash spent on non-cash expenses
- B) Adjusting entries for activities that do not involve actual cash flow
- C) Adjusting salaries paid in cash
- D) Adjusting cash used for purchasing non-cash assets
- Answer: B

Why is the accuracy of cash records crucial as per the discussed financial tools?

- A) To ensure effective marketing
- B) To ensure accuracy in financial reporting
- C) To guide product development
- D) To improve customer service
- Answer: B

Which statement helps ensure that cash records reflect actual available funds?

- A) Income Statement
- B) Balance Sheet
- C) Bank Reconciliation Statement
- D) Statement of Shareholder Equity
- Answer: C



This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins or other markings on the paper.

## 5. Bank Reconciliation

- Unit 5.1 - Basic Concept and Meaning
- Unit 5.2 - Types of Adjustment for Reconciling
- Unit 5.3 - Preparation of Bank Reconciling Statement
- Unit 5.4 - Summary of cash flow classification of common Transactions
- Unit 5.5 - Case Study



## Key Learning Outcomes

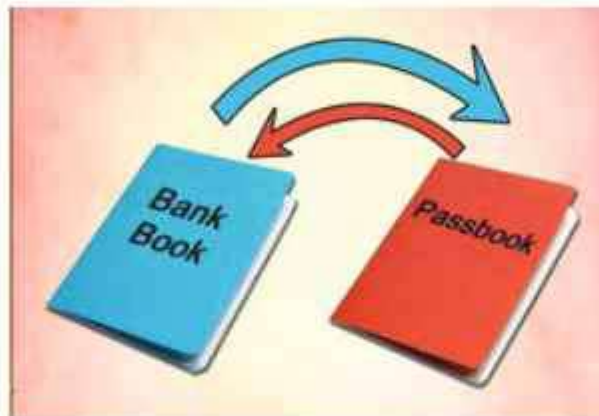


- Understand the Basic Concept and Meaning of Bank Reconciliation
- Identify Types of Adjustments for Reconciling
- Prepare a Bank Reconciliation Statement
- Summarize Cash Flow Classification of Common Transactions
- Apply Knowledge through Case Studies

## Unit 5 - Bank Reconciliation

### Unit Objectives

- Understand the basics of the bank reconciliation
- Knowledge of various adjustments for reconciliation
- Preparation and presentation of bank reconciliation



## Unit 5.1 - Basic Concept and Meaning

A bank reconciliation statement could be defined as the summary of the banking and business accounts that reconciles a company's bank account with its financial record. The statement contains a record of all the deposits, withdrawals, and other financial activities with a bank over a certain period of time.

"Bank Reconciliation Statement is a statement prepared to reconcile the difference between the balances as per the bank column of the cash book and passbook on any given date".

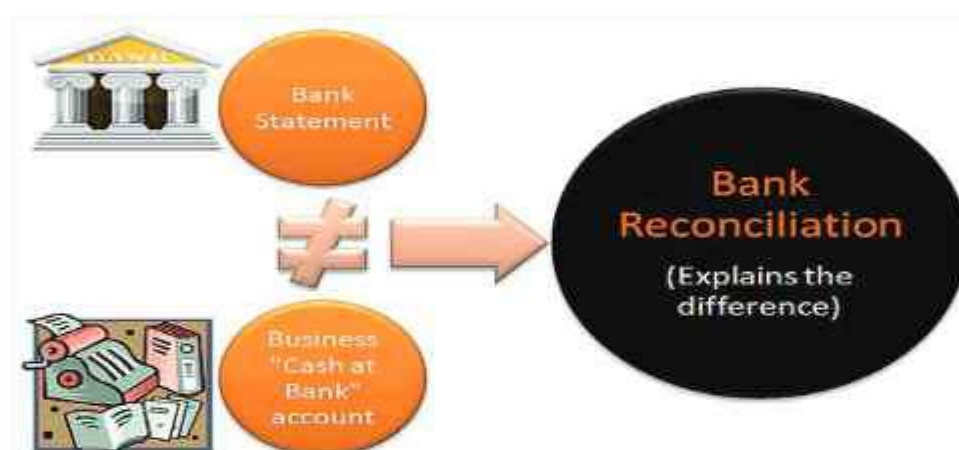


Fig 5.1



## Unit 5.2 - Types of Adjustment for Reconciling

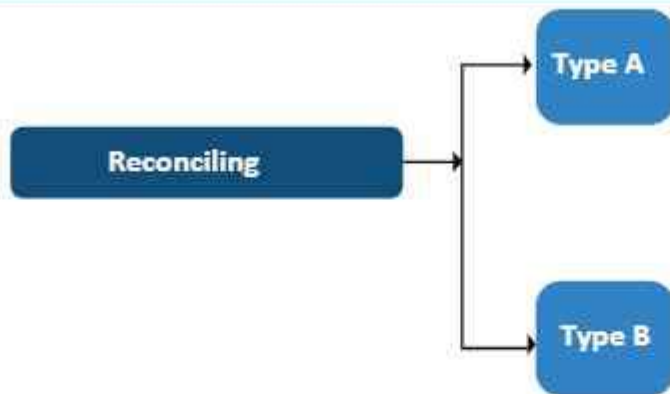


Fig 5.2

- **Type A adjustment**

The item that has been missed out by the bank, that means bank has not recorded the respective item in Bank Book.

Example: Cheque deposit

You received a cheque from the customer, so you credit the amount in your cash books, but after the deposit, the bank hasn't cleared the cheque.

- **Type B adjustment**

The item that has been missed out by the company, that means the company has not recorded the respective item in cash book.

Example: Bank charges

Bank has already charged an amount and deducted the amount from the bank book, but you have not recorded the same in cash books.

Reasons for differences between balances as per cash book and balance as per bank book.

| Basis of differences        | Particulars                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-----------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Type A adjustment<br>☒<br>☒ | <p>The following transactions that are recorded in cash book is not recorded in bank book</p> <ol style="list-style-type: none"> <li><b>Cheques issued but not presented for payment:</b> Balance as per cash book reduces immediately (entered on the credit side of the bank column of the cash book) but balance as per bank passbook remains the same unless it is presented for payment.</li> <li><b>Cheques deposited but not yet collected:</b> When we deposit a cheque, the balance as per cash book increases immediately (entered on the debit side of the bank column of the cash book) but the balance as per bank passbook remains the same until it is cleared and actually collected by the bank.</li> </ol> <p>The error committed by the bank in the recording of transactions:<br/>           Wrong debit or credit in the account holder's account.<br/>           Recording bank charges and interest more than once.</p> |

|                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Type B Adjustment | <p>These differences may arise when a transaction is recorded by the bank book, but not recorded in the cash book.<br/>           These types of transactions are unknown to the account holder.<br/>           Some examples of such transactions are:</p> <ol style="list-style-type: none"> <li>Interest allowed/credited by the bank.</li> <li>Bank charges and interest charged/debited by the bank.</li> <li>Direct payment made by the account holders bank via standing instruction.</li> <li>Direct deposit made by the customer.</li> <li>Interest/dividend collected by the bank.</li> <li>Bills Receivables collected by the bank on our behalf.</li> <li>Dishonor of a bill discounted.</li> <li>Bills payable is met by bank on our behalf.</li> </ol> <p>The error committed by the account holder in the recording of transactions:</p> <ul style="list-style-type: none"> <li>Cheque issued but not recorded in the cash book.</li> <li>Cheques deposited into the bank but omitted to record in the cash book.</li> <li>Error in totaling or balancing the bank column of the cash book.</li> </ul> |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

## Unit 5.3 - Preparation of Bank Reconciliation Statement

|                              |                                 |
|------------------------------|---------------------------------|
| <b>Balance per Bank</b>      | <b>Balance per books</b>        |
| <b>+/- Type A adjustment</b> | <b>+/- Type B adjustment</b>    |
| <b>Corrected balance</b>     | <b><i>Corrected balance</i></b> |

Fig 5.3

- Steps taken to prepare the bank reconciliation statement:



Fig 5.4

**Adjust the Bank Statement**

Start with Bank Balance at the end of the period

(Add): Deposit in transit

(Less): Outstanding (Not yet deposited) cheque

Bank errors may be added or subtracted as per the transaction

**Adjust the Cash Book Balance**

Start with Cash Balance at the end of the period

(Add): Unrecorded deposit  
Interest income or dividend

(Less): Bank fee / charges

Journal entry errors may be added or subtracted as per the transaction

**Compare the end of Balance**

Fig 5.5

- Treatment of difference between balances as per cash book and balance as per bank passbook.

| No  | Reason for the difference                                                     | Favorable balance (dr.) as per the cash book | Favorable balance (cr.) as per pass book |
|-----|-------------------------------------------------------------------------------|----------------------------------------------|------------------------------------------|
| 1.  | Cheque deposited but not cleared                                              | Less                                         | Add                                      |
| 2.  | Cheque issued but not presented for the payment.                              | Add                                          | Less                                     |
| 3.  | Cheque directly deposited in the bank by a customer                           | Add                                          | Less                                     |
| 4.  | Expenses (e.g., telephone bills, insurance charges) directly paid by the bank | Less                                         | Add                                      |
| 5.  | Locker rent levied by the bank                                                | Less                                         | Add                                      |
| 6.  | Bank charges levied by the bank                                               | Less                                         | Add                                      |
| 7.  | Wrongly credited in the cash book                                             | Add                                          | Less                                     |
| 8.  | Wrongly debited in the cash book                                              | Add                                          | Less                                     |
| 9.  | Wrongly credited in the passbook                                              | Add                                          | Less                                     |
| 10. | Wrongly debited in the passbook                                               | Less                                         | Add                                      |
| 11. | Bill Receivable collected directly by the bank                                | Add                                          | Less                                     |
| 12. | Interest on bank overdraft charges                                            | Less                                         | Add                                      |



## Unit 5.4 - Case study

### • Illustration 1

From the following particulars of Anil & Co. prepare bank reconciliation statement as on December 31, 2021.

- Bank balance as per cash book ₹ 32,500.
- Cheques deposited into the bank but not credited up to December 31, 2021, ₹8,900.
- Cheques issued but not presented for payment ₹ 12,500.
- Bank credited ₹5,000 for receiving dividends through electronic clearing system.
- Bank charges debited by bank ₹ 600.

#### Solution:

Bank Reconciliation statement of Anil & Co. as on December 31, 2021

| Particulars                                          | Amount  |
|------------------------------------------------------|---------|
| Balance as per cash book                             | 32,500  |
| Add: Cheques issued but not presented for payment    | 12,500  |
| Dividend received through ECS                        | 5,000   |
| Less: Cheques deposited but not credited by the bank | (8,900) |
| Bank charges debited by the bank                     | (600)   |
| Balance as per passbook                              | 40,500  |

### Illustration 2

The bank passbook of XYZ Industries showed a credit balance of ₹ 27,300 on December 31, 2021. The following differences were found on that date between the cash book and the passbook:

- Cheques issued before December 31, 2021, amounting to ₹ 19,000 had not been presented for payment.
- Two cheques of ₹ 5,000 and ₹ 3,500 were deposited into the bank on December 31, but the bank gives credit for the same in January.
- Insurance premium directly paid by bank ₹ 5,000.
- ₹ 2,000 was wrongly debited to the firm account by the bank.

Prepare bank reconciliation statement as on December 31, 2021

#### Solution:

Bank reconciliation statement of XYZ Industries as on December 31, 2021

| Particulars                                                            | Amount   |
|------------------------------------------------------------------------|----------|
| Balance as per passbook                                                | 27,300   |
| Add: Cheques deposited but credited by the bank in January (5000+3500) | 8,500    |
| Insurance premium directly paid by bank                                | 5,000    |
| Wrongly debited by the bank                                            | 2,000    |
| Less: Cheques issued but not presented for payment                     | (19,000) |
| Balance as per cash book                                               | 23,800   |



## Summary

Bank reconciliation is a fundamental financial process designed to match the balance of cash in a company's books to the balance reported by the bank, ensuring accuracy in records and identifying any discrepancies. This procedure involves various types of adjustments for reconciling differences, such as accounting for outstanding checks, deposits in transit, bank fees, and errors in recording transactions. The preparation of a Bank Reconciliation Statement is meticulous and requires a careful review of the bank statements against the company's cash account records. Adjustments are made to reflect transactions that have not yet been recorded by the bank or discrepancies due to timing differences between when a transaction is recorded by the company and when it is reflected in the bank's records. This practice is critical in maintaining the integrity of financial statements, providing a clear view of the actual cash available, and ensuring that all financial records are accurate and up-to-date.

## Exercise

What is the main purpose of bank reconciliation?

- A) To increase bank deposits
- B) To match the company's book balance with the bank-reported balance
- C) To evaluate employee performance
- D) To forecast future sales
- Answer: B

What does bank reconciliation help identify?

- A) Market trends
- B) Discrepancies in cash records
- C) New investment opportunities
- D) Customer satisfaction levels
- Answer: B

Which of the following is a common type of adjustment in bank reconciliation?

- A) Adjusting for outstanding checks
- B) Adjusting sales targets
- C) Revising employee benefits
- D) Modifying product prices
- Answer: A

What does the preparation of a Bank Reconciliation Statement involve?

- A) Careful review of bank statements against the company's cash account records
- B) Annual performance reviews of employees
- C) Strategic planning for market expansion
- D) Analysis of competitor financial statements
- Answer: A

Why are adjustments made during bank reconciliation?

- A) To account for differences in reported and actual sales
- B) To reflect transactions not yet recorded by the bank
- C) To modify the company's marketing strategy
- D) To adjust the company's stock price
- Answer: B

What might cause discrepancies that require reconciliation?

- A) Differences in product quality
- B) Errors in recording transactions
- C) Changes in management
- D) Fluctuations in market demand
- Answer: B

What is an example of an item that might be adjusted in a bank reconciliation?

- A) Bank fees
- B) Employee wages
- C) Product development costs
- D) Marketing expenses
- Answer: A

Which of the following is a typical adjustment for bank reconciliation?

- A) Deposits in transit
- B) Adjustment of goodwill
- C) Recalculation of depreciation
- D) Restructuring of corporate loans
- Answer: A

Why is the accuracy of financial records crucial in bank reconciliation?

- A) To ensure all marketing expenses are justified
- B) To maintain integrity of financial statements
- C) To facilitate new product launches
- D) To determine employee bonuses
- Answer: B

What does a Bank Reconciliation Statement provide?

- A) A detailed view of a company's investment portfolio
- B) A clear view of the actual cash available
- C) Insights into customer demographics
- D) An overview of global market trends
- Answer: B

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. On the left side, there are faint vertical markings that appear to be part of a binder or folder edge. The overall appearance is that of a clean, unused piece of stationery.



## 6. Preparation of Financial Statement of Non-Profit Organization

- Unit 6.1 - Non-Profit Organization
- Unit 6.2 - Financial Statement
- Unit 6.3 - Treatment in non-profit organizations
- Unit 6.4 - Receipt and Payment Account
- Unit 6.5 - Case Study





## Key Learning Outcomes



- Understand the Nature and Characteristics of Non-Profit Organizations
- Prepare and Interpret Financial Statements for Non-Profit Organizations
- Understand the Specific Accounting Treatments in Non-Profit Organizations
- Prepare and Analyze the Receipt and Payment Account
- Apply Knowledge through Case Studies

## Unit 6 - Preparation of Financial statement of Non-Profit Organization

### Unit Objectives

- Understand Non-Profit Organisations
- Provide Knowledge on Financial Statements and Treatments of Accounts of Non-Profit Organisations
- Familiarise with Receipt and Payment Account & Income and Expenditure Account of Non-Profit Organisations

## Unit 6.1 - Non-profit Organization

Non-Profit organizations are also called non-business entities. These are certain organizations that are not established for making profit but to provide some services. Motive of such organization are service oriented and not profit maximization. These services are generally given to members who make subscriptions to avail them. These are also called Non-Profit Organization.



Fig.6.1

These organizations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc. The accounting of such organizations is based on similar principles followed by the other profit-making organizations.

There are certain items of revenue and expenses that are unique for the Non-Profit Organization.

| Revenue Items  | Expenditure Items   |
|----------------|---------------------|
| Donations      | Tournament Expenses |
| Entrance fees  | Events              |
| Subscriptions  | Prizes              |
| Grant Received | Other Expenses      |

## Unit 6.2 - Financial Statements



Fig 6.2

## Unit 6.3 - Treatment items in Non-Profit Organizations

**Donation:** They could be used for meeting capital or revenue expenses. Donation received for special purposes are credited to that fund. Small donations for general purpose are treated as revenue receipts.

**Journal:**

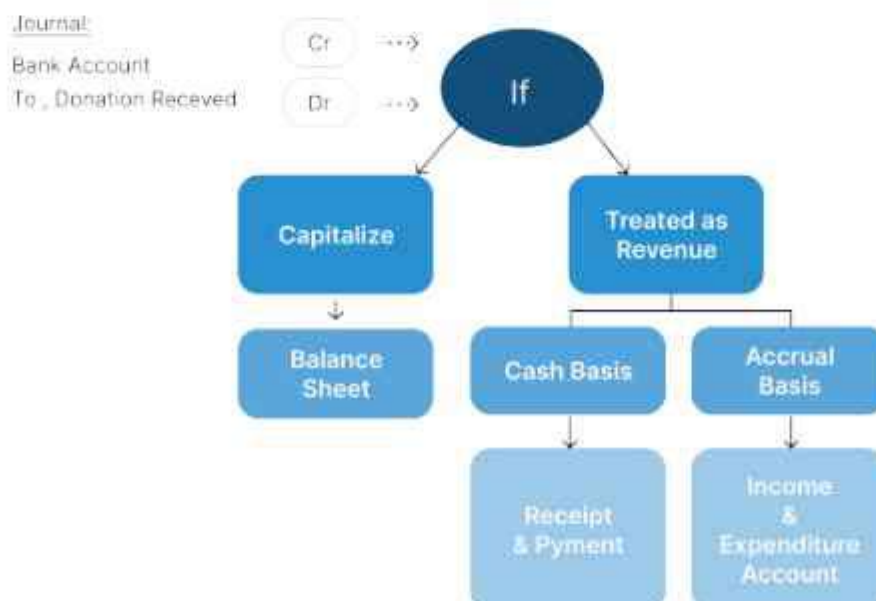


Fig 6.3

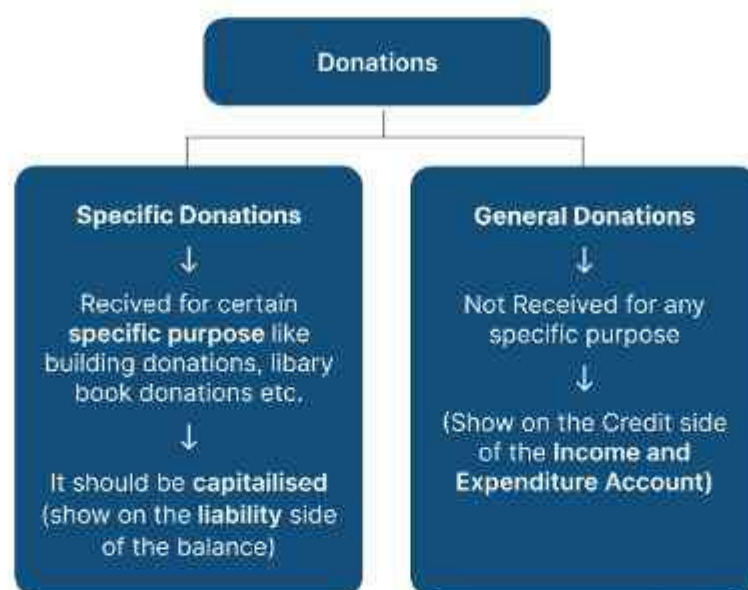


Fig 6.4

**Entrance Fees:** It is received at the time of admission of a new member. It is also known as admission fees. Entrance fees should be capitalized and added to the capital fund of organization as it is a one-time fee, they are non-recurring in nature. As per the rules of the organization, it is either treated as revenue or capital in nature:

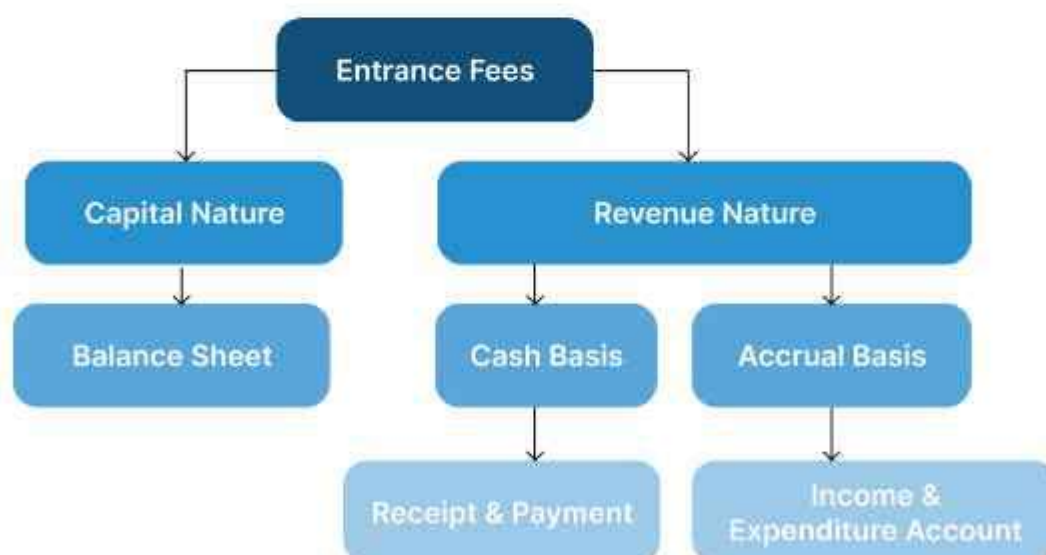


Fig 6.5



- **Legacy:** It is an amount received by an organization as per the will of the person after the death of that person. It should be capitalized and shown on the liability side of the balance sheet by adding it to the capital fund.
- **Honorarium:** It is a voluntary payment made to a person in exchange for services for which payment is not customarily or legally required is known as an honorarium.
- **Life membership fees:** It is a deferred receipt in balance sheet, and every year a specific amount is credited to the income and expenditure account. It should be capitalized and shown on the liability side of the balance sheet.

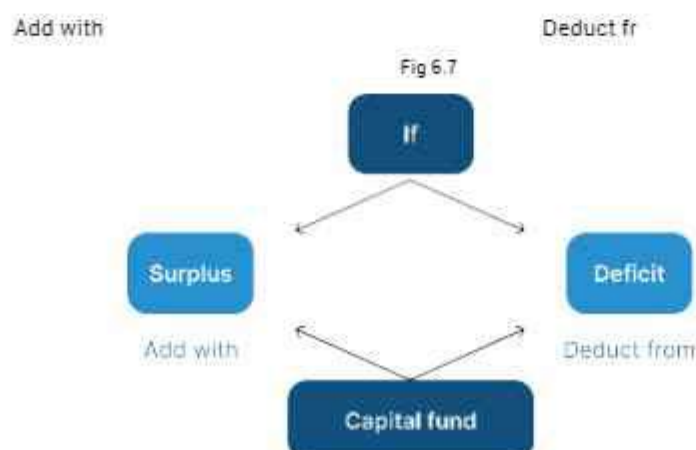
**Sale of old fixed asset:** The sale proceed of old fixed assets are treated as capital receipts. The profit or loss on sale of fixed assets is shown in the income and expenditure.



Fig 6.6

**Capital Fund:** It is also called "General Fund" or "Accumulated Fund." It is actually the capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually "Surplus" or "Deficit" during a period is added with or deducted from it.

**Capital Fund = Liabilities - Asset (Excess of liabilities over assets)**



- **Special Fund:** It may be created out of special donation or subscription or out of a portion of the "Surplus". For example, a club may have a "Building Fund". It may be used for meeting some specific expenses or for acquiring an asset. Income arising out of this fund or profit or loss arising out of sale of such investment are transferred to the specific fund itself.
- **Subscription:** These are annual receipt therefore must be recognized as revenue on accrual concept.

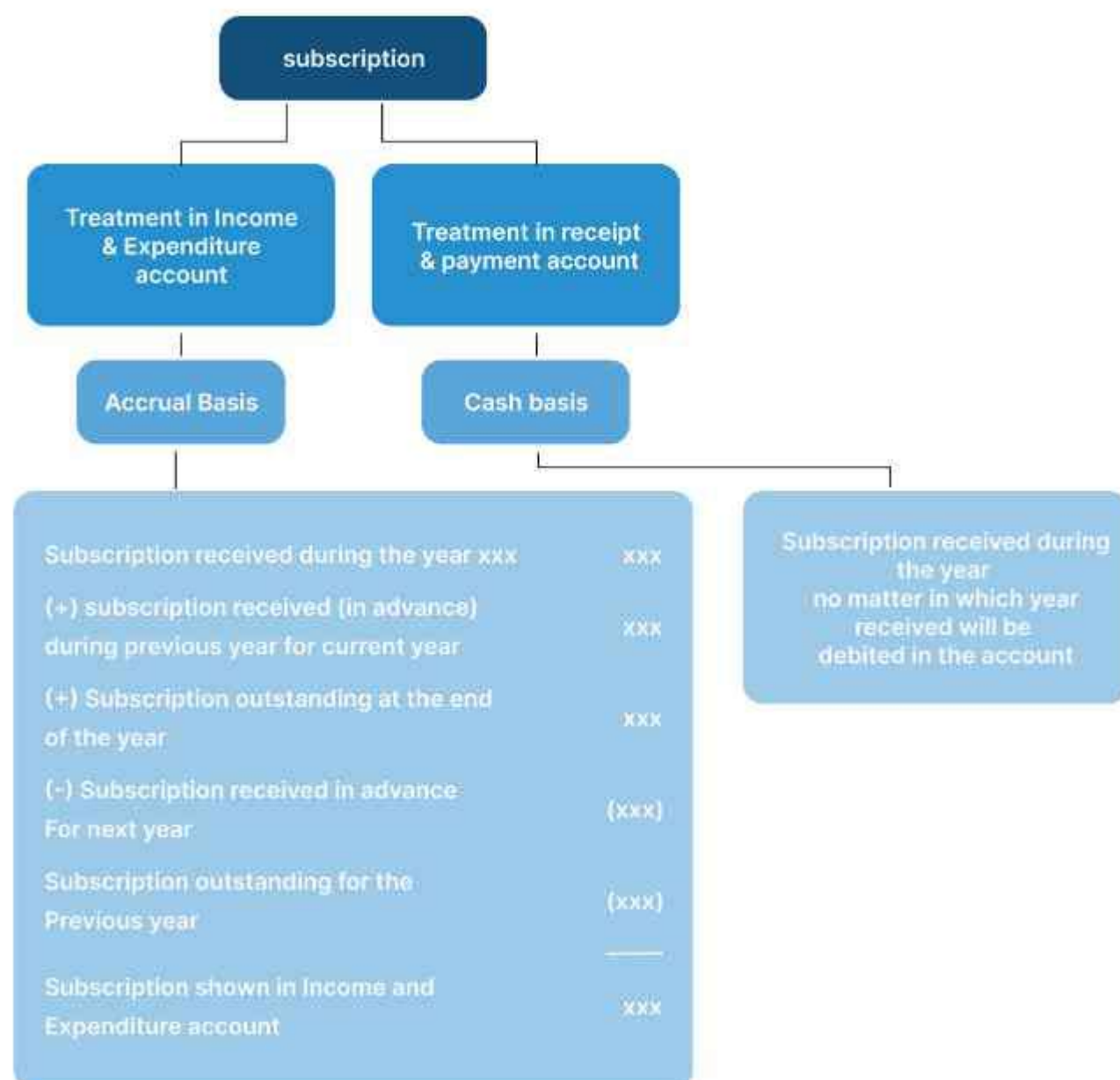


Fig 6.8

## Unit 6.4 - Receipt and Payment Account

This is similar to a cash book. Entries are made on a cash basis and items related to the previous year or current year or subsequent years are also recorded. Receipts are shown on the debit side and payments are shown on the credit side. Capital as well as revenue items are entered in the R & P A/c. This account is a real account. No provisions are recorded in this account. The account has an opening and a closing balance which is reflected as an asset in the balance sheet.

Dr. Receipts and Payment Account

Cr

| Receipts                                                      | Amount | Payments                                                      | Amount |
|---------------------------------------------------------------|--------|---------------------------------------------------------------|--------|
| Starts with opening Balance                                   | XXX    |                                                               |        |
| All receipts - capital or revenue                             | XXX    | All payments - Capital or revenue                             | XXX    |
| May be related to any period previous, current or subsequent. | XXX    | May be related to any period previous, current or subsequent. | XXX    |
|                                                               |        | Ends with closing balance                                     | XXX    |

- Specimen of Receipts and Payment Account:

Dr. Receipts and Payments Account

Cr.

| Receipts                         | Amount | Payments               | Amount |
|----------------------------------|--------|------------------------|--------|
| To, Balance b/d:                 |        | By Balance B/d         | XXX    |
| Cash:             XXX            |        | Annual Sports Expenses | XXX    |
| Bank: <del>XXX</del>             | XXX    | Salaries & Wages       | XXX    |
| Subscription:                    |        | Rent, Rate & Tax       | XXX    |
| Previous Year     XXX            |        | Insurance              | XXX    |
| Current Year     XXX             |        | Furniture              | XXX    |
| Next Year <del>XXX</del>         | XXX    | Sports Equipment's     | XXX    |
| Entrance Fees                    | XXX    | Books & periodicals    | XXX    |
| Donation for building            | XXX    | Honorarium             | XXX    |
| General Donations                | XXX    | Bank Charges           | XXX    |
| Life membership Fees             | XXX    | Sundry Expenses        | XXX    |
| Legacy                           | XXX    |                        |        |
| Grant from government            | XXX    | By balance c/d         |        |
| Receipts on annual sports        | XXX    | Cash:             XXX  |        |
| Sale of old sports materials     | XXX    | Bank: <del>XXX</del>   |        |
| Sale of old magazines            | XXX    |                        | XXX    |
| Sundry Receipts                  | XXX    |                        |        |
| To Balance c/d (Bank over draft) | XXX    |                        |        |
|                                  | XXXX   |                        | XXXX   |

## Unit 6.5 - Case Study

### Illustration No:1

The Receipts and Payments for the Cricket club for the year ended 31st march was:

Entrance fee ₹ 200

membership fee ₹ 4,000

Donation to club pavilion Rs ₹ 15,000

Food stuff sales ₹ 2,000

Salaries and wages ₹ 5,000

Purchase of food stuff ₹ 500

Construction of club pavilion ₹ 14,000

General expenses ₹ 500

Rent and taxes ₹ 700

Bank charges ₹ 180

Cash in hand as on 1st April ₹ 300 and as on 31st March ₹ 400.

Cash at bank as on 1st April ₹ 500 and as on 31st March ₹ 720.

### Solution:

Receipts and Payments Account for the year ended 31st March

| Receipts             | Amount | Payments                      | Amount |
|----------------------|--------|-------------------------------|--------|
| To, Balance b/d:     |        | Salaries & wages              | 5,000  |
| Cash: 300            |        | Purchase of food stuff        | 500    |
| Bank: 500            | 800    | Construction of club pavilion | 14,000 |
| Entrance fees        | 200    | General expenses              | 500    |
| Membership fees      | 4,000  | Rent                          | 700    |
| Donation to pavilion | 15,000 | Bank charges                  | 180    |
| Sales of food stuff  | 2,000  | By balance c/d:               |        |
|                      |        | Cash: 400                     |        |
|                      |        | Bank: 720                     | 1,120  |
|                      | 22,000 |                               | 22,000 |

### • Income and Expenditure Account: -

This is similar to the Profit and loss A/c and is prepared exactly based on the same principles. Incomes are recorded on the credit side and the expenses on the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are related to the current period. Previous and subsequent year items are to be excluded. This account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called deficit.



| Dr.                            |        | Income And Expenditure Account |        | Cr. |  |
|--------------------------------|--------|--------------------------------|--------|-----|--|
| Expenses                       | Amount | Income                         | Amount |     |  |
| Only revenue expenses          | XXX    | Only revenue receipts          | XXX    |     |  |
| Only related to current period | XXX    | Only related to current period | XXX    |     |  |
| Shows surplus                  | XXX    | shows deficit                  | XXX    |     |  |

• Specimen of Income and Expenditure Account:

Dr. Income & Expenditure Account Cr.

| Expenditures                                      | Amount | Income                                         | Amount |
|---------------------------------------------------|--------|------------------------------------------------|--------|
| To, Honorarium                                    | XXX    | By Subscription                                | XXX    |
| Salary & wages                                    | XXX    | Grand Received                                 |        |
| Entertainment Expenses                            | XXX    | (For general purpose)                          | XXX    |
| Newspapers & Periodicals                          | XXX    | General Donation                               | XXX    |
| Postage                                           | XXX    | Interest on deposit                            | XXX    |
| Loss on sale of fixed assets                      | XXX    | Dividend                                       | XXX    |
| Depreciation of fixed assets                      | XXX    | Profit on sale of fixed assets                 | XXX    |
| Miscellaneous Expenses                            | XXX    | Receipts from sale of newspapers and magazines | XXX    |
|                                                   |        | Miscellaneous income                           | XXX    |
| To Surplus<br>(Excess of income over expenditure) | XXX    |                                                |        |
|                                                   | XXX    | By Deficit (Excess of expenditure over income) | XXX    |
|                                                   |        |                                                | XXX    |

**Illustration No:2**

From the following receipts and payment account of Mumbai club, prepare income and expenditure account for the year ended 31.3.2021 and its Balance sheet as on that date.



| Receipts                    | Amount | Payment                 | Amount |
|-----------------------------|--------|-------------------------|--------|
| Cash in Hand                | 4,000  | Salary                  | 2,000  |
| Cash in Bank                | 10,000 | Repair expense          | 500    |
| Subscription                | 5,000  | Purchase of furniture   | 6,000  |
| Entrance fees               | 12,000 | Miscellaneous expenses  | 500    |
| Interest on investment      | 1,000  | Purchase of investments | 6,000  |
| Interest received from Bank | 100    | Insurance premium       | 200    |
| Sale of old newspapers      | 400    | Billard table           | 8,000  |

|                       |        |                  |        |
|-----------------------|--------|------------------|--------|
| Sale of Drama Tickets | 150    | Paper, ink etc., | 150    |
|                       |        | Drama expenses   | 500    |
|                       |        |                  |        |
|                       |        | Cash in Hand     | 2,650  |
|                       |        | Cash at Bank     | 7,200  |
|                       | 33,700 |                  | 33,700 |

**Additional Information:**

- Subscription in arrears for 2021 is ₹ 900 and subscription received in Advance for 2022 ₹ 350.
- Insurance Premium outstanding ₹ 40.
- Miscellaneous expense prepaid ₹ 90.
- 50% of Donation is to be capitalized.
- Entrance fees are to be treated as revenue income.
- 8% of the interest has accrued on investment for 5 months.
- Billiard table costing Rs.30,000 was purchased during the last year and 22,000 were paid for it.

**Solution:**

Balance sheet as on 31 December 2020 (to find opening Balance of Capital fund)

| Liabilities                                | Amount | Asset           | Amount |
|--------------------------------------------|--------|-----------------|--------|
| Capital fund (balancing figure)            | 36,000 | Billiards Table | 30,000 |
| Creditors for Billiard table (30000-22000) | 8,000  | Cash in Hand    | 4,000  |
|                                            |        | Cash at Bank    | 10,000 |
|                                            | 44,000 |                 | 44,000 |

## Income and expenditure account for the year ended 31st December 2021

| Expenditure                                | Amount | Income                                     | Amount |
|--------------------------------------------|--------|--------------------------------------------|--------|
| Salary                                     | 2,000  | Donation (working note no:3)               | 2,500  |
| Repair and expenses                        | 500    | Subscription (working note No:4)           | 12,550 |
| Miscellaneous expenses (working note no:1) | 410    | Entrance fee                               | 1,000  |
| Insurance premium (working note no:2)      | 240    | Interest on investment (working note No:5) | 200    |
| Paper, ink                                 | 150    | Interest received from Bank                | 400    |
| Drama expenses                             | 500    | Sale of old news paper                     | 150    |
| Surplus                                    | 14,050 | Sale of Drama tickets                      | 1,050  |
|                                            | 17,850 |                                            | 17,850 |

## Balance sheet as on 31st December 2021

| Liabilities                      | Amount | Asset                                | Amount |
|----------------------------------|--------|--------------------------------------|--------|
| Capital fund                     | 36,000 | Billiards table                      | 30,000 |
| Add: surplus                     | 14,050 | Furniture                            | 6,000  |
| Donation                         | 2,500  | Investment                           | 6,000  |
|                                  | 52,550 | Interest accrued (working note no:6) | 100    |
| Insurance premium payable        | 40     | Prepaid expenses                     | 90     |
| Subscription received in Advance | 350    | Subscription receivable              | 900    |
|                                  |        | Cash in Hand                         | 2,650  |
|                                  |        | Cash at Bank                         | 7,200  |
|                                  | 52,940 |                                      | 52,940 |

• Working Notes:

1. Miscellaneous expense = 500  
 (-) prepaid expenses = (90)

---

410

2. Insurance Premium = 200  
 (+) Outstanding Premium = 40

---

240

3. Donation = 5,000  
 50% donation to be capitalized = 2,500  
 50% donation to be treated as revenue = 2,500

4. Subscription in receipt and payment account = 5,000  
 Subscription outstanding during the year = 900  
 Subscription received in advance = (350)

---

12,550

5. Interest on investment = 6,000  
 Interest accrued during the year  
 $(6000 \times 8\% \times 5/12) = 200$

6. Interest accrued:  
 Interest accrued during the year = 200  
 Interest received during the year = (100)

---

100

## Summary

Non-profit organizations, unlike for-profit entities, focus on achieving objectives that are not primarily financial in nature, such as charitable, educational, or cultural goals. Consequently, their financial statements are uniquely tailored to reflect this focus. Key among these statements is the Receipt and Payment Account, which summarizes all cash receipts and payments within a given period. This account provides a straightforward depiction of the organization's cash flow, showing the sources of income and the areas of expenditure without distinguishing between capital and revenue items. The treatment of finances in non-profit organizations also includes maintaining separate accounts for restricted and unrestricted funds, ensuring that donations and grants are used in accordance with donor specifications. This method of financial reporting allows stakeholders to see transparently how funds are sourced and used, helping maintain accountability and support the organization's mission and objectives.

## Exercise

What is the primary focus of non-profit organizations?

- A) Maximizing shareholder value
- B) Achieving non-financial objectives
- C) Generating profit
- D) Expanding market share
- Answer: B

Which financial statement is key for non-profit organizations?

- A) Balance Sheet
- B) Income Statement
- C) Receipt and Payment Account
- D) Cash Flow Statement
- Answer: C

What does the Receipt and Payment Account summarize?

- A) All credit transactions
- B) All cash receipts and payments
- C) All non-cash transactions
- D) Profit and loss data
- Answer: B

How does the Receipt and Payment Account report transactions?

- A) Distinguishes between capital and revenue items
- B) Does not distinguish between capital and revenue items
- C) Only reports revenue items
- D) Only reports capital items
- Answer: B

What is an important aspect of financial management in non-profit organizations?

- A) Focusing on profitability
- B) Maintaining separate accounts for restricted and unrestricted funds
- C) Maximizing earnings per share
- D) Reducing operational costs to increase margins
- Answer: B

Why is it important to maintain transparency in financial reporting for non-profits?

- A) To reduce taxes
- B) To ensure accountability and support the organization's mission
- C) To attract more commercial partnerships
- D) To increase the stock price
- Answer: B

What does the Receipt and Payment Account allow stakeholders to understand?

- A) The profitability of the organization
- B) How funds are sourced and used
- C) The market value of the organization
- D) The total assets owned by the organization
- Answer: B



Why do non-profits separate restricted and unrestricted funds?

- A) To comply with investment regulations
- B) To ensure donations are used as intended by donors
- C) To facilitate stock trading
- D) To prepare for mergers and acquisitions
- Answer: B

Which statement best describes the focus of financial statements in non-profit organizations?

- A) To track shareholder equity
- B) To show financial gain
- C) To reflect charitable, educational, or cultural goals
- D) To demonstrate competitive market position
- Answer: C

What role does the Receipt and Payment Account play in non-profit financial management?

- A) It predicts future financial trends
- B) It reports detailed profit margins
- C) It provides a straightforward depiction of cash flow
- D) It manages stockholder investments
- Answer: C

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## 7. Government Accounting

Unit 7.1 - Introduction

Unit 7.2 - Important Features of Government Accounting

Unit 7.3 - Difference between Government Account  
& commercial Accounting

Unit 7.4 - IFRS (International Financial Reporting Standard)

Unit 7.5 - NFRA (National Financial Reporting Authority)



## Key Learning Outcomes



- Understand the Introduction to Government Accounting
- Identify the Important Features of Government Accounting
- Differentiate Between Government Accounting and Commercial Accounting
- Understand the Role of IFRS (International Financial Reporting Standards)
- Learn About NFRA (National Financial Reporting Authority)

## Unit 7 - Government Accounting

### Unit Objectives

- Concepts of Accounting in Government Sectors
- Structural Overview of Government Accounting
- Provide key Awareness of the Difference between Corporate and Government Accounting
- Familiarise with National and International Financial Authorities



## Unit 7.1 - Introduction

Governmental accounting is a systematic and scientific process of recording, analyzing, classifying, summarizing, communicating, and interpreting all financial transactions incurred by the government.

The accounting system is put to use in government offices or institutions for the purpose of recording and reporting financial transactions. It is also referred to as public finance accounting.



Fig 7.1

## Unit 7.2 - Important Features of Government Accounting

- **Based on budget:** Government accounting is based on the annual budget of the government. Every year, the Government is forecasting the possible accuracy of what is expected to be received or paid during the year. On the basis of budget and accounts, Government shall take decisions.
- **Auditing:** The books of accounts maintained by government departments, institutions, and offices are audited by a recognized department of the government. So as to ensure proper governance and prevent the misappropriation of public funds.
- **Government regulations:** Government accounting is maintained according to government rules and regulations. The financial policies, rules, and regulations as determined from time to time provide the system of government accounting.
- **System of Accounting:** Government accounting is based on the principles and assumptions of double entry system of bookkeeping. All transactions are performed through banks and recorded on cash basis.

## Unit 7.3 - Difference between Government Accounting and Commercial Accounting

|                      | Government Accounting                                                                              | Commercial Accounting                                                                                           |
|----------------------|----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------|
| Meaning              | Maintained by government offices                                                                   | Maintained by business organizations                                                                            |
| Objective            | To know the position of public fund                                                                | To know the profit or loss and the financial position of the business                                           |
| Budget               | Strictly follows the government budgeting system                                                   | Does not follow the government budgeting system                                                                 |
| Basis                | Prepared on cash basis                                                                             | Prepared on cash as well as accrual basis.                                                                      |
| Rules and provisions | Strictly maintained by following the financial rules and provisions of government                  | Rules and principles of 'Generally Accepted Accounting Principles'                                              |
| Information          | Provides information to the government about the receipts, transfer and deposition of public funds | Provides information to the concerned parties about the operating result and financial position of the business |
| Auditing             | Auditor General Office audits the book of accounts                                                 | A professional auditor can audit the books of accounts                                                          |

## Unit 7.4 IFRS ( International Financial Reporting Standard)

International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world. IFRS currently has complete profiles for 167 jurisdictions, including those in the European Union. The United States uses a different system, the generally accepted accounting principles (GAAP). The IFRS is issued by the International Accounting Standards Board (IASB).

### • Elements of Financial Statement



Fig 7.2

## Unit 7.5 - NFRA (National Financial Reporting Authority)

The National Financial Reporting Authority (NFRA) is a body constituted under the provisions of Section 132 of the Companies Act, 2013. The constitution of this authority is effective from 1st October 2018. The aim of the Central Government in this regard appears to be:

- Setting up of a separate and independent regulatory body to assist in the framing and enforcement of legislation relating to accounting & auditing.
- Improving investor and public confidence in the financial reporting of an entity.

Role of the NFRA

The NFRA has the following responsibilities:

- Make recommendations on the foundation and laying down of accounting and auditing policies and standards.
- Monitor and enforce the compliance of the accounting standards and auditing standards.
- Oversee the quality of service of the professionals (such as auditors, CFOs, etc) and suggest measures required for improvement in the quality of service.
- Perform other such functions related to the above. Prior to the constitution of this authority, the Central Government would prescribe accounting standards on the recommendation of ICAI. The ICAI would prescribe the same only after consulting with the National Advisory Committee on Accounting Standards who will provide their recommendations. The ICAI will now have to consult with the NFRA and examine its recommendations in this regard. Thus the National Advisory Committee on Accounting Standards is effectively replaced by the NFRA.

- **Powers of the NFRA**

- To investigate the matters of professional or other misconduct committed by a prescribed class of CA firms or CAs. No other authority can initiate or continue proceedings where the NFRA has initiated an investigation. Such an investigation can be initiated either *Suo moto* (by itself) or on a reference made by the Central Government.
- The same powers as a Civil Court under the Code of Criminal Procedure, 1908, in respect of a suit involving the following matters:
  - Discovery and production of books of account and other documents, at such place and time as may be specified by the NFRA.
  - Summoning and enforcing the attendance of persons and examining them under oath.
  - Inspection of any books, registers, and other documents of any person at any place.
  - Issuing commissions for the examination of witnesses or documents. Where professional or other misconduct is proved, it shall have the power to impose punishment.



## Summary

Government accounting, distinct from commercial accounting, is designed to track the allocation and utilization of public funds in order to ensure transparency and accountability in government operations. This form of accounting emphasizes the stewardship of public resources and compliance with legal requirements, rather than profitability. Key features of government accounting include the focus on budgets, the use of fund accounting, and adherence to government-specific financial regulations. A significant difference between government and commercial accounting lies in their objectives: government accounting focuses on adherence to budgets and fiscal responsibility, while commercial accounting emphasizes profitability and value creation for shareholders. Additionally, while commercial entities often follow International Financial Reporting Standards (IFRS) to standardize financial statements for global consistency, government accounting may be regulated by national bodies such as the National Financial Reporting Authority (NFRA) in some countries, which tailor standards to meet the specific needs of public sector reporting and accountability. This setup ensures that government financial statements provide a clear picture of financial positions and resource flows, crucial for informed public oversight and governance.

## Exercise

What is the primary focus of government accounting?

- A) Maximizing profits
- B) Transparency and accountability in the use of public funds
- C) Enhancing shareholder value
- D) Developing new markets
- Answer: B

Which of the following is a key feature of government accounting?

- A) Focus on profitability
- B) Use of fund accounting
- C) Investment in private sectors
- D) Revenue maximization
- Answer: B

What is the main objective difference between government accounting and commercial accounting?

- A) Government accounting is more complex
- B) Government accounting focuses on budget adherence and fiscal responsibility
- C) Commercial accounting focuses more on budget adherence
- D) Commercial accounting uses simpler financial models
- Answer: B

Which standards do commercial entities often follow?

- A) Local financial regulations
- B) International Financial Reporting Standards (IFRS)
- C) National Financial Reporting Authority (NFRA)
- D) Government-specific financial regulations
- Answer: B

What does the National Financial Reporting Authority (NFRA) regulate?

- A) International businesses
- B) Government financial reporting
- C) Small businesses
- D) Non-profit organizations
- Answer: B

Why is it important for government accounting to adhere to specific regulations?

- A) To ensure global market competitiveness
- B) To secure private investments
- C) To ensure transparency and proper use of public resources
- D) To maximize international trade
- Answer: C

How does government accounting differ from commercial accounting in terms of reporting focus?

- A) Government accounting focuses on sales figures
- B) Commercial accounting emphasizes fiscal responsibility
- C) Government accounting emphasizes stewardship of resources



- D) Commercial accounting focuses on public welfare
- Answer: C

What is emphasized in government accounting that is less emphasized in commercial accounting?

- A) Profitability and financial gain
- B) Budgets and compliance with financial regulations
- C) Shareholder interests
- D) Market expansion strategies
- Answer: B

Which accounting system is likely to use fund accounting?

- A) Commercial accounting
- B) Government accounting
- C) Personal accounting
- D) Startup accounting
- Answer: B

What is the primary aim of IFRS in the context of commercial entities?

- A) To standardize financial statements globally
- B) To regulate government spending
- C) To manage non-profit organizations
- D) To oversee local businesses
- Answer: A

## Notes

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## 8. The Employees State Insurance ACT, 1948

- Unit 8.1 - Employee State Insurance Act 1948
- Unit 8.2 - Objective of the ESI Act
- Unit 8.3 - Important Definitions
- Unit 8.4 - Applicability
- Unit 8.5 - Employees' State Insurance funds
- Unit 8.6 - Contribution
- Unit 8.7 - Rights and Obligations
- Unit 8.8 - Interest and penalty
- Unit 8.9 - Registration



## Key Learning Outcomes



- Understand Legislative Context and Purpose
- Comprehend Key Definitions
- Identify Applicability and Coverage
- Understand Funding and Contributions
- Recognize Rights and Obligations
- Learn About Penalties and Compliance
- Navigate the Registration Process

## Unit 8.1 - The Employees State Insurance ACT, 1948

### Unit Objectives

After studying this module, the students shall able to understand –

- Explain various definitions under this Act
- Get an overview and applicability of Employee's State Insurance Act
- Discuss about benefits, Rights and obligations of this Act
- Idea about Interest and Penalties



## Unit 8.1.1 - Appropriate Government

Section 2(1) defines the term 'appropriate Government', in respect of establishments under the control of the Central Government or a railway administration or a major port or a mine or oilfield, the Central Government, and in all other cases, the State Government.

## Unit 8.1.2 - Employee

The term "employee" as defined under Section 2(9) of the Act, refers to any person employed on wages in, or in connection with, the work of a factory or establishment to which this Act applies. It has a wide connotation and includes within its scope clerical, manual, technical and supervisory functions. Persons whose remuneration (excluding the remuneration for over-time work) does not exceed ` Rs.21,000 in a month are covered under the Act. The Act does not make any distinction between casual and temporary employees or between technical and non-technical employees. There is also no distinction between those employed on time-rate and piece-rate basis.

## Unit 8.1.3 - Wages

"Wages" means all remuneration paid in cash if the terms of the contract are fulfilled, and includes any payment in any period of authorised leave, lockout or strike which is not illegal or lay-off, and includes other remuneration paid at intervals not exceeding two months but does not include –

- Contribution paid to the provident fund or pension fund;
- Travelling allowance or value of travelling concession.
- Sum paid to defray special expenses; and
- Gratuity payable on discharge.

## Unit 8.14 - Factory

Section 2(12) defines the term 'factory' as any premises including the precincts thereof whereon ten or more persons are employed or were employed on any day of the preceding 12 months and in any part of which a manufacturing process is being carried on or is ordinarily so carried on but does not include a mine subject to the operation of the Mines Act, 1952 or a railway running shed.

## Unit 1.5 - Principal Employer

Section 2(17) defines the term 'principal employer' as-

- In a factory, the owner or occupier of the factory and includes the managing agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as the manager of the factory under the Factories Act, 1948, the person so named;
- In any establishment under the control of any department of any Government in India, the authority appointed by such Government in this behalf or where no authority is so appointed, the head of the Department.
- In any other establishment, any person responsible for the supervision and control of the establishment.

## Unit 1.6 - Employment Injury

It is a personal injury to an employee caused by an accident or occupational disease arising out of and in the course of his insurable employment within or outside the territorial limits of India

## Unit 2 - Applicability

The Employees State Insurance Act, 1948 (ESI Act), as amended from time to time extends to the whole of India. It was intended that the scheme should be implemented stage-by-stage. The Employees State Insurance is a unique, multi-dimensional, and self-financing social security scheme in which every contributor is a beneficiary or benefactor. The Act becomes applicable to all establishments, wherein 10 or more persons are employed other than a seasonal factory. However, in case of an establishment carrying on any notified hazardous or life-threatening occupation, these provisions shall apply even if a single employee is employed. Besides, the plantation may voluntarily opt for the application of these provisions if the benefits provided herein are better than those provided by the employer.

A factory or an establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below the limits specified by or under this Act or the manufacturing process therein ceases to be carried on with the aid of power.

The Central Government has since prescribed the wage limit for coverage of an employee under Section 2(9) of the Act, as ₹ 21,000 per month. Further, it is provided that an employee whose wages (excluding remuneration for overtime work) exceeds ₹ 21,000 a month at any time after and not before the beginning of the contribution period shall continue to be an employee until the end of the said period.

## Unit 3 - Exemptions

The provisions relating to ESI scheme do not apply to the following:

- Establishments wherein less than 10 persons are employed and
- Seasonal factories engaged exclusively in any of the following activities viz., cotton ginning, cotton or jute pressing, decortications of groundnuts, the manufacture of coffee, indigo, rubber, sugar (including gur) or tea or any manufacturing process, and including factories engaged for a period not exceeding seven months in a year in such other manufacturing process as may be notified by the Central Government.

Besides, the appropriate Government may exempt any factory or other establishment belonging to the Government or any local authority, from the provisions of ESI scheme, if the employees in such factory or establishment are in receipt of benefits substantially similar or superior to the benefits provided in the scheme. Further, Corporation exempts any establishment or class of establishments or an employee from the provisions of the scheme, subject to specified conditions.



## Unit 4 - Benefits of ESIC

The benefits can be broadly categorized in two ways: medical benefits and cash benefits. The benefits are;

### Medical Benefit

- Benefits are in effect from the day he becomes an employee.
- It extends to the family as well.

### Sickness Benefit

- During a medical leave, 70% of their average wages during the period of sickness for a maximum of 91 days in a year.
- The worker cannot seek this benefit if he contributes for less than 78 days out of 6 months.

### Maternity Benefit

- This benefit is provided with 100 % average daily wage for a mother up to 26 weeks, for 6 weeks in case of miscarriage, 12 weeks for a commissioning mother/adopting mother.
- (Can be extendable for one more month depending on medical advice)

### Dependants Benefit

- In case of death during course of employment or occupational hazard.
- The monthly payment is granted to dependents.

### Disablement Benefit

- In case of injury during course of employment, monthly payment for temporary disablement till injury lasts.
- Whereas lifelong payment in the case of permanent disablement, based on the determination of medical board.

### Other Benefits

- **Funeral Expense**- It will be borne by the ESIC for the dependants.
- **Vocational/ Physical Rehabilitation Expense**
- **Old Age Medical Care**
- **Unemployment Allowance**- In case of involuntary loss of employment, ESIC provides for monthly cash allowance for a duration of 24 months (maximum).

Fig 1.1

**Need-Based Benefits:**

- **Vocational Rehabilitation:** Permanently physically challenged employees who are insured are entitled to vocational rehabilitation training at VRS.
- **Physical Rehabilitation:** Can be availed by the employees in case of physical disablement or injury or hazards due to employment.
- **Old Age Medical Care:** By the annual payment of Rs.120 medical care benefits can be availed for the ESI employees or for those who are opting for VRS/ERS. The members who retiring on account of permanent disability can also avail themselves of the same.
- **Extended Sickness Benefits:** In case an employee covered under ESI is suffering from long term diseases and experiencing great hardship, then on expiry of 91 days of sickness benefit, extended sickness benefit of up to 2 years can be provided. Hence, extended sickness benefit is available only after exhausting sickness benefit to which an employee may be eligible. Further, to be entitled to the Extended Sickness Benefit the employee should have been in continuous employment for 2 years or more at the beginning of a spell of sickness in which the disease is diagnosed and should also satisfy other contributory conditions.

**Benefits not to be combined**

Section 65 provides that an insured person shall not be entitled to receive for the same period-

- Both sickness benefit and maternity benefit; or
- Both sickness benefit and disablement benefit for temporary disablement; or
- Both maternity benefit and disablement benefit for temporary disablement.

Where a person is entitled to more than one of the benefits he shall be entitled to choose which benefit he shall receive.

## Unit 5 - Administrative Authority

The provisions relating to ESI are administered both by the Central and State Governments in their respective spheres. Establishments controlled by the central government, railways, mines, major ports, and oil fields are looked after by the Central Government, whereas all other establishments are controlled by the State Governments. The Central Government is the main rule-making authority. Besides, the State Governments are also empowered to make rules with regard to certain matters.



## Unit 6 - Constitution of Employee State Corporation

- The Director General of ESIC, ex officio
- Chairman appointed by the central government
- Vice-president appointed by the CG
- Not more than 5 persons nominated by the CG
- 1 person representing each state appointed by the CG
- 1 Person nominated by CG representing UTs
- 10 persons representing employers nominated by CG
- 10 persons representing employees nominated by CG
- 2 persons representing the medical profession nominated by CG
- 3 members of the parliament (2 from Lok Sabha and 1 from Rajya Sabha)

## Unit 7 - Employees' State Insurance Fund

Section 26 of the Act provides for the creation of the Employees' State Insurance Fund held and administered by the Corporation. All contributions paid under this Act and all other money received on behalf of the corporation shall be paid into this fund. The grants, donations and gifts received from the Central Government or any State Government, local authority or any individual or body whether incorporated or not, are also paid into this Fund.

## Unit 8 - Contributions

The term of 'contributions' means the sum of money payable to the Employee State Insurance Corporation (ESIC) by the principal employer in respect of an employee. It also includes any amount payable by or on behalf of the employee in accordance with the provisions of the Employees' State Insurance Act, 1948 (ESI Act). Where an enactment uses the word 'includes' in the definition, it is intended to retain the ordinary meaning of the word, but its scope that widened by specific enumeration of certain matters. Even when there is a bona fide impression that the establishment of the employer was not coverable under the ESI Act, it will not justify the non-payment of ESI contributions.

### Unit 8.1 - Calculation of Contributions Payable

| Rates of contribution | Amount |
|-----------------------|--------|
| Wages ceiling         | 21,000 |
| Employer contribution | 3.25%  |
| Employee contribution | 0.75%  |

### Unit 8.2 - Computation of Wages For The Purpose of Coverage

There are different categories of employees like monthly-rated employees, who are employed on regular basis and are paid a monthly salary/wage, daily-rated employees and piece-rated employees.

|    |                                                                                                                        |                                                                                                                                      |
|----|------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
| a) | Monthly rated employees                                                                                                | The amount of wages (excluding remuneration of overtime) fixed by the employer as monthly rate be reckoned as the wages for a month. |
| b) | Other categories of daily rated and piece rated employees (including Badli workers engaged against category (a) above) | The amount of total wages paid/payable (excluding overtime) during the month is reckoned as the wages for a month.                   |

For example:

- a) Mr. 'A' is a monthly rated employee, and his gross wages (excluding remuneration for overtime) are more than the ceiling of Rs. 21,000/-. He was paid wages for 20 days which worked out to an amount that was less than the prescribed ceiling (less than Rs. 21,000/- during that month. His status would continue to be an 'excluded employee, even though the actual wages received fall within the wage ceiling.
- b) Mr. 'P' is a piece-rated employee. If he works for 24 days in a month and earns wages below Rs.21000/-, he will be treated as a covered employee.

### Unit 8.3 - The time limit for Making Payment of Contribution

The employees of independent contractors could not be held to the employees of the principal employer for the purpose of the payment of contribution under the ESI Act.

### Unit 8.4 - Contribution Period and Benefit Period

There are two contribution periods of six months duration each in a year, in a respect of an employee with a corresponding benefit period of six months each as under:

| Contribution Period                             | Benefit Period                                  |
|-------------------------------------------------|-------------------------------------------------|
| 1st April to 30th September                     | 1st January to 30th June of the year following. |
| 1st October to 31st March of the year following | 1st July to 31st December of the calendar year. |

In case a person becomes an employee within the meaning of the Employee State Insurance Act, 1948 for the first time, the first contribution period will commence from the date he enters into insurable employment for the first time in the contribution current on that day and his corresponding benefit period will commence on the expiry of nine months from the date of such employment.

Mr. 'Devan' joined insurable employment for the first time, say on 5th January, his first contribution period will be from 5 January to 31st and his corresponding first benefit period will be from 5th October to 31st December.

## Unit 8.5 - Calculations based on wages

ESI calculation comprises of various elements of an employee's monthly salary such as Basic Pay, Dearness Allowance, City Compensatory Allowance, HRA, Incentives, Attendance and Overtime Payments, Meal Allowance, Uniform Allowance, and other special allowances.

For Example:

- Let the employee's gross salary be INR 10,000/ month.  
Now, the employer's contribution will be =  $3.25/100 \times 10,000 = 325$ .  
The employee's contribution would be =  $0.75/100 \times 10,000 = 75$ .  
Hence, the total ESI contribution, in this case, is INR 400.

The rates of contribution, as a percentage of gross wages paid to the employees, are explained in the table below;

|                                       | Percentage of Gross Pay | Example Gross Salary | Contributions                         |
|---------------------------------------|-------------------------|----------------------|---------------------------------------|
| Employee Deduction                    | 0.75%                   | Rs 15,000            | $15,000 \times 0.75\% = 112.50$       |
| Employer Contribution                 | 3.25%                   |                      | $15,000 \times 3.25\% = 487.50$       |
| Total Contributions for this employee |                         |                      | $112.50 + 487.50 = \text{Rs } 600.00$ |



## Unit 8.6 - Deduction for Employee's Contribution from wages

The employer may deduct the employee's contribution from his wages in respect of the period for which the contribution is payable.

## Unit 8.7 - Employer's Contribution Not to be Deducted

No deduction shall be made from the wages of any employee, for the employer's contribution paid or payable in respect of him.

## Unit 8.8 - Recoverable of Contribution in respect of Contract Labour

The principal employer may deduct the amount of contributions, both employer's and employee's, payable in respect of employees engaged through a contractor, from the bills of the contractor.

## Unit 8.9 - Employer Not to Reduce Wages, Benefits, etc.

The employer shall not reduce wages or discontinue or reduce any benefits conferred under the conditions of service payable to an employee, on account of his liability for contributions payable under the ESI scheme.

- **Levy of Interest**

Interest shall be payable at the specified rate in respect of each day of default or delay in payment of contributions.



## Unit 9 - Non-Payment of contributions

If an employer fails or neglects to pay any contribution in respect of any employee, due to which such employee becomes disentitled to any benefit or entitled to a benefit on a lower scale, the corporation may pay to the employee the benefit at the rate to which he would have been entitled had there been no such failure or neglect on the part of the employer. However, the corporation shall recover from the employer, the capital value of the benefit paid to the employee, calculated in the prescribed manner, after adjusting the amount of contribution, interest, or damages payable by the employer in respect of such short payment/non-payment. The sum shall be recoverable as arrears of land revenue.

### Unit 9.1 - Determination and Recovery

In a case where a dispute arises regarding the applicability of the Employee's State Insurance Act, 1948, the corporation or any other officer (to whom the powers of determination have been delegated), may decide the dispute and determine the amount due from an employer under the code. Before making an order, the officer shall give a reasonable opportunity to the employer for representing his case.

### Unit 9.2 - Modes of Recovery

Any amount of contributions, damages or administrative charges, due from an employer, may be recovered from him in any of the following modes;

- Attachment and sale of the movable or immovable property of the establishment/ employer;
- Arrest of the employer and his detention in prison;
- Appointing a receiver for the management of the movable or immovable properties of the establishment/ employer.

The recovery shall be made by the Recovery officer pursuant to a Recovery certificate issued by the authorized officer specifying the amount of arrears.

## Unit 9.3 - Procedure for Submission of Medical Reimbursement

1. To file a compensation, claim bill/bills, an Insured Person must write an application to the Administrative Medical Officer, ESI Scheme, Assam via the appropriate Insurance Medical Officer i/c, ESI Scheme Dispensary, including the claim statement form, which is accessible at the Dispensary.
2. The employee must state the source of the sickness.
3. Along with the bill(s), the employee must submit a clear Photocopy of the insured person's card, and bank information, including the name of the bank, branch, IFSC code, account number, and insured person's phone number.
4. The deadline for submitting reimbursement claims is only 1 (one) year.

## Unit 9.4 - Appeal

An employer aggrieved by an order of determination may prefer an appeal to the appellate authority within 60 days from the date of such order. He shall, however, have to deposit 25% of the amount determined in the order being appealed against before making an appeal. The appellate authority shall decide the appeal within 6 months from the date it is preferred.

## Unit 10 - Rights and Obligations

### Unit 10.1 - Obligations of Employers

The obligations of employers under the ESI Acts are;

- The employer should deposit the employees' and his own contributions to the ESI Account in the prescribed manner. Whether he has sufficient resources or not, his liability under the code cannot be disputed. He cannot justify non-payment of ESI Corporation due to the non-availability of finance.
- The employer should not reduce the wages of an employee on account of the employer's contribution payable in respect of him.

## Unit 10.2 - Obligations of Employees

The obligations of Employees under the ESI provisions of the code are;

- The employees who are in receipt of sickness or temporary disablement benefits, should remain under medical treatment and observe the instructions of the medical officer of the ESI hospital/dispensary and should not do anything to retard the process of recovery.
- The employee should submit the claims for the benefits within the prescribed time along with the prescribed documents.

## Unit 10.3 - Rights of Employers

- Right to recover the employee's share of contribution from his wages.
- Right to appeal against an order under section 125 of the Corporation determining the amount of contribution payable by an employer.
- Right to appeal to the High Court against an order of the Employee's State Insurance court, involving a substantial question of law within 60 days.

## Unit 10.4 - Rights of Employees

- Right to claim the medical and cash benefits allowable in accordance with the code and the regulations.
- Right to appeal to the High Court against an order of the Employees' Insurance Court, involving a substantial question of law, within 60 days.

## Unit 11 - Mandatory for Employers to Register ESI

Employer legal responsibility to register their factory or establishment under ESI Act within 15 days of applicability under section 2A of ESI Act.

Section 46 provides six social security benefits; however, there are conditions to avail these benefits according to the ESIC. There are the benefits that can be availed from ESI scheme.

### Unit 11.1 - Returns to be Filed after ESIC Registration

- Register of attendance of the employees
- Form – 6 Register
- Monthly return and challans.

## Unit 12 - Interest

The Corporation may levy and recover damages under Reg. 31C at the following rates, not exceeding the amount of contribution payable for default or delay in payment of the contribution.

| No | Period of delay in payment of contribution | Rate of damages as the amount delay |
|----|--------------------------------------------|-------------------------------------|
| 1  | Up to or less than 2 months                | 5%                                  |
| 2  | 2 months and above but less than 4 months  | 10%                                 |
| 3  | 4 months and above but less than 6 months  | 15%                                 |
| 4  | 6 months and above                         | 25%                                 |



## Unit 13 - Jurisdiction of Civil Court

Section 75(3) provides that no Civil Court have jurisdiction to decide or deal with any question or dispute as aforesaid or to adjudicate on any liability which is to be decided by a medical board or a medical appeal tribunal or ESI Court.

## Unit 14 - Penalty

Sections 84 to 86 of the Act provide for penalties for certain offences. These penalties were substantially increased by the Employee's State Insurance (Amendment) Act, 1975. The amended Act introduced three new sections namely, Section 85-A, 85-B and 85-C.

**Section - 84:** This section deals with penalties for making wrong / false statements made by the Insured Persons with a view to take any benefit which is not admissible to him under the Act. Such Act is an offence punishable under Act with imprisonment for a term which may extend to six months or with fine which may extend to Two thousand rupees or with both.

**Section - 85:** This section deals with penalties for non – compliance with the various provisions of the ESI Act and Regulations made there under. Such non- compliance with any of the provisions of the Act constitutes an offence committed by the employer of a covered Factory / Establishment which is punishable under Section 85(a) to 85(g) of the Act.

**Section-86:** Provides that no prosecution under this Act shall be instituted without previous sanction of the Insurance Commissioner or of such other officer of the corporation as may be authorized in this behalf by the Director General of the Corporation.

- **Penal Action u/s 138 of N.I. Act:**

If the employer submits a cheque to the corporation towards payment of contribution, interest, damages or any other amount due, which is bounced subsequently by the Bank for the reasons of Insufficient Funds he thereby commits an offence under this section and shall be punished with imprisonment for a term up to one year or with fine which may extend to twice the amount of cheque or with both.

- **Penal Action u/s 405/406/409 of I.P.C:**

If an employer deducts employees' share of contribution from their wages but does not pay the said contribution, he thereby commits an offence of criminal Breach of Trust which is punishable under this section with imprisonment which may extend to 3 years or with fine or with both.



## Unit 15 - Maintenance of Records

- Muster roll, wage record and books of Account maintained under other laws.
- Accident Register in new Form-11 and
- An inspection book.
- The immediate employer is also required to maintain the Employees' Register for the employees deployed to the principal employer

### Unit 15.1 - Pehchan Card

The ESI card is a health card given to the insured person/worker/employee enrolled under the ESI scheme. The workers covered under the ESI scheme can claim medical and sickness benefits at the ESI network hospitals or dispensaries by producing the ESI card or E-Pehchan card. The benefits are provided under the ESI scheme in the form of insurance coverage for the medical expenses of the insured person/beneficiaries and their dependents.

## Unit 16 - Scenarios:

Scenario – I

(Q) 'A' is a Labour officer who decides to visit the establishment of 'B' for a routine inspection. 'A' is particular about employee coverage.

Name the required documents to be maintained while the inspection is conducted in the premises.

(A) The necessary things required to be maintained are as follows:

- An ESI registration certificate.
- The muster roll maintained for the employees.
- An office copy of the employee salary slips (stating the contributions).

Scenario – II

(Q) Can an establishment once covered go out of coverage if the number of persons employed therein goes down to the minimum limit prescribed?

(A) Once an Establishment is covered under the Act, it continues to be covered notwithstanding the fact that the number of persons/ coverable employees employed therein at any time falls below the required limit or there is a change in the manufacturing activity.

#### Scenario – III

(Q) What is the effect of the increase in wages from a retrospective date?

(A) In case the wages of an employee are increased from a retrospective date resulting in crossing the wage limit prescribed, its effect on coverage of that employee is only after the expiry of the Contribution period during the wage of which such increase is announced or declared. The contribution on enhanced wages is also payable from the month in which such an increase is announced. There is no need to pay the contribution on the arrears for the period prior to the month of declaration/ announcement/ agreement.

#### Scenario – IV

(Q) What is the manner of calculation and payment of contributions?

(A) The employer needs to file monthly contributions online through ESIC portal in respect of all its employees after duly registering them. Through this exercise, the employer must file employee-wise number of days for which wages were paid & the number of wages paid respectively to ascertain the number of contributions payable. ESIC has facilitated the payment of ESI contributions online by Employer via the payment gateway of 58 banks in addition to SBI.

The total amount of contribution (both the shares) in respect of all the employees for each month is to be deposited in any branch of SBI by the ONLINE generation of a challan through ESIC portal using his credentials. ESIC has facilitated the payment of ESI Contribution online by the employer via the payment gateway of 58 banks in addition to SBI.

#### Scenario – V

(Q) What are the returns/ reports to be submitted by the employer?

(A) The Employer must submit the following records:

- Accident Report: Notice of Accident to the concerned Branch office in Form -12 should be submitted online within 24 hours.
- Abstention verification Report: It is required to be submitted to the Branch office as and when it is sought by the Branch Manager in respect of any IP.
- Records including attendance, wages and books of accounts etc. in respect of principal employer and records of the immediate employer as required by the Labour Laws.

## Unit 17 - Registration of Employees

Every employee is to register himself under the provisions of the Act. Registration is the process of obtaining and recording information about his employment which is insurable employment. This process also identifies to provide the benefits available under the Act that are related to the contributions paid by the employer on behalf of insured employees. The employee is required to give his details and his family details to his employer. A family photo is also to be provided so that the employer can register the employee.

Registration is the process of obtaining and recording information about the entry of an employee into 'insurable employment, for the purpose of his identification under the Act. Registration of employees is the process of identification to provide the benefits under the Act which are related to the contributions paid by the employer on behalf of each of the insured persons. At the time of joining the insurable employment, an employee is required to provide his and his family's details to the employer along with a family photo so that the employer can register the employee online. This exercise of registering an employee has to be a one-time exercise in the lifetime of an employee. The insurance number generated on the first occasion of registration is to be used throughout his life irrespective of change of employment including change of place

### Unit 17.1 - Compliances after ESIC Registration

- Maintaining the attendance register
- Maintaining a complete register of wages for workers
- Inspection of book
- Monthly return and challan within 15 of the succeeding months
- Maintaining a register whether an accident happens on the premises
- Cash Book / Bank Book
- Account Books including Ledgers and Vouchers, Balance Sheets.
- Returns of Contribution
- Return of Declaration Forms
- Submit the return of contribution within 42 days of the expiry of the contribution period.
- Intimate the date of closure of shifting (Temporary or Permanent) of the Factory
- Establishment of the Regional Office/ Local Office within seven days of its closure or shifting
- Promptly report the change in business activity, ownership of the concern or its management.



- Ascertain the liability towards ESI dues, while taking over the ownership of any factory/establishment by purchase, gift, lease, or license or in any other manner whatsoever as the new owner is liable to discharge the past liabilities if any;

## Unit 17.2 - ESI – Registration Process

- To apply for ESI, please visit the website of Employees' Provident Fund Organization, India
- <https://registration.shramsuvudha.gov.in/>
- Click the Link 'Establishment Registration'

The screenshot displays the official website of the Employees' Provident Fund Organisation (EPFO), India. The header includes the EPFO logo, the organization's name, and the Ministry of Labour & Employment, Government of India. A navigation bar at the top lists various services and documents. A large banner in the center asks "Do you know?" and highlights the importance of a document for PF accumulation. Below this, the "Online Services" section provides links for Principal Employers, Pensioners, and other services. The "What's New" section lists recent notices and updates. The "About Us" section provides information about the EPFO's history and structure. The footer includes contact information and social media links.

**Employees' Provident Fund Organisation, India**  
Ministry of Labour & Employment, Government of India

**Do you know?**  
Annexure K is a document which mentions the member details, his PF accumulations with interest, service history, Date of joining and Date of Exit and employment details including past and present MUA. This document is required by the Field Office/Trust to effect a transfer in.  
Annexure K can be downloaded through online member portal.

**Online Services**

- Principal Employers-CAIU Portal
- Pensioners' Portal
- EDLI & Pension Calculator
- Jeevan Pramaan Through Mobile App (Process Flow & App)
- TRRN Query Search
- International Workers Portal

**What's New**

- Notice inviting application for empanelment of Advocates for Delhi State (Block Year 2023-2026) ... Read
- RFP for Empanelment of Law Firms for "Legal Opinion and associated services" ... Read
- National Labour Conference of Labour Ministers and Labour Secretaries of States/UTs ... Read
- EPFO Training Policy 2022 ... Read
- Conducting Study for Rationalisation of field offices and manpower requirement in EPFO ... Read
- Compendium to Para 6.19 i.e. Key Activities and date on the RFP for Selection of Asset Management Companies of mutual funds for EPFO's ... See all...

**About Us**

- EPFO is one of the World's largest Social Security Organisations in terms of clientele and the volume of financial transactions undertaken. At present it maintains 24.77 crore accounts (Annual Report 2019-20) pertaining to its members.
- The Employees' Provident Fund came into existence with the promulgation of the Employees' Provident Funds Ordinance on the 15th November, 1951. It was replaced by the Employees' Provident Funds Act, 1952. The Employees' Provident Funds Bill was introduced in the Parliament as Bill Number 15 of the year 1952 as a Bill to provide for the institution of provident funds for employees in factories and other establishments. The Act is now referred as the Funds & Miscellaneous Provisions Act, 1952 which India. The Act and Schemes framed there under tri-partite Board known as the Central Board of Provident fund, consisting of representatives of Government (Central and State), Employers, and Employees.
- The Central Board of Trustees administers a contributory provident fund, pension scheme and an insurance scheme for the workforce engaged in the organized sector in India. The Board is assisted by the Employees' PF Organization (EPFO), consisting of offices at 138 locations across the country. The Organization has a well equipped training set up where officers and employees of the Organization as well as Representatives of the Employers and Employees attend sessions for trainings and

**Vision & Mission**  
**EPFO Schemes**

**Employers Portal** **Prashant Kishor Rajgopal** **Prakashan Rajgopal** **Intelligence** **EPFO's Press Release** **Photo Gallery**

**Ministry of Labour & Employment**

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**Fig. 1.1**

Fig. 1.1

- Step 1 : Click on Sign Up on the USSP Portal

Fig. 1.2

- Step 2 : Select the Registration Tab

Fig. 1.3



- Step 3 : Enter the Verification Code

Home

Dashboard

Activate Your Registration With USIP Portal

Identification Code

565399



Generate QR

Fig. 1.4

- Step 4 : Enter the OTP and verify the same

Home

Dashboard

Activate Your Registration With USSD Portal

OTP Verification

We received code is 1234 for your mobile number and Email against your Request

Enter OTP sent to Your Mobile Number

Verify OTP

Resend OTP

Fig. 1.5

- Step 5 : Create the new User Id and enter the password

[Main menu](#)

## Activate Your Registration With USSP Portal

---

**Get Your ID and Password**

**Note:** The password must contain 8-15 characters, 6-8 bit (2 bits) and one upper case letter, one number and one special character. Upper, lower case letters (a-z, A-Z), numbers (0-9) and special characters are not allowed. The password case and the id, except 0-9, are of (max) 40 characters in the whole registration.

Enter User ID of Your Choice

Enter Password

Confirm Password

Fig. 1.6

- Step 6 : Enter your User Id and Password and click Login

Fig. 1.7

- Step 7 : Click- Registration for ESI

Fig. 1.8

- Step 8 : Act (s) Applying for Employee's State Insurance Act, 1948

The screenshot displays the SHRAM SUVIDHA portal interface. At the top, there's a header with the portal name and a navigation bar. The left sidebar contains a 'DASHBOARD' section with links for 'Apply for New LIN', 'IN Status', 'Registration', 'License Under CLRA/SMW', 'Establishments', 'Initial Return under Central Act', 'License (Renewal / Amendment)', 'Security Deposit Refund', and 'Lacking Entry for Licences before EEP'. The main content area is titled 'Act(s) Applying For' and features a table with two rows: 'Employees State Insurance Act, 1948' and 'Employees' Provident Fund and Miscellaneous Provisions Act, 1952'. Below the table, there's a 'Submit' and 'Cancel' button. A detailed notice follows, stating that registration for EPFO & ESI for new Public & Private Limited Companies and One Person Company has been stopped on the SHRAM SUVIDHA Portal from 08.10.2020. It mentions that with effect from 08.10.2020, new Public & Private Limited Companies and One Person Company shall get registration number for EPFO & ESI on MCA portal (<https://mca21.mca.gov.in>) through Spicer and AGS&PMS along with at the time of incorporation. However, the above new companies will have to comply with the provisions of EPF & MP Act, 1952, and ESI Act, 1948 when they cross the threshold limit of employment under the respective Acts. To get benefit of full time EPF employer shall under Provisional Registration, please register at <https://mca21.mca.gov.in>. Below this, there's a 'Download User Manual' section with links for 'Registration under EPFO Act, 1952', 'Registration under ESI Act, 1948', and 'Consent Instructions for ESI & ESI'. The footer contains the portal name, a disclaimer, copyright information, and the India.gov.in logo.

Fig. 1.9

- Step 9 : Establishment details

SHRAM SUVIDHA  
MINISTRY OF LABOUR & EMPLOYMENT

Home Know Your LfE Know Your Minimum Wage Registration License Under CLRA/SMW Download Manual Contact Us

Dashboard > Registration > Registration form

Common Registration form for ESIC

Establishment Details Contacts Contact Persons Identifiers Employment Details Branch/Division Activities

Note: Required fields are indicated by an (\*)

1. Establishment Name (as per PAN)\*  
(In case of Proprietary firm Name, as per PAN is not required)

A. Work Place Address (Address proof required in attachment)

Address :

2. Firm/Shop Name\* Province No. / Name\* 3. State\* Select State

4. Sub-Location/Village/Street Name\* Sub-Location / Colony / Road Name 5. District\* Select District

6. Locality/Village/Town Name\* Locality / Village / Town Name\* 7. Area Code/Pin Code\* Pin code\*

8. Nearest Police Station\*

9. Setup Date\* DD/MM/YYYY

10. Establishment Category\* Select

11. PAN\*

12. Sector (Ownership Type)\* Select

B. If Factory, Specify Factory License Details

13. Factory Licensed Under Section\* Select

14. Factory License Number\*

15. Issued By Authority, Place\*

16. Date of License Registration\* DD/MM/YYYY

17. Date of Trial Production, if Factory\*

C. If Start-up, Specify Start-up Registration Number

18. DIPP Start-up Certificate No.\*

19. DIPP Start-up Certificate Date\* DD/MM/YYYY

D. If Establishment is MSME, Specify MSME Registration Number

20. MSME Certificate No.\*

21. MSME Certificate date\* DD/MM/YYYY

E. Ownership Details

22. Date Of Registration\* DD/MM/YYYY

23. No Of Owners\*

24. Issued At\*

25. Registration/Deed No.\*

26. Issued By\*

27. ON\*

Cancel Save as Draft Next

Website Policies / Acts and Rules / Help / PAN / Contact Us

Shram Suvidha Portal is an 'Scale of Ease' to avail License / Registration initiative by Ministry of Labour & Employment, Government of India.  
To know more, Please contact help@shramsuvidha.gov.in

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india.gov.in

Fig. 1.10

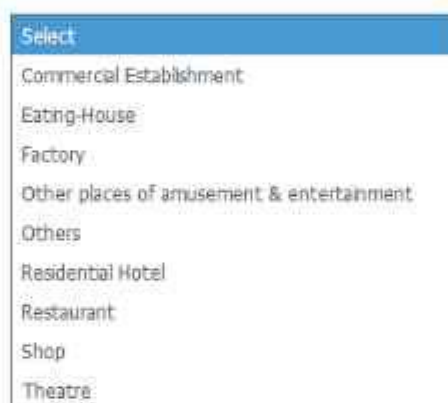
Required fields are indicated by an asterisk (\*)

**Establishment Details**

Enter establishment details:

Establishment Name (as per PAN): \* -

- Enter the name of the factory or establishment as per PAN details.
- The applicant should have a PAN in the name of the establishment/proprietor of the establishment for which he/she is applying. Only in the case of the Proprietorship firm can the PAN be in the name of the Proprietor.
- The name should be entered exactly as furnished to Income Tax Department. Even a slight variance with an extra space etc. will result in rejection as the data is verified online
- Work Place Address (Address proof required in attachment)
- Establishment Category: \* - Select the establishment category from the dropdown as shown below



A screenshot of a web-based dropdown menu. The menu is open, showing a list of establishment categories. The header of the dropdown is a blue bar with the word 'Select' in white. The list items are: Commercial Establishment, Eating-House, Factory, Other places of amusement & entertainment, Others, Residential Hotel, Restaurant, Shop, and Theatre.

Fig. 1.11

- Sector (Ownership Type): \* - Select establishment category from drop-down as shown below



A screenshot of a web-based dropdown menu for ownership types. The menu is open, showing a long list of options. The header is a blue bar with the word 'Select' in white. The list items include: Central Govt. Controlled, Central Govt. Department, Central Public Sector Undertaking, Co-operative Society, Firms Run By Trust, HUF, Limited Liability Partnership, Local Bodies / Municipal Corporations, Partnership Firms, Private Ltd Company, Proprietary Firms, Public Ltd Company, Registered Society, State Govt. Controlled, State Govt. Department, State Public Sector Undertaking, and a final 'Select' option at the bottom with a small downward arrow icon.

Fig. 1.12



- If Factory, Specify Factory License Details
- If Start-up, Specify Start-up Registration Number
- If Establishment Is MSME, Specify MSME Registration Number

- Step 10 : Proceed further to enter eContacts

The screenshot displays the SHRAM SUVIDHA portal interface. The top navigation bar includes the portal logo, a language selector, and a user profile icon. The main content area is titled 'Common Registration form for ESIC' and features a tabbed interface with 'eContacts' currently selected. Below the tabs, there are input fields for '25. Primary E-Mail' and '25. Primary Mobile', each with a 'Please enter primary E-Mail' or 'Please enter primary Mobile' prompt. A 'Previous' button and a 'Save as Draft' button are visible at the bottom right of the form. The left sidebar contains a 'DASHBOARD' menu with various options for users to manage their registrations and licenses.

Fig. 1.13

- You can add as many e-Contact details as you wish
- Enter description/value for selection and click Add button

The screenshot shows a dropdown menu titled 'Select eContact Type'. The menu is open, displaying a list of contact types: 'E-Mail', 'Landline with Ext', 'Linked-In', 'Mobile', 'Skype Id', and 'Website'. The 'E-Mail' option is currently selected and highlighted in blue.

Fig. 1.14

- Added contact detail will be displayed in grid below

Fig. 1.13

**Primary Owner\***

Please Insert Contact Address and Atleast one record of Email and Mobile in E-contacts for Primary Owner.

Owner  Owner  Male  02-02-1995

Father's Name  02-02-2005  Designation-owner  0000022220

Please check your input. Please enter the Enter Designation contain only a-z, A-Z

[Add/Edit Address of Primary Owner](#) [Add/Edit Econtact of Primary Owner](#)

| E Contact Type     | E Contact Value | Action                        |
|--------------------|-----------------|-------------------------------|
| Landline with Exnt | 40022773510     | <a href="#">Edit / Delete</a> |

Fig. 1.14

## OTHER CONTACTS

**Other Contact Person**

Select Representation  Enter name  Select Gender  00-MM-YYYY

Father's Name  00-MM-YYYY  Enter Designation  Enter PAN

[Add](#) [Reset](#)

Please Insert only 1 owners from Other Contact Person

**Contact Persons**

| Sr No              | Contact Person Name | Representing as               | Address                          | eContacts                                                                                                                                                                                                                                                                        |                |                 |        |                    |             |                               |
|--------------------|---------------------|-------------------------------|----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|-----------------|--------|--------------------|-------------|-------------------------------|
| 1                  | Accountant          | Accountant                    | <a href="#">Add/Edit Address</a> | <a href="#">Add/Edit E-Contacts</a> <table border="1"> <thead> <tr> <th>E Contact Type</th> <th>E Contact Value</th> <th>Action</th> </tr> </thead> <tbody> <tr> <td>Landline with Exnt</td> <td>40022783510</td> <td><a href="#">Edit / Delete</a></td> </tr> </tbody> </table> | E Contact Type | E Contact Value | Action | Landline with Exnt | 40022783510 | <a href="#">Edit / Delete</a> |
| E Contact Type     | E Contact Value     | Action                        |                                  |                                                                                                                                                                                                                                                                                  |                |                 |        |                    |             |                               |
| Landline with Exnt | 40022783510         | <a href="#">Edit / Delete</a> |                                  |                                                                                                                                                                                                                                                                                  |                |                 |        |                    |             |                               |

[Delete](#) [Next](#) [Previous](#)

Fig. 1.15

- Select Contact person's representation from dropdown list
- Enter name of the contact person
- Select gender
- Select date of birth of contact person
- Enter the contact person's father's name
- Select the Effective Date and enter the designation
- Enter PAN number
- Click Add to save contact person detail.
- Added contact details will be displayed as follows:

- Step 11 : Click Next to proceed further to enter, Identifiers

Fig. 1.16

- You can add/edit address by selecting Add/Edit Address link.
- You can add/edit E-Contacts by selecting Add/Edit E-Contracts link.
- Click Delete to delete entered record

Fig. 1.17

When any available License type/identifier is not in the drop-down list, user should select OTHERS, in which case the License Type to be entered in REMARKS field compulsorily.

- Select identifier type
- Enter identifier value
- Enter name as on identifier
- Select date
- Enter issued by and location
- Check the checkbox to mark the same as address proof

- Click Next to proceed further to enter, Employment Details

The screenshot shows the 'Common Registration form for EPFO' with the 'Employment Details' tab selected. The form includes a navigation bar with tabs: Establishment Details, eContacts, Contact Persons, Identifiers, Employment Details (active), Branch/Division, Activities, and Attachments. A note states: 'Note: Required fields are indicated by an (\*)'. The 'Employee Details Covered under EPF Act:' section contains the following fields:

- Do EPF and MP Act applies to Establishment: \* (Dropdown menu showing 'Yes')
- Number of Employees (Including Excluded Employees) As On Date Of Application: \* (Text input field showing '500')
- Number of Excluded Employees: \* (Text input field showing '400')
- Date On Which the Employment Strength Exceed 19: \* (Date picker showing '01-01-2005')

Below this section, there is a field: 'Is there any Hazardous activity in your establishment:' (Dropdown menu showing 'Select').

Fig. 1.18

Enter employment details as shown above:

The application should be made by the employer if the Act applies to its establishment. For this purpose, you may refer to Section 1 (3) (a) and 1 (3) (b) of the EPF and MP Act 1952. The list of activities to which the Act applies should also be referred.

The employer of an establishment on which the Act does not apply can also apply for a code number on a voluntary basis (Please refer to Section 1(4) of the said Act, if the majority of the employees of the establishment give their written consent for coverage from the date on which it is agreed upon or any subsequent date in the agreement. The consent cannot be from a previous date.

The employer should select the appropriate option for the applicability.

- Enter the Number of workers as of date, male, female, contract workers and other
- Enter No. of Employees drawing wages Rs.21,000/- or less\*
- Select the date since when 10/20 or more coverable employees under ESI Act, were employed for wages\*



Total number of employees employed for wages directly and through immediate employers on the date of application:

Number of Workers as on date:

|        | Regular | Contract Labour | Total |
|--------|---------|-----------------|-------|
| Male   | 0       | 0               | 0     |
| Female | 0       | 0               | 0     |
| Others | 0       | 0               | 0     |
| Total  | 0       | 0               | 0     |

Give first date since when 10/20 or more coverable employees under ESI Act, were employed for wages: DD MM YYYY

No of Employees drawing wages Rs. 21,000 or less\*:

|        | Regular | Contract Labour | Total |
|--------|---------|-----------------|-------|
| Male   |         |                 |       |
| Female |         |                 |       |
| Others |         |                 |       |
| Total  |         |                 |       |

Total wages paid in the preceding month:

|                                                          | TOTAL WAGES | WAGES PAID TO EMPLOYEES DRAWING WAGES Rs. 21,000/- or LESS |
|----------------------------------------------------------|-------------|------------------------------------------------------------|
| To employees employed directly by the principal employer |             |                                                            |
| To employees employed through immediate contractor       |             |                                                            |

Fig. 1.19

Enter total wages paid in the preceding month to:

- To employees employed directly by the principal employer
- To employees employed through immediate contractor

Other Details:

Whether the building/premises of factory/Unit is owned or hired: Leased

If hired or there is a change in the name of Unit/ownership: No

Leased from: 01-11-2000

Leased till: 01-11-2020

Is Establishment Multinational: Yes

ESI Code number if Covered under:

Name of Income Tax Ward/Circle/Area:

Maximum No. of persons that can be employed on any one day, as per License:

Whether Any work/Business is being carried out through contractor/immediate employer: Yes

Describe work Carried Out:

Whether Establishment is Working With Aid Of Power?: Yes

Lessee Details:

Name \*:

Gender \*: Select Gender

Designation \*: Designation

Date Of Birth \*: DD-MM-YYYY

Father's Name \*: Father's Name

Mobile \*: Mobile

Email: Email

Date From Which in Position \*: DD-MM-YYYY

Residential Address \*: Residential Address

Fig. 1.20

Enter other detail:

- Whether the building/premises of the factory/Establishment is owned or hired
- If hired or there is a change in the name of the Unit/ownership
- Specify if Leased from and to
- Is Establishment Multinational (select value)
- ESI Code number if Covered earlier:
- Enter the Name of the Income Tax Ward/Circle/Area
- Enter the Maximum No. of persons that can be employed on any one day, as per License :
- Specify Whether Any work/Business is being carried out through a contractor/immediate employer
- Describe the Work Carried Out
- Whether Establishment Is Working with Aid of Power?

The screenshot displays the SHRAM SUVIDHA portal interface for customizing a registration form for ESI. The top navigation bar includes the Ministry of Labour & Employment logo and links for Home, Know Your LN, Know Your Minimum Wage, Registration, License Under CRR/SMW, Download Manual, and Contact Us. The left sidebar lists various services such as Apply for New LN, LN Status, Registration, License Under CRR/SMW, and Security Deposit Refund. The main content area is titled 'Customize Registration form for ESI' and features a 'Back' button. The form is divided into several tabs: Establishment Details, eContacts, Contact Persons, Identity, Employment Details, Branch/Division, and Activities. The 'Establishment Details' tab is currently selected, showing fields for:
 

- 109. Name of Unit (Required)
- 110. Relationship Type (Select Relationship Type)
- 111. No. of Members in the Branch (No. of Employees in the Branch)
- 112. Name of Responsible Person for Office (Select Name of Responsible Person for office)
- 113. LN (Select LN)
- Address section with fields for:
  - 114. Permit No./Name (Permit No. / Name)
  - 115. Sub (Sub Establish / Colony / Town / Road)
  - 116. Location/Colony/Street Name (Location / Village / Town / Road)
  - 117. State (Select State)
  - 118. District (Select District)
  - 119. Area Code/Pin Code (Pincode)
- e-Contacts section with fields for:
  - 120. Email (Enter email)
  - 121. Mobile (Enter mobile)

 Below the form fields, there is a 'Related Offices' table with columns: Sr No, Name of unit, Relationship type, No. Of members in Branch, Entry LN number, Name of Responsible for Office, Address, eContacts, and Action. At the bottom of the form, there are buttons for 'Previous', 'Save as Draft', and 'Next'. The footer contains the Ministry of Labour & Employment logo and copyright information for 2022.

Fig. 1.20

- Enter Branch
  - Select relation
  - Enter no. of employees
  - Enter the responsible person's name
  - Enter LIN
- Step 13 : Click the Next tab

The screenshot shows the SHRAM SUVIDHA portal interface. The header includes the logo and navigation links. The left sidebar contains a 'Dashboard' menu with options like 'Apply for New LIN', 'Life Status', 'Registration', 'License Under CLRA/CLRW', 'Establishments', 'Annual Return under Central Act', 'License Renewal / Amendments', 'Security Deposit Refund', and 'Banking Entry for License before SOP'. The main content area is titled 'Common Registration form for ESI' and includes tabs for 'Establishment Details', 'Contacts', 'Contact Persons', 'Members', 'Employment Details', 'Branch/Division', and 'Activities'. The 'Establishment Details' tab is active, showing a form for 'K. Economic Activity as per National Industrial Classification'. It includes a dropdown for 'TIC, NIC Code (Not Mandatory)' with a 'Search for Code' button, and two input fields for '123. Nature of Work\*' and '124. Subcategory of Nature of Work\*'. At the bottom right of the form are buttons for 'Previous', 'Save as Draft', and 'Save'.

Fig. 1.21

- You can view the summary of the registration form from the dashboard:

The screenshot shows the 'Summary & Submission' page of the SHRAM SUVIDHA portal. At the top, there is a green success message: 'Establishment details Added/Updated Successfully'. Below this, the 'Establishment Details' section displays a table with the following information:

|                          |                                                |                                       |            |
|--------------------------|------------------------------------------------|---------------------------------------|------------|
| Establishment Name:      | Md Steel                                       | Setup Date:                           | 01-11-1999 |
| Address:                 | Abed, Gidc, Naroda, Ahmedabad, Gujarat, 380015 |                                       |            |
| Nearest Police Station:  |                                                | PAN:                                  | ABCD111111 |
| Establishment Category:  | Factory                                        | Factory Licensed Under Section:       | 250        |
| Sector (Ownership Type): | Private Factory                                | Issued By Authority, Place:           | Pvt        |
| Factory License Number:  | SSSSSSSSSSSSSSSSSSSS                           | Date of Trial Production, if Factory: | 06-11-2001 |
| Date:                    | 01-11-2000                                     | Start up Registration date:           |            |
| Start Up Number:         |                                                | MSME Registration date:               |            |
| MSME Number:             |                                                |                                       |            |

Fig. 1.22

| Sr No | Type                          | Specify Document Name                           | File                |
|-------|-------------------------------|-------------------------------------------------|---------------------|
| 1     | scannedCopyPanAttachment      |                                                 | 8c2731ed13ac0fa.pdf |
| 2     | addressProofAttachment        | Copy of post paid telephone bill of any company | 6785e90728870d3.pdf |
| 3     | dateOfSetupProofAttachment    | Copy of the first Sales Invoice                 | 8a4850983415006.pdf |
| 4     | licenseProofAttachment        | CAR licence                                     | 3415190a3c5d717.pdf |
| 5     | specimenSignatureAttachment   |                                                 | 994a8b07b0962e.pdf  |
| 6     | scannedCopyOfChequeAttachment |                                                 | 21588f3b4e0be7.pdf  |
| 7     | nonDeceasedAttachment         | Agreement                                       | 625a0b95682d040.pdf |

Fig. 1.23

- Click Submit button to submit the registration.  
The following screen will be displayed:

GOVERNMENT OF INDIA Ministry of Labour & Employment

SHRAM SUVIDHA  
MINISTRY OF LABOUR & EMPLOYMENT

English/English - Arjant das - Sign Out

Logged in As: Arjant das  
Registration Registered User

Home Know Your LIn Know Your Minimum Wage Registration License Under CLRA/SMW Download Manual Contact Us

**DASHBOARD**

- Apply for New LIn
- LIn Status
- Registration
  - Registration For EPFO-ESIC
  - Registration for QJC
- License Under CLRA/SMW
- Establishments
- Annual Return under Central Acts

Dashboard > Registration > ESIC Offices

### Select office & Submission

Select ESIC branch office where you want to submit this Common registration form\*

Select ESIC Inspection Division office where you want to submit this Common registration form\*

Select office

- Select office
- BO - BRIDGE
- BO - BEHALA
- BO - BIRLAPORE
- BO - Chingung
- BO - KALPORE
- BO - SICHITRAGUNGE
- CCBO - Tata

Fig. 1.24

- Click Digital Signature to Sign the Registration form digitally!
- System displays the following message.
- Click RUN to continue.
- Enter PIN.

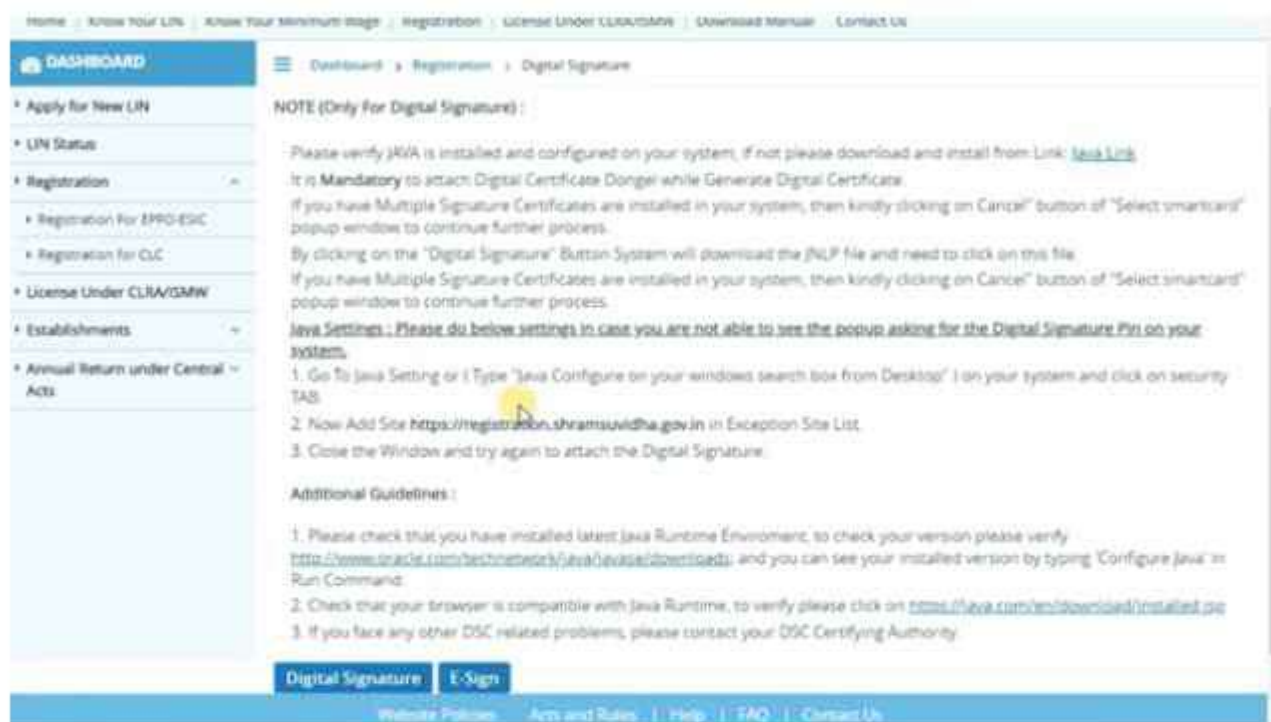


Fig. 1.25

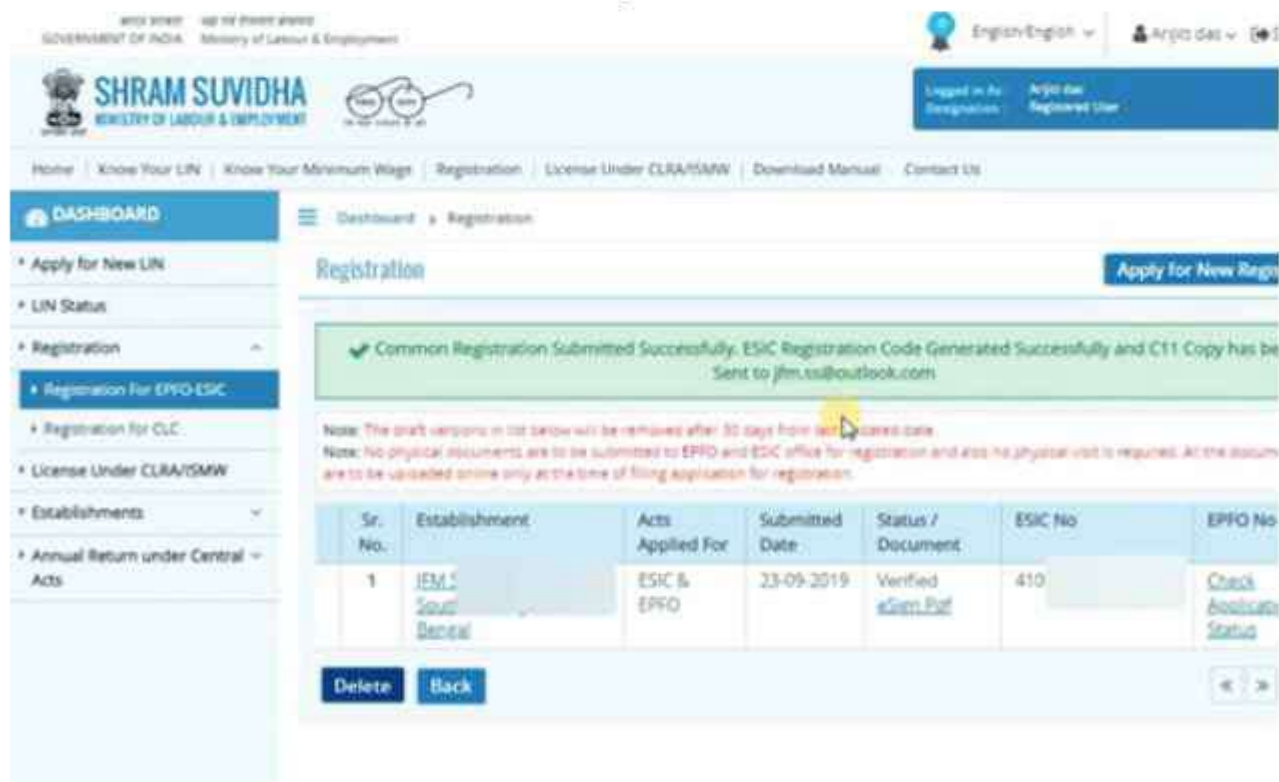


Fig. 1.26



Fig. 1.27

## Summary

The Employee State Insurance Act (ESI Act) of 1948 is a comprehensive social security legislation in India designed to provide health insurance and social protection to workers in the formal sector. It extends to employees working in non-seasonal factories and other establishments like shops, hotels, and cinemas, employing 10 or more persons. The Act mandates contributions from both employers and employees based on a percentage of the employees' wages. The fundamental principles of the ESI Act include compulsory contributions, provision of defined benefits, and shared responsibility between employers and employees. Under the Act, workers are entitled to benefits like medical relief, cash benefits during sickness or maternity, and compensation for employment-related injury or disability. Employers are obligated to register under the Act, ensure timely contribution payments, and comply with various regulatory requirements. Non-compliance and delays in contributions attract penalties and interest charges. Overall, the ESI Act plays a crucial role in the welfare and protection of workers, ensuring they receive necessary medical care and financial support in times of need.

## Exercise

What is the primary purpose of the Employee State Insurance Act (ESI Act) of 1948?

- A) To provide job training to employees
- B) To provide social security and health insurance to workers
- C) To enforce employment laws
- D) To regulate private companies
- Answer: B

Which types of establishments are covered under the ESI Act?

- A) IT companies only
- B) Seasonal factories
- C) Non-seasonal factories employing 10 or more persons
- D) All private companies
- Answer: C

Who contributes to the funding under the ESI Act?

- A) Employees only
- B) Government only
- C) Both employers and employees
- D) Employers only
- Answer: C

What percentage of wages is used to calculate contributions under the ESI Act?

- A) A fixed percentage determined by the government
- B) 50% by each employee
- C) 20% by employers
- D) Variable each month
- Answer: A

What are employers obligated to do under the ESI Act?

- A) Pay taxes
- B) Provide training
- C) Register and comply with the Act
- D) Offer free meals
- Answer: C

What kind of penalties does the ESI Act impose?

- A) For criminal offenses only
- B) For non-payment or delay in payment of contributions
- C) For hiring unqualified staff
- D) For not providing annual bonuses
- Answer: B

Which of the following is a benefit provided under the ESI Act?

- A) Stock options
- B) Cash benefits during sickness
- C) Free company shares
- D) Unlimited paid leave
- Answer: B

What must employers do within 15 days according to the ESI Act?

- A) Pay employees
- B) Register under the ESI Act
- C) Start operations
- D) Close their accounts
- Answer: B

Which principle does the ESI Act emphasize for both employers and employees?

- A) Voluntary contributions
- B) Compulsory contributions
- C) Optional registration
- D) Flexible benefits
- Answer: B

What can lead to interest and penalty charges under the ESI Act?

- A) Expanding the business
- B) Delay in the payment of contributions
- C) Employing more than 10 people
- D) Decreasing the number of employees
- Answer: B

[illegible]





## 9. The Employees Provident Fund Organization

- Unit 9.1 - Introduction
- Unit 9.2 - The Employees Provident Fund Organization (EPFO)
- Unit 9.3 - Applicability of Employees Provident Fund Miscellaneous Provisions Act, 1952
- Unit 9.4 - Non-Applicability of this Act
- Unit 9.5 - Important Terms and Definitions
- Unit 9.6 - Benefits of EPF
- Unit 9.7 - Employees' Provident Fund Scheme (Section 5)
- Unit 9.8 - Contributions
- Unit 9.9 - Withdrawal from the fund
- Unit 9.10 - Advances From The Fund
- Unit 9.11 - Types of EPF
- Unit 9.12 - Employee's Pension Scheme - Section 6A
- Unit 9.13 - III. Employees' Deposit Linked Insurance Scheme- Section 6C
- Unit 9.14 - General Provisions
- Unit 9.15 - EPF - Registration Process



## Key Learning Outcomes



- Understand Legislative Context and Purpose
- Comprehend the Role of EPFO
- Identify Applicability and Coverage
- Recognize Non-Applicability
- Learn Important Terms and Definitions
- Understand Benefits of EPF
- Employees' Provident Fund Scheme
- Comprehend Contributions
- Understand Withdrawal Rules
- Learn About Advances & Types of EPF
- Understand the General Provisions
- Explain Employees' Pension Scheme, Employees' Deposit Linked Insurance Scheme & EPF Registration Process

## Unit 9 - EPFO

### Unit Objectives

After studying this module, the students shall be able to understand:

- Operations of Employees' Provident Fund Scheme
- Operations of the Employee's Pension Scheme
- Operations of the Deposit-Linked Insurance Scheme
- Obligations of the employer and employee towards PF accounts
- Other provisions of the Act such as powers of the Central Government, determination of remuneration due from employers etc

## Unit 9.1 - Introduction

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is a social welfare legislation to provide for the institution of Provident Fund, Pension Fund and Deposit Linked Insurance Fund for employees working in factories and other establishments. The Act aims at providing social security and timely monetary assistance to industrial employees and their families when they are in distress.

Employees Provident Fund Organization (EPFO) is a statutory body registered under the Employee Provident Fund and Miscellaneous Provisions Act 1952 for the overall supervision and regulation of provident funds in India.

There are 3 schemes operated under this Act:

- Employees' Provident Fund Scheme 1952
- The Employees' Deposit Linked Insurance Scheme 1976
- Employees' Pension Scheme 1995

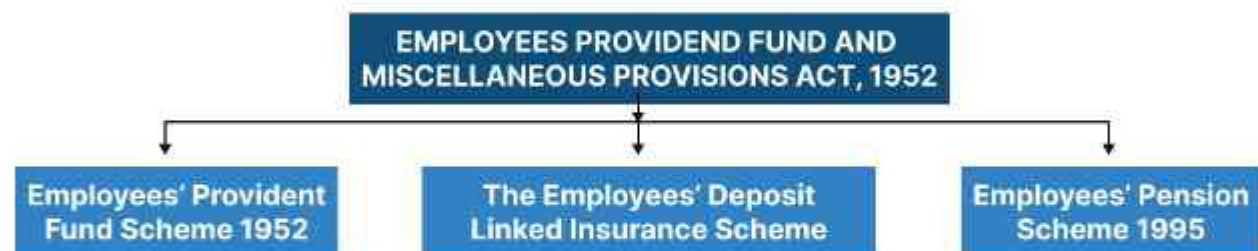


Fig 2.1

## Unit 9.2 - The Employees Provident Fund Organization (EPFO)

Employees Provident Fund Organization (EPFO) is one of the World's largest Social Security Organizations in terms of clientele and the volume of financial transactions undertaken. The EPFO is a statutory body which assists Central Board in administering compulsory contributory Provident Fund Scheme, Pension Scheme and Insurance Scheme for the workforce engaged in the organized sector in India. The Central Board of Trustees in EPFO administers a contributory provident fund, pension scheme and an insurance scheme for the workforce engaged in the organized sector in India.



Fig 2.2



## Unit 9.3 - Applicability of Employees Provident Fund Miscellaneous Provisions Act, 1952

Section 1(3) provides that subject to Section 16, this Act applies: - every establishment which is a factory engaged in any industry specified in Schedule I and in which 20 or more persons are employed; and

- To any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf.
- Central Government may, after giving not less than 2 months notice of its intention to do so, apply the provisions of this Act to any establishment with less than 20 persons in the employment.
- Where it appears to the Central Provident Fund Commissioner, that the employer and the majority of the employees have agreed that the provisions of this Act should be made applicable to their establishment, he may, by notification, apply the provisions of this Act to that establishment on and from the date of such agreement or from any subsequent date specified in such agreement;
- Once the Act is covered to any establishment it shall continue to apply not with standing the number of the persons employed therein shall at any time falls below 20.

## Unit 9.4 - Non-Applicability of this Act

This Act is not applicable to the following organizations under Section 16(1) of the Act

- To any establishment registered under the Co-operative Societies Act, 1912 or under any other law for time being in force in any State relating to co-operative Societies, employing less than 50 persons and working without the aid of the power; or
- To any other establishment belong to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or
- To any other establishment set up under the Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under that Act governing such benefits.



## Unit 9.5 - Important Terms and Definitions

- **Appropriate Government Means**

- In relation to an establishment belonging to, or under the control of Central Government or in relation to an establishment connected with "a railway" company, a major port, a mine or an oilfield or a controlled industry, or in relation to an establishment having departments or branches in more than one State, the Central Government; and
- In relation to any other establishment, the State Government.

- **Authorized Officer Means**

- The Central Provident Fund Commissioner;
- Additional Central Provident Fund Commissioner;
- Deputy Provident Fund Commissioner;
- Regional Provident Fund Commissioner; or
- such other officer as may be authorized by the Central Government, by Notification in the Official Gazette.

- **Employer**

- In relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier and, where a person has been named as a manager of the factory, the person so named; and
- In relation to any other establishment, the person who, or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager, managing director or managing agent, such manager, managing director or managing agent.

- **Employee :** any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with work of an establishment, and who gets his wages directly or indirectly from the employer, and includes any person,

- employed by or through a contractor in or in connection with the work of the establishment;
- engaged as an apprentice, not being an apprentice engaged under the Apprentice Act, 1961 (52 of 1961), or under the standing orders of the establishment.

- **Basic Wages :** means all emoluments which are earned by an employee while on duty or on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

- The cash value of any food concessions;
- Any dearness allowance (that is to say all cash payments, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment; or
- Any presents made by the employer.

- **Contribution :** means contribution payable in respect of a member under a scheme or the contribution payable in respect of an employee to whom the insurance scheme applies.

- **Factory means any premises :** including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power.

- **Industry :** means an industry specified in Schedule I, and includes any other industry added to the Schedule by notification under Section 4.

- **Manufacture or Manufacturing :** process means any process for making, altering, repairing, ornamenting, finishing, packing, washing, cleaning, breaking up, demolishing, otherwise treating or adapting any, article or substance with a view to its use, sale, transport, delivery or disposal.

- **Occupier of a Factory :** the person who has ultimate control over the affairs of a factory, and, where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.
- Section 5 – Employees' Provident Fund Schemes;
- Section 6A – Employees' Pension Scheme;
- Section 6C – Employees' Deposit Linked Insurance Scheme.

## Unit 9.6 - Benefits of EPF

- **Retirement benefits:**

In the long run, sum amount deposited in the EPF helps to build a healthy retirement corpus. Such corpus assures a sense of financial security and independence to them after retirement. The pension scheme assures a regular income after retirement to private sector employees also.

- **Easy premature Withdrawal :**

Members of EPF are allowed for partial withdrawal for meeting specific expenses such as house construction, higher education, marriage, illness etc.

- **Capital Appreciation :**

Deductions are made on a monthly basis from the employee's salary and interest accrued thereon helps in saving adequate amount of money and maintain good life style after retirement.

- **Tax Saving :**

Under section 80C of Income Tax Act, the employees' contribution to PF will get deduction from Income subject to maximum of ₹ 1,50,000 which will help to employees for tax deduction. Interest accrued in EPF account are exempted subject to Employees' voluntarily contribution does not exceed 2.5 Lakh (5Lakh in case of Government employee) with effect from 1st April 2021.

- **Death of Member :**

Upon the death of an EPF member, the EPF amount is paid to the nominee that was nominated at the time of initiation of the account. If there was no nominee assigned then the EPF amount is paid to the immediate members of the family. If the family members and the nominee are not applicable for the account then the legal heir can claim EPF amount.

- **Free insurance :**

Under EDLI (Employee Deposit Linked Insurance) scheme, In case of death during the service period, a PF account holder by default becomes eligible for free insurance up to Rs 7 lakh. Under the EDLI scheme, the PF account holder need not pay any insurance premium for the death cover.

- **Easy access :**

When employees' register themselves under EPF scheme, the EPFO provides them with a Universal Account Number (UAN), which shall be used for easy access to their accounts. The UAN remains unchanged even when the employees' move to different organization.



## Unit 9.7 - Employees' Provident Fund Scheme (Section 5)

The Central Government may frame a scheme to be called Employees' Provident Fund Scheme for the employees or class of employees of establishments to which the Act applies. It may also specify the establishments or class of establishments to which the said scheme is to apply. After the framing of scheme, a Fund must be established in accordance with provisions of this Act and the Scheme. The fund shall vest in and be administered by Central Board of trustees constituted under Section 5A by the Central Government.

The fund shall vest in and be administered by Central Board of trustees constituted under Section 5A by the Central Government

- Central Board:
  - A Chairman and a Vice-Chairman appointed by the Central Government; and the Central Provident Fund Commissioner is ex-officio
  - Not more than fifteen persons appointed by the Central Government from amongst its officials
  - Not more than fifteen persons, representing Governments of such State as the Central Government may specify in this behalf, appointed by the Central Government;
  - Ten persons representing employers of the establishments to which the Scheme applies, appointed by the Central Government after consultation with such organizations of employers as may be recognized by the Central Government in this behalf; and
  - Ten persons representing employees in the establishments to which the Scheme applies, appointed by the Central Government after consultation with such organizations of employees as may be recognized by the Central Government in this behalf.
- State Board: The Central Government may constitute Trustees for a State Board in consultation with the Government of that State. The State Board shall exercise such powers and perform such duties as the Central Government may assign to it from time to time.
- Board of Trustees to be body corporate: The above Central Board or the State Board shall be a body corporate under the name specified in the notification constituting it having perpetual succession and a common seal.
- Appointment of Officers: The Central Government shall appoint a Central Provident Fund Commissioner who shall be the Chief Executive Officer of the Central Board. He shall be subject to the general control and superintendence of that Board.

## Unit 9.8 - Contributions

As per Section 6, the contribution which shall be paid by the employer to the fund shall be 10%, of the basic wages, dearness allowance and retaining allowance, if any, for the time being payable to each of the employees whether employed by him directly or through a contractor and the employees' contribution shall be equal to the contribution payable by the employer.

Employees, if they desire, may make contribution exceeding the prescribed rate but subject to the condition that employer shall not be under any obligation to contribute over and above the contribution payable as prescribed by the Government from time to time under the Act. The Government has raised the rate of Provident Fund Contribution from the current 8.33% to 10% in general and in cases of establishments specially notified by the Government, from 10% to 12% with effect from September 22, 1997.

## Unit 9.9 - Withdrawal From The Fund

Withdrawal from the fund is allowed for the following purposes: -

- For the purchase of a dwelling house/flat or for the construction of a dwelling house including the acquisition of a suitable site for this purpose;
- For repayment of loans in special cases;
- Withdrawal within one year before the retirement;
- Withdrawal up to 75% of the balance, if not employed from one month or more, subject to approval of P.F. Commissioner or any officer authorised by him.

The above-mentioned withdrawals are not required to be repaid.

## Unit 9.10 - Advances From The Fund

Advances from the fund are paid for the following purposes-

- For illness in certain cases;
- For marriages or post matriculation education of children;
- In abnormal conditions such as calamity of exceptional nature such as flood, earthquakes or riots (non-refundable)
- Granted to members affected by cut in the supply of electricity; (non-refundable)
- Grant of advance to members who are physically handicapped; (non-refundable)

## Unit 9.11 - Types of EPF

- **Statutory Provident Fund (SPF):**

The local authorities, government agencies, railways, universities, etc. manage this Provident fund. This action falls within the scope of the Insurance Funds Act of 1925. Employers may not have tax on their contributions, while employee contributions are taxable under 80C.

- **Recognized Provident Fund (RPF):**

Recognized Provident Fund is the popular type of PF. All employees in companies with more than 20 employees contribute to the PF. Employees can set up the scheme for their contributions in their own PF trust or follow the PF commissioner system, but CIT (Commissioner of Income Tax) must approve all schemes. If the employee's contribution is more than 12%, it will be taxed for the year in which the contribution was made. Tax is deducted under Section 80B for the share of employee contributions. The total amount at the time of redemption is exempt from tax only if the employee has worked continuously for five years.

- **Unrecognized Provident Fund (UPF):**

The Commissioner of Income Tax, i.e., CIT, does not recognize these funds. With this insurance fund, contributions made during the financial year are not subject to tax. This amount is taxable as "salary income" at the time of withdrawal. However, employee contributions are not taxed under this section, but other taxes are assumed for them.

- **Public Provident Fund (PPF):**

This scheme of public provident funds is generally available for everyone, regardless of whether they are employed or unemployed. The minimum rate should be Rs. 500, and the maximum amount extends up to



Rs 1.5 lacs. This amount is paid after 15 years. It is one of the most profitable programs for future savings and investment. Interest on the amount paid is also tax-free.

## Unit 9.12 - Employees' Pension Scheme- Section 6A

The Central Government framed Employees' Pension Scheme with an objective of-

- Superannuation pension;
- Retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which this Act applies; and
- Widow or widower's pension;
- Children pension or orphan pension payable to the beneficiaries of such employees.

The Pension Scheme may provide for all or any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in that behalf in that scheme.

### ▪ Contribution to pension scheme

The employer is to contribute 8.33% of the basic wages, dearness allowance and retaining allowance, if any of the concerned employees as may be specified in the pension scheme. Contribution is not payable when the employee crosses 58 years of age since the scheme ceases on completion of 58 years. There is no contribution from the employee.

### ▪ Pension Fund

A pension fund has been created for the purpose of this scheme. The Pension Fund shall vest in and administered by the Central Board

## Unit 9.13 - Employees' Deposit Linked Insurance Scheme- Section 6C

The Central Government made the Employees' Deposit Linked Insurance Scheme, 1976 which came into effect from 01.09.1976. It applies to all factories and other establishments to which the Act applies except tea factories in State of Assam.

The wage ceiling limit under Employees Deposit linked Insurance is ₹ 15,000. The insurance benefit under the scheme shall be an amount between 2.5 lakhs and 6 lakhs.

▪ **Contribution to Employees' Deposit Linked Insurance Scheme**

The employer shall pay such amount not being more than 1% of the aggregate of basic wages, dearness allowance and retaining allowance of every such employee in relation to whom he is the employer. The employer shall pay into the Insurance Fund such further amount of money not exceeding one fourth of the contribution which is required to make as the Central Government may from time to time determine to meet all the expenses in connection with the administration of the scheme other than the expenses towards the cost of any benefits provided by or under that scheme. Where the monthly pay of an employee exceeds ₹ 15,000 the contribution payable is restricted to the amounts payable on a monthly pay of ₹ 15,000, dearness allowance, retaining allowance and cash value of food concession.

## Unit 9.14 - General Provisions

**Protection against attachment**

The amount standing to the credit of any member in the fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member and neither the official assignee appointed under the Presidency-towns Insolvency Act, 1909, nor any receiver appointed under the Provincial Insolvency Act, 1920 shall be entitled to, or have any claim on, any such amount.

**Priority of payment of contributions over other debts:**

This provision existed when Section 11(2) was inserted in the EPF Act by Act No. 40 of 1973 and any amount due from an employer in respect of the employees' contribution was declared first charge on the assets of the establishment and became payable in priority to all other debts.

**Transfer of Accounts**

Section 17A provides that where an employee employed in an establishment to which the Act applies, leaves his employment and obtains re-employment in another establishment to which this Act does not apply, the amount of accumulations to the credit of such employee shall be transferred to the credit of his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules, in relation, to that provident fund permit such transfer.

## Unit 9.15 - EPF – Registration Process

- To apply for EPF, please visit the website of Employees' Provident Fund Organization, India
- <https://registration.shramsuvudha.gov.in/>
- Click the Link 'Establishment Registration



# Employees' Provident Fund Organisation, India

Ministry of Labour & Employment, Government of India




Services

Exempted Estt.

EPFO Corner

Miscellaneous

Directory

Payroll Data

ABRY

Dashboards

Covid-19

Downloads



Annexure K is a document which mentions the member details, his PF accumulations with interest, service history, Date of joining and Date of Exit and employment details including past and present ADRs. This document is required by the Field Office/Trust to effect a Withdrawal.

Annexure K can be downloaded through member portal.

Establishment Registration

KYC Update (Member)

UMANS

ECN/Benefits/ Payment

Online Claims Member Account Transfer

e-Passbook

Performance of Establishments

Shram Suvidha Common ECR (EPFO/ESIC)

Online Services

- Principal Employers-CAIU Portal
- Pensioners' Portal
- EDLI & Pension Calculator
- Jeevan Pramaan Through Mobile App (Process Flow & App)
- TRRN Query Search
- International Workers Portal

About Us

- EPFO is one of the World's largest Social Security Organisations in terms of clientele and the volume of financial transactions undertaken. At present it maintains 24.77 crore accounts (Annual Report 2019-20) pertaining to its members.
- The Employees' Provident Fund came into existence with the promulgation of the Employees' Provident Funds Ordinance on the 15th November, 1951. It was replaced by the Employees' Provident Funds Act, 1952. The Employees' Provident Funds Bill was introduced in the Parliament as Bill Number 15 of the year 1952 as a Bill to provide for the institution of provident funds for employees in factories and other establishments. The Act is now referred as the Funds & Miscellaneous Provisions Act, 1952 which India. The Act and Schemes framed there under a tri-partite Board known as the Central Board of Provident Fund, consisting of representatives of Government (two members and State), Employers, and Employees.
- The Central Board of Trustees administers a contributory provident fund, pension scheme and an insurance scheme for the workforce engaged in the organized sector in India. The Board is assisted by the Employees' PF Organization (EPFO), consisting of offices at 130 locations across the country. The Organization has a well equipped training set up where officers and employees of the Organization as well as Representatives of the Employers and Employees attend sessions for trainings and

What's New

- Notice inviting application for empanelment of Advocates for Delhi State (Block Year 2023-2026).... Read
- RFP for Empanelment of Law Firms for "Legal Opinion and associated services".... Read
- National Labour Conference of Labour Ministers and Labour Secretaries of States/UTs.... Read
- EPFO Training Policy 2022.... Read
- Conducting Study for Rationalisation of field offices and manpower requirement in EPFO.... Read
- Corrigendum to Para 6.19 i.e. Key Activities and date on the RFP for Selection of Asset Management Companies of mutual funds for EPFO's

Know Your Balance

Provide a missed call to 800044425  
Phone: 011-23004000/1800-12110000

Employers Portal

Pradhan Mantri Suraksha Pension Yojana

inQuerencia

EPFO's Press Release

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Ministry of Labour & Employment





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© Employees' Provident Fund Organisation, India  
Last updated: 15-04-2023  
Website created by: www.mca.gov.in, www.epfo.gov.in

Fig. 2.1



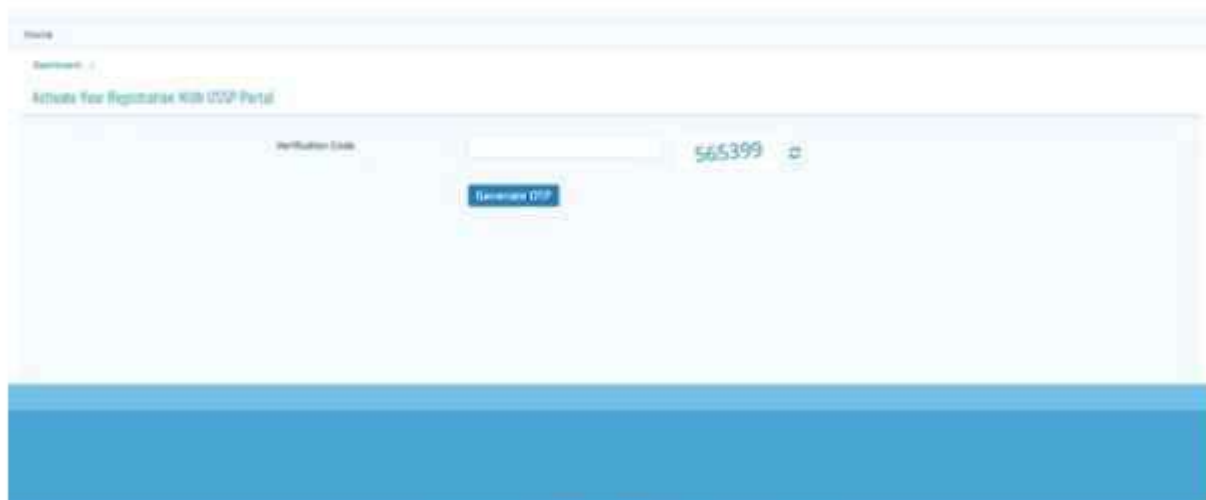
- Step 1 : Click on Sign Up on the USSP Portal



The image shows the USSP Portal login and sign-up interface. On the left, there is a circular logo with a map of India and the text 'USSP'. Below the logo, it says 'Login with Shram Suvidha Portal' and 'If you do not have User Id and Password, Create your Shram Suvidha Portal Account (Sign Up)'. On the right, there is a blue login form with fields for 'User Id', 'Password', and 'Verification Code'. The 'Verification Code' field shows '8475 53' and a refresh button. Below the fields is a 'LOGIN' button and a link for 'Forgot User Id or Password ?'.

Fig. 2.2

- Step 2 : Enter the Verification Code



The image shows the USSP Portal verification code entry interface. It has a header with 'Home' and 'Dashboard'. Below the header, it says 'Activate Your Registration With USSP Portal'. The main form has a 'Verification Code' field and a 'Generate OTP' button. The 'Verification Code' field shows '565399' and a refresh button.

Fig. 2.3

- Step 3 : Enter the OTP and verify the same



The image shows the USSP Portal OTP verification interface. It has a header with 'Home' and 'Dashboard'. Below the header, it says 'Activate Your Registration With USSP Portal'. The main form has an 'OTP Verification' section with a green bar that says 'The OTP code is 1234 for your mobile number and Email address you provided'. Below this, there is a field for 'Enter OTP sent to Your Mobile Number' and buttons for 'Verify OTP' and 'Resend OTP'.

Fig. 2.4

- Step 4 : Enter the User Id and enter the password

Fig. 2.5

- Step 5 : Enter your User Id and Password and click Login

Fig. 2.6

- Step 6 : Click- Registration for EPFO- ESI

Fig. 2.7



- Step 7 : Act (s) Applying for Employee's State Insurance Act, 1948

**DASHBOARD**

- Apply for New LIn
- LIn Status
- Registration
  - Registration for EPFO/ESIC
  - Registration for CG
- License Under CLRA/SMW
- Establishments
- Annual Return under Central Acts
- License (Renewal / Amendment)
- Security Deposit Refund
- Backlog Entry for Licences before SEP

Dashboard > Registrations > Act(s) Applying For
 

### Act(s) Applying For

| List of Act                         |                                                                  |
|-------------------------------------|------------------------------------------------------------------|
| <input type="checkbox"/>            | Employees' State Insurance Act, 1948                             |
| <input checked="" type="checkbox"/> | Employees' Provident Fund and Miscellaneous Provisions Act, 1952 |

Registration for EPFO & ESIC for new Public & Private Limited Companies and One Person Company has been stopped on Shree Swastha Portal from 08.10.2020.

With effect from 08.10.2020, new Public & Private Limited Companies and One Person Company shall get registration number for EPFO & ESIC on MCA portal ([www.mca2018.in](http://www.mca2018.in)) through 'Spice' and AGIL (PFI) forms only at the time of incorporation.

However, the above new companies will have to comply with the provisions of EPF & MP Act, 1952, and ES Act, 1948 when they cross the threshold limit of employment under the respective Acts.

To get benefit of full 12% EPF employer share under Profibus Mann Regar Provisional Regn, please register at [dhegubihar.mca2018.in](http://dhegubihar.mca2018.in)

**Download User Manual**

- [Registration under EPFO Act, 1952](#)
- [Registration under ESIC Act, 1948](#)
- [Common Registration for EPFO & ESIC](#)

Fig. 2.8

- Step 8 : Click Next to proceed further to enter eContacts

Dashboard > Registration > Registration Portal

Common Registration form for ESIC Back

Establishment Details eContacts Contact Persons Identifiers Employment Details Branch/Division Activities

Note: Required fields are indicated by an (\*)

1. Establishment Name (as per PAN)\*

(Incase of Proprietary firm Name as per PAN is not required)

**A. Work Place Address (Address proof required in attachment)**

Address :

2. Permit No./Name\*

3. Sub-Location/Colony/Street Name\*

4. Locality/Village/Town Name\*

5. State\*

6. District\*

7. Area Code/Pin Code\*

8. Nearest Police Station\*

9. Setup Date\*

10. Establishment Category\*

11. PAN\*

12. Sector (Ownership Type)\*

**B. If Factory, Specify Factory License Details**

13. Factory Licensed Under Section:

14. Factory License Number:

15. Issued By Authority, Place:

16. Date of License Registration:

17. Date of Trial Production, if Factory:

**C. If Start-up, Specify Start-up Registration Number**

18. DIPP Start-up Certificate No.

19. DIPP Start-up Certificate Date:

**D. If Establishment is MSME, Specify MSME Registration Number**

20. MSME Certificate No.:

21. MSME Certificate date:

**E. Ownership Details**

22. Date Of Registration:

23. No Of Owners:

24. Issued At:

25. Registration/ Deed No:

26. Issued By:

27. CIN:

Cancel Save as Draft Next

Fig. 2.9

Required fields are indicated by an asterisk (\*)

**Establishment Details**

Enter establishment details:

Establishment Name (as per PAN): \* -

- Enter the name of the factory or establishment as per PAN details.
- The applicant should have a PAN in the name of the establishment/proprietor of the establishment for which he/she is applying. Only in the case of the Proprietorship firm can the PAN be in the name of the Proprietor.
- The name should be entered exactly as furnished to Income Tax Department. Even a slight variance with an extra space etc. will result in rejection as the data is verified online
- Work Place Address (Address proof required in attachment)
- Establishment Category: \* - Select the establishment category from the dropdown as shown below



A dropdown menu with a blue header labeled 'Select'. The list of options includes: Commercial Establishment, Eating-House, Factory, Other places of amusement & entertainment, Others, Residential Hotel, Restaurant, Shop, and Theatre.

Fig. 2.10

- Sector (Ownership Type): \* - Select establishment category from dropdown as shown below



A dropdown menu with a blue header labeled 'Select'. The list of options includes: Central Govt. Controlled, Central Govt. Department, Central Public Sector Undertaking, Co-operative Society, Firms Run By Trust, HUF, Limited Liability Partnership, Local Bodies / Municipal Corporations, Partnership firms, Private Ltd Company, Proprietary Firms, Public Ltd Company, Registered Society, State Govt. Controlled, State Govt. Department, State Public Sector Undertaking, and a final 'Select' option with a dropdown arrow.

Fig. 2.11

- If Factory, Specify Factory License Details
- If Start-up, Specify Start-up Registration Number
- If Establishment is MSME, Specify MSME Registration Number

The screenshot shows the SHRAM SUVIDHA portal interface. The header includes the logo and name of the Ministry of Labour & Employment, Government of India, along with a language selection dropdown and a user profile icon. The main navigation bar contains links for Home, Know Your LFN, Know Your Minimum Wage, Registration, License Under CLRA/SMW, Download Manual, and Contact Us. The left sidebar lists various services under a 'DASHBOARD' heading, including 'Apply for New LFN', 'LFN Status', 'Registration', 'License Under CLRA/SMW', 'Establishments', 'Annual Return under CMAM Act', 'License (Renewal / Amendment)', 'Security Deposit Refund', and 'Backing Entry for Licences before SDP'. The main content area is titled 'Common Registration form for ESIC' and features a tabbed interface with 'Establishment Details', 'eContacts', 'Contact Persons', 'Identifiers', 'Employment Details', 'Branch/Division', and 'Activities'. The 'eContacts' tab is active, displaying a form for adding contact details. It includes a note: 'Name Required fields are indicated by an (\*)'. Below this, there are input fields for '28. Primary E-Mail\*' and '29. Primary Mobile\*', each with a red asterisk indicating a required field. At the bottom of the form are 'Previous' and 'Save as Draft' buttons. The footer contains links for Website Policies, Act and Rules, Help, FAQ, and Contact Us, along with a disclaimer about the portal's purpose and a link to the Terms of Use.

Fig. 2.12

- You can add as many e-Contact details as you wish
- Enter description/value for selection and click Add button

The screenshot shows a dropdown menu titled 'Select eContact Type'. The menu is open, displaying a list of options: 'E-Mail', 'Landline with Ext', 'Linked-In', 'Mobile', 'Skype Id', and 'Website'. The dropdown has a blue header bar with the title 'Select eContact Type'.

Fig. 2.13

- Added contact detail will be displayed in grid below

- Step 9 : Click Next to proceed further to enter, Contact Persons

**SHRAM SUVIDHA**  
MINISTRY OF LABOUR & EMPLOYMENT

Common Registration form for EPFO

**F. Contact Person**

**Primary Manager**

40. Name: [Text Field]  
41. Gender: [Dropdown]  
42. Date of Birth: [Date Field]  
43. Father's Name: [Text Field]  
44. State: [Dropdown]  
45. District: [Dropdown]  
46. Address: [Text Field]

**Primary Owner**

47. Name: [Text Field]  
48. Gender: [Dropdown]  
49. Date of Birth: [Date Field]  
50. Father's Name: [Text Field]  
51. State: [Dropdown]  
52. District: [Dropdown]  
53. Address: [Text Field]

**Add More Owners**

54. Name: [Text Field]  
55. Gender: [Dropdown]  
56. Date of Birth: [Date Field]  
57. Father's Name: [Text Field]  
58. State: [Dropdown]  
59. District: [Dropdown]  
60. Address: [Text Field]

**Add More Owners**

61. Name: [Text Field]  
62. Gender: [Dropdown]  
63. Date of Birth: [Date Field]  
64. Father's Name: [Text Field]  
65. State: [Dropdown]  
66. District: [Dropdown]  
67. Address: [Text Field]

**Contact Persons**

| No. | Name | Representative Type | Designation | Address | E-Contact | Action |
|-----|------|---------------------|-------------|---------|-----------|--------|
| 1   |      |                     |             |         |           |        |

[Previous](#) [Save as Draft](#) [Next](#)

Fig. 2.14

**Primary Owner**

Please insert Contact Address and atleast one record of Email and Mobile in E-contacts for Primary Owner

Owner: [Text Field] Gender: [Dropdown] Date of Birth: [Date Field] Father's Name: [Text Field] Designation: [Text Field]

**E-Contact**

| E-Contact Type     | E-Contact Value | Action        |
|--------------------|-----------------|---------------|
| Landline with Ext. | 40022773510     | Edit / Delete |

[Add/Edit Address of Primary Owner](#) [Add/Edit Econtact of Primary Owner](#)

[Next](#)

Fig. 2.15



## OTHER CONTACTS

**Other Contact Person**

Select Representation  Other name  Select Gender  DD-MM-YYYY 

Father's name  DD-MM-YYYY  Other Designation  Other PAN

**Add** **Reset**

Please insert only 1 owners from Other Contact Person

Contact Persons

| Sr No                                                                               | Contact Person Name | Representing as               | Address                                                                                                            | eContacts                                                                                                                                                                                                                                    |                |                 |        |                    |             |                               |
|-------------------------------------------------------------------------------------|---------------------|-------------------------------|--------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|-----------------|--------|--------------------|-------------|-------------------------------|
|  1 | Accountant          | Accountant                    | <a href="#">Add/Edit Address</a>  | <a href="#">Add/Edit E-Contacts</a>                                                                                                                                                                                                          |                |                 |        |                    |             |                               |
|                                                                                     |                     |                               |                                                                                                                    | <table border="1"> <thead> <tr> <th>E Contact Type</th> <th>E Contact Value</th> <th>Action</th> </tr> </thead> <tbody> <tr> <td>Landline with Extn</td> <td>40022783510</td> <td><a href="#">Edit / Delete</a></td> </tr> </tbody> </table> | E Contact Type | E Contact Value | Action | Landline with Extn | 40022783510 | <a href="#">Edit / Delete</a> |
| E Contact Type                                                                      | E Contact Value     | Action                        |                                                                                                                    |                                                                                                                                                                                                                                              |                |                 |        |                    |             |                               |
| Landline with Extn                                                                  | 40022783510         | <a href="#">Edit / Delete</a> |                                                                                                                    |                                                                                                                                                                                                                                              |                |                 |        |                    |             |                               |

**Delete** **Next** **Previous** 

Fig. 2.16

- Select Contact person's representation from dropdown list
- Enter name of the contact person
- Select gender
- Select date of birth of contact person
- Enter the contact person's father's name
- Select the Effective Date and enter the designation
- Enter PAN number
- Click Add to save contact person detail.
- Added contact details will be displayed as follows:

- Step 10 : Click Next to proceed further to enter, Identifiers

The screenshot shows the SHRAM SUVIDHA portal interface. The top navigation bar includes links for Home, Know Your LIn, Know Your Minimum Wage, Registration, License Under CLRA/SMW, Download Manual, and Contact Us. The left sidebar contains a DASHBOARD with various links like Apply for New LIn, LIn Status, Registration, etc. The main content area is titled 'Common Registration form for ESIC' and includes tabs for Establishment Details, eContacts, Contact Persons, Identifiers, Employment Details, Branch/Division, and Activities. The 'Identifiers' tab is active, showing a form with fields for Select Identifier, Identifier value, Name as on Identifier, Date of Issue, Issued by (Authority), and Issued at (Place). There are 'Add' and 'Reset' buttons. Below the form is a table for 'Establishment Identifiers' with columns for Sr No, Identifier Type, Value, Name of Identifier, Date of Issue, Issued by (Authority), and Issue. The table is currently empty, showing 'There are no Records.' At the bottom, there are 'Delete', 'Previous', and 'Save' buttons.

Fig. 2.17

- You can add/edit address by selecting Add/Edit Address link.
- You can add/edit E-Contacts by selecting Add/Edit E-Contracts link.
- Click Delete to delete entered record

The screenshot shows the 'Contact Persons' section of the portal. It features a table with columns: Sr No, Contact Person Name, Representing as, Address, and eContacts. The first row shows an Accountant representing as an Accountant, with an 'Add/Edit Address' link and a green checkmark. The 'eContacts' column has an 'Add/Edit E-Contacts' link. Below this, there is a sub-table for eContacts with columns: E Contact Type, E Contact Value, and Action. The first row shows 'Landline with Extn' with value '40022783510' and an 'Edit / Delete' link. At the bottom right, there are 'Delete', 'Next', and 'Previous' buttons.

Fig. 2.18

When any available License type/identifier is not in the drop-down list, user should select Others, in which case the License Type to be entered in REMARKS field compulsorily.

- Select identifier type
- Enter identifier value
- Enter name as on Identifier
- Select date
- Enter issued by and location
- Check the checkbox to mark the same as address proof

- Step 11 : Click Next to proceed further to enter, Employment Details

Home > Registration > Registration form

Common Registration form for EPFO Back

Establishment Details | eContacts | Contact Persons | Identifiers | **Employment Details** | Branch/Division | Activities | Attachments

Note: Required fields are indicated by an (\*)

**Employee Details Covered under EPF Act:**

Do EPF and MP Act applies to Establishment: \*

Number of Employees (including Excluded Employees) As On Date Of Application: \*

Number of Excluded Employees: \*

Date On Which the Employment Strength Exceed 10: \*

Is there any Hazardous activity in your establishment:

Fig. 2.19

Enter employment details as shown above:

The application should be made by the employer if the Act applies to its establishment. For this purpose, you may refer to Section 1 (3) (a) and 1 (3) (b) of the EPF and MP Act 1952. The list of activities to which the Act applies should also be referred.

The employer of an establishment on which the Act does not apply can also apply for a code number on a voluntary basis (Please refer to Section 1(4) of the said Act, if the majority of the employees of the establishment give their written consent for coverage from the date on which it is agreed upon or any subsequent date in the agreement. The consent cannot be from a previous date.

The employer should select the appropriate option for the applicability.

- Enter the Number of workers as of date, male, female, contract workers and other
- Enter No. of Employees drawing wages Rs.21,000/- or less\*
- Select the date since when 10/20 or more coverable employees under ESI Act, were employed for wages \*

Total number of employees employed for wages directly and through immediate employers on the date of application:

Number of Workers as on date:

|        | Regular | Contract Labour | Total |
|--------|---------|-----------------|-------|
| Male   | 0       | 0               | 0     |
| Female | 0       | 0               | 0     |
| Others | 0       | 0               | 0     |
| Total  | 0       | 0               | 0     |

No of Employees drawing wages Rs. 21,000 or less\*:

|        | Regular | Contract Labour | Total |
|--------|---------|-----------------|-------|
| Male   |         |                 |       |
| Female |         |                 |       |
| Others |         |                 |       |
| Total  |         |                 |       |

Give first date since when 10/20 or more coverable employees under ESI Act, were employed for wages:

Total wages paid in the preceding month:

|                                                          | TOTAL WAGES | WAGES PAID TO EMPLOYEES DRAWING WAGES Rs. 21,000/- or LESS |
|----------------------------------------------------------|-------------|------------------------------------------------------------|
| To employees employed directly by the principal employer |             |                                                            |
| To employees employed through immediate contractor       |             |                                                            |

Fig. 2.20

Enter total wages paid in the preceding month to:

- To employees employed directly by the principal employer
- To employees employed through immediate contractor

**Other Details**

Whether the building/premises of factory/Unit is owned or hired:

If hired or there is a change in the name of Unit/ownership:

Leased from:

Leased Till:

Is Establishment Multinational:

ESI Code number if Covered earlier:

Name of Income Tax Ward/Circle/Area:

Maximum No. of persons that can be employed on any one day, as per License:

Whether Any work/Business is being carried out through contract/immediate employer:

Describe work Carried Out:

Whether Establishment is Working With Aid Of Power?:

**Lessor Details**

Name \*:

Gender \*:

Designation \*:

Date Of Birth \*:

Father's Name \*:

Mobile \*:

Email:

Date From Which In Position \*:

Residential Address \*:

Fig. 2.21

Enter other detail:

- Whether the building/premises of the factory/Establishment is owned or hired
- If hired or there is a change in the name of the Unit/ownership
- Specify if Leased from and to
- Is Establishment Multinational (select value)
- ESI Code number if Covered earlier:
- Enter the Name of the Income Tax Ward/Circle/Area
- Enter the Maximum No. of persons that can be employed on any one day, as per License :
- Specify Whether Any work/Business is being carried out through a contractor/Immediate employer
- Describe the Work Carried Out
- Whether Establishment Is Working with Aid of Power?

- Step 12 : Click Next to proceed further to enter Branch/Division Branch / Division

SHRAM SUVIDHA  
MINISTRY OF LABOUR & EMPLOYMENT

Home Know Your LIN Know Your Minimum Wage Registration License Under CRR/MW Download Manual Contact Us

Dashboard Registration Registration Form

### Complete Registration form for ESI

Back

Establishment Details eContacts Contact Persons Identity Employment Details **Branch/Division** Activities

**Note:** Information entered after this step will not be updated in the Head.

109. Name of Unit  
110. Relationship Type  
111. No. of Members in the Branch

112. Name of Responsible Person for Office  
113. LIN

Address :

114. Permittee Name  
115. Sub Location  
116. Locality/Village/Town Name

117. State  
118. District  
119. Area Code/Pin Code

e-Contacts :

120. Email  
121. Mobile

Add Reset

Related Offices

| S/N                   | Name of unit | Relationship type | No. Of members in Branch | Entry LIN number | Name of Responsible for Office | Address | eContacts | Action |
|-----------------------|--------------|-------------------|--------------------------|------------------|--------------------------------|---------|-----------|--------|
| There are no Records. |              |                   |                          |                  |                                |         |           |        |

Previous Save as Draft Next

Ministry of Labour & Employment | App and Portal | Page 12 of 100 | Contact Us

Special Notice: Please inform us in case of change in business details. Labour Law Reform Act, 2019, Ministry of Labour & Employment, Government of India. To know more, please contact helpdesk@shram.gov.in

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india.gov.in

Fig. 2.22



Fig. 2.23

- Step 14 : Add attachment below described field

Fig. 2.24

- Step 15 : Click Digital Signature to Sign the Registration form digitally!
- System displays the following message.
- Click RUN to continue.
- Enter PIN.

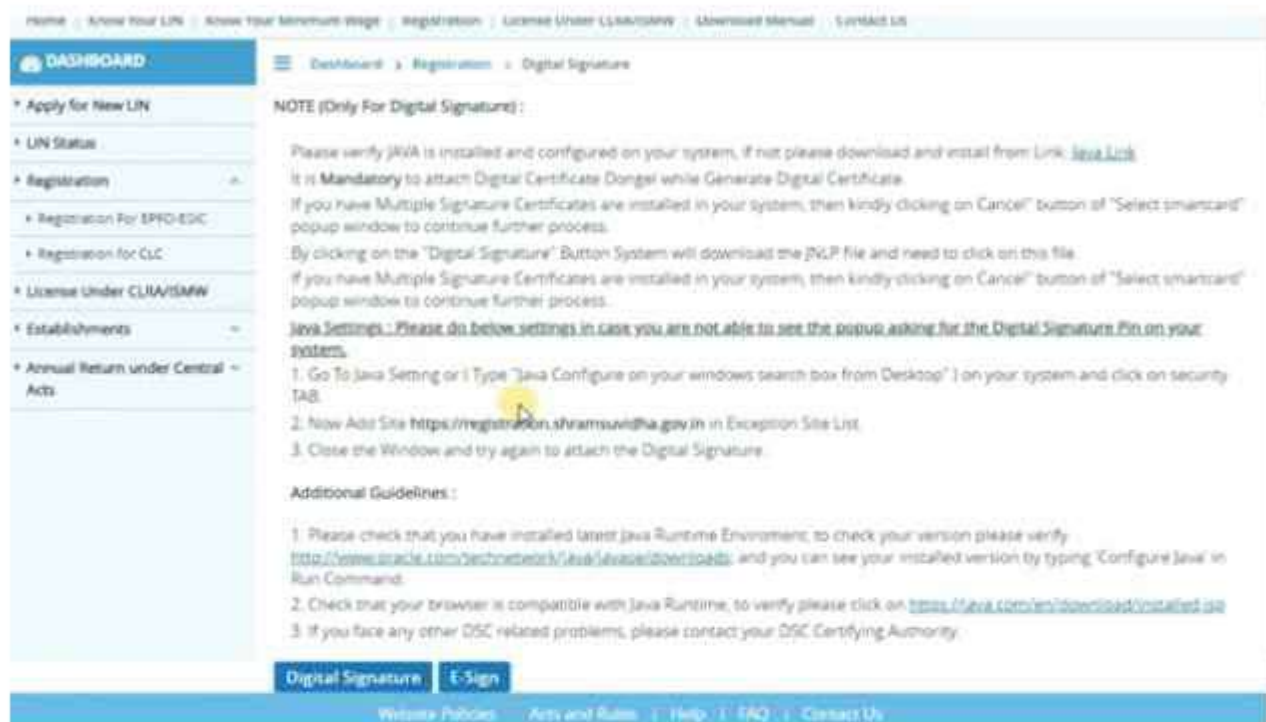


Fig. 2.25

Home / Know Your LHA / Know Your Minimum Wage / Registration / License Under CLAA/SMR / Download Manual / Contact Us

**DASHBOARD**

- Apply for New LHA
- LHA Status
- Registration
  - Registration for EPPF ESE
  - Registration for ESE
- License Under CLAA/SMR
- Establishments
- Annual Return under Central Acts

Document : Registration : SU/Modify & Submit/2020

**Establishment Details Added/Updated Successfully**

**ESIC SYSTEM :- EPPF**  
 Ministry of Labour & Employment :- Ministry of Labour  
 Government of India :- GOI, India  
 Employer Registration Application No :- EPPF

Application Reference Number :- 202002402 Date of Application :- 21-02-2020

**NEW ESTABLISHMENT REGISTRATION**  
 Name :- New Village, Sector-10A, Salt Lake City  
 Address :- Kolkata  
 Pincode :- 700061  
 Nearest Police Station :-

**(A) Basic Information**

|                                              |                          |                                   |  |
|----------------------------------------------|--------------------------|-----------------------------------|--|
| Set-up Date :-                               | 21-02-2020               | Factory License Details :-        |  |
| NAIC :-                                      | 2011010000               | Factory Licensed Under Section :- |  |
| Establishment Category :-                    | Commercial Establishment | Date of Licensed Registration :-  |  |
| Name :-                                      | Proprietary Firm         | Factory License Number :-         |  |
| EPPF Set-up Registration Number and State :- |                          | Issued by Authority/Place :-      |  |
| ESIC Registration Number and State :-        |                          | Date of First Production :-       |  |

**Ownership Details :-**  
 Type of Registration of Establishment :- (1) Self Help  
 (2) LHA

Primary Business Activity (for EPPF) :- EXPERT SERVICES

Nature of Work (for ESE) :- Commercial Establishments

Subcategory of Nature of Work :- Others

Brief Description of Work :-

**(B) Attachments**

1) Attachment as Proof of Address :- Document Type [addressProofAttachment] File Name [a77e7bc0240c6.pdf]  
 2) Date of Setup Proof Attachment :- Document Type [dateOfSetupProofAttachment] Reference No [2PM5519-25001] Date of Issue [21-02-2018] Issued By Place [Kolkata] File Name [2b0c0aef6a55b405.pdf]  
 3) License Proof Attachment :- Document Name [licenseProofAttachment] File Name [25a444ef6a55b405.pdf]  
 4) Employer Signature Attachment :- File Name [25b444ef6a55b405.pdf]

**EPPF Office**

|         |                                                                                                              |
|---------|--------------------------------------------------------------------------------------------------------------|
| Name    | KOLKATA                                                                                                      |
| Address | DK Block Sector-II, Salt Lake City, Near Karunamoyee Bus Stop - 700061 Kolkata South-24 Parganas West Bengal |
| Email   | NO.KOLKATA@EPFIN.DIA.GOV.IN                                                                                  |
| Phone   | 033-23568831                                                                                                 |
| Fax     | 033-23568825                                                                                                 |

I hereby declare that the statement given above is correct to the best of my knowledge and belief, I also undertake to intimate changes, if any, promptly to the Regional Office/Sub-Regional Office, ESI Corporation as soon as such changes take place.

Fig. 2.26

Fig. 2.26

## Summary

The Employees Provident Fund Organization (EPFO) administers the Employees Provident Fund (EPF) under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. This act applies to establishments with 20 or more employees, excluding those specifically exempted. The EPF scheme, detailed in Section 5, mandates employer and employee contributions to the provident fund, which accrue interest and offer a secure retirement or contingency fund. Benefits of the EPF include retirement savings, loan advances, and withdrawals under specific conditions, enhancing financial security for employees. Additionally, the act encompasses the Employees' Pension Scheme and the Employees' Deposit Linked Insurance Scheme, providing pension and insurance benefits respectively. Non-applicability of this act includes establishments with fewer than the specified number of employees and certain other conditions. The EPFO registration process is mandatory for eligible employers, ensuring they and their employees contribute towards the fund, which is crucial for the financial well-being of the workforce.

## Exercise

What is the primary role of the Employees Provident Fund Organization (EPFO)?

- A) Managing unemployment benefits
- B) Administering the Employees Provident Fund (EPF)
- C) Regulating private pension schemes
- D) Offering medical insurance
- Answer: B

Under which act is the Employees Provident Fund (EPF) administered?

- A) Labour Act of 1950
- B) EPF and Miscellaneous Provisions Act, 1952
- C) Social Security Act, 1952
- D) Pension Fund Act, 1955
- Answer: B

What is the minimum number of employees required for the applicability of the EPF Act?

- A) 10 employees
- B) 15 employees
- C) 20 employees
- D) 25 employees
- Answer: C

Which section of the act specifies the Employees' Provident Fund Scheme?

- A) Section 5
- B) Section 6A
- C) Section 6C
- D) Section 7
- Answer: A

What benefits does the EPF offer to employees?

- A) Only retirement savings
- B) Retirement savings, loan advances, and withdrawals
- C) Stock options
- D) Health insurance benefits
- Answer: B

Who contributes to the Employees Provident Fund?

- A) Employees only
- B) Employers only
- C) Both employers and employees
- D) The government
- Answer: C

What is the purpose of the Employees' Pension Scheme detailed in Section 6A?

- A) To provide unemployment benefits
- B) To provide health insurance
- C) To provide pension benefits
- D) To manage worker's compensation
- Answer: C



Which section details the Employees' Deposit Linked Insurance Scheme?

- A) Section 5
- B) Section 6A
- C) Section 6C
- D) Section 7
- Answer: C

What circumstances might lead to non-applicability of the EPF Act?

- A) Companies with only managerial staff
- B) Establishments employing fewer than 20 employees
- C) Government organizations
- D) Foreign-owned companies
- Answer: B

What is required from employers under the EPFO registration process?

- A) Registration with local municipalities
- B) Registration for tax purposes only
- C) Registration with the EPFO to ensure contributions to the fund
- D) Registration with trade unions
- Answer: C

## Notes

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.This image shows a completely blank white rectangular area, which appears to be a scanned piece of paper or a digital canvas. It is surrounded by a thin, uniform orange border. There are no markings, text, or illustrations on the surface.

## 10. Introduction To Income Tax

- Unit 10.1 - Overview of Income Tax
- Unit 10.2 - Components of Income Tax Laws
- Unit 10.3 - Important definitions
- Unit 10.4 - Residential status
- Unit 10.5 - Heads of Income
- Unit 10.6 - Deduction from Gross Total Income
- Unit 10.7 - Income [Section 2(24)]
- Unit 10.8 - India [Section 2(25A)]
- Unit 10.9 - Rates of tax



## Key Learning Outcomes



- Understand Income Tax Basics
- Learn Key Definitions
- Determine Residential Status
- Identify Income Categories
- Understand Deductions
- Comprehend Income and India Definitions
- Learn Tax Rates & Regimes
- Understand Surcharge and Relief
- Knowledge about Education Cess and Rebates

## Unit 10 - Introduction To Income Tax

### Unit Objectives

At the end of the unit, you will be able to understand:

- Overview of Income Tax
- Components of Income Tax Laws
- Rates of Tax



## Unit 10.1 - Overview of Income Tax

Taxation is the primary source of revenue for the government for incurring public expenditure. Thus, taxes are compulsory or enforced public contribution towards the government revenue. Government may levy taxes on income, business profits or wealth or add it to the cost of goods, services, and transactions that are considered to be the cost of living in the society.

There are two types of taxes:

- Direct tax
- Indirect tax

## Unit 10.2 - Components of Income Tax Laws



Fig 2.1

### Income Tax Act, 1961

Levy of Income tax is governed by Income Tax act 1961.

It extends to whole of India.

It came into force on 1st April, 1962.

It contains sections 1 to 298 and schedules I to XIV.

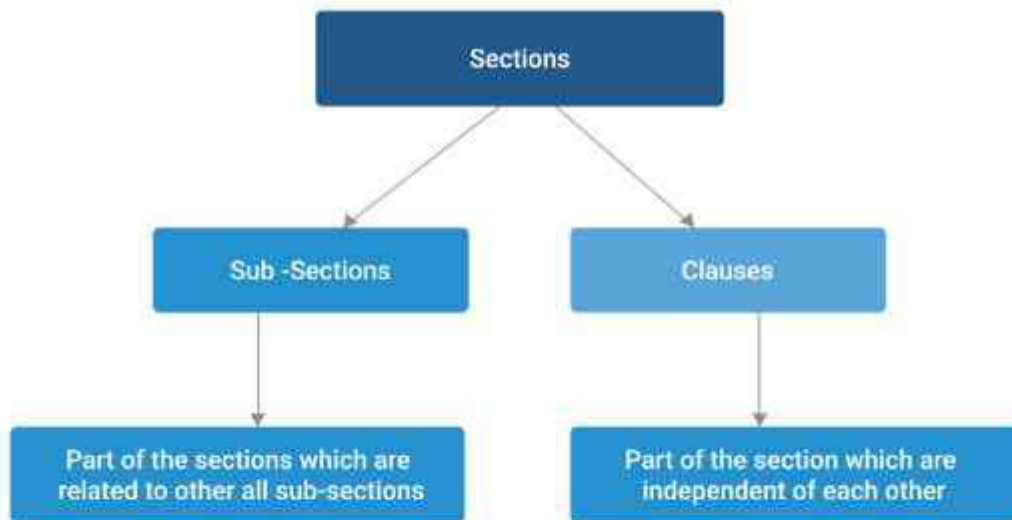


Fig 2.2

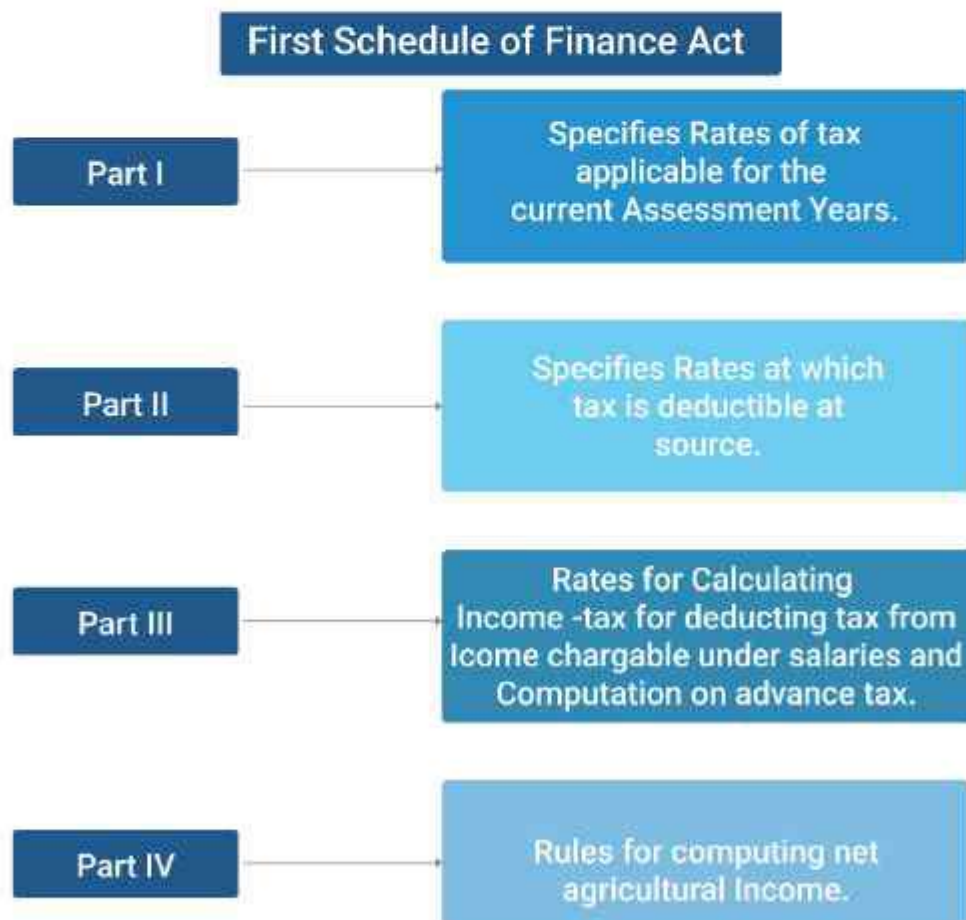


Fig 2.3

**Income Tax Rules, 1962**

The Central Board of Direct Taxes (CBDT) is responsible for overseeing the administration of direct taxes. The CBDT has the authority to enact regulations to carry out the Act's objectives. The CBDT periodically creates regulations to ensure the appropriate administration of the Income-tax Act. These rules collectively form Income tax Rules, 1962.

**Circulars and Notification****Circulars**

Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assesses.

**Notifications**

Notifications are issued by the central government to give effect to the provisions of the Act. The CBDT is also empowered to make and amend rules for the purposes of the Act by issuing notifications which are binding both, the department and assesses.

**Legal decisions of courts**

The Parliament is unable to anticipate and address every issue that might arise during the application of any Act. The court shall therefore hear any disagreements between the assessee and the department and render judgement based on the issues.

**Decision by supreme court:** Until the Parliament changes the law, any judgement made by the Supreme Court is enforceable as per the law. All courts, tribunals, income tax authorities, assesses, etc. shall abide by such a judgement.

**Decision by ITAT or High court:** All assesses and income tax agencies that fall under the jurisdiction of a High Court or ITAT (Income Tax Appellate Tribunal) are bound by their decisions, unless they are overruled by a higher authority

## Unit 10.3 - Important definitions

**Assessee [Section 2(7)]**

"Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes

Every person in respect of whom any proceeding under this Act has been taken for the assessment of his income; or  
the income of any other person in respect of which he is assessable; or  
the loss sustained by him or by such other person; or  
the amount of refund due to him or to such other person.

Every person who is deemed to be an assessee under any provision of this Act.

Every person who is deemed to be an assessee-in-default under any provision of this Act.

**Assessment [Section 2(8)]**

This is the procedure by which the income of an assessee is determined. It may be, by way of a normal assessment or by way of reassessment of an income previously assessed.

**Person [Section 2(31)]**

The term 'person' as defined under the Income tax Act covers in its ambit, natural as well as artificial persons, i.e., apart from a natural person/ individual, any sort of artificial entity will also be liable to pay income tax. For the purpose of charging income tax, the term 'person' has been defined under Section 2(31) of the Income Tax Act, 1961 to include Individual, Hindu Undivided Family [HUF], Company, Firm, Association of Person [AOP], Body of individuals [BOIs], Local authority and any artificial juridical person.

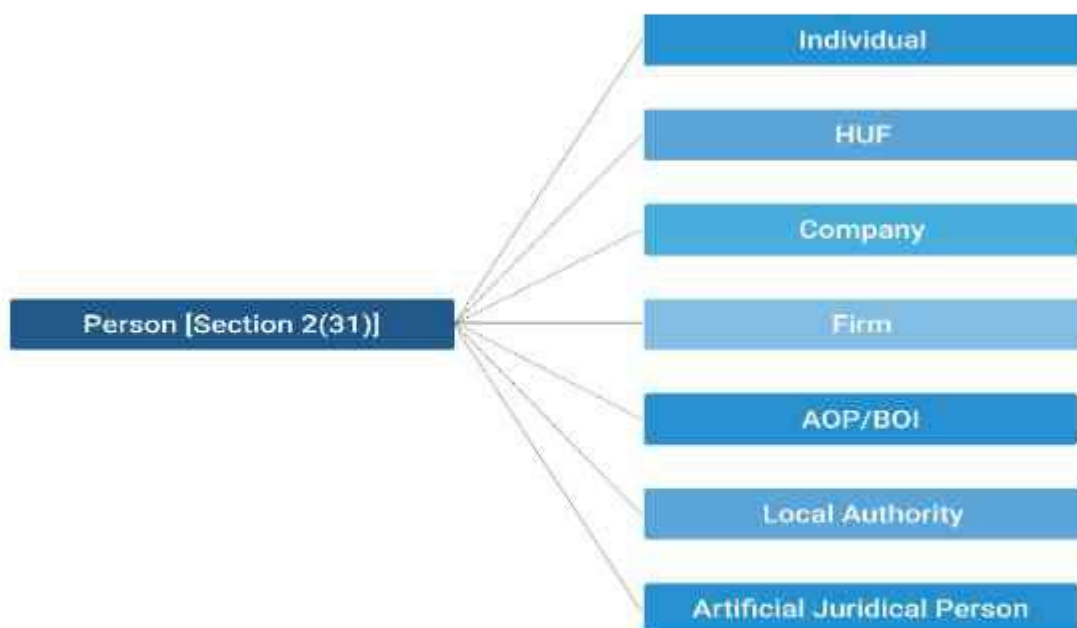


Fig 2.3

- **Individual:** The term 'individual' means only a natural person, i.e., a human being.
  - It also includes a minor or a person of unsound mind. But the assessment in such a case may be made on the guardian or manager of the minor or lunatic who is entitled to receive his income. In the case of deceased person, assessment would be made on the legal representative.

- **HUF:** Under the Income tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income tax is on "every person". Therefore, income tax is payable by a HUF.

"Hindu undivided family" has not been defined under the Income tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters. Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co-parceners.



- **Company [Section 2(17)]:** For all purposes of the Act, the term 'Company', has a much wider connotation than that under the Companies Act. Under the Act, the expression 'Company' means:
  - any Indian company as defined in section 2(26); or
  - Any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
  - Any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income tax Act, 1922 or for any assessment year commencing on or before 1st April, 1970 under the present Act; or
  - Any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.
- **Firm [Section 2(23)]:** The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act, 1932. In addition, the definitions also include the terms limited liability partnership and a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008. However, for income tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner.
- **Association of Persons (AOP):** When persons combine together for promotion of joint enterprise, they are assessable as an AOP, if they do not in law constitute a partnership. In order to constitute an association, persons must join for a common purpose or action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.
- **Body of Individuals (BOI):** It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus, co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI. For e.g., mutual trade associations, members club, etc. Section 2(31) further explains that an association of persons/body of individuals or a local authority or an artificial juridical person shall be treated as a person, whether or not it was formed with the object of deriving income, profits or gains. Accordingly, even if such entities have been formed not for earning any income/ profit still they are "person" for the purpose of the Act and are covered by the provisions of the Act.
- **Local Authority:** The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

**Note:** A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority's own jurisdictional area is exempt from tax.



- **Artificial Juridical: Persons** Artificial Juridical Persons are the entities which are not natural persons but are separate entities in the eyes of law. This as a residual category could cover all artificial persons with a juristic personality not falling under any other category of persons. Deities, bar council, universities are some important examples of artificial juridical persons.

## Unit 10.4 - Residential Status

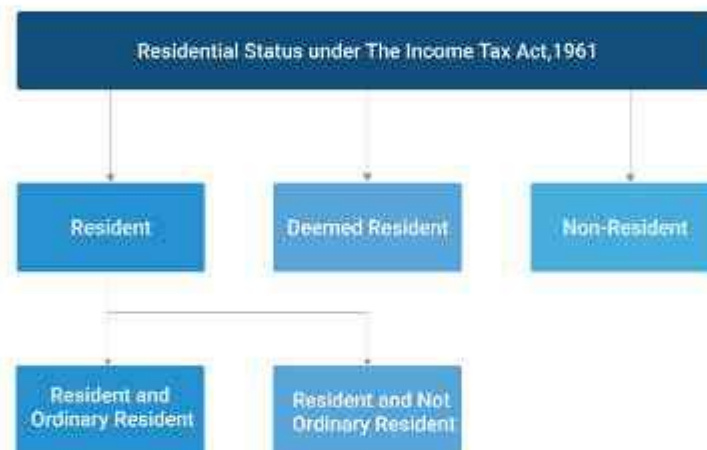


Fig 2.4

The residential status of a person determines the taxability of the income. In the event of income earned and received outside India shall not be taxable in the hands of a non-resident but shall be taxable in case of a resident and ordinarily resident.

### Resident:

Section 6 (1) defines the conditions for determine residential status of an individual. Conditions for checking the residential status is different in each and every person. In case of an individual the residential status is determined by the duration of their stay in India.

### Non-Resident:

An assessee who is not satisfying sec. 6(1) shall be treated as a non-resident in India for the relevant previous year.

### Deemed Resident:

An Indian citizen shall be deemed to be resident in India only if his total income, other than income from foreign sources, exceeds ₹15 lakhs during the previous year. For this provision, income from foreign sources means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India). Deemed resident is considered as resident but not ordinary resident.

## Unit 10.5 - Heads of Income



Fig 2.5

### Salaries:

A salary is a form of fixed compensation given to a person for performing work during a specified period. However, in income tax, the definition of salary also includes various other forms of payments offered by the employer to the employee.

### Income from House property:

The Income tax Act does not differentiate between a commercial and residential property. All types of properties are taxed under the head income from house property in the income tax. An owner for the purpose of income tax is its legal owner, someone who can exercise the rights of the owner in his own right and not on someone else's behalf. An individual who has the legal right to exercise ownership rights in his or her own name and not on behalf of another person is considered the owner for income tax purposes.

### Profits and Gains from Business or Profession

Under this head of income, the profit and gains from any business or profession carried on by the assessee at any time during the financial year should be reported.

### Capital Gain

Any profit or gain that arises from the sale of capital asset comes under the category 'Income' and hence the individual will need to pay tax for that amount in the year in which the transfer of the capital asset takes place. This is called tax on capital gain. There are two types of capital gain, they are Long Term Capital gain (LTCG) and Short-Term Capital Gain (STCG).

### Income From Other Sources

As per Section 56(1), any income, which is not specifically exempted and not chargeable under any other heads of income, shall be chargeable under the head "Income from other sources". This is the last and residuary head of income.

## Unit 10.6 - Deduction from Gross Total Income

**Gross Total Income:** - Aggregate of all incomes and losses under each head of the income after adjusting deductions, allowances and other adjustments after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, is the gross total income.

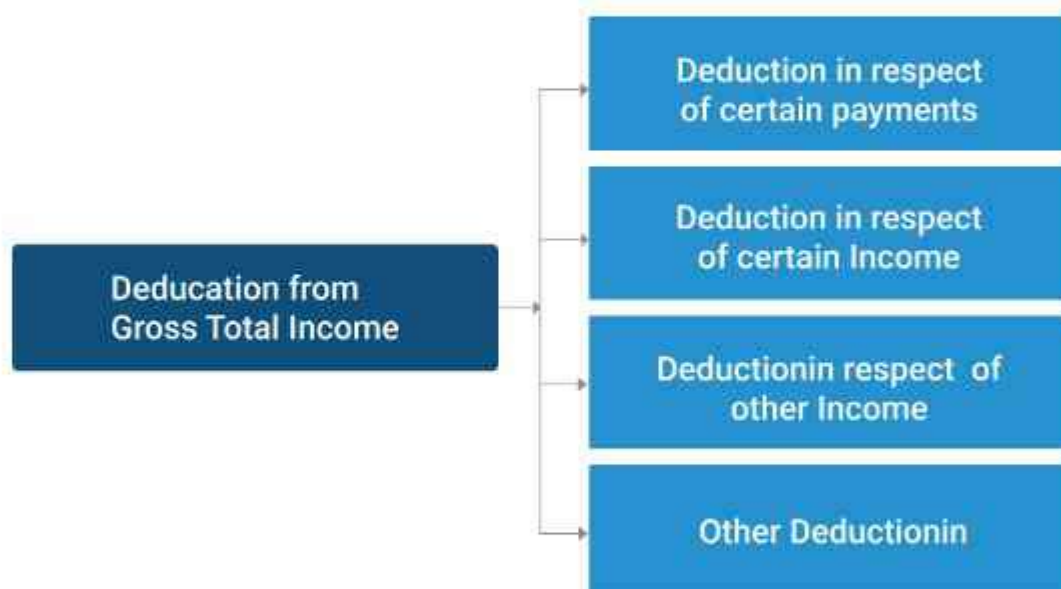


Fig 2.6

### Deduction in respect of certain payments:

Certain deductions are available from the gross total income according to certain payments made by the assessee. Deduction from Sec 80C to 80GGC is available on payments, some of them are follows:

- Life insurance premium paid
- Contribution to provident fund/ pension fund
- Medical insurance premium paid
- Payment of interest on loan taken for higher education
- Payment of interest on loan taken for residential house
- Payment of interest on loan taken for purchase of electric vehicle
- Rent paid
- Donation to certain funds, charitable institutions, etc.
- Contributions to political parties



**Deduction in respect of certain Incomes:**

Deduction in respect of certain income is taxable from the gross total income, they are as follows:

- Employment of new employees [section 80JJAA]
- Royalty income etc. of authors of certain books other than text books [section 80QQB]
- Royalty on patents [Section 80RRB]

**Deduction in respect of Other Income:**

Deduction in respect of other income is taxable from gross total income:

- Interest on deposits in saving account [Section 80TTA]
- Interest on deposits in case of senior citizens [Section 80TTB]

**Other Deductions:**

Deduction in respect of person with disability [Section 80U]

**Computation of Total Income:**

The income arrived at, after claiming the deductions from the gross total income is known as the total income. It should be rounded off to the nearest multiple of ₹ 10 as per section 288A.

**The following is the process of computation of total income:**

- Step 1: Determine the residential status.
- Step 2: Compute income under the head by applying provisions and permissible deductions or exemptions.
- Step 3: Apply clubbing provisions.
- Step 4: Set-off/carry forward and set-off of losses as per the provisions of the Act.
- Step 5: Compute Gross Total Income (GTI).
- Step 6: Less deductions from gross total income.
- Step 7: Total income.

## Unit 10.7 - Income [Section 2(24)]

Section 2(24) of the Act defines the statutory definition of the income. It is an inclusive definition and not an exclusive one.

The following receipts are included in the income:

- Profits and gains.
- Dividends.
- Perquisites.
- Allowances or benefits to meet the expenses wholly or exclusively related to the employment.
- Allowances granted to meet personal expenses for the increased cost of living.
- Deemed profits chargeable under Sec 41 or Sec 59.
- Donations received by the trust, research association, hospital, education institution etc.
- Profits and gains from business or profession chargeable under section 28.

Capital gain under section 45.

Perquisite or benefit received by the director or any other person who have substantial interest in the company.

Any winnings from lottery or crossword puzzles, races including horse race, card games betting and gambling.

Perquisite or benefit received by a representative or beneficiary.

Profit or gains from any insurance business carried by an insurance company or a co-operative society.

Employees contribution to provident fund, Employee State Insurance fund (ESI), and superannuation fund.

Profits and gains from any banking business.

Sum received under keyman insurance policy.

Fair market value of inventory converted in to capital asset.

Compensation received during termination and other modification in the employment.

Any sum received

Under any agreement for not carrying business.

For not sharing any knowhow, patent, copy right, trade mark, licence etc.

Sum received without consideration or inadequate consideration.

Consideration received for issue of shares in excess of fair market value.

Any assistance whatever name called by the central government or state government or any other authority, body or agency in cash or in kind.

Any sum received in advance if sum forfeited consequent failure of negotiation of transfer of capital asset.

### Concept of Income under the Income tax Act, 1961

- **Regular receipt vis-a-vis casual receipt:** Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income tax Act, 1961, even certain casual receipts which do not arise regularly are treated as income for tax purposes e.g., winnings from lotteries, crossword puzzles.
- **Revenue receipt vis-a-vis capital receipt:** Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income in general parlance. However, the Income tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g., capital gains i.e., gains on sale of a capital assets like land.
- **Net receipt vis-a-vis gross receipt:** Income means net receipts and not gross receipts. Net receipts are arrived after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head is prescribed under the Income tax Act, 1961. Income from certain eligible businesses/ professions is also determined on presumptive basis i.e., as a certain percentage of gross receipts. [We shall discuss this in detail in chapter: Profits and gains of business or profession].
- **Due basis vis-a-vis receipt basis:** Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be



either cash system or mercantile system. Some receipts are taxable only on receipt basis, like, income by way of interest received on compensation or enhanced compensation

#### Difference between Capital Receipt and Revenue Receipt

| Basis                                                                  | Capital Receipt                                                                                          | Revenue Receipt                                                     |
|------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| Nature of assets.                                                      | If a receipt is referred to fixed asset, it is a capital receipt.                                        | If it is referred to circulating asset it is revenue receipt.       |
| Termination of source of income.                                       | Any sum received in compensation for the termination of source of income is a capital receipt.           | -                                                                   |
| Compensation received on termination of Lease or surrender of a right. | Amount received as compensation on surrendering a right or termination of any lease is a capital receipt | Any amount received for loss of future income is a revenue receipt. |
| Amount received in substitution of income.                             | -                                                                                                        | Any sum received in substitution of income is revenue receipt.      |

## Unit 10.8 - India [Section 2(25A)]

As per Section 2(25A) the term India means:

The territory of India as per Article 1 of the Constitution,  
 Exclusive economic zone or,  
 Any other specified maritime zone and the air space above its territory and territorial waters.  
 Its territorial waters, seabed and subsoil underlying such waters,  
 Continental shelf.

### Assessment Year and Previous Year

#### Assessment Year [Section 2(9)]

Assessment year is the period of 12 months commencing from 1st April and ending on 31st march of the year after the previous year. It is the year in which income is taxed.

Example: - Assessment year 2022-23 is an year which starts from 1st April, 2022 and ends on 31st march 2023  
 Income of the assesses earned in the previous year 2021-2022 is taxed in the assessment year 2022-2023.

#### Previous Year [Section 3]

Previous year is a period of 12 months commencing from 1st April every year. It is the year in which income is

earned. It is the year immediately preceding the assessment year. Assessment year is the year in which tax is earned.

Determination of Previous year in case of newly set up business or profession or for a new source of income:

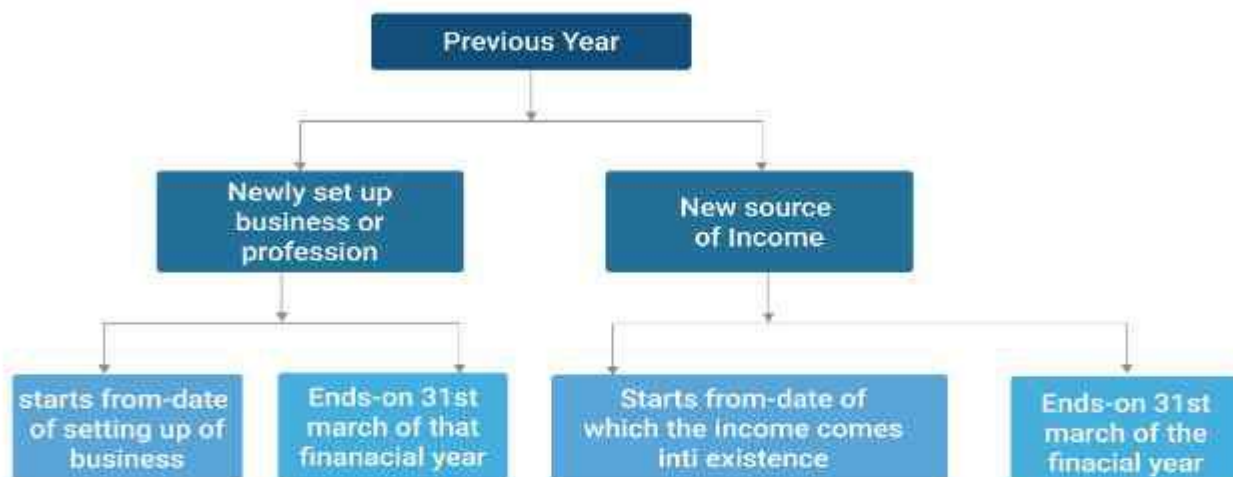


Fig 2.7

**Note:** In the above explanation, the previous year shall be computed, from the date, the new business, profession, or a new source of income was established. The first preceding year in such circumstances could be less than a full year. Second year onwards 'previous years' would be of 12 months, i.e., from April to March. However, it cannot be more than 12 months.

Certain cases when income of a previous year shall be assessed in the previous year itself. In such cases, the income is taxed in the previous year itself where the income is earned. It is applicable for the following incomes:

- Income from non-resident assesses from shipping business [Sec 172]
- Income of a person who is leaving India permanently or for a long period [Sec 174]
- Income of bodies, formed for a short duration [Sec 174A]
- Income of person who likely to transfer property to avoid tax [Sec 175]
- Income of discontinued business [Sec 176]

## Unit 10.9 - Rates of tax

Income tax is to be charged at the rates fixed for the year by the Annual Finance Act.

**Part I** - of the first schedule to the Finance Act, 2021 - specify the rates at which income tax is to be levied on income chargeable to tax for the assessment year 2021-2022.

**Part II** - rate at which tax is to be deducted at source.

**Part III** - rates for deducting income tax from income chargeable under the head "salaries" and the rates for computing advance tax for the financial year 2021-22.

### The Slab rates for Assessment year 2022-2023

Individual/ Hindu Undivided Family (HUF)/ Association of Persons (AOP)/ Body of Individuals (BOI)/ Artificial Juridical Person.

#### Below 60 years of Age

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 2,50,000                         | NIL                                                                             |
| 2. | Where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000  | 5% of the amount by which the total income exceeds ₹ 2,50,000                   |
| 3. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 12,500 plus 20% of the amount by which the total income exceeds ₹ 5,00,000    |
| 4. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,12,500 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |

#### Senior citizens (being resident individuals of the age of 60 years or more but not more than 80 years)

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 3,00,000                         | NIL                                                                             |
| 2. | Where the total income exceeds 3,00,000 but does not exceed ₹ 5,00,000    | 5% of the amount by which the total income exceeds ₹ 3,00,000                   |
| 3. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 10,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000    |
| 4. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,10,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |



**Resident individuals of the age of 80 years or above**

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 5,00,000                         | NIL                                                                             |
| 2. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | 20% of the amount by which the total income exceeds ₹ 5,00,000                  |
| 3. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,00,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |

**Surcharge:**

Surcharge is applicable as per the normal provisions including rates and threshold limits.

**Cess:**

Health and education cess is applicable at the rate of 4% along with the surcharge if applicable.

## Unit 1.10 - New Tax Regime [section 115 BAC]

As per section 115BAC, individuals or HUFs have an option to pay tax at concessional tax slab rates in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB etc.)

By satisfying certain conditions, tax can be paid at the following concessional tax slab rates:



Fig 2.8

## Summary

Income tax is a critical component of a country's fiscal framework, designed to collect revenue from individuals and entities based on their earnings. The structure of income tax laws includes various components such as definitions of key terms, the determination of residential status, and different heads of income under which tax is calculated. The law allows for deductions from gross total income before arriving at the taxable income, on which the tax rates are applied. These rates vary under the traditional and new tax regimes introduced by section 115 BAC, which offers lower rates but with fewer deductions. Specific tax rates are also prescribed for different forms of organizations, such as firms, LLPs, local authorities, cooperative societies, and companies, both domestic and international. Each entity type has distinct tax slabs, and additional financial charges such as surcharge, marginal relief, education cess, and tax rebates under section 87A are considered to ensure fairness and promote education funding. This comprehensive structure aims to balance tax collection with economic growth and social equity.



## Exercise

What is the purpose of defining key terms in income tax laws?

- A) To confuse taxpayers
- B) To provide clear meanings for legal purposes
- C) To increase government revenue
- D) To reduce tax rates
- Answer: B

How does residential status affect income tax?

- A) It determines eligibility for employment
- B) It does not affect tax calculations
- C) It influences the tax liability based on the period of stay in the country
- D) It determines citizenship
- Answer: C

What are the 'Heads of Income'?

- A) Various categories under which income is taxed
- B) The leaders of the tax department
- C) Bank heads where tax payments are made
- D) International tax laws
- Answer: A

What is the purpose of deductions from Gross Total Income?

- A) To reduce the administrative burden on tax authorities
- B) To increase the taxpayer's burden
- C) To determine the net taxable income
- D) To comply with international laws
- Answer: C

What does the new tax regime under section 115 BAC offer?

- A) Higher tax rates with more deductions
- B) Lower tax rates with fewer deductions
- C) Fixed tax rates for all taxpayers
- D) No change in tax rates or deductions
- Answer: B

What are the tax rates for firms/LLPs under the current income tax laws?

- A) Variable based on international income
- B) Consistent regardless of profit
- C) Specific rates prescribed in the tax laws
- D) Negotiable annually
- Answer: C

How are cooperative societies taxed under the income tax laws?

- A) Same as individual taxpayers
- B) At a fixed rate of 30%
- C) According to specific tax slabs
- D) They are exempt from tax
- Answer: C

What is the role of surcharge in the tax structure?

- A) It is an additional charge on the base tax liability for certain taxpayers
- B) It reduces the total tax liability
- C) It is optional for taxpayers
- D) It applies only to foreign companies
- Answer: A

What is 'Marginal Relief'?

- A) Relief provided to taxpayers with marginal incomes
- B) A reduction in surcharge when it causes the tax liability to exceed a certain percentage of income
- C) A form of tax rebate for educational expenses
- D) A fixed relief available to all taxpayers
- Answer: B

What is the purpose of the education cess?

- A) To fund educational programs through additional tax
- B) To reduce the overall tax rates
- C) To provide direct subsidies to students
- D) It is a rebate for educational expenses
- Answer: A

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# 11. Residential Status And Taxability

Unit 11.1 - Overview

Unit 11.2 - Residential status (section 6)

Unit 11.3 - Scope of Total Income

Unit 11.4 - Income Received and Deemed to be Received



## Key Learning Outcomes



- Gain an Overview of Income Tax
- Determine Residential Status
- Understand the Scope of Total Income
- Knowledge of Income Received and Deemed to be Received



## Unit 11 - Residential Status And Taxability

### Unit Objectives

At the end of the unit, you will be able to understand:

Residential status: Knowledge of provisions to determine the residential status of different persons.  
Scope of total income: Examine and ascertain the scope of income of a person on the basis of residential status.

## Unit 11.1 - Overview

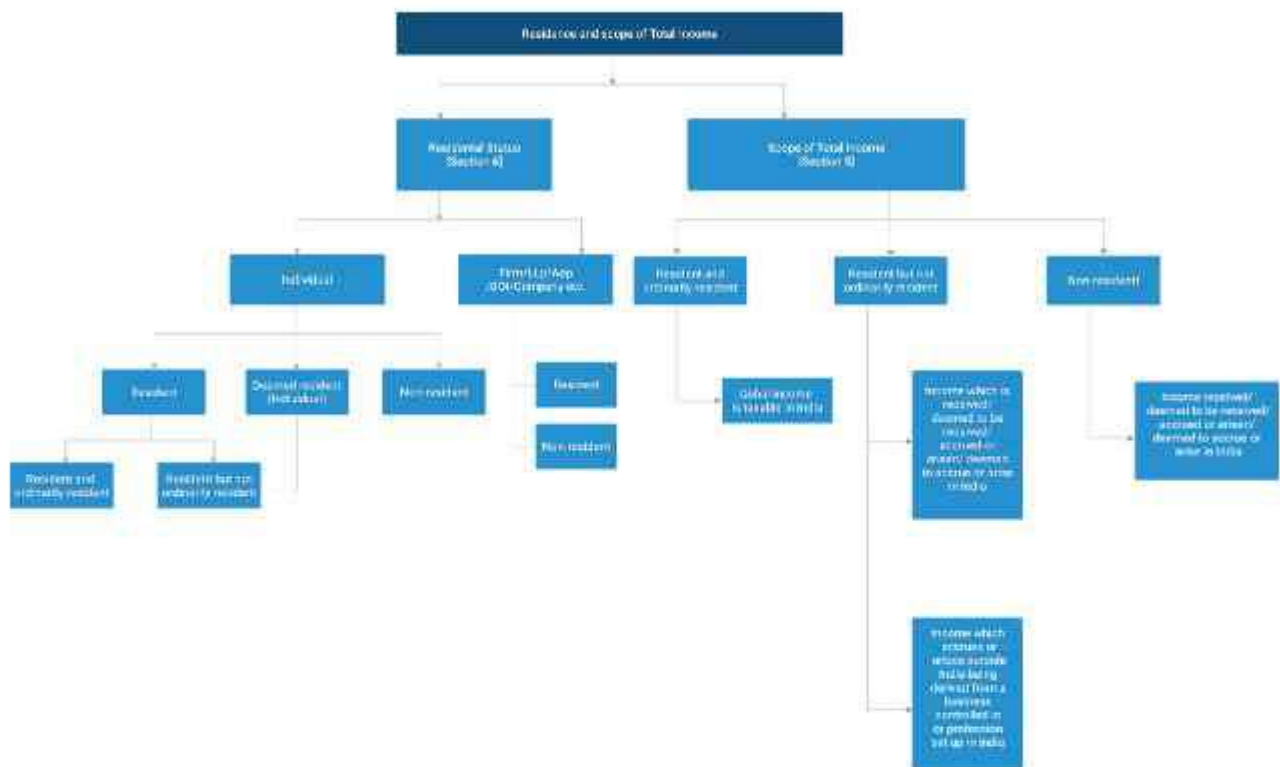


Fig 3.1

## Unit 11.2 - Residential status (section 6)

Under income tax provisions, taxpayers are classified into three broad categories on the basis of their residential status.

- Resident and ordinarily resident.
- Resident but not ordinarily resident.
- Non-resident.

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in a particular year may become non-resident or resident but not ordinarily resident in another year or vice-versa.

Various provisions for determining residential status of assesses are:

#### **Residential status of individuals**

Residential status of individuals is determined on the basis of number of days of stay in India, under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the following conditions:

He has been in India during the previous year for a total period of 182 days or more, or

He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the relevant previous year.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

#### **Exceptions**

The following categories of individuals will be treated as resident in India only if the period of their stay during the relevant previous year amounts to 182 days or more. In other words, even if the individual was in India for 60 days or more (but less than 182 days) in the relevant previous year, they will not be treated as resident due to the reason that their stay in India was for 365 days or more during the 4 immediately preceding years.

Indian citizen, who leaves India during the relevant previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or

Indian citizen or person of Indian origin who, being outside India comes on a visit to India during the relevant previous year.

However, such person having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the previous year will be treated

as resident in India if:

The period of his stay during the relevant previous year amounts to 182 days or more, or

He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 120 days in the previous year.

#### **Deemed resident [Section 6(1A)]**

An individual shall be deemed to be resident but not ordinarily resident in India, if following conditions are satisfied:

He is an Indian citizen or a person of Indian origin.

He comes on a visit to India during the previous year.

His total income, other than the income from foreign sources, exceeds ₹ 15 lakhs during the previous year.

He is in India for a period of 120 days or more (but less than 182 days) during the previous year and for 365 or more days during 4 previous years immediately preceding the relevant previous year.

**Note:** If aforesaid conditions are satisfied, then such individual shall be deemed to be resident but not ordinarily resident even though he has satisfied both conditions specified u/s 6(6).

However, this provision will not apply in case of an individual who is a resident of India in the previous year as per section 6(1).

Meaning of "liable to tax" – Liable to tax, in relation to a person and with reference to a country, means, that there is an income tax liability on such person under the law of that country for the time being in force. It also includes a person who has subsequently been exempted from such liability under the law of that country.

- **Resident and ordinarily resident/Resident but not ordinarily resident**

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

- If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
- If such individual has, during the 7 previous years preceding the relevant previous year, been in India for a period of 729 days or less, or
- If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any previous year) having total income, other than the income from foreign sources i.e., income which accrues or arises outside India (other than income derived from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the previous year, who has been in India for 120 days or more, but less than 182 days during that previous year, or
- If such individual is an Indian citizen who is deemed to be resident in India under section 6(1A) [It may be noted that a deemed resident will always be a resident but not ordinarily resident].

- **Illustration 1**

C Gayle, a West Indies cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years.

- Find out his residential status for the assessment year 2022-23.
- Would your answer change if the above facts relate to Sachin, an Indian citizen who resides in West Indies and represents the West Indies cricket team?
- What would be your answer if Sachin had visited India for 120 days instead of 100 days every year, including P.Y.2021-22?

- **Solution**

- Determination of residential status of C Gayle for the AY 2022-23:**

Period of stay during previous year 2021-22 = 100 days



Calculation of period of stay during 4 preceding previous years ( $100 \times 4 = 400$  days)

|              |                 |
|--------------|-----------------|
| 2020-21      | 100 days        |
| 2019-20      | 100 days        |
| 2018-19      | 100 days        |
| 2017-18      | 100 days        |
| <b>Total</b> | <b>400 days</b> |

C Gayle has been in India for a period more than 60 days during previous year 2021-22 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2022-23.

Computation of period of stay during 7 preceding previous years =  $100 \times 7 = 700$  day

|              |                 |
|--------------|-----------------|
| 2020-21      | 100 days        |
| 2019-20      | 100 days        |
| 2018-19      | 100 days        |
| 2017-18      | 100 days        |
| 2016-17      | 100 days        |
| 2015-16      | 100 days        |
| 2014-15      | 100 days        |
| <b>Total</b> | <b>700 days</b> |

Since his period of stay in India during the past 7 previous years is less than 729 days, he is a not-ordinarily resident during the A.Y. 2022-23.

Therefore, C Gayle is a resident but not ordinarily resident during the previous year 2021-22 relevant to the assessment year 2022-23.

**Note:** An individual, not being an Indian citizen, would be not-ordinarily resident person if he satisfies any one of the conditions specified under section 6(6), i.e.,

If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

In this case, since C Gayle satisfies condition (ii), he is a not-ordinarily resident for the A.Y. 2022-23.



If the above facts relate to Mr. Sachin, an Indian citizen, who residing in West Indies, comes on a visit to India, he would be treated as non-resident in India, irrespective of his total income (excluding income from foreign sources), since his stay in India in the current financial year is, in any case, less than 120 days.

In this case, if Sachin's total income (excluding income from foreign sources) exceeds ₹ 15 lakhs, he would be treated as resident but not ordinarily resident in India for P.Y.2021-22, since his stay in India is 120 days in the P.Y.2021-22 and 480 days (i.e., 120 days x 4 years) in the immediately four preceding previous years. If his total income (excluding income from foreign sources) does not exceed ₹ 15 lakhs, he would be treated as non-resident in India for the P.Y.2021-22, since his stay in India is less than 182 days in the P.Y.2021-22.

### Illustration 2

Mr. B, a Sweden citizen, comes to India for the first time during the P.Y. 2017-18. During the financial years 2017-18, 2018-19, 2019-20, 2020-21 and 2021-22, he was in India for 55 days, 60 days, 90 days, 150 days and 70 days, respectively. Determine his residential status for the A.Y. 2022-23.

### Solution

During the previous year 2021-22, Mr. B was in India for 70 days and during the 4 years preceding the previous year 2021-22, he was in India for 355 days (i.e., 55+ 60+ 90+ 150 days). Thus, he does not satisfy the basic condition under section 6(1). Therefore, he is a non-resident for the previous year 2021-22.

#### • Residential status of HUF

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

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

### Control and management means:

- The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents.
- The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated.
- The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. This is because the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee.
- But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.

#### • Resident and ordinarily resident/Resident but not ordinarily resident

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

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

### Illustration 3

The business of a HUF is transacted from Sri Lanka and all the policy decisions are taken there. Mr. E, the Karta of the HUF, who was born in Kolkata, visits India during the P.Y. 2021-22 after 15 years. He comes to India on 1st April, 2021 and leaves for Sri Lanka on 1st December, 2021. Determine the residential status of Mr. E and the HUF for A.Y. 2022-23.

### Solution

During the P.Y. 2021-22, Mr. E has stayed in India for 245 days (i.e., 30+31+30+31+31+30+31+30+1 days). Therefore, he is a resident. However, since he has come to India after 15 years, he does not satisfy the condition for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y. 2021-22 is resident but not ordinarily resident.

Since the business of the HUF is transacted from Sri Lanka and policy decisions are taken there, it is assumed that the control and management is in Sri Lanka i.e., the control and management is wholly outside India. Therefore, the HUF is a non-resident for the P.Y. 2021-22.

### Residential status of firms, AOPs and BOIs

**Resident:** A firm, AOP and BOI would be resident in India if the control and management of its affairs is situated wholly or partly in India.

**Non-resident:** Where the control and management of the affairs is situated wholly outside India, the firm, AOP and BOI would become a non-resident.

### Residential status of companies

A company would be resident in India in any previous year, if:

- It is an Indian company; or
- Its place of effective management, in that year, is in India.

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

### Residential status of local authorities and artificial juridical persons

**Resident:** Local authorities and artificial juridical persons would be resident in India if the control and management of its affairs is situated wholly or partly in India.

**Non-resident:** Where the control and management of the affairs is situated wholly outside India, they would become non-residents.



## Unit 11.3 - Scope of Total Income

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

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

### Resident and Ordinarily Resident

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

- Income received or deemed to be received in India during the previous year;
- Income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
- Income which accrues or arises outside India even if it is not received or brought into India during the previous year.

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

### Resident but Not Ordinarily Resident

Under section 5(1), total income of resident but not ordinarily resident would consist of:

- Income received or deemed to be received in India during the previous year;
- Income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
- Income derived from a business controlled in or profession set up in India, even though it accrues or arises outside India.

All other income accruing or arising outside India which is not received or deemed to be received or deemed to accrue or arise in India would not be included in his total income.

### Non resident

A non-resident's total income under section 5(2) includes:

- Income received or deemed to be received in India in the previous year; and
- Income which accrues or arises or is deemed to accrue or arise in India during the previous year.

All assesseees, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India whereas a resident alone (resident and ordinarily resident in the case of individuals and HUF) is chargeable to tax in respect of income which accrues or arises outside India.

| Where tax incidence arises in case of                                                                                                        | Resident or Resident & Ordinarily Resident | Resident but not Ordinarily Resident (only Individual or HUF) | Non-Resident |
|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|---------------------------------------------------------------|--------------|
| Income received in India (Whether accrued in or outside India)                                                                               | TAXABLE                                    | TAXABLE                                                       | TAXABLE      |
| Income deemed to be received in India (Whether accrued in or outside India)                                                                  | TAXABLE                                    | TAXABLE                                                       | TAXABLE      |
| Income accruing or arising in India (Whether received in India or outside India)                                                             | TAXABLE                                    | TAXABLE                                                       | TAXABLE      |
| Income deemed to accrue or arise in India (Whether received in India or outside India)                                                       | TAXABLE                                    | TAXABLE                                                       | TAXABLE      |
| Income received and accrued outside India from a business controlled or a profession set up in India                                         | TAXABLE                                    | TAXABLE                                                       | NOT TAXABLE  |
| Income received and accrued outside India from a business controlled from outside India or a profession set up outside India                 | TAXABLE                                    | NOT TAXABLE                                                   | NOT TAXABLE  |
| Income earned and received outside India but later on remitted to India (whether tax incidence arises at the time of remittance)             | NOT TAXABLE                                | NOT TAXABLE                                                   | NOT TAXABLE  |
| Agricultural Income in India                                                                                                                 | EXEMPT U/S 10(1)                           |                                                               |              |
| Long term capital gain (on securities units on which Securities transaction tax is paid)                                                     | EXEMPT upto 1 lakh                         |                                                               |              |
| Past untaxed profits (of earlier years)                                                                                                      | NOT TAXABLE                                |                                                               |              |
| Remittances (Second receipt) to India                                                                                                        | NOT TAXABLE                                |                                                               |              |
| Gifts from relative (on any occasion) or Gift on marriage from any person (section 56(2) explained under the head income from other sources) | NOT TAXABLE                                |                                                               |              |

Residential Status and Scope of Total Income: Whether the following incomes are to be included in Total Income?

| Scope of total Income                                                                      | Resident and Ordinarily Resident                                                         | Resident but not Ordinarily Resident                                                                                | Non- Resident |
|--------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|---------------|
| Income received or deemed to be received in India during the previous year                 | Yes                                                                                      | Yes                                                                                                                 | Yes           |
| Income accruing or arising or deeming to accrue or arise in India during the previous year | Yes                                                                                      | Yes                                                                                                                 | Yes           |
| Income accruing or arising outside India during the previous year                          | Yes, even if such income is not received or brought into India during the previous year. | Yes, but only if such income is derived from a business controlled in or profession set up in India; Otherwise, No. | No            |

#### Illustration 4

From the following particulars of income furnished by Mr. Anish pertaining to the year ended on 31st March, 2022, compute the total income for the assessment year 2022-23, if he is:

Resident and ordinary resident;  
Resident but not ordinarily resident;  
Non-resident

|     | Particulars                                                                                                      | ₹      |
|-----|------------------------------------------------------------------------------------------------------------------|--------|
| (a) | Short term capital gains on sale of shares of an Indian Company, received in China                               | 15,000 |
| (b) | Dividend from an American company, received in America                                                           | 10,000 |
| (c) | Rent from property in UK deposited in a bank in UK, later on remitted to India through approved banking channels | 75,000 |
| (d) | Dividend from ABC Ltd., an Indian company                                                                        | 6,000  |
| (e) | Agricultural income from land in Goa                                                                             | 25,000 |



**Solution**

Computation of total income of Mr Amish for the AY 2022-23

| Particulars                                                                        | Resident & ordinarily resident | Resident But not ordinarily resident | Non-Resident  |
|------------------------------------------------------------------------------------|--------------------------------|--------------------------------------|---------------|
| Short term capital gains on sale of shares of an Indian company, received in China | 15,000                         | 15,000                               | 15,000        |
| Dividend from an American company, received in America                             | 10,000                         | -                                    | -             |
| Rent from property in London deposited in a bank in UK [See Note below]            | 52,500                         | -                                    | -             |
| Dividend from ABC Ltd., an Indian company                                          | 6,000                          | 6,000                                | 6,000         |
| Agricultural income from land in Goa [See Note below]                              |                                |                                      |               |
| <b>Total Income</b>                                                                | <b>83,500</b>                  | <b>21,000</b>                        | <b>21,000</b> |

Notes: It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction of 30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

|                                                    | Amount ₹ |
|----------------------------------------------------|----------|
| Rent received (assumed as gross annual value)      | 75,000   |
| Less: Deduction under section 24 (30% of ₹ 75,000) | 22,500   |
| Income from house property                         | 52,500   |

Note: Agricultural income is exempt under section 10(1).

## Unit 11.4 - Income Received and Deemed to be Received

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

- their residential status, and
- the place of its accrual

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

### Income accruing and arising

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g., salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January. Similarly, on government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation.

With a view to removing difficulties and clarifying doubts in the taxation of income, explanation 1 to section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, explanation 2 to section 5 makes it clear that once an item of income is included in the assessee's total income and subjected to tax on the ground of its accrual/deemed accrual, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

### Income deemed to accrue or arise in India

Certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India are:

Any income accruing or arising to an assessee in any place outside India whether directly or indirectly:

- Through or from any business connection in India,
  - Through or from any property in India,
  - Through or from any asset or source of income in India or
  - Through the transfer of a capital asset situated in India would be deemed to accrue or arise in India.
- [Section 9(1)(i)]

### Business connection

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident [Explanation 2 to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident:

- Must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or habitually concludes contracts or
- Habitually plays the principal role leading to conclusion of contracts by that non-resident and such contracts should be in the name of the non-resident; or
- For the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- For the provision of services by that non-resident, or
- In a case, where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or
- habitually secures orders in India, mainly or wholly for the non-resident.

Further, there may be situations when the person acting on behalf of the non-resident secures order for other non-residents. In such situation, business connection for other non-residents is established if:

- Such other non-resident controls the non-resident or
- Such other non-resident is controlled by the non-resident or
- Such other non-resident is subject to same control as that of non-resident.

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

#### **Agents having independent status are not included in Business Connection**

Business connection, however, shall not be established, where the non-resident carries on business activity through a broker, general commission agent or any other agent having an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident.

He will, however, not be considered to have an independent status in the three situations explained above, where he works mainly or wholly on behalf of such a non-resident. Where a business is carried on in India through a person referred to in (1), (2) or (3) of (a) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

#### **Income from property, asset or source of income in India**

Any income which arises from any property (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

#### **Income through transfer of a capital asset situated in India**

Capital gains arising through the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether:



- the capital asset is movable or immovable, tangible or intangible;
- the place of registration of the document of transfer etc., is in India or outside; and
- the place of payment of the consideration for the transfer is within India or outside.

Further, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

- **Income from salaries earned in India**

Income, which falls under the head "Salaries", is deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

- **Income from salaries payable by the government for services rendered outside India**

Income from salaries which is payable by the government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

#### Illustration 5

Mr. Thilak, an Indian citizen aged 40 years, a government employee serving in the Ministry of External Affairs, left India for the first time on 31st March, 2021 due to his transfer to High Commission of Germany. He did not visit India any time during the previous year 2021-22. He has received the following income for the Financial Year 2021-22:

| S. No. | Particulars                                   | ₹        |
|--------|-----------------------------------------------|----------|
| (i)    | Salary (Computed)                             | 5,00,000 |
| (ii)   | Foreign Allowance [not included in (i) above] | 4,00,000 |
| (iii)  | Interest on fixed deposit from bank in India  | 1,00,000 |
| (iv)   | Income from agriculture in Nepal              | 2,00,000 |
| (v)    | Income from house property in Nepal           | 2,50,000 |

Compute his gross total income for Assessment Year 2022-23.

#### Solution

As per section 6(1), Mr. Thilak is a non-resident for the A.Y. 2022-23, since he was not present in India at any time during the previous year 2021-22.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

- Income received or deemed to be received in India; and
- Income accruing or arising or deemed to accrue or arise in India,

In view of the above provisions, income from agriculture in Nepal and income from house property in Nepal would not be chargeable to tax in the hands of Mr. Thilak, assuming that the same were received in Nepal. Income from salaries payable by the government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. Thilak, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7) in the hands of Mr. Thilak.

#### Gross total income of Mr. Thilak

| Particulars                                                    | ₹        |
|----------------------------------------------------------------|----------|
| Salaries (computed)                                            | 5,00,000 |
| Income from other sources (Interest on fixed deposit in India) | 1,00,000 |
| Gross Total Income                                             | 6,00,000 |

#### Dividend paid by an Indian company outside India

Dividends paid by an Indian company outside India is deemed to be accrue or arise in India and would be taxable in the hands of shareholders.

#### Interest

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by:

The Government;

A person who is resident in India;

Exception: Where it is payable in respect of any debt incurred or money borrowed and used for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India, it will not be deemed to accrue or arise in India.

A person who is a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used for the purpose of a business or profession carried on in India by him.

#### Exception

Interest on moneys borrowed by the non-resident for any purpose in India other than a business or profession, will not be deemed to accrue or arise in India.

#### Royalty

Royalty will be deemed to accrue or arise in India when it is payable by:

The government;

A person who is a resident in India

Exception: where it is payable in respect for the transfer of any right or the use of any property or information used or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

A person who is a non-resident, only when the royalty is payable in respect of any right, property or information used or services utilized for purposes of a business or profession carried on in India or for the purposes of making or earning any income from any source in India.



- **Other points**

- Lumpsum royalty not deemed to accrue or arise in India: Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a license) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the Policy on Computer Software Export, Software Development and Training, 1986 shall not be deemed to accrue or arise in India.
- Meaning of royalty: The term 'royalty' means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for:
  1. The transfer of all or any rights (including the granting of license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
  2. The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
  3. The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
  4. The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
  5. The use or right to use any industrial, commercial or scientific equipment;
  6. The transfer of all or any rights (including the granting of license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting.

**Note: Consideration for sale, distribution or exhibition of cinematographic films is covered within the scope of royalty. The rendering of any service in connection with the activities listed above.**

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The definition specially excludes income which should be chargeable to tax under the head capital gains.

- Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi).
- The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred.
- Consideration in respect of any right, property or information – Is it royalty? Royalty includes and has always included consideration in respect of any right, property or information, whether or not,
  - the possession or control of such right, property or information is with the payer;
  - such right, property or information is used directly by the payer;
  - the location of such right, property or information is in India.
- Meaning of Process: The term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for downlinking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret.

- **Fees for technical services**

Any fees for technical services will be deemed to accrue or arise in India if they are payable by:

- The government,
- A person who is resident in India
- Exception: Where the fees are payable in respect of technical services utilized in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India,
- A person who is a non-resident, only where the fees are payable in respect of services utilized in a business or profession carried on by the non-resident in India or where such services are utilized for the purpose of making or earning any income from any source in India.
- Fees for technical services means any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head salaries.

#### **Illustration 6**

Miss Mariya paid a sum of US\$ 5000 to Mr. Kiran, a management consultant practising in Singapore, specializing in project financing. The payment was made in Singapore. Mr. Kiran is a non-resident. The consultancy is related to a project in India with possible Singapore collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kiran, since the services were used in India?

#### **Solution**

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India. The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In this case, since the services were utilized in India, the payment received by Mr. Kiran, a non-resident, in Singapore is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India. Any sum of money paid by a resident Indian to a non-corporate non-resident or foreign company.

Income arising outside India, being any sum of money paid without consideration, by an Indian resident person to a non-corporate, non-resident or foreign company would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2) (x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ₹ 50,000.

It may be noted that this deeming provision applies to only sum of money paid outside India to a non-corporate, non-resident or foreign company, and not in respect of property, movable or immovable, transferred outside India without consideration or for inadequate consideration to a non-corporate, non-resident or foreign company

## Summary

Residential status, as defined under section 6 of the income tax laws, plays a pivotal role in determining the scope of total income that is subject to taxation. The residential status of an individual or an entity dictates whether their global income will be taxed or only the income that is earned or received within the country. The law distinguishes between residents and non-residents, with residents generally being taxed on their worldwide income while non-residents are taxed only on income sourced within the jurisdiction. Additionally, the law specifies certain incomes that are deemed to be received in the country, regardless of where the actual transaction takes place. This includes incomes such as benefits or salaries paid by a resident entity for services rendered anywhere in the world. Understanding these distinctions is crucial for proper tax compliance and planning, as it influences the total scope of income that is assessable under the law.



**Exercise**

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins or other markings on the paper.





## 12. Salaries

- Unit 12.1 - Introduction
- Unit 12.2 - Basic Elements of Salary
- Unit 12.3 - Definition of Salary [Sec. 17(1)]
- Unit 12.4 - Basis of Charge [Sec. 15]
- Unit 12.5 - Allowances
- Unit 12.6 - Pension
- Unit 12.7 - Gratuity
- Unit 12.8 - Fees, commission, perquisites, or profits in lieu of or in addition to any salary or wages
- Unit 12.9 - Leave Salary or Leave Encashment
- Unit 12.10 - Provident Fund
- Unit 12.11 - Profits in lieu of salary [Section 17(3)]
- Unit 12.12 - Retrenchment compensation [Section 10(10B)]
- Unit 12.13 - Voluntary Retirement Receipts [Section 10(10c)]
- Unit 12.14 - Perquisites (Sec 17(2))
- Unit 12.15 - Specified Employees [Sec. 17(2)(iii)]
- Unit 12.16 - Leave Travel Concession [Sec. 10(5)]
- Unit 12.17 - Deductions from Salary
- Unit 12.18 - Relief Under Section 89 (1)



## Key Learning Outcomes



- Understand Salary Components
- Knowledge of Taxation Principles
- Awareness of Specific Provisions
- Able to Apply Rules and Calculations
- Skills in Financial Planning and Compliance
- Legal and Regulatory Awareness

## Unit 12 - Salaries

### Unit Objectives

At the end of the unit, you will be able to understand:

- Introduction to salary, elements and basis of charge
- Scope of salary
- Allowances – Taxable and Exempted
- Pension
- Gratuity
- Provident Fund
- Profit in lieu of salary
- Perquisites
- Deduction from salary
- Relief under sec 89(1)

## Unit 12.1 - Introduction

The provisions related to Income under the head "Salaries" are contained in under section 15, 16 and 17 of the Income Tax 1961.



Fig 6.1

Salary is a fixed form of remuneration given to an individual for performing work for a specific period of time. However, in income tax, the definition of salary includes many other forms of payment that employers offer to employees. Let's understand the meaning of salary under section 15, 16 and 17, as per Income Tax Act, 1961.

## Unit 12.2 - Basic Elements of Salary

Payer and payee must have employer and employee (or Master & Servant) relationship; and Payment must have been made by the employer in such (employer's) capacity

### Employer-employee relationship

A payment can be construed as salary only if the payer is the employer and payee is the employee of the payer.

- **Criteria for employer-employee relationship:** The key criteria to hold this relationship is that, the employee is always bound to work as per direction and supervision of the employer.
- **Payment in employer's capacity:** To treat any payment as salary it is necessary that payer, being the employer, must have made the payment in such (employer's) capacity.
- **Full-time or part-time employment:** Once the relationship of employer and employee exists, the income is to be charged under the head "salaries". It does not matter whether the employee is a full-time or a part time employee. If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years.
- **Contract of service Vs contract for service:** In "contract of service", the employer can direct and control the duties and the manner of performance of employee hence employer-employee relationship exists in such contract. However, in case of "contract for service" the employer can simply decide and quote the object or target to be achieved but cannot decide or direct the manner of performance.
- **Forgoing of salary:** Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income tax. Such waiver is only an application and hence, chargeable to tax.
- **Surrender of salary:** When an employee surrenders his salary to the central government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.
- **Salary paid tax-free:** This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer. However, as per section 10(10CC), the income tax paid by the employer on non-monetary perquisites on behalf of the employee would be exempt in the hands of the employee.
- **Place of accrual of salary:** Under section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or paid or payable after the contract of employment in India comes to an end. If an employee is paid pension abroad in respect of services rendered in India, the same will be deemed to accrue in India. Similarly, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.
- **Agent and Principal:** If a person is acting as an agent for his principal, any commission or remuneration earned by the agent is not taxable under the head "Salaries". This is because, an agent is not the employee of his principal.



- **Salary received by a partner:** When the salary received is through a partner from its own firm, then it shall not be taxable as salary, because there is no employer-employee relationship between the firm and the partner. Such salary shall be taxable under the head "profits & gains of business or profession".
- **Salary received by proprietor from his proprietorship firm:** Such salary is not an income. As proprietor and proprietorship firm are the same person and hence the amount cannot be termed as salary. Remuneration to director: Remuneration paid to the director by his company can be treated as salary only if the director is employee of the company, otherwise the same shall be taxable under the head "Income from other sources".
- **Remuneration to director:** Remuneration paid to the director by his company can be treated as salary only if the director is employee of the company, otherwise the same shall be taxable under the head "Income from other sources".

**Note:** Directors' sitting fee is taxable under the head "Income from other sources".

- **Pension received by the widow:** Pension received by the widow or legal heir of deceased employee is not taxable as salary as no employer-employee relationship exists between the payer and the payee. However, such amount shall be taxable under the head "Income from other sources".
- **Remuneration received by Judges:** Remuneration received by Judges are taxable under the head "Salaries" even though they do not have an employer.

Concluding the above, a payment received for services rendered, from a person other than employer, is not taxable under the head "Salaries" but may be taxed under the head "Profits & gains of business or profession" or "Income from other sources".

## Unit - 12.3 Definition of Salary [Sec. 17(1)]

As per sec. 17(1) of the Income tax Act, 1961, salary includes the following:

Wages.

Any annuity or pension.

Any gratuity.

Any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages.

Any advance of salary.

Any payment received in respect of any period of leave not availed of by the assessee.

The portion of the annual accretion in any previous year to the balance at the credit of an employee, participating in recognized provident fund, to the extent it is taxable.

Transferred balance in a recognized provident fund, to the extent it is taxable.

Contribution made by the employer in the previous year, to the account of an employee under a pension scheme referred to in sec. 80CCD [National Pension Scheme and Atal Pension Yojana].

## Unit 12.4 - Basis of Charge [Sec. 15]

Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier. Hence, taxable salary includes:

- **Advance salary (on 'receipt' basis):** Salary paid in advance is taxable under the head 'Salaries' in the year of receipt.

**Note:** Such advance salary shall not be included again in the total income when the salary becomes due.

### Difference between advance salary and advance against salary:

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified instalments, the loan amount cannot be brought to tax as salary of the employee. Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time. It cannot be taxed as salary.

- **Outstanding salary (on 'due' basis):** Salary falling due is taxable under the head 'Salaries' in the year in which it falls due.

**Note:** Such due salary shall not be included again in the total income when it is received.

- **Arrear salary:** Any increment in salary with retrospective effect which have not been taxed in the past, such arrears will be taxed in the year in which it is allowed. Arrear salary are taxable on receipt basis.

### Place of accrual of salary

Salary which is received in India or earned in India shall be taxable in hands of all assessee whether resident or non-resident in India. Salary is deemed to be earned in India provided:

The service is rendered in India

The rest period or leave period, which is preceded and succeeded by the service rendered in India and forms part of the service contract of employment.

### Principles of salary

Employee employer relationship  
 Salary from a former employer  
 Place of accrual of salary income  
 Foregoing salary  
 Tax free salary  
 Surrender of salary  
 Accrual basis  
 Payment made after termination

**Scope of salary**

Basic salary or wages  
 Advance pay  
 Arrears of salary  
 Dearness pay  
 Annuity  
 Pension

**Computation of Salary (Proforma)**

Computation of income under the head "Salaries" of ..... for the A.Y. ....

| Particulars                                             | Details | Amount |
|---------------------------------------------------------|---------|--------|
| Basic Salary                                            |         | ****   |
| Fees                                                    |         | ****   |
| Commission                                              |         | ****   |
| Bonus                                                   |         | ****   |
| Gratuity                                                |         | ****   |
| Leave Encashment                                        |         | ****   |
| Pension                                                 |         | ****   |
| Retrenchment Compensation                               |         | ****   |
| Compensation received under voluntary retirement scheme |         | ****   |
| <b>Allowances:</b>                                      |         |        |
| Dearness Allowance (DA)/Dearness Pay (DP)               | ****    |        |
| House Rent Allowance                                    | ****    |        |
| Children Education Allowance                            | ****    |        |
| Children Hostel Allowance                               | ****    |        |
| Entertainment Allowance                                 | ****    |        |
| Medical Allowance                                       | ****    |        |
| Conveyance Allowance                                    | ****    |        |
| City Compensatory Allowance                             | ****    |        |
| Uniform Allowance                                       | ****    |        |
| Professional Development Allowance                      | ****    |        |
| Transport Allowances                                    | ****    |        |
| Other Allowances                                        | ****    | *****  |
| <b>Perquisites u/s 17(2)</b>                            |         |        |
| Any Obligation of Employee Paid by the Employer         | ****    |        |
| Accommodation                                           | ****    |        |
| Shares and Securities issues under ESOP                 | ****    |        |
| Employer's contribution to Superannuation fund          | ****    |        |
| Gas, Electricity & Water                                | ****    |        |



|                                            |      |       |
|--------------------------------------------|------|-------|
| Medical Facility                           | **** |       |
| Other Fringe Benefits                      | **** | ****  |
| Leave Travel Concession                    |      | ****  |
| Contribution of Employer to Provident Fund |      | ****  |
| Interest on Recognised Provident Fund      |      | ****  |
| Any Other Item                             |      | ****  |
| Gross Salary                               |      | ***** |
| Less: Deduction u/s 16                     |      |       |
| (i) Standard Deduction                     | **** |       |
| (ii) Entertainment Allowance               | **** |       |
| (iii) Tax on Employment/ Professional Tax  | **** | ****  |
| Taxable Salary                             |      | ***** |

- **Basic Salary:** It is the sum paid by employer to employee as salary and shall be fully taxable.
- **Pay-Scale (Grade system):** It is a system of payment where increment scale is pre-known to employee. E.g., Basic salary is given as 5,000 – 1,000 – 8,000 – 2,000 – 12,000. The above data indicates the increment schedule. As per this schedule initial payment is ₹. 5,000 p.m. which will increased by ₹ 1,000 every year until salary reaches to ₹ 8,000 p.m. Once salary reaches to ₹. 8,000 then increment will be ₹ 2,000 every year till salary reaches the scale of ₹ 12,000. Accordingly, basic salary is calculated.
- **Dearness Allowance (DA) or Dearness Pay (DP):** It is an extra amount given to an employee to meet the burden of inflation or increased cost of living. This is fully taxable.
- **Fees:** An employee may be given apart from basic salary, extra remuneration for doing specific job under the terms of employment. Such extra remuneration is termed as fee and shall be fully taxable.
- **Commission:** It may be as a percentage of turnover or as a percentage of profit. In either case, it is taxable.
- **Bonus:** Bonus may be contractual or voluntary. In either case, it is fully taxable.

## Unit 12.5 - Allowances

Allowance means fixed quantum of money given regularly in addition to salary to meet particular requirement. The name of particular allowance may reveal the nature of its requirement, e.g., house rent allowance, tiffin allowance, medical allowance etc.

Allowances at a glance:

| FULLY TAXABLE                                                                                        | PARTLY TAXABLE                     | FULLY EXEMPT                                                      |
|------------------------------------------------------------------------------------------------------|------------------------------------|-------------------------------------------------------------------|
| Entertainment Allowance                                                                              | House Rent Allowance [u/s 10(13A)] | Allowances to High Court Judges                                   |
| Dearness Allowance                                                                                   | Special Allowances [u/s 10(14)]    | Allowance paid by the United Nations Organization                 |
| Overtime Allowance                                                                                   |                                    | Compensatory Allowance received by a judge                        |
| Fixed Medical Allowance                                                                              |                                    | Sumptuary allowance granted to High Court or Supreme Court Judges |
| City Compensatory Allowance (to meet increased cost of living in cities)                             |                                    | Allowance granted to Government employees outside India           |
| Interim Allowance                                                                                    |                                    |                                                                   |
| Servant Allowance                                                                                    |                                    |                                                                   |
| Project Allowance                                                                                    |                                    |                                                                   |
| Tiffin/Lunch/Dinner Allowance                                                                        |                                    |                                                                   |
| Any other cash allowance                                                                             |                                    |                                                                   |
| Warden Allowance                                                                                     |                                    |                                                                   |
| Non-practicing Allowance                                                                             |                                    |                                                                   |
| Transport allowance to employee other than blind/ deaf and dumb/ orthopedically handicapped employee |                                    |                                                                   |

#### Allowances which are Fully Taxable

- **City compensatory allowance:** City compensatory allowance is normally intended to compensate the employees for the higher cost of living in cities. It is taxable irrespective of the fact whether it is given as compensation for performing his duties in a particular place or under special circumstances.
- **Entertainment allowance:** This allowance is given to employees to meet the expenses towards hospitality in receiving customers etc. The Act gives a deduction towards entertainment allowance only to a government employee. The details of deduction permissible are discussed later in this unit.
- **Transport allowance:** Transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty is fully taxable. However, in case of blind/ deaf and dumb/ orthopedically handicapped employees' exemption up to ₹ 3,200 p.m. is provided under section 10(14)(ii) read with Rule 2BB.



**Allowances which are Partly Taxable****House rent allowance (HRA) [Sec. 10(13A) and rule 2A]**

HRA stands for housing rent allowance in the context of income tax. It refers to the salary component of the rent payment that is authorized as a deduction from taxable salary under Section 10. (13A).

**Tax Treatment: Minimum of the following is exempted from tax:**

- Actual HRA received.
- An amount equal to 50% of salary (when house is situated in a metro city) or 40% of salary (when house is situated in any other place) for the relevant period
- The excess of rent paid over 10% of salary. [Arithmetically, (Rent Paid – 10% of Salary)]
- Salary here means: Basic + D.A. (If it forms a part of retirement benefit) + Commission as a fixed % on turnover.

**Notes**

- Salary shall be determined on due basis for the period for which the employee occupies rented accommodation in the previous year and gets HRA.
- Exemption is not available if employee lives in his own house, or in a house for which he does not pay any rent.
- For criteria of 50% or 40% of salary as deduction, place of employment is not significant but place where the house is situated is important. metro cities are Delhi, Mumbai, Chennai, Kolkata
- Deduction from HRA depends on Salary of the employee, Amount of HRA, place of residence (not place of employment), rent paid by the employee.

**Illustration 1**

Mr. Anand, a resident of Ajmer, receives ₹ 48,000 as basic salary during the previous year 2020-21. In addition, he gets ₹ 4,800 as dearness allowance forming part of basic salary, 7% commission on sales made by him (sale made by Anand during the relevant previous year is ₹ 86,000) and ₹ 6,000 as house rent allowance. He, however, pays ₹ 5,800 as house rent. Determine the quantum of exempted house rent allowance.

**Solution**

Computation of taxable house rent allowance of Anand for the A.Y. 2021-22

| Particulars                                               | Details (₹) | Amount (₹) |
|-----------------------------------------------------------|-------------|------------|
| House Rent Allowance Received                             |             | 6,000      |
| Less: Minimum of the following being exempted u/s 10(13A) |             |            |
| a) Actual Amount Received                                 | 6,000       |            |
| b) 40% of Salary (Note)                                   | 23,528      |            |
| c) Rent paid – 10% of salary [₹ 5,800 – ₹ 5,882]          | Nil         | Nil        |
| Taxable House Rent Allowance                              |             | 6,000      |

**Note:** Salary for the purpose of HRA

|                             |          |
|-----------------------------|----------|
| Basic salary                | ₹ 48,000 |
| Dearness Allowance          | ₹ 4,800  |
| Commission (7% of ₹ 86,000) | ₹ 6,020  |
| Total                       | ₹ 58,820 |

Hence, exemption u/s 10(13A) is Nil.

#### Illustration 2

Compute the taxable house rent allowance of Mr. Sachin from the following data:

Basic salary ₹ 5,000 p.m., D.A. ₹ 2,000 p.m., HRA ₹ 4,000 p.m., Rent paid ₹ 4,000 p.m. in Pune.

On 1st July, 2020, there is an increment in basic salary by ₹ 1,000.

On 1st October, 2020, employee hired a new flat in Kolkata at the same rent as he was posted to Kolkata.

On 1st January, 2021, employee purchased his own flat and started residing there.

#### Solution

Computation of taxable house rent allowance of Mr. Sachin for the A.Y. 2021-22

| Particulars                                                                   | Details (₹) | Amount (₹) | Amount (₹) |
|-------------------------------------------------------------------------------|-------------|------------|------------|
| House Rent Allowance Received (from 1st April, 2020 to 30th June 2020)        |             | 12,000     |            |
| Less: Minimum of the following being exempted u/s 10(13A)                     |             |            |            |
| (a) Actual Amount Received                                                    | 12,000      |            |            |
| (b) 40% of Salary [(₹ 5,000 + ₹ 2,000) × 3]                                   | 8,400       |            |            |
| (c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,100)                            | 9,900       | 8,400      | 3,600      |
| House Rent Allowance Received (from 1.7.2020 to 30.9.2020)                    |             | 12,000     |            |
| Less: Minimum of the following being exempted u/s 10(13A)                     |             |            |            |
| (a) Actual Amount Received                                                    | 12,000      |            |            |
| (b) 40% of Salary [(₹ 6,000 + ₹ 2,000) × 3]                                   | 9,600       |            |            |
| (c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,400)                            | 9,600       | 9,600      | 2,400      |
| House Rent Allowance Received (from 1st October, 2020 to 31st December, 2020) |             | 12,000     |            |
| Less: Minimum of the following being exempted u/s 10(13A)                     |             |            |            |
| a) Actual Amount Received                                                     | 12,000      |            |            |
| (b) 50% of Salary [(₹ 6,000 + ₹ 2,000) × 3]                                   | 12,000      |            |            |
| (c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,400)                            | 9,600       | 9,600      | 2,400      |

|                                                                            |  |  |               |
|----------------------------------------------------------------------------|--|--|---------------|
| House Rent Allowance Received (from 1st January, 2021 to 31st March, 2021) |  |  |               |
| (Fully taxable as assessee resides in his own house)                       |  |  | 12,000        |
| <b>Taxable House Rent Allowance</b>                                        |  |  | <b>20,400</b> |

**Special allowance exempt u/s 10(14)**

Allowances, deduction from which depends on actual expenditure [Sec. 10(14)(i)]

| Allowance                    | Meaning                                                                                                                                                                                                                                                                                                                                                                                       |
|------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Travel or transfer Allowance | An allowance, by whatever name called, to meet the cost of travel on tour. Cost of travel includes any sum paid in connection with transfer, packing and transportation of personal effects on such transfer.                                                                                                                                                                                 |
| Daily Allowance              | An allowance, by whatever name called, granted on tour (or for the period of journey in connection with transfer) to meet the ordinary daily charges incurred by employee on account of absence from his normal place of duty.                                                                                                                                                                |
| Conveyance Allowance         | Any allowance granted to meet the expenditure on conveyance in performance of duties of the office, provided free conveyance is not provided by the employer.<br>Tax point: Expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of office and consequently not covered under this allowance. (Refer Transport allowance) |
| Helper / Assistant Allowance | Any allowance, by whatever name called to meet the expenditure of assistant or helper, provided such helper is appointed for the performance of duties of an office.<br>Tax point: Servant allowance is fully taxable.                                                                                                                                                                        |
| Research Allowance           | Any allowance, by whatever name called, granted to encourage academic, research and other professional pursuits. This allowance may also be termed as Professional Development / Academic allowance                                                                                                                                                                                           |
| Uniform Allowance            | Any allowance, by whatever name called, to meet the expenditure on purchase or maintenance of uniform wear, during the performance of duties of an office.<br>Tax point: Uniform allowance is different from dress allowance. Dress allowance is fully taxable.                                                                                                                               |

**Tax Treatment of aforesaid allowances:**

Minimum of the following shall be exempted:

- Actual amount received; or
- Actual expenditure incurred for such purpose.



## Allowances, deduction which do not depend on actual expenditure [Sec. 10(14)(ii)]

| Sr.No | Name of Allowance                                                                                                                                                                                                                                                   | Extend to which allowance is exempt                                                                                       |
|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------|
| 1     | Any special compensatory allowance in the nature of special compensatory (hilly areas) allowance or high-altitude allowance or uncongenial climate allowance or snow bound area allowance or avalanche allowance                                                    | ₹ 800 or ₹ 300 per month depending upon the specified locations<br>₹ 7,000 per month in Siachen area of Jammu and Kashmir |
| 2     | Any special compensatory allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance                                                                                                      | ₹ 1,300, ₹ 1,100, ₹ 1,050, ₹ 750, ₹ 300 or ₹ 200 per month depending upon the specified locations                         |
| 3     | Special compensatory (tribal areas/schedule areas/agency areas) allowance [specified states]                                                                                                                                                                        | ₹ 200 per month                                                                                                           |
| 4     | Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running such transport from one place to another, provided that such employee is not in receipt of daily allowance | 70% of such allowance up to a maximum of ₹ 10,000 per month                                                               |
| 5     | Children education allowance                                                                                                                                                                                                                                        | ₹ 100 per month per child up to a maximum of two children                                                                 |
| 6     | Any allowance granted to an employee to meet the hostel expenditure on his child                                                                                                                                                                                    | ₹ 300 per month per child up to a maximum of two children                                                                 |
| 7     | Compensatory field area allowance [specified areas in specified states]                                                                                                                                                                                             | ₹ 2,600 per month                                                                                                         |
| 8     | Compensatory modified field area allowance [specified areas in specified states]                                                                                                                                                                                    | ₹ 1,000 per month                                                                                                         |
| 9     | Any special allowance in the nature of counter insurgency allowance granted to the members of the armed forces operating in areas away from their permanent locations.                                                                                              | ₹ 3,900 per month                                                                                                         |

|    |                                                                                                                                                                                                                                                |                    |
|----|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| 10 | Any transport allowance granted to an employee who is blind or deaf and dumb or orthopedically handicapped with disability of the lower extremities of the body, to meet his expenditure for commuting between his residence and place of duty | ₹ 3,200 per month. |
| 11 | Underground allowance granted to an employee who is working in uncongenial, unnatural climate in underground mines.                                                                                                                            | ₹ 800 per month    |
| 12 | Any special allowance in the nature of high-altitude allowance granted to the member of the armed forces operating in high altitude areas for altitude of 9,000 to 15,000 feet for above 15,000 feet                                           | ₹ 1,600 per month  |
| 13 | Any special allowance in the nature of special compensatory highly active field area allowance granted to the member of the armed forces                                                                                                       | ₹ 4,200 per month  |
| 14 | Any special allowance in the nature of Island (duty) allowance granted to the member of the armed forces in Andaman & Nicobar and Lakshadweep Group of Islands                                                                                 | ₹ 3,250 per month  |

**Notes**

Any assessee claiming exemption in respect of allowances mentioned at serial numbers 7, 8 and 9 shall not be entitled to exemption in respect of the allowance and disturbed area allowance referred at in serial number 2, respectively.

An employee, being an assessee, who opts for the provisions of section 115BAC would be entitled for exemption only in respect of transport allowance granted to an employee who is blind or deaf and dumb or orthopedically handicapped with disability of the lower extremities of the body to the extent of ₹ 3,200 p.m.

**Illustration 3**

Mr. Umesh received education allowance of ₹. 80 p.m. for his 1st child, ₹. 90 p.m. for his 2nd child and ₹. 120 p.m. for his 3rd child. He also received hostel allowance of ₹. 1,000 p.m. None of his children are studying. Find taxable children education allowance and hostel allowance.

**Solution**

Computation of taxable children education allowance for Mr. Umesh for the A.Y. 2021-22

| Particulars                                                                                | Details | Amount       |
|--------------------------------------------------------------------------------------------|---------|--------------|
| Hostel allowance                                                                           | 12000   |              |
| Less: Exempted ( $₹ 300 \times 2 \times 12$ )                                              | 7,200   | 4,800        |
| Children Education allowance [ $(₹ 80 \times 12) + (₹ 90 \times 12) + (₹ 120 \times 12)$ ] | 3,480   | 1,200        |
| Less: Exempted $\{(₹ 100 + ₹ 90) \times 12\}$                                              | 2,280   |              |
| <b>Taxable Allowance</b>                                                                   |         | <b>6,000</b> |



**Note:** Education allowance is allowed for any two children of assessee therefore education allowance of first child (which is the lowest one i.e., ₹ 80 only) is not considered, to avail higher deduction.

#### Illustration 4

Mr. & Mrs. Sharma have three children and two of them are not studying. Both Mr. & Mrs. Sharma are working in Apex Ltd. and getting children education allowance ₹ 500 per month and hostel allowance ₹ 1,000 per month. Compute taxable children education allowance and hostel allowance.

| Particulars                      | Mr. Sharma  |              | Mrs. Sharma |              |
|----------------------------------|-------------|--------------|-------------|--------------|
|                                  | Details (₹) | Amount (₹)   | Details (₹) | Amount (₹)   |
| Education allowance (₹ 500 × 12) | 6,000       |              | 6000        |              |
| Less: Exemption (₹ 100 × 12 × 2) | 2,400       | 3,600        | 2,400       | 3,600        |
| Hostel Allowance (₹ 1,000 × 12)  | 12,000      |              | 12,000      |              |
| Less: Exemption (₹ 300 × 12 × 2) | 7,200       | 4,800        | 7,200       | 4,800        |
| <b>Taxable Allowance</b>         |             | <b>8,400</b> |             | <b>8,400</b> |

#### Allowances which are Fully Exempt:

- **Allowance to Supreme Court/ High Court Judges:** Any allowance paid to a Judge of a High Court and Supreme Court under section 22A(2) of the High Court Judges (Conditions of Service) Act, 1954 and section 23(1A) of the Supreme Court Judges (Salaries and Conditions of services) Act, 1958, respectively, are not taxable.
- **Allowance received from United Nations Organisation (UNO):** Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the United Nations (Privileges and Immunities) Act, 1947.
- **Compensatory allowance under Article 222(2) of the Constitution:** Compensatory allowance received by judge under Article 222(2) of the Constitution is not taxable since it is neither salary nor perquisite.
- **Sumptuary allowance:** Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.
- **Allowances payable outside India [Section 10(7)]:** Allowances or perquisites paid or allowed as such outside India by the government to a citizen of India for services rendered outside India are exempt from tax. Students may remember that in such cases under section 9(1)(iii), the income chargeable under the head 'Salaries' is deemed to accrue in India. The residential status of the recipient will, however, not affect this exemption.

## Unit 12.6 - Pension

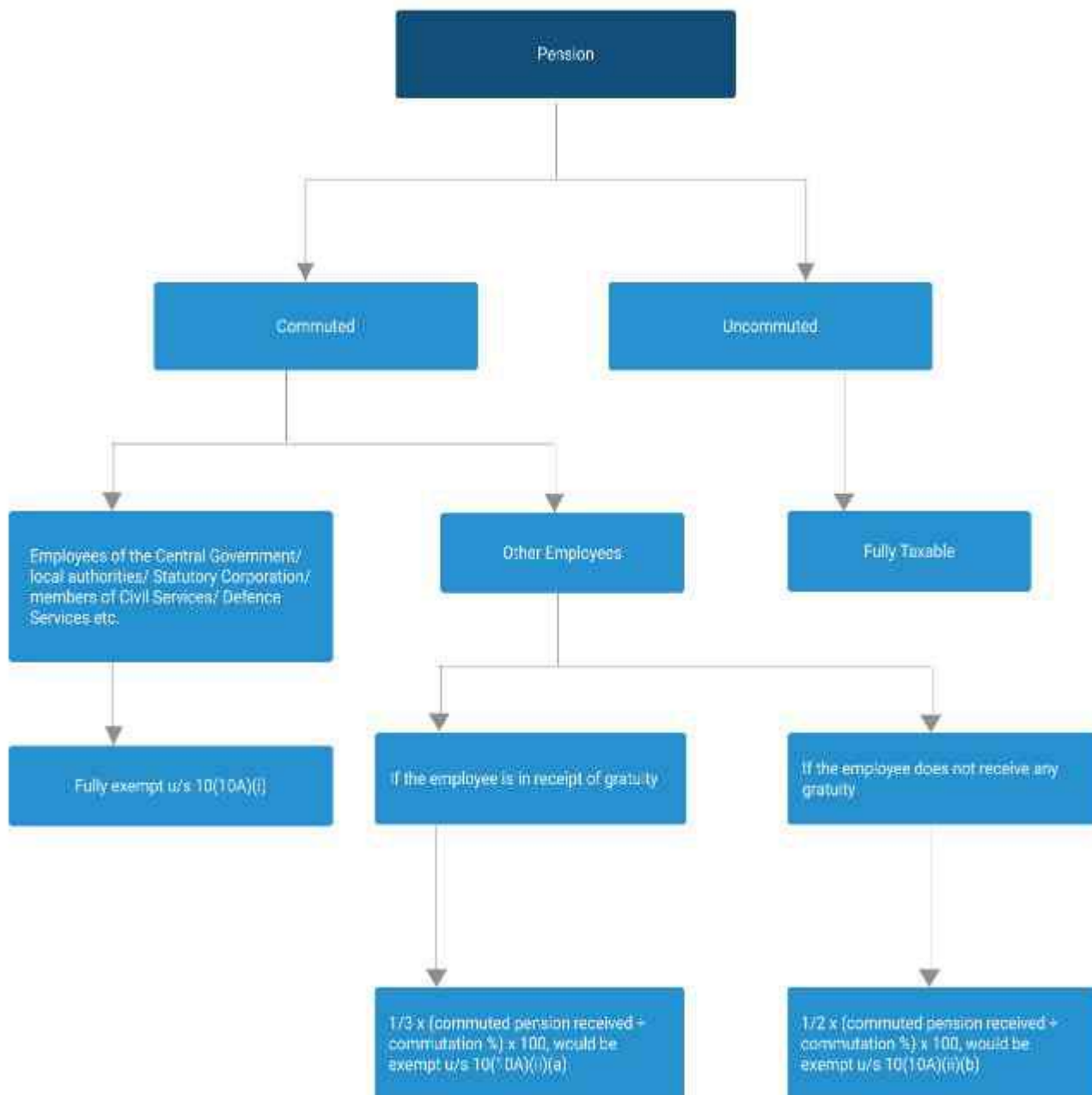


Fig 6.2

**Uncommuted Pension:** Uncommuted pension refers to pension received periodically. It is fully taxable in the hands of both government and non-government employees.

**Commuted Pension:** Commutation means inter-change. Commuted pension means lump sum amount taken by commuting the whole or part of the pension. Many people convert their future right to receive pension into a lumpsum amount receivable immediately.

**Exemption in respect of Commuted Pension [Section 10(10A)]**

As per section 10(10A), the payment in respect of commuted pension is exempt, subject to the conditions specified therein. Its treatment is discussed below:

- **Employees of the Central Government/ local authorities/ Statutory Corporation/ members of the Civil Services/ Defence Services:** Any commuted pension received is fully exempt from tax.
- **Other Employees:** Any commuted pension received is exempt from tax to the extent of the following:

**If the employee is in receipt of gratuity also,**

Exemption =  $\frac{1}{3}$ rd of the amount of pension which he would have received had he commuted the whole of the pension.

**If the employee does not receive any gratuity**

Exemption =  $\frac{1}{2}$  of the amount of pension which he would have received had he commuted the whole of the pension.

**Notes:**

- Judges of the Supreme Court and High Court will be entitled to exemption of the entire commuted pension.
- Any commuted pension received by an individual out of annuity plan of the Life Insurance Corporation of India (LIC) from a fund set up by that Corporation will be exempted.

#### Illustration 5

Mr. Vishal who retired on 1st October, 2022 is receiving ₹ 5,000 p.m. as pension. On 1st February, 2023, he commuted 60% of his pension and received ₹ 3,00,000 as commuted pension. You are required to compute his taxable pension assuming:

1. He is a government employee.
2. He is a private sector employee and received gratuity of ₹ 5,00,000 at the time of retirement.
3. He is a private sector employee and did not receive any gratuity at the time of retirement.

**Solution**

**He is a government employee**

|                                                                                                       |            |                   |
|-------------------------------------------------------------------------------------------------------|------------|-------------------|
| Uncommuted pension received (October – March)<br>[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)] |            | ₹ 24,000          |
| Commuted pension received                                                                             | ₹ 3,00,000 |                   |
| Less: Exempt u/s 10(10A) ( $\frac{1}{3} \times 3,00,000 / 60\% \times 100\%$ )                        | ₹ 1,66,667 | ₹ 1,33,333        |
| <b>Taxable pension</b>                                                                                |            | <b>₹ 1,57,333</b> |

**b. He is a private sector employee and received gratuity ₹ 5,00,000 at the time of retirement**

|                                                                                                       |            |                 |
|-------------------------------------------------------------------------------------------------------|------------|-----------------|
| Uncommuted pension received (October – March)<br>[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)] |            | ₹ 24,000        |
| Commuted pension received                                                                             | ₹ 3,00,000 |                 |
| Less: Exempt u/s 10(10A)                                                                              | ₹ 3,00,000 | NIL             |
| <b>Taxable pension</b>                                                                                |            | <b>₹ 24,000</b> |



c. He is a private sector employee and did not receive any gratuity at the time of retirement

|                                                                                                                                  |            |                 |
|----------------------------------------------------------------------------------------------------------------------------------|------------|-----------------|
| Uncommuted pension received (October – March) [ $\text{₹ } 5,000 \times 4$ months] + (40% of $\text{₹ } 5,000 \times 2$ months)] |            | ₹ 24,000        |
| Commuted pension received                                                                                                        | ₹ 3,00,000 |                 |
| Less: Exempt u/s 10(10A)(1/2*300000/60%*100%)                                                                                    | ₹ 2,50,000 | ₹ 50,000        |
| <b>Taxable Pension</b>                                                                                                           |            | <b>₹ 74,000</b> |

## Unit - 3.7 Gratuity

Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee. Now-a-days gratuity has become a normal payment applicable to all employees. In fact, Payment of Gratuity Act, 1972 is a statutory recognition of the concept of gratuity. Almost all employers enter into an agreement with employees to pay gratuity.

- Retirement gratuity received under the Pension Code or Regulations applicable to members of the Defence Service is fully exempt from tax.
- Employees of Central Government/ Members of Civil Services/ local authority employees: Any death cum retirement gratuity is fully exempt from tax under section 10(10)(i).
- Other employees:

- **Covered by the Payment of Gratuity Act, 1972**

Any death-cum-retirement gratuity is exempt from tax to the extent of least of the following:

- ₹ 20,00,000
- Gratuity actually received
- 15 days' salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months

**Note:** Salary for this purpose means basic salary and dearness allowance. No. of days in a month for this purpose, shall be taken as 26.

- **Not covered by the Payment of Gratuity Act, 1972**

Any death cum retirement gratuity received by an employee on his retirement or his becoming incapacitated prior to such retirement or on his termination or any gratuity received by his widow, children or dependents on his death is exempt from tax to the extent of least of the following:

- ₹ 20,00,000
- Gratuity actually received
- Half month's salary (based on last 10 months' average salary immediately preceding the month of retirement or death) for each completed year of service (fraction to be ignored)



**Note:** Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits, forming part of salary and commission which is expressed as a fixed percentage of turnover.

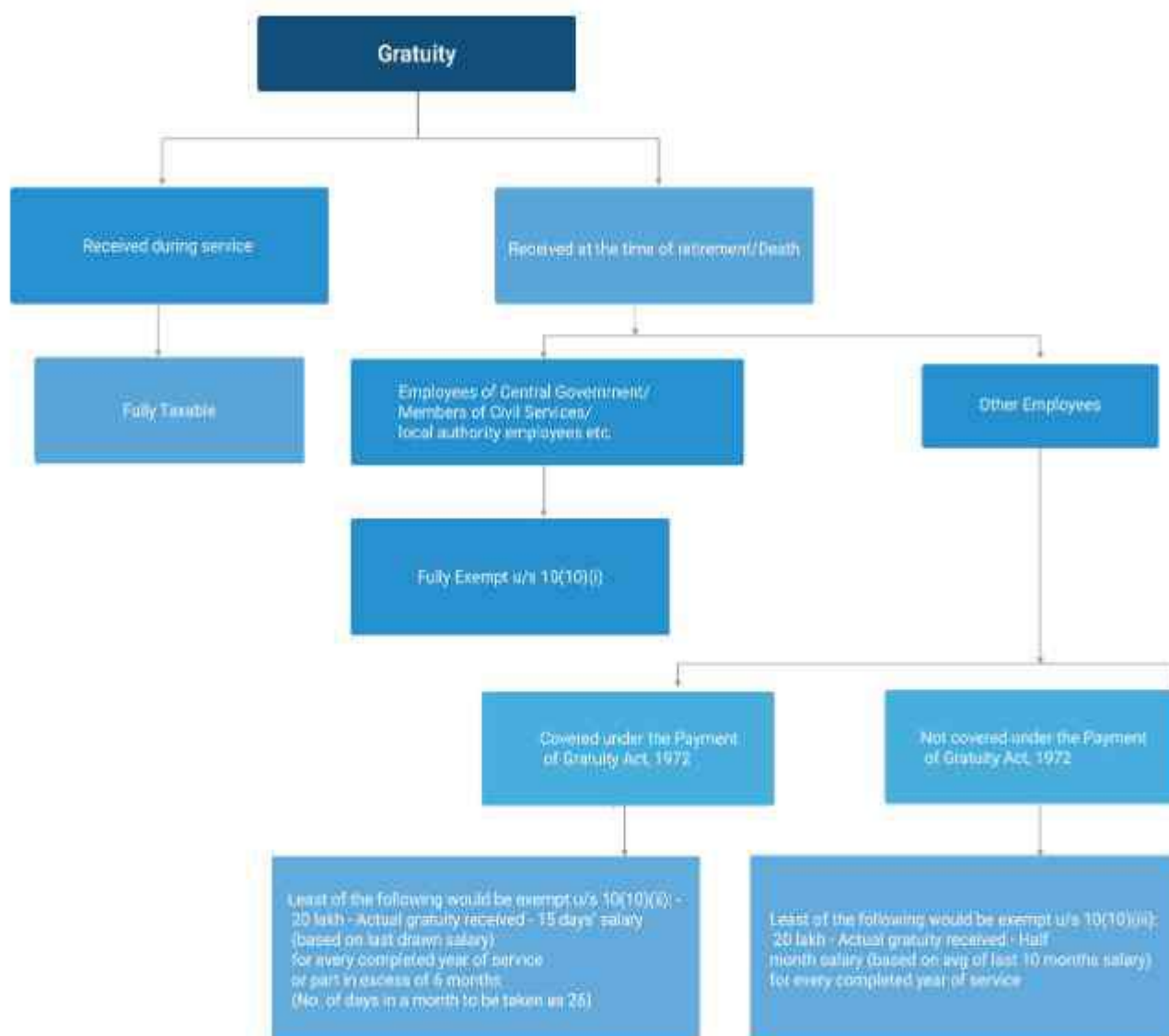


Fig 6.3

**Students must also note the following points:**

- Gratuity received during the period of service is fully taxable.
- Where gratuity is received from 2 or more employers in the same previous year then aggregate amount of gratuity exempt from tax cannot exceed ₹ 20,00,000.
- Where gratuity is received in any earlier previous year from former employer and again received from another employer in a later previous year, the limit of ₹ 20,00,000 will be reduced by the amount of gratuity exempt earlier.

**Illustration 6**

Mr. Anirudh retired on 15th June, 2022 after completion of 26 years 8 months of service and received gratuity of ₹ 15,00,000. At the time of retirement, his salary was:

Basic Salary : ₹ 50,000 p.m.

Dearness Allowance : ₹ 10,000 p.m. (60% of which is for retirement benefits)

Commission : 1% of turnover (turnover in the last 12 months was ₹ 1,20,00,000)

Bonus : ₹ 25,000 p.a.

Compute his taxable gratuity assuming:

- He is private sector employee and covered by the Payment of Gratuity Act, 1972.
- He is private sector employee and not covered by Payment of Gratuity Act, 1972.
- He is a government employee.

**Solution****a. He is covered by the Payment of Gratuity Act 1972**

| Particulars                                                                                                                                                                                                                                       | Amount      |                   |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------------|
| Gratuity received at the time of retirement                                                                                                                                                                                                       |             | ₹ 15,00,000       |
| Less: Exemption under section 10(10)<br>Least of the following:                                                                                                                                                                                   |             |                   |
| i. Gratuity received                                                                                                                                                                                                                              | ₹ 15,00,000 |                   |
| ii. Statutory limit                                                                                                                                                                                                                               | ₹ 20,00,000 |                   |
| iii. 15 days' salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months $15/26 \times \text{last drawn salary} \times \text{years of service}$<br>[ $15/26 \times (50,000 + 10,000) \times 27$ ] | ₹ 9,34,615  | ₹ 9,34,615        |
| <b>Taxable Gratuity</b>                                                                                                                                                                                                                           |             | <b>₹ 5,65,385</b> |

**b. He is not covered by the Payment of Gratuity Act 1972**

| Particulars                                 | Amount            |
|---------------------------------------------|-------------------|
| Gratuity received at the time of retirement | ₹ 15,00,000       |
| Less: Exemption under section 10(10) (Note) | ₹ 8,58,000        |
| <b>Taxable Gratuity</b>                     | <b>₹ 6,42,000</b> |

**Note:** Exemption under section 10(10) is least of the following:

Gratuity received ₹ 15,00,000

Statutory limit ₹ 20,00,000

Half month's salary based on average salary of last 10 months preceding the month of retirement for each completed year of service.

$$= \frac{1/2 (50,000 \times 10) + (10,000 \times 60\% \times 10) + (1\% \times 1,20,00,000 \times 10/12)}{10} \times 26$$

$$= ₹ 8,58,000$$

c. He is a government employee

| Particulars                                 | Amount      |
|---------------------------------------------|-------------|
| Gratuity received at the time of retirement | ₹ 15,00,000 |
| Less: Exemption under section 10(10)        | ₹ 15,00,000 |
| Taxable Gratuity                            | NIL         |

## Unit - 12.8 Fees, commission, perquisites, or profits in lieu of or in addition to any salary or wages

The payment in the form of fees or commission by the employer to the employee are fully taxable. Commission may be paid as fixed percentage of turnover or net profits etc. Section 17(2) and 17(3) contains the provisions relating to perquisites and profits in lieu of salary, respectively. The provisions of these sections would be discussed in detail separately in this unit.

## Unit - 12.9 Leave Salary or Leave Encashment

Generally, employees are allowed to take leave during the period of service. Employee may avail such leave or in case the leave is not availed, then the leave may either lapse or be accumulated for future or allowed to be encashed every year or at the time termination/ retirement. The payment received on account of encashment of un-availed leave would form part of salary. However, section 10(10AA) provides exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his retirement, whether on superannuation or otherwise.

**Government employees:** Leave salary received at the time of retirement is fully exempt from tax.

**Non-government employees:** Leave salary received at the time of retirement is exempt from tax to the extent of least of the following:



₹ 3,00,000

Leave salary actually received

10 months' salary (on the basis of average salary of last 10 months)

Cash equivalent of leave (based on last 10 months' average salary immediately preceding the date of retirement) to the credit of the employee at the time of retirement or death. Earned leave entitlement cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired

#### Notes:

Leave salary received during the period of service is fully taxable.

Where leave salary is received from two or more employers in the same previous year, then the aggregate amount of leave salary exempt from tax cannot exceed ₹ 3,00,000.

Where leave salary is received in any earlier previous year from a former employer and again received from another employer in a later previous year, the limit of ₹ 3,00,000 will be reduced by the amount of leave salary exempt earlier.

Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits and commission which is expressed as a fixed percentage of turnover.

Average salary' will be determined on the basis of the salary drawn during the period of ten months immediately preceding the date of his retirement whether on superannuation or otherwise.

#### Illustration 7

Mr. Malik retired on 1st December, 2022 after 20 years of service and received leave salary of ₹ 5,00,000.

Other details of his salary income are:

Basic Salary : ₹ 5,000 p.m. (₹ 1,000 was increased w.e.f. 1.4.2022)

Dearness Allowance : ₹ 3,000 p.m. (60% of which is for retirement benefits)

Commission : ₹ 500 p.m.

Bonus : ₹ 1,000 p.m.

Leave availed during service: 480 days

He was entitled to 30 days leave every year.

You are required to compute his taxable leave salary assuming:

He is a government employee.

He is a non-government employee.

#### Solution

a. He is a government employee

| Particulars                                     | Amount     |
|-------------------------------------------------|------------|
| Leave salary received at the time of retirement | ₹ 5,00,000 |
| Less: Exemption under section 10(10AA)          | ₹ 5,00,000 |
| Taxable Leave salary                            | Nil        |



b. He is a non-government employee

| Particulars                                             | Amount     |
|---------------------------------------------------------|------------|
| Leave salary received at the time of retirement         | ₹ 5,00,000 |
| Less: Exemption under section 10(10AA) [See Note below] | ₹ 26,400   |
| Taxable Leave salary                                    | ₹ 4,73,600 |

Note: Exemption under section 10(10AA) is least of the following:

| Particulars                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Amount     |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|
| Exemption under section 10(10AA) is least of the following:                                                                                                                                                                                                                                                                                                                                                                                                                                      |            |
| (i) Leave salary received                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | ₹ 5,00,000 |
| (ii) Statutory limit                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | ₹ 3,00,000 |
| (iii) 10 months' salary based on average salary of last 10 months<br>i.e., Salary of last 10 months i.e. Feb-Nov<br>$= \left[ \frac{10 \times \text{Salary of last 10 months i.e. Feb-Nov}}{10} \right]$ $= \left[ \frac{10 (5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{10} \right]$                                                                                                                                                                                       | ₹ 66,000   |
| (iv) Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months' (max. 30 days per year of service)<br>Leave Due = Leave allowed – Leave taken<br>$= (30 \text{ days per year} \times 20 \text{ years}) - 480 \text{ days} = 120 \text{ days}$ i.e. $\left[ \frac{\text{leave due (in days)}}{30 \text{ days}} \times \text{Average salary p.m} \right]$ $= \left[ \frac{120 \text{ days}}{30 \text{ days}} \times \frac{66,000}{10} \right]$ | ₹ 26,400   |

## Unit 12.10 - Provident Fund

Provident fund scheme is intended to give substantial benefits to an employee at the time of his retirement. Under this scheme, a specified sum is deducted from the salary of the employee as his contribution towards the fund. The employer also generally contributes the same amount out of his pocket, to the fund. The contributions of the employer and the employee are invested in approved securities. Interest earned thereon is also credited to the account of the employee. Thus, the credit balance in a provident fund account of an employee consists of the following:

- employee's contribution
- interest on employee's contribution
- employer's contribution
- interest on employer's contribution.

The accumulated balance is paid to the employee at the time of his retirement or resignation. In the case of death of the employee, the same is paid to his legal heirs. The provident fund represents an important source of small savings available to the government. Hence, the Income tax Act, 1961 gives certain deductions on savings in a provident fund account.

- **Recognised Provident Fund (RPF):** Recognised provident fund means a provident fund recognised by the Commissioner of Income tax for the purposes of income tax. It is governed by Part A of Schedule IV to the Income tax Act, 1961. This schedule contains various rules regarding the following:
  - Recognition of the fund
  - Employee's and employer's contribution to the fund
  - Treatment of accumulated balance etc. A fund constituted under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 will also be a Recognised Provident Fund.
- **Unrecognised Provident Fund (URPF):** A fund not recognised by the Commissioner of Income tax is Unrecognised Provident Fund.
- **Statutory Provident Fund (SPF):** The SPF is governed by Provident Funds Act, 1925. It applies to employees of government, railways, semi government institutions, local bodies, universities and all recognised educational institutions.
- **Public Provident Fund (PPF):** Public provident fund is operated under the Public Provident Fund Act, 1968. A membership of the fund is open to every individual though it is ideally suited to self-employed people. A salaried employee may also contribute to PPF in addition to the fund operated by his employer. An individual may contribute to the fund on his own behalf as also on behalf of a minor of whom he is the guardian.

For getting a deduction under section 80C, a member is required to contribute to the PPF a minimum of ₹ 500 in a year. The maximum amount that may qualify for deduction on this account is ₹ 1,50,000 as per PPF rules.

A member of PPF may deposit his contribution in as many instalments in multiples of ₹ 500 as is convenient to him. The amount of contribution may be paid at any of the offices or branch offices of the State Bank of India or its subsidiaries and specified branches of banks or any Post Office.



Fig 6.4

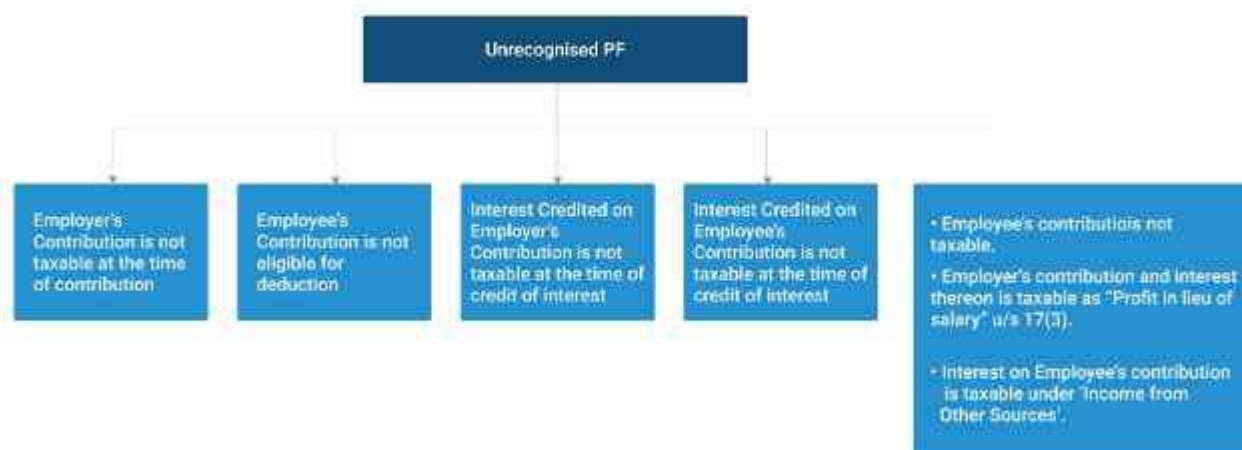


Fig 6.5



Fig 6.6



Fig 6.7

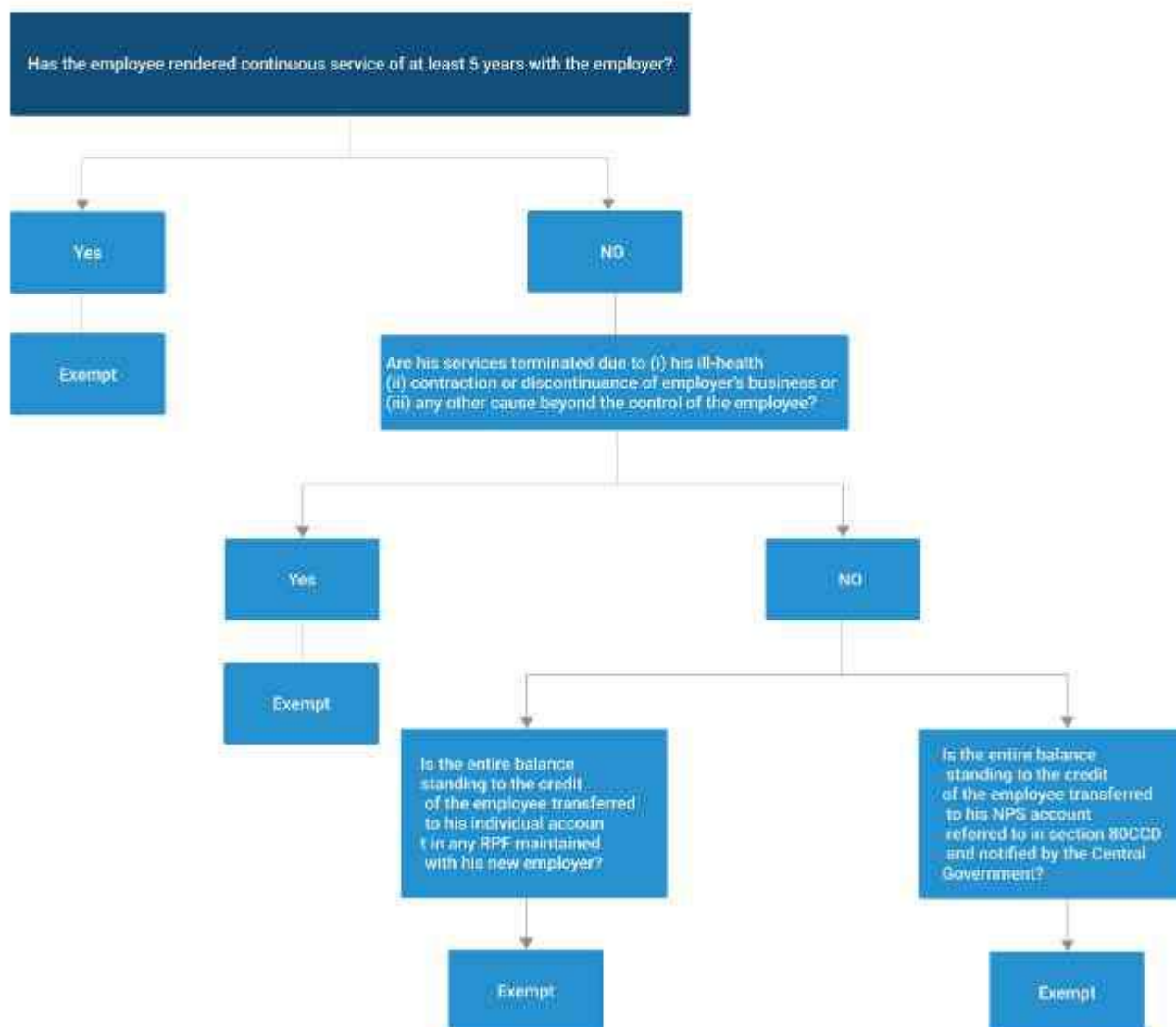


Fig 6.8



As per section 10(11), any payment from a Provident Fund (PF) to which Provident Fund Act, 1925, applies or from Public Provident Fund would be exempt. Accumulated balance due and becoming payable to an employee participating in a Recognized Provident Fund (RPF) would be exempt under section 10(12).

However, the exemption under section 10(11) or 10(12) would not be available in respect of income by way of interest accrued during the previous year to the extent it relates to the amount or the aggregate of amounts of contribution made by that person/employee exceeding ₹ 2,50,000 in any previous year in that fund, on or after 1st April, 2021.

If the contribution by such person/employee is in a fund in which there is no employer's contribution, then, a higher limit of ₹ 5,00,000 would be applicable for such contribution, and interest accrued in any previous year in that fund, on or after 1st April, 2021 would be exempt upto that limit.

It may be noted that interest accrued on contribution to such funds upto 31st March, 2021 would be exempt without any limit, even if the accrual of income is after that date.

#### **Exemption of Accumulated balance of RPF, payable to an employee**

\* Where the accumulated balance in Recognised Provident Fund becomes taxable, the tax payable in each of the years would be computed as if the fund had been an Unrecognised Provident Fund and the difference in tax would be payable by the employee.

#### **Note:**

If, after termination of his employment with one employer, the employee obtains employment under another employer, then, only the accumulated balance in his provident fund account will be exempt which is transferred to his individual account in a recognised provident fund maintained by the new employer. In such a case, for exemption of payment of accumulated balance by the new employer, the period of service with the former employer shall also be taken into account for computing the period of five years' continuous service.

#### **Illustration 8**

Mr. A retires from service on December 31, 2021, after 25 years of service. Following are the particulars of his income/investments for the previous year 2021-22:

|                                                                                            |          |
|--------------------------------------------------------------------------------------------|----------|
| Basic pay ₹ 16,000 per month for 9 months                                                  | 1,44,000 |
| Dearness pay (50% forms part of the retirement benefits)<br>₹ 8,000 per month for 9 months | 72,000   |
| Lumpsum payment received from the:<br>Unrecognized Provident Fund                          | 6,00,000 |
| Deposits in the PPF account                                                                | 40,000   |

Out of the amount received from the unrecognised provident fund, the employer's contribution was ₹ 2,20,000 and the interest thereon ₹ 50,000. The employee's contribution was ₹ 2,50,000 and the interest thereon ₹ 60,000. What is the taxable portion of the amount received from the unrecognized provident fund in the hands of Mr. A for the assessment year 2022-23?

**Solution**

Taxable portion of the amount received from the URPF in the hands of Mr. A for the A.Y. 2022-23 is computed hereunder:

|                                                             |          |
|-------------------------------------------------------------|----------|
| Amount taxable under the head 'Salaries':                   |          |
| Employer's share in the payment received from the URPF      | 2,20,000 |
| Interest on the employer's share                            | 50,000   |
| Total                                                       | 2,70,000 |
| Amount taxable under the head 'Income from Other Sources':  |          |
| Interest on the employee's share                            | 60,000   |
| Total amount taxable from the amount received from the fund | 3,30,000 |

**Note:** Since the employee is not eligible for deduction under section 80C for contribution to URPF at the time of such contribution, the employee's share received from the URPF is not taxable at the time of withdrawal as this amount has already been taxed as his salary income.

**Illustration 9**

Will your answer be any different if the fund mentioned above was a recognised provident fund?

**Solution**

Since the fund is a recognised one, and the maturity is taking place after a service of 25 years, the entire amount received on the maturity of the RPF will be fully exempt from tax.

**Illustration 10**

Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y. 2021-22.

You are required to compute his gross salary from the details given below:

|                                        |                         |
|----------------------------------------|-------------------------|
| Basic Salary                           | ₹ 10,000 p.m.           |
| D.A. (50% is for retirement benefits)  | ₹ 8,000 p.m.            |
| Commission as a percentage of turnover | 0.1%                    |
| Turnover during the year               | ₹ 50,00,000             |
| Bonus                                  | ₹ 40,000                |
| Gratuity                               | ₹ 25,000                |
| His own contribution in the RPF        | ₹ 20,000                |
| Employer's contribution to RPF         | 20% of his basic salary |
| Interest accrued in the RPF @ 13% p.a. | ₹ 13,000                |

**Solution**

Computation of Gross Salary of Mr. B for the A.Y.2022-23

|                                                               |        |                 |
|---------------------------------------------------------------|--------|-----------------|
| Basic Salary [ $\text{₹ } 10,000 \times 12$ ]                 |        | 1,20,000        |
| Dearness Allowance [ $\text{₹ } 8,000 \times 12$ ]            |        | 96,000          |
| Commission on turnover [ $0.1\% \times \text{₹ } 50,00,000$ ] |        | 5,000           |
| Bonus                                                         |        | 40,000          |
| Gratuity [Note 1]                                             |        | 25,000          |
| Employers' contribution to RPF [20% of ₹ 1,20,000]            | 24,000 |                 |
| Less: Exempt [Note 2]                                         | 20,760 | 3,240           |
| Interest accrued in the RPF @ 13% p.a.                        | 13,000 | 3,500           |
| Less: Exempt @ 9.5% p.a.                                      | 9,500  |                 |
| <b>Gross Salary</b>                                           |        | <b>2,92,740</b> |

Note 1: Gratuity received during service is fully taxable.

Note 2: Employers contribution in the RPF is exempt up to 12% of the salary i.e., 12% of [Basic Salary + Dearness Allowance forming part of retirement benefits + Commission based on turnover] = 12% of [ ₹ 1,20,000 + (50% × ₹ 96,000) + ₹ 5,000] = 12% of ₹ 1,73,000 = ₹ 20,760

Note 3: Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

## Unit - 12.11 Profits in Lieu of Salary [Section 17(3)]

It includes the following:

- **Compensation on account of Termination of Employment**

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.

- **Compensation on account of modification of the terms and conditions of employment**

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions of employment. Usually, such compensation is treated as a capital receipt. However, by virtue of this provision, the same is treated as a revenue receipt and is chargeable as salary.



**Note:** It is to be noted that merely because a payment is made by an employer to a person, who is his employee, does not automatically fall within the scope of the above provisions. The payment must be arising due to master-servant relationship between the payer and the payee. If it is not on that account, but due to considerations totally unconnected with employment, such payment is not profit in lieu of salary.

- **Payment from provident fund or other funds**

Any payment due to or received by an assessee from his employer or former employer from a provident or other funds other than:

1. Gratuity [Section 10(10)]
2. Pension [Section 10(10A)]
3. Compensation received by a workman under Industrial Disputes Act, 1947 [Section 10(10B)]
4. From provident fund or public provident fund [Section 10(11)]
5. From recognized provident fund [Section 10(12)]
6. From approved superannuation fund [Section 10(13)]
7. Any house rent allowance [Section 10(13A)],

To the extent to which it does not consist of employee's contributions or interest on such contributions.

**Note:** If any sum is paid to an employee at the time of maturity from an unrecognised provident fund it is to be dealt with as follows:

- That part of the sum, which represents the employer's contribution to the fund and interest, thereon, is taxable under the head "Salaries".
- That part of the sum, which represents employee's contribution is not chargeable to tax as no deduction or exemption was available at the time of contribution.
- That part of the sum which represents the interest on employee's contribution is chargeable to tax as 'Income from other sources'.
- Keyman Insurance policy: Any sum received by an assessee under a Keyman Insurance policy including the sum allocated by way of bonus on such policy.
- Lumpsum Payment or otherwise

Any amount, whether in lumpsum or otherwise, due to the assessee or received by him, from any person:

- Before joining employment with that person, or
- After cessation of his employment with that person.



## Unit - 12.12 Retrenchment Compensation [Section 10(10B)]

The retrenchment compensation means the compensation paid under Industrial Disputes Act, 1947 or under any Act, rule, order or notification issued under any law. It also includes compensation paid on transfer of employment under section 25F or closing down of an undertaking under section 25FF of the Industrial Disputes Act, 1947. It may be noted that compensation on account of termination and due to modification in terms and conditions of employment would be taxable as “profits in lieu of salary”. However, the retrenchment compensation would be exempt under section 10(10B), subject to following limits:

- Amount calculated in accordance with the provisions of section 25F of the Industrial Disputes Act, 1947

i.e., 15 days average pay x completed years of service and part thereof in excess of 6 months (or) (b) An amount, not less than ₹ 5,00,000 as may be notified by the Central Government in this behalf, whichever is lower.

## Unit - 12.13 Voluntary Retirement Receipts [Section 10(10C)]

Lumpsum payment or otherwise received by an employee at the time of voluntary retirement would be taxable as “profits in lieu of salary”. However, it would be exempt under section 10(10C), subject to the following conditions:

### Eligible Undertakings:

The employees of the following undertakings are eligible for exemption under this clause:

Public sector company

Any other company

An authority established under a Central/State or Provincial Act

A local authority

A co-operative society

A University established or incorporated under a Central/State or Provincial Act and an institution declared to be a university by the University Grants Commission

An Indian Institute of Technology

Such institute of management as the central government may, by notification in the official gazette, specified in this behalf

Any state government

The central government

An institution, having importance throughout India or in any state or states, as the central government may specify by notification in the official gazette.

**Limit:**

The maximum limit of exemption should not exceed ₹ 5 lakhs. Such compensation should be at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or, in the case of public sector company, a scheme of voluntary separation. The exemption will be available even if such compensation is received in instalments.

**Guidelines:**

The schemes should be framed in accordance with such guidelines, as may be prescribed and should include the criteria of economic viability.

**Illustration 11**

Mr. Dutta received voluntary retirement compensation of ₹ 7,00,000 after 30 years 4 months of service. He still has 6 years of service left. At the time of voluntary retirement, he was drawing basic salary ₹ 20,000 p.m.; dearness allowance (which forms part of pay) ₹ 5,000 p.m. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.

**Solution**

Voluntary retirement compensation received ₹ 7,00,000

Less: Exemption under section 10(10C) [See Note below] ₹ 5,00,000

Taxable voluntary retirement compensation ₹ 2,00,000

**Note:** Exemption is to the extent of least of the following:

Compensation actually received = ₹ 7,00,000

Statutory limit = ₹ 5,00,000

3 months' salary × completed years of service =  $(₹20,000 + ₹5,000) \times 3 \times 30 \text{ years} = ₹ 22,50,000$

Last drawn salary × remaining months of service left =  $(₹20,000 + ₹5,000) \times 6 \times 12 \text{ months} = ₹ 18,00,000$

## Unit - 12.14 Perquisites (Sec 17(2))

In common parlance, perquisite means, any casual emoluments or benefits attached to an office or position, in addition to salary or wages, which is availed by an employee. In other words, perquisites are the benefits in addition to normal salary.

**As per sec. 17(2) of the Income tax Act, Perquisite includes:**

- Value of rent-free accommodation provided by the employer.
- Value of concession in rent in respect of accommodation provided to the assessee by his employer.
- The value of any benefit or amenity granted or provided free of cost or at concessional rate to specified employees.
- Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee.

**Tax point:** Any obligation of the employee met by employer shall be taxable on cash basis i.e., in the year in which amount is paid by the employer.

Example: Employer paid employees' professional tax liability pertaining to period 2019-20 in April 2020, such perquisite shall be taxable in the previous year 2020-21.

- Sum payable by an employer, whether directly or through a fund other than recognised provident fund or approved superannuation fund or deposit-linked insurance fund, to affect an assurance on the life of the assessee or to affect a contract for an annuity. Tax point: Such sum shall be taxable on accrual basis.
- The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.
- Any contribution in excess of ₹ 1,50,000 to an approved superannuation fund by the employer in respect of the assessee.
- The value of any other fringe benefit or amenity as may be prescribed.

**Notes:**

- Perquisites are taxable under the head "Salaries" only if, they are:
  - Allowed by an employer to his employee or any member of his household.
  - Resulting in the nature of personal advantage to the employee.
  - Derived by virtue of employee's authority.
- Perquisite may be contractual or voluntary. In other words, it is not necessary that the benefit must have been received under an enforceable right.
- Perquisite may be received from the former, present, or prospective employer. Member of household includes:
  - i. Spouse (whether dependent or not)
  - ii. Parents (whether dependent or not);
  - iii. Servants; and
  - iv. Children and their spouse (whether dependent or not);
  - v. Dependents.

## Unit - 3.15 Specified Employees [Sec. 17(2)(iii)]

**Specified Employee Means:**

- A director Employee.

**Note: It is immaterial:**

- Whether he is a nominee of the workers, financial institutions, etc. on the board;
- Whether the employee is full time director or a part time; and
- Whether he was a director throughout the previous year or not.

**Tax point:**

- A director-employee shall be treated as specified employee of that company only. Example: If Steve is working with X Ltd. as director employee and with Y Ltd. as employee only, he will be treated as specified employee only for X Ltd. and not for Y Ltd.
- Director even for a day is construed as specified employee of such company.



- **An Employee who has Substantial Interest in the Employer Company.**

Substantial interest means the employee who beneficially holds 20% or more voting power in the employer company.

**Tax point:**

- Such employee shall be treated as specified employee of that company only.
- The main criteria is, beneficial ownership and not the legal ownership.
- Substantial interest must be held by the assessee individually, and not together with relative.

**Example:** Mr. Kevin holds 18% equity share of X Ltd. and his wife holds 7% equity share of the same company. In such case Mr. Kevin will not be treated as specified employee.

- **An Employee whose Aggregate salary from all Employers Together exceeds ₹ 50,000 p.a.**

For computing the sum of ₹ 50,000, following are to be excluded/deducted:

- All non-monetary benefits;
- Non-taxable monetary benefits;
- Deduction u/s 16(ia), 16(ii) and 16(iii) [Discussed later in this chapter]; and
- Employer's contribution to Provident Fund. Tax point:

- Where salary is received from two or more employers, the aggregate salary from all employers shall be considered for calculation of above ceiling. And if aggregate salary exceeds ₹ 50,000 p.a. the employee shall be treated as specified employee of all employers.

**Example:** Mr. Rohan is working with X & Co. and Y Ltd. His taxable monetary salary from X & Co. is ₹ 36,000 p.a. and from Y Ltd. is ₹ 45,000 p.a. Since the aggregate salary is more than ₹ 50,000 p.a. Mr. Rohan will be treated as specified employee for both the employer i.e., X & Co. and Y Ltd.

- Even 'DA not forming a part of salary for retirement benefit' shall be included in salary, while determining the above limit of ₹ 50,000 p.a.

### Exempted Perquisites

Following perquisites are exempted in hands of employee:

- **Tea or Snacks:** Tea, similar non-alcoholic beverages and snacks provided during working hours.
- **Food:** Food provided by employer in working place.
- **Recreational Facilities:** Recreational facilities extended to a group of employees.
- **Goods Sold to Employee at concessional rate:** Goods manufactured by employer and sold by him to his employees at concessional (not free) rates.
- **Conveyance Facility:** Conveyance facility provided:
  - To employees for journey between office and residence and vice versa.
  - To the judges of High Court and Supreme Court
- **Training:** Amount spent on training of employees including boarding & lodging expenses for such training.
- **Services Rendered Outside India:** Any perquisite allowed outside India by the government to a citizen of India for rendering services outside India.



- **Contribution In Some Specified Schemes**

- Employer's contribution to a pension or deferred annuity scheme.
- Employer's contribution to staff group insurance scheme.
- Annual premium paid by the employer on personal accident policy affected by him in respect of his employee.

- **Loans**

- Loan given at nil or at concessional rate of interest by the employer provided the aggregate amount of loan does not exceed ₹ 20,000.
- Interest free loan for medical treatment of the diseases specified in Rule 3A.

\*Medical facility: A provision of medical facility at office is exempt.

**Note: However, Medical Allowance is Fully Taxable.**

- **Periodicals and Journals:** Periodicals and journals required for discharge of work.
- **Telephone, Mobile Phones:** Expenses for telephone, mobile phones actually incurred on behalf of employee by the employer whether by way of direct payment or reimbursement.
- **Free education facility:** Free education facility to the children of employee in an institution owned or maintained by the employer provided cost of such facility does not exceed ₹ 1,000 p.m. per child.

**Note: Such facility is not restricted to two children as in case of Children Education allowance.**

- **Computer or Laptop:** Computer or Laptop provided whether to use at office or at home (provided ownership is not transferred to the employee).
- **Movable assets:** Sale or gift of any movable asset (other than car and electronic items) to employee after being used by the employer for 10 or more years.
- **Leave Travel Concession:** Leave Travel Concession (LTC) subject to few conditions.
- **Rent-free accommodation**
  - Rent-free official residence provided to a Judge of a High Court or the Supreme Court.
  - Rent-free furnished residence (including maintenance thereof) to Official of Parliament, a Union Minister or a Leader of opposition in Parliament.
- **Accommodation:** Accommodation provided:
  - on transfer of an employee in a hotel for a period not exceeding 15 days in aggregate.
  - In a remote area to an employee working at a mining site or an onshore exploration site or a project execution site or a dam site or a power generation site or an offshore site.
- **Tax on non-monetary perquisite paid by employer on behalf of employee.** With effect from A.Y. 2003-04 a new sec. 10(10CC) has been inserted which provides that income tax paid by employer on behalf of employee on income, being non-monetary perquisite, is not a taxable perquisite.
- **Health club, Sports club facility**

## Unit 12.16 - Leave Travel Concession [Sec. 10(5)]

If an employee goes on travel (on leave) with his family and traveling cost is reimbursed by the employer, then such reimbursement is fully exempted.

### Notes

Journey may be performed during service or after retirement.

Employer may be present or former.

Journey must be performed to any place within India.

In case, journey was performed to various places together, then exemption is limited to the extent of cost of journey from the place of origin to the farthest point reached, by the shortest route.

Employee may or may not be a citizen of India.

Stay cost is not exempt

Exemption: Exemption is limited to the amount actually incurred on the travel to the extent as under:

| Journey performed                                                                                                     | Maximum exempted fare                                                                                                                                       |
|-----------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|
| By Air                                                                                                                | Air economic class fare of shortest route                                                                                                                   |
| When the place of origin and destination is connected by rail but journey is performed by any other mode of transport | Same as above                                                                                                                                               |
| When the place of origin and destination is not connected by rail:                                                    |                                                                                                                                                             |
| Where a recognized public transport system exists                                                                     | First class or deluxe class fare, as the case may be, on such transport.                                                                                    |
| Where no recognized public transport system exists                                                                    | Amount equivalent to air- conditioner 1st class rail fare, for the distance of the journey by the shortest route, as if journey had been performed by rail. |

### Notes

No exemption can be claimed without performing journey and incurring expenses thereon.

**Block-period:** Exemption is available in respect of 2 journeys performed in a block of 4 calendar years commencing from 1st January 1986.

Academically, for the A.Y. 2019-20, the relevant block is Jan 2018 to Dec. 2021.

**Carry-forward facility:** Where concession is not availed during the preceding block (whether on one occasion or both), then any one journey performed in the first calendar year of the immediately succeeding block will be additionally exempted (i.e., not counted in two journey limit)

**Family:** Family here means:

Spouse and children of the individual; and

Parents, brothers and sisters of the individual, who are wholly or mainly dependent on him.

**Restriction on number of children:** Exemption can be claimed for any number of children born on or before 30th September, 1998. In addition, exemption is available only for 2 surviving children born on or after 1st October, 1998. However, children born out of multiple birth, after the first child, will be treated as one child only.



**Fixed Leave travel allowance:** Fixed amount paid to employees by way of leave travel allowance shall not be exempt.

The exemption u/s 10(5) is for travel cost and does not include stay cost or other cost.

#### **Valuation of Rent-free unfurnished accommodation (RFA) [Rule 3(1)]**

Rent-free accommodation is taxable in the hands of all employees (except the Judges of High Court or Supreme Court and Official of the Parliament or Union Minister and a leader of Opposition).

**Accommodation here includes fixed as well as floating structure.**

|                    |                                                                                                                   |
|--------------------|-------------------------------------------------------------------------------------------------------------------|
| Fixed Structure    | A house, flat, farmhouse (or apart thereof), accommodation in hotel, motel, service apartment, a guest house etc. |
| Floating Structure | A caravan, mobile home, ship etc.                                                                                 |

#### **For The Purpose of Valuation, Employees are Divided into Three Categories:**

- Employees of the central or state government or of any undertaking under the control of the government;
- Accommodation provided by government to an employee serving on deputation
- Other employees
- **Central and State Government Employee (Including military person)**

Where the accommodation is provided by the central government or any state government to the employees either holding office or post in connection with the affairs of the union or of such state, the value of perquisite in respect of such accommodation is equal to the license fee, which would have been determined by the central or state government in accordance with the rules framed by the government.

Accommodation provided by government to an employee serving on

**deputation:** Where the accommodation is provided by the central government or any state government to an employee who is serving on deputation with anybody or undertaking under the control of such government, then the value of perquisite of such an accommodation shall be:

| Which accommodation is provided                                                    | Value of perquisite                                                                      |
|------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|
| Having population exceeding 25 Lakhs as per 2001 census                            | 15% of salary for the period during which the employee occupied the said accommodation.  |
| Having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census | 10% of salary for the period during which the employee occupied the said accommodation.  |
| Any other city                                                                     | 7.5% of salary for the period during which the employee occupied the said accommodation. |

**Other Employees (residual category)**

The value of perquisite is determined as per the following table:

| City in which accommodation is provided                                            | Accommodation is owned by the employer                                                   | Accommodation is not owned by the employer                                 |
|------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|
| Having population exceeding 25 lakhs as per 2001 census                            | 15% of salary for the period during which the employee occupied the said accommodation.  |                                                                            |
| Having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census | 10% of salary for the period during which the employee occupied the said accommodation.  | Rent paid or payable by the employer or 15% of salary, whichever is lower. |
| Any other city                                                                     | 7.5% of salary for the period during which the employee occupied the said accommodation. |                                                                            |

**Illustration 12**

Mr. Mukesh has the following salary structure:

|                                                                       |                                         |
|-----------------------------------------------------------------------|-----------------------------------------|
| a) Basic Salary ₹ 5,000 p.m.                                          | b) Entertainment Allowance ₹ 1,000 p.m. |
| c) Education Allowance ₹ 500 p.m.<br>(he has three children)          | d) DA ₹ 3,000 p.m.                      |
| e) Fees ₹ 5,000 p.a.                                                  | f) Bonus ₹ 10,000 p.a.                  |
| g) Professional tax of employee paid by employer ₹ 2,000 for the year |                                         |

He has been provided a rent-free accommodation in Mumbai. 60% of DA only forms part of retirement benefits.

Compute taxable value of accommodation in the hands of Mr. Mukesh in the following cases:

The employer owns such accommodation.

The employer hires such accommodation at a monthly rent of ₹ 900.

**Solution**

Taxable value of rent-free accommodation for the A.Y. 2021- 22

| Particulars            | Basis of determination                                            | Taxable Perquisite |
|------------------------|-------------------------------------------------------------------|--------------------|
| (i) Owned by employer  | 15% of Salary (Working)                                           | ₹ 16,830           |
| (ii) Hired by employer | 15% of Salary or actual rent paid by employer, whichever is lower | ₹ 10,800           |



Working: Salary for the purpose of rent-free accommodation:

| Particulars             | Details           | Amount (₹.) | Amount (₹) |
|-------------------------|-------------------|-------------|------------|
| Basic Salary            |                   |             | 60,000     |
| Bonus                   |                   |             | 10,000     |
| Fees                    |                   |             | 5,000      |
| Allowances              |                   |             |            |
| Dearness allowance      | ₹ 36,000 × 60%    | 21,600      |            |
| Entertainment Allowance |                   | 12,000      |            |
| Education Allowance     | ₹ 6,000 – ₹ 2,400 | 3,600       | 37,200     |
| Gross Taxable Salary    |                   |             | 1,12,200   |

Note: Professional tax paid on behalf of employee is a perquisite; hence the same shall not be included in salary for the aforesaid purpose.

#### Illustration 13

In above illustration, how shall answer differ if the property is situated in a city where population is only 14,60,000.

#### Solution

Taxable value of rent-free accommodation for the A.Y.2021- 22

| Particulars           | Basis of determination                                            | Taxable value of Perquisite |
|-----------------------|-------------------------------------------------------------------|-----------------------------|
| i. Owned by employer  | 10% of Salary (as per the above working)                          | ₹ 11,220                    |
| ii. Hired by employer | 15% of Salary or Actual rent paid by employer, whichever is lower | ₹ 10,800                    |

#### Illustration 14

- Miss Sharma has the following salary structure:
- Basic salary ₹ 15,000 p.m.
- Dearness Allowance ₹ 5,000 p.m. (not forming part of retirement benefit)
- Hostel Allowance ₹ 1,000 p.m. (does not have any child)
- Tiffin Allowance ₹ 500 p.m.
- Transport Allowance ₹ 200 p.m.
- Bonus ₹ 20,000 p.a.
- Commission ₹ 15,000 p.a.
- Free refreshment in office worth ₹ 5,000 p.a.
- Mobile phone facility by employer ₹ 900 p.m.
- Computer facility worth ₹ 10,000 p.a.

She has been provided a rent-free accommodation (owned by employer) in Kolkata. The house was allotted to her with effect from 1st May, 2020 but she could occupy the same only from 1st June, 2020. Find her gross taxable salary.

**Solution**

Computation of gross taxable salary of Miss Sharma for the A.Y. 2021-22

| Particulars                                          | Amount (₹) | Amount (₹) |
|------------------------------------------------------|------------|------------|
| Basic Salary                                         |            | 1,80,000   |
| Bonus                                                |            | 20,000     |
| Commission                                           |            | 15,000     |
| Allowances:                                          |            |            |
| Dearness Allowance                                   | 60,000     |            |
| Hostel Allowance (Fully taxable as she has no child) | 12,000     |            |
| Tiffin Allowance                                     | 6,000      |            |
| Transport Allowance                                  | 2,400      | 80,400     |
| Perquisite u/s 17(2):                                |            |            |
| Free Refreshment (not taxable)                       | Nil        |            |
| Mobile or telephone facility                         | Nil        |            |
| Computer facility                                    | Nil        |            |
| Rent Free Accommodation (Working)                    | 29,425     | 29,425     |
| Gross Salary                                         |            | 3,24,825   |

Working: Salary for the purpose of rent-free accommodation

|                                                                                 |          |
|---------------------------------------------------------------------------------|----------|
| Basic Salary                                                                    | 1,80,000 |
| Bonus                                                                           | 20,000   |
| Commission                                                                      | 15,000   |
| Allowances:                                                                     |          |
| Dearness allowance                                                              | Nil      |
| Hostel Allowance                                                                | 12,000   |
| Tiffin Allowance                                                                | 6,000    |
| Transport Allowance                                                             | 2,400    |
| Total                                                                           | 2,35,400 |
| Value of Rent-Free Accommodation (being $15\% \times ₹ 2,35,400 \times 10/12$ ) | 29,425   |

**Motor Car**

There are various perquisites which are provided by the employer to employee during the year. Motor car as a perquisite is one of the famous perquisites provided by employer. Generally, this kind of perquisite is provided to senior employees of the organization. The taxability of perquisites is covered under Rule 3 of Income Tax Rules, 1962.

- **If Motor Car is Owned or Leased by The Employer**

- **Used Exclusively for official Purpose**

If the car is used for only official purpose, it will not be taxable in the hands of employee irrespective of cubic capacity of engine.

- **Used for Both official and Personal Purpose**

- If running and maintenance cost is reimbursed by the employer cubic capacity within 1.6 litre – ₹ 1,800 p.m. + ₹ 900 p.m. (If driver is provided) cubic capacity exceeding 1.6 litre – ₹ 2,400 p.m. + ₹ 900 p.m. (If driver is provided)

If running and maintenance cost is reimbursed by the employee Cubic capacity within 1.6 litre – ₹ 600 p.m. + ₹ 900 p.m. (If driver is provided) Cubic capacity exceeding 1.6 litre – ₹ 900 p.m. + ₹ 900 p.m. (If driver is provided)

#### **Used Exclusively for Personal Purpose**

If the car is used for only personal purpose, it will be fully taxable in the hands of employee irrespective of cubic capacity of engine.

The taxable value is as under:

Actual cost of running and maintenance of motor car

Plus: driver's salary

Plus: normal wear and tear ₹10% per annum of the actual cost of motor car

Less: any charges recovered from the employee

#### **If motor car is owned by the employee but running and maintenance and driver's salary reimbursed by employer:**

Used exclusively for official purpose

If the car is used for only official purpose, it will not be taxable in the hands of employee irrespective of cubic capacity of engine.

Used for both official and personal purpose

If running and maintenance cost is reimbursed by the employer

Cubic capacity within 1.6 litre – Actual expenses less ₹ 2,700 p.m. Cubic capacity

exceeding 1.6 litre – Actual expenses less ₹ 3,300 p.m.

#### **If Employee owns any other automotive conveyance but running and maintenance is reimbursed by employer**

Used exclusively for official purpose

If the car is used for only official purpose, it will not be taxable in the hands of employee if cubic capacity of engine is within 1.6 litre.

Used for both official and personal purpose

If running and maintenance cost is reimbursed by the employer

Cubic capacity within 1.6 litre – Actual expenses less ₹ 900 p.m. Cubic capacity exceeding 1.6 litre –

Not Applicable

## **Unit - 12.17 Deductions From Salary**

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

Standard deduction [Section 16(ia)]

Entertainment allowance [Section 16(ii)]

Professional tax [Section 16(iii)]



**Standard Deduction**

A standard deduction of ₹ 50,000 or the amount of salary, whichever is lower, is to be provided to the employees.

**Entertainment Allowance**

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

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

One-fifth of his basic salary or

₹ 5,000 or

Entertainment allowance received.

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

**Professional Tax on Employment**

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

## Unit - 12.18 Relief Under Section 89 (1)

- On account of arrears of salary or advance salary: Where by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than twelve months or a payment of profit in lieu of salary under section 17(3), his income is assessed at a rate, higher than that, at which it would otherwise have been assessed. The Assessing Officer shall, on an application made to him in this behalf, grant such relief as prescribed. The procedure for computing the relief is given in Rule 21A.
- On account of family pension: Similar tax relief is extended to assessee who receive arrears of family pension as defined in the Explanation to clause (ia) of section 57. "Family pension" means a regular monthly amount payable by the employer to a
  - Person belonging to the family of an employee in the event of his death.
- No relief at the time of voluntary retirement or termination of service:
 

No relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.



**Illustration 15**

Mr. X is employed with AB Ltd. on a monthly salary of ₹ 25,000 per month and an entertainment allowance and commission of ₹ 1,000 p.m. each. The company provides him with the following benefits:

- A company owned accommodation is provided to him in Delhi. Furniture costing ₹ 2,40,000 was provided on 1st August, 2021.
- A personal loan of ₹ 5,00,000 was provided on 1st, July, 2021 on which interest is charged ₹ 6.75% p.a. The entire loan is still outstanding. (Assume SBI rate of interest on 1st April, 2021 was 12.75% p.a.)
- His son is allowed to use a motor cycle belonging to the company. The company had purchased this motor cycle for ₹ 60,000 on 1st May, 2018. The motor cycle was finally sold to him on 1st August, 2021 for ₹ 30,000.
- Professional tax paid by Mr. X is ₹ 2,000.

Compute the income from salary of Mr. X for the A.Y. 2022-23 assuming Mr. X has not opted for the provisions of section 115BAC.

**Solution**

| Particulars                                                  | Details | Amount (₹.)     |
|--------------------------------------------------------------|---------|-----------------|
| Basic salary [₹ 25,000 × 12]                                 |         | 3,00,000        |
| Commission [₹ 1,000 × 12]                                    |         | 12,000          |
| Entertainment allowance [₹ 1,000 × 12]                       |         | 12,000          |
| Rent free accommodation [Note 1]                             | 48,600  |                 |
| Add: Value of furniture [₹ 2,40,000 × 10% p.a. for 8 months] | 16,000  | 64,600          |
| Interest on personal loan [Note 2]                           |         | 22,500          |
| Use of motor cycle [₹ 60,000 × 10% p.a. for 4 months]        |         | 2,000           |
| Transfer of motor cycle [Note 3]                             |         | 12,000          |
| <b>Gross Salary</b>                                          |         | <b>4,25,100</b> |
| Less: Deduction under section 16;                            |         |                 |
| Under section 16(ia) – Standard deduction Under section      | 50,000  |                 |
| 16(iii) - Professional tax paid                              | 2,000   | 52,000          |
| <b>Income from Salary</b>                                    |         | <b>3,73,100</b> |

**Note 1: Value of rent-free unfurnished accommodation**

= 15% of salary for the relevant period

= 15% of (₹3,00,000 + ₹12,000 + ₹12,000) = ₹48,600

**Note 2: Value of perquisite for interest on personal loan**

= [₹5,00,000 × (12.75% - 6.75%) for 9 months] = ₹22,500

**Note 3: Depreciated value of the motor cycle**

= Original cost – Depreciation ₹10% p.a. for 3 completed years.

= ₹60,000 – (₹60,000 × 10% p.a. × 3 years)

= ₹42,000. Perquisite = ₹42,000 – ₹30,000 = ₹12,000

**Illustration 16**

Mr. Ram, employed as Production Manager in Beta Ltd., furnishes you the following information for the year ended 31st March, 2022:

- Basic salary up to 31st October, 2021 ₹ 50,000 p.m.  
Basic salary from 01st November, 2021 ₹ 60,000 p.m.

**Note: Salary is due and paid on the last day of every month.**

- Dearness allowance ₹ 40% of basic salary.
- Bonus equal to one month salary. Paid in October 2021 on basic salary plus dearness allowance applicable for that month.
- Contribution of employer to recognized provident fund account of the employee @16% of basic salary.
- Professional tax paid ₹ 2,500 of which ₹ 2,000 was paid by the employer.
- Facility of laptop and computer was provided to Mr. Ram for both official and personal use. Cost of laptop ₹ 45,000 and computer ₹ 35,000 were acquired by the company on 01st December, 2021.
- Motor car owned by the employer (cubic capacity of engine exceeds 1.60 litres) provided to the employee from 01st November, 2021 meant for both official and personal use. Repair and running expenses of ₹ 45,000 from 01st November, 2021 to 31st March, 2022, were fully met by the employer. The motor car was self-driven by the employee.
- Leave travel concession given to employee, his wife and three children (one daughter aged 7 and twin sons aged 3). Cost of air tickets (economy class) reimbursed by the employer ₹ 30,000 for adults and ₹ 45,000 for three children. Mr. Ram is eligible for availing exemption this year to the extent it is permissible in law.

Compute the salary income chargeable to tax in the hands of Mr. Ram for the assessment year 2022-23 assuming he has not opted for the provisions of section 115BAC.

**Solution****Computation of Taxable Salary of Mr. Ram for A.Y. 2022-23**

| Particulars                                                                                                     | Details | Amount (₹.)      |
|-----------------------------------------------------------------------------------------------------------------|---------|------------------|
| Basic salary [(₹ 50,000 × 7) + (₹ 60,000 × 5)]                                                                  |         | 6,50,000         |
| Dearness Allowance (40% of basic salary)                                                                        |         | 2,60,000         |
| Bonus (₹ 50,000 + 40% of ₹ 50,000) (See Note 1)                                                                 |         | 70,000           |
| Employers' contribution to recognised provident fund in excess of 12% of salary = 4% of ₹ 6,50,000 (See Note 2) |         | 26,000           |
| Professional tax paid by employer                                                                               |         | 2,000            |
| Perquisite of Motor Car (₹ 2,400 for 5 months) (See Note 4)                                                     |         | 12,000           |
| <b>Gross Salary</b>                                                                                             |         | <b>10,20,000</b> |
| Less: Deduction under section 16                                                                                |         |                  |
| Standard deduction u/s 16(ia)                                                                                   | 50,000  |                  |
| Professional tax u/s 16(iii) (See Note 6)                                                                       | 2,500   | 52,500           |
| <b>Taxable Salary</b>                                                                                           |         | <b>9,67,500</b>  |



**Notes:**

1. Since bonus was paid in the month of October, the basic salary of ₹ 50,000 for the month of October is considered for its calculation.
2. It is assumed that dearness allowance does not form part of salary for computing retirement benefits.
3. As per Rule 3(7)(vii), facility of use of laptop and computer is a tax-free perquisite, whether used for official or personal purpose or both.
4. As per the provisions of Rule 3(2), in case a motor car (engine cubic capacity exceeding 1.60 liters) owned by the employer is provided to the employee without chauffeur for personal as well as office use, the value of perquisite shall be ₹ 2,400 per month. The car was provided to the employee from 01st November, 2022, therefore the perquisite value has been calculated for 5 months.
5. Mr. Ram can avail exemption under section 10(5) on the entire amount of ₹ 75,00 reimbursed by the employer towards leave travel concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child. It is assumed that the leave travel concession was availed for journey within India.
6. As per section 17(2)(iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of ₹ 2,000 paid by the employer is taxable as a perquisite in the hands of Mr. Ram. As per section 16(iii), a deduction from the salary is provided on account of tax on employment i.e., professional tax paid during the year. Therefore, in the present case, the professional tax paid by the employer on behalf of the employee ₹ 2,000 is first included in the salary and deduction of the entire professional tax of ₹ 2,500 is provided from salary.

**Illustration 17**

From the following details, find out the salary chargeable to tax for the A.Y. 2022-23 assuming he has not opted for the provisions of section 115BAC. Mr. X is a regular employee of Rama & Co., in Gurgaon. He was appointed on 1st January, 2021 in the scale of ₹ 20,000 - ₹ 1,000 - ₹ 30,000. He is paid 10% D.A. & Bonus equivalent to one month pay based on salary of March every year. He contributes 15% of his pay and D.A. towards his recognized provident fund and the company contributes the same amount. D.A. forms part of pay for retirement benefits.

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

Facility of laptop costing ₹ 50,000.

Company reimbursed the medical treatment bill of his brother of ₹ 25,000, who is dependent on him.

The monthly salary of ₹ 1,000 of a house keeper is reimbursed by the company.

A gift voucher of ₹ 10,000 on the occasion of his marriage anniversary.

Conveyance allowance of ₹ 1,000 per month is given by the company towards actual reimbursement of conveyance spent on official duty.

He is provided personal accident policy for which premium of ₹ 5,000 is paid by the company.

He is getting telephone allowance ₹ 500 per month.

## Solution

Computation of taxable salary of Mr. X for A.Y. 2022-23

| Particulars                                                                                                          | Amount (₹.)     |
|----------------------------------------------------------------------------------------------------------------------|-----------------|
| Basic pay [(₹ 20,000×9) + (₹ 21,000×3)] = ₹ 1,80,000 + ₹ 63,000                                                      | 2,43,000        |
| Dearness allowance [10% of basic pay]                                                                                | 24,300          |
| Bonus                                                                                                                | 21,000          |
| Employer's contribution to Recognized Provident Fund in excess of 12% (15%-12% =3% of ₹ 2,67,300) [See Note 1 below] | 8,019           |
| <b>Taxable allowances ;</b>                                                                                          |                 |
| Telephone allowance                                                                                                  | 6,000           |
| <b>Taxable perquisites ;</b>                                                                                         |                 |
| Rent-free accommodation [See Note 1 & 2 below]                                                                       | 44,145          |
| Medical reimbursement                                                                                                | 25,000          |
| Reimbursement of salary of housekeeper                                                                               | 12,000          |
| Gift voucher [See Note 5 below]                                                                                      | 10,000          |
| <b>Gross Salary</b>                                                                                                  | <b>3,93,464</b> |
| Less: Deduction under section 16(ia) – Standard deduction                                                            | 50,000          |
| <b>Salary income chargeable to tax</b>                                                                               | <b>3,43,464</b> |

## Notes:

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

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

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

Therefore, salary works out to

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

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

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

Therefore, the perquisite value is ₹ 44,145.

3. Facility of, use of laptop is not a taxable perquisite.
4. Conveyance allowance is exempt since it is based on actual reimbursement for official purposes.
5. The value of any gift or voucher or token in lieu of gift received by the employee or by member of his household below ₹ 5,000 in aggregate during the previous year is exempt. In this case, the gift voucher was received on the occasion of marriage anniversary and the sum exceeds the limit of ₹ 5,000, anniversary and the sum exceeds the limit of ₹ 5,000.



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

**Note-**An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable. In such a case, the value of perquisite would be ₹ 5,000.

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

## Summary

The concept of salary in income tax law encompasses various components, each governed by specific sections to define its taxability. Section 17(1) clearly defines salary to include wages, annuities, pensions, gratuity, fees, commissions, perquisites, profits in lieu of salary, and advances. The basis of charging tax on these earnings is established in Section 15, which stipulates that salary is taxed on due or receipt basis, whichever is earlier. Allowances provided by an employer can either be fully taxable, partially taxable, or exempt, depending on their nature and the stipulations in the tax laws. Pension and gratuity are retirement benefits with their tax implications; pensions are generally taxable unless specified, and gratuity is exempt up to a certain limit under specific conditions. Other notable components include fees and commissions which are taxed as part of salary, perquisites (valued additions provided by the employer), and profits in lieu of salary, which encompass various non-salary compensations. Leave salary or encashment, provident fund contributions, retrenchment compensation under Section 10(10B), and receipts from voluntary retirement under Section 10(10c) are other crucial elements, each with distinct tax treatments that reflect their role in an employee's compensation structure.

## Exercise

What is included in the definition of salary according to Section 17(1)?

- A) Only wages and fees
- B) Wages, pensions, gratuity, and other compensations
- C) Only perquisites and profits
- D) Solely commissions
- Answer: B

According to Section 15, on what basis is salary taxed?

- A) Only when it is due
- B) Only when it is received
- C) On the basis of the higher amount between due and received
- D) On a due or receipt basis, whichever is earlier
- Answer: D

Which type of allowance is not fully taxable?

- A) House Rent Allowance in some cases
- B) Transport Allowance
- C) Special Allowance
- D) Dearness Allowance
- Answer: A

What is the tax treatment of pension received by an employee?

- A) Always non-taxable
- B) Always taxable
- C) Taxable, unless specified otherwise
- D) Non-taxable, if received from an approved fund
- Answer: C

Under what condition is gratuity exempt from tax?

- A) Always exempt
- B) Exempt up to a certain limit under specific conditions
- C) Never exempt
- D) Exempt only for government employees
- Answer: B

How are fees and commissions categorized for taxation?

- A) As capital gains
- B) As business income
- C) As other sources of income
- D) As part of salary
- Answer: D

What are perquisites according to tax law?

- A) Additional benefits, often taxable, provided by an employer
- B) Basic components of salary
- C) Always non-taxable benefits
- D) Only include vehicle and housing benefits
- Answer: A

What are profits in lieu of salary?

- A) Profits earned from personal investments
- B) Bonuses only
- C) Includes non-salary compensations like bonuses, terminated contracts compensation
- D) Only includes stock options
- Answer: C

What is the tax treatment for retrenchment compensation under Section 10(10B)?

- A) Fully taxable
- B) Exempt under certain conditions
- C) Always exempt
- D) Partially taxable
- Answer: B

How are voluntary retirement receipts treated under Section 10(10c)?

- A) Taxable as regular income
- B) Fully exempt without conditions
- C) Exempt up to a specified limit under certain conditions
- D) Considered as capital gains



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## 13. Income From House Property

- Unit 13.1 - Chargeability [Sec. 22]
- Unit 13.2 - Conditions for Chargeability
- Unit 13.3 - Composite Rent
- Unit 13.4 - Income from House Property Situated Outside India
- Unit 13.5 - Exempted House Properties
- Unit 13.6 - Determination of Annual Value
- Unit 13.7 - Deductions from Annual Value [Section 24]
- Unit 13.8 - Arrears of Rent and Unrealized Rent Received Subsequently [Section 25A]
- Unit 13.9 - Treatment of Income from Co-Owned Property [Section 26]
- Unit 13.10 - Deemed Ownership [Section 27]



## Key Learning Outcomes



- Understand Chargeability
- Learn Classification of Properties
- Understand Concept of Annual Value
- Identify Deductions Allowed
- Knowledge of Exemptions and Concessions
- Understand Treatment of Foreign Properties
- Learn to Handle Special Situations
- Understand Co-ownership Issues
- Knowledge of Reporting and Compliance
- Learn Strategy to Optimize Tax Planning

## Unit 13 - Income From House Property

### Unit Objectives

At The End of The Unit, You Will be Able To Understand:

1. Comprehend Income Chargeable Under The Head "Income From House Property.
2. Tax Treatment of Composite Rent, Co-Owned Property.
3. Compute Income From House Property For Different Categories Of House Property.
4. Tax Treatment On Recovery Of Unrealized Rent and Arrears of Rent.
5. Deductions



## Sections 22 to 27 Deal with Income From House Property.

## Unit 13.1 - Chargeability [Sec. 22]

- The process of computation of income under the head "Income from house property" starts with the determination of the annual value of the property.
- The annual value of property consisting of any building or lands appurtenant thereto of which the assessee is the owner is chargeable to tax under the head "Income from house property."

**Exceptions:**

Annual value of the following properties, is chargeable under the head "Profits and gains of business or profession":

Property occupied by the assessee for the "purpose of any business or profession carried on by him"

Properties of an assessee engaged in the business of letting of properties"

Fig: 7.1

## Unit 13.2 - Conditions for Chargeability

**Condition 1: Property Should Consist of any Building or land Appurtenant Thereto**

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

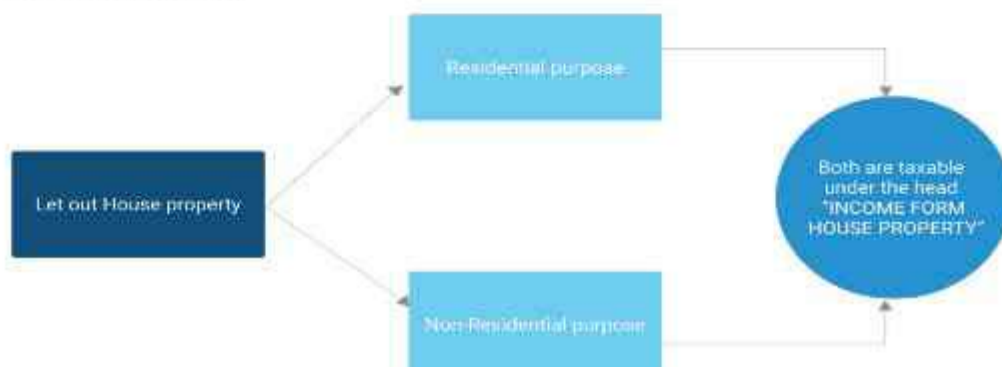


Fig: 7.3

- Land appurtenant means land connected with the building like garden, car parking area, garage, backyards, etc.

#### Notes:

- Building includes an enclosure of bricks, stone work or even mud walls.
- Building includes residential as well as commercial houses.
- Vacant land is not a house property. Hence, income from letting of vacant land is not taxable under this head but taxed as business income or as income from other sources.
- Roof is not necessary for a non-residential house property. A large stadium or an open-air swimming pool is also considered as building.
- It should be a permanent structure meant for a useful purpose.
- If a building consists of several flats, then each flat is considered as a separate house property.
- An incomplete, a ruined or demolished house cannot be termed as house property.
- Land appurtenant to a building includes car parking area, approach roads, backyards, courtyards, etc. attached to such building.

#### Condition 2: Assessee must be the owner of the property

The assessee must be the owner of the property:

- Owner is the person who is entitled to receive income from the property in his own right.
- The requirement of registration of the sale deed is not warranted.
- Ownership includes both free-hold and lease-hold rights.
- Ownership includes deemed ownership.
- The person who owns the building need not also be the owner of the land upon which it stands.
- The assessee must be the owner of the house property during the previous year. It is not material whether he is the owner in the assessment year.
- If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income tax under section 22 will be of the income tax department till the court gives its decision to the suit filed in respect of such property.

E.g., Mr. X being a tenant of a house property acquired it at a monthly rent of ₹ 20,000 to Mr. Y (owner of such house property). Mr. X sublets the property to Mr. Z for a monthly rent of ₹ 22,000. Income from subletting being ₹ 2,000 p.m. is taxable as business income or as income from other sources.

#### Condition 3: Use of Property

- The property may be used for any purpose, but not used for business or profession carried on by the assessee.
- The income earned by an assessee engaged in the business of letting out properties on rent would be taxable as business income.

#### Condition 4: Property held as stock-in-trade

Where house property is held as stock-in-trade & not let out during any part of the previous year, then annual value of such property will be charged under the head "Income from house property"

However, the annual value of the property being held as stock in trade would be treated as nil for a period of two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, if such property is not let-out during such period [Section 23(5)].

## Unit 13.3 - Composite Rent

### • Meaning

The owner of a property may sometimes receive rent in respect of the building as well as additional facilities provided by him, such as:

- Provided assets like furniture, plant and machinery.
- Different services provided in the building, like lifts, security, power backup etc.

The amount so received is known as "composite rent".

|                                                                                            |
|--------------------------------------------------------------------------------------------|
| <b>Composite Rent = Rent for building + Rent for assets / Charges for various services</b> |
|--------------------------------------------------------------------------------------------|

### • Tax Treatment

If the owner of house property gets composite rent for both property as well as for services rendered or other separable asset, such composite rent has to be split up in the following manner:

| Particulars                                            | Taxable under the head                                                                                                                                                                                                                                                                                       |
|--------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| If let out building and other assets are "inseparable" | Rent is taxable either as business income or income from other sources, the case may be.                                                                                                                                                                                                                     |
| If let out building and other assets are separable     | <ul style="list-style-type: none"> <li>• Income from letting out of building is taxable under "Income from house property";</li> <li>• Income from letting out of other assets is taxable under "Profits and gains of business or profession" or "Income from other sources", as the case may be.</li> </ul> |

## Unit 13.4 - Income From House Property Situated Outside India

If house property is situated abroad, then annual value of such property shall be taxable as:

| Assessee                                                                            | Condition for taxability         |
|-------------------------------------------------------------------------------------|----------------------------------|
| Resident in India (resident and ordinarily resident in case of individuals and HUF) | Always taxable                   |
| Not ordinarily resident or Non-resident in India                                    | Income must be received in India |

**Note:** The annual value of such property would be computed as if the property is situated in India.



## Unit 13.5 - Exempted House Properties

Income from the Following house Properties are Exempted from Tax:

- Annual value of one palace or part thereof of an ex-ruler [Sec. 10(19A)].  
Tax point: If the ex-ruler has a house property and the part of which is self-occupied and remaining let out then only the self-occupied part of the house property shall be exempted.
- Income From House Property owned by:
  - Local authority
  - Scientific research association
  - Educational institution
  - Hospitals / Medical Institutions
  - Trade union
  - Political party
- Income from farm house [Sec. 10(1)]
- House Property held for charitable Purpose [Sec. 11]
- House Property used for own Business or Profession [Sec. 22]

## Unit 13.6 - Determination of Annual Value



Fig: 7.4

Determination of Annual Value for Different Types of House Properties:

- Where the property is let out throughout the previous year [Section 23(1)(a)/(b)]
- Where let out property is vacant for part of the year [Section 23(1)(c)]
- In case of self-occupied property or unoccupied property [Section 23(2)]
- Where a house property is let-out for part of the year and self-occupied for part of the year [Section 23(3)]
- In case of deemed to be let out property [Section 23(4)]
- In case of a house property held as stock-in-trade [Section 23(5)]
- In case of a house property, a portion let out and a portion self-occupied



## Computation of Income From House Property

| Particulars                           | Details | Amount      |
|---------------------------------------|---------|-------------|
| Gross Annual Value (GAV)              |         | ****        |
| Less: Municipal tax                   |         | ****        |
| Net Annual Value (NAV)                |         | ****        |
| Less: Deductions u/s                  |         |             |
| 24(a) Standard deduction [30% of NAV] | ****    |             |
| 24(b) Interest on borrowed capital    | ****    | ****        |
| <b>Income from house property</b>     |         | <b>****</b> |

Fig: 7.5

- **Gross Annual Value (GAV)**

**Section 23** – Income from house property is taxable on the basis of annual value. Even if the property is not let out during the year or let out only for a part of the year, notional rent receivable is taxable as its annual value.

Annual value is determined considering the following factors:

- **Actual Rent Receivable [ARR]** – This is the actual rent received/ receivable by the owner of the house property on letting out the house property. While computing actual rent receivable, outstanding rent shall be considered but advance rent received during the financial year is not to be considered.
- **Municipal Value** – This is the value as determined by the Municipal authorities. They normally charge house tax/Municipal taxes on the basis of annual letting value of such house property.
- **Fair Rent** – Fair rent is the rent which, a similar property can fetch in the same or similar locality, if it is let out for a year.
- **Standard Rent** – The standard rent is fixed under the Rent Control Act. The owner cannot be expected to get a rent higher than the standard rent fixed under the Rent control Act.
- **Expected Rent** – Expected rent is the higher value among municipal value and fair rent subject to a maximum of standard rent.

- **Computation of Gross Annual Value of House Property**

- **Where the Property is let out Throughout the Previous year [Section 23(1)(a)/(b)]**

Where the property is let out for the whole year, then the GAV would be higher of:

- Expected Rent (ER) and
- Actual rent received or receivable during the year

“The Expected Rent (ER) is the higher of fair rent (FR) and municipal value (MV), but restricted to standard rent (SR)”

From the GAV computed above, municipal taxes paid by the owner during the previous year are to be deducted to arrive at the NAV.

- **Where let out Property is vacant for Part of the Year [Section 23(1)(c)]**

Where let out property is vacant for part of the year and owing to vacancy:

Actual rent is lower than the Expected rent, then the actual rent received or receivable will be the GAV of the property.

- **In case of Self-Occupied Property or Unoccupied Property [Section 23(2)]**

- Where the property is self-occupied for own residence or unoccupied throughout the previous year, its annual value will be Nil, provided no other benefit is derived by the owner from such property.

**Note:** The expression “Unoccupied property” refers to a property which cannot be occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.

- The benefit of “Nil” annual value is available only for up to two self-occupied or unoccupied house properties i.e., for either one house property or two, house properties. This provision is available only to an individual/ HUF.
- **Where a House Property is let-out for Part of the year and Self-Occupied for Part of the year [Section 23(3)]**
  - If a single unit of a property is self-occupied for part of the year and let-out for the remaining part of the year, then the expected rent for the whole year shall be taken into account for determining the GAV. The expected rent for the whole year shall be compared with the actual rent for the let-out period and whichever is higher shall be adopted as the GAV.
  - However, municipal tax for the whole year is allowed as deduction provided it is paid by the owner during the previous year
- **In Case of Deemed to be Let out Property [Section 23(4)]**
  - Where the assessee owns more than two properties for self-occupation, then the income from any two properties, at the option of the assessee, shall be computed under the self-occupied property category. Their annual value will be nil.
  - The other (more than two properties) self-occupied/unoccupied properties shall be treated as “deemed let-out properties”.
  - This option can be changed year after year in a manner beneficial to the assessee. In case of deemed let-out property, the expected rent shall be taken as the GAV.
  - Municipal taxes actually paid by the owner during the previous year, in respect of the deemed let out properties, can be claimed as deduction
- **In Case of a House Property Held as Stock-in-Trade [Section 23(5)]**
  - In some cases, property consisting of any buildings or lands appurtenant thereto may be held as stock-in-trade, and the whole or any part of the property may not be let out during the whole or any part of the previous year.
  - In such cases, the annual value of such property or part of the property shall be nil.
  - This benefit would be available for the period up to two years from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority.
- **In Case of a House Property, a Portion let out and a Portion Self-Occupied**
  - Income from any portion or part of a property which is let out shall be computed separately under the “let out property” category and the other portion which is self-occupied shall be computed under the “self-occupied property” category.
  - There is no need to treat the whole property as a single unit for computation of income from house property.
  - Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion on built-up floor, space or on such other reasonable basis.

**Illustration 1**

Amal owns four houses in India, all which are let out. Compute the GAV of each house from the information given below.

| Particulars                        | H1       | H2     | H3     | H4     |
|------------------------------------|----------|--------|--------|--------|
| Municipal value                    | 90,000   | 65,000 | 75,000 | 90,000 |
| Fair rent                          | 1,00,000 | 70,000 | 75,000 | 85,000 |
| Standard rent                      | NA       | 85,000 | 68,000 | 88,000 |
| Actual rent received or receivable | 82,000   | 82,000 | 70,000 | 82,000 |

**Solution:**

As per section 23(1) GAV is higher of expected rent and actual rent received. Expected rent is higher of municipal value and fair rent but restricted to standard rent.

**Computation of GAV**

|       | Particulars                           | H1              | H2            | H3            | H4            |
|-------|---------------------------------------|-----------------|---------------|---------------|---------------|
| (I)   | Municipal value                       | 90,000          | 65,000        | 75,000        | 90,000        |
| (II)  | Fair rent                             | 1,00,000        | 70,000        | 75,000        | 85,000        |
| (III) | Higher of (I) & (II)                  | 1,00,000        | 70,000        | 75,000        | 90,000        |
| (IV)  | Standard rent                         | NA              | 85,000        | 68,000        | 88,000        |
| (V)   | Expected Rent Lower of (III) & (IV)   | 1,00,000        | 70,000        | 68,000        | 88,000        |
| (VI)  | Actual rent received or receivable    | 82,000          | 82,000        | 70,000        | 82,000        |
|       | <b>GAV (Higher of (V) &amp; (VI))</b> | <b>1,00,000</b> | <b>82,000</b> | <b>70,000</b> | <b>88,000</b> |

**Treatment of Unrealised Rent**

The Actual rent received/receivable should not include any amount of rent which is not capable of being realised.

**GAV Shall be Computed as Under**

|         | Particulars                                  | Amount |
|---------|----------------------------------------------|--------|
| Steps 1 | Calculate Expected Rent                      |        |
| (I)     | Municipal value                              | XXX    |
| (II)    | Fair rent                                    | XXX    |
| (III)   | Higher of (I) & (II)                         | XXX    |
| (IV)    | Standard rent                                | XXX    |
| A       | Expected Rent (Lower of (III) & (IV))        | XXX    |
| Steps 2 | Calculate Actual Rent Received or Receivable |        |
|         | Actual Rent Received or Receivable           | XXX    |
|         | (Less) Unrealized Rent of the current year   | (XXX)  |
| B       | Actual Rent Received                         | XXX    |
|         | Higher of A and B shall be considered as GAV | xxx    |



- Unrealised rent will be allowed to be excluded from the rent received, only if satisfied **Rule 4**. Following are the conditions:
- The tenancy is bona fide.
- The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
- The defaulting tenant is not in occupation of any other property of the assessee.
- The assessee has taken all the reasonable steps to institute legal proceedings for the recovery of the unpaid rent.

### Illustration 2

Find out the gross annual value in case of the following properties let out throughout the previous year for the assessment year 2022-23

| Particulars                                              | H1       | H2       | H3       | H4       |
|----------------------------------------------------------|----------|----------|----------|----------|
| Municipal value                                          | 90,000   | 5,00,000 | 30,000   | 1,00,000 |
| Fair rent                                                | 3,00,000 | 3,00,000 | 3,00,000 | 3,00,000 |
| Standard rent                                            | 50,000   | 8,00,000 | 2,40,000 | 2,50,000 |
| Actual rent received or receivable                       | 1,20,000 | 6,00,000 | 1,80,000 | 3,60,000 |
| Unrealised rent of the P.Y. 2021-22 (in terms of months) | 2        | 3        | 1        | 3        |

Solution:

|                                                | Particulars                                             | H1             | H2              | H3              | H4              |
|------------------------------------------------|---------------------------------------------------------|----------------|-----------------|-----------------|-----------------|
| Step 1: Calculation of ER                      |                                                         |                |                 |                 |                 |
| (I)                                            | Municipal value                                         | 90,000         | 5,00,000        | 30,000          | 1,00,000        |
| (II)                                           | Fair rent                                               | 3,00,000       | 3,00,000        | 3,00,000        | 3,00,000        |
| (III)                                          | Higher of (I) & (II)                                    | 3,00,000       | 5,00,000        | 3,00,000        | 3,00,000        |
| (IV)                                           | Standard rent                                           | 50,000         | 8,00,000        | 2,40,000        | 2,50,000        |
| (A)                                            | Expected Rent Lower of (III) & (IV)                     | 50,000         | 5,00,000        | 2,40,000        | 2,50,000        |
| Step 2: Calculation of (ARR – Unrealised Rent) |                                                         |                |                 |                 |                 |
| (I)                                            | Actual rent received or receivable (p.a.)               | 1,20,000       | 6,00,000        | 1,80,000        | 3,60,000        |
| (II)                                           | Unrealised rent of the P.Y. 2021-22                     | 20,000         | 1,50,000        | 15,000          | 90,000          |
| (B)                                            | Actual Rent Received                                    | 100,000        | 4,50,000        | 1,65,000        | 2,70,000        |
|                                                | <b>Gross Annual Value (being higher of (A) and (B).</b> | <b>100,000</b> | <b>5,00,000</b> | <b>2,40,000</b> | <b>2,70,000</b> |



- **Property Taxes (Municipal Taxes)**

- Property taxes are allowable as deduction from the GAV subject to the following two conditions:

It should be borne by the assessesee (owner): and

It should be actually paid during the previous year

Fig: 7.6

- If property taxes for a particular previous year are not paid during that year, no deduction shall be allowed.
- However, if in any subsequent year, the arrears are paid, then, the amount so paid is allowed as deduction in computation of income from house property for that year.
- In respect of self-occupied/unoccupied house property/properties for which "nil" annual value benefit is claimed, deduction of municipal taxes paid is not allowable.
- In case of property situated outside India, taxes levied by local authority of the country in which the property is situated, is deductible.

### Illustration 3

Shyam, an American citizen, is a resident and ordinarily resident in India during the P.Y. 2021-22. He owns a house in New York, which he has let out at US\$ 12,000 p.m. The municipal taxes paid to the Municipal Corporation of New York is US\$ 9,000 during the P.Y. 2021-22. The value of one US\$ in Indian rupee is to be taken at ₹ 83. Compute Shyam's Net Annual Value of the property for the A.Y. 2022-23.

### Solution:

For the P.Y. 2021-22, Mr. Shyam, an American citizen, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in New York is to be included in the total income in India. Municipal taxes paid in New York is to be allowed as deduction from the Gross Annual Value.

| Particulars                                            | Amount      |
|--------------------------------------------------------|-------------|
| Gross Annual Value ( $\$ 12,000 \times 12 \times 83$ ) | 1,19,52,000 |
| Less: Municipal taxes paid ( $\$ 9,000 \times 83$ )    | 7,47,000    |
| Net Annual Value (NAV)                                 | 1,12,05,000 |

## Unit 13.7 - Deductions from Annual Value [Section 24]



Fig: 7.7

The list of deduction u/s 24 is exhaustive i.e., no deduction can be claimed in respect of expenditures which are not specified under this section e.g., no deduction is allowed for repairs, collection charges, insurance, ground rent, land revenue, etc

- **Standard Deduction u/s 24(a)**

- 30% of the net annual value is allowed as standard deduction in respect of all expenditures (other than interest on borrowed capital) irrespective of the actual expenditure incurred.

**Note:** Where NAV is negative or zero, standard deduction u/s 24(a) is not available.

- **Interest on loan or Borrowed Capital u/s 24(b)**

Interest payable on amount borrowed for the purpose of purchase, construction, renovation, repairing, extension, renewal or reconstruction of house property can be claimed as deduction on accrual basis. Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.

- **Interest for Pre-Construction Period:**

Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed (Preconstruction interest) as reduced by any part thereof allowed as deduction under any other provision of the Act, can be claimed as deduction over a period of 5 years in equal annual instalments commencing from the year of acquisition or completion of construction.

- **Interest For The Year in which Construction is Completed/ Property is Acquired:**

Interest relating to the year of completion of construction/ acquisition of property can be fully claimed in that year irrespective of the date of completion/ acquisition

In this case, the assessee will be allowed a deduction on account of interest as under:

| Let out / Deemed to be let out property                                        | Self-occupied for full year (NAV is NIL)                                                  |                                                         |
|--------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|---------------------------------------------------------|
| Any amount of interest is allowed as deduction of both Pre and Post (No Limit) | Interest both pre + post limited to                                                       |                                                         |
|                                                                                | (a) 2,00,000 if all the following 3 conditions are satisfied,                             | (b) otherwise, 30,000.                                  |
|                                                                                | 1 The loan is borrowed on or after 1-4-1999                                               | The loan is borrowed <b>before 1-4-1999</b>             |
|                                                                                | 2 The loan is borrowed for purchase or construction of residential house property.        | The loan is borrowed for <b>repairs, and renewal.</b>   |
|                                                                                | 3 The building comes into existence within 5 years from the FY in which loan is borrowed. | The building comes into existence <b>after 5 years.</b> |

Fig: 7.8

Note: "Deduction under section 24(b), in respect of (a) and (b) above to be restricted to ₹ 2,00,000".

#### Deductions from Net Annual Value: At a Glance

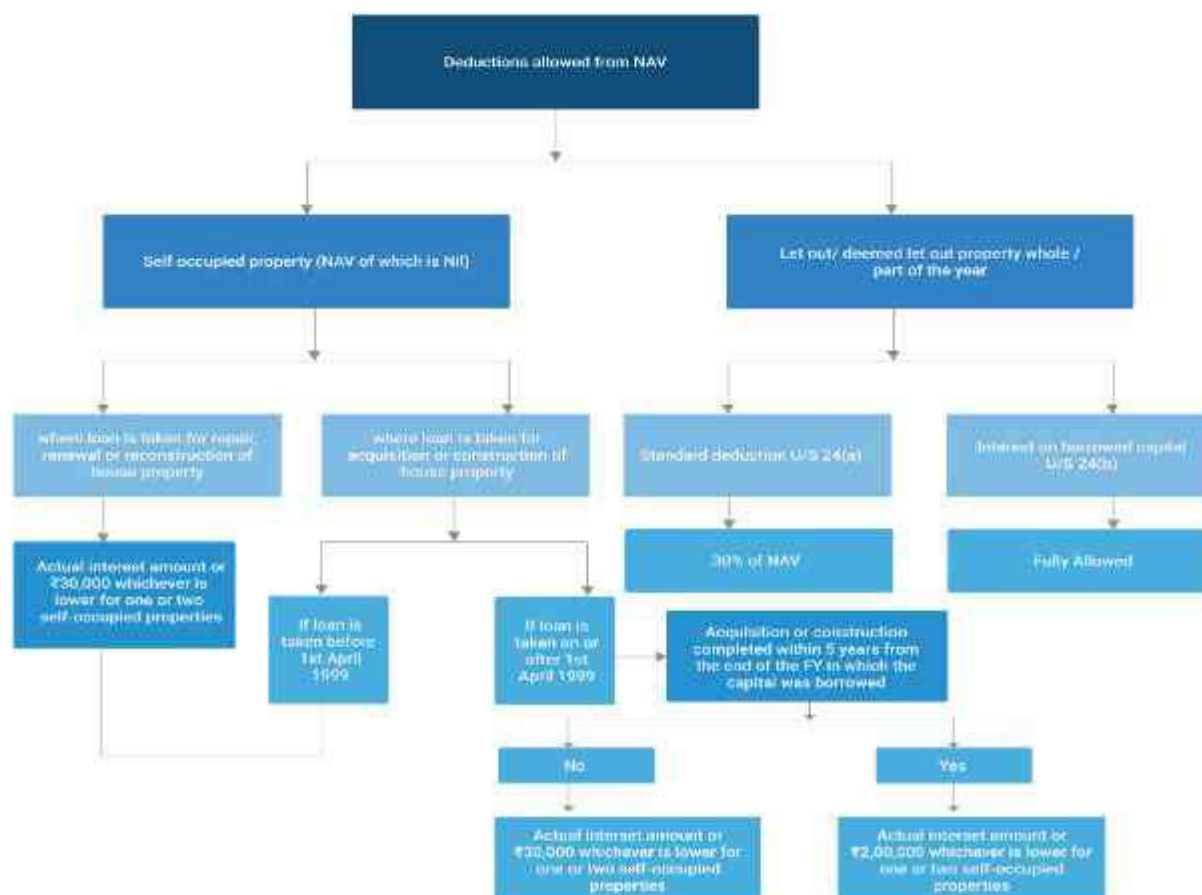


Fig: 7.9



**Note:**

- Interest on borrowed capital is allowed on accrual basis even if the books of account are kept on cash basis.
- Interest paid on fresh loan, which is taken to repay the original loan (being taken for the above-mentioned purpose) shall be allowed as deduction.
- Interest on new loan, taken for paying outstanding interest on old loan, is not deductible.
- Amount paid as brokerage or commission, for arrangement of the loan, is not deductible.
- Interest on loan taken for payment of municipal tax, etc. is not allowed as deduction

**Illustration 4**

Mrs. Revathi owns two house properties one at Bombay, wherein her family resides and the other at Delhi, which is unoccupied. She lives in Chandigarh for her employment purposes in a rented house. For acquisition of house property at Bombay, she has taken a loan of ₹ 35 lakhs @ 10% p.a. on 1st April, 2020. She has not repaid any amount so far. In respect of house property at Delhi, she has taken a loan of ₹ 5 lakhs @ 12% p.a. on 1st October, 2020 towards repairs. Compute the deduction which would be available to her under section 24(b) for A.Y. 2022-23 in respect of interest payable on such loan.

**Solution;**

Mrs. Revathi can claim benefit of nil annual value in respect of her house property at Bombay and Delhi, since no benefit is derived by her from such properties. Computation of deduction u/s 24(b) for A.Y. 2022-23

| Particulars                                                                                                                                        | Amount ₹ |
|----------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| (I) Interest on loan taken for acquisition of residential house property at Bombay ;<br>₹ 35,00,000 x 10% = ₹ 3,50,000<br>Restricted to ₹ 2,00,000 | 2,00,000 |
| (II) Interest on loan taken for repair of residential house property at Delhi<br>₹ 5,00,000 x 12% = ₹ 60,000<br>Restricted to ₹ 30,000             | 30,000   |
| Total interest                                                                                                                                     | 2,30,000 |
| Deduction under section 24(b) in respect of (I) and (II) above to be restricted to                                                                 | 2,00,000 |

**Illustration 5**

Anil has a property whose municipal valuation is ₹ 1,30,000 p.a. The fair rent is ₹ 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 1,20,000 p.a. The property was let out for a rent of ₹ 11,000 p.m. throughout the previous year. Unrealised rent was ₹ 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @ 10% of municipal valuation. Interest on borrowed capital was ₹ 40,000 for the year. Compute his income from house property for A.Y. 2022-23.

**Solution;**

PROPERTY LET OUT THROUGHOUT THE PREVIOUS YEAR

Computation of Income from house property of Mr. Anil for A.Y. 2022-23



| Particulars                                                                                    | Amount in ₹ |          |
|------------------------------------------------------------------------------------------------|-------------|----------|
| <b>Computation of GAV</b>                                                                      |             |          |
| <b>Step 1; Compute Expected Rent</b>                                                           |             |          |
| Expected Rent = Higher of Municipal value of ₹ 1,30,000 p.a. and Fair Rent of ₹ 1,10,000 p.a., |             |          |
| But restricted to Standard Rent of ₹ 1,20,000 p.a.                                             | 1,20,000    |          |
| <b>Step 2; Compute actual rent received/receivable</b>                                         |             |          |
| Actual rent received/ receivable less unrealized rent                                          |             |          |
| = ₹ 1,32,000 - ₹ 11,000                                                                        | 1,21,000    |          |
| <b>Step 3; GAV is the higher of Expected Rent and Actual rent received/receivable.</b>         |             |          |
| Expected Rent of ₹ 1,20,000                                                                    |             |          |
| Actual rent received/receivable of ₹ 1,21,000                                                  | 1,21,000    |          |
| <b>Gross Annual Value (GAV)</b>                                                                |             | 1,21,000 |
| Less: Municipal taxes (paid by the owner during the previous year) = 10% of ₹ 1,30,000         |             | 13,000   |
| <b>Net Annual Value (NAV)</b>                                                                  |             | 1,08,000 |
| <b>Less: Deductions under section 24</b>                                                       |             |          |
| • 30% of NAV                                                                                   | 32,400      |          |
| • Interest on borrowed capital (actual without any ceiling limit)                              | 40,000      |          |
|                                                                                                |             | 72,400   |
| <b>Income from house property</b>                                                              |             | 35,600   |

**Illustration 6**

Aparna has one house property at Kochi in Kerala. She stays with her family in that house. The rent of a similar property in the neighbourhood is ₹ 25,000 p.m. The municipal valuation is ₹ 2,80,000 p.a. Municipal taxes paid is ₹ 8,000. The house construction began in April 2016 with a loan of ₹ 20,00,000 taken from SBI Housing Finance Ltd. ₹ 9% p.a. on 1st April, 2016. The construction was completed on 30th November, 2018.

The accumulated interest up to 31st March, 2018 is ₹ 3,60,000. On 31st March, 2023, Aparna paid ₹ 2,40,000 which included ₹ 1,80,000 as interest. There was no principal repayment prior to this date. Compute Aparna's income from house property for A.Y. 2022-23.

**Solution:**

"SELF-OCCUPIED PROPERTIES OR UNOCCUPIED PROPERTIES"

Computation of Income from house property of Aparna for A.Y. 2022-23.

| Particulars                                                         | Amount ₹ |
|---------------------------------------------------------------------|----------|
| Annual Value of house used for self-occupation under section 23(2)  | Nil      |
| Less: Deductions under section 24                                   |          |
| Total interest is ₹ 1,80,000 + ₹ 72,000 (Being 1/5th of ₹ 3,60,000) |          |
| = ₹ 2,52,000.                                                       | 2,00,000 |
| (Interest deduction is restricted to ₹ 2,00,000)                    |          |
| Income from house property                                          | 2,00,000 |

**Working note**

Interest on borrowed capital:

Interest on loan was taken for construction of house on or after 1st April, 1999 and same was completed within the prescribed time. Interest paid or payable subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest) will be allowed as deduction.

**Illustration 7**

Ramesh has three houses, all of which are self-occupied. The particulars of the houses for the P.Y. 2021-22 are as under:

| Particulars                                                                          | House I   | House II  | House III |
|--------------------------------------------------------------------------------------|-----------|-----------|-----------|
| Municipal valuation p.a.                                                             | 3,00,000  | 3,60,000  | 3,30,000  |
| Fair rent p.a.                                                                       | 3,75,000  | 2,75,000  | 3,80,000  |
| Standard rent p.a.                                                                   | 3,50,000  | 3,70,000  | 3,75,000  |
| Date of completion/purchase                                                          | 31.3.1999 | 31.3.2002 | 01.4.2015 |
| Municipal taxes paid during the year                                                 | 12%       | 8%        | 6%        |
| Interest on money borrowed for repair of property during the current year.           | -         | 55,000    | -         |
| Interest for current year on money borrowed in April, 2015 for purchase of property. | -         | -         | 1,75,000  |

Compute Ramesh's income from house property for A.Y.2022-23 and suggest which houses should be opted by Ramesh to be assessed as self-occupied and which property should he let out, so that his tax liability is minimum.

**Solution:**

**"DEEMED TO BE LET OUT PROPERTY"**

Computation of Income from house property of Ramesh for the A.Y. 2022-23

| Particulars                                                            | Amount          |                 |                 |
|------------------------------------------------------------------------|-----------------|-----------------|-----------------|
|                                                                        | House I         | House II        | House III       |
| Gross Annual Value (GAV)<br>Expected Rent is the GAV of house property | 3,50,000        | 3,60,000        | 3,75,000        |
| Less: Municipal taxes<br>(paid by the owner during the previous year)  | 36,000          | 28,800          | 19,800          |
| <b>Net Annual Value (NAV)</b>                                          | <b>3,14,000</b> | <b>3,31,200</b> | <b>3,55,200</b> |
| Less: Deductions under section 24                                      |                 |                 |                 |
| • 30% of NAV                                                           | 94,200          | 99,360          | 1,06,560        |
| • Interest on borrowed capital                                         | -               | 55,000          | 1,75,000        |
| <b>Income from house property</b>                                      | <b>2,19,800</b> | <b>1,76,840</b> | <b>73,640</b>   |

"Ramesh can opt to treat any two of the above house properties as self-occupied property".

**Computation of Income From House Property for the A.Y. 2022-23;**

- **OPTION 1** (House I and II - self-occupied and House - are deemed to be let out)

| Particulars                                                                                         | Amount        |
|-----------------------------------------------------------------------------------------------------|---------------|
| House I (Self-occupied)                                                                             | Nil           |
| House II (Self-occupied) Interest on loan = ₹ 55,000<br>(Interest deduction restricted to ₹ 30,000) | (30,000)      |
| House III (Deemed to be let out)                                                                    | 73,640        |
| <b>Income from house property</b>                                                                   | <b>43,640</b> |

- **OPTION 2** (House I and III – self-occupied and House II – deemed to be let out)

| Particulars                                             | Amount       |
|---------------------------------------------------------|--------------|
| House I (Self-occupied)                                 | Nil          |
| House II (Deemed to be let out)                         | 1,76,840     |
| House III (Self-occupied) Interest on loan = ₹ 1,75,000 | (1,75,000)   |
| <b>Income from house property</b>                       | <b>1,840</b> |



- OPTION 3 (House II and III – self-occupied and House I – deemed to be let out)

| Particulars                                                                                                    | Amount     |
|----------------------------------------------------------------------------------------------------------------|------------|
| House I (Deemed to be let out)                                                                                 | 2,19,800   |
| House II (Self-occupied) Interest on loan = ₹ 55,000<br>(Interest deduction restricted to ₹ 30,000)            |            |
| House III (Self-occupied) Interest on loan = ₹ 1,75,000<br>(Total interest deduction restricted to ₹ 2,00,000) | (2,00,000) |
| Income from house property                                                                                     | 19,800     |

Since Option 2 is most beneficial, Ramesh should opt to treat House I and III as self-occupied and House II as deemed to be let out. His income from house property would be ₹ 1,840 for the A.Y. 2022-23.

## Unit 13.8 - Arrears of Rent And Unrealized Rent Received Subsequently [Section 25A]

The amount received by the assessee as arrears or unrealised rent subsequently realised from the tenant, as the case may be, the assessee shall treat it as deemed income from house property in respect of the financial year in which such rent is received or realised.

- The amount so received shall be taxable under the head 'Income from house property' in the year of receipt after deducting standard deduction @30% of such amount.
- **Taxability**
- No other deduction shall be allowed from such income except standard deduction i.e., 30% of such receipt. (even legal expenditure shall not be allowed as deduction)
- The income is taxable on cash basis.

**Note:** Such receipt shall be chargeable as income from house property although the assessee is not the owner of such property in the year of receipt.

### Illustration 8

Mr. RAJ owns a house property let out since 1st April, 2017 to a school for monthly rent of ₹ 10,000. There was no change in rent till 31st March, 2021. On 1st April, 2021, as per the court decision, rent was increased to ₹ 12,000 p.m. with retrospective effect from 1st April, 2019 and duly paid by school in the same year. Legal expenditure for such suit incurred by Mr. Raj is ₹ 30,000. Discuss tax treatment u/s 25A.

### Solution:

Arrears rent belongs to the period 1st April, 2019 to 31st March, 2021 i.e., for 24 months.

Arrears rent received =  $(12,000 - 10,000) \times 24 \text{ months} = ₹ 48,000$

Such rent is taxable in the year of receipt as under



| Particulars                                                  | Amount |
|--------------------------------------------------------------|--------|
| Arrears of rent received                                     | 48,000 |
| Less: Standard deduction u/s 24(a) equal to 30% of such rent | 14,400 |
| Income from house property u/s 25A                           | 33,600 |

Note: Legal expenditure is not Deductible.

## Unit 4.9 - Treatment Of Income From Co-Owned Property [Section 26]

If two or more persons own a house property jointly, then they are known as co-owners. If individual share of each co-owner is definite and ascertainable then the share of each such person shall be taxable as his income from house property.

### • Tax Treatment

The share income of each such co-owner should be determined in accordance with sections 22 to 25 and included in his individual assessment.

### Self-Occupied Property

- Where the house property is owned by co-owners and is self-occupied by each of the co-owners, the annual value of the property of each co-owner will be nil and interest on loan shall be allowed to all the co-owners to the extent of ₹ 30,000 / ₹ 2,00,000 as the case may be.
- However, the aggregate deduction of interest to each co-owner in respect of interest payable on loan taken for co-owned house property and interest, if any, payable on loan taken for another self-occupied property owned by him cannot exceed ₹ 30,000 / ₹ 2,00,000, as the case may be.

### Let-out Property

Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

## Unit 13.10 - Deemed Ownership [Section 27]

U/s 27, in the following cases, a person shall be treated as deemed owner of the property and liable to tax (in such case legal owner or beneficial owner shall not be further liable to tax)

**Note:**

- **Legal owner:** Legal owner means a person who has the legal title of the property as per the Transfer of Property Act, Registration Act, etc.
- **Beneficial owner:** For income tax purpose it is not necessary that the property must be registered in the name of the assessee. If the assessee is enjoying the property as an owner to full extent he will be treated as a beneficial owner of such property and will be charged under the head 'Income from house property'.
- **Transfer To a Spouse [Section 27(i)]**  
When an individual transfer a house property to:

His or her spouse (not being a transfer in connection with an agreement to live apart); or

His or her minor child (not being a married daughter

Fig: 7.10

without adequate consideration, then transferor shall be treated as "deemed owner" of such property.

**Exception –**

- In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.
- In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.

**Note -** Where cash is transferred to spouse/minor child and the transferee(spouse/minor) acquires property out of such cash, then, the transferor shall not be treated as deemed owner of the property. However, clubbing provisions will be attracted.

- **Holder of an Impartible Estate [Section 27(ii)]:**

The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

- **Member of a Co-Operative Society Etc. [Section 27(iii)]:**

A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of a society/ company/ association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/ company/ association is the legal owner of that building.

- **Person in Possession of a Property [Section 27(iia)] –**

A person who is allowed to take or retain possession of any building (or part thereof) in part performance of a contract u/s 53A of the Transfer of Property Act, 1882, is deemed as the owner of that building (or part thereof).

This would include cases where the:

- Possession of property has been handed over to the buyer.
- Sale consideration has been paid or promised to be paid to the seller by the buyer.
- Sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/ agreement to sell/ will etc. have been executed. In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

- **Person Having Right in a Property for a Period Not Less than 12 years [Section 27(iib)]:**

A person who acquires any right u/s 269UA(f) in or with respect to any building or part thereof, by way of lease agreement for a period of not less than 12 years is deemed as the owner of that building (or part thereof).

**Notes:**

- Lease period should not be less than 12 years [as per sec. 269UA(f)] including extension period.
- Above provision does not include any right by way of lease from month to month or for a period not exceeding 1 year.

E.g.: X lets out a property to Miss Y on lease of 9 years. However, Miss Y has a right to renew the lease for further period of 3 years. In such case, Miss Y shall be deemed as an owner of the property u/s 27. However, if such right of renewal of lease (for 3 years) is subject to condition that at each occasion it will be renewed for a period of 11 months, then X will be owner of the property and liable to tax u/s 22.



## Summary

Under Section 22 of the Income Tax Act, income from house property is chargeable to tax, providing it meets certain conditions such as ownership and the property's capability to earn income. Composite rent, which includes payment for tenancy and associated services, is also considered under this head if the property-related component dominates. Income from properties located outside India is taxable for resident individuals, further expanding the scope of this income category. However, certain properties are exempt from tax, which helps mitigate the tax burden for specific types of property usage or ownership.

The annual value of the property, which forms the basis for taxation, is determined after considering factors like fair market rent, municipal valuation, and actual rent received. From this value, deductions are allowed as per Section 24, such as for property taxes paid and interest on mortgage. Additionally, Section 25A outlines the treatment of arrears of rent and unrealized rent that is later recovered, allowing these to be taxed in the year received after adjusting for a standard deduction.

The treatment of income from co-owned properties is detailed in Section 26, where each co-owner's share of income from the property is taxed separately, based on their respective ownership percentages. Deemed ownership concepts ensure that individuals receiving income from properties without formal title, under circumstances like lease or part performance of a contract, are still subject to taxation. This comprehensive framework ensures that all potential income from property is appropriately taxed, maintaining equity and fairness in the tax system.



## Exercise

What does Section 22 of the Income Tax Act specify?

- A) Deductions on business income
- B) Chargeability of income from house property
- C) Exemptions on agricultural income
- D) Taxation of capital gains
- Answer: B

What is included in composite rent?

- A) Rent for property only
- B) Rent for property and services when property rent is significant
- C) Service charges only
- D) Business income from property
- Answer: B

How is income from house property situated outside India treated for resident individuals?

- A) It is exempt from tax
- B) It is not taxable in India
- C) It is taxable
- D) Only taxed if above a certain amount
- Answer: C

Which properties are exempt from tax under the Income Tax Act?

- A) All residential properties
- B) Properties used for commercial purposes
- C) Specified properties under certain conditions
- D) All rented properties
- Answer: C

What is the basis for determining the annual value of a property?

- A) The cost of the property
- B) The owner's income level
- C) Market conditions only
- D) Factors like fair market rent, municipal valuation, and actual rent received
- Answer: D

Which section details deductions from the annual value of house property?

- A) Section 22
- B) Section 24
- C) Section 25A
- D) Section 26
- Answer: B

What does Section 25A of the Income Tax Act deal with?

- A) Tax treatment of composite rent
- B) Deductions available on mortgage interest
- C) Tax treatment of arrears of rent and unrealized rent received subsequently
- D) Exemptions for co-owned properties
- Answer: C

How is income from co-owned property treated under Section 26?

- A) Taxed as a single entity
- B) Each co-owner's share is taxed separately
- C) Completely exempt from tax
- D) Taxed at a higher rate
- Answer: B

What is deemed ownership in the context of house property?

- A) Ownership based on actual purchase deeds
- B) Ownership assumed for tax purposes under specific conditions
- C) Ownership disputed in court
- D) Ownership by inheritance only
- Answer: B

What standard deduction is applicable for arrears of rent received under Section 25A?

- A) 30% of the arrears
- B) 50% of the arrears
- C) 100% of the arrears
- D) No deduction is allowed
- Answer: A

## Notes

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## 14. Profits And Gains Of Business Or Profession (PGBP)

- Unit 14.1 - Introduction
- Unit 14.2 - Method of Accounting [Section 145]
- Unit 14.3 - Income Chargeable Under This Head [Section 28]
- Unit 14.4 - Computation of Profits and Gains from Business or Profession [Section 29]
- Unit 14.5 - Admissible Deductions [Section 30 To 37]
- Unit 14.6 - Inadmissible Deductions [Section 40]
- Unit 14.7 - Expenses or Payment Not Deductible in Certain Circumstances [Section 40A]
- Unit 14.8 - Vent Profits Chargeable to Tax [Section 41]
- Unit 14.9 - Changes in The Rate of Exchange of Currency [Section 43A]
- Unit 14.10 - Certain Deductions to Be Allowed Only on Actual Payment [Section 43B]
- Unit 14.11 - Stamp Duty Value of Land and Building to Be Taken as The Full Value of Consideration in Respect of Transfer, Even If the Same Are Held by The Transferor as Stock- In-Trade [Section 43CA]
- Unit 14.12 - Compulsory Maintenance of Accounts [Section 44AA]
- Unit 14.13 - Audit of Accounts of Certain Persons Carrying on Business or Profession [Section 44ab]
- Unit 14.14 - Special Provisions for Computing Profits and Gains of Business on Presumptive Basis [Sections 44AD/ 44ADA/ 44AE]





## Key Learning Outcomes



- Understand Business Income
- Learn Classification of Income
- Computation of Business Income
- Identify Allowable Deductions
- Understand Depreciation and Amortization
- Learn Treatment of Capital Expenses
- Apply Special Provisions and Adjustments
- Understand Taxation of Professional Income
- Knowledge of Reporting and Compliance
- Understand Loss Set-off and Carry Forward
- Apply Tax Planning Strategies

## Unit 14 - Profits And Gains of Business Or Profession (PGBP)

### Unit Objectives

At The End of The Unit, You Will Be Able To Understand:

1. What Is Business or Profession
2. Computation of Profit and Gains
3. Admissible Deductions and Inadmissible Deductions
4. Applicability of Audit
5. Taxation Under Presumptive Basis

## Unit 14.1 - Introduction

Under this head of income, the profit and gains from any business or profession, carried on by the assessee, at any time during the financial year should be reported. Business income is the profit that is earned from the business. It is nothing but total revenue/total turnover minus total expense. The profit from the business is the taxable income/ business income.

### Business:

The term "business" has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture".

### Profession:

The term "profession" has not been defined in the Act. It means an occupation requiring some degree of learning. The term 'profession' includes vocation as well [Section 2(36)]

E.g.: a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and even an astrologer, are persons who can be said to be carrying on a profession but not business.

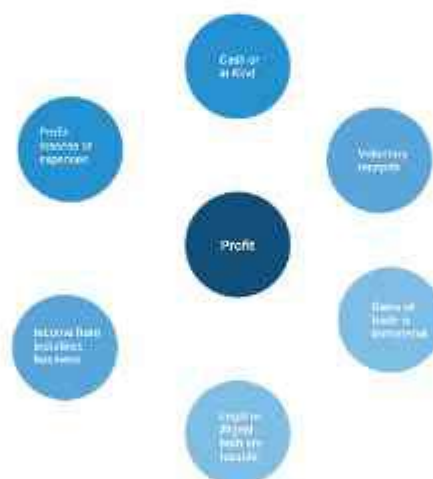


Fig: 8.1

**Note: Capital receipts:** Capital receipts are not generally to be taken into account while computing profits under this head.

## Unit 14.2 - Method of Accounting [Section 145]

Income chargeable under this head shall be computed in accordance with the method of accounting, either cash or mercantile basis, regularly and consistently employed by the assessee.

However, as per section 145B, certain income would be taxable in the following manner:

|                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                            |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Interest received:</b> <ul style="list-style-type: none"> <li>• On compensation</li> <li>• Enhanced compensation</li> </ul>                                                                                                                                                                                                                                                 | It is deemed to be the income of the year in which it is received. [Such income is taxable under the head "Income from other sources"]     |
| <b>Section 2(24)(xviii) i.e., assistance in the form of:</b> <ul style="list-style-type: none"> <li>• A subsidy or grant or cash incentive or</li> <li>• Duty drawback or</li> <li>• Waiver or concession or</li> <li>• Reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind.</li> </ul> | Shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year. |

## Unit 14.3 - Income Chargeable Under This Head [Section 28]



Fig: 8.2



- **Income from Business or Profession:**

Income arising to any person by way of profits and gains from the business or profession carried on by him at any time during the previous year.

- **Any Compensation or other Payment due to or Received by:**
  - Any person, by whatever name called, managing the whole or substantially the whole of:
    - The affairs of an Indian company or
    - The affairs in India of any other company
    - In connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto.
  - Any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto.
  - Any person, for or in connection with the vesting in the government or in any corporation owned or controlled by the government under any law for the time being in force, of the management of any property or business.
  - Any person, by whatever name called, at or in connection with the termination or modification of the terms and conditions, of any contract relating to his business.
- **Income from specific services performed for its members by a trade, professional or business:**  
Income derived by a trade, professional or similar association from rendering specific services to its members shall be taxable under this head.

**Note:**

**This is an Exception to the General Principle that a surplus of mutual association cannot be Taxed.**

- **Incentives received or receivable by assessee carrying on export business:**
  - Profit on sale of import entitlements.
  - Profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947.
  - Cash assistance against exports under any scheme of Government of India.
  - Customs duty or excise re-paid or repayable as drawback.
  - Profit on transfer of Duty Entitlement Pass Book Scheme or Duty-Free Replenishment Certificate.
- **Value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of any profession.**
- **Sum due to, or received by, a partner of a firm:**  
Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business.

However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b) (Interest and remuneration to Partners) in the computation of the income of the firm, the income to be taxed shall be adjusted to the extent of the amount disallowed.

Suppose a firm pays interest to a partner at 18% simple interest per annum. The allowable rate of interest is 12% per annum. Hence the excess 6% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm, the same will not be taxed in the hands of the partner.

- Any Sum Whether Received or Receivable, in cash or kind, Under an agreement:
  - For not carrying out any activity in relation to any business or profession or
  - For not sharing any
    - Know-how                      Patent
    - Copyright                    Trade mark
    - Licence                        Franchise

Or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, the following sums received or receivable would not be chargeable to tax under the head "profits and gains from business or profession."

Any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business or profession, which is chargeable under the head "Capital gains".

Any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

- Any sum received under a keyman insurance policy by the assessee, as an employer, under a keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business.
- Fair market value of inventory on its conversion/treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income.
- Sum received on account of capital asset referred under section 35AD being demolished, destroyed, discarded or transferred.

**Note:**

Section 35AD permits a deduction of 100% of capital expenditures made during the previous year wholly and solely from company income.

## Unit 14.4 - Computation of Profits and Gains From Business or Profession [Section 29]

According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D.



Fig: 8.3

## Unit 5.5 - Admissible Deductions [Section 30 to 37]

### 5.5.1 Rent, rates, taxes, repairs and insurance for buildings [Section 30]

Deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purposes of his business or profession.

- **Rent**

Where the premises are occupied by the assessee as a tenant,

- The rent paid for such premises.
- Amount paid on account of cost of repairs if the assessee has undertaken to bear such repairs to the premises.
- Assessee being the owner: occupies them for his business purposes the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

Notional Rent: Rent paid to proprietor is disallowed but rent paid by firm to its partner for using his premises is an allowed expenditure.



- Maintenance and repairs (revenue only) paid by the assessee, if:
  - The assessee is the owner of the building or
  - The assessee is a tenant who has undertaken to bear the cost of repairs to the premises.
  - Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.
  - Current repair vs Capital repair: Only current repairs are allowed as deduction. Capital repairs are not allowed as deduction whether the assessee occupies the building as a tenant or as a landlord.

Current repair (irrespective of the amount involved) means:

- A repair incurred to preserve and maintain an existing asset.
- A repair which does not result in a new or fresh advantage.

- **Property Tax on Cash Basis**

Rates & taxes (for e.g., land revenue, municipal tax, etc) are deductible on cash basis (paid basis).

- **Insurance Premium**

Premises used partly for business and partly for other purposes: Where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction.

### 5.5.2 Repairs and Insurance of Machinery, Plant and Furniture [Section 31]

- **Repairs and Maintenance:**

Repairs exclude replacement or reconstruction: The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction.

Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

- Usage of the asset: In order to claim this deduction, the assets must have been used for purposes of the assessee's own business, the profits of which are being taxed.

Insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount, proportionate to the period of use.

- **Insurance Premium:**

The deduction allowable in respect of premia paid, for insuring the machinery, plant or furniture is subject to the following conditions:

- The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
- The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
- The premium should have been actually paid (or payable under the mercantile system of accounting).
- Current repair vs Capital repair: Only current repairs are allowed as deduction.



**Note:**

The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss.

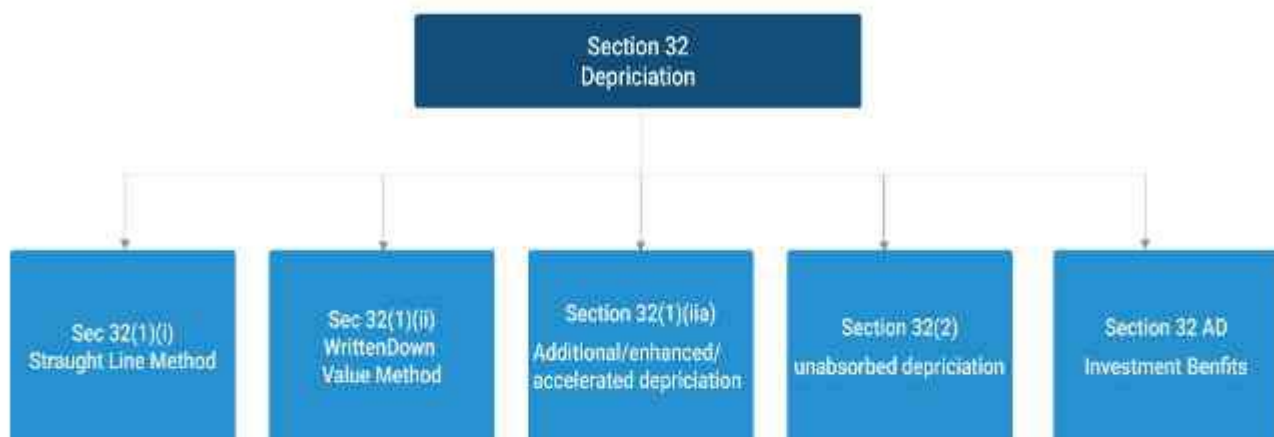
**5.5.3 Depreciation [Section 32]**

Fig: 8.4

- Charge of Depreciation Mandatory:
  - Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets. Deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income
- Conditions:

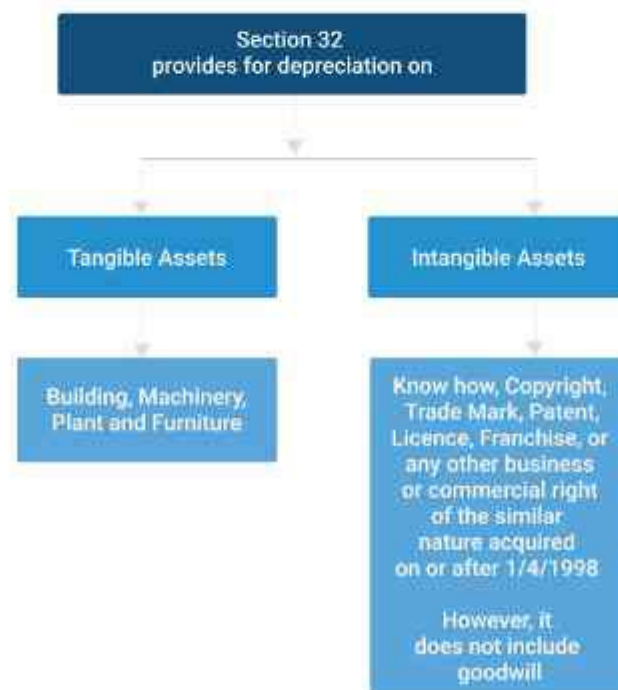


Fig: 8.5

The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income.

**Building:**

Building refers only to superstructure,

**Includes:**

- The term 'buildings' includes within its scope roads, bridges, culverts, wells and tube - Building includes a part of the building.

**Excludes:**

- Land on which it has been erected.

**Plant:**

**Includes:**

- Ships, books, vehicles, scientific apparatus and surgical equipments used for the purposes of the business or profession.
- All goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.
- Includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.

**Excludes:**

- Tea bushes or livestock or buildings or furniture and fittings.
- An animal, human body or stock-in-trade.

• **Asset Must be Owned by the Assessee.**

Owner can be a beneficial owner or co- owner.

- Beneficial owner: Assessee need not be a registered owner, even a beneficial owner can claim depreciation.
  - Co-owner: In case of joint ownership, depreciation is allowed on proportionate basis.
  - Property acquired on hire purchase: In case of hire purchase, the buyer can claim depreciation even though he does not get legal title of the asset till he pays the last instalment.
  - Capital expenditure on a property by the lessee: Where an assessee being a lessee of a property incurs any capital expenditure by way of improvement, extension, super construction, etc. on a building being used for his business or profession, he is entitled to depreciation in respect of such capital expenditure.
  - Sec. 53A of Transfer of Property Act: Possessor of an immovable property u/s 53A of Transfer of Property Act can claim depreciation even though he is not the registered owner of the property.
- Asset must be used for the purpose of business or profession during the previous year.
- Use of the asset includes active use as well as passive use

Active use means actual use of the property for the purpose of business or profession. Whereas passive use includes "ready to use". It means, if a property was not actually used for business or profession but was ready to use in the previous year, in such case, assessee can claim depreciation on such assets.

|                                                                     |                                                                                                                                                                         |
|---------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Partly used for business or profession                              | Then proportionate depreciation (as determined by the assessing officer) shall be allowed.                                                                              |
| House property let out to tenant for smooth running of the business | Rent received from employee shall be chargeable under the head "Profits & gains of business or profession" and such property shall be eligible for depreciation u/s 32. |

- The assets should be actually used by the assessee for purposes of his business during the previous year.

The amount of depreciation allowance is not proportionate to the period of use during the previous year.  
Significance of date of purchase (Effect of time on depreciation):

- An asset is acquired by the assessee during the previous year; and
- Is put to use in the same previous year for less than 180 days, - the depreciation in respect of such asset is restricted to 50% of the normal depreciation.

Except above, date of purchase has no relevance.

**Note:** If the assets are not used exclusively for the business or profession of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

- Computation of Depreciation Allowance

| Particulars            | Section 32(1)(i)                                | Section 32(1)(ii)               | Sec 32(1)(iii)                                       |
|------------------------|-------------------------------------------------|---------------------------------|------------------------------------------------------|
| Method of depreciation | Straight line method (SLM)                      | Written down value method (WDV) | Additional depreciation                              |
| Assessee               | Power generation undertakings                   | All assessee                    | Assessee engaged in manufacturing or production.     |
|                        | Has an option for opting depreciation under WDV |                                 | Only applicable to those assessee follows WDV method |

- Power Generation Undertakings:**

An undertaking engaged in the business of generation or generation and distribution of power may charge depreciation (in respect of asset acquired after 31st March, 1997) at its choice under:

- Written-down value method as followed by all other assessee (usual); or
- Straight-line method at the prescribed rate in 'Appendix IA' of the income tax rules on actual cost of asset (not the block value of asset)

**Note:**

However, such option shall be exercised before the due date of furnishing return of income. Further, it may be noted that once the option is exercised, it shall be applicable for all subsequent assessment years.



Additional depreciation is not available to the assessee who claims depreciation as per Straight-Line Method.

#### Terminal Depreciation and Balancing Charge

|                      |                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                          |
|----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Applicable to</b> | Assessee engaged in generation or generation and distribution of power.                                                                                                                                                                                                                       |                                                                                                                                                                                                          |
| <b>Conditions</b>    | <ul style="list-style-type: none"> <li>Assessee must follow the straight-line method of depreciation at specified rates.</li> <li>The asset is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use).</li> </ul> |                                                                                                                                                                                                          |
|                      | <b>Terminal Depreciation</b>                                                                                                                                                                                                                                                                  | <b>Balancing Charge</b>                                                                                                                                                                                  |
| <b>Meaning</b>       | Loss on transfer of such asset is treated as terminal depreciation.<br>Terminal depreciation is written off in the books of accounts.                                                                                                                                                         | Profit on transfer of such asset to the maximum of accumulated depreciation shall be treated as balancing charge.<br>The difference between sale price and actual cost shall be treated as capital gain. |
| <b>Treatment</b>     | Terminal depreciation is fully allowed as deduction as a business loss.                                                                                                                                                                                                                       | Balancing charge is fully taxable as business income in the previous year in which such income falls due.<br>The provision holds valid even if the business does not exist in that year.                 |

- Method of computing depreciation (other than power units)

Depreciation shall be allowed on written down value method at the rates prescribed. For Income tax purpose, assets are categorised into block of assets.

#### Block of Assets [Sec. 2(11)]

Block of assets means a group of assets of same nature, in respect of which same rate of depreciation is charged. In other words, to fall in the same block, the following two conditions are to be satisfied:

- Assets Must be of Same Nature:
  - Tangible assets being building, machinery, plant or furniture, and
  - Intangible assets, being know-how, patents, copy-rights, trade marks, licenses, franchises or any other business or commercial rights of similar nature acquired on or after 1st April, 1998 (it does not include goodwill).
- Rate of depreciation on such asset must be same.

#### Calculation of Depreciation



Depreciation is Not Charged in the following Two Cases:

Case 1:

| Particulars                                                                                          | Amount |
|------------------------------------------------------------------------------------------------------|--------|
| W.D.V of the block at the beginning of the previous year                                             | A      |
| Add: Assets (falling within the block) acquired during the previous year                             | B      |
|                                                                                                      | C      |
| Less: Sale Proceeds of assets (falling within the block) sold during the previous year (More than C) | (D)    |
| Short term capital gain                                                                              | E      |

When 'D' (Sale proceeds) exceeds "C", the excess shall be treated as short term capital gain.

Case 2:

| Particulars                                                                                                   | Amount |
|---------------------------------------------------------------------------------------------------------------|--------|
| W.D.V of the block at the beginning of the previous year                                                      | A      |
| Add: Assets (falling within the block) acquired during the previous year                                      | B      |
|                                                                                                               | C      |
| Less: Sale Proceeds of assets (falling within the block) sold during the previous year [subject to max. of C] | (D)    |
| Short term capital gain [Block of asset comes to nil]                                                         | E      |

When 'E' (Value of block before depreciation) is positive but the block does not have any asset. In such case, such positive value shall be treated as short term capital loss

**5.5.4 Additional Depreciation [Sec. 32(1)(iia)]**

|                                        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|----------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Applicability</b>                   | All assessee engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <b>Conditions to be satisfied</b>      | <ul style="list-style-type: none"> <li>Assessee must be an industrial undertaking, which manufactures or produces any article or thing or in the business of generation, transmission or distribution of power.</li> <li>Assessee acquired and installed after 31st March, 2005, a new plant or machinery, other than the following: <ul style="list-style-type: none"> <li>Ships and air crafts; or</li> <li>Any plant or machinery which was used either within or outside India by any other person before such installation or</li> <li>Any plant or machinery installed in office premises or any residential accommodation or guest house or</li> <li>Any office appliances or road transport vehicle or</li> <li>Any plant or machinery, which is allowed for 100% deduction (whether by way of depreciation or otherwise) in the previous year.</li> </ul> </li> </ul> |
| <b>Rate of additional depreciation</b> | 20%                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|                                        | Where, if the asset is acquired and put to use for less than 180 days then additional depreciation ₹ 10% (i.e., 50% of 20%) of actual cost shall be allowed in that previous year and the deduction for the balance 10% shall be allowed in the immediately succeeding previous year.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

**Note:**

Additional depreciation shall be reduced while computing the closing WDV of the respective block.

Additional depreciation is not available if the new plant or machinery is sold in the year of acquisition.

Additional depreciation is not available if the power unit is claiming depreciation under straight line method i.e., u/s 32(1)(i)

## Rates of Depreciation

| PART A TANGIBLE ASSETS |                                                                                                                                                                                                                                                  |     |
|------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| I                      | Buildings                                                                                                                                                                                                                                        |     |
| Block 1.               | Buildings which are used mainly for residential purposes except hotels and boarding houses.                                                                                                                                                      | 5%  |
| Block 2.               | Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below.                                                                                                                                   | 10% |
| Block 3.               | Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities. | 40% |
| Block 4.               | Purely temporary erections such as wooden structures.                                                                                                                                                                                            | 40% |
| II                     | Furniture and Fittings                                                                                                                                                                                                                           |     |
| Block 1.               | Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]                                                                                         | 10% |
| III                    | Plant & Machinery                                                                                                                                                                                                                                |     |
| Block 1.               | (i) Motor cars other than those used in a business of running them on hire, acquired during the period from 23rd August, 2019 to 31st March, 2020 and put to use on or before 31st March, 2020.                                                  | 30% |
|                        | (ii) Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1st April, 1990 [Other than motor cars mentioned in (i) above].                                                                  | 15% |
| Block 2.               | (i) Motors buses, motor lorries, motor taxis used in a business of running them on hire, acquired during the period from 23rd August, 2019 to 31st March, 2020 and put to use on or before 31st March, 2020.                                     | 45% |
|                        | (ii) Motors buses, motor lorries, motor taxis used in the business of running them on hire [Other than mentioned in (i) above].                                                                                                                  | 30% |
| Block 3.               | Woulds used in rubber and plastic goods factories                                                                                                                                                                                                | 30% |
| Block 4.               | Aeroplanes, Aeroengines                                                                                                                                                                                                                          | 40% |
| Block 5.               | Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems.                                                                           | 40% |
| Block 6.               | Plant & Machinery used in semi-conductor industry covering all integrated circuits (ICs)                                                                                                                                                         | 30% |
| Block 7.               | Lifesaving medical equipment                                                                                                                                                                                                                     | 40% |
| Block 8.               | Machinery and plant, acquired and installed on or after the 1st day of September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility.           | 40% |
| Block 9.               | Oil wells                                                                                                                                                                                                                                        | 15% |
| Block 10.              | Renewable Energy Saving Devices (as specified)                                                                                                                                                                                                   | 40% |



|                                 |                                                                                                                                                                                                                                           |     |
|---------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
|                                 | Windmills and any specially designed devices which run on wind mills installed on or after 1st April, 2014.                                                                                                                               | 40% |
|                                 | Any special devices including electric generators and pumps running on wind energy installed on or after 1st April, 2014 would be eligible for depreciation.                                                                              | 40% |
|                                 | Windmills and any specially designed devices running on windmills installed on or before 31st March, 2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31st March, 2014. | 15% |
| Block 11.                       | Computers including computer software                                                                                                                                                                                                     | 40% |
| Block 12.                       | Books (annual publications or other than annual publications) owned by assessee carrying on a profession.                                                                                                                                 | 40% |
| Block 13                        | Books owned by assessee carrying on business in running lending libraries.                                                                                                                                                                | 40% |
| Block 14                        | Plant & machinery (General rate)                                                                                                                                                                                                          | 15% |
| iv                              | Ships                                                                                                                                                                                                                                     |     |
| Block 1.                        | Ocean-going ships                                                                                                                                                                                                                         | 20% |
| Block 2.                        | Vessels ordinarily operating on inland waters not covered by Block (3) below.                                                                                                                                                             | 20% |
| Block 3.                        | Speed boats operating on inland water                                                                                                                                                                                                     | 20% |
| <b>PART B INTANGIBLE ASSETS</b> |                                                                                                                                                                                                                                           |     |
|                                 | Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession.                                                             | 25% |

**Illustration :1**

Mr. M, a proprietor engaged in manufacturing business, furnishes the following particulars:

|   |                                                                                                                                              |             |
|---|----------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| 1 | Opening balance of plant and machinery as on 1st April, 2021 (i.e., WDV as on 31st March, 2021 after reducing depreciation for P.Y. 2020-21) | ₹ 50,00,000 |
| 2 | New plant and machinery purchased and put to use on 05th June, 2021                                                                          | ₹ 10,00,000 |
| 3 | New plant and machinery acquired and put to use on 18th December, 2021                                                                       | ₹ 20,00,000 |
| 4 | Computer acquired and installed in the office premises on 6th January, 2022                                                                  | ₹ 7,00,000  |

Compute the amount of depreciation and additional depreciation as per the Income tax Act, 1961 for the A.Y. 2022-23. Assume that all the assets were purchased by way of account payee cheque.



## Solution

Computation of depreciation and additional depreciation for A.Y. 2022-23.

| Particulars                                                                             | Normal depreciation | Additional depreciation |
|-----------------------------------------------------------------------------------------|---------------------|-------------------------|
| Plant and machinery (put to use more than 180 days) ₹15% & additional depreciation ₹20% | ₹ 9,00,000          | ₹ 12,00,000             |
| New Plant and machinery (put to use less than 180 days) (note no:1)                     | ₹ 1,50,000          | ₹ 2,00,000              |
| Computer (Note 2)                                                                       | ₹ 1,40,000          | -                       |
|                                                                                         | ₹ 11,90,000         | ₹ 14,00,000             |

## Note:

- As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage, the balance additional depreciation would be allowed as deduction in the A.Y. 2023-24.
- Additional depreciation shall not be allowed in respect of, inter alia, any machinery or plant installed in office premises, residential accommodation or in any guest house. Therefore, additional depreciation is not allowable on computer installed in the office premises.

Actual cost of assets [Sec. 43(1)]



Fig: 8.6

| Particulars                                                                                                                                 | Actual cost of acquisition                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                      |
|---------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|
| Assets acquired against cash.                                                                                                               | <ul style="list-style-type: none"> <li>• Payment or aggregate of payments made to a person in a day is made otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through other prescribed electronic mode; and</li> <li>• Such payment exceeds ₹ 10,000.</li> <li>• Such payment shall be ignored for the purposes of determination of actual cost.</li> </ul> |                                      |
| Asset acquired by way of gift or inheritance.                                                                                               | Actual cost to the previous owner as reduced by: <ul style="list-style-type: none"> <li>• Amount of depreciation actually allowed under this Act till the A.Y. 1987-88; and</li> <li>• Amount of depreciation that would have been allowable to the assessee from A.Y. 1988-89, as if the asset was the only asset in the relevant block.</li> </ul>                                                                                                              |                                      |
| Interest treatment in case of asset acquired out of borrowed fund.                                                                          | Before asset is put to use:                                                                                                                                                                                                                                                                                                                                                                                                                                       | Interest to be added to actual cost. |
|                                                                                                                                             | After asset is put to use:                                                                                                                                                                                                                                                                                                                                                                                                                                        | Interest is allowed u/s 36(1)(iii).  |
| Any subsidies received from the government or any other authority for purchase of an asset.                                                 | Grant or subsidies will be subtracted from cost of acquisition of such asset.                                                                                                                                                                                                                                                                                                                                                                                     |                                      |
| GST included in the invoice.                                                                                                                | Actual cost of asset shall be reduced by the amount of input tax credit taken against GST.                                                                                                                                                                                                                                                                                                                                                                        |                                      |
| Asset acquired from any person using the asset for his business or profession with a view to avoid tax.                                     | Actual cost to be determined by the AO with the prior permission of Deputy Commissioner.                                                                                                                                                                                                                                                                                                                                                                          |                                      |
| Re-acquisition of transferred asset.                                                                                                        | <ul style="list-style-type: none"> <li>• WDV at the time of first transfer</li> <li>or</li> <li>• The price paid for reacquisition</li> </ul> whichever is lower.                                                                                                                                                                                                                                                                                                 |                                      |
| Asset acquired by an assessee from another person and given on lease to the same person who had earlier claimed depreciation on such asset. | WDV of the asset to the transferor.                                                                                                                                                                                                                                                                                                                                                                                                                               |                                      |

|                                                                                                                                                  |                                                                                                                                                                                                                                                                              |
|--------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Building used for personal purpose subsequently brought into business.                                                                           | Cost of purchase or construction of the building as reduced by the notional depreciation by applying the rate applicable on the date of such conversion.                                                                                                                     |
| Asset, which was acquired outside India, is brought by a non-resident assessee to India and used for the purposes of his business or profession. | Actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.            |
| Any capital asset transferred by a holding company to its 100% subsidiary company or vice versa where transferee company is an Indian company.   | Actual cost to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purpose of its business.                                                                                 |
| Transfer of capital asset by amalgamating company to an amalgamating Indian company.                                                             | Actual cost to the amalgamated company as it would have been if the amalgamating company had continued to hold the capital asset for the purpose of its own business.                                                                                                        |
| Transfer of capital asset by demerged company to resulting Indian company.                                                                       | Actual cost to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.                                                                                |
| Capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India.                            | Actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.                                                                                                                              |
| Where an assessee was not required to compute his total income under Income tax Act for any previous year(s).                                    | Actual cost shall be reduced by the total amount of depreciation on such asset, provided in the books of account (as adjusted by amount attributable to the revaluation of assets) of the assessee in respect of such previous year(s) preceding the relevant previous year. |
| The actual cost of any capital asset on which deduction is allowable u/s 35AD.                                                                   | Actual cost of the asset shall be taken as nil.<br><br>Note: If such asset is transferred to other person as gift, etc., actual cost of asset shall be taken as nil in hands of transferee.                                                                                  |
| Conversion of inventory into capital asset.                                                                                                      | The actual cost of such asset to the assessee shall be the fair market value which has been taken into account for the purposes of sec. 28(via).                                                                                                                             |



**Illustration:2**

- Compute depreciation u/s 32 for the A.Y. 2022-23 from the following information:
- W.D.V. of plant and machinery (15%) as on 01st April, 2020 ₹ 12,00,000
- Plant D acquired on 10th July, 2020 for ₹ 8,00,000/- ₹ 2,00,000 has been paid in cash to the vendor and balance amount has been paid through an account payee cheque. Such plant was put to use on the same day.
- The assessee is engaged in the business of manufacturing of industrial paints

**Solution**

Computation of depreciation for A.Y. 2021-22.

| Particulars                                                                       | Amount ₹ | Amount ₹   |
|-----------------------------------------------------------------------------------|----------|------------|
| WDV as on 01st April, 2020                                                        |          | 12,00,000  |
| Add: Actual cost of Plant D acquired during the year<br>[₹ 8,00,000 – ₹ 2,00,000] |          | 6,00,000   |
|                                                                                   |          | 18,00,000  |
| Less: Depreciation for the P.Y. 2021-22 [₹ 18,00,000 x 15%]                       | 2,70,000 |            |
| Less: Additional Depreciation for the P.Y. 2021-22<br>[₹ 6,00,000 x 20%]          | 1,20,000 | (3,90,000) |
| WDV on 01st April, 2022                                                           |          | 14,10,000  |

**Written Down Value [Section 43(6)]**

| Particulars                                               | Written down value                                                                                               |        |
|-----------------------------------------------------------|------------------------------------------------------------------------------------------------------------------|--------|
| Assets acquired by the assessee during the previous year. | Actual cost to the assessee.                                                                                     |        |
| Assets acquired before the previous year.                 | Actual cost to the assessee less the aggregate of all deductions actually allowed in respect of depreciation.    |        |
| In case of any block of assets.                           | Particulars                                                                                                      | Amount |
|                                                           | W.D.V of the block at the beginning of the previous year.                                                        | A      |
|                                                           | Add: Assets (falling within the block) acquired during the previous year.                                        | B      |
|                                                           |                                                                                                                  | C      |
|                                                           | Less: Sale Proceeds of assets (falling within the block) sold during the previous year [subject to max. of "C"]. | (D)    |
|                                                           | Written Down Value [ E cannot be negative].                                                                      | E      |
|                                                           | Less: Depreciation (as a % on E).                                                                                | (F)    |
|                                                           | Opening WDV for 1st day of next year.                                                                            | H      |



**8.5.5 Unabsorbed depreciation [Sec. 32(2)]**

Depreciation which could not be fully deducted from profits and gains of current year of business or profession (due to insufficient profit), is termed as unabsorbed depreciation.

Treatment: The unabsorbed depreciation can be deducted from income under any other head (except with casual income and salaries) of the same assessment year.

- If depreciation still remains unabsorbed, it can be carried forward for indefinite period and can be set off against any income (except with casual income and salaries) of the assessee.
- For set-off purpose following order is to be followed:

- 1** • Current year Depreciation
- 2** • Brought forward Business loss
- 3** • Unabsorbed depreciation

Fig: 8.7

**Note:**

- It is not necessary that the same business should be continued.
- Unabsorbed depreciation shall be (subject to sec. 72 and sec. 73) added to the amount of the depreciation for the following previous year and deemed to be the depreciation allowance for that previous year, and so on for the succeeding previous years.
- Unabsorbed depreciation shall be allowed to be carried forward for any number of years and such carried forward unabsorbed depreciation may be set off against any income, other than salary income and winning from lotteries, cross word puzzles, etc.
- Unabsorbed depreciation can be carried forward even when, return of income has not been filed.

### 5.5.6 Special Deduction for Assessee Engaged in Tea, Coffee or Rubber Growing & Manufacturing Business [Sec. 33AB and Rule 5AC]

|                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Applicable to              | <p>All assessee carrying on business of growing and manufacturing of the followings in India:</p> <ul style="list-style-type: none"> <li>• Tea</li> <li>• Coffee or</li> <li>• Rubber</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                  |
| Conditions to be satisfied |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Deposit of amount          | <p>Assessee must deposit (hereinafter referred to as special account) an amount in:</p> <ul style="list-style-type: none"> <li>• National Bank for Agriculture &amp; Rural Development (NABARD) in an account maintained by him in accordance with, and for the purpose specified in the scheme approved by Tea Board, Coffee Board or Rubber Board, as the case may be.</li> <li>• An account in accordance with, and for the purpose specified in a scheme approved by Tea Board or Coffee Board or Rubber Board, as the case may be, with prior approval of the Central Government.</li> </ul> |
| Time of deposit            | <p>Within 6 months</p> <p>From the end of the previous year</p> <p>or</p> <p>Before the due date of furnishing the return of income, whichever is earlier.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Audit of accounts          | Should be audited by a chartered accountant & the report of an auditor in Form 3AC is required to be uploaded one month prior to the due date of filing of return.                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Quantum of Deduction       | <p>Minimum of the following:</p> <ul style="list-style-type: none"> <li>• Amount so deposited (as discussed above); or</li> <li>• 40% of the profit of such business computed under the head "Profits &amp; gains of business or profession" before allowing any deduction u/s 33AB and before adjusting brought forward business loss.</li> </ul>                                                                                                                                                                                                                                                |
| Withdrawal from account:   | <p>During continuation of business: The amount credited to such special account shall be withdrawn only for the purpose(s) specified in respective schemes.</p> <p>If the amount so withdrawn is not utilised for the specified purpose in the same previous year then the amount not so utilised shall be treated as income of the year.</p> <p>On closure of business: Apart from the specified purpose(s) of scheme, the amount deposited may be withdrawn in the following circumstances:</p>                                                                                                 |

|                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |               |
|-------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|
|                                     | Closure of business                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | Fully taxable |
|                                     | Dissolution of firm                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | Fully taxable |
|                                     | Death of the tax payer                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Not taxable   |
|                                     | Partition of HUF                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Not taxable   |
|                                     | Liquidation of company                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Not taxable   |
| Double deduction is not permissible | <ul style="list-style-type: none"> <li>Where an amount standing to the credit of the assessee in the special account is utilised by the assessee for the purposes of any expenditure in connection with such business in accordance with the scheme.</li> <li>Here the assessee is a firm, AOP or BOI, then deduction under this section shall not be allowed in computation of income of any partner/member.</li> <li>Any deduction in respect of an amount deposited in any special account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.</li> </ul> |               |

**Note:**

- **Excess Deposit:** Any excess deposit made during a previous year is not treated as deposit made for the next year.
- **Restriction on utilisation of amount for certain purposes:** No deduction shall be allowed in respect of any amount, being credited in special account, utilised for the purpose of:
  - Purchase of plant or machinery to be installed in any office premises /residential accommodation / accommodation in the nature of guest-house.
  - Purchase of any office appliances (other than computer).
  - Purchase of any plant or machinery, the entire cost of which is allowed as deduction in form of depreciation or otherwise in any one previous year.
  - Purchase of any plant or machinery to be installed in an industrial undertaking for constructing, manufacturing or producing any items specified in Schedule XI of the Act.

**Calculation of Taxable Income**

| Nature of Business                                                                                                                                                                                        | Calculation of Income                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|
| Tea growing & manufacturing business (Rule 8)                                                                                                                                                             | 40% of [Income from business – Deduction u/s 33AB]        |
| Coffee growing & manufacturing business <ul style="list-style-type: none"> <li>• Grown and cured by the seller in India.</li> <li>• Grown, cured, roasted and grounded by the seller in India.</li> </ul> | 25%<br>40%<br>[Income from business – Deduction u/s 33AB] |
| Rubber growing & manufacturing business (Rule 7A)                                                                                                                                                         | 35% of [Income from business – Deduction u/s 33AB]        |



**5.5.7 Site Restoration Fund [Sec. 33ABA & Rule 5AD]**

|                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|---------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Applicable to                         | All assessee engaged in the business of:<br>Prospecting for petroleum or natural gas; or<br>Extraction or production of petroleum or natural gas; or<br>Both – in India.                                                                                                                                                                                                                                                                        |
| <b>Conditions to be satisfied</b>     |                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| Agreement with the Central Government | The Central Government has entered into an agreement with the assessee for such business.                                                                                                                                                                                                                                                                                                                                                       |
| Deposit of amount                     | The assessee must deposit an amount: <ul style="list-style-type: none"> <li>• With the State Bank of India in an account (herein after referred to as special account) maintained.</li> <li>• In an account (hereinafter referred as Site Restoration Account) opened by the assessee.</li> </ul> in accordance with and for the purposes specified in a scheme approved by the Government of India in the Ministry of Petroleum & Natural Gas. |
| Treatment of interest                 | Interest shall be deemed to be a deposit.                                                                                                                                                                                                                                                                                                                                                                                                       |
| Time of deposit                       | must be deposited before the end of the previous year.                                                                                                                                                                                                                                                                                                                                                                                          |
| Audit of books of account             | Accounts must be audited & auditor's report should be filed in Form 3AD is required to be uploaded one month prior to the due date of filing of return.                                                                                                                                                                                                                                                                                         |
| Quantum of Deduction                  | Minimum of the following: <ul style="list-style-type: none"> <li>• Amount so deposited (as discussed above);</li> </ul> or <ul style="list-style-type: none"> <li>• 20% of the profit of such business computed under the head "Profits &amp; gains of business or profession" before allowing deduction under this section and before adjusting brought forward business loss.</li> </ul>                                                      |
| Excess Deposit                        | Any excess deposit made during a previous year is not treated as deposit made for the next year(s).                                                                                                                                                                                                                                                                                                                                             |



|                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
|----------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|--|-------------|--------|--------------------------------------|------|----------------------------------------------------------------------------------------------------------------------------------|--------|----------------|-------|
| Withdrawal from account                                                                                                          | <p>During continuation of business</p> <p>If the amount withdrawn in a year is not utilised for the specified purpose in the same previous year, then the amount not so utilised shall be treated as income of the year.</p> <table border="1" data-bbox="624 443 1422 741"> <tr> <td colspan="2">On closure of account:</td></tr> <tr> <td>Particulars</td><td>Amount</td></tr> <tr> <td>Amount so withdrawn from the account</td><td>****</td></tr> <tr> <td>Less: Amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement u/s 42</td><td>(****)</td></tr> <tr> <td>Taxable amount</td><td>*****</td></tr> </table> <p>In case of closure of business, the amount stated above shall be taxable as if the business is in existence.</p>                                                                                                                                                                                                                                                                                                                            | On closure of account: |  | Particulars | Amount | Amount so withdrawn from the account | **** | Less: Amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement u/s 42 | (****) | Taxable amount | ***** |
| On closure of account:                                                                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
| Particulars                                                                                                                      | Amount                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
| Amount so withdrawn from the account                                                                                             | ****                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
| Less: Amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement u/s 42 | (****)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
| Taxable amount                                                                                                                   | *****                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |
| Restriction on sale of such asset                                                                                                | <p>Such asset cannot be sold or transferred within 8 years from the end of the previous year in which it was acquired.</p> <p>If such asset is sold or otherwise transferred, deduction allowed shall be treated as taxable profit under the head "Profits &amp; gains of business or profession", in the year in which the asset is transferred.</p> <p>In the following cases, the provision shall not be applicable:</p> <ul style="list-style-type: none"> <li>• Sale or otherwise transfer to the government, local authority, statutory corporation or government company.</li> <li>• Sale or otherwise transfer, in connection with the succession of a firm by a company, subject to following conditions:             <ul style="list-style-type: none"> <li>□ All assets and liabilities of the firm, immediately before the succession became assets and liabilities of the company.</li> <li>□ All the shareholders of the company were the partners of the firm immediately before succession.</li> <li>□ The scheme continues to apply to the company in the manner applicable to the firm.</li> </ul> </li> </ul> |                        |  |             |        |                                      |      |                                                                                                                                  |        |                |       |

#### 5.5.8 Expenditure on Scientific Research [Section 35]

This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee.

Scientific research means any activity for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries [Sec. 43(4)]



Fig: 8.8

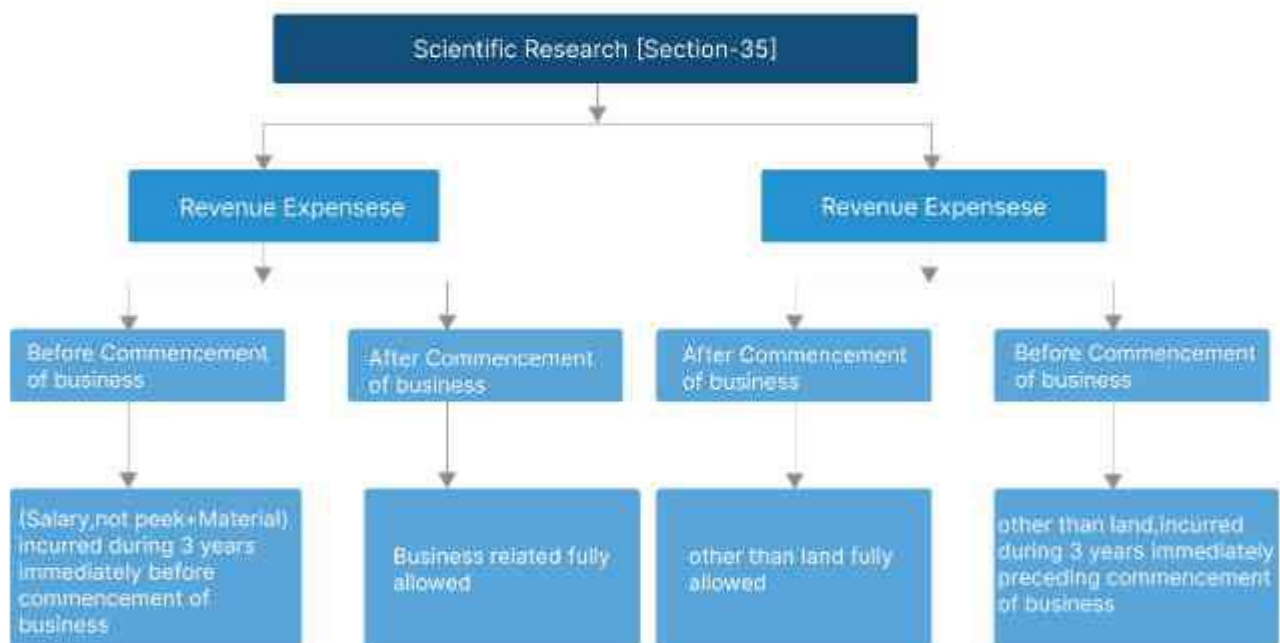


Fig: 8.9

**Note:** In-house research for a purpose not related to the business of the assessee shall not be allowed as deduction.

- **Carry Forward of Deficiency:**

Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward. This means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year.

- **No Depreciation:**

Where a deduction is allowed in any previous year in respect of any capital expenditure for scientific research, no deduction u/s 32 shall be allowed on such assets. [Sec. 35(2)(iv)].

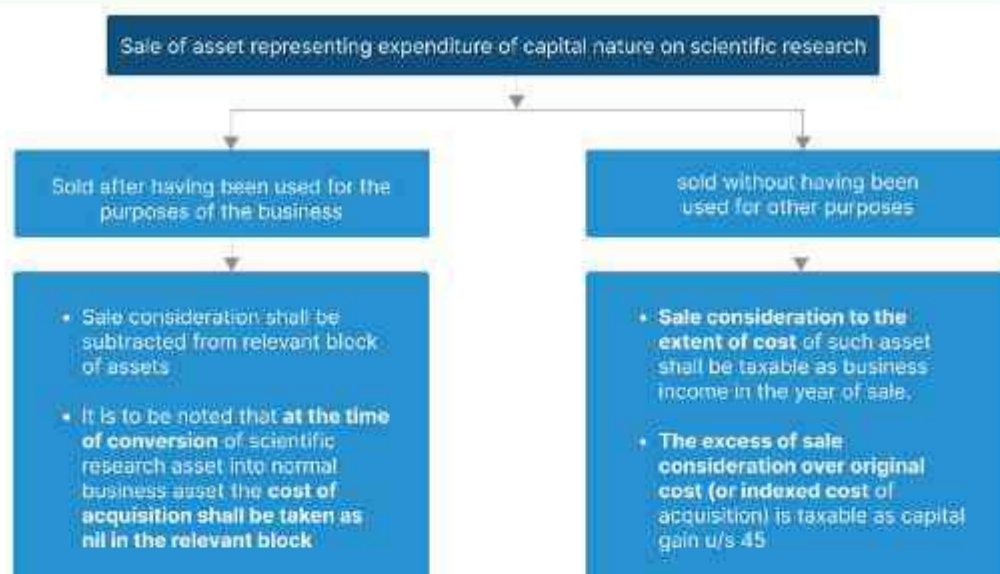


Fig: 8.10

**Illustration:3**

Hover Enterprises purchased machinery for ₹ 5,00,000 as on 20th July, 2021 for scientific research. On 15th August, 2022, the research work being completed. On 24th March, 2023, the machinery being sold for:

Case 1) ₹ 2,00,000

- After using the same for business purpose other than scientific research. The WDV of the respective block is ₹ 2,80,000. Depreciation rate 15%.
- Without using the same for any other purpose

Case 2) ₹ 8,00,000

- After using the same for business purpose other than scientific research. The WDV of the respective block is ₹ 2,80,000. Depreciation rate 15%.
- Without using the same for any other purpose.

State Tax Implications

**Solution**

Tax impact in case 1(a) and 2(a)

| Particulars                                                                              | Case 1(a) | Case 2(a) |
|------------------------------------------------------------------------------------------|-----------|-----------|
| Opening WDV of the block                                                                 | 2,80,000  | 2,80,000  |
| Add: Addition during the year being machinery earlier used for scientific research       | Nil       | Nil       |
| Less: Sale value of the machinery [ Max. to the extent of (Opening WDV + Addition made)] | 2,00,000  | 2,80,000  |
| Written down value before charging depreciation                                          | 80,000    | Nil       |
| Less: Depreciation ₹ 15%                                                                 | (12,000)  | Nil       |
| Written down value after charging depreciation                                           | 68,000    | Nil       |
| Short term capital gain [ Excess sale proceeds]                                          | Nil       | 5,20,000  |



Tax impact in case 1(b) and 2(b)

| Particulars                                                                                                 | Case 1(b) |          | Case 2(b) |            |
|-------------------------------------------------------------------------------------------------------------|-----------|----------|-----------|------------|
|                                                                                                             | Details   | Amount   | Details   | Amount     |
| Profits & gains of business or profession                                                                   |           |          |           |            |
| Being minimum of the following:                                                                             | 5,00,000  | 2,00,000 | 5,00,000  | 5,00,000   |
| • Earlier deduction claimed                                                                                 | 2,00,000  |          | 8,00,000  |            |
| • Surplus i.e. {Sale consideration – (Cost of assets – Earlier deduction allowed in respect of such asset)} |           |          |           |            |
| Capital gains                                                                                               |           |          |           |            |
| Sale consideration                                                                                          |           |          |           | 8,00,000   |
| Less: Cost of acquisition                                                                                   |           |          |           | (5,00,000) |
| Short-term capital gain                                                                                     |           |          |           | 3,00,000   |

#### 5.5.9 In-House Research & Development Expenses Incurred by Certain Companies [Sec. 35(2AB)]

|                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|----------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Applicable to              | Company engaged in the business of bio-technology or any business of manufacture or production of any article or thing (other than those specified in the 11th Schedule).                                                                                                                                                                                                                                                                                                                |
| Conditions to be satisfied | <ul style="list-style-type: none"> <li>The expenditure shall be incurred on in-house scientific research and development facility including capital expenditure.</li> </ul> <p><b>Note: other than expenditure in the nature of cost of any land or building.</b></p>                                                                                                                                                                                                                    |
|                            | In-house research and development facility shall be approved by the secretary, department of scientific and industrial research.                                                                                                                                                                                                                                                                                                                                                         |
|                            | <ul style="list-style-type: none"> <li>The assessee must enter into an agreement with the prescribed authority: <ul style="list-style-type: none"> <li>For co-operation in such research and development facility; and</li> <li>Fulfil such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed.</li> </ul> </li> </ul>                                                                                    |
| Deduction                  | <p>100% of the expenditure incurred on in-house research and development facility shall be allowed.</p> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>If the above conditions are not satisfied, then deduction may be claimed as per the provision of sec. 35(1)(i) or sec. 35(2).</li> <li>Where deduction is allowed in any previous year in respect of any capital expenditure under this section, then no deduction u/s 32 shall be allowed on such asset.</li> </ul> |



**Research Through outside institutions**

- Deduction ₹ 100% shall be allowed in respect of expenditure on research through following outside institution:
  - Any payment to national laboratory or a university or Indian Institute of Technology or a specified person [Sec. 35(2AA)].
  - Any payment made to a notified (by the Central Government) research association or to an approved university, college or other institutions<sup>3</sup> [Sec. 35(1)(ii)].
  - Any payment made to a notified (by the central government) research association, university, college or other institution<sup>3</sup> [Sec. 35(1)(iii)].
  - Any payment to an approved Indian company (main object of whom is scientific research & development)<sup>3</sup> [Sec. 35(1)(ia)].

**Note:**

- Such association, university, college or institution must be approved in accordance with prescribed guidelines and must be notified by the central government.
- Withdrawal of approval: Deduction shall not be denied merely on the ground that subsequent to the payment made by the assessee, the approval granted to the association, university, IIT, etc. has been withdrawn.
- Carry forward of unabsorbed scientific research expenditure: Unabsorbed capital expenditure can be carried forward for unlimited years and set off in any subsequent assessment year(s) like unabsorbed depreciation.
- Effect of amalgamation [Sec. 35(5)]: Provisions of sec. 35 shall apply to the amalgamated company, as it would have been applied to the amalgamating company, if the latter had not transferred such asset.

**Illustration:4**

Mr. Atul, furnishes the following particulars for the P.Y.2021-22. Compute the deduction allowable under section 35 for A.Y.2022-23, while computing his income under the head "Profits and gains of business or profession".

|                                                                                                                                                                   |            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|
| Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research                                                                  | ₹ 2,00,000 |
| Amount paid to IIT, Delhi for an approved scientific research programme                                                                                           | ₹ 3,50,000 |
| Amount paid to Z Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority | ₹ 5,00,000 |
| Expenditure incurred on in-house research and development facility as approved by the prescribed authority                                                        |            |
| • Revenue expenditure on scientific research                                                                                                                      | ₹ 4,00,000 |
| • Capital expenditure (including cost of acquisition of land ₹5,00,000) on scientific research                                                                    | ₹ 6,40,000 |

**Solution:**

Computation of deduction under section 35 for the A.Y.2022-23

| Particulars                                                        | ₹        | Deduction % | Amount    |
|--------------------------------------------------------------------|----------|-------------|-----------|
| Payment for scientific research                                    |          |             |           |
| Indian Institute of Science, Bangalore                             | 2,00,000 | 100%        | 2,00,000  |
| IIT, Delhi                                                         | 3,50,000 | 100%        | 3,50,000  |
| Z Ltd.                                                             | 5,00,000 | 100%        | 5,00,000  |
| Expenditure incurred on in-house research and development facility | Nil      | Nil         | Nil       |
| Deduction allowable under section 35                               |          |             | 10,50,000 |

Note: Only company assessee are entitled to deduction 100% under section 35(2AB) in respect of in-house research and development expenditure incurred. In this case, the assessee is an individual.

**5.5.10 "Investment-linked Tax Incentives" for Specified Businesses [Section 35AD]**

| Applicable to                    | Assessee engaged in the business Specified (Note: 1)                                                                                                                                                                                             |                                         |
|----------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|
| Conditions to be satisfied       |                                                                                                                                                                                                                                                  |                                         |
| Owned by                         | Cross-country oil pipeline                                                                                                                                                                                                                       | Other Business                          |
|                                  | An Indian company or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central/State Ac.                                                                                     | Any assessee                            |
| Date of commencement of business | On or after 01st April, 2007                                                                                                                                                                                                                     | On or after date given in Note: 2 below |
| Restriction on usage             | It has made not less than such proportion of its total pipeline capacity as specified by the Petroleum and Natural Gas Regulatory Board available for use on common carrier basis by any person other than the assessee or an associated person. | No Restriction                          |
| New Business                     | Such business should not be set up by splitting up, or the reconstruction, of a business already in existence.                                                                                                                                   |                                         |

|                                                                                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| New Plant Machinery                                                                                                                | <p>Such business should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose.</p> <p>Exceptions:</p> <ul style="list-style-type: none"> <li>• A plant or machinery is deemed as new asset if: <ul style="list-style-type: none"> <li>□ Such plant or machinery is imported into India.</li> <li>□ Depreciation on such asset has not been allowed under this Act to any person and</li> <li>□ The assessee was the first user of such asset in India.</li> </ul> </li> <li>• Where the total value of old plant and machinery transferred to the new business does not exceed 20% of total value of plant and machinery used in such business, then this condition is deemed to be satisfied.</li> </ul> |
| Audit                                                                                                                              | Books of account should be audited by a chartered accountant.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>Quantum of deductions</b>                                                                                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| 100% of capital expenditure incurred during the previous year, wholly and exclusively, for the purposes of any specified business. |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Capital Expenditure shall not include                                                                                              | <ul style="list-style-type: none"> <li>• Any expenditure incurred on the acquisition of any land or goodwill or financial instrument.</li> <li>• Any expenditure in respect of which the payment (or aggregate of payments made to a person in a day), otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through other prescribed electronic mode, exceeds ₹ 10,000.</li> </ul>                                                                                                                                                                                                                                                                             |
| Pre-commencement expenditure                                                                                                       | Where the expenditure is incurred prior to the commencement of its operations which has been capitalised in the books of account of the assessee on the date of commencement of its operations, shall be allowed as deduction in the previous year in which the assessee commences such business.                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| No Double Deduction                                                                                                                | Assessee shall not be allowed any deduction u/s 10AA or 80HH to 80RRB in respect of the specified business for the same or any other assessment year.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| Restriction of use of the asset                                                                                                    | Shall be used only for the specified business, for a period of 8 years beginning with the previous year in which such asset is acquired or constructed.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |



|                                                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |       |
|---------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| Consequences of usage of asset otherwise than for specified purpose | Then following amount shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used:                                                                                                                                                                                                                                                                                                                                                                                                      |       |
|                                                                     | The total amount of deduction so claimed and allowed in one or more previous years.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | ***   |
|                                                                     | Less: Depreciation allowable in accordance with the provisions of section 32, as if no deduction under this section was allowed.                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | (***) |
|                                                                     | Deemed Income                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | ***   |
|                                                                     | <ul style="list-style-type: none"> <li>However, the provision of reversal of deduction shall not be applied to a company which has become a sick industrial company u/s 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during that period.</li> </ul>                                                                                                                                                                                                                                                                                                                           |       |
| Actual cost of asset for depreciation                               | The actual cost of any capital asset for the purpose of computing depreciation is NIL.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |       |
| Treatment of Realisation                                            | Any sum received or receivable (in cash or kind) on account of such capital asset being demolished, destroyed, discarded or transferred shall be taxable as business income.                                                                                                                                                                                                                                                                                                                                                                                                                            |       |
| Carry forward and set off of losses [Sec. 73A]                      | Any loss, computed in respect of such specified business shall be set off only against profits and gains, if any, of any other specified business.                                                                                                                                                                                                                                                                                                                                                                                                                                                      |       |
| Transfer of operation                                               | Where the assessee builds a hotel of two-star or above category as classified by the central government and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, the assessee shall be deemed to be carrying on the specified business.                                                                                                                                                                                                                                                                                                                  |       |
| Inter-unit transfer                                                 | <ul style="list-style-type: none"> <li>Assessee carries on at least two units.</li> <li>Out of such units at least one is eligible u/s 35AD and at least one is not eligible for exemption.</li> <li>Goods or services are transferred from eligible unit to any non-eligible unit or vice versa.</li> <li>The consideration for such transfer does not correspond to the market value of such goods as on the date of transfer.</li> <li>Then, deduction shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date.</li> </ul> |       |



**Note No: 1****Specified business**

- Setting up and operating a cold chain facility.
- Setting up and operating a warehousing facility for storage of agricultural produce or
- Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.

**Note: The project has been approved by the Petroleum and Natural Gas Regulatory Board and being notified by the central government.**

- Building and operating, anywhere in India, a hotel of two-star or above category as classified by the central government.
- Building and operating, anywhere in India, a hospital with at least 100 beds for patients.
- Developing and building a notified housing project under a scheme for slum redevelopment or rehabilitation framed by the central government (or a state government).
- Production of fertilizer in India.
- Setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962.
- Bee-keeping and production of honey and beeswax.
- Setting up and operating a warehousing facility for storage of sugar.
- Laying and operating a slurry pipeline for the transportation of iron ore.
- Setting up and operating a semi-conductor wafer fabrication manufacturing unit, and which is notified by the board in accordance with such guidelines as may be prescribed.
- Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility by an Indian company (or consortium thereof) / authority / board / corporation having agreement with central government or state government or local authority or any statutory body.

**Note No: 2**

| Date of commencement of business (on or after) | Specified Business                                       |
|------------------------------------------------|----------------------------------------------------------|
| 01st April, 2009                               | Warehousing facility for storage of agricultural produce |
|                                                | Cold chain facility                                      |
| 01st April, 2010                               | Hotel                                                    |
|                                                | Slum redevelopment                                       |
|                                                | Hospital                                                 |
| 01st April, 2011                               | Fertilizer                                               |
|                                                | Affordable housing                                       |
| 01st April, 2012                               | Inland container depot                                   |
|                                                | Warehousing facility for storage of Sugar                |
|                                                | Bee-keeping                                              |
| 01st April, 2014                               | Slurry pipeline for transportation of iron-ore           |
| 01st April, 2017                               | Semi-conductor wafer fabrication manufacturing unit      |
|                                                | Infrastructure facility                                  |

## 5.5.11 Amortisation of Telecom-Licence fee [Sec. 35ABB]

| Applicable to                                                             | All assessee                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
|---------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|--------------------|--------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------------|----------------------------------------------------------------|--------------------|--|
| Conditions to be satisfied                                                | <ul style="list-style-type: none"> <li>Assessee has incurred capital expenditure for acquiring any right to operate telecommunication services.</li> <li>Payment for such expenditure has actually been made.</li> </ul> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>Such expenditure may be incurred before or after commencement of business.</li> <li>Revenue expenditure incurred relating to telecom licence fee shall not be eligible for deduction u/s 35ABB. However, assessee can claim deduction u/s 37(1) for such expenditure.</li> </ul>                                                                                                                      |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| Deduction u/s 35ABB(1)                                                    | <p>Actual expenditure incurred and paid shall be allowed as deduction in equal instalments over the period for which the license remains in force starting from the year as under:</p> <table> <tr> <th>Case</th><th>Period starts from</th></tr> <tr> <td>Where the license-fee is paid before the commencement of business.</td><td>The previous year in which such business commenced.</td></tr> <tr> <td>When license is acquired after commencement of business.</td><td>The previous year in which license fee has been actually paid.</td></tr> <tr> <td>In any other case.</td><td></td></tr> </table> <p><b>Note: No depreciation is allowed on such capital expenditure.</b></p> | Case | Period starts from | Where the license-fee is paid before the commencement of business. | The previous year in which such business commenced. | When license is acquired after commencement of business. | The previous year in which license fee has been actually paid. | In any other case. |  |
| Case                                                                      | Period starts from                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| Where the license-fee is paid before the commencement of business.        | The previous year in which such business commenced.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| When license is acquired after commencement of business.                  | The previous year in which license fee has been actually paid.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| In any other case.                                                        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| Where such license is sold in full                                        | <ul style="list-style-type: none"> <li>Loss on sale shall be deductible as business loss in the year of sale.</li> <li>Profit on sale, to the extent of aggregate of deduction allowed in preceding year(s) shall be treated as business income.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| Capital gain treatment                                                    | The excess of sale consideration over original cost (or indexed cost of acquisition) is taxable as capital gain u/s 45.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |
| Where such licence is transferred in a scheme of amalgamation or demerger | The amalgamated company or resulting company (being Indian company) as the case may be shall be entitled to claim deduction u/s 35ABB.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |      |                    |                                                                    |                                                     |                                                          |                                                                |                    |  |

### 5.5.12 Payment to Associations and Institutions for Carrying out Rural Development Pro-grammes [Sec. 35CCA]

- Where an assessee incurs any expenditure by way of payment of any sum: To an association or institution, which has as its object the undertaking of any programme of rural development approved by the prescribed authority and the assessee furnishes a certificate from such association or institution.
- To an association or institution, which has as its object the training of persons for implementing programmes of rural development.
- The National fund for rural development.
- To the National Urban Poverty Eradication Fund set up and notified by the central government in this behalf.

**Double Deduction is not Permissible:** Where a deduction under this section is claimed and allowed for any assessment year in respect of any expenditure, deduction shall not be allowed in respect of such expenditure u/s 80G or any other provision of this Act.

**Withdrawal of Approval:** Deduction shall not be denied merely on the ground that subsequent to the contribution made by the assessee, the approval granted to such programme, etc. has been withdrawn.

### 5.5.13 Expenditure on Agricultural Extension Project [Sec. 35CCC]

Where an assessee incurs any expenditure on notified agricultural extension project, such expenditure is fully allowed.

- Double deduction is not permissible.

Expenditure on skill development project [Sec. 35CCD]

Where a company incurs any expenditure (not being expenditure in the nature of cost of any land or building) on any notified skill development project, such expenditure is fully allowed.

- Double deduction is not permissible.

### 5.5.14 Amortisation of Preliminary Expenses [Sec. 35D & Rule 6AB]

|            |                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Applicable | <ul style="list-style-type: none"> <li>• Only to Indian companies and resident non-corporate assessees.</li> <li>• In the case of new companies to expenses incurred before the commencement of the business.</li> <li>• In the case of extension of an existing undertaking to expenses incurred till the extension is completed.</li> </ul> <p><b>Note:</b> A foreign company, which is resident in India, is not covered under this section.</p> |
|------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|



|                                                                   |                                                                                                                                                                                                                                                                       |                                                                                                                                                                          |
|-------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions                                                        | <ul style="list-style-type: none"> <li>Assessee has incurred certain amount as preliminary expense.</li> <li>Purpose of expense</li> </ul>                                                                                                                            |                                                                                                                                                                          |
|                                                                   | Expense is incurred before commencement of business                                                                                                                                                                                                                   | Expense must be incurred for setting up a new undertaking or business.                                                                                                   |
|                                                                   | Expense is incurred after commencement of business                                                                                                                                                                                                                    | Expense must be incurred in connection with extension of any undertaking or in connection with setting up a new unit.                                                    |
|                                                                   | Report of a chartered accountant                                                                                                                                                                                                                                      |                                                                                                                                                                          |
|                                                                   | One month prior to the due date of filing of return relating to the year in which such expenditure was first claimed.                                                                                                                                                 |                                                                                                                                                                          |
| Total preliminary expense (maximum amount) eligible for deduction | In case of non-corporate resident assessee                                                                                                                                                                                                                            | 5% of the cost of project                                                                                                                                                |
|                                                                   | In case of Indian company                                                                                                                                                                                                                                             | <ul style="list-style-type: none"> <li>5% of the 'cost of project.</li> </ul> OR <ul style="list-style-type: none"> <li>capital employed</li> </ul> whichever is higher. |
| Amount of deduction                                               | 1/5th of the total eligible preliminary expense is allowed in 5 equal annual instalments <ul style="list-style-type: none"> <li>starting from the year in which the business commences or unit expanded or the new unit commences production or operation.</li> </ul> |                                                                                                                                                                          |
| Effect of amalgamation or demerger                                | Shall be entitled to claim deduction u/s 35D for the residual period as if the amalgamation or demerger had not taken place [Sec. 35D(5) & (5A)].                                                                                                                     |                                                                                                                                                                          |

Note:

Cost of Project:

|                   |                                                                                                                                                                                                                                                 |
|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| New business      | Actual cost of fixed assets (being land, buildings, leaseholds, plant machinery, furniture, fittings and railway sidings) which are shown in the books of the assessee as on the last day of the previous year in which the business commences. |
| Existing business | Actual cost of fixed assets which are shown in the books of the assessee in which the extension of industrial undertaking is completed or new industrial undertaking commences production or operation.                                         |



Capital Employed:

|                   |                                                                                                                                                                                                                                                                        |
|-------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| New business      | The aggregate of issued share capital, debentures & long-term borrowings as on the last day of the previous year in which the business commences.                                                                                                                      |
| Existing business | The aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the extension is completed so far as such capital etc., have been issued or obtained in connection with the extension of the business. |

**Illustration: 5**

Dwell smith Ltd. is an existing Indian company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit:

| Particulars                                                                       | Amount ₹  |
|-----------------------------------------------------------------------------------|-----------|
| Preparation of project report                                                     | 5,00,000  |
| Market survey                                                                     | 7,00,000  |
| Legal and other charges for issue of additional capital required for the new unit | 3,00,000  |
| Total                                                                             | 15,00,000 |

| Particulars                      | Amount ₹  |
|----------------------------------|-----------|
| Cost of project                  | 50,00,000 |
| Capital employed in the new unit | 60,00,000 |

What is the deduction admissible to the company u/s 35D?

**Solution:**

Calculation of admissible preliminary expenditure

| Particulars                                                                           | Amount ₹  |
|---------------------------------------------------------------------------------------|-----------|
| Cost of project (X)                                                                   | 50,00,000 |
| Capital employed (Y)                                                                  | 60,00,000 |
| Eligible preliminary expenditure being minimum of the following:                      |           |
| • Actual expenditure                                                                  | 15,00,000 |
| • 5% of (X) or (y) whichever is higher [i.e., 60,00,000*5%]                           | 3,00,000  |
| Amount eligible for amortization                                                      | 3,00,000  |
| Amount of deduction u/s 35D for current year (till 5 years) being 1/5th of ₹ 3,00,000 | 60,000    |

**5.5.15 Deduction of Expenses Incurred in case of Amalgamation or Demerger [Sec. 35DD]**

| Applicable to        | An Indian company                                                                                                                                                                                                                                   |
|----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions           | <ul style="list-style-type: none"> <li>Assessee has incurred certain expenditure wholly &amp; exclusively for the purpose of amalgamation or demerger.</li> <li>No deduction has been claimed for such expenses under any other section.</li> </ul> |
| Quantum of deduction | 1/5th of expenses so incurred for a period of 5 years commencing from the year in which amalgamation or demerger takes places.                                                                                                                      |

**5.5.16 Bonus or Commission to Employees [Sec. 36(1)(ii)]**

Any bonus or commission (other than in lieu of profit or dividend) paid to employees shall be allowed as deduction. Such amount must have been actually paid before the due date of furnishing return [Sec. 43B].

**5.5.17 Interest on Borrowed Capital [Sec. 36(1)(iii)]**

Amount of interest paid in respect of capital borrowed for the purposes of business or profession shall be allowed as deduction.

|                                                                |                                                                                                                                                                                                                                                                                           |                                                      |
|----------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------|
| Conditions                                                     | <ul style="list-style-type: none"> <li>The assessee must have borrowed money.</li> <li>The money so borrowed must have been used for the purpose of business or profession during the previous year.</li> <li>The assessee must have incurred interest on the borrowed amount.</li> </ul> |                                                      |
| Interest paid to another person                                | Interest on capital to proprietor is disallowed expenditure. However, interest on capital to partners is allowed u/s 40(b) [to be discussed in the chapter 'Firm Assessment'].                                                                                                            |                                                      |
| Interest paid to relative                                      | Allowed as deduction subject to sec. 40A(2) i.e., if the interest paid is in excess of market rate, then excess portion shall be disallowed.                                                                                                                                              |                                                      |
| Interest on share capital                                      | Is not allowed.                                                                                                                                                                                                                                                                           |                                                      |
| Interest on borrowings made for acquiring & installing assets: | Interest for the period                                                                                                                                                                                                                                                                   | Treatment of interest                                |
|                                                                | Prior to commencement of business.                                                                                                                                                                                                                                                        | Interest is to be added to actual cost of the asset. |
|                                                                | After commencement of business but before asset is put to use.                                                                                                                                                                                                                            |                                                      |
|                                                                | After asset is put to use.                                                                                                                                                                                                                                                                | Interest is allowed u/s 36(1)(iii).                  |
| Interest on money borrowed to pay income tax                   | Is not allowed.<br><b>Note: Interest on money borrowed for payment of sales tax is allowed as deduction.</b>                                                                                                                                                                              |                                                      |
| Interest paid outside India                                    | Without deducting tax at source is not allowed.                                                                                                                                                                                                                                           |                                                      |
| Other interest                                                 | Interest other than interest on borrowed capital shall not be allowed under this section but can be claimed u/s 37(1).                                                                                                                                                                    |                                                      |

**5.5.18 Discount on Issue of Zero-Coupon Bonds (ZCB) [Sec. 36(1)(iiia)]**

Meaning: As per Sec.2(48) "Zero Coupon Bond" means a bond:

- Issued by any infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank on or after 1/6/2005.
- In respect of which no payment and benefit is received or receivable before maturity or redemption from the issuer and
- Which the central government may, by notification in the official gazette, specify in this behalf.

Discount on issue of Zero-Coupon Bonds shall be allowed on pro rata basis having regard to the period of life of such bond.

**5.5.19 Contribution Towards RPF & Superannuation Fund [Sec. 36(1)(iv)]**

Any sum paid, by the employer towards recognised provident fund or an approved superannuation fund as per rules specified in the fourth schedule of the Act is allowed as deduction in full.

**Note:**

Such amount must have been actually paid before the due date of furnishing return [Sec. 43B].

Contribution towards unrecognised provident fund is not allowed as deduction.

Contribution towards statutory provident fund is allowed as deduction u/s 37(1).

**5.5.20 Contribution Towards Notified Pension Scheme U/s 80CCD [Sec. 36(1)(iva)]**

Any sum paid by the assessee, as an employer, by way of contribution towards a pension scheme, as referred to in section 80CCD, on account of an employee is allowed as deduction.

|               |                                                                                                                                |
|---------------|--------------------------------------------------------------------------------------------------------------------------------|
| Maximum Limit | Such contribution should not exceed 10% of the salary of the employee in the previous year.                                    |
| Salary        | Includes:<br>Dearness allowance, if the terms of employment so provided.<br>excludes:<br>All other allowances and perquisites. |

**5.5.21 Contribution Towards Approved Gratuity Fund [Sec. 36(1)(v)]**

Any sum paid as employer's contribution towards an approved gratuity fund created by him exclusively for the benefit of his employees under an irrevocable trust is allowed as deduction.

**Note:**

Such amount must have been actually paid before the due date of furnishing return [Sec. 43B].

**5.5.22 Employee's Contribution Towards Staff Welfare Scheme [Sec. 36(1)(va)]**

Any sum received by an employer from his employees as contribution towards:

- Provident Fund or
- Superannuation Fund or
- Any other fund set up under the provision of the Employee's State Insurance Act, 1948 or
- Any other fund for the welfare of such employees.



Is treated as an income of the employer. Subsequently, when such sum is credited by the employer to the employee's account in the relevant fund on or before the due date of crediting such contribution prescribed under the relevant Act, then deduction is allowed.

|                                                                                       |                             |
|---------------------------------------------------------------------------------------|-----------------------------|
| If employee's contribution is deposited by the employer on or before the due date     | No treatment                |
| If employee's contribution is not deposited by the employer on or before the due date | Taxable as business income. |

#### 5.5.23 Bad Debts [Sec. 36(1)(vii)]

Taxable as business income.

Any debt or part thereof, which becomes bad shall be allowed as deduction.

##### Conditions:

- Debt must be incidental to the business or profession of the assessee.
- The debt has been considered as income of the assessee of that previous year or of earlier previous years

##### Note:

Bad debt arising due to insolvency of borrower is allowed as deduction provided money has been lent in ordinary course of money lending business (even though such money lent had never been a part of income).

- It must have been written off in the accounts of the assessee.

##### Note:

Provision for bad debt is not allowed as deduction.

- Business must be carried on during the previous year or any part of the previous year.

##### Note:

Bad debt of a discontinued business is not allowed as deduction even though the assessee has any other business continued.

- It must be of a revenue nature.

##### Note:

- Bad debt arising due to insolvency of a debtor for sale of an asset (not goods) is not allowed as deduction.
- Bad debt is not allowed as deduction to the assessee who maintains accounts on cash basis.
- Bad debts are also allowed in the hands of successor of the business

#### 5.5.24 Recovery of Bad Debts [Sec. 41(4)]

If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession, and the same will be chargeable as income of the previous year in which it is recovered mathematically.



| Particulars                                                                                                              | Amount |
|--------------------------------------------------------------------------------------------------------------------------|--------|
| Amount recovered                                                                                                         | ****   |
| Less: Bad debt claimed – Bad debt allowed as deduction                                                                   | (****) |
| Taxable bad debt recovery                                                                                                | ****   |
| <b>Note:</b><br><b>Such recovery shall be taxable irrespective of the fact whether the business is continued or not.</b> |        |

#### 5.5.25 Provision for Bad Debts [Sec. 36(1)(viia)]

In the case of following person, provision for bad debts shall be allowed to the extent of specified amount:

| Person                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | To that extent PBDD is allowed                                                                        |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|
| Scheduled bank [not being a foreign bank]                                                                                                                                                                                                                                                                                                                                                                                                                                          | 8.5% of the total income<br>(Computed before making any deduction under this section and Chapter VIA) |
| A non-scheduled bank                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                                                                                                       |
| A co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank                                                                                                                                                                                                                                                                                                                                             |                                                                                                       |
| Additional Deduction for the person covered above:                                                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                       |
| <ul style="list-style-type: none"><li>• 10% of the aggregate average advances made by the rural branches of such bank</li><li>• Further, at its option, further deduction shall also be allowed for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the central government, provided such income has been disclosed in the return of income under the head "Profits and gains of business or profession".</li></ul> |                                                                                                       |
| <ul style="list-style-type: none"><li>• Foreign bank</li><li>• Public financial institution or</li><li>• State financial corporation or</li><li>• State industrial investment corporation or</li><li>• Non-banking financial company</li></ul>                                                                                                                                                                                                                                     | 5% of the total income<br>(Computed before making any deduction under this section and Chapter VIA)   |

**Note:** PBPP (Provision for bad and doubtful debts)- In case of person covered under this section, the deduction for bad debts u/s 36(1)(vii) shall be limited to an amount by which such debts exceed the credit balance in the provision for bad and doubtful debts. If the actual bad debt during the previous year is less or equal to the provision for doubtful debts, no deduction for bad debt shall be allowed.

Rural branch means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

**5.5.26 Deduction in respect of Special Reserve [Sec. 36(1)(viii)]**

Deduction is allowed in respect of any special reserve created and maintained by a specified entity in respect of reserve created from the specified business.

The amount of deduction shall be least of the following:

- Amount transferred to the reserve account during the previous year; or
- 20% of the profits derived from the specified business of providing long-term finance;
- Twice the amount of the paid-up share capital and the general reserve.

**Treatment on withdrawal from Special Reserve Account**

As per sec. 41(4A), if a deduction has been allowed in respect of any special reserve created under this section, any amount subsequently withdrawn from such special reserve shall be deemed to be profits or gains of business or profession and shall be taxable in the year of such withdrawal.

**8.5.27 Securities Transaction Tax [Sec. 36(1)(xv)]**

Any amount of securities transaction tax (STT) paid by the assessee during the previous year shall be allowed as deduction provided income arising from such transactions is included in the income computed under the head "Profits and gains of business or profession".

**5.5.28 Commodities Transaction Tax [Sec. 36(1)(xvi)]**

Any amount of commodities transaction tax (CTT) paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowed as deduction provided income arising from such transactions is included in the income computed under the head "Profits and gains of business or profession".

**5.5.29 General deductions [Sec. 37(1)]**

Any expenditure which is not specifically provided in any provisions (discussed earlier) of the Act and fulfils following conditions, shall be allowed as deduction under this section.

- It must be real and not notional, fictitious or in lieu of distribution of profit.
- It must be expended wholly & exclusively for the purpose of business or profession carried on by the assessee.
- It must have been incurred in the previous year.
- It must not be a personal expenditure.
- It must be lawful and not have been incurred for any purpose, which is an offence or prohibited, under any law.

It also includes the expenditure incurred by an assessee:

- For any purpose which is an offence or prohibited by any law for the time being in force, in India or outside India or
- To provide any benefit or perquisite to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person or
- To compound an offence under any law for the time being in force, in India or outside India.



## Unit 5.6 - Inadmissible Deductions [Section 40]

Whereas sec. 30 to 37(1) deals with the expenditure, which is allowed, the Act also lists certain expenditures which are specifically disallowed. Sec. 40 states that, certain amounts shall not be deducted in computing the income chargeable under the head "Profits & gains of business or profession". Such provisions are discussed below:

- **8.6.1** In the case of any assessee, the following expenses are not deductible [Sec. 40(a)]
- **8.6.1(a)** Interest, royalty, fees for technical services payable to a non-resident or outside India [Sec.40(a)(i)]

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable to:

- Outside India or
- In India to a non-resident (not being a company) or to a foreign company.

| Payment made to Non-resident /person outside India                                                           | Deduction                           |
|--------------------------------------------------------------------------------------------------------------|-------------------------------------|
| • Without deducting TDS                                                                                      | 100% of such expenses is Disallowed |
| OR                                                                                                           |                                     |
| • After deducting TDS failed to pay before the due date of filing the income tax return under section 139(1) |                                     |

Notes:

- Where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date of submission of return of income u/s 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.
- Where an assessee fails to deduct the whole or any part of the tax on any sum but is not deemed to be an assessee in default under the first proviso to sec. 201(1), then, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee.

### 5.6.1 (b) Any Sum Payable to a Resident on which TDS provision is Applicable [Sec.40(a) (ia)]

| Payment made to resident                                                                                   | Deduction                          |
|------------------------------------------------------------------------------------------------------------|------------------------------------|
| Without deducting TDS                                                                                      | 30% of such expenses is Disallowed |
| OR                                                                                                         |                                    |
| After deducting TDS failed to pay before the due date of filing the income tax return under section 139(1) |                                    |

**Notes:**

- Where tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.
- Where an assessee fails to deduct the whole or any part of the tax on any sum but is not deemed to be an assessee in default under the first proviso to sec. 201(1), then, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

**5.6.1 (c) Consideration on Which Equalisation Levy is Applicable [Sec. 40(a)(ib)]**

| Any consideration paid or payable to a non-resident for a specified service                                              | Deduction                           |
|--------------------------------------------------------------------------------------------------------------------------|-------------------------------------|
| Without deducting equalisation levy                                                                                      | 100% of such expenses is Disallowed |
| OR                                                                                                                       |                                     |
| After deducting equalisation levy failed to pay before the due date of filing the income tax return under section 139(1) |                                     |

The equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date of furnishing return of income, such sum shall be allowed as a deduction in computing the income of the previous year in which such levy has been paid.

**5.6.1 (d) Income Tax [Sec. 40(a)(ii)]**

Income tax paid by the assessee on income of predecessor is not deductible. Tax including surcharge and cess would be disallowed while computing business income.

**5.6.1 (e) Royalty, licence fees, etc. payable by State Government Undertaking [Sec. 40(a) (iib)]**

Any amount paid by way of royalty, licence fee, service fee, service charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a state government undertaking by the state government (SG).

**5.6.1 (e) Royalty, licence fees, etc. payable by State Government Undertaking [Sec. 40(a) (iib)]**

Any amount paid by way of royalty, licence fee, service fee, service charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a state government undertaking by the state government (SG).

**5.6.1 (f) Any Payment which is Chargeable Under The Head "Salaries" [Sec. 40(a)(iii)]**

Any sum which is chargeable under the head 'salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom.



### 5.6.1 (g) Any payment to a Provident fund or any other Fund Established for the Benefit of employees of the assessee [Sec. 40(a)(iv)]

The assessee has not made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'salaries'.

### 5.6.1 (h) Tax Paid on Perquisites on Behalf of Employees is Not Deductible [Sec. 40(a)(v)]

Any tax on non-monetary perquisites is actually paid by his employer it is exempt from tax in the hands of that employee.

Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on non-monetary perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

### 5.6.2 In the case of any firm or limited liability partnership (LLP), the following amounts shall not be deducted in computing the business income. [Section 40(b)]

#### 5.6.2. (a) Interest To Partner

Payment of interest to any partner authorised by and in accordance with the terms of the partnership deed. Such interest to partners whether on capital or on loan is allowed as deduction.

- **Deduction:**

Minimum of the following is allowed as deduction:

- Actual interest given to partner as per deed.
- 12% p.a. simple interest.

#### 5.6.2. (b) Remuneration to Partner

Remuneration to a partner includes salary, fees, commission, bonus, etc. Such Payment of remuneration to a working partner which is authorized by and in accordance with the partnership deed.

- **Deduction**

Remuneration (in total) is allowed to the minimum of the following:

- Actual remuneration allowed to all partners.
- Maximum permissible limit u/s 40(b)(v) as discussed under:

| Amount of book-profit  | Maximum remuneration allowed                           |
|------------------------|--------------------------------------------------------|
| In case of loss        | ₹ 1,50,000                                             |
| In case of profit      |                                                        |
| First ₹ 3,00,000       | 90% of book profit or ₹ 1,50,000, whichever is higher. |
| On balance book-profit | 60% of next book profit.                               |

**Meaning of Book Profit:**

Book profit means the net profit as shown in the P & L A/c for the relevant previous year computed in accordance with the provisions for computing income from profits and gains. The above amount should be increased by the remuneration paid or payable to all partners of the firm if the same has been deducted while computing net profit.

- Computation of Book Profit**

Step 1: Find out the net profit of the firm as per Profit & Loss A/c.

Step 2: Make adjustment as per sec. 28 to 44DB (including adjustment for interest on partner's capital).

Step 3: Add remuneration to partner, if debited to the Profit & Loss A/c.

Step 4: Subtract unabsorbed depreciation but do not subtract brought forward business losses. The resultant figure is book profit.

**Note:** Due to subtraction of unabsorbed depreciation the residual profit should not be less than the brought forward losses, which are to be set-off in the current year.

**Illustration 6**

A firm has paid ₹ 8,50,000 as remuneration to its partners for the P.Y. 2021-22, in accordance with its partnership deed, and it has a book profit of ₹ 10,00,000,00,000. What is the remuneration allowable as deduction?

**Solution**

The allowable remuneration calculated as per the limits specified in section 40(b)(v)

| Particulars                                            | Amount   |
|--------------------------------------------------------|----------|
| On first ₹ 3 lakhs of book profit [₹ 3,00,000 × 90%]   | 2,70,000 |
| On balance ₹ 7 lakhs of book profit [₹ 7,00,000 × 60%] | 4,20,000 |
| Total                                                  | 6,90,000 |

The excess amount of ₹ 1,60,000 (i.e., ₹ 8,50,000 – ₹ 6,90,000) would be disallowed as per section 40(b)(v).

## Unit 5.7 - Expenses or Payment Not Deductible in Certain Circumstances [Section 40A]

**5.7.1 Payments to Relatives and Associates [Sec. 40A (2)]**

Any payment made by an assessee to a related person shall be disallowed to the extent it is excess or unreasonable as per the assessing officer.

| For the assessee | Related Person means                                                                                                                                                                                                                                                                                                                                                          |
|------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| An Individual    | <ul style="list-style-type: none"> <li>Relative</li> <li>A person in whose business or profession the individual has substantial interest.</li> </ul>                                                                                                                                                                                                                         |
| A Company        | <ul style="list-style-type: none"> <li>Director of the company or any relative of the director.</li> <li>A person in whose business or profession the company or any of its director or relative of such director has substantial interest.</li> <li>Any other company carrying on business or profession in which the aforesaid company has substantial interest.</li> </ul> |
| A Firm           | <ul style="list-style-type: none"> <li>Partner of the firm or relative of partner.</li> <li>A person in whose business or profession the firm or any of its partner or relative of such partner has substantial interest.</li> </ul>                                                                                                                                          |
| HUF / AOP        | <ul style="list-style-type: none"> <li>A member of the Association or HUF or any relative of the member.</li> <li>A person in whose business or profession the AOP or any of its member or relative of such member has substantial interest.</li> </ul>                                                                                                                       |
| Any assessee     | <ul style="list-style-type: none"> <li>Any individual who has a substantial interest in the business or profession of the assessee or the relative of such individual.</li> </ul>                                                                                                                                                                                             |

**Relative u/s 2(41)** means the spouse, brother, sister or any lineal ascendant or descendant of that individual.

**Person having substantial interest:** A person is deemed to have substantial interest in the business or profession, if:

1. In a case, where the business or profession is carried on by a company, such person is at any time during the previous year, the beneficial owner of equity share carrying not less than 20% of voting power.
2. In any other case, such person is at any time during the previous year, the beneficially entitled to not less than 20% of the profits of such business or profession.

#### **5.7.2. Consequences of Payment exceeding ₹ 10,000/- otherwise than by account payee cheque or demand draft [Sec. 40A(3)]**

- Any expenditure, in respect of which a payment or aggregate of payments made to a person in a single day other than by account payee cheque or account payee bank draft or ECS through bank account or through such other prescribed electronic modes exceeds ₹ 10,000.
- The prescribed electronic modes: are credit card, debit card, net banking, IMPS, UPI, RTGS, and NEFT.
- In case of payments made to transport operator for plying, hiring or leasing goods carriages, an enhanced limit of ₹ 35,000 shall apply.
- If the payment/payments exceed this limit, the entire expenditure would be disallowed.



**Notes:**

- The provision of sec. 40A(3) is attracted only when such expenditure is claimed as deduction u/s 30 to 37.
- If an assessee makes payment of two different bills (none of them exceeds ₹ 10,000/₹35,000) at the same time in cash to the same person, provision of sec. 40A(3) is not attracted.
- If an assessee makes payment of a single bill (exceeding ₹ 10,000/ ₹ 35,000) on different days to the same person in cash, provision of sec. 40A(3) is not attracted, provided any of the payment does not exceed ₹ 10,000 / ₹ 35,000.
- Where payment is made over ₹ 10,000 (or ₹ 35,000) at a time, partly by account payee cheque & partly in cash but the payment in cash alone at one time does not exceed ₹ 10,000 (or ₹ 35,000), assessee is not attracted by sec. 40A(3).



Fig: 8.11

However, disallowance would not be attracted if the cases and circumstances in which payment is made other than by way of an account payee cheque or bank draft are covered in Rule 6DD.

- **Few Examples of Exceptions Covered in Rule 6DD**

(Cases where disallowances would not be attracted)

Under the following circumstances as prescribed under Rule 6DD, provision of Sec.40A(3) is not attracted even the payment in excess of ₹ 10,000 (or ₹ 35,000) has been made otherwise than by an account payee cheque or account payee bank draft or other prescribed modes.

- Where the payment is made to:
  - The Reserve Bank of India or any banking company.
  - The State Bank of India or any subsidiary bank.
  - Any co-operative bank or land mortgage bank.
  - Any primary agricultural credit society or any primary credit society.
  - The Life Insurance Corporation of India.
- Where the payment is made to the government.
- Loan transactions.
- Where the payment is made for the purchase of Agricultural or forest produce etc.

**Illustration 7**

Determine the applicability of SECTION 40A

- Mr. A made following payment in cash to a road transport operator for their respective bills:
  - ₹ 24,000 to Mr. A on 10th May, 2022 against his Bill No. 100
  - ₹ 33,000 to Mr. B on 10th December, 2022 against his Bill No. 200
- X paid to Y ₹ 12,000 in cash against his Bill No.301 of ₹ 7,000 and Bill No. 318 of ₹ 5,000.
- X paid to Y in cash (against bill 120) of ₹ 24,000 as follows:
  - On 10th November, 2021: ₹ 7,000
  - On 11th November, 2021: ₹ 8,000
  - On 12th November, 2021: ₹ 9,000



**Solution**

- Payment made to Mr. C shall be disallowed fully u/s 40A(3). The monetary limit for payment to Road Carrier is ₹ 35,000.
- Nothing shall be disallowed under this section. If the assessee makes payment of two different bills (none of them exceeds ₹ 10,000) at the same time to the same person in cash, provision of sec. 40A(3) is not attracted.
- Nothing shall be disallowed. If an assessee makes payment of a single bill (exceeding ₹ 10,000) on different days to the same person in cash, provision of sec. 40A(3) is not attracted, provided any of the payment does not exceed ₹ 10,000.

**5.7.3 Provision for Gratuity [Sec. 40A(7)]**

No deduction shall be allowed in respect of any provision (by whatever name called) made by the assessee for the payment of gratuity to his employees.

**Exceptions:** Any provision made by the assessee for the purpose of payment of a sum, by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year, shall be allowed as deduction.

**5.7.4 Contributions by employers to funds, trust etc. [Section 40A(9)]**

No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards setting up or formation of, or as contribution to, any fund, trust, company, AOP, BOI, society or other institution for any purpose.

**Exception:** Where such sum is paid by way of contribution towards approved superannuation fund, recognised provident fund, approved gratuity fund, NPS as per the requirements under any law, then such sum is allowed. But Contribution to unrecognized provident fund is disallowed.

## Unit 5.8 - Profits Chargeable To Tax [Section 41]

The following receipts are chargeable to tax as business income even if the business to which such receipt is related is not in existence during the previous year.

- Recovery against any deduction
- Balancing charge
- Sale of asset used for scientific research
- Recovery of Bad debts

**5.8.1 Recovery against any deduction [Sec. 41(1)]**

- Where an allowance or deduction is allowed in any assessment year in respect of loss, expenditure, or trading liability incurred by the assessee, and
- Subsequently during any previous year such assessee has obtained, whether in cash or in any other manner any amount in respect of such loss, expenditure, or any benefit in respect of such trading liability by way of remission or cessation thereof.
- The amount obtained or benefit accrued shall be deemed to be the profits & gains of business or profession and chargeable to income tax as income of the previous year in which such benefit is obtained.

## Unit 14.9 - Changes in the Rate of Exchange of Currency [Section 43A]

The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved.

There is increase or decrease the liability of the assessee at the time of making the payment:

- Towards the whole or a part of the cost of the asset, or
- Towards repayment of the whole or a part of the moneys borrowed by him from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the asset along with interest.

The amount of liability is increased or reduced at the time of making the payment shall be added to or deducted from the actual of the asset.

## Unit 14.10 - Certain Deductions to be allowed only on Actual Payment [Section 43B]

In respect of the following sums payable by an assessee during the P.Y., deduction is allowable only if the sum is actually paid on or before the due date of filing of return u/s 139(1) for the said P.Y:

- Tax, duty, cess or fee, under any law for the time being in force.
- Contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.
- Any sum payable by an employer in lieu of any leave at the credit of employee (i.e., leave encashment).
- Any sum payable as bonus or commission to employees for services rendered.
- Interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation, in accordance with the terms and conditions.
- Interest on any loan or borrowing from a deposit taking NBFC or non-deposit taking NBFC in accordance with the terms and conditions of the agreement governing such loan or borrowing
  - Non-deposit taking non-banking financial company means a non-banking financial company which is not accepting or holding public deposits (having total assets of not less than ₹ 500 crore as per the last audited balance sheet and is registered with the RBI).
  - Deposit taking non-banking financial company means a non-banking financial company which is accepting or holding public deposits and is registered with the RBI.
- Interest on any loan or advance from a scheduled bank or cooperative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and conditions.
- Any sum payable to the Indian Railways for use of railway assets.



**Notes:**

- Sec.43B is applicable only if the assessee is following mercantile system of accounting. However, if an assessee follows cash basis of accounting, deduction shall be allowed only in the year in which payment is made, even though the payment has been made on or before due date of filing of return.

**Illustration 8**

Debit side of the profit and loss account of Jyothi Ltd. shows the following expenses, which have been due but are outstanding as on 31st March, 2022.

| Payment outstanding on 31-3-2022 |          | First payment |        | Second payment |        |
|----------------------------------|----------|---------------|--------|----------------|--------|
| Particulars                      | Amount ₹ | Date          | Amount | Date           | Amount |
| Bonus payable to employees       | 87,000   | 02-05-2022    | 30,000 | 30-09-2022     | 57,000 |
| Leave encashment expenses        | 65,000   | 01-06-2022    | 15,000 | 25-12-2022     | 50,000 |
| Interest payable to LIC loan     | 75,000   | 13-05-2022    | 50,000 | 10-01-2023     | 25,000 |
| Interest payable to Bank         | 14,000   | 10-06-2022    | 3,000  | 13-12-2022     | 11,000 |

Due date for filing return of income is 31st October, 2022. Find out the previous years in which the aforesaid payments are deductible. The company maintains books of accounts on the basis of mercantile system of accounting.

**Solution:**

As per provision of sec. 43B following payment shall be allowed.

| Particulars                                                              | Amount ₹ | Deduction allowed in the assessment year |           |
|--------------------------------------------------------------------------|----------|------------------------------------------|-----------|
|                                                                          |          | 2022- 2023                               | 2023-2024 |
| Bonus payable to employees                                               | 87,000   | 87,000                                   | -         |
| Leave encashment expenses                                                | 65,000   | 15,000                                   | 50,000    |
| Interest payable to LIC loan                                             | 75,000   | 50,000                                   | 25,000    |
| Interest payable to Bank                                                 | 14,000   | 3,000                                    | 11,000    |
| <b>Note: Due date for filing return of income is 31st October, 2022.</b> |          |                                          |           |

### Unit 14.11 - Stamp Duty Value of Land and Building to be Taken As The Full Value of Consideration in Respect of Transfer, Even If the Same Are Held by the Transferor as Stock- in-Trade [Section 43CA]

Where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the stamp duty value shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business or profession".

|                                                                                                |                                                                                                                                                      |
|------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| If the stamp duty value does not exceed 110% of the actual consideration received or accruing. | Such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset. |
|------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|

Further, the stamp duty value may be taken as on the date of the agreement for transfer. At least a part of the consideration has been received by way of an account payee cheque/ account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.

### Unit 14.12 - Compulsory Maintenance of Accounts [Section 44AA]

This section provides that every person carrying on (Specified Professions) the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the CBDT in the official gazette must statutorily maintain such books of accounts and other documents as may enable the assessing officer to compute his total income.



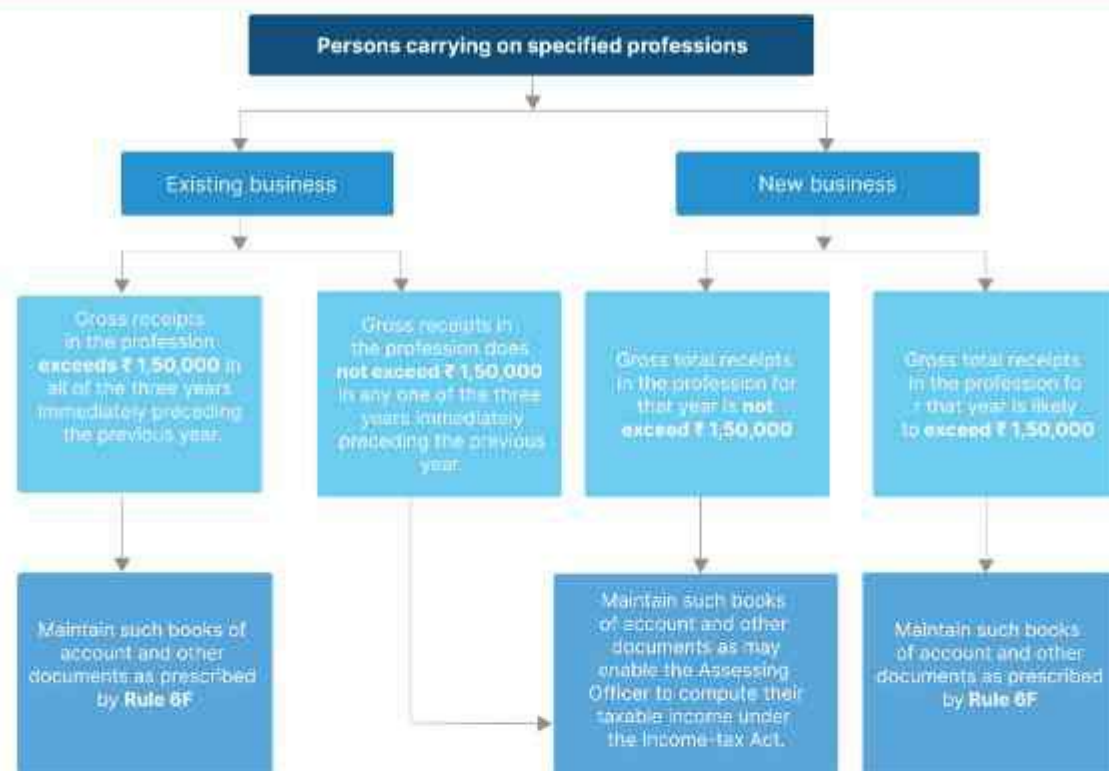


Fig: 8.12

Following Books of Account are required to be Maintained as Per Rule 6F:

- Cash book
- Journal, if mercantile system of accounting is followed.
- Ledger
- Carbon copies of machine numbered bills, exceeding ₹ 25, issued by the person.
- Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50.
- Assessee engaged in medical profession are required to maintain two more books:
  - Daily Case Register in Form 3C.
  - Inventory records of drugs, medicines and other consumable accessories used in the profession.



Fig: 8.13

|                                                                                                                                                                            |                                                                                                                               |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------|
| An assessee (covered u/s 44AE, 44BB or 44BBB) who claims income from such business to be lower than the deemed income computed in accordance with the respective sections. | Maintain such books of account & other documents as may enable the AO to compute his taxable income under the Income tax Act. |
| Where the provision of sec. 44AD(4) is applicable and income of the assessee exceeds the basic exemption limit which is not chargeable to income tax.                      |                                                                                                                               |

**Notes:**

- The books of account and other documents shall be kept and maintained for a period of 6 years from the end of the relevant assessment year.

## Unit 14.13 - Audit of Accounts of Certain Persons Carrying on Business or Profession [Section 44AB]

Following assessee are required to get their accounts audited by a chartered accountant and to furnish the audit report in a specified form one month prior to the due date of filing of return of income.

### 5.13.1 An assessee carrying on business

If his total sales, turnover, or gross receipts in business exceeds ₹1 crore in the relevant PY.

- **Exception for Audit U/s 44AB (Audit u/s 44AB does not apply)**
  - A person who declares profits and gains on **presumptive basis u/s 44AD** and his total sales, turnover, or gross receipts **does not exceed ₹ 2 crore**.
  - If the following conditions are satisfied, then the higher threshold limit of ₹ 10 crore shall be applicable for a person carrying on business:
    - Aggregate cash receipts in the relevant PY does not exceed 5% of total receipts (incl. receipts for sales, turnover, gross receipts) and
    - Aggregate cash payments in the relevant PY does not exceed 5% of total payments (incl. amount incurred for expenditure).

| Case                                                                                                                          | Applicability  |
|-------------------------------------------------------------------------------------------------------------------------------|----------------|
| Turnover exceeds ₹ 10 crore                                                                                                   | Applicable     |
| Turnover does not exceed ₹ 2 crore and assessee is covered u/s 44AD                                                           | Not applicable |
| Turnover does not exceed ₹ 10 crore and conditions* are satisfied.                                                            | Not applicable |
| Turnover does not exceed ₹ 10 crore but exceed ₹ 1 crore and conditions* are not satisfied (assessee is not covered u/s 44AD) | Applicable     |

**5.13.2 An Assessee Carrying on Profession**

If his gross receipts in profession exceeds ₹ 50 lakhs in the relevant PY.

**5.13.3 An Assessee Covered u/s 44AE, 44BB or 44BBB**

Assessee has claimed that his income from such business is lower than the deemed income computed in accordance with the presumptive basis under respective section.

**5.13.4 An Assessee Covered u/s 44ADA**

Assessee has claimed that:

- His income is lower than the presumptive income (computed u/s 44ADA) and
- His income exceeds the basic exemption limit, which is not chargeable to Income tax.

**5.13.5 An Assessee Covered u/s 44AD(4)**

His income exceeds the basic exemption limit which is not chargeable to income tax in any previous year.

## Unit 14.14 - Special Provisions for Computing Profits and Gains Of Business on Presumptive Basis [Sections 44AD/ 44ADA/ 44AE]

To give relief to small taxpayers from maintenance of books of account and from getting the accounts audited, the Income tax Act has framed the **presumptive taxation scheme u/s 44AD, 44ADA and 44AE.**

**5.14.1 Computation of Business Profit on Presumptive Basis [Sec.44AD]**

- **Applicability:**

| Eligible Assessee                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Eligible business/ profession                                                                                                         |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| A resident individual, resident Hindu undivided family or a resident partnership firm.                                                                                                                                                                                                                                                                                                                                                                                       | Any business, other than business referred to in section 44AE, whose total turnover/ gross receipts in the P.Y. not exceed ₹ 2 crore. |
| The provision is not applicable in case of the following: <ul style="list-style-type: none"> <li>• Limited liability partnership firm.</li> <li>• A person carrying on profession as referred to u/s 44AA.</li> <li>• A person earning income in the nature of commission or brokerage or</li> <li>• A person carrying on any agency business.</li> <li>• A person carrying on the business of plying, hiring or leasing goods carriages referred to in sec. 44AE</li> </ul> |                                                                                                                                       |



- Estimated Income

|                                                                                                                                                                                                                                                      |                                  |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|
| Where amount of turnover or gross receipts is received by an account payee cheque or account payee bank draft or use of ECS or through other prescribed electronic modes during the previous year or before the due date of filing return of income. | 6% of such turnover or receipts. |
| In any other case.                                                                                                                                                                                                                                   | 8% of such turnover or receipts. |

**Notes:**

- Restriction on claiming deductions:** The above estimated income is aggregated with other income of the assessee, from any other business or under any other heads of income.
- Deductions allowable under sections 30 to 38** shall be deemed to have been given full effect, and further deduction under chapter VIA be available to the assessee as usual (other than deduction u/s 10AA or 80HH to 80RRB) in the relevant assessment year. Even in case of a firm, salary and interest paid to partners is not deductible.
- Depreciation:** Depreciation is deemed to have been already allowed. The written down value of asset will be calculated, as if depreciation has been allowed.
- Maintenance of books of account and audit:** An assessee to whom provision of sec. 44AD(4) is applicable and whose total income exceeds basic exemption limit and which is not chargeable to tax, he shall be required:
  - To maintain books of account and other documents as required u/s 44AA and
  - To get his accounts audited and furnish a report of such audit as prescribed u/s 44AB.
- Provision is not applicable [Sec. 44AD(4)]:

**Where an Eligible Assessee:**

- Declares profit for any previous year in accordance with the provisions of this section (i.e., specified percentage of the turnover) &
- Declares profit less than specified percentage of the turnover for any of the 5 assessment years relevant to the previous year succeeding aforesaid previous, then, he shall not be eligible to claim the benefit of the provisions of this section for 5 assessment years subsequent to the assessment year relevant to the previous year in which he has declared lower profit.

E.g., an assessee claims to be taxed on presumptive basis u/s 44AD for A.Y. 2021-22. For A.Y. 2022-23 and 2023-24, he declares income on the basis of presumptive taxation scheme. However, for A.Y. 2024-25, he did not opt for presumptive taxation Scheme. In this case, he will not be eligible to claim benefit of presumptive taxation scheme for next 5 A.Y.s, i.e., from A.Y. 2025-26 to 2029-30.

**Illustration 9**

SGS associates, a firm, is engaged in the business of trading of cloth (turnover of 2021-22 being ₹ 57,80,000, out of which ₹ 25,00,000 has been received in account payee cheque). It wants to claim the following deductions:



| Particulars                                                  | Amount ₹  |
|--------------------------------------------------------------|-----------|
| Salary and interest to partners [as permitted by sec. 40(b)] | 60,000    |
| Salary to employees                                          | 4,90,000  |
| Depreciation                                                 | 2,70,000  |
| Cost of materials used                                       | 35,90,000 |
| Other expenses                                               | 13,45,000 |
| Total                                                        | 57,55,000 |
| Net profit (₹ 57,80,000 – ₹ 57,55,000)                       | 25,000    |

Determine the net income of SGS associates for the assessment year 2022-23, assuming that:

- Taxable interest income is ₹ 90,000
- Long term capital gain is ₹ 1,40,000 and
- Firm is eligible for a deduction of ₹ 15,000 under sec. 80G.

**Solution:**

Since turnover from business does not exceed ₹ 2 crore, hence sec. 44AD is applicable. However, income computed as per provision other than presumptive income u/s 44AD is less than estimated income. Hence, the firm may be assessed for such lesser income provided following conditions are satisfied:

- Maintain books of account as prescribed u/s 44AA; and
- Get accounts audited u/s 44AB

**Where it Maintains Accounts and gets it Audited**

Computation of total income of SGS associates for the A.Y. 2022-23

| Particulars                                         | Amount ₹        |
|-----------------------------------------------------|-----------------|
| <b>Profits and gains of business or profession:</b> |                 |
| Income from cloth business                          | 25,000          |
| <b>Capital gains:</b>                               |                 |
| Long term capital gain                              | 1,40,000        |
| <b>Income from Other Sources:</b>                   |                 |
| Interest Income                                     | 90,000          |
| <b>Gross Total Income</b>                           | <b>2,55,000</b> |
| Less: Deduction u/s 80G                             | 15,000          |
| <b>Total Income</b>                                 | <b>2,40,000</b> |

It is assumed that all the expenditures are allowed.

**Where it does not maintain account or fails to get accounts audited**

Computation of total income of SGS associates for the A.Y.2022-23,

| Particulars                                          | Amount ₹ | Amount ₹        |
|------------------------------------------------------|----------|-----------------|
| <b>Profits and gains of business or profession:</b>  |          |                 |
| Income from cloth business (being 6% of ₹ 25,00,000) | 1,50,000 | 4,12,400        |
| Income from cloth business (being 8% of ₹ 32,80,000) | 2,62,400 |                 |
| <b>Capital gains:</b>                                |          |                 |
| Long term capital gain                               |          | 1,40,000        |
| <b>Income from Other Sources:</b>                    |          |                 |
| Interest Income                                      |          | 90,000          |
| <b>Gross Total Income</b>                            |          | <b>6,42,400</b> |
| Less: Deduction u/s 80G                              |          | 15,000          |
| <b>Total Income</b>                                  |          | <b>6,27,400</b> |

#### 8.14.2 Computation of Professional Income on Presumptive Basis [Sec. 44ADA]

- **Applicability**

| Eligible Assessee                                          | Eligible business/ profession                                                                                                                                                                                                                                       |
|------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Any resident individual and resident firm (other than LLP) | Any profession specified u/s 44AA, whose gross receipts ≤ ₹ 50 lakhs in the relevant P.Y.<br>(44AA: engaged in any profession Legal, medical, engineering, architectural profession or profession of accountancy, technical consultancy, interior decoration, etc.) |

- **Estimated income**

50% of the gross receipts. However, a taxpayer can voluntarily declare a higher income in his return.

#### Notes

- **Deduction:** The above estimated income is aggregated with other income of the assessee, from any other business or under any other heads of income. Further deduction under chapter VIA shall be available to the assessee as usual. Even in case of a firm, salary and interest paid to partners is not deductible.
- **Depreciation:** Depreciation is deemed to have been already allowed. The written down value of asset will be calculated, as if depreciation has been allowed. Maintenance of books of account and audit: If eligible assessee declares profits and gains in accordance with the provisions of section 44ADA, he is not required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents u/s 44AA(1) and get his accounts audited u/s 44AB, if his total income exceeds the basic exemption limit for that year.
- **Assessee can change his option from year to year**

**5.14.3 Business of plying, leasing or hiring goods carriage [Sec. 44AE]**

- Applicability

| Eligible Assessee                                                               | Eligible business/ profession                          |
|---------------------------------------------------------------------------------|--------------------------------------------------------|
| An assessee owning not more than 10 goods carriages at any time during the P.Y. | Business of plying, hiring or leasing goods carriages. |

- Estimated income

| Type of Goods Carriage         | Presumptive Income (Per month or part of a month)          |
|--------------------------------|------------------------------------------------------------|
| Heavy                          | ₹ 1,000 per ton of gross vehicle weight or unladen weight. |
| Other than heavy goods vehicle | ₹ 7,500                                                    |

Income shall be calculated from the month when assessee acquired the property whether it has been put to use or not.

Meaning of certain terms for the purpose of section 44AE:

| Term                 | Meaning                                                                                                                                                                                                                                                                                                                               |
|----------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Heavy goods vehicle  | Any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.                                                                                                                                                                                                                                                       |
| Gross vehicle weight | Total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.                                                                                                                                                                                                           |
| Unladen weight       | The weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part. |

**Notes**

- **Deduction:** The above estimated income is aggregated with other income of the assessee, from any other business or under any other heads of income. Further deduction under chapter VIA shall be available to the assessee as usual. In the case of a firm, deduction in respect of remuneration and interest to partner u/s 40(b) shall be further deductible from income so computed.
- **Depreciation:** Depreciation is deemed to have been already allowed. The written down value of asset will be calculated, as if depreciation has been allowed. Maintenance of books of account and audit: If eligible assessee declares profits and gains in accordance with the provisions of section 44AE, he is not required to maintain books of account u/s 44AA or get them audited u/s 44AB.

However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account u/s 44AA(2) and get his accounts audited u/s 44AB.

- Assessee can change his option from year to year



**Illustration 10**

Mr. Ravi is engaged in the business of plying goods carriages. On 1st April, 2021, he owns 10 trucks (out of which 6 are heavy good vehicles of (unladen weight of each is 20 ton)). On 2nd May, 2021, he sold one of the heavy goods vehicles & purchased a light goods vehicle on 6th May, 2021. This new vehicle could however be put to use only on 15th June, 2021.

Compute the total income of Mr. Ravi for the A.Y. 2022-23, taking note of the following data:

| Particulars                            | Amount ₹ |
|----------------------------------------|----------|
| Freight Charges collected              | 8,70,000 |
| Less: Operational expenses : 6,25,000  | 8,25,000 |
| Depreciation as per Sec. 32 : 1,85,000 |          |
| Other Office expenses : 15,000         |          |
| Net Profit                             | 45,000   |
| Other business and non-business income | 70,000   |

**Solution**

Alternative (1) Direct estimation of income u/s 44AE

| Vehicle                                       | No. of vehicle | No. of Month | Details                                   | Amount ₹  |
|-----------------------------------------------|----------------|--------------|-------------------------------------------|-----------|
| Heavy                                         | 5              | 12           | ₹ 1,000 x 5 vehicles x 12 months x 20 ton | 12,00,000 |
| Heavy                                         | 1              | 2            | ₹ 1,000 x 1 vehicle x 2 months x 20 ton   | 40,000    |
| Light                                         | 4              | 12           | ₹ 7,500 x 4 vehicles x 12 months          | 3,60,000  |
| Light                                         | 1              | 11           | ₹ 7,500 x 1 vehicles x 11 months          | 82,500    |
| Income from business of plying goods carriage |                |              |                                           | 16,82,500 |

Note: Income shall be calculated from the month when assessee acquired the property whether it has been put to use or not. For this purpose, any fraction of the month shall be considered as month.

| Particulars                                            | Amount ₹  |
|--------------------------------------------------------|-----------|
| Income from business of plying goods carriage u/s 44AE | 16,82,500 |
| Add: Other business and non-business income            | 70,000    |
| Total Income                                           | 17,52,500 |



| Particulars                                   | Details  | Amount ₹ |
|-----------------------------------------------|----------|----------|
| Freight charges collected                     |          | 8,70,000 |
| Less: Expenditure related to business         | 6,25,000 | 8,25,000 |
| Operational expenses                          | 1,85,000 |          |
| Depreciation u/s 32                           | 15,000   |          |
| Other office expenses                         |          |          |
| Income from business of plying goods carriage |          | 45,000   |
| Add: Other business and non-business income   |          | 70,000   |
| Total Income                                  |          | 1,15,000 |

Since Mr. Ravi has lower taxable income in alternative 2 hence his total income is ₹ 1,15,000. But to claim such lower income than the estimated income (computed in alternative 1) as per provision of section 44AE, he will have to maintain books of account as required u/s 44AA and get his accounts audited.

## Summary

Income from “Profits and Gains of Business or Profession” under the Income Tax Act encompasses a broad range of earnings associated with the conduct of any trade, commerce, or manufacturing activity, or the provision of services. This head of Income includes not only the net profit earned from business operations after deducting allowable expenses but also gains arising from the professional services rendered by individuals. These profits or gains are calculated based on the taxpayer’s accounting records, adhering to the tax rules regarding permissible deductions and exclusions.

For taxation purposes, allowable expenses might include costs directly related to the generation of income, such as raw materials, salaries, and overhead. Additionally, specific deductions for depreciation of assets and certain types of reserves are permitted. Taxable business income also covers profits on the sale of business assets and income from business-related leases or licenses. Business losses can be carried forward and set off against future profits under certain conditions. This comprehensive approach ensures that the actual income earned from business activities is accurately taxed, reflecting both the income generated and the expenses incurred.

## Exercise

What does the income from “Profits and Gains of Business or Profession” generally include?

- A) Only fixed salaries from employment
- B) Interest from savings accounts
- C) Net profit from business operations and professional services
- D) Capital gains from the sale of personal assets
- Answer: C

On what basis are profits or gains calculated for taxation?

- A) Market value of the business
- B) Personal assessment by the business owner
- C) Based on the taxpayer’s accounting records according to tax rules
- D) Flat rate decided annually by the tax authorities
- Answer: C

Which type of expenses are deductible when calculating taxable business income?

- A) Personal expenses
- B) Entertainment expenses not related to business
- C) Costs directly related to the generation of income
- D) Political donations
- Answer: C

Are depreciation of assets and certain types of reserves allowed as deductions?

- A) Yes, as specific deductions
- B) No, they are fully taxable
- C) Only in certain industries
- D) Only if audited by tax authorities
- Answer: A

What happens to business losses under the Income Tax Act?

- A) They are ignored for tax purposes
- B) They can be carried forward and set off against future profits
- C) They are fully deductible in the year they occur
- D) They must be written off immediately
- Answer: B

What is included in the business income for tax purposes?

- A) Profits from non-profit activities
- B) Only the primary business activity
- C) Profits on sale of business assets and income from leases or licenses
- D) Income from employee wages
- Answer: C

Which of the following is not a permissible deduction under business income?

- A) Raw material costs
- B) Salaries to employees
- C) Capital expenses for expansion
- D) Overhead costs
- Answer: C (Capital expenditures are typically not immediately deductible.)

How are salaries related to business deducted for tax purposes?

- A) Not deductible at all
- B) Deducted as personal expenses
- C) Deducted as a business expense if paid to employees
- D) Fully taxable as extra income
- Answer: C

Which statement best describes the treatment of income from professional services under this head of income?

- A) It is treated as a hobby and not taxed
- B) Taxed separately under special rates
- C) Included and taxed under business income
- D) Exempt from taxation
- Answer: C

In what scenario might a business not be able to deduct certain expenses?

- A) When expenses are directly related to income generation
- B) When expenses are fully documented and necessary
- C) When expenses are not related to the business or are personal in nature
- D) When expenses are audited externally
- Answer: C



## Notes

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## 15. Capital Gains

- Unit 15.1 - Capital Asset [Sec 2(14)]
- Unit 15.2 - Short Term and Long-Term Capital Assets
- Unit 15.3 - Transfer [Section 2(47)]
- Unit 15.4 - Scope and Year of Chargeability [Section 45]
- Unit 15.5 - Capital Gains on Distribution of Assets by Companies in Liquidation [Section 46]
- Unit 15.6 - Capital Gains on Buyback of Shares or Specified Securities [Section 46a]
- Unit 15.7 - Transactions Not Regarded as Transfer [Section 47]
- Unit 15.8 - Computation of Capital Gains [Sec. 48]
- Unit 15.9 - Ascertainment of Cost in Specified Circumstances [Section 49]
- Unit 15.10 - Cost of Acquisition [Section 55(2)]
- Unit 15.11 - Cost of Improvement [Section 55(1)]
- Unit 15.12 - Advance Money Received [Section 51]
- Unit 15.13 - Computation of Capital Gains in Case of Depreciable Assets [Sections 50 & 50A]
- Unit 15.14 - Capital Gains in Respect of Slump Sale Section 50B]
- Unit 15.15 - Exemption of Capital Gains
- Unit 15.16 - Reference to Valuation Officer [Section 55A]
- Unit 15.17 - Tax on Short Term Capital Gains in Respect of Equity Shares/ Units of an Equity Oriented Fund [Section 111A]
- Unit 15.18 - Tax on Long Term Capital Gains [Section 112]
- Unit 15.19 - Tax on Long Term Capital Gains on Certain Assets [Section 112A]



## Key Learning Outcomes



- Identify Capital Assets
- Classification of Capital Gains
- Learn Computation of Capital Gains
- Understand Exemptions and Indexation
- Knowledge of Tax Rates and Applicability
- Understand Transfer of Capital Assets
- Apply Special Provisions and Adjustments
- Understand Loss Set-off and Carry Forward
- Knowledge of Reporting and Compliance
- Apply Tax Planning Strategies

## Unit 15 - Capital Gains

### Unit Objectives

At the end of the unit, you will be able to understand:

1. Residential status: Knowledge of provisions to determine the residential status of different persons.
2. Scope of total income: Examine and ascertain the scope of income of a person on the basis of residential status.



## Unit 15.1 - Capital Asset [Sec 2(14)]

- Property held by the assessee, whether or not connected with business or profession.
- Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with SEBI regulation by any securities held by foreign institutional investors.
- Any unit linked insurance policy where 10(10D) exemption does not apply on account of

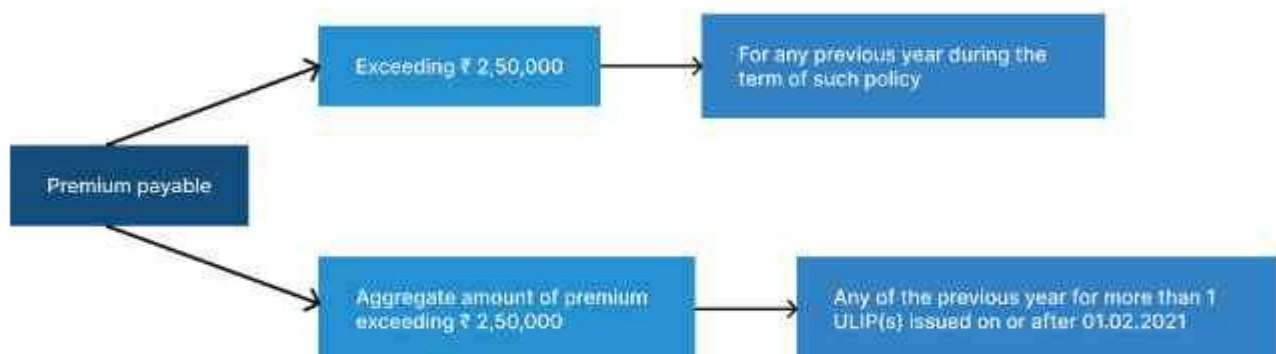


Fig: 9.1

However, it does not include:

- **Stock-in trade:** Any stock-in-trade other than:
  - Securities held by a foreign institutional investor.
  - Consumable stores or raw materials held for the purpose of the business or profession of the assessee.
- **Personal Effects:** Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.
- **Exclusions:**
  - Jewellery
  - Archaeological collections
  - Drawings
  - Paintings
  - Sculptures
  - Any work of art

**Note:**

For this purpose, the expression 'jewellery' includes the following:

- 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 stones and whether or not worked or sewn into any wearing apparel.
- Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

**Rural Agricultural land**

- In India i.e., agricultural land in India which is not situated in any specified area.
- Urban agricultural lands constitute capital assets.
- Agricultural land described below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax.
  - Agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand.
  - or
  - Agricultural land situated in any area within such distance, measured aerially, in relation to the range of population.



Fig: 9.2

- Specified Gold Bonds: 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government.
- Special Bearer Bonds, 1991 issued by the Central Government.
- Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 and Gold Monetisation Scheme, 2018 notified by the Central Government.

## Unit 15.2 - Short Term and Long-Term Capital Assets



Fig: 9.3

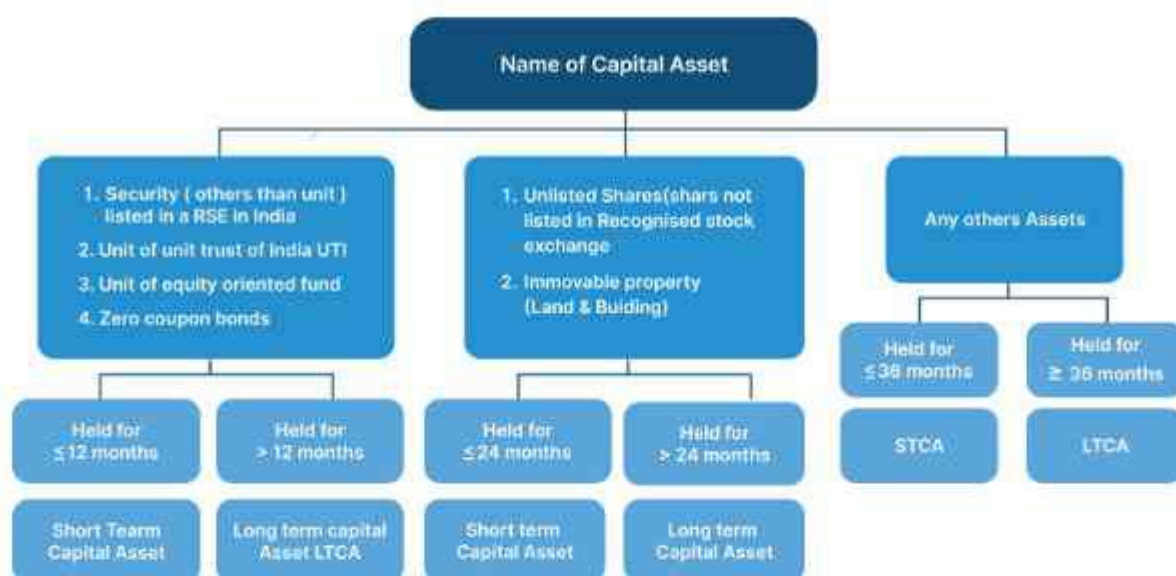


Fig: 9.4

Determination of period of holding [Clause (i) of Explanation 1 to section 2(42A)]:

| Sr. No. | Circumstances                                                                                                                                                                                               | Period of holding                                                                                                  |
|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
| 1       | Shares held in a company in liquidation.                                                                                                                                                                    | The period subsequent to the date of liquidation of company shall be excluded.                                     |
| 2       | Asset becomes the property of an assessee by virtue of section 49(1).                                                                                                                                       | The period for which the capital asset was held by the previous owner shall be included.                           |
| 3       | Inventory of business is converted as a capital asset.                                                                                                                                                      | Period from the date of conversion.                                                                                |
| 4       | Share/s in the Indian company (amalgamated company), becomes the property of an assessee in lieu of share/s held by him in the amalgamating company at the time of transfer referred under section 47(vii). | The period for which the share(s) was held by the assessee in the amalgamating company shall be included.          |
| 5       | Share or any other security is subscribed by the assessee on the basis of right to subscribe to any share or security or by the person in whose favour such right is renounced by the assessee.             | Period from the date of allotment of such share or security shall be included.                                     |
| 6       | Specified security or sweat equity shares is allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees).           | Period from the date of allotment or transfer of such specified security or sweat equity shares shall be included. |



|    |                                                                                                                              |                                                                                                   |
|----|------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|
| 7  | Equity share in a company becomes the property of the assessee by way of conversion of preference shares into equity shares. | The period for which the preference shares were held by the assessee shall be included.           |
| 8  | Share/s in the Indian company being a resulting company becomes the property of an assessee in consideration of demerger.    | The period for which the share/s were held by the assessee in demerged company shall be included. |
| 9  | Any financial asset is allotted without any payment and on the basis of holding of any other financial asset.                | Period from the date of allotment of such financial asset shall be included.                      |
| 10 | Right to subscribe to any share or security is renounced in favour of any other person.                                      | Period from the date of offer of such right by the company or institution shall be included.      |

## Unit 15.3 - Transfer [Section 2(47)]

The Act contains an inclusive not an exclusive definition of the terms transfer of capital assets and hence transfer includes:

- The sale, exchange or relinquishment of the asset.
- The extinguishment of any rights therein.
- The compulsory acquisition thereof under any law.
- The owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer.
- The maturity or redemption of a zero-coupon bond.
- Part-performance of the contract: Sometimes, possession of an Immovable property is given in consideration of part-performance of a contract.
- Lastly, there are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property.

### Explanation To The Above Points.

- **Exchange:** Includes barter which means mutual transfer of ownership of one thing for the ownership of another.  
 ◦ Though there is only one transaction the tax liability arises on both the parties.  
 The sale consideration shall be taken as the fair market value of assets received.
- **Relinquishment of the asset:** Relinquish literally means 'to withdraw from' or 'to abandon' or 'to give up anything or any right' or 'to cease to hold' or 'to surrender'.

### Notes:

- Right of the assessee in the asset is given up or abandoned.
- Asset itself continues to exist after such relinquishment and becomes the property of someone else.
- There must be mutual consent of the parties. A unilateral action of writing off the claim in the books of account cannot be treated as relinquishment.



- **Extinguishment of Any Right in an Asset**

Extinguishment literally means 'to put a total end to' or 'total destruction' or 'blot out of existence' or 'annihilation'.

**Example:**

- Cancellation of licences: Abandonment of a project and termination of industrial licence, shall be treated as transfer.
- Reduction of share capital: When a part of the share capital is paid to the shareholder by a company, such reduction of share capital shall be treated as extinguishment of proportionate right in the shares and such shareholder shall be liable to capital gain.

- **Compulsory acquisition of an asset under any law**

Normally, sale means a mutual will full agreement between two or more parties. But for the purpose of sec. 2(47), transfer includes compulsory acquisition of any property under any law in force.

- **Conversion of asset into stock in trade by the owner**

Generally, a transfer requires two or more parties, but in Income tax Act even one party's involvement may constitute transfer.

As per sec. 2(47)(iv) where an asset is converted by the owner into or treated by him as 'stock in trade' of the business carried on by him, such conversion or treatment shall constitute transfer.

## Unit 15.4 - Scope and Year of Chargeability [Section 45]

- **General Provision [Section 45(1)]**

Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to income tax under this head in the previous year in which the transfer took place.

**Note:**

The relevant date of transfer is not the date of the agreement to sell, but the actual date of sale i.e., the date on which the effect of transfer of title to the property as contemplated by the parties has taken place.

|       | Circumstances                                                                | Year of chargeability                                                                            | Full value of Consideration                                                                                  |
|-------|------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| (ii)  | Insurance Receipts [Section 45(1A)]                                          | Previous year in which such money or other asset was received.                                   | Fair market value of other assets on the date of such receipt.                                               |
| (iii) | Unit Linked Insurance Policy Receipts [Section 45(1B)]                       | Previous year in which such amount was received.                                                 |                                                                                                              |
| (iv)  | Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)] | Previous year in which such stock-in-trade is sold or otherwise transferred by him.              | Fair market value of the asset on the date of such conversion.                                               |
| (v)   | Compensation on compulsory acquisition [Section 45(5)]                       | Chargeable as income of the previous year in which such compensation is received (refer note 1). |                                                                                                              |
| (vi)  | Specified Agreement [Section 45(5A)]                                         | Refer note 2                                                                                     | Stamp duty value, on the date of issue of certificate of completion, of his share (+)<br>Cash consideration. |

Note no: 1

### Compensation on Compulsory Acquisition [ sec 45(5) ]

Normally, chargeable in the year in which such Compensation is received. In case of enhanced compensation,

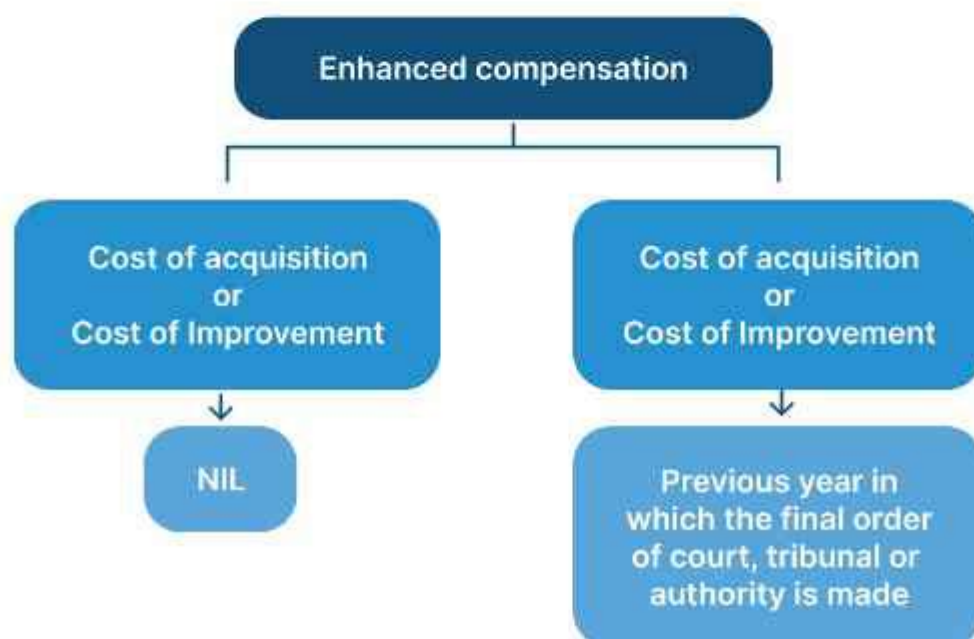


Fig: 9.5

|                                    |                                                                                                       |
|------------------------------------|-------------------------------------------------------------------------------------------------------|
| Reduction of enhanced compensation | Capital gain of that year shall be recomputed by taking into consideration the reduced amount.        |
| Death of the transferor            | The enhanced compensation will be chargeable to tax in the hands of the person who receives the same. |

**Note no: 2**

**Taxability of capital gain in case of Specified agreement U/s 45(5A):** in case of assessee being individual or HUF, who enters in to a specified agreement for development of a project, the capital gain arising from such transfer shall be chargeable into tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority.

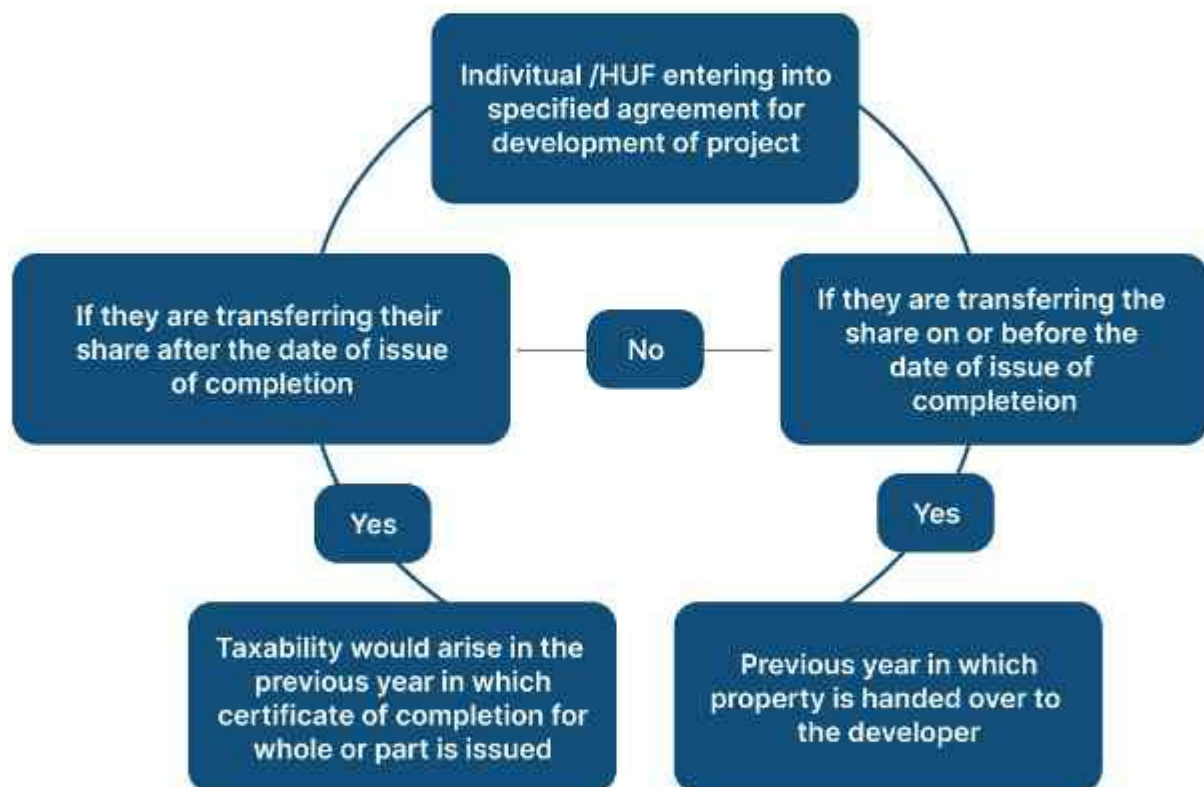


Fig: 9.5

## Unit 15.5 - Capital Gains on Distribution of Assets by Companies In Liquidation [Section 46]

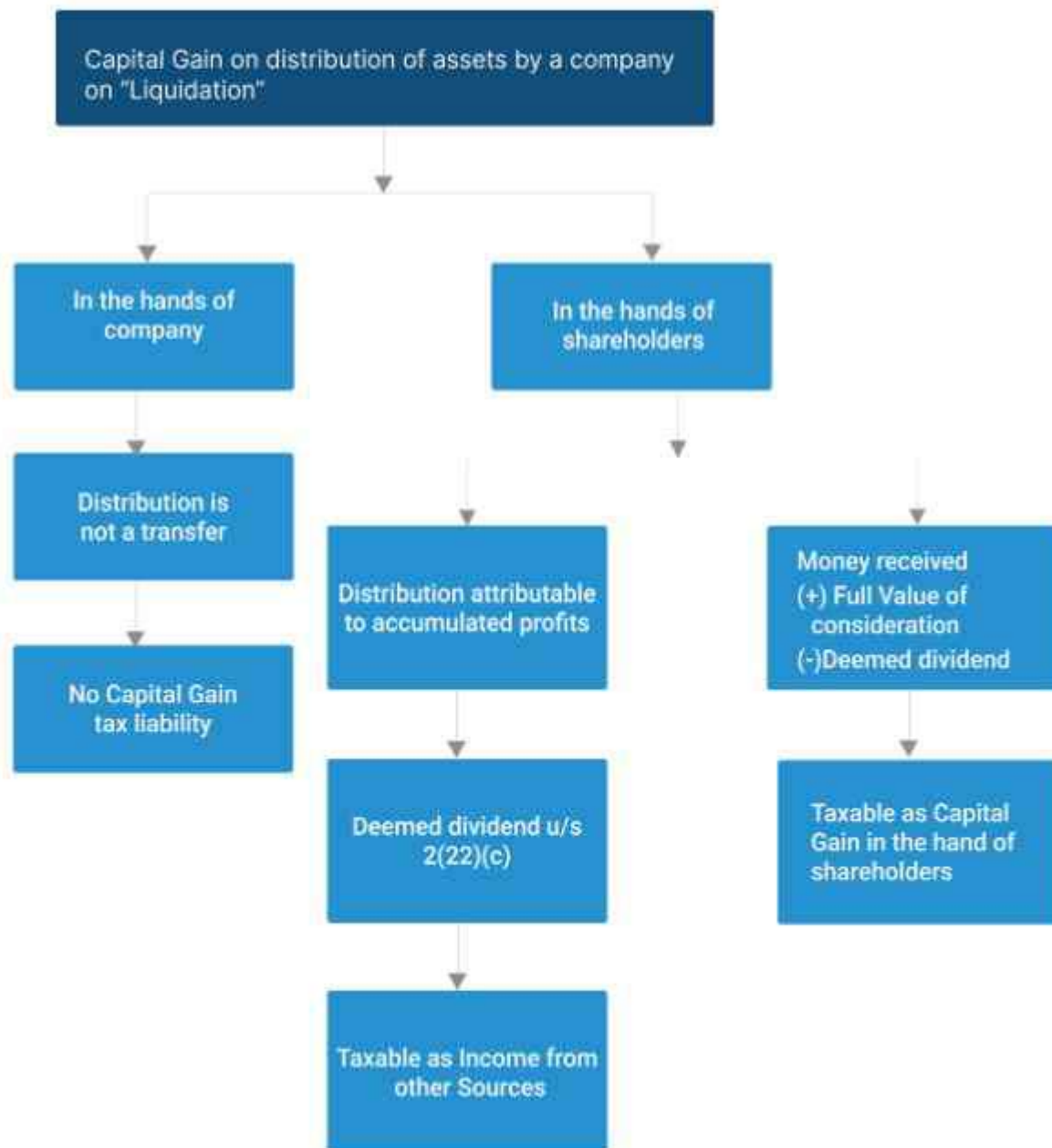


Fig: 9.6



## Unit 15.6 - Capital Gains on Buyback of Shares or Specified Securities [Section 46A]

Buyback of shares ordinarily means:

- Repurchasing of shares by the company that issued them.
- He company pays the shareholders the market value of the shares and reclaims the ownership that was previously distributed.

| Taxability in the hands of                 | Buyback of shares by domestic companies                     | Buyback of shares by a company, other than a domestic company  | Buyback of specified securities by any company                                    |
|--------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------------|-----------------------------------------------------------------------------------|
| Company                                    | Subject to additional income tax ₹23.296%                   | Not subject to tax in the hands of the company                 | Not subject to tax in the hands of the company                                    |
| Shareholder/holder of specified securities | Income arising to shareholders exempt under section 10(34A) | Income arising to shareholder taxable as capital gains u/s 46A | Income arising to holder of specified securities taxable as capital gains u/s 46A |

## Unit 15.7 - Transactions Not Regarded as Transfer [Section 47]

1. Any distribution of capital assets on the total or partial partition of a HUF  
**Note:** this clause shall not include 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.
2. Any transfer of a capital asset under a gift or will or an irrevocable trust.
3. Any transfer of capital asset by a company to its subsidiary company

**Conditions:**

- The parent company or its nominee must hold the whole of the shares of the subsidiary company.
  - The subsidiary company must be an Indian company.
4. Transfer of capital asset by a subsidiary company to its 100% holding company, being an Indian company.  
 Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is transferred as stock-in-trade.
  5. Transfer of capital asset by amalgamating company to amalgamated Indian company, in a scheme of amalgamation.

**Note :** The amalgamated company is an Indian company.

**Amalgamation [Section 2(1B)] - "Amalgamation",** in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company.

6. Transfer of capital asset by the demerged company to the resulting Indian company, in a scheme of demerger.

**Note:** "Demerger", in relation to companies, means the transfer, pursuant to a scheme by a demerged company of its one or more undertaking to any resulting company.

7. Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company.

**Note:** Transfer is made in consideration of the demerger of the undertaking. Demerged Company Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

8. Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company.

#### Conditions

- The amalgamated company is an Indian company.
- The transfer is made in consideration of the allotment to him of any share/s in the amalgamated company, except where the shareholder itself is the amalgamated company.

9. Transfer of Rupee denominated bond outside India by a non-resident to another non-resident.

**Note:** Rupee denoted Bond is a bond issued by an Indian entity in foreign markets and the interest payments and principal reimbursements are denominated (expressed) in rupees.

10. Transfer of Government Security outside India by a non-resident to another non-resident.

**Note:** Government Security: Security carrying a periodic payment of interest, made out side India through an intermediary.

11. Redemption of sovereign gold bonds by an Individual.

12. Transfer of specified capital asset to the government or university etc.

13. Conversion of preference shares into equity shares.

14. Transfer on conversion of bonds or debentures etc. into shares or debentures.

15. Transfer of capital asset under Reverse Mortgage.

**Note:** The Reverse Mortgage scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount or for a regular monthly/quarterly/annual income.

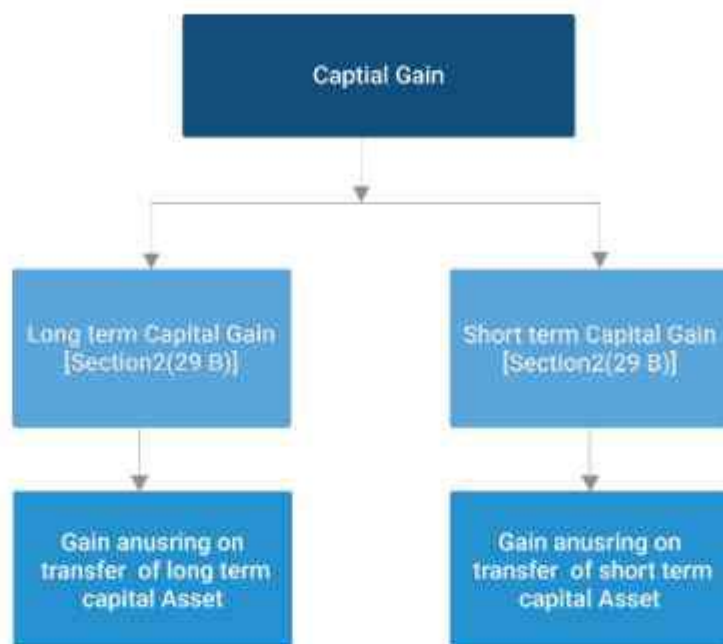


Fig: 9.6

## Computation of Short-Term Capital Gain (STCG)

| Particulars                                      | Details | Amount |
|--------------------------------------------------|---------|--------|
| Sale consideration (Full value of consideration) |         | ****   |
| Less: Expenses on transfer                       |         | (****) |
| Net sale consideration                           |         | ****   |
| Less: i) Cost of acquisition                     | ****    |        |
| ii) Cost of improvement                          | ****    |        |
| Short Term Capital Gain                          |         | ****   |
| Less: Exemption u/s 54B, 54D, 54G, 54GA etc.     |         | (****) |
| Taxable Short Term Capital Gain                  |         | ****   |

**Note:** No deduction shall be allowed in computing the income chargeable under the head "Capital gains" in respect of any sum paid on account of securities transaction tax.

The meaning of terms used in the computation:

- **Sale consideration (full value of consideration)**

It refers to sale value of the asset (in form of money or money's worth)

- **Consideration in instalments:** In case, consideration is receivable in instalment in different years, the entire value of the consideration shall be taxable in the year of transfer.
- **Fair market value deemed to be full value of consideration:** In certain cases [Sec. 50D] where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration.



- **Expenses on Transfer**

- It means any expenditure incurred wholly and exclusively in connection with such transfer such as:
- Brokerage or commission incurred for securing buyer.
- Cost of stamp and registration fee by the vendor.
- Traveling expenses, etc.
- It is reduced from sale consideration to get net sale consideration.

**Notes:**

Expenditure on transfer may be incurred prior to or after completion of transfer. If expenditure has been allowed as deduction under any other heads of income, then the same cannot be claimed as deduction u/s 48.

- **Cost of Acquisition [Sec. 55(2)]**

Cost of acquisition includes expenditure incurred for acquiring the asset or completing the title of the asset.

**Example:**

- Sum paid for discharge of mortgage debt to clear charge over the property (created by previous owner) is a part of cost of acquisition.
- Litigation expenditure incurred by a shareholder to get the shares registered in his name will form part of cost of acquisition of shares.

- **Cost of Improvement [Sec. 55(1)(b)]**

Cost of improvement means an expenditure incurred to increase the productive quality of the asset. It includes all expenditures of a capital nature incurred in making any additions or alterations to the capital asset.

**Notes:**

- Any expenditure which is deductible in computing the income chargeable under any other head of income shall not be treated as cost of improvement.
- An expenditure incurred by a shareholder to file a suit to amend articles of association, which results in appreciation of value of share shall be treated as cost of improvement.

**Illustration 1.**

Mr. Sajan had purchased a golden ring as on 10th July, 2020 for ₹ 50,000. On 4th February, 2021, he has sewn a diamond on it costing ₹ 25,000. On 5th September, 2021, he sold such ring for ₹ 1,00,000 and incurred brokerage for arranging customer 8,000. Compute capital gain.

**Solution:**

| Particulars                                      | Details  | Amount ₹ |
|--------------------------------------------------|----------|----------|
| Sale consideration (Full value of consideration) |          | 100,000  |
| Less: Expenses on transfer                       |          | (8,000)  |
| Net sale consideration                           |          | 92,000   |
| Less: i) Cost of acquisition                     | (50,000) |          |
| ii) Cost of improvement                          | (25,000) | (75,000) |
| Short Term Capital Gain                          |          | 17,000   |



## COMPUTATION OF LONGTERM CAPITAL GAIN (LTCG)

| Particulars                                      | Details | Amount |
|--------------------------------------------------|---------|--------|
| Sale consideration (Full value of consideration) |         | ****   |
| Less: Expenses on transfer                       |         | (****) |
| Net sale consideration                           |         | *****  |
| Less: i) Indexed Cost of acquisition             | ****    |        |
| ii) Indexed Cost of improvement                  | ****    |        |
| Short Term Capital Gain                          |         | ****   |
| Less: Exemption u/s 54, 54B, 54D, 54EC, 54F, etc |         | (****) |
| Taxable Long Term Capital Gain                   |         | ****   |

**Note:** No deduction shall be allowed in computing the income chargeable under the head "Capital gains" in respect of any sum paid on account of securities transaction tax. respect of any sum paid on account of securities transaction tax.

The meaning of terms used in the computation:

- Indexed cost of acquisition**

"Indexed cost of acquisition" means the cost of acquisition adjusted according to the price level of the year of sale. cost of acquisition and cost of improvement will be increased by applying the cost inflation index (CII). This means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 2001, whichever is later.

$$\text{Indexed cost of acquisition} = \frac{\text{Cost of acquisition} \times \text{Index of the year of transfer}}{\text{Index of the year of acquisition}}$$

**Indexed cost of improvement**

"Indexed cost of improvement" means the 'cost of improvement' (as discussed in case of short-term capital gain) adjusted according to the price level of year of sale. Indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place.

$$\text{Indexed cost of Improvement} = \frac{\text{Cost of Improvement} \times \text{Index of the Year of Transfer}}{\text{Index of the Year of Improvement}}$$

**Cost Inflation Index**

Under section 48, for computation of long-term capital gains, the cost of acquisition and cost of improvement will be increased by applying the cost inflation index (CII).

**Note-**The benefit of indexation will not apply to the long-term capital gains arising from the transfer of bonds or debentures other than:

- Capital indexed bonds issued by the Government or
- Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015.

The cost inflation indices for the financial years so far have been notified as under:

| Financial Year | Cost Inflation Index |
|----------------|----------------------|
| 2001-02        | 100                  |
| 2002-03        | 105                  |
| 2003-04        | 109                  |
| 2004-05        | 113                  |
| 2005-06        | 117                  |
| 2006-07        | 122                  |
| 2007-08        | 129                  |
| 2008-09        | 137                  |
| 2009-10        | 148                  |
| 2010-11        | 167                  |
| 2011-12        | 184                  |
| 2012-13        | 200                  |
| 2013-14        | 220                  |
| 2014-15        | 240                  |
| 2015-16        | 254                  |
| 2016-17        | 264                  |
| 2017-18        | 272                  |
| 2018-19        | 280                  |
| 2019-20        | 289                  |
| 2020-21        | 301                  |
| 2021-22        | 317                  |

**Note:** Indexed cost of acquisition has to be ascertained with reference to the date of acquisition and not with reference to the date when such asset became a capital asset.

#### Illustration 2:

Ms. Deepthi has purchased a house property as on 11th May, 2002 for ₹ 1,00,000. On 3rd July, 2004, she constructed a new floor on the same house at a cost of ₹ 4,50,000. On 6th November, 2021, she sold such house for ₹ 20,00,000 and incurred brokerage @ 2% for arranging customer. Compute capital gain.

#### Solution

| Particulars                          | Working                 | Details   | Amount ₹    |
|--------------------------------------|-------------------------|-----------|-------------|
| Sale consideration                   |                         |           | 20,00,000   |
| Expenses on transfer                 | 2% on 20,00,000         |           | (40,000)    |
| Net sale consideration               |                         |           | 19,60,000   |
| Less: i) Indexed cost of acquisition | 1,00,000 x<br>(317+105) | 3,01,905  |             |
| ii) Indexed cost of improvement      | 4,50,000 x<br>(317+113) | 12,62,389 | (15,64,294) |
| Long Term Capital Gain               |                         |           | 3,95,706    |

## Unit 15.9 - Ascertainment of Cost in Specified Circumstances [Section 49]

- In the following circumstances cost to previous owner deemed as cost of acquisition of asset:
  - On any distribution of assets on the total or partition of a HUF.
  - Under a gift or will.
  - By succession, inheritance or devolution.
  - On any distribution of assets on the liquidation of a company.
  - Under a transfer to revocable or an irrevocable trust.
  - Under any transfer of capital asset by a holding company to its wholly owned subsidiary Indian company or by a subsidiary company to its 100% holding Indian company.
  - Any transfer of a capital asset by amalgamating company to the amalgamated Indian company.
  - Any transfer of a capital asset by the demerged company to the resulting Indian company.
  - Conversion by an individual of his separate property into a HUF property.

| SR NO | Circumstances                                                                                                    | Cost of acquisition                                                                                                                                                                                                                                                                                                                                                                            |
|-------|------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.    | Shares received under the scheme of Amalgamation                                                                 | Cost of acquisition of the shares in the amalgamating company                                                                                                                                                                                                                                                                                                                                  |
| 3.    | Shares received during the process of conversion of bonds or debentures, debenture stock or deposit certificates | cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset is acquired by that person                                                                                                                                                                                                                                                                    |
| 4.    | Cost of acquisition of specified security or sweat equity shares                                                 | Fair market value which has been taken into account for perquisite valuation                                                                                                                                                                                                                                                                                                                   |
| 5.    | Time of conversion of preference shares                                                                          | Cost of the preference shares in relation to which such asset is acquired by the assessee                                                                                                                                                                                                                                                                                                      |
| 6.    | Shares received in the resulting company, in the scheme of demerger                                              | Cost of acquisition of the shares in the resulting company shall be:<br>Cost of acquisition of shares in the resulting company = $A \times B \div C$ <ul style="list-style-type: none"> <li>• A = Cost of acquisition of shares held in the demerged company</li> <li>• B = Net book value of the assets transferred in a demerger</li> <li>• C = Net worth of the demerged company</li> </ul> |
| 7.    | Shares held in the demerged company                                                                              | Cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C) [Section 49(2D)]                                                                                                                                                                                        |
| 8.    | Cost of acquisition of capital asset, being share in the project referred under section 45(5A)                   | Amount which is deemed as full value of consideration in that sub-section i.e., stamp duty value on the date of issue of certificate of completion plus cash consideration.                                                                                                                                                                                                                    |
| 9.    | Capital asset which was used by the assessee as an inventory                                                     | Fair market value of the inventory as on the date on such conversion                                                                                                                                                                                                                                                                                                                           |
| 10.   | Cost of acquisition of property subject to tax under section 56(2)(x)                                            | Value taken into account for the purposes of section 56(2)(x) [Section 49(4)].                                                                                                                                                                                                                                                                                                                 |



Section 56(2)(x)- As per Section 56 (2)(x) of the Income-tax Act, 1961 (ITA), you are required to pay taxes if the gift value is greater than ₹ 50,000. While gifts received up to ₹ 50,000 are completely tax-free, if this limit is crossed, the whole amount of gifts received becomes taxable in the hands of the recipient.

## Unit 15.10 - Cost of Acquisition [Section 55(2)]

- Goodwill, trademark or brand name, right to manufacture, right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours

|       | Circumstances                                                              | Cost of Acquisition                                                                                   |
|-------|----------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|
| (i)   | In case of acquisition from previous owner                                 | Cost of acquisition means the amount of the purchase price.                                           |
| (ii)  | In case of circumstances mentioned under section 49(1)(i)/(ii)/(iii)/(iv): | Cost of acquisition to the assessee will be the amount of the purchase price for such previous owner. |
| (iii) | In case of self-generated assets                                           | Cost of acquisition will be taken as Nil.                                                             |

- Financial Assets

|       | Circumstances                                                                                                     | Cost of Acquisition                                                                                                                      |
|-------|-------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|
| (i)   | Original shares (which form the basis of entitlement of rights shares)                                            | Amount actually paid for acquiring the original financial assets.                                                                        |
| (ii)  | Rights entitlement (which is renounced by the assessee in favour of a person)                                     | Nil                                                                                                                                      |
| (iii) | Rights shares acquired by the assessee                                                                            | Amount actually paid by him for acquiring such asset                                                                                     |
| (iv)  | Bonus Shares (Refer Note)                                                                                         | Nil                                                                                                                                      |
| (v)   | Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement | Cost of acquisition means:<br>Amount of the purchase price+ Amount paid to the company or institution for acquiring such financial asset |

**Note:**

Bonus shares allotted before 01st April, 2001 = fair market value as on 1st April, 2001



| Circumstances                                                                                                                                                                                                                                                                                                                                                                                                                                           | Cost of acquisition                                                                                                                                                                                                                                                                                                                        |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Where the capital asset became the property of the assessee by any of the modes specified in section 49(1)                                                                                                                                                                                                                                                                                                                                              | Cost of acquisition to the previous owner<br>Before 1st April, 2001 - fair market value as on 1st April, 2001 as the cost of acquisition<br>In case of land or building or both, the fair market value of such asset on 1st April, 2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1st April, -4-2001. |
| Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation                                                                                                                                                                                                                                                                                                                   | Fair market value of the asset on the date of distribution.                                                                                                                                                                                                                                                                                |
| A share or a stock of a company<br>The consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares<br>The conversion of any shares of the company into stock<br>Re-conversion of any stock of the company into shares<br>Sub-division of any of the shares of the company into shares of smaller amount<br>The conversion of one kind of shares of the company into another kind | Cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.                                                                                                                                                                                             |
| Where the capital asset become the property of the assessee before 1st April, 2001                                                                                                                                                                                                                                                                                                                                                                      | Fair market value of the asset on 1st April, 2001, at the option of the assessee.<br>In case of capital asset, being land or building or both, the fair market value of such asset on 1st April, 2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1st April, 2001.                                      |

Bonus shares allotted before 1st February, 2018, on which STT has been paid at the time of transfer = the cost would be the higher of:

- Actual cost of acquisition
  - (a) In case of bonus shares allotted on or after 1st April, 2001 - Nil
  - (b) In case of business shares allotted before 1st April, 2001 - FMV 1st April, 2001

Lower of:

- (a) FMV as on 31st January, 2018
- (b) Actual sale consideration

- **Long-term capital assets referred to in section 112A**

The cost of acquisition in relation to the long-term capital assets being:

- Equity shares in a company on which STT is paid both at the time of purchase and transfer or
- /Unit of equity-oriented fund or unit of business trust on which STT is paid at the time of transfer.

Acquired before 1st February, 2018 shall be the higher of:

- Cost of acquisition of such asset
- **Lower of:**
  - The fair market value of such asset
  - The full value of consideration received or accruing as a result of the transfer of the capital asset.
- Any other capital asset
- Where the cost for which the previous owner acquired the property cannot be ascertained, The cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

## Unit 15.11 - Cost of Improvement [Section 55(1)]

- Goodwill of a business, etc. [Section 55(1)(b)(1)]: Nil
- Any other capital asset [Section 55(1)(b)(2)]
- Previous owner or the assessee before 1st April, 2001: expenditure of a capital nature incurred in making any addition or alteration to the capital asset.
- In any other case: all expenditure of a capital nature incurred in making any additions or alterations to the capital assets.

## Unit 15.12 - Advance Money Received [Section 51]

Section 51 provides that while calculating capital gains, in regard to the transfer of capital asset advance retained by the assessee must go to reduce the cost of acquisition.

However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset shall be taxable as 'income from other sources', if:

- Such sum is forfeited; and
- The negotiations do not result in transfer of such capital asset [Sec. 56(2)(ix)]

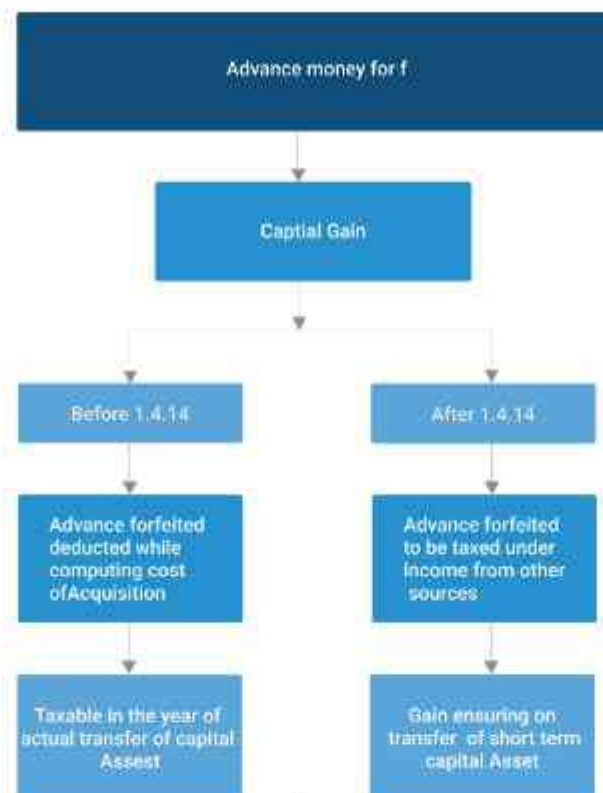


Fig: 9.7

## Unit 15.13 - Computation of Capital Gains in Case of Depreciable Assets [Sections 50 & 50a]

### Transfer of Depreciable Assets [Section 50]:

Where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

- Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:
  - Expenditure incurred wholly and exclusively in connection with such transfer.
  - WDV of the block of assets at the beginning of the previous year.
  - The actual cost of any asset falling within the block of assets acquired during the previous year.

**Such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.**

- Where all assets in a block are transferred during the previous year, the block itself will cease to exist.
- The difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.



- In a case where goodwill of a business or profession forms part of a block of asset 1 and depreciation thereon has been obtained by the assessee under the Act.
- If full value of consideration (v) > Opening WDV of Block (+) Actual Cost of Asset acquired in the Block during the P.Y. (+) Expenses in connection with transfer of asset, (c) Then:

**V (-) C is STCG**

- The Block Ceases to Exist:

**C (-) V is the closing WDV of the block**

- If the Block Exists:

**C (-) V is STCL**

#### • Cost of Acquisition In Case of Power Sector Assets [Section 50A]

With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset (as defined in section 43(6)), as adjusted, shall be taken to be the cost of acquisition.

#### Illustration: 3

Johnson & Co., a sole proprietorship owns 8 machines, put in use for business in Feb, 2020. The depreciation on these machines is charged @15%. The opening balance of these machines after providing depreciation for P.Y. 2020-21 was ₹ 10,50,000. 4 of the old machines were sold on 11th August, 2021 for ₹ 15,00,000. A second-hand plant was bought for ₹ 9,00,000 on 15th December, 2021.

You are required to:

- Determine the claim of depreciation for Assessment Year 2022-23.
- Compute the capital gains liable to tax for Assessment Year 2022-23.
- If Johnson & Co. had sold the 4 machines in June, 2021 for ₹ 25,00,000, will there be any difference in your above workings? Explain

#### Solution:

1.

| Particulars                                                                                                              | Amount ₹    |
|--------------------------------------------------------------------------------------------------------------------------|-------------|
| Opening balance of the block as on 1.4.2021 [i.e., W.D.V. as on 31.3.2021 after providing depreciation for P.Y. 2020-21] | 10,50,000   |
| Add: Purchase of second-hand plant during the year                                                                       | 9,00,000    |
| Less: Sale consideration of old machinery during the year                                                                | (15,00,000) |
| W.D.V of the block as on 31.03.2022                                                                                      | 4,50,000    |



2. In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

3. If the 4 machines are sold in June, 2021 for ₹ 25,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

| Particulars                                                                                                                    | Amount ₹    |
|--------------------------------------------------------------------------------------------------------------------------------|-------------|
| Sale consideration                                                                                                             | 25,00,000   |
| Less: Opening balance of the block as on 1.4.2021 [i.e., W.D.V. as on 31.3.2021 after providing depreciation for P.Y. 2020-21] | (10,50,000) |
| Purchase of second plant during the year                                                                                       | (9,00,000)  |
| Short term capital gains                                                                                                       | 5,50,000    |

## Unit 15.14 - Capital Gains in Respect of Slump Sale Section 50B]

Slump sale means transfer of one or more undertakings, by any means, for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

- Capital Gains:

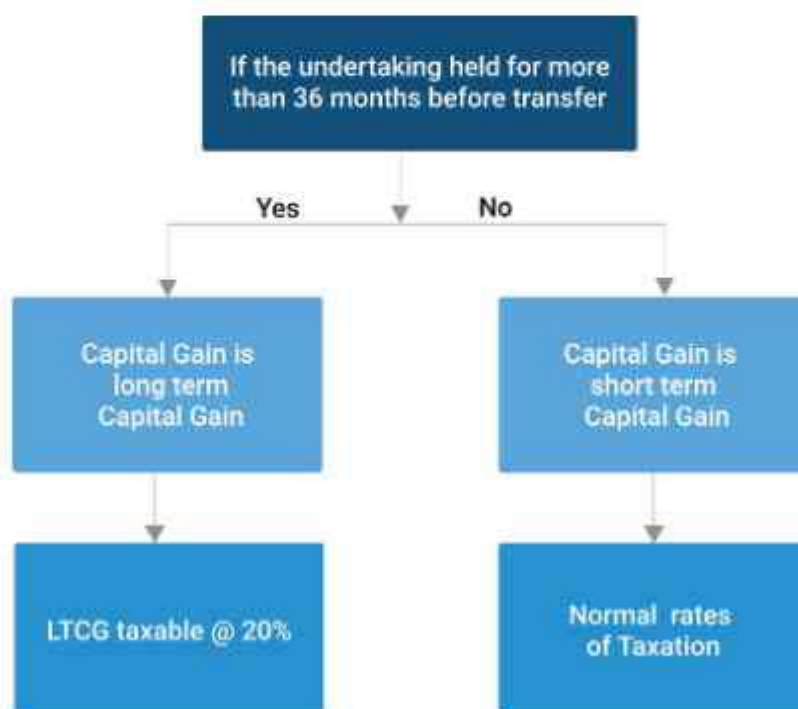


Fig: 9.8

- **Deemed cost of acquisition and cost of improvement [Section 50B(2)(i)]:**
- The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred.
- No indexation benefit would, however, be available, even if the slump sale has taken place of an undertaking held for more than 36 months, resulting in a long-term capital gain.

**Networth:**

Aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. Any change in the value of assets on account of revaluation of assets shall not be considered for this purpose

- **Deemed Full Value of Consideration [Section 50B(2)(ii)]**  
Fair market value of the capital assets as on the date of transfer.

**Deemed Full Value Of Consideration For Computing Capital Gains [Sections 50C, 50CA & 50D]**

| Capital asset            | Circumstances                                                                                                                                                                                                                                                            | Deemed full value of consideration                    |
|--------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|
| Land or building or both | 1. If Stamp Duty Value > 110% of consideration received or accruing as a result of transfer                                                                                                                                                                              | Stamp Duty Value                                      |
|                          | • If date of agreement is different from the date of transfer and whole or part of the consideration is received by way of account payee cheque or account payee bank draft or ECS or through such other prescribed electronic modes on or before the date of agreement. | Stamp Duty Value on the date of agreement             |
|                          | • If date of agreement is different from the date of transfer but the whole or part of the consideration has not been received by any of the prescribed mode.                                                                                                            | Stamp Duty Value on the date of transfer              |
|                          | • If the stamp duty value on the date of agreement or the date of transfer, as the case may be $\leq$ 110% of the sale consideration received.                                                                                                                           | Consideration so received                             |
|                          | 2. Where the Assessing Officer refers the valuation to a Valuation Officer, on the assessee's claim                                                                                                                                                                      |                                                       |
|                          | • If Valuation by Valuation Officer > Stamp Duty Value                                                                                                                                                                                                                   | Stamp Duty Value                                      |
|                          | • If Valuation by Valuation Officer < Stamp Duty Value                                                                                                                                                                                                                   | Valuation by Valuation Officer                        |
|                          | 3. If stamp duty value has been adopted as full value of consideration, and subsequently the value is revised in any appeal or revision                                                                                                                                  | Value so revised in such appeal or revision           |
| Unquoted shares          | consideration received or accruing as a result of transfer < FMV of such share determined in the prescribed manner                                                                                                                                                       | FMV of such share determined in the prescribed manner |
| Any Capital asset        | Where the consideration received or accruing is not ascertainable or cannot be determined                                                                                                                                                                                | FMV of the said asset on the date of transfer         |

- **Report of a Chartered Accountant**
- Every assessee in the case of slump sale shall furnish in the prescribed form on or before 30th September of the A.Y.
- A report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

## Unit 15.15 - Exemption of Capital Gains

### Exemptions Under Section 10

Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)]

- Clause (37) of section 10 exempts the capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition.
- Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1st April, 2004
- The exemption is available only when such land has been used for agricultural purposes during the preceding two years immediately preceding the date of transfer by such individual or a parent of his or by such HUF.

### Exemption of Capital Gains under section 54/54B/54D/54EC/54F

#### Capital Gains on sale of residential house [Section 54]

- Eligible assessee – Individual & HUF
- Conditions to be fulfilled:
  - There should be a transfer of residential house (buildings or lands appurtenant thereto).
  - It must be a long-term capital asset.
  - Income from such house should be chargeable under the head "income from house property".



Fig. 9.9



- **Quantum of Exemption**
- If cost of new residential house or houses, as the case may be  $\geq$  long term capital gains, entire long term capital gains is exempt.
- If cost of new residential house or houses,  $<$  long term capital gains, long term capital gains to the extent of cost of new residential house is exempt.
- **Consequences of transfer of new asset before 3 years:**
- If the new asset is transferred before 3 years from the date of its acquisition or construction, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

**Illustration:4**

Mr. Vimal purchased a residential house on September 22, 2019 for ₹ 12,00,000 and made some additions to the house incurring ₹ 4,00,000 in January 2020. He sold the house property in April 2021 for ₹ 25,00,000. Out of the sale proceeds, he spent ₹ 10,00,000 to purchase another house property in September 2021. What is the amount of capital gains taxable in the hands of Mr. Vimal for the A.Y.2022-23?

**Solution:**

The house is sold before 24 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

| Particulars               | Amount ₹    |
|---------------------------|-------------|
| Sale consideration        | 25,00,000   |
| Less: Cost of acquisition | (12,00,000) |
| Cost of improvement       | (4,00,000)  |
| Short term Capital gain   | 9,00,000    |

**Note:**

The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Vimal cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹ 9,00,000

- **Capital gains on transfer of agricultural land [Section 54B]**
- Eligible assessee – Individual & HUF
- **Conditions:**
  - There should be a transfer of urban agricultural land.
  - Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 years immediately preceding the date of transfer.
  - He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.
  - If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS.

**Note: Capital Gains Account Scheme (CGAS)**

Under sections 54, 54B, 54D and 54F, capital gains is exempt to the extent of investment of such gains/ net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS.



- **Time limit**

Such deposit in CGAS should be made:

- Before filing the return of income.
- Or
- On or before the due date of filing the return of income.

- **Whichever is Earlier**

- Proof of such deposit should be attached with the return.
- The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

- **Consequences:** If the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years.

The unutilized amount shall be charged as capital gain of the previous year in which the specified period expires. In the case of section 54F, proportionate amount will be taxable.

- **Quantum of Exemption:**

|                                                       |                                                                         |
|-------------------------------------------------------|-------------------------------------------------------------------------|
| If cost of new agricultural land $\geq$ capital gains | Capital gains is exempt.                                                |
| If cost of new agricultural land $<$ capital gains    | Capital gains to the extent of cost of new agricultural land is exempt. |

- **Consequences of transfer of new agricultural land before 3 years:**

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing capital gains of new agricultural land.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.

**Illustration: 5**

The capital gains is ₹ 5 lakhs and the cost of the new agricultural land is ₹ 8 lakhs if the new agricultural land (urban land) is sold after, 1 year for ₹ 10 lakhs.

**Solutions:**

| Particulars                                                                           | Amount ₹   |
|---------------------------------------------------------------------------------------|------------|
| Net consideration                                                                     | 10,00,000  |
| Less: Cost of acquisition minus capital gains exempt earlier<br>(8,00,000 – 5,00,000) | (3,00,000) |
| Short-term capital gains chargeable to tax                                            | 7,00,000   |

- **Capital Gains on transfer by way of compulsory acquisition of land and building of an industrial undertaking [Section 54D]**

- **Eligible assessee – Any assessee**

**Conditions to be fulfilled:**

- There must be compulsory acquisition of land and building or any right in land or building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.

If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS.

- **Quantum of Exemption:**

|                                           |                                                             |
|-------------------------------------------|-------------------------------------------------------------|
| If cost of new asset $\geq$ capital gains | Entire capital gains is exempt                              |
| If cost of new asset $<$ capital gains    | Capital gains to the extent of cost of new asset is exempt. |

- **Consequences of transfer of new asset before 3 years**

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

- **Capital Gains not chargeable on investment in certain bonds [Section 54EC]**

- **Eligible assessee – Any assessee**

- **Conditions:**

- There should be transfer of a long-term capital asset being land or building or both.
- Such asset can also be a depreciable asset (in this case, building) held for more than 24 months.
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 5 years, issued on or after 1st April, 2018 by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf [Bonds of Power Finance Corporation (PFC) and Indian Railways Finance Corporation (IRFC)].
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of 5 years from the date of acquisition of such bonds.

- **Quantum of exemption:**

- Capital gains
- OR
- Amount invested in specified bonds,

- **Whichever is lower.**

The maximum investment which can be made in notified bonds or bonds of NHAI and RECL, out of capital gains arising from transfer of one or more assets, during the previous year in which the original asset is transferred and in the subsequent financial year cannot exceed ₹ 50 lakhs.

- **Violation of condition:**

In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 5 years. Capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

- Capital gains in cases of investment in residential house [Section 54F]
- Eligible assessee: Individuals / HUF
- Conditions to be fulfilled:
  - There must be transfer of a long-term capital asset, not being a residential house.
  - Transfer of plot of land is also eligible for exemption
  - The assessee should:
    - Purchase one residential house situated in India within a period of 1 year before or 2 years after the date of transfer.
    - OR
    - Construct one residential house in India within 3 years from the date of transfer. If such investment is not made before the date of filing of return of income, then the net sale consideration has to be deposited under the CGAS.
  - The assessee should not own more than one residential house on the date of transfer.
  - The assessee should not:
    - Purchase any other residential house within a period of 2 years or
    - OR
    - Construct any other residential house within a period of 3 years from the date of transfer of the original asset
- Quantum of Exemption

| Circumstances                                                                    | Exemption                                                                                                  |
|----------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|
| If cost of new residential house $\geq$ net sale consideration of original asset | Entire capital gains is exempt                                                                             |
| If cost of new residential house $<$ net sale consideration                      | Only proportionate capital gains is exempt i.e.,                                                           |
|                                                                                  | $\frac{\text{LTCG} \times \text{Amount invested in new residential house}}{\text{Net sale consideration}}$ |

- Consequences Where:
  - Assessee purchases any other residential house within a period of 2 years
  - Or
  - Constructs any other residential house within a period of 3 years from the date of transfer of original asset.

The capital gains exempt earlier under section 54F shall be deemed to be taxable as long-term capital gains in the previous year in which such residential house is purchased or constructed.

**Consequences if the new house is transferred within a period of 3 years from the date of its purchase:**

- Capital gains would arise on transfer of the new house. And
- The capital gains exempt earlier under section 54F would be taxable as long-term capital gains.

In case the new residential house is sold after 2 years, the capital gains would be long-term capital gains and indexation benefit would be available.



- Deduction from Capital Gain on Transfer of Capital Assets in case of shifting of industrial undertaking from Urban areas [SEC. 54G]

| Applicable to                       | All assessee                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions                          | <ul style="list-style-type: none"> <li>• Assessee must have transferred a capital asset, being:               <ul style="list-style-type: none"> <li>□ A machinery or plant or building or land.</li> <li>□ Any rights in building or land.</li> <li>□ used for the purposes of the business of an industrial undertaking situated in an urban area.</li> </ul> </li> <li>• Such transfer is affected in the course of shifting of such industrial undertaking to any area other than an urban area.</li> <li>• Assessee has within a period of 1 year before, or 3 years after, the date of transfer:               <ul style="list-style-type: none"> <li>□ Purchased new machinery or plant for the purpose of business of the industrial undertaking in the area to which the said undertaking is shifted.</li> <li>□ Acquired building or land or constructed building for the purposes of his business in the said area.</li> <li>□ Shifted the original asset and transferred the establishment of such undertaking to such area. and</li> <li>□ Incurred expenses on such other purpose as may be specified in a scheme framed by the central government for the purposes of this section.</li> </ul> </li> </ul> |
| Time limit for acquiring new asset. | Within 1 year before, or 3 years after, the date of transfer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| Amount of Deduction                 | Minimum of the following:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|                                     | <ul style="list-style-type: none"> <li>• Amount expended for the above purposes [as stated in (a) to (d) above];</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|                                     | <ul style="list-style-type: none"> <li>• Capital gain</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |



- Deduction from capital gain on transfer of capital assets in case of shifting of industrial undertaking from urban areas to special economic zone [SEC. 54GA]

| Applicable to                      | All assessee                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions                         | <ul style="list-style-type: none"> <li>• Assessee must have transferred a capital asset, being:               <ul style="list-style-type: none"> <li>• A machinery or plant or building or land or</li> <li>• Any rights in building or land, used for the purposes of the business of an industrial undertaking situated in an urban area.</li> </ul> </li> <li>• Such transfer is affected in the course of shifting of such industrial undertaking to Special Economic Zone (SEZ).<br/>Note: The SEZ may be developed in any urban area or any other area.</li> <li>• Assessee has within a period of 1 year before, or 3 years after, the date of transfer:               <ul style="list-style-type: none"> <li>□ Purchased new machinery or plant for the purpose of business of the industrial undertaking in the SEZ to which the said undertaking is shifted.</li> <li>□ Acquired building or land or constructed building for the purposes of his business in the SEZ.</li> <li>□ Incurred expenditure on shifting the original asset and transferred the establishment of such undertaking to such SEZ and</li> <li>□ Incurred expenses on such other purpose as may be specified in a scheme framed by the central government for the purposes of this section.</li> </ul> </li> </ul> |
| Time limit for acquiring new asset | Within 1 year before or 3 years after, the date of transfer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| Amount of Deduction                | Minimum of the following: <ul style="list-style-type: none"> <li>• Amount expended for the above purposes [as stated in (a) to (d) above];</li> <li>• Capital gain</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |

- Deduction from capital gain on transfer of residential property for investment in eligible company [SEC. 54GB] Amended

| Applicable to                       | Individual & HUF                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions                          | <ul style="list-style-type: none"> <li>• Assessee must have transferred a long-term capital asset being residential property (i.e., a house or a plot of land)</li> <li>• Such transfer should take place between 01st April, 2012 and 31st March, 2022.</li> <li>• Assessee must subscribe in the equity shares of an eligible company within the due date of furnishing income tax return for the relevant assessment year.               <ul style="list-style-type: none"> <li>□ Eligible company means a company which fulfils the following conditions:                   <ul style="list-style-type: none"> <li>□ It is an Indian company.</li> <li>□ The company should be incorporated during the period from the 1st day of April of the previous year relevant to the assessment year in which the capital gain arises to the due date of furnishing of return of income u/s 139(1) by the assessee.</li> <li>□ The company is engaged in the business of manufacture of an article or a thing or in an eligible business.</li> <li>□ Eligible business means a business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property.</li> <li>□ It is a company in which the assessee has more than 25% share capital or more than 25% voting rights after the subscription in shares by the assessee</li> <li>□ It is a company which qualifies to be a small or medium enterprise (i.e., SME) under the Micro, Small and Medium Enterprises Act, 2006 or is an eligible start up (as referred to in sec. 80-IAC);</li> </ul> </li> </ul> </li> </ul> |
| Time limit for acquiring new asset. | The company should purchase new asset within 1 year from the date of subscription in equity shares by the assessee.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| Amount of Deduction                 | Minimum of the following: <div style="border: 1px solid black; padding: 5px; margin: 10px 0;">             Investment in the new asset by the eligible company * Capital gain           </div> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;">             Net Sale consideration           </div> <ul style="list-style-type: none"> <li>• Capital gain</li> </ul> Net sale consideration = Sale consideration – Expenditure on transfer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

- **Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]**

In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.

## Unit 15.16 - Reference to Valuation Officer [Section 55A]

Section 55A provides that the assessing officer may refer the valuation of a capital asset to a valuation officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains:

- In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer.
- Under this provision, the assessing officer can make a reference to the valuation officer in certain cases like:
  - Where the fair market value is taken to be the sale consideration of the asset.
  - Where the fair market value of the asset as on 01st April, 2001 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01st April, 2001 claimed by the assessee.
- If the assessing officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as claimed or by more than ₹ 25,000 of the value of the asset as claimed by the assessee.
- The assessing officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference



## Unit 15.17 - Tax on Short Term Capital Gains in Respect of Equity Shares/ Units of an Equity Oriented Fund [Section 111A]

| Exemption of Capital Gains [Sections 54 to 54F] |                   |                                                                                         |                                                                                                                                        |                                                                                                                                                                                                                   |                                 |                                                                                                                                                                                                           |
|-------------------------------------------------|-------------------|-----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Sl. No                                          | Particulars       | Section 54                                                                              | Section 54B                                                                                                                            | Section 54D                                                                                                                                                                                                       | Section 54EC                    | Section 54F                                                                                                                                                                                               |
| 1                                               | Eligible Assessee | Individual/ HUF                                                                         | Individual/ HUF                                                                                                                        | Any assessee                                                                                                                                                                                                      | Any assessee                    | Individual/ HUF                                                                                                                                                                                           |
| 2                                               | Asset transferred | Residential House (LTCA)                                                                | Urban Agricultural Land                                                                                                                | Land & building forming part of an industrial undertaking                                                                                                                                                         | Land or building or both (LTCA) | Any LTCA other than Residential House.                                                                                                                                                                    |
| 3                                               | Other Conditions  | Income from such house should be chargeable under the head "Income from house property" | Land should be used for agricultural purposes by assessee or his parents or HUF for 2 years immediately preceding the date of transfer | Land & building have been used for business of undertaking for at least 2 years immediately preceding the date of transfer. The transfer should be by way of compulsory acquisition of the industrial undertaking | -                               | Assessee should not own more than one residential house on the date of transfer. He should not purchase within 2 years or construct within 3 years after the date of transfer, another residential house. |



|   |                                                                        |                                                                                                                                                       |                                                                |                                                                                                                                                                   |                                                                                     |                                                                                                                              |
|---|------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------|
| 4 | Qualifying asset i.e., asset in which capital gains has to be invested | One Residential House situated in India/Two residential houses in India, at the option of the assessee, where capital gains does not exceed ₹ 2 crore | Land for being used for agricultural purpose (Urban/Rural)     | Land or Building or right in land or building                                                                                                                     | Bonds of NHAI or RECL or any other bond notified by C.G. (Redeemable after 5 years) | One Residential House situated in India                                                                                      |
| 5 | Time limit for purchase/construction                                   | Purchase within 1 year before or 2 years after the date of transfer (or) construct within 3 years after the date of transfer                          | Purchase within a period of 2 years after the date of transfer | Purchase/construct within 3 years after the date of transfer, for shifting or reestablishing the existing undertaking or setting up a new industrial undertaking. | Purchase within a period of 6 months after the date of transfer                     | Purchase within 1 year before or 2 years after the date of transfer (or) Construct within 3 years after the date of transfer |

|   |                     |                                                                                                                          |                                                                              |                                                        |                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                 |
|---|---------------------|--------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------|--------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6 | Amount of Exemption | Cost of new Residential House or two houses, as the case may be or Cost of new asset or Capital Gain, whichever is lower | Cost of new Agricultural Land or Capital Gain, whichever is lower, is exempt | Cost of new asset or Capital Gain, whichever is lower. | Capital Gain or amount invested in specified bonds, whichever is lower. Maximum permissible investment out of capital gains arising in any financial year is ₹ 50 lakhs, whether such investment is made in the current FY or subsequent FY or both. | Cost of new Residential House $\geq$ Net sale consideration of original asset, entire Capital gain is exempt. Cost of new Residential House $<$ Net sale consideration of original asset, proportionate capital gain is exempt. |
|---|---------------------|--------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------|--------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

|                                                                           |                                                                                                                                                                                                                                        |
|---------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Concessional rate of tax in respect of STCG on transfer of certain assets | This section provides for a concessional rate of tax (i.e., 15%) on the short-term capital gains on transfer of:<br>(1) An equity shares in a company or<br>(2) A unit of a business trust or<br>(3) A unit of an equity-oriented fund |
| Applicability                                                             | All assessee                                                                                                                                                                                                                           |

|                                                                      |                                                                                                                                                                                                                                                        |
|----------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Conditions                                                           | (i) The transaction of sale of such equity share or unit should be entered into on or after 1st October, 2004<br>(ii) Such transaction should be chargeable to securities transaction tax under the said chapter                                       |
| Tax rate                                                             | Such short-term capital gains shall be taxed ₹ 15% + surcharge + Health and Education Cess.                                                                                                                                                            |
| Deduction under Chapter VI-A against STCG taxable under section 111A | Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains.                                                                                                                                                           |
| Adjustment of Unexhausted Basic Exemption Limit                      | In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then, such short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 15%. |

However, short-term capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 15% even though STT is not leviable in respect of such transaction.

**Illustration:6**

Short term capital gain on transfer of shares on which STT is paid - ₹ 1,20,000  
 other income - ₹ 1,70,000  
 calculate tax of Mr. Lal aged 35 years.

**Solution**

| Particulars                                               | Other Income ₹ | STCG ₹   |
|-----------------------------------------------------------|----------------|----------|
| Income                                                    | 1,70,000       | 1,20,000 |
| Exemption limit on which no tax is charged i.e., 2,50,000 | 1,70,000       | 80,000   |
| (note)                                                    |                |          |
|                                                           | 0              | 40,000   |
| Tax rate                                                  | Nil            | 15%      |
| Tax                                                       | Nil            | 6000     |
| Less: Rebate u/s 87A                                      |                | 6000     |
| Tax after Rebate u/s 87A                                  | -              | -        |
| Add: Health & Education Cess                              | -              | -        |
| Tax Liability (Rounded off)                               | Nil            | Nil      |

**Note:**

In the case of resident individuals or HUF,

If the basic exemption is not fully exhausted by any other income, then, such short-term capital gain will be reduced by the unexhausted basic exemption limit.

STCG - (basic exemption limit - other income)

1,20,000 - (2,50,000 - 1,70,000)

1,20,000 - 80,000 = 40,000

Therefore 15% is charged on the balance amount of ₹ 40,000.

Short-term capital gain in any other case

In any other case, short-term capital gain is to be taxed as per usual rates, as applicable to any other income.

## Unit 6.18 - Tax on Long Term Capital Gains [Section 112]

Where the total income of an assessee includes long-term capital gains, tax is payable by the assessee @20% on such long-term capital gains.

The treatment of long-term capital gains in the hands of different types of assessee are as follows:

|    | Person                                                                                                                                                                                                                         | Rate of tax                                                                                                                               |
|----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|
| 1. | Resident individual or Hindu undivided family                                                                                                                                                                                  | Income tax payable at normal rates on total income as reduced by long-term capital gains plus 20% on such long-term capital gains. (Note) |
| 2. | Resident AOPs and BOIs                                                                                                                                                                                                         | 20%                                                                                                                                       |
| 3. | Resident Firms and LLPs                                                                                                                                                                                                        | 20%                                                                                                                                       |
| 4. | Domestic companies                                                                                                                                                                                                             | Long-term capital gains will be charged ₹20%                                                                                              |
| 5. | Non-corporate non-residents and foreign companies                                                                                                                                                                              | 10%                                                                                                                                       |
|    | <ul style="list-style-type: none"> <li>Unlisted securities or shares of closely held companies (without benefit of indexation or foreign currency fluctuation)</li> <li>In respect of other long-term capital gains</li> </ul> | 20%                                                                                                                                       |

**Note:**

Where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income tax then such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income tax.



**Tax Computation**

- In the case of an individual or a Hindu undivided family [a resident]—
- Where [Total Income - Long-term capital gains] > Exempted ceiling (i.e., ₹ 2,50,000 or ₹ 3,00,000 or ₹ 5,00,000, as the case may be)

|                                                      |                 |
|------------------------------------------------------|-----------------|
| Tax on LTCG                                          | @ 20%           |
| Tax on [Total income - such long-term capital gains] | As per the slab |

- Where [Total Income - Long-term capital gains] < Exempted ceiling (i.e., ₹ 2,50,000 or ₹ 3,00,000 or ₹ 5,00,000, as the case may be)

|                                                                             |       |
|-----------------------------------------------------------------------------|-------|
| Tax on LTCG – [Exempted ceiling – (Total Income - Long-term capital gains)] | @ 20% |
| Tax on [Total income - Long-term capital gains]                             | Nil   |

- Lower rate of tax for transfer of listed securities and zero-coupon bonds  
In case of transfer of listed securities (other than units) and Zero-Coupon Bonds, LTCG would be taxable at the lower of the following rates:
  - (1) 10% without indexation benefit and
  - (2) 20% with indexation benefit.
- No Chapter VI-A deduction against LTCG  
Deductions under Chapter VIA cannot be availed in respect of the long term capital gains included in the total income of the assessee.

**Illustration:7**

Ms. Riya a resident aged 52 years, has other income of ₹ 2,10,000 and LTCG ₹ 70,000. Compute her Tax liability.

**Solution**

| Particulars                                  | LTCG   | Other income |
|----------------------------------------------|--------|--------------|
| Taxable income                               | 70,000 | 2,10,000     |
| Exempted up to 2,50,000(2,50,000 – 2,10,000) | 40,000 | 2,10,000     |
| Balance                                      | 30,000 | Nil          |
| Tax rate                                     | 20%    | Slab         |
| Tax liability before rebate                  | 8,000  | Nil          |
| Less: Rebate u/s 87A                         | 8,000  | -            |
| Tax payable                                  | Nil    | Nil          |

## Unit 15.19 - Tax on Long Term Capital Gains on Certain Assets [Section 112A]

|                                                                           |                                                                                                                                                                                                                                                                                                                                                                               |
|---------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Concessional rate of tax in respect of LTCG on transfer of certain assets | Section 112A provides that notwithstanding anything contained in section 112, a concessional rate of tax@10% will be leviable on the long-term capital gains exceeding ₹ 1,00,000 on transfer of:— <ul style="list-style-type: none"> <li>• An equity shares in a company or</li> <li>• A unit of a business trust or</li> <li>• A unit of an equity-oriented fund</li> </ul> |
| Applicability                                                             | All assessee                                                                                                                                                                                                                                                                                                                                                                  |
| Conditions                                                                | (i) In case of equity share in a company, STT has been paid on acquisition and transfer of such capital asset                                                                                                                                                                                                                                                                 |
|                                                                           | (ii) In case of unit of an equity-oriented fund or unit of business trust, STT has been paid on transfer of such capital asset.                                                                                                                                                                                                                                               |
| Rebate under section 87A                                                  | Rebate under section 87A is not available in respect of tax payable@10% on LTCG under section 112A.                                                                                                                                                                                                                                                                           |
| Deduction under Chapter VI-A against LTCG taxable under section 112A      | Deductions under Chapter VI-A cannot be availed in respect of such Long-term capital gains.                                                                                                                                                                                                                                                                                   |
| Adjustment of Unexhausted Basic Exemption Limit                           | In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then such long-term capital gain exceeding 1 lakh will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 10%.                                                                                                         |

### Note:

Long-term capital gains arising from transaction undertaken on a recognized stock exchange located in an International Financial Service Centre (IFSC) would be taxable at a concessional rate of 10%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not leviable in respect of such transaction.

### Computation of cost of acquisition of such capital assets in certain cases:

The cost of acquisition for the long-term capital asset acquired on or before 31st of January, 2018 will be higher of the following:

- The actual cost of acquisition of such asset
- The lower of:
  - The fair market value of such asset.
  - The full value of consideration received or accruing as a result of the transfer of the capital asset.
  -

### Notes:

- No Index benefit is available.
- The holding period will be counted from the date of acquisition.
- The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per aforesaid rule. Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition.

**Illustration:8**

Mr. Neeraj, a resident aged 55 years, has other income of 50,000 and LTCG u/s 112A ₹ 4,25,000. Compute his Tax liability.

**Solution**

| Particulars                                         | LTCG u/s 112A  | Other income |
|-----------------------------------------------------|----------------|--------------|
| Taxable income                                      | 4,25,000       | 50,000       |
| Exempted up to 2,50,000 (2,50,000 – 50,000)         | 2,00,000       | 50,000       |
| Balance                                             | 2,25,000       | 0            |
| Tax rate applicable on income in excess of 1,00,000 | 10%            | Slab         |
| Tax liability before rebate                         | 22,500         | Nil          |
| Less: Rebate u/s 87A                                | Not applicable |              |
| Tax after rebate                                    | 22,500         | Nil          |
| Add: Health & Education Cess                        | 900            |              |
| Tax and Cess Payable                                | 23,400         | Nil          |

**Illustration:9**

During the previous year 2021-22, Krithi exchanges her agricultural land (being acquired on 1st June, 2003 for ₹ 60,000) against the agricultural land of Varun (being acquired on 1st March, 2021 for ₹ 80,000). Fair market value of such properties on the date of transfer is ₹ 5,00,000. Compute capital gain assuming that both the land is situated in urban area.

**Solution:****In case of Krithi:**

| Particulars                       | Working                      | Amount ₹   |
|-----------------------------------|------------------------------|------------|
| Sale consideration                |                              | 5,00,000   |
| Less: Expenses on transfer        |                              | Nil        |
| Net sale consideration            |                              | 5,00,000   |
| Less: Indexed cost of acquisition | $60,000 \times 317 \div 109$ | (1,74,495) |
| Less: Indexed cost of improvement |                              | Nil        |
| Long Term Capital Gain            |                              | 3,25,505   |
| Less: Exemption U/s 54B           |                              | (3,25,505) |
| Taxable Long Term Capital Gain    |                              | Nil        |

**In case of Varun:**

| Particulars                     | Working | Amount ₹ |
|---------------------------------|---------|----------|
| Sale consideration              |         | 5,00,000 |
| Less: Expenses on transfer      |         | Nil      |
| Net sale consideration          |         | 5,00,000 |
| Less: cost of acquisition       |         | (80,000) |
| Less: cost of improvement       |         | Nil      |
| Short Term Capital Gain         |         | 4,20,000 |
| Less: Exemption U/s 54B         |         | Nil      |
| Taxable short Term Capital Gain |         | 4,20,000 |



Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income (Salary, income from house property, profit and gains of business or profession and capital gain), is chargeable under the head 'Income from other sources'. In other word any income is taxable under this head if the following conditions are satisfied.

- There is an Income.
- Such income is not exempt under the provisions of Income Tax Act.
- Such income is not taxable under the first four heads of income.

#### Meaning of Certain Terms

| Term     | Meaning                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Property | <p>A capital asset of the assessee, namely:</p> <ul style="list-style-type: none"> <li>• immovable property being land or building or both,</li> <li>• shares and securities,</li> <li>• jewellery,</li> <li>• archaeological collections,</li> <li>• drawings,</li> <li>• paintings,</li> <li>• sculptures,</li> <li>• any work of art or</li> <li>• bullion.</li> </ul>                                                                                                                                                                                                                                                                                |
| Relative | <ul style="list-style-type: none"> <li>• In case of an individual:               <ul style="list-style-type: none"> <li>□ spouse of the individual;</li> <li>□ brother or sister of the individual;</li> <li>□ brother or sister of the spouse of the individual;</li> <li>□ brother or sister of either of the parents of the individual;</li> <li>□ any lineal ascendant or descendant of the individual;</li> <li>□ any lineal ascendant or descendant of the spouse of the individual;</li> <li>□ spouse of any of the persons referred in (1) to (6) above</li> </ul> </li> <li>• In case of Hindu Undivided Family, any member thereof.</li> </ul> |
| Family   | <p>For the purpose of calculating income from other source, family in relation to an individual means:</p> <ul style="list-style-type: none"> <li>• the spouse and children of the individual; and</li> <li>• the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual</li> </ul>                                                                                                                                                                                                                                                                                                                |



## Summary

Income from capital gains in India refers to the profit earned from the sale of capital assets such as property, stocks, or bonds. This income is categorized under the head "Capital Gains" in the Income Tax Act and is taxable depending on the nature and duration of ownership of the asset. There are two main types of capital gains: short-term capital gains (STCG) and long-term capital gains (LTCG). STCG arises when a capital asset is held for a short period (typically less than 36 months for most assets and 12 months for listed securities), and the gains are taxed at a higher rate compared to LTCG, which applies to assets held for longer periods. LTCG benefits from lower tax rates and various exemptions under sections like 54, which provide relief on reinvestments in specified assets. The determination of capital gains involves subtracting the cost of acquisition and improvements from the sale price of the asset, adjusted for inflation in the case of LTCG (indexed cost of acquisition). This framework ensures that capital gains are taxed fairly, encouraging investment while providing avenues for tax relief on reinvestment.

## Exercise

What constitutes income from capital gains in India?

- A) Interest received from bank deposits
- B) Profit from the sale of capital assets
- C) Dividends received from investments
- D) Rental income from property
- Answer: B

How are capital gains classified for tax purposes in India?

- A) Fixed and Variable gains
- B) Short-term and Long-term capital gains
- C) Primary and Secondary gains
- D) Realized and Unrealized gains
- Answer: B

What is the holding period for assets to qualify as short-term capital gains for most assets?

- A) Less than 12 months
- B) Less than 24 months
- C) Less than 36 months
- D) Less than 48 months
- Answer: C

For which type of asset is a holding period of 12 months applicable to qualify as short-term capital gains?

- A) Unlisted stocks
- B) Real estate
- C) Listed securities
- D) Gold
- Answer: C

What are long-term capital gains taxed at in India for most assets?

- A) A higher rate compared to short-term gains
- B) A lower rate compared to short-term gains
- C) The same rate as ordinary income
- D) No tax is applicable
- Answer: B

Which section of the Income Tax Act provides relief on reinvestment of capital gains into specified assets?

- A) Section 54
- B) Section 80C
- C) Section 24
- D) Section 44AD
- Answer: A

How is the cost base of a capital asset adjusted for inflation in the case of long-term capital gains?

- A) Indexed cost of acquisition
- B) Standard deduction rate

- C) Fixed percentage of the cost
- D) It is not adjusted for inflation
- Answer: A

What is subtracted from the sale price to determine capital gains?

- A) Initial purchase price only
- B) Cost of acquisition and improvements
- C) Depreciation
- D) Previous taxes paid on the asset
- Answer: B

Which of the following is not considered a capital asset under the Income Tax Act?

- A) Shares
- B) Bonds
- C) Personal car
- D) Consumable goods used in a business
- Answer: D

What tax benefit does LTCG offer over STCG?

- A) Exemption from tax
- B) Lower tax rates
- C) Higher tax rates
- D) The same tax rates as STCG
- Answer: B

## Notes

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.This image shows a completely blank white rectangular area, which appears to be a page from a book or document. It is surrounded by a thin, dark brown border. There are no markings, text, or illustrations on the page itself.





## 16. Income From Other Sources

- Unit 16.1 - Dividend Income
- Unit 16.2 - Deemed Dividend
- Unit 16.3 - Casual Income
- Unit 16.4 - Income by way of interest on securities
- Unit 16.5 - Income from hiring of machinery, etc
- Unit 16.6 - Hiring out of building with machinery etc. [Section 56(2)(iii)]
- Unit 16.7 - Share Premiums in Excess of The Fair Market Value To Be Treated as Income
- Unit 16.8 - Income By way of Interest Received on Compensation or on Enhanced Compensation Referred To in Clause (b) of Section 145A Shall Be Chargeable To Tax Under Income From Other Sources. [Section 56(2) (viii)]
- Unit 16.9 - Advance Money Received
- Unit 16.10 - Any Sum of Money or Value of Property Received without Consideration Or for Inadequate Consideration To Be Subject To Tax in The Hands of The Recipient [Section 56(2)(x)]
- Unit 16.11 - Immovable property [Land or building or both];
- Unit 16.12 - Movable Property [Property, other than Immovable Property]
- Unit 16.13 - Compensation or Any other Payment Received in Connection With Termination of His Employment [Section 56(2)(xi)]
- Unit 16.14 - Keyman Insurance Policy
- Unit 16.15 - Residual Income:
- Unit 16.16 - Deductions Allowable [Section 57]
- Unit 16.17 - Deductions Not Allowable [Section 58]



## Key Learning Outcomes



- Identify Income Sources
- Understand Taxability of Different Incomes
- Learn Computation of Income
- Identify Allowable Deductions
- Understand Taxation Rules for Interest Income
- Knowledge of Rental Income Taxation
- Understand Treatment of Dividend Income
- Learn Taxation on Gifts and Windfall Gains
- Understand Treatment of Insurance Income
- Knowledge of Reporting and Compliance
- Apply Tax Planning Strategies

## Unit 16 - Income From Other Sources

### Unit Objectives

At The End of the Unit, You will Be Able To Understand:

1. Identification Of Income which Comes Under "Income From Other Source"
2. Eligible Deductions
3. Taxable Transactions without or Inadequate Considerations
4. Understanding of Ineligible Deductions
5. Computation of Tax on Casual Income
6. Computation of Income Chargeable Under This Head

## Incomes Chargeable Under, Income From Other Sources [Section 56]

## Unit 16.1 - Dividend income

Dividend means any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend, if it entails the release of all or any part of its assets. Meaning of "accumulated profits" is all profits of the company, up to the date of distribution or payment of dividend. Some terms relating to dividend are as follows:

**Dividend Declared** : Dividend declared by the company at its annual general meeting is deemed to be the income of the shareholder in the previous year in which it is so declared.

**Interim Dividend** : Interim dividend would be deemed to be the income of the previous year in which such dividend is unconditionally made available by the company to the members who is entitled to it.

## Unit 16.2 - Deemed Dividend

- Any distribution to its shareholders by a company of debentures, debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is deemed as dividend in the hands of the preference shareholder. Bonus shares given to equity shareholders are not treated as dividend.
- **Distribution on reduction of capital** : Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.
- **Advance or loan by a closely held company to its shareholder** : Any payment by a company in which the public are not substantially interested, of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.
- **Tax rate on dividend income** - Any income by way of dividends received by a resident from a company, whether domestic or foreign, is taxable in the hands of a resident shareholder at normal rates of tax. U/s 115BBDA, where the total income of a "specified assessee", resident in India, includes any income in aggregate exceeding ten lakh rupees, by way of dividends declared, distributed or paid by a domestic company.
  - The amount of income tax calculated on the income by way of such dividends in aggregate exceeding ten lakh rupees, at the rate of ten per cent; and
  - The amount of income tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income by way of dividends.



### Unit 16.3 - Casual Income

Casual income means income in the nature of winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort, gambling, betting etc. Any winning from lotteries, crossword puzzles race including horse races, card games and other games of any sort or from gambling or betting of any form or nature shall be chargeable to tax under Income from other sources. The entire income of winnings, with out any expenditure or allowance or deductions under Sections 80C to 80U. However, expenses relating to the activity of owning and maintaining race horse are allowable. Such winnings are chargeable to tax at a flat rate of 30% under section 115BB and tax is deductible at source 30% on such income in case it exceeds ₹ 10,000.

### Unit 16.4 - Income By Way of Interest on Securities

If the income by way of interest on securities is not chargeable to income tax under the head, "profits and gains of business or profession", then such income shall be taxable under 'income from other sources'. It is chargeable on "receipt" basis if books of accounts are maintained on "cash basis" however if books are maintained on "mercantile system" then interest is taxable on "accrual" basis.

### Unit 16.5 - Income From Hiring of Machinery, Etc.

Income from machinery, plant or furniture belonging to the assessee and let on hire; if the income is not chargeable to income tax under the head "profit and gains of business or profession" shall be taxable under income from other sources.

### Unit 16.6 - Hiring Out of Building With Machinery Etc. [Section 56(2) (iii)]

Where an assessee lets on hire machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income tax under the head "profits and gains of business or profession" shall be taxable under Income from other sources.

## Unit 16.7 - Share Premiums In Excess of The Fair Market Value To Be Treated as Income

Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be taxable under income from other sources.

## Unit 16.8 - Income By Way of Interest Received on Compensation Or on Enhanced Compensation Referred To in Clause (b) Of Section 145A Shall Be Chargeable To Tax Under Income From Other Sources. [Section 56(2) (viii)].

## Unit 16.9 - Advance Money Received

Any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset is chargeable to income tax under the head income from other sources, if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

## Unit 16.10 - Any Sum of Money or Value of Property Received Without Consideration or For Inadequate Consideration To Be Subject To Tax In The hands of The Recipient [Section 56(2)(x)]

- In order to prevent the practice of receiving sum of money or the property without consideration or for inadequate consideration, section 56(2)(x) brings to tax any sum of money or the value of any property received by any person without consideration or the value of any property received for inadequate consideration.
- Sum of Money: If any sum of money is received without consideration and the aggregate value of which exceeds ₹ 50,000, the whole of the aggregate value of such sum is chargeable to tax.



## Unit 16.11 - Immovable Property [Land or Building or Both]:

- **Without Consideration:** The stamp duty value of such property would be taxed as the income of the recipient if it exceeds ₹ 50,000
- **For Inadequate consideration:** If consideration is less than the stamp duty value of the property and the difference between the stamp duty value and consideration is more than the higher of:
  - ₹ 50,000 and
  - 10% of consideration,
 The difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the assessee as income from other sources.

In case immovable property, being a residential unit fulfilling the stipulated conditions mentioned below, is received for inadequate consideration from a person who holds such property as his stock-in-trade, then, only if the stamp duty value of the residential unit exceeds the sale consideration by 20% of the consideration or ₹ 50,000, whichever is higher, would the difference between the stamp duty value and the actual consideration be chargeable to tax in the hands of the recipient of immovable property. The benefit of higher threshold of 20% of consideration vis-à-vis 10% of consideration shall be available, subject to the satisfaction of following conditions:

- The residential unit is transferred during the period between 12th November, 2020 and 30th June, 2021;
- Such transfer is by way of first-time allotment of the residential unit and
- The consideration paid or payable as a result of such transfer  $\leq$  ₹ 2 crores.

## Unit 16.12 - Movable Property [Property, other than immovable property]:

If Movable Property is Received:

- **Without consideration:** The aggregate fair market value of such property on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000.
- **For inadequate consideration:** If the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient.

**Applicability of section 56(2)(x):** The provisions of section 56(2)(x) would apply only to property which is the nature of a capital asset of the recipient and not stock-in-trade, raw material or consumable stores of any business of the recipient. Therefore, only transfer of a capital asset, without consideration or for inadequate consideration would attract the provisions of section 56(2)(x).

## Gifts Taxability - Summary

| Sr. No. | Nature of Assets   | Taxable Value                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|---------|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1.      | Money              | The whole amount if the same exceeds ₹ 50,000.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| 2.      | Movable property   | <ul style="list-style-type: none"> <li>Without consideration: The aggregate fair market value of the property, if it exceeds ₹ 50,000.</li> <li>Inadequate consideration: The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| 3.      | Immovable property | <ul style="list-style-type: none"> <li>Without consideration: The stamp value of the property, if it exceeds ₹ 50,000</li> <li>Inadequate consideration: The difference between the stamp duty value and the consideration, if such difference is more than the higher of ₹ 50,000 and 10% of consideration.<br/>The difference between the stamp duty value and the consideration, if such difference is more than the higher of ₹ 50,000 and 20% of consideration, in case the immovable property is a residential unit which is held as stock-in-trade by the seller and the transfer is during the period between 12th November, 2020 and 30th June, 2021 by way of first-time allotment to the buyer and the consideration for transfer <math>\leq</math> ₹ 2 crores.</li> </ul> |

**Non-Applicability of Section 56(2)(x):** However, any sum of money or value of property received, in the following circumstances would be outside the ambit of section 56(2)(x):

- From any relative; or
- On the occasion of the marriage of the individual; or
- Under a will or by way of inheritance; or
- In contemplation of death of the payer or donor, as the case may be; or
- From any local authority; or
- From any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution; or
- From or by any trust or institution registered; or
- By any fund or trust or institution or any university or other educational institution or any hospital or other medical institution.
- From an individual by a trust created or established solely for the benefit of relative of the individual.
- From such class of persons and subject to such conditions, as may be prescribed.
- By an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19 subject to conditions notified by the central government.
- By a member of the family of a deceased person:
  - (A) From the employer of the deceased person (without any limit); or
  - (B) From any other person or persons to the extent that such sum or aggregate of such sums  $\leq$  ₹ 10 lakhs, where the cause of death of such person is illness related to COVID-19 and the payment is:
    - Received within 12 months from the date of death of such person; and
    - Subject to such other conditions notified by the central government.



**Illustration 1**

Mr. X, a dealer in shares, received the following without consideration during the P.Y. 2021-22 from his friend Mr. Y:

- Cash gift of ₹ 75,000 on his anniversary, 15th April, 2021.
- Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2021.
- A plot of land at Faridabad on 1st July, 2021, the stamp value of which is ₹ 5 lakhs on that date. Mr. Y had purchased the land in April, 2008.

Mr. X purchased from his friend Mr. Z, who is also a dealer in shares, 1000 shares of X Ltd. ₹ 400 each on 19th June, 2021, the fair market value of which was ₹ 600 each on that date. Mr. X sold these shares in the course of his business on 23rd June, 2021. Further, on 1st November, 2021, Mr. X took possession of property (office building) booked by him two years back at ₹ 20 lakhs. The stamp duty value of the property as on 1st November, 2021 was ₹ 32 lakhs and on the date of booking was ₹ 23 lakhs. He had paid ₹ 1 lakh by account payee cheque as down payment on the date of booking. On 1st March, 2022, he sold the plot of land at Faridabad for ₹ 7 lakhs. Compute the income of Mr. X chargeable under the head "Income from other sources" for A.Y. 2022-23.

**Solution**

Computation of "Income from other sources" of Mr. X for the A.Y. 2022-23

| Sr. No. | Particulars                                                                                                                                                                                                                                                                                                                                          | ₹               |
|---------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|
| 1.      | Cash gift is taxable under section 56(2)(x), since it exceeds ₹ 50,000                                                                                                                                                                                                                                                                               | 75,000          |
| 2.      | Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000                                                                                                                                                      | 60,000          |
| 3.      | Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(x)                                                                                                                                                                                                                                          | 5,00,000        |
| 4.      | Difference of ₹ 2 lakhs in the value of shares of X Ltd. purchased from Mr. Z, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. X. Since Mr. X is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. X. | -               |
| 5.      | Difference between the stamp duty value of ₹ 23 lakhs on the date of booking and the actual consideration of ₹ 20 lakhs paid is taxable under section 56(2)(x) since the difference exceeds ₹ 2,00,000, being the higher of ₹ 50,000 and 10% of consideration                                                                                        | 3,00,000        |
|         | <b>Income from Other Sources</b>                                                                                                                                                                                                                                                                                                                     | <b>9,35,000</b> |

**Illustration 2**

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) the Income tax Act, 1961:

- Akhil HUF received ₹ 75,000 in cash from his niece (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.
- Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.
- Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.
- Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.

## Solution

|    | Taxable/<br>Non-taxable | Amount liable<br>to tax (₹) | Reason                                                                                                                                                                                                                                                                                                                                                                                              |
|----|-------------------------|-----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1. | Taxable                 | 75,000                      | Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(x). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.                                                                                                                                                                        |
| 2. | Non-taxable             | Nil                         | Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).                                                                                                                      |
| 3. | Taxable                 | 55,000                      | As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹ 50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable. |
| 4  | Non-taxable             | Nil                         | Car is not included in the definition of property for the purpose under section 56(2)(x), therefore, the same shall not be taxable.                                                                                                                                                                                                                                                                 |

### Unit 7.13 - Compensation or Any Other Payment Received in Connection with Termination of His Employment [Section 56(2)(xi)]:

Any compensation or any other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to tax under this head.



### Unit 16.14 - Keyman Insurance Policy:

Any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if such income is not chargeable under the head "profits and gains of business or profession" or under the head "salaries" i.e., if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

### Unit 16.15 - Residual Income:

Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "income from other sources" e.g., salary received by an MPs/MLAs will not be chargeable to income tax under the head 'salary' but will be chargeable as "income from other sources" under section 56.

### Unit 16.16 - Deductions Allowable [Section 57]

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions:

- In case of dividend or income in respect of units of a mutual fund or income in respect of units of a specified company: Interest expenditure to earn such income is allowed as deduction subject to a maximum of 20% of such income included in the total income, without deduction under this section.
- In the case of interest on securities: Any reasonable sum paid by, way of commission or remuneration, to a banker or any other person for the purpose of realising such interest on behalf of the assessee.
- Income consists of recovery from employees as contribution to any provident fund etc. in terms of section 2(24)(x): A deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e., to the extent the contribution is remitted before the due date under the respective Acts.
- Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building. The following items of deductions are allowable in the computation of such income:
  - The amount paid on account of any current repairs to the machinery, plant, furniture or building.
  - The amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant, furniture or building.
  - The normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.
- In case of income in the nature of family pension: A deduction of a sum equal to 33-1/3 per cent of such income or ₹ 15,000, whichever is less, is allowable. For the purposes of this deduction, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

- In case of income by way of interest on compensation/ enhanced compensation received chargeable to tax under section 56(2)(viii): Deduction of 50% of such income. No deduction would be allowable under any other clause of section 57 in respect of such income.

## Unit 16.17 - Deductions Not Allowable [Section 58]

No deduction shall be made in computing the "income from other sources" of an assessee in respect of the following items of expenses:

- **In the Case of Any Assessee:**

- Any personal expense of the assessee;
- Any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source;
- Any payment chargeable to tax under the head "salaries", if it is payable outside India unless tax has been paid thereon or deducted at source.
- Any expenditure in respect of which a payment is made to a related person: In addition to these disallowances, section 58(2) specifically provides that the disallowance of any expenditure in respect of which a payment is made to a related person, to the extent the same is considered excessive or unreasonable by the assessing officer, having regard to the FMV and disallowance of payment or aggregate of payments exceeding ₹ 10,000 made to a person during a day otherwise than by account payee cheque or draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay covered by section 40A will be applicable to the computation of income under the head 'income from other sources' as well.
- Disallowance of 30% of expenditure: 30% of expenditure shall not be allowed, in respect of a sum which is payable to a resident and on which tax is deductible at source, if:
  - Such tax has not been deducted or
  - Such tax after deduction has not been paid on or before the due date of return specified in section 139(1).

- **No deduction in respect of any expenditure incurred in connection with casual income:**

No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income. The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.



## Summary

Income from Other Sources is a distinct head of income under the Indian Income Tax Act, which encompasses various types of income that do not specifically fall under the other heads of income such as salaries, house property, business or profession, and capital gains. This category typically includes earnings such as interest from bank deposits, dividends, lottery winnings, gifts, and rental income from machinery. It acts as a catch-all section to ensure that all income types are taxed, preventing any potential leakage in the tax framework. Taxation under this head is generally at the normal applicable rates unless specified otherwise by the law. Certain specific deductions are also allowed under this head, such as expenses incurred to earn that income. Moreover, some receipts like gifts above a certain threshold or income from lotteries and game shows are taxed at special rates or have specific rules regarding their taxability, highlighting the broad and inclusive approach of this category to encompass a variety of income sources.

## Exercise

Which category does 'Income from Other Sources' fall under in the Indian Income Tax Act?

- A) Salaries
- B) House property
- C) Business or profession
- D) A catch-all category for miscellaneous income
- Answer: D

What types of income typically fall under 'Income from Other Sources'?

- A) Salary and wages
- B) Rent from land
- C) Interest from bank deposits, dividends, and lottery winnings
- D) Capital gains
- Answer: C

How is income from other sources generally taxed?

- A) At a special rate for all types
- B) At the normal applicable rates
- C) Completely exempt from tax
- D) At a flat rate of 10%
- Answer: B

Are expenses incurred to earn income from other sources deductible?

- A) Yes, specific deductions are allowed
- B) No, no deductions are allowed
- C) Only if they exceed 50% of the income
- D) Only in the case of lottery income
- Answer: A

Which of the following is not typically categorized under 'Income from Other Sources'?

- A) Dividend income
- B) Income from freelance work
- C) Rental income from machinery
- D) Profits from a business
- Answer: D (Business profits fall under "Profits and Gains of Business or Profession")

What is the tax treatment for lottery winnings under 'Income from Other Sources'?

- A) Taxed at a special rate
- B) Exempt from tax
- C) Taxed at the normal rate
- D) Not considered taxable income
- Answer: A

How are gifts treated under this head of income?

- A) Always exempt from tax
- B) Taxed only if above a certain threshold
- C) Not taxable at any point
- D) Taxed only if from specific sources
- Answer: B

Which of the following income is not included under 'Income from Other Sources'?

- A) Rental income from own property
- B) Interest received on compensation or enhanced compensation
- C) Pension received
- D) Capital gains from sale of shares
- Answer: D (Capital gains fall under the "Capital Gains" head)

Are any special deductions applicable to children's income reported under 'Income from Other Sources'?

- A) Yes, a standard deduction is applicable
- B) No, it's taxed at the parent's rate without deductions
- C) Yes, but only if the child is a minor
- D) No, it's taxed as it is
- Answer: C (Income earned by minors may be clubbed with the income of the parent)

What is a necessary condition for deducting expenses under 'Income from Other Sources'?

- A) Expenses must be documented
- B) Expenses must be related to the earning of the taxable income
- C) Expenses must exceed 25% of the income
- D) No conditions, all expenses are deductible
- Answer: B

[illegible]



## 17. Aggregation Of Income; Set-Off, Or Carry Forward And Set-Off Of Losses

- Unit 17.1 - Aggregation of Income
- Unit 17.2 - Set Off and Carry Forward
- Unit 17.3 - Inter Source Adjustment (Section 70)
- Unit 17.4 - Inter Head Adjustment
- Unit 17.5 - Carry Forward & Set-Off of Loss from House Property [Section 71B]
- Unit 17.6 - Carry Forward and Set-Off of Business Losses [Sections 72]
- Unit 17.7 - Losses in Speculation Business [Section 73]
- Unit 17.8 - Carry Forward & Set off Of Losses Of Specified Business [Section 73a]
- Unit 17.9 - Losses Under the Head 'Capital Gains' [Section 74]
- Unit 17.10 - Losses from the Activity of Owning and Maintaining Race Horses [Section 74A (3)]
- Unit 17.11 - Order of Set-Off of Losses
- Unit 17.12 - Submission Of Return of Losses [SECTION 80]



## Key Learning Outcomes



- Understand Aggregation of Income
- Learn Set-Off of Losses
- Understand Carry Forward of Losses
- Identify Types of Losses
- Learn Inter-Source & Intra-Source Set-Off
- Knowledge of Reporting and Compliance
- Consider Impact on Tax Planning
- Recognise Anti-Avoidance Provisions
- Understand Legal Considerations

## Unit 17 - Aggregation Of Income; Set-Off, Or Carry Forward And Set-Off Losses

### Unit Objectives

At The End of The Unit, You Will Be Able To Understand:

1. Aggregation of Income
2. Set Off Same Head And Other Head of Income
3. Carry Forward The Loss For Future Years To Set Off
4. Order of Set off

## Unit 17.1 - Aggregation of Income

Under Income tax Act 1961 there are certain provisions as per which an income of, though legally belonging to one person, is to be included in the total income of another person. Term is also used to denote the adding together of the taxpayer's income from all sources in order to determine the applicable tax rate for income tax purpose. 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. These are discussed in detail in chapter 1. 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.

## Unit 17.2 - Set Off and Carry Forward

Specific provisions have been made in the Income tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

## Unit 17.3 - Inter Source Adjustment (Section 70)

**Inter-source set-off of losses:** Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

### Examples:

- Short-term capital loss of ₹ 1,00,000 can be adjusted against long-term capital gains of ₹ 1,50,000. Total Income under the head capital gains = ₹ 50,000/- (LTCG)
- Long-term capital loss of ₹ 1,00,000 can be adjusted against long-term capital gains of ₹ 1,20,000. Total income from capital gains = ₹ 20,000/- (LTCG)
- Long-term capital loss of ₹ 1,00,000 can't be adjusted against short-term capital gains of ₹ 1,40,000. Income under the head capital gains = ₹ 1,40,000 (STCG) & ₹ 1,00,000 losses of long-term which will be carried forward.



- Normal business loss of ₹ 6,00,000 can be adjusted against speculation income of ₹ 8 Lacs. Income under the head business = ₹ 2,00,000 which is speculation income.  
Normal business loss of ₹ 5 Lakhs can be adjusted against Section 35AD income of 4 Lakhs. Net result of PGBP head will be losses of ₹ 1 Lakh which will be adjusted against other heads of income.
- Impermissible inter-source set-off: Inter-source set-off, however, is not permissible in the following cases:
  - **Long-term capital loss [Section 70(3)]**  
Short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not against short-term capital gain.
  - **Speculation loss [Section 73(1)]**  
A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income. However, losses from other business can be adjusted against profits from speculation business.
  - **Loss from the activity of owning and maintaining race horses [Section 74A(3)]**  
Such loss can be set-off only against income from the activity of owning and maintaining race horses.
  - **Losses from Specified business [Section 73A(1)]**  
A loss in any specified business referred in section 35AD can be set-off only against any other specified business. However, losses from other business can be set-off against profits from specified business. It must be noted that loss from an exempt source cannot be set-off against profits from a taxable source of income.  
  
Example: Share of loss from a partnership firm cannot be set-off against business income, since share of income of the firm is exempt under section 10(2A).

## Unit 17.4 - Inter Head Adjustment

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

- Loss under any head other than capital gains: 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".
- Loss under the head "Profits and gains from business or profession": 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".
- Loss under the head "Capital Gains": 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.

- Loss under the head "Income from house property": Where the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the amount of such loss exceeding ₹ 2 lakhs would not be allowable to be set-off against income under the other head. In other words, the maximum loss from house property which can be set-off against income from any other head is ₹ 2 lakhs.
- Speculation loss, loss from the activity of owning and maintaining race horses and losses from specified business referred to in section 35AD cannot be set off against income under any other head.

**Illustration 1**

Mr. A (aged 35 years) submits the following particulars pertaining to the A.Y.2022-23:

| Particulars                      | Amount ₹     |
|----------------------------------|--------------|
| Income from salary (computed)    | 4,00,000     |
| Loss from self-occupied property | (-) 70,000   |
| Loss from let-out property       | (-) 1,50,000 |
| Business loss                    | (-) 1,00,000 |
| Bank interest (FD) received      | (-) 80,000   |

Compute the total income of Mr. A for the A.Y.2022-23, assuming that he does not opt for the provisions of section 115BAC.

**Solution**

Computation of total income of Mr. A for the A.Y.2022-23

| Particulars                                                                                                     | Amount ₹     | Amount ₹ |
|-----------------------------------------------------------------------------------------------------------------|--------------|----------|
| Income from salary                                                                                              | 4,00,000     |          |
| Less: Loss from house property of ₹ 2,20,000 to be restricted to ₹ 2,00,000 by virtue of section 71(3A)         | (-) 2,00,000 | 2,00,000 |
| Balance loss of ₹ 20,000 from house property to be carried forward to next assessment year.                     |              |          |
| Income from other sources (interest on fixed deposit with bank)                                                 | 80,000       |          |
| Business loss of ₹ 1,00,000 set-off to the extent of ₹ 80,000                                                   | (-) 80,000   |          |
| Business loss of ₹ 20,000 to be carried forward for set-off against business income of the next assessment year |              |          |
| Gross total income [See Note below]                                                                             |              | 2,00,000 |
| Less: Deduction under Chapter VI-A                                                                              |              | Nil      |
| Total income                                                                                                    |              | 2,00,000 |

**Notes:**

- Gross total income includes salary income of ₹ 2,00,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 20,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.
- Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.



## Unit 17.5 - Carry Forward & Set-Off of Loss from House Property [Section 71b]

- **Set-off and Carry Forward & Set-off of losses:** In any assessment year, if there is a loss under the head "Income from house property", such loss will first be set-off against income from any other head to the extent of ₹ 2,00,000 during the same year. The unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head "Income from house property".
- **Maximum period for carry forward & set-off of losses:** The loss under this head is allowed to be carried forward up to 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

In other words, loss from one house property can be adjusted against the income from another house property in the same assessment year. Thereafter, any loss under the head 'income from house property' can be set off against any income under any other head to the extent of ₹ 2,00,000 in the same assessment year. However, if after such set off, there is still any loss remaining to be set-off under the head "Income from house property", then, the same shall be carried forward to the next year.

**Note:** It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

## Unit 17.6 - Carry Forward and Set-Off of Business Losses [Sections 72]

Under the Act, the assessee has the right to carry forward the loss from business and profession in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years. Section 72 covers the carry forward and set-off of losses arising from a business or profession.

### Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:

- The loss should have been incurred in business, profession or vocation.
- The loss should not be in the nature of a loss in the business of speculation.
- Loss from one business can be carried forward & set-off against the income from any other business: The loss may be carried forward and set off against the income from same business or profession in which the loss was incurred. However, a loss carried forward cannot, under any circumstances, be set-off against the income from any head other than "profits and gains of business or profession".
- Person who incurred the loss alone is entitled to carry forward & set off the loss: The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward & set off the same. Consequently, the successor of a business cannot carry forward & set off the losses of his predecessor except in the case of succession by inheritance.

Maximum period for carry forward & set-off of losses: A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

### Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2021-22:

| Particulars                             | Amount ₹ |
|-----------------------------------------|----------|
| Income from salary (computed)           | 45,000   |
| Income from house property              | (24,000) |
| Income from non-speculative business    | (22,000) |
| Income from speculative business        | (4,000)  |
| Short-term capital losses               | (25,000) |
| Long-term capital gains taxable u/s 112 | 19,000   |

What is the total income chargeable to tax for the A.Y.2022-23, assuming that he does not opt for the provisions of section 115BAC?

### Solution

Total income of Mr. B for the A.Y. 2022-23.

| Particulars                                                                                                     | Amount ₹ | Amount ₹ |
|-----------------------------------------------------------------------------------------------------------------|----------|----------|
| Income from salaries                                                                                            | 45,000   |          |
| Income from house property                                                                                      | (24,000) | 21,000   |
| Profits and gains of business and profession                                                                    |          |          |
| Business loss to be carried forward [Note (i)]                                                                  | (22,000) |          |
| Speculative loss to be carried forward [Note (ii)]                                                              | (4,000)  |          |
| Capital Gains                                                                                                   |          |          |
| Long term capital gain taxable u/s 112                                                                          | 19,000   |          |
| Short term capital loss ₹ 25,000 set off against long-term capital gains to the extent of ₹ 19,000 [Note (iii)] | (19,000) |          |
|                                                                                                                 | Nil      |          |
| Balance short term capital loss of ₹ 6,000 to be carried forward [Note (iii)]                                   |          |          |
| Taxable income                                                                                                  |          | 21,000   |

### Notes:

- Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set off against business profits, if any.
- Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.
- Short term capital loss can be set off against both short term capital gain and long-term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gain to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.



## Unit 17.7 - Losses In Speculation Business [Section 73]

The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "profits and gains of business or profession".

- **Set-off and Carry forward & set-off of loss from speculation business:** Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years. Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.
- **Maximum period for carry forward & set-off of losses:** The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of the relevant assessment year in respect of which the loss was computed.
- **When a business of a company deemed to be carrying on a speculation business:** The explanation to this section provides that, where any part of the business of a company consists in the purchase and sale of the shares of other companies, such company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies:

- A company whose gross total income consists of mainly income chargeable under the heads "interest on securities", "income from house property", "capital gains" and "income from other sources";
- A company, the principal business of which is:
  - The business of trading in shares; or
  - The business of banking; or
  - The granting of loans and advances.

Thus, these companies would be exempted from the operation of this explanation. Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

## Unit 17.8 - Carry Forward & Set Off Of Losses Of Specified Businesses [Section 73A]

- **Set-off and carry forward & set-off of losses of specified business:** Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.
- **Loss can be set-off indefinitely:** There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

**Note -** The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with at least 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

## Unit 17.9 - Losses Under the Head 'Capital Gains' [Section 74]

**Carry forward & set-off of losses:** Section 74 provides that, for any assessment year, the net result under the head 'capital gains' is short term capital loss or long-term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

**Short-Term Capital Loss:** Where the loss so carried forward is a short-term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.

**Long-Term capital Loss:** Where the loss so carried forward is a long-term capital loss, it shall be set off only against long term capital gain arising in that year.

**Loss Under Head Capital Gains:** Net loss under the head capital gains cannot be set off against income under any other head.

**Maximum period for carry forward & set-off of loss:** Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

**Note- With effect from 1st April, 2018, the long-term capital gain exceeding ₹ 1,00,000 arising on sale of equity shares or units of equity-oriented fund or unit of business trust on which STT is paid:**

- In respect of equity shares, both at the time of acquisition and sale and
- In respect of units of equity-oriented fund or unit of business trust, at the time of sale is taxable under section 112A@10%. Long-term capital loss on sale of such shares/units can, therefore, be set-off and carried forward for set-off against long-term capital gains by virtue of section 70(3) and section 74.



**Illustration 3**

During the P.Y. 2021-22, Mr. C has the following income and the brought forward losses:

| Particulars                                | Amount ₹ |
|--------------------------------------------|----------|
| Short term capital gains on sale of shares | (96,000) |
| Long term capital loss of A.Y.2020-21      | (37,000) |
| Short term capital loss of A.Y.2021-22     | 75,000   |
| Long term capital gain u/s 112             | 1,50,000 |

What is the capital gain taxable in the hands of Mr. C for the A.Y.2022-23?

**Solution**

Taxable capital gains of Mr. C for the A.Y. 2022-23.

| Particulars                                                                                                                | Amount ₹ | Amount ₹ |
|----------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Short term capital gains on sale of shares                                                                                 | 1,50,000 |          |
| Less: Brought forward short-term capital loss of the A.Y.2021-22                                                           | (37,000) | 1,13,000 |
| Long term capital gain                                                                                                     | 75,000   |          |
| Less: Brought forward long-term capital loss of A.Y.2020-21<br>₹ 96,000 set off to the extent of ₹ 75,000 [See Note below] | (75,000) | Nil      |
| Taxable short-term capital gains                                                                                           |          | 1,13,000 |

**Note:** Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long-term capital loss of A.Y.2020-21 of ₹ 21,000 (i.e., ₹ 96,000 – ₹ 75,000) can be carried forward to the next year to be set-off against long-term capital gains of that year.

## Unit 17.10 - Losses From The Activity of Owning and Maintaining Race Horses [Section 74a(3)]

**Set-off and carry forward & set-off of loss:** According to the provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

**Maximum period for carry forward & set-off of losses:** Such loss can be carried forward for a maximum period of 4 assessment years for being set-off against the income from the activity of owning and maintaining race horses in the subsequent years.

## Meaning of Certain Terms:

| Term                                                                                         | Meaning                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Amount of loss incurred by the assessee in the activity of owning and maintaining racehorses | (i) In case assessee has no income by way of stake money – amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses.<br>(ii) In case assessee has income by way of stake money - The amount by which such income, by way of stake money falls short of the amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses. i.e., Loss = Stake money – revenue expenditure for the purpose of maintaining race horses. |
| Horse race                                                                                   | A horse race upon which wagering or betting maybe lawfully made.                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| Income by way of stake money                                                                 | The gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or anyone or more of the horses winning or being placed second or in any lower position in horse races.                                                                                                                                                                                                                                                                                                      |

## Illustration 4

Mr. D has the following Income for the P.Y.2021-22:

| Particulars                                                                                                | Amount ₹ |
|------------------------------------------------------------------------------------------------------------|----------|
| Income from the activity of owning and maintaining the race horses                                         | 75,000   |
| Income from textile business                                                                               | 85,000   |
| Brought forward textile business loss (relating to A.Y. 2022-23)                                           | 50,000   |
| Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2019-20) | 96,000   |

What is the total income in the hands of Mr. D for the A.Y. 2022-23?

## Solution

Total income of Mr. D for the A.Y. 2022-23.

| Particulars                                                                                                                                  | Amount ₹ | Amount ₹ |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Income from the activity of owning and maintaining race horses                                                                               | 75,000   |          |
| Less: Brought forward loss of ₹ 96,000 from the activity of owning and maintaining race horses set-off to the extent of ₹ 75,000             | 75,000   | Nil      |
| Balance loss of ₹ 21,000 (₹ 96,000 – ₹ 75,000) from the activity of owning and maintaining race horses to be carried forward to A.Y.2023-24. |          |          |
| Income from textile business                                                                                                                 | 85,000   |          |
| Less: Brought forward business loss from textile business                                                                                    | 50,000   | 35,000   |
| Total income                                                                                                                                 |          | 35,000   |

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.



## Unit 17.11 - Order of Set-Off of Losses

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected are as follows –

- Current year depreciation [Section 32(1)];
- Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed,
- Brought forward loss from business/profession [Section 72(1)];
- Unabsorbed depreciation [Section 32(2)];
- Unabsorbed capital expenditure on scientific research [Section 35(4)];
- Unabsorbed expenditure on family planning [Section 36(1)(ix)].

### Illustration 5

Mr. E has furnished his details for the A.Y.2022-23 as under:

| Particulars                           | Amount ₹ |
|---------------------------------------|----------|
| Income from salaries (computed)       | 1,50,000 |
| Income from speculation business      | 60,000   |
| Loss from non-speculation business    | (40,000) |
| Short term capital gain               | 80,000   |
| Long term capital loss of A.Y.2021-22 | (30,000) |
| Winning from lotteries (Gross)        | 20,000   |

What is the taxable income of Mr. E for the A.Y.2022-23?

### Solution

Computation of taxable income of Mr. E for the A.Y.2022-23.

| Particulars                              | Amount ₹ | Amount ₹ |
|------------------------------------------|----------|----------|
| Income from salaries                     |          | 1,50,000 |
| Income from speculation business         | 60,000   |          |
| Less: Loss from non-speculation business | (40,000) | 20,000   |
| Short-term capital gain                  |          | 80,000   |
| Winnings from lotteries                  |          | 20,000   |
| Taxable income                           |          | 2,70,000 |

- Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

## Unit 17.12 - Submission Of Return of Losses [Section 80]

As per section 80,

- Business loss under section 72(1),
- Speculation business loss under section 73(2),
- Loss from specified business under section 73A(2),
- Loss under the head "Capital Gains" under section 74(1) and
- Loss from activity of owning and maintaining race horses under section 74A(3),

Which has not been determined in pursuance of a return filed under section 139(3) cannot be carried forward and set-off. Thus, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off of such losses.

Such a return of loss should be filed within the time allowed under section 139(1). However, this condition does not apply to a loss from house property carried forward under section 71B and unabsorbed depreciation carried forward under section 32(2).

### Illustration 6

Compute the gross total income of Mr. F for the A.Y. 2022-23 from the information given below:

| Particulars                                                                      | Amount ₹ |
|----------------------------------------------------------------------------------|----------|
| Income from house property (computed)                                            | 1,25,000 |
| Income from business (before providing for depreciation)                         | 1,35,000 |
| Short term capital gains on sale of unlisted shares                              | 56,000   |
| Long term capital loss from sale of property (brought forward from A.Y. 2021-22) | (90,000) |
| Income from tea business                                                         |          |
| Dividends from Indian companies carrying on agricultural operations (Gross)      | 1,20,000 |
| Current year depreciation                                                        | 80,000   |
| Brought forward business loss (loss incurred six years ago)                      | 26,000   |
|                                                                                  | (45,000) |

### Solution

Gross Total Income of Mr. F for the A.Y. 2022-23

| Particulars                                            | Amount ₹ | Amount ₹ |
|--------------------------------------------------------|----------|----------|
| Income from house property (Computed)                  |          | 1,25,000 |
| Income from business                                   |          |          |
| Profits before depreciation                            | 1,35,000 |          |
| Less: Current year depreciation                        | 26,000   |          |
| Less: Brought forward business loss                    | 45,000   |          |
| Income from tea business (40% is business income)      | 64,000   |          |
| Capital gains                                          | 48,000   | 1,12,000 |
| Short term capital gains                               |          | 56,000   |
| Income from Other Sources                              |          |          |
| Dividend income (taxable in the hands of shareholders) |          | 80,000   |
| Gross Total Income                                     |          | 3,73,000 |

**Notes:**

- Dividend from Indian companies is taxable at normal rates of tax in the hands of resident shareholders.
- 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax.
- Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2021-22 cannot be set-off in the A.Y.2022-23, since there is no long-term capital gains in that year. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2023-24.

## Summary

The Income Tax Act provisions for “Set Off and Carry Forward” of losses allow taxpayers to manage losses efficiently across different sources and heads of income. Inter Source Adjustment under Section 70 permits the set-off of losses from one source against income from another within the same head of income. Following this, Inter Head Adjustment enables the set-off of losses from one head against income from another, optimizing tax liabilities across diverse income streams.



## Exercise

Specific sections detail the carry forward and set-off rules for various types of losses:

- Section 71B deals with losses from house property, which can be carried forward for set-off in subsequent years against income from house property.
- Section 72 addresses business losses, allowing them to be carried forward to offset future business income.
- Section 73 outlines the treatment of losses in speculative businesses, which are typically more restrictive due to their volatile nature.
- Section 73A focuses on losses from specified businesses, granting different conditions and time limits for carry forward.
- Section 74 pertains to losses under the head "Capital Gains," distinguishing between short-term and long-term capital gains for set-off purposes.
- Section 74A(3) specifically regulates losses from the activity of owning and maintaining race horses, recognizing the unique aspects of such activities.

The Order of Set-Off of Losses determines the sequence in which losses are to be adjusted, ensuring systematic and fair utilization of losses. Furthermore, Section 80 mandates the submission of a return of losses to carry forward certain losses, which is critical for compliance and to benefit from the provisions

What is the purpose of Inter Source Adjustment under Section 70?

- A) To set off losses from one head of income against another
- B) To allow losses from one source to be set off against income from another source within the same head
- C) To carry forward business losses indefinitely
- D) To exempt certain incomes from taxes
- Answer: B

Which section deals with the carry forward and set-off of losses from house property?

- A) Section 71B
- B) Section 72
- C) Section 73
- D) Section 74A
- Answer: A

What restriction applies to the set-off of losses in speculative businesses as per Section 73?

- A) Losses can be set off against any income
- B) Losses can only be set off against speculative gains
- C) There are no restrictions; losses are fully deductible
- D) Losses must be carried forward for a minimum of five years
- Answer: B

Under Section 74, what is differentiated when setting off capital gains losses?

- A) The type of asset
- B) The duration for which the asset was held
- C) Whether the asset was domestically or internationally based
- D) The taxpayer's tax bracket
- Answer: B

What is required by Section 80 in relation to the return of losses?

- A) The return must be filed to carry forward losses
- B) All losses must be reported on the return, regardless of their nature
- C) The return is only for declaring capital gains losses
- D) The taxpayer must file a return in the subsequent year to utilize the losses
- Answer: A

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## 18. Computation Of Total Income And Tax Liability Of Individuals

- Unit 18.1 - Meaning of Total Income
- Unit 18.2 - Income to be Considered While Computing Total Income of Individuals
- Unit 18.3 - Computation of Total Income and Tax Liability of Individuals





## Key Learning Outcomes



- Recognise Total Income Components
- Understand Gross Total Income Calculation
- Identify Deductions from Gross Total Income
- Learn Arriving at Total Income
- Understand Tax Slabs and Rates
- Knowledge to Apply Rebates and Relief
- Determine Computing Taxable Income & Tax Liability
- Understand Advance Tax and TDS
- Knowledge of Filing Income Tax Returns
- Apply Tax Planning Strategies

## Unit 18 - Computation Of Total Income And Tax Liability Of Individuals

### Unit Objectives

At the end of the unit, you will be able to understand:

1. Computation of taxable income and tax liability of an individual
2. Examine the applicability of the provisions of Alternate Minimum Tax (AMT)
3. Computation of tax liability of an individual
4. Compare the tax liability computed under the regular provisions of the Act with the tax liability computed under section 115BAC.

## Unit 18.1 - Meaning of Total Income

The total income of an individual is arrived at, after making deductions under Chapter VI-A (80 c to 80 u) from the gross total income. The gross total income is the aggregate of the income computed under the 5 heads of income, after giving effect to the provisions for clubbing the income and set-off and carry forward & set-off of losses.

**Total Income = Gross Total income - Chapter VI-A deductions (80 c to 80 u)**

**Computation of Total Income of..... for the A.Y. 2022-23**

| Particulars                                                                                                | Amount |
|------------------------------------------------------------------------------------------------------------|--------|
| Income from salaries                                                                                       | XXX    |
| Income from house property                                                                                 | XXX    |
| Income from profits and gains of business or profession                                                    | XXX    |
| Income from capital gains                                                                                  | XXX    |
| Income from other sources                                                                                  | XXX    |
| Gross Total Income                                                                                         | XXX    |
| Less: Deductions u/s 80C to 80U (subject to Max. of GTI before casual income, STCG covered u/s 111A& LTCG) | (XXX)  |
| Total income / taxable income (Rounded off u/s 288A)                                                       | XXX    |

## Unit 18.2 - Income to be Considered While Computing Total Income of Individuals

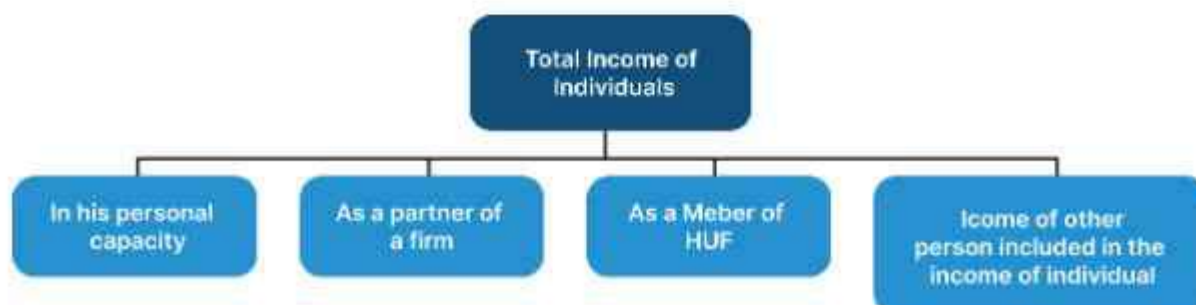


Fig 14.1

- **In his Personal Capacity**

Income from salaries, income from house property, profits and gains of business or profession, capital gains and income from other sources.

- **As a Partner of a firm**

|     |                                                                    |                                            |
|-----|--------------------------------------------------------------------|--------------------------------------------|
| i   | Salary, bonus etc. received by a partner                           | Taxable as his business income.            |
| ii  | Interest on capital and loans to the firm                          | Taxable as business income of the partner. |
| iii | Share of profit in the firm is exempt in the hands of the partner. |                                            |

The income mentioned in (i) and (ii) above are taxable to the extent that they are allowed as deduction to the firm.

- **As a Member of HUF**

|     |                                                                                                          |                                                                                       |
|-----|----------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|
| i   | Share of income of HUF exempt in the hands of the member.                                                |                                                                                       |
| ii  | Income from an impartible estate of HUF.                                                                 | Taxable in the hands of the holder of the estate who is the eldest member of the HUF. |
| iii | Income from self-acquired property converted into joint family property, without adequate consideration. | Taxable in the hands of transferor.                                                   |

- Income of other persons included in the income of the individual

- Transfer of income without transfer of assets.
- Income arising to transferee from a revocable transfer of an asset. (Not applicable if transfer is irrevocable. e.g., transfer of asset or income to any trust, such transfer is not revocable during the life time of the beneficiary).

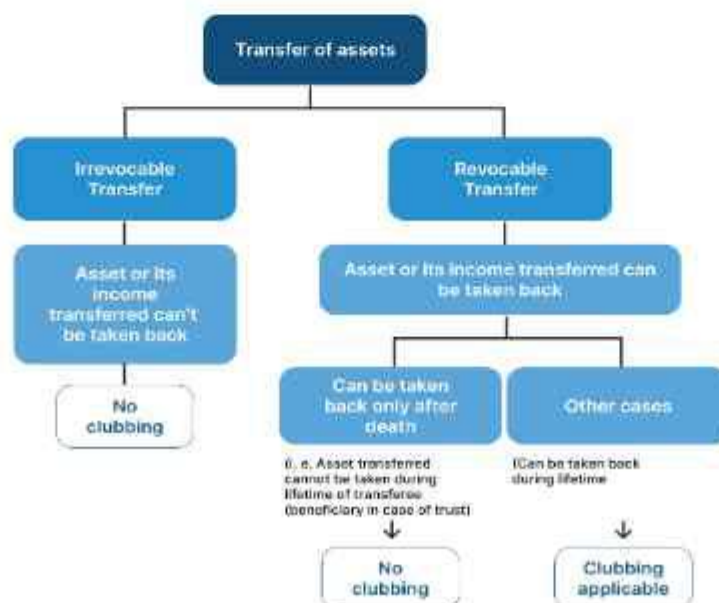


Fig 14.2



In cases (i) and (ii), income is includible in the hands of the transferor.

iii. Any salary, commission, fees or any other remuneration received by spouse from a concern in which other spouse has substantial interest.

iv. Income from assets transferred without adequate consideration.

v. Income from assets transferred without adequate consideration to son's wife or to any person for the benefit of son's wife.

vi. Income of minor child as mentioned in section 64(1A).

## Unit 18.3 - Computation of Total Income and Tax Liability of Individuals

Income tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income tax Act, 1961.

The procedure for computation of total income for the purpose of levy of income tax is detailed hereunder:

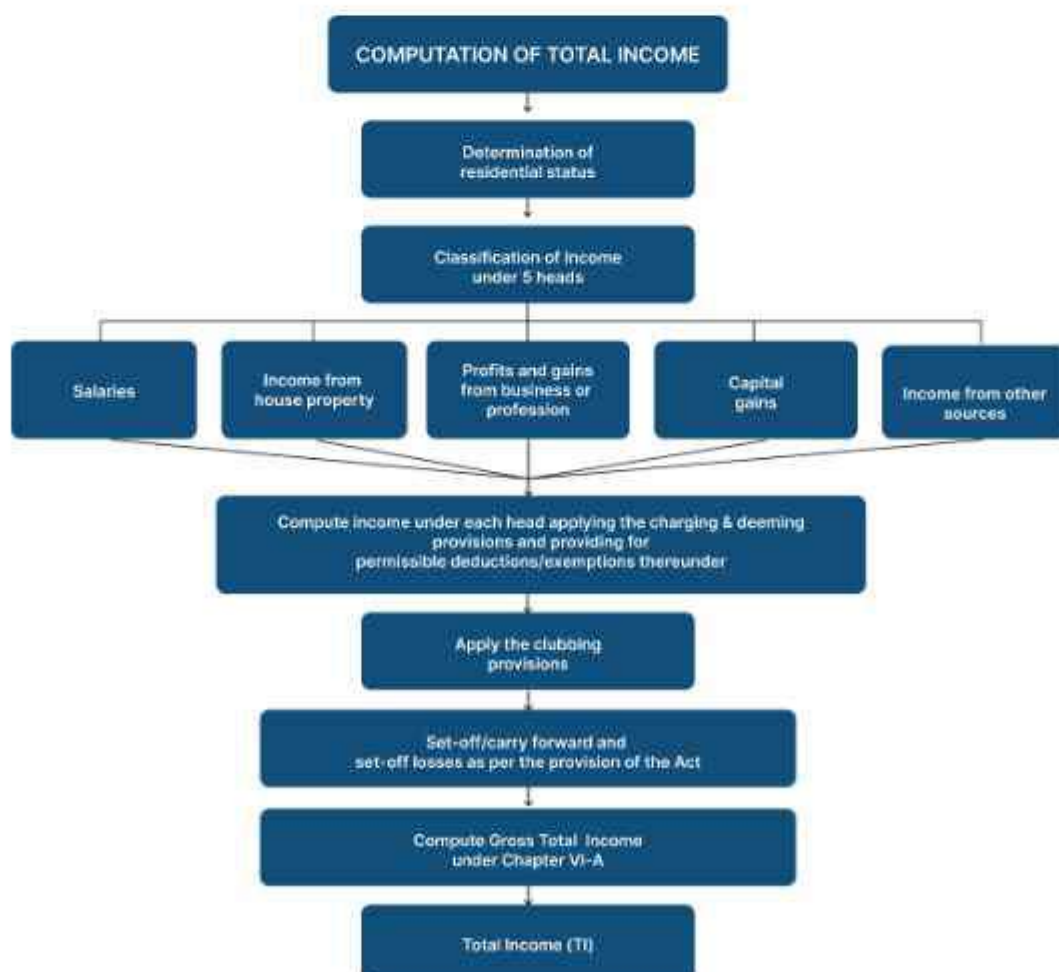


Fig 14.3

- **Step 1 – Determination of residential status**

- According to the Income Tax Act, 1961, the residential status of a person is one of the important criteria in determining the tax implications.
- In case of an individual, the duration for which he is present in India in relevant previous year and the earlier previous years, as the case may be, determines his residential status.

An individual/HUF can be either a;

- Resident and ordinarily resident
- Resident but not ordinarily resident
- Non-resident
- An individual who is a citizen of India, having total income, other than the income from foreign sources, exceeding ₹ 15 lakhs during the previous year, would be deemed resident in India in that previous year. Such deemed resident would be a resident but not ordinarily resident in India in that previous year.
- Persons, other than an individual and HUF, can be either resident or non-resident.
- An Indian company is resident in India. A company, not being an Indian company and having its place of effective management in India in a particular year, would be resident in India for that year.
- The residential status of a person determines the scope of his taxable income. For example, income which accrues outside India and is received outside India is taxable in the hands of a resident and ordinarily resident but is not taxable in the case of a non-resident.

- **Step 2 – Classification of income under different heads**

There are five heads of income, namely:



Fig 14.4

The income of a person should be identified and grouped under the respective head of income.

- **Step 3 – Computation of income under each head**

Assess the income under each head by:

- Applying the charging and deeming provisions.
- Excluding items of income relating to that head provided in section 10.  
(Section 10 of Income Tax Act, 1961 includes such income that does not form part of the total income while calculating the total tax liability of any person. These incomes are also known as exempted income.) There are certain incomes which are "wholly exempt from income tax" e.g., agricultural income. These incomes have to be excluded and will not form part of gross total income. Also, some incomes are "partially exempt from income tax" e.g., house rent allowance, education allowance. These incomes are excluded while computing income under the relevant head only to the extent of the limits specified in the Act.

- Allowing the permissible deductions under that head.  
For example, while calculating income from house property, municipal taxes paid by the owner and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income.
- Disallowing the non-permissible deductions.  
For example, while computing income under the head "profits and gains from business or profession" expenditure of personal nature and expenditure which is in the nature of offence are not allowable as deduction. Hence, such expenditure, if any, debited to profits and loss account, has to be added back while computing income under this head.  
While computing net consideration for capital gains, brokerage is a permissible deduction from gross sale consideration but, securities transaction tax paid is not permissible.
- **Step 4 – Clubbing of income of spouse, minor child etc.**
- Many taxpayers attempt to reduce their income tax liability by transferring their income and asset to their family member. An individual who has higher tax liability may have a tendency to divert his income to another person who is not subject to tax or who has lower tax liability.  
For example, an individual may open a fixed deposit in the name of his minor son, so that income from such deposit would accrue to his son, who does not have any other income.
- In order to prevent tax evasion, clubbing provisions have been incorporated in the income tax, under which income arising to certain persons (like spouse, son's wife etc.) have to be included in the income of the person who has diverted his income to such persons for the purpose of computing tax liability. Where the minor child's income (not being a minor child suffering from any disability of the nature specified in section 80U) has been clubbed in the total income of his/her parent, whose total income is higher before including minor's income. The exemption entitled to extent of such income or ₹ 1,500 whichever is less, in respect of each minor child whose income is so included (under section 10(32).
- **Step 5 – 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.  
For example, an individual may have profit from his let-out house property and loss from his self-occupied property. This loss can be set-off against the profits of the let-out property to arrive at the net income chargeable under the head "income from house property".

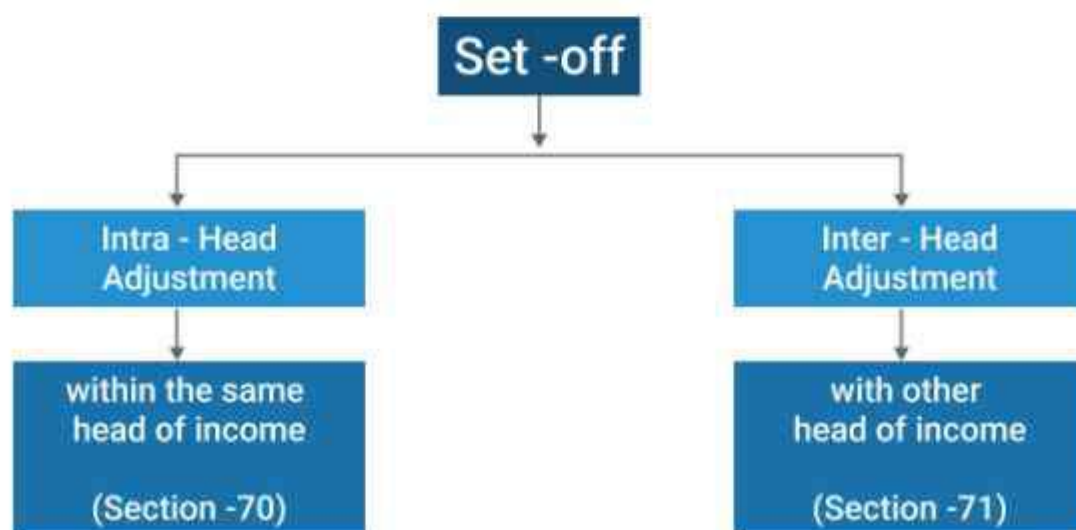


Fig 14.5



- **Inter-source set-off of losses (Intra Head adjustments)**

"A person may have income from one source and loss from another source under the same head of income".

Set-off of loss from one source against income from another source within the same head of income is permissible, subject to certain exceptions, like;

- Long-term capital loss cannot be set-off against short term capital gains.
- Short-term capital loss can be set-off against long-term capital gains.

- **Inter-head set-off of losses (Inter Head adjustments)**

Set-off of loss from one head (e.g., loss from house property) against income from another head (e.g., salaries) is also permissible, subject to certain exceptions, like;

- Business loss cannot be set-off against salary income;
- Loss under the head "capital gains" cannot be set-off against any other head of income.
- Loss under the head, house property can be set-off against income under any other head only to the extent of ₹ 2 lakhs.

- **Carry forward and set-off of losses**

Unabsorbed losses of the current year can be carried forward to the next year for set-off only against the respective head of income. For example, long-term capital loss which is carried forward can be set-off only against long-term capital gains and not short-term capital gains of a later year.

The maximum number of years up to which any particular loss can be carried forward is also provided under the Act.

- Business loss can be carried forward for a maximum of 8 assessment years to be set-off against business income.
- Loss from specified business referred to in section 35AD can be carried forward indefinitely for set-off against profits of any specified business.

- **Step 6 – Computation of Gross Total Income**

The income computed under each head, after adjusting the clubbing provisions and provisions for set-off and carry forward and set-off of losses, have to arrive at the gross total income.

The process of computing gross total income is:

Step 1: Add income computed under each head

Step 2: Apply clubbing provisions

Step 3: Apply the provisions for set-off and carry forward of losses.

- **Step 7 – Deductions from Gross Total Income**

Certain deductions are allowable from gross total income to arrive at the total income. These deductions contained in Chapter VI-A can be classified as:



| Section | Nature of Payment/Deposit                                                                                                     |                                           |
|---------|-------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|
| 80C     | Payment of life insurance premium, tuition fees of children, deposit in public provident fund, repayment of housing loan etc. | Deduction in respect of certain payments. |
| 80D     | Medical insurance premium paid by an individual/ HUF for the specified persons/ contribution to CGHS etc                      |                                           |
| 80E     | Payment of interest on educational loan taken for self or relative                                                            |                                           |
| 80QQB   | Royalty income of authors of certain books other than text books                                                              | Deduction in respect of certain incomes.  |
| 80RRB   | Royalty on patents                                                                                                            |                                           |
| 80TTA   | Interest on savings account with a bank, co-operative society and post office.                                                | Deduction in respect of other incomes.    |
| 80TTB   | Interest on deposit with a bank, co-operative society and post office in case of senior citizens                              |                                           |
| 80U     | Person with disability                                                                                                        | Other Deductions.                         |

These deductions are allowable subject to satisfaction of the conditions prescribed in the relevant sections. There are limits in respect of deduction under certain sections. The payments/incomes are allowable as deduction subject to such limits. For example, the maximum deduction:

|           |            |
|-----------|------------|
| u/s 80RRB | ₹ 3,00,000 |
| u/s 80TTA | ₹ 10,000   |
| u/s 80TTB | ₹ 50,000   |

• **Step 8 – Total income**

Computation of Tax Liability of Mr. X ..... for the A.Y. 2022-23

| Particulars                                                                                                 | Amount |
|-------------------------------------------------------------------------------------------------------------|--------|
| Salaries                                                                                                    | ***    |
| Income from house property                                                                                  | ***    |
| Profits and gains of business or profession                                                                 | ***    |
| Capital gains                                                                                               | ***    |
| Income from other sources                                                                                   | ***    |
| Gross Total Income                                                                                          | ****   |
| Less: Deductions u/s 80C to 80U (subject to Max. of GTI before casual income, STCG covered u/s 111A & LTCG) | ***    |
| Total Income / Taxable Income (Rounded off u/s 288A)                                                        | ****   |

Total income = GTI – Deductions under Chapter VI-A

Note: Total income should be rounded off to the nearest multiple of ₹10.

• **Step 9 – Application of the rates of tax on the total income**

The rates of tax are specified in the Finance Act.

For individuals, there is a slab rate and basic exemption limit.

Below 60 years of age Computation of Tax Liability of Mr. X ..... for the A.Y. 2022-24

| Particulars                                                 | Rate      | Details | Amount |
|-------------------------------------------------------------|-----------|---------|--------|
| Total Income other than STCG u/s 111A, LTCG & casual income |           |         |        |
| Up to 2,50,000                                              | Nil       | Nil     |        |
| Add: From 2,50,001 to * 5,00,000                            | 5%        | ****    |        |
| Add: From 5,00,001 to 10,00,000                             | 20%       | ****    |        |
| Add: Above 10,00,000                                        | 30%       | ****    |        |
|                                                             |           | ****    |        |
| Add: Tax on casual income                                   | 30%       | ****    | XYZ    |
| Add: Tax on LTCG                                            | 20% / 10% |         | ***    |
| Add: Tax on STCG covered u/s 111A                           | 15%       |         | ***    |
| Total tax liability before rebate and cess                  |           |         | PQR    |
| Less: Rebate u/s 87A                                        |           |         | **     |
|                                                             |           |         | STY    |
| Add: Surcharge                                              |           |         | **     |
|                                                             |           |         | ABC    |

- For individuals, there is a slab rate and basic exemption limit.
- Below 60 years of age

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 2,50,000                         | NIL                                                                             |
| 2. | Where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000  | 5% of the amount by which the total income exceeds ₹ 2,50,000                   |
| 3. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 12,500 plus 20% of the amount by which the total income exceeds ₹ 5,00,000    |
| 4. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,12,500 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |

- Senior citizens (being resident individuals of the age of 60 years or more but not more than 80 years)

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 3,00,000                         | NIL                                                                             |
| 2. | Where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000  | 5% of the amount by which the total income exceeds ₹ 3,00,000                   |
| 3. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 10,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000    |
| 4. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,10,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |

- Resident individuals of the age of 80 years or above

|    |                                                                           |                                                                                 |
|----|---------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| 1. | Where the total income does not exceed ₹ 5,00,000                         | NIL                                                                             |
| 2. | Where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | 20% of the amount by which the total income exceeds ₹ 5,00,000                  |
| 3. | Where the total income exceeds ₹ 10,00,000                                | ₹ 1,00,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000 |

#### Notes

- Companies and firms are subject to a flat rate of tax, without any basic exemption limit.
- The rates of tax have to be applied on the total income to compute the tax liability.
- Rates of tax in respect of certain income are provided under the Income tax Act, 1961 itself.

| Particulars                                                   | Rates of tax |
|---------------------------------------------------------------|--------------|
| Long term capital gains on certain assets (u/s 112)           | 20%          |
| Long-term capital gains on other assets (u/s 112A)            | 10%          |
| Short-term capital gains (u/s 111A)                           | 15%          |
| Winnings from lotteries, crossword puzzles, races (u/s 115BB) | 30%          |

Under section 112A, long term capital gains exceeding ₹ 1,00,000 on transfer of equity shares of a company or unit of equity-oriented fund or a unit of a business trust is taxable @10%.

The special rates of tax have to be applied on the respective component of total income and the general slab rates have to be applied on the balance of total income after adjusting the basic exemption limit.



The unexhausted basic exemption limit can, however, be adjusted against long-term capital gains taxable under section 112/112A and short-term capital gains taxable under section 111A in case of resident individual or HUF.

- **Step 10 – Rebate under section 87A**(where total income  $\leq$  ₹5,00,000)/**Surcharge**(where total income  $>$  ₹ 50,00,000)
- **Rebate under section 87A:** In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose "total income does not exceed ₹5,00,000. The rebate shall be equal to, the amount of income tax payable on the total income for any assessment year or an amount of ₹ 12,500, whichever is less.
- However, rebate under section 87A is not available in respect of tax payable @10% on long-term capital gains taxable under section 112A.
- **Surcharge:** Surcharge is an additional tax payable over and above the income tax. Surcharge is levied as a percentage of income tax.
- **Individual/HUF/AOP/BOI/Artificial juridical person** (the rate of surcharge applicable would be as follows):

| Total Income                                               | Rate of Surcharge |
|------------------------------------------------------------|-------------------|
| Total income does not exceed 50 lakhs                      | Nil               |
| Total income exceeds 50 lakhs but does not exceed 1 crore  | 10% of tax        |
| Total income exceeds 1 crore but does not exceed 2 crores  | 15% of tax        |
| Total income exceeds 2 crores but does not exceed 5 crores | 25% of tax        |
| Total income exceeds 5 crores                              | 37% of tax        |

**Note:** Where the total income includes dividend, any income chargeable u/s 111A, 112 and 112A, the surcharge on the amount of income tax computed on that part of income shall not exceed 15%. In other words, surcharge higher than 15% is applicable only on tax on income other than dividend, income covered u/s 111A, 112 and 112A.

An AOP consisting of only companies as members

|                                                      |                                                                                 |
|------------------------------------------------------|---------------------------------------------------------------------------------|
| Total income $>$ ₹ 50 lakhs but is $\leq$ ₹ 1 crore. | Surcharge is payable at the rate of 10% of income tax computed on total income  |
| Total income $>$ ₹ 1 crore                           | Surcharge is payable at the rate of 15% of income tax computed on total income. |



• **Step 11– Health and Education cess (HEC) on Income tax**

The income tax is to be increased by health and education cess @4% on income tax plus surcharge/ minus rebate under section 87A, wherever applicable. This cess is payable by all assesseees who are liable to pay income tax irrespective of their level of total income.

**Total Tax Liability of an individual** = Total Tax Liability of an individual + Surcharge, (at applicable rates, if total income > ₹ 50 lakhs), or rebate u/s 87A, (if total income ≤ ₹ 5 lakhs) + HEC @4%.

• **Step 12 – Alternate Minimum Tax (AMT) u/s 115JC**

• Applicable to

All assessee (other than company) who has claimed any deduction under:

- Sec. 80H to Sec. 80RRB (other than sec. 80P); or
- Sec. 10AA
- Sec. 35AD

• **Exception:**

The provisions of AMT would, however, not be applicable to an individual, HUF, AOPs, BOIs, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹20 lakhs [Section 115JEE(2)].

**Note:**

- The exception is not applicable in case of firm and limited liability partnership. That means, AMT is applicable on LLP / Firm (claiming deduction under aforesaid section) even though adjusted total income does not exceed ₹ 20 lakhs.
- The provisions of this section shall not apply to a person who has exercised the option referred to in sec. 115BAC or 115BAD [alternative tax regime].

|               |                                                                                                   |                 |      |
|---------------|---------------------------------------------------------------------------------------------------|-----------------|------|
| <b>Step 1</b> | Compute regular income tax liability (before Cess) of the assessee covered under these provisions | A               | ***  |
| <b>Step 2</b> | Compute Adjusted Total income of the assessee i.e.                                                |                 | ***  |
|               | Total income of the assessee                                                                      | ***             | B    |
|               | Add:                                                                                              |                 |      |
|               | Deduction claimed u/s 80H to sec. 80RRB (other than sec. 80P)                                     | ***             | C    |
|               | Deduction claimed u/s 35AD less Depreciation u/s 32                                               | ***             | D    |
|               | Deduction u/s 10AA                                                                                | ***             | E    |
|               | Adjusted Total Income                                                                             | ***             | F    |
| <b>Step 3</b> | Compute Alternate Minimum Tax (AMT) [Being 18.5% of Adjusted Total Income]                        | G = F*18.5%     | ***  |
| <b>Step 4</b> | Income Tax liability                                                                              | Higher of A & G | ***  |
|               | Add: Health & Education Cess                                                                      |                 | **   |
|               | Tax liability after Cess                                                                          |                 | **** |

**Note:**

- If 'C', 'D' and 'E' is zero, then these provisions are not applicable to any assessee.
- If 'F' does not exceed ₹ 20 lakh, then these provisions are not applicable in case of an Individual/HUF/AOP/BOI/Artificial juridical person. However, the provision is applicable on LLP/Firm.

If AMT is greater than tax computed as per regular provisions, then the adjusted total income would be deemed to be the total income. (When Step 3 is higher in value than Step 1)

|                                   |                                                                                                           |
|-----------------------------------|-----------------------------------------------------------------------------------------------------------|
| In case of an individual          | Alternate minimum tax would be 18.5% of adjusted total income plus surcharge, if applicable, and HEC @4%. |
| In case of a co-operative society | Alternate minimum tax would be 15% of adjusted total income plus surcharge, if applicable, and HEC @4%.   |

**Tax credit for AMT [Section 115JD]**

Normal amount of tax payable is less than the tax amount payable under AMT. Any difference between normal taxpayer and tax paid with respect to AMT is allowed as an AMT credit. Such tax credit shall be carried forward and set-off against income tax payable in the later year to the extent of excess of regular income tax payable under the provisions of the Act over the AMT payable in that year.

Tax Credit allowable even if adjusted total income does not exceed ₹ 20 lakhs in the year of set-off [Section 115JEE(3)]

- AMT credit can be carried forward for set-off upto a maximum period of 15 assessment years succeeding the assessment year in which the credit becomes allowable.

**Note:** The provisions of the Income tax Act, 1961 relating to advance tax, interest under sections 234A, 234B and 234C etc., shall also apply to an assessee paying alternate minimum tax.

- **Step 13 – Examine whether or not to exercise the option under section 115BAC for availing concessional tax slab rates**
- **Option to pay income tax at concessional tax slab rates**  
As per section 115BAC, individuals or HUFs have an option to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB etc.,) at the following concessional rates, if they do not avail certain exemptions/deductions like LTC, standard deduction under the head "salaries", interest on housing loan on self-occupied property, deductions under Chapter VI-A (other than 80CCD(2) or section 80JJAA), set-off of brought forward loss or depreciation, if they relate to any of the above deductions, set-off of loss from house property against income under any other head, etc.

|                                 |     |
|---------------------------------|-----|
| Upto ₹ 2,50,000                 | Nil |
| From ₹ 2,50,001 to ₹ 5,00,000   | 5%  |
| From ₹ 5,00,001 to ₹ 7,50,000   | 10% |
| From ₹ 7,50,001 to ₹ 10,00,000  | 15% |
| From ₹ 10,00,001 to ₹ 12,50,000 | 20% |



|                                 |     |
|---------------------------------|-----|
| From ₹ 12,50,001 to ₹ 15,00,000 | 25% |
| Above ₹ 15,00,000               | 30% |

AMT liability not attracted: Individuals or HUFs exercising option u/s 115BAC are not liable to alternate minimum tax u/s 115JC.

- Conditions to be satisfied for availing concessional rates of tax:
- Certain deductions/exemptions not allowable for new tax regime or Concessional rate of Tax u/s 115BAC:

Section 115BAC(2) provides that while computing total income, the following deductions/exemptions would not be allowed, if an individual or HUF opts for concessional rates of taxes under section 115BAC(1):

|                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10(5)                              | Leave travel concession                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 10(13A)                            | House rent allowance                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 10(14)                             | Exemption in respect of special allowances or benefit to meet expenses relating to duties or personal expenses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| 10(17)                             | Daily allowance of MPs and MLAs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 10(32)                             | Exemption in respect of income of minor child included in the income of parent                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| 10AA                               | Tax holiday for units established in SEZ                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| 16                                 | <ul style="list-style-type: none"> <li>• Standard deduction under the head "salaries"</li> <li>• Entertainment allowance</li> <li>• Professional tax</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 24(b)                              | Interest on loan in respect of self-occupied property                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| 32(1) (iia)                        | Additional depreciation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 35(1)(ii), (iia), (iii) or 35(2AA) | Deduction in respect of contribution to <ul style="list-style-type: none"> <li>• Notified approved research association/ university/ college/ other institutions for scientific research [Section 35(1)(ii)]</li> <li>• Approved Indian company for scientific research [Section 35(1)(iia)] - notified approved research association/ university/ college/ other institutions for research in social science or statistical research [Section 35(1)(iii)]</li> <li>• An approved National laboratory/ university/ IIT/ specified person for scientific research undertaken under an approved programme [Section 35(2AA)]</li> </ul> |
| 35AD                               | Investment linked tax incentives for specified businesses                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 57(iia)                            | Deduction in respect of family pension                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| 80C to 80U                         | Deductions under Chapter VI-A<br>Other than:<br>Employers' contribution towards NPS under section 80CCD(2)<br>deduction in respect of employment of new employees under [section 80JJAA]                                                                                                                                                                                                                                                                                                                                                                                                                                             |

- **Certain losses not allowed to be set-off:**
  - Any losses carried forward or depreciation, if such loss or depreciation is attributable to any of the deductions mentioned above.
  - Under the head house property or any other income
- **Depreciation or additional depreciation:**
  - Depreciation in respect of any block of assets entitled to more than 40%, would be restricted to 40% on the written down value of such block of assets.
  - Additional depreciation under section 32(1)(iia) also cannot be claimed.
- **Exemption or deduction for allowances or perquisite:**  
Any exemption or deduction for allowances or perquisite, provided under any other law, for the time being, forced in India would not be allowed.
- **Time limit to exercise the option:**  
The concessional rate would be applicable only if option is exercised in the prescribed manner:

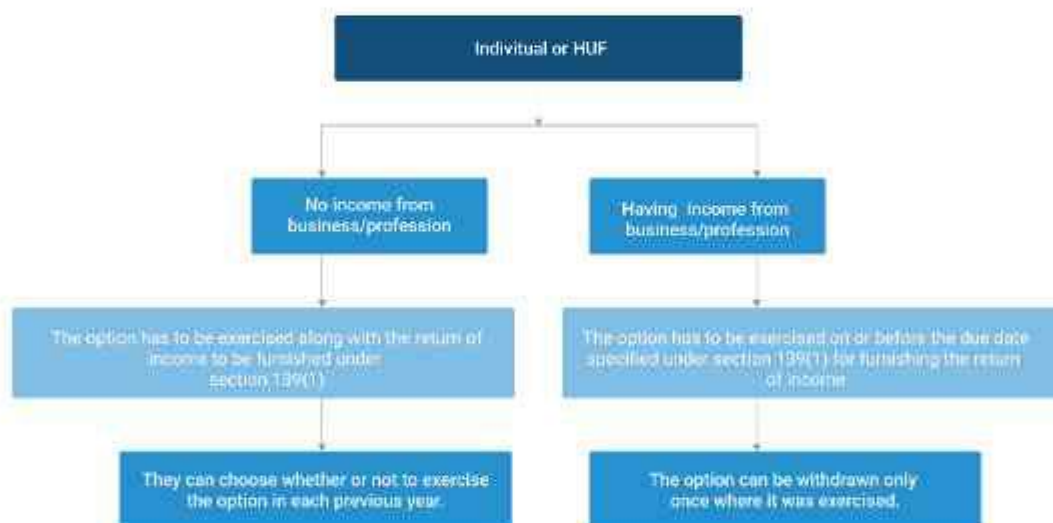


Fig 14.6

- **Consequences for failure to satisfy conditions mentioned in section 115BAC(2):**



Fig 14.7



- **Step 14 – Credit for advance tax, TDS and TCS**

- Tax is deductible at source at the time of payment of salary, rent, interest, fees for professional services, royalty etc. The payer has to deduct tax at source at the rates specified in the respective sections. The payer has to deduct tax at source at the rates specified in the respective sections.
- Tax is collectible by the seller in case of certain goods at the rate specified in the respective section. Credit of such tax collection at source is allowable to determine the tax liability.
- Payment of advance tax in instalments during the previous year itself on the basis of estimated income, if the tax payable, after reducing TDS/TCS, is ₹ 10,000 or more.
- Both Corporate and non-corporate assessee are required to pay advance tax in four instalments.

| Due Date                    | % of Advance Tax Payable |
|-----------------------------|--------------------------|
| On or before 15th June      | 15%                      |
| On or before 15th September | 45%                      |
| On or before 15th December  | 75%                      |
| On or before 15th March     | 100%                     |

**Note:** Assessee opting for presumptive provisions under section 44AD or under section 44ADA can, however, pay the entire advance tax on or before 15th March of the financial year.

**Tax payable = Total tax liability - TDS - TCS - Advance tax paid**

- **Step 15 – Tax payable/ Tax refundable**

- Tax payable should be rounded off to the nearest multiple of ₹ 10.
- The assessee has to pay the amount of tax payable (called self-assessment tax) at the time of filing of the return.
- If any refund is due, assessee will get the same after filing the return of income.

**Illustration 1**

Determine the tax liability of Mr. Amal, who is a handicap, for the A.Y.2022-23:

| Particulars                            | Amount ₹ |
|----------------------------------------|----------|
| Net salary                             | 2,85,000 |
| Annual value of let-out house property | 60,000   |
| Lottery income                         | 50,000   |
| Taxable business & profession income   | 50,000   |
| He paid LIC premium                    | 10,000   |

Mr. Amal deposited in LIC annuity plan ₹ 12,000 & paid medical insurance premium ₹ 5,000.

**Solution:**

Computation of Total Income of Mr. Amal for the A.Y. 2022-23

| Particulars                                           | Amount ₹ |                 |
|-------------------------------------------------------|----------|-----------------|
| Income from Salary                                    | -        | 2,85,000        |
| Income from House property                            |          |                 |
| Annual value of let-out house property:               | 60,000   |                 |
| Less: Standard deduction u/s 24(a) (30 % of NAV):     | (18,000) |                 |
|                                                       |          | 42,000          |
| Income from Profits & gains of business or profession | -        | 50,000          |
| Income from other sources                             |          |                 |
| Lottery income:                                       | 50,000   | 50,000          |
| <b>Gross Total Income</b>                             |          | <b>4,27,000</b> |
| Less: Deductions under Chapter VI-A                   |          |                 |
| 80C (LIC Premium)                                     | 10,000   |                 |
| 80CCC (Deposit in LIC annuity plan)                   | 12,000   |                 |
| 80D (Medical insurance premium paid)                  | 5,000    |                 |
| 80U (Assessee is handicap)                            | 75,000   |                 |
|                                                       |          | 1,02,000        |
| <b>Total Income</b>                                   |          | <b>3,25,000</b> |
| Tax Liability on Lottery income (u/s 115BB) @ 30 %    | 15,000   | 15,000          |
| Tax Liability on Other Income (Note 1)                |          |                 |
| Upto ₹ 2,50,000                                       | Nil      |                 |
| From ₹ 2,50,001 to ₹ 2,75,000 @ 5%                    | 1,250    | 1,250           |
| <b>Tax Liability</b>                                  |          | <b>16,250</b>   |
| Less: Rebate u/s 87A                                  |          | 12,500          |
|                                                       |          | 3,750           |
| Add: 4 % Health & Education cess (3,750 * 4%)         |          | 150             |
| <b>Tax and cess payable</b>                           |          | <b>3,900</b>    |

(Note 1) Income other than casual income (Lottery income (u/s 115BB) ₹ 2,75,000 (being ₹3,25,000 – ₹ 50,000) on which slab is applicable.

**Illustration 2**

- Compute taxable income and tax liability of Arun from the following information:
- He is working with X Ltd. for a basic of ₹ 24,000 p.m. and dearness allowance
- ₹ 2,000 p.m. bonus ₹ 50,000
- He and his employer contribute to RPF @ 6% of salary.
- His income from business & profession is ₹ 52,000
- During the year, interest on fixed deposit ₹ 5,000
- LIC premium paid ₹ 4,000

**Solution:**

Computation of Total Income of Arun for the A.Y. 2022-23

| Particulars                                           | Amount ₹        |                 |
|-------------------------------------------------------|-----------------|-----------------|
| Income from Salary                                    |                 |                 |
| Basic                                                 | 2,88,000        |                 |
| Dearness allowance                                    | 24,000          |                 |
| Bonus                                                 | 50,000          |                 |
| Employer's contribution to RPF                        | Nil             |                 |
| <b>Gross Salary</b>                                   | <b>3,62,000</b> |                 |
| Less: Standard Deduction u/s 16(ia)                   | 50,000          | 3,12,000        |
| Income from Profits & gains of business or profession |                 | 52,000          |
| Income from other sources                             |                 |                 |
| Interest on Fixed deposit                             |                 | 5,000           |
| <b>Gross Total Income</b>                             |                 | <b>3,69,000</b> |
| Less: Deductions under Chapter VI-A                   |                 |                 |
| 80C Deductions                                        |                 |                 |
| ‡ LIC Premium                                         | 4,000           |                 |
| ‡ Employees contribution to RPF (6% of basic and DA)  | 18,720          | 22,720          |
| <b>Total Income</b>                                   |                 | <b>3,46,280</b> |
| Tax Liability on income                               |                 |                 |
| Upto ₹ 2,50,000                                       | Nil             |                 |
| From ₹ 2,50,001 to ₹ 3,46,280 @ 5%                    | 4,814           | 4,814           |
| <b>Tax Liability</b>                                  |                 | <b>4,814</b>    |
| Less: Rebate u/s 87A                                  |                 | 4,814           |
|                                                       |                 | Nil             |
| Add: 4 % Health & Education cess                      |                 | Nil             |
| <b>Tax and cess payable</b>                           |                 | <b>Nil</b>      |

**Illustration 3**

Raghu (aged 67 years) is an employee of a government organisation at Kochi. During the year ending 31st March, 2022, he received the following income from his employer:

Salary ₹ 20,000 p.m.

Dearness allowance ₹ 4,000 p.m.

Entertainment allowance ₹ 6,500 p.m.

Annual bonus ₹ 20,000

Rent-free unfurnished accommodation of which licence fee is ₹ 30,000 whereas fair rental value is ₹ 1,00,000.

Find his taxable income and tax liability for the assessment year 2022-23 on the basis of the following further information:

- His own contribution to a provident fund is ₹ 30,000 and his employer's contributed the same amount.
- He pays life insurance premium ₹ 30,000 p.a.

Solution:

Computation of Total Income of Raghu for the A.Y. 2022-23

| Particulars                                               | Amount ₹ |                 |
|-----------------------------------------------------------|----------|-----------------|
| Income from Salary                                        |          |                 |
| Basic                                                     | 2,40,000 |                 |
| Dearness allowance                                        | 48,000   |                 |
| Entertainment allowance                                   | 78,000   |                 |
| Bonus                                                     | 20,000   |                 |
|                                                           | 3,86,000 |                 |
| Perquisite u/s 17(2):                                     |          |                 |
| Rent free accommodation                                   | 30,000   |                 |
| Employer's contribution to PF                             | Nil      |                 |
| <b>Gross Salary</b>                                       |          | <b>4,16,000</b> |
| Less: Deduction u/s                                       |          |                 |
| 16(ia) Standard Deduction                                 | 50,000   |                 |
| 16(ii) Entertainment allowance (Least of the followings): | 5,000    |                 |
| 20% of basic : 48,000                                     |          |                 |
| : Maximum limit : 5,000                                   |          |                 |
| : Actual amount : 78,000                                  |          | 55,000          |
| <b>Gross Total Income</b>                                 |          | <b>3,61,000</b> |
| Less: Deductions under Chapter VI-A                       |          |                 |
| 80C Deductions:                                           |          |                 |
| Employees contribution to PF                              | 30,000   |                 |
| Life insurance premium                                    | 30,000   | 60,000          |
| <b>Total Income</b>                                       |          | <b>3,01,000</b> |

|                                          |     |            |
|------------------------------------------|-----|------------|
| Tax Liability on income (Senior citizen) |     |            |
| Upto ₹ 3,00,000                          | Nil |            |
| From ₹ 3,00,001 to ₹ 3,01,000 @ 5%       | 50  | 50         |
| <b>Tax Liability</b>                     |     | <b>50</b>  |
| Less: Rebate u/s 87A                     |     | 50         |
|                                          |     | Nil        |
| Add: 4 % Health & Education cess         |     | Nil        |
| <b>Tax and cess payable</b>              |     | <b>Nil</b> |



**Illustration 4**

Rohith 45 years, has provided following details relating to his income for the previous year 2021-22: Income from business ₹ 15,00,000. Income from saving bank interest ₹ 12,000. Interest on PPF ₹ 36,000. Investment in PPF ₹ 1,50,000. You are requested to compute his tax liability and advise him whether he should opt for alternative tax regime u/s 115BAC.

**Solution:**

Computation of Income and tax liability of Mr. Rohith for A.Y. 2022-23

| Particulars                                                              | Regular Tax Regime ₹ | Alternative Tax Regime ₹ |
|--------------------------------------------------------------------------|----------------------|--------------------------|
| Income from profits & gains of business or profession                    | 15,00,000            | 15,00,000                |
| Income from other source                                                 |                      |                          |
| Interest on saving bank deposit                                          | 12,000               | 12,000                   |
| Interest on PPF                                                          | Exempt               | Exempt                   |
| Gross Total Income                                                       | 15,12,000            | 15,12,000                |
| Less: Deduction                                                          |                      |                          |
| U/s 80C (PPF Contribution)                                               | 1,50,000             | NA                       |
| U/s 80TTA (Interest on Saving Bank Interest*) (*Maximum limit Rs 10,000) | 10,000               | NA                       |
| Total Income                                                             | 13,52,000            | 15,12,000                |
| Tax on above                                                             | 2,18,100 (N-i)       | 191100 (N-ii)            |
| Less: Rebate u/s 87A                                                     | NA                   | NA                       |
| Add: Surcharge                                                           | Nil                  | Nil                      |
| Tax and surcharge                                                        | 2,18,100             | 1,91,100                 |
| Add: Health & Education cess                                             | 8,724                | 7,644                    |
| Tax liability (Rounded off u/s 288B)                                     | 2,26,820             | 1,98,740                 |

In the above case, tax liability under alternative tax regime u/s 115BAC is lower, hence it is advisable to opt for provision of sec. 115BAC.

**Working Note**

| (N-i)                           |          | (N-ii)                         |          |
|---------------------------------|----------|--------------------------------|----------|
| Up to ₹ 2,50,000                | Nil      | Up to ₹ 2,50,000               |          |
| ₹ 2,50,000 – ₹ 5,00,000 @ 5%    | 12,500   | ₹ 2,50,000 – ₹ 5,00,000 @5%    | 12,500   |
| ₹ 5,00,001 – ₹ 10,00,000 @ 20%  | 1,00,000 | ₹ 5,00,001 – ₹ 7,50,000 @10%   | 25,000   |
| ₹ 10,00,001 - ₹ 13,52,000 @ 30% | 1,05,600 | ₹ 7,50,001 - ₹ 10,00,000 @15%  | 37,500   |
|                                 |          | ₹ 10,00,001 - ₹ 12,50,000 @20% | 50,000   |
|                                 |          | ₹ 12,50,001 - ₹ 15,00,000 @25% | 62,500   |
|                                 |          | ₹ 15,00,000- ₹ 15,12,000 @30%  | 3600     |
| Total                           | 2,18,100 | Total                          | 1,91,100 |

## Summary

The computation of total income and tax liability for individuals under the Indian Income Tax Act involves several systematic steps to determine the taxable income and the corresponding tax amount due. Initially, an individual must calculate their gross total income (GTI) by aggregating income from various sources such as salaries, house property, business/profession, capital gains, and other sources. From this GTI, allowable deductions under sections like 80C (investments, insurance, etc.), 80D (medical insurance), and other relevant sections are subtracted to arrive at the net taxable income.

Once the taxable income is determined, the next step is to apply the applicable tax rates, which vary based on the individual's age group and income slab—resulting in a basic tax computation. Special rates may apply to specific types of income, such as long-term capital gains or business income from specified activities.

Additionally, any applicable cess and surcharge are added to the basic tax liability to compute the final tax payable. Individuals can also reduce their tax liability through credits for advance tax paid, TDS (Tax Deducted at Source), and relief under sections like 89(1) for arrears of salary. The resulting figure after these credits is the actual tax liability of the individual. This systematic approach ensures that the tax computation is fair, transparent, and in accordance with legal provisions, allowing individuals to plan their finances effectively and comply with tax obligations.

## Exercise

What is the first step in computing the total income and tax liability for individuals?

- A) Calculating the gross total income (GTI) by aggregating incomes from all sources
- B) Deducting applicable cess and surcharge
- C) Applying the tax rates based on income slab
- D) Subtracting deductions under Section 80C
- Answer: A

Under which section can individuals deduct investments and insurance premiums from their gross total income?

- A) Section 80C
- B) Section 80D
- C) Section 89(1)
- D) Section 80TTA
- Answer: A

Which of the following is not a source of income when calculating gross total income?

- A) Salary
- B) Capital gains
- C) Gifts from friends
- D) Income from house property
- Answer: C (Gifts from friends are generally not considered a source of income unless they meet certain criteria under other sources of income.)

How is the final tax liability of an individual determined?

- A) By adding cess and surcharge to the basic tax computation
- B) By simply applying the highest tax rate to the gross total income
- C) By deducting TDS from gross total income
- D) By subtracting deductions under Section 80G
- Answer: A

What can reduce an individual's tax liability aside from deductions?

- A) Inflation adjustments
- B) Credits for advance tax paid and TDS
- C) Reduction in cess applied
- D) Increases in tax slab thresholds
- Answer: B

[illegible]



## 19. Advance Tax, TDS And TCS

- Unit 19.1 - Deduction of Tax at Source and Advance Payment [Section 190]
- Unit 19.2 - Direct Payment [Section 191]
- Unit 19.3 - Consequences of Failure To Deduct Or Pay [Section 201]
- Unit 19.4 - Due Date of Depositing Deducted Tds
- Unit 19.5 - Liability for Payment of Advance Tax
- Unit 19.6 - Computation of Advance Tax
- Unit 19.7 - Instalments of Advance Tax and Due Dates
- Unit 19.8 - Interest For Non-Payment Or Short-Payment Of Advance Tax [Section 234B]
- Unit 19.9 - Interest Payable for Deferment of Advance Tax [Section 234C]
- Unit 19.10 - Tax Collection At Source – Basic Concept
- Unit 19.11 - Rate of Tcs in Case of Collection by an Authorized Dealer
- Unit 19.12 - Higher Rate Of Tcs For Non-Furnishers Of Pan [Section 206CC]



## Key Learning Outcomes



- Understand the Concept of Advance Tax
- Learn Calculation of Advance Tax
- Understand Due Dates and Installments
- Knowledge of TDS & TCS
- Identify Types of Payments Covered by TDS
- Understand Compliance and Filing Requirements
- Learn Adjustment of TDS/TCS Against Tax Liability
- Consider Impact on Tax Planning

## Unit 19 - Advance Tax, TDS, TCS

### Unit Objectives

At the end of the unit, you will be able to understand:

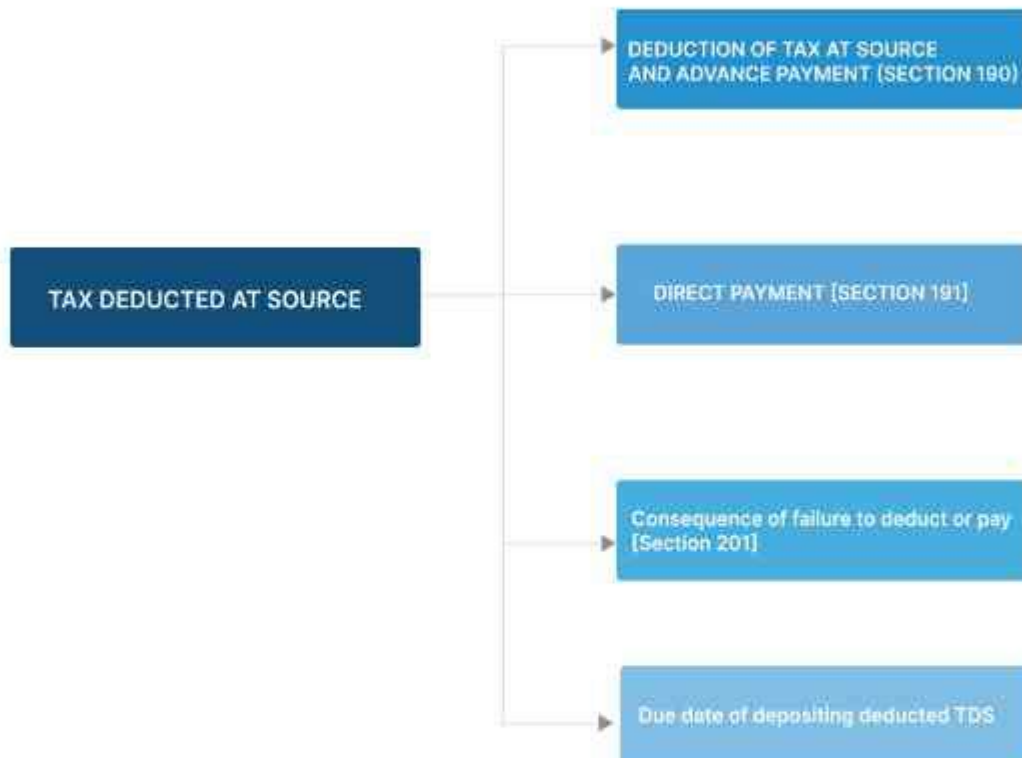


Fig 15.1

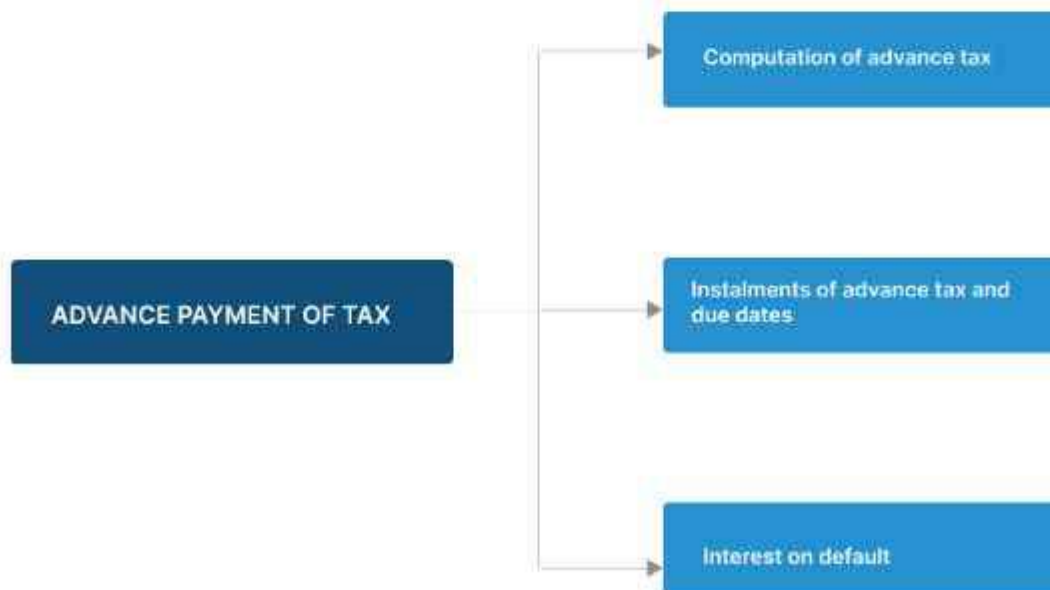


Fig 15.2

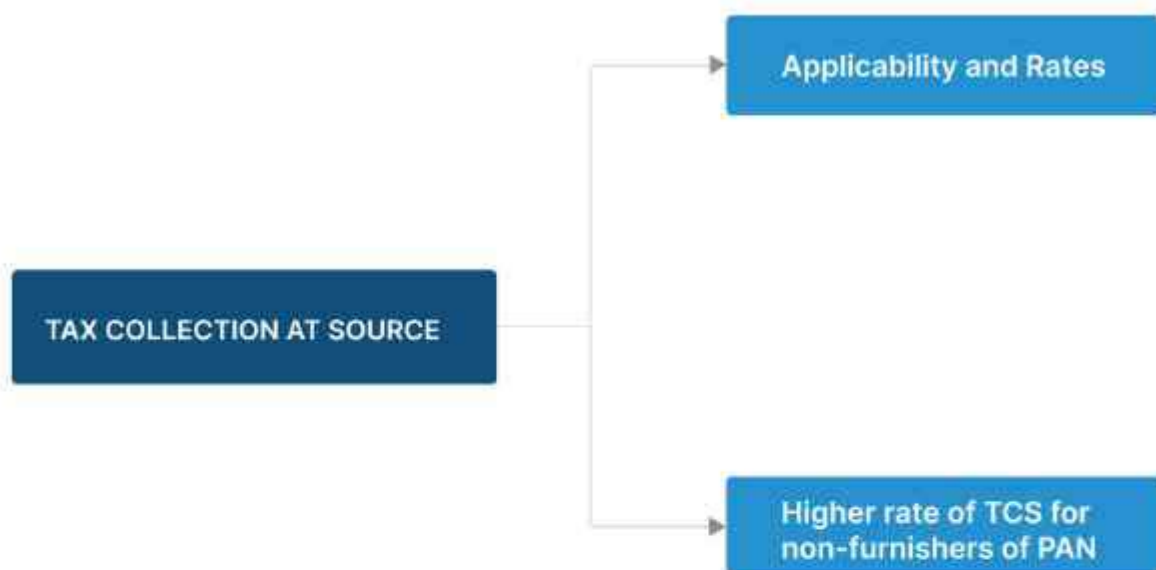


Fig 15.3



## Unit 19.1 - Deduction of Tax at Source and Advance Payment [Section 190]

The total income of an assessee for the previous year is taxable in the relevant assessment year. For example, the total income for the P.Y. 2021-22 is taxable in the A.Y. 2022-23. However, income tax is recovered from the assessee in the previous year itself through:

- Tax deduction at source (TDS)
- Tax collection at source (TCS)
- Payment of advance tax

Another mode of recovery of tax is from the employer through tax paid by him under section 192(1A) on the non-monetary perquisites provided to the employee. These taxes are deductible from the total tax due from the assessee. The assessee, while filing his return of income, has to pay self-assessment tax under section 140A, if tax is due on the total income as per his return of income after adjusting, inter alia, TDS, TCS, relief of tax claimed under section 89, tax credit claimed to be set off in accordance with the provisions of section 115JD, any tax or interest payable according to the provisions of section 191(2) and advance tax.

## Unit 19.2 - Direct Payment [Section 191]

### • Direct payment of tax [Section 191(1)]

Section 191 provides that in the following cases, tax is payable by the assessee directly:

- In the case of income in respect of which tax is not required to be deducted at source; and
- Income in respect of which tax is liable to be deducted but is not actually deducted.

In view of this provision, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted. In order to overcome this difficulty, the explanation to this section provides that if any person, including the principal officer of a company:

- Who is required to deduct tax at source; or
- An employer paying tax on non-monetary perquisites under section 192(1A),

Does not deduct, or after deducting fails to pay such tax, or does not pay, the whole or part of the tax, then, such person shall be deemed to be an assessee-in-default. However, if the assessee himself has paid the tax, this provision will not apply.

- Direct payment of tax, where income of the assessee includes value of specified security or sweat equity shares allotted or transferred free of cost or at a concessional rate to the assessee by an employer being an eligible start up<sup>1</sup> [Section 191(2)]

## Deduction of Tax at Source

| Section | Deductee | Nature of transaction                                                                                     | Threshold Limit (₹)                                                                                                                  | TDS Rate          |
|---------|----------|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|-------------------|
| 192     | R, NR    | Payment of salary                                                                                         | Basic exemption limit of employee                                                                                                    | Normal Slab Rates |
| 192A    | R, NR    | Premature withdrawal from EPF                                                                             | ₹ 50,000                                                                                                                             | 10%               |
| 193     | R        | Interest on securities                                                                                    | Debentures- ₹ 5,000<br>8% Savings (Taxable) Bonds 2003 or 7.75% Savings (Taxable) Bonds 2018- ₹ 10,000<br>Other securities- No limit | 10%               |
| 194     | R        | Payment of any dividend                                                                                   | ₹ 5,000                                                                                                                              | 10%               |
| 194A    | R        | Interest other than interest from securities (from deposits with banks/post office /co-operative society) | Senior Citizens- ₹ 50,000<br>Others- ₹ 40,000                                                                                        | 10%               |

|       |           |                                                                                                                                                               |                                                                    |     |
|-------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|-----|
| 194A  | R         | Interest other than interest on securities u/s 193 and interest from banks/post office/co-operative society.<br>For e.g., interest from friends and relatives | ₹ 5,000                                                            | 10% |
| 194B  | R, NR, FC | Income from lottery winnings, card games, crossword puzzles, and other games of any type                                                                      | ₹ 10,000                                                           | 30% |
| 194BB | R, NR, FC | Income from horse race winnings                                                                                                                               | ₹ 10,000                                                           | 30% |
| 194C  | R         | Payment to contractor/sub-contractor:<br>Individuals/HUF                                                                                                      | Single transaction- ₹ 30,000<br>Aggregate transactions- ₹ 1,00,000 | 1%  |
| 194C  | R         | Payment to contractor/sub-contractor:<br>Other than Individuals/HUF                                                                                           | Single transaction- ₹ 30,000<br>Aggregate transactions- ₹ 1,00,000 | 2%  |
| 194D  | R         | Insurance commission to domestic companies                                                                                                                    | ₹ 15,000                                                           | 10% |
| 194D  | R         | Insurance commission to other than companies                                                                                                                  | ₹ 15,000                                                           | 5%  |
| 194DA | R         | Income for the insurance pay-out, while payment of any sum in respect of a life insurance policy.                                                             | ₹ 1,00,000                                                         | 5%  |
| 194E  | NR, FC    | Payment to non-resident sportsmen/sports association                                                                                                          | No limit                                                           | 20% |
| 194EE | R, NR     | Payment of amount standing to the credit of a person under National Savings Scheme (NSS)                                                                      | ₹ 2,500                                                            | 10% |
| 194F  | R, NR     | Payment for the repurchase of the unit, by Unit Trust of India (UTI) or a Mutual Fund                                                                         | No limit                                                           | 20% |
| 194G  | R, NR, FC | Payments, commission, etc., on the sale of lottery tickets                                                                                                    | ₹ 15,000                                                           | 5%  |
| 194H  | R         | Commission or brokerage                                                                                                                                       | ₹ 15,000                                                           | 5%  |
| 194-I | R         | Rent on plant and machinery                                                                                                                                   | ₹ 2,40,000                                                         | 2%  |

|        |        |                                                                                                                                    |                    |     |
|--------|--------|------------------------------------------------------------------------------------------------------------------------------------|--------------------|-----|
| 194-I  | R      | Rent on land/building/<br>furniture/fitting                                                                                        | ₹ 2,40,000         | 10% |
| 194-IA | R      | Payment in consideration of<br>transfer of certain<br>immovable property<br>other than agricultural land.                          | ₹ 50,00,000        | 1%  |
| 194-IB | R      | Rent payment by an individual<br>or HUF not covered u/s. 194-I                                                                     | ₹ 50,000 per month | 5%  |
| 194-IC | R      | Payment under Joint<br>Development Agreements<br>(JDA) to Individual/HUF                                                           | No limit           | 10  |
| 194J   | R      | Any sum paid by way of fee for<br>professional services                                                                            | ₹ 30,000           | 10% |
| 194J   | R      | Any sum paid by way of<br>remuneration/fee/commission<br>to a director                                                             | ₹ 30,000           | 10% |
| 194J   | R      | Any sum paid for not carrying<br>out any activity concerning<br>any business                                                       | ₹ 30,000           | 10% |
| 194J   | R      | Any sum paid for not sharing<br>any know-how, patent,<br>copyright, etc.                                                           | ₹ 30,000           | 10% |
| 194J   | R      | Any sum paid as a fee for<br>technical services                                                                                    | ₹ 30,000           | 2%  |
| 194J   | R      | Any sum paid by way of<br>royalty towards the sale or<br>distribution, or exhibition of<br>cinematographic films                   | ₹ 30,000           | 2%  |
| 194J   | R      | Any sum paid as fees for<br>technical services, but the<br>payee is engaged in the<br>business of operation of the<br>call centre. | ₹ 30,000           | 2%  |
| 194K   | R      | Payment of any income for<br>units of a mutual fund, for<br>example, dividend                                                      | No limit           | 10% |
| 194LA  | R      | Payment in respect of<br>compensation on acquiring<br>certain immovable property                                                   | ₹ 2,50,000         | 10% |
| 194LB  | NR, FC | Payment of interest on<br>infrastructure debt fund to<br>Non-Resident                                                              | No limit           | 5%  |



|           |        |                                                                                                                                                                         |          |     |
|-----------|--------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-----|
| 194LC     | NR, FC | Payment of interest for the loan borrowed in foreign currency by an Indian company or business trust against loan agreement or the issue of long-term bonds             | No limit | 5%  |
| 194LC     | NR, FC | Payment of interest for the loan borrowed in foreign currency by an Indian company or business trust against the issue of long-term bonds listed in IFSC                | No limit | 4%  |
| 194LD     | NR, FC | Payment of interest on bond (rupee-denominated) to FII or a QFI                                                                                                         | No limit | 5%  |
| 194LBA(1) | R      | Certain income distributed by a business trust to its unitholder                                                                                                        | No limit | 10% |
| 194LBA(2) | NR, FC | Interest income of a business trust from SPV distribution to its unitholders                                                                                            | No limit | 5%  |
| 194LBA(2) | NR, FC | Dividend income of a business trust from SPV, in which it holds the entire share capital exempt the capital held by the government, and distribution to its unitholders | No limit | 10% |
| 194LBA(3) | NR     | Rental income payment of assets owned by the business trust to the unitholders of such business trust                                                                   | No limit | 30% |
| 194LBA(3) | FC     | Rental income payment of assets owned by the business trust to the unitholders of such business trust                                                                   | No limit | 40% |
| 194LBB    | R, NR  | Certain income paid to a unitholder in respect of units of an investment fund                                                                                           | No limit | 10% |
| 194LBB    | FC     | Certain income paid to a unitholder in respect of units of an investment fund                                                                                           | No limit | 40% |
| 194LBC    | R      | Income from investment in securitisation fund received to an individual and HUF                                                                                         | No limit | 25% |

|                       |        |                                                                                                                                           |                                                                   |                       |
|-----------------------|--------|-------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------|-----------------------|
| 194LBC                | R      | Income from investment in securitisation fund received to a domestic company                                                              | No limit                                                          | 10%                   |
| 194LBC                | FC     | Income from investment in securitisation fund received to a foreign company                                                               | No limit                                                          | 40%                   |
| 194LBC                | NR     | Income from investment in securitisation fund received to NRI                                                                             | No limit                                                          | 10%                   |
| 194M                  | R      | Certain payments by Individual/HUF not liable to deduct TDS under Section 194C, 194H, and 194J                                            | ₹ 50,00,000                                                       | 5%                    |
| 194N                  | R, NR  | Cash withdrawal exceeding a certain amount                                                                                                | ₹ 1 crore                                                         | 2%                    |
| 194N                  | R, NR  | Cash withdrawal in case person not filing ITR for last three years and the original ITR filing due date expired                           | ₹ 20 lakh to ₹ 1 crore<br>₹ 1 crore                               | 2%<br>5%              |
| 194O                  | R      | Payment for the sale of goods or provision of services by the e-commerce operator through its digital or electronic facility or platform. | ₹ 5,00,000                                                        | 1%                    |
| 194P                  | R      | Payment of pension or interest to specified senior citizens of age 75 years or more                                                       | Basic exemption limit of senior citizens or super senior citizens | Normal tax slab rates |
| 194Q                  | R      | Payments for the purchase of goods                                                                                                        | ₹ 50,00,000                                                       | 0.10%                 |
| 194R<br>(Refer notes) | R      | Perquisite or benefit to a business or profession                                                                                         | ₹ 20,000                                                          | 10%                   |
| 194S<br>(Refer notes) | R      | TDS on the transfer of virtual digital assets                                                                                             | Specified Persons- 50,000<br>Others- 10,000                       | 1%                    |
| 195                   | NR     | Income on investments made by NRI citizen                                                                                                 | No limit                                                          | 20%                   |
| 195                   | NR     | Income by way of LTCG referred to in section 115E in the case of NRI                                                                      | No limit                                                          | 10%                   |
| 195                   | NR, FC | Income by way of LTCG under section 112(1)(c)(iii)                                                                                        | No limit                                                          | 10%                   |

|     |        |                                                                                                                                                                                                                                             |          |     |
|-----|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-----|
| 195 | NR, FC | Income by way of LTCG under section 112A                                                                                                                                                                                                    | No limit | 10% |
| 195 | NR, FC | Income by way of STCG under section 111A                                                                                                                                                                                                    | No limit | 15% |
| 195 | NR, FC | Any other income by way of LTCG                                                                                                                                                                                                             | No limit | 20% |
| 195 | NR, FC | Interest payable on money borrowed by the government or Indian concern in foreign currency                                                                                                                                                  | No limit | 20% |
| 195 | NR, FC | Income from royalty payable by the Indian concern or the government, for the copyright in a subject referred in the first provision of section 115A or computer software referred to in the second proviso of section 115A                  | No limit | 10% |
| 195 | NR     | Income from royalty payable by government or Indian concern in pursuance of an agreement on matters included in the industrial policy                                                                                                       | No limit | 10% |
| 195 | FC     | Income from royalty payable by government or Indian concern in pursuance of an agreement on matters included in the industrial policy<br>If the agreement for such royalty payment is entered in between 31st March 1961 and 1st April 1976 | No limit | 50% |
| 195 | FC     | Income from royalty payable by government or Indian concern in pursuance of an agreement on matters included in the industrial policy<br>If the agreement for such royalty payment is entered in between 31st March 1961 and 1st April 1976 | No limit | 10% |

|      |        |                                                                                                                                                                                                                                          |          |     |
|------|--------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-----|
| 195  | NR     | Income from technical fees payable by government or Indian concern in pursuance of an agreement on matters related to industrial policy                                                                                                  | No limit | 10% |
| 195  | FC     | Income from technical fees payable by government or Indian concern in pursuance of an agreement on matters related to industrial policy<br>If the agreement for such payment is entered in between 29th February 1964 and 1st April 1976 | No limit | 50% |
| 195  | FC     | Income from technical fees payable by government or Indian concern in pursuance of an agreement on matters related to industrial policy                                                                                                  | No limit | 10% |
|      |        | If the agreement for such payment is entered after 31st March 1976                                                                                                                                                                       |          |     |
| 195  | NR     | Any other income                                                                                                                                                                                                                         | No limit | 30% |
| 195  | FC     | Any other income                                                                                                                                                                                                                         | No limit | 40% |
| 196B | NR, FC | Income (including LTCG) from units of an offshore fund                                                                                                                                                                                   | No limit | 10% |
| 196C | NR, FC | Income (including LTCG) from foreign currency bonds or GDR of an Indian company                                                                                                                                                          | No limit | 10% |
| 196D | NR, FC | Income (excluding dividend and capital gain) from Foreign Institutional Investors.                                                                                                                                                       | No limit | 20% |

**Note:** R = Resident, NR = Non-resident, FC = Foreign Citizen



## Unit 19.3 - Consequences of failure to deduct or pay [Section 201]

- Deemed assessee-in-default

Any person including the principal officer of a company:

- Who is required to deduct any sum in accordance with the provisions of the Act; or
- An employer paying tax on non-monetary perquisites under section 192(1A).
- Shall be deemed to be an assessee-in-default, if he does not deduct, or does not pay or after deducting, fails to pay, the whole or any part of the tax, as required by or under the provisions of the Income tax Act, 1961

- Non-applicability of deeming provision

Any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or paid to a payee shall not be deemed to be an assessee-in-default in respect of such tax if such payee:

- Has furnished his return of income under section 139;
- Has taken into account such sum for computing income in such return of income; and
- Has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

## Unit 19.4 - Due Date Of Depositing Deducted TDS

The tax deducted at source must be deposited to the government by the 7th of the subsequent month.

Tax deducted at source has to be deposited using Challan ITNS-281 on the government portal. Filing tax deducted at source returns, is mandatory for all the persons who have deducted TDS. TDS return is to be submitted quarterly and various details need to be furnished like TAN, amount of TDS deducted, type of payment, PAN of deductee, etc. Also, different forms are prescribed for filing returns depending upon the purpose of the deduction of TDS. Various types of return forms are as follows

| Furnishing Statement of TDS [Rule 31A] [Form 24Q/26Q/27Q] |              |
|-----------------------------------------------------------|--------------|
| Quarter ending                                            | Due date     |
| 30th June                                                 | 31st July    |
| 30th September                                            | 31st October |
| 31st December                                             | 31st January |
| 31st March                                                | 31st May     |

### • Interest Liability

A person deemed to be an assessee-in-default under section 201(1), for failure to deduct tax or to pay the tax after deduction, is liable to pay simple interest @ 1% for every month or part of month, on the amount of such tax from the date on which tax was deductible, to the date on which such tax was actually deducted and simple interest @ 1.5% for every month or part of month from the date on which tax was deducted, to the date on which such tax is actually paid [Section 201(1A)].

#### Illustration 1

An amount of ₹ 40,000 was paid to Mr. X on 1st July, 2022 towards fees for professional services without deduction of tax at source. Subsequently, another payment of ₹ 50,000 was due to Mr. X on 28th February, 2023, from which tax @10% (amounting to ₹ 9,000) on the entire amount of ₹ 90,000 was deducted. However, this tax of ₹ 9,000 was deposited only on 22nd July, 2023. Compute the interest chargeable under section 201(1A).

#### Solution

Interest under section 201(1A) would be computed as follows:

|                                                                           |       |
|---------------------------------------------------------------------------|-------|
| 1% on tax deductible but not deducted i.e., 1% on ₹ 4,000 for 8 months    | ₹ 320 |
| 1.5% on tax deducted but not deposited i.e., 1.5% on ₹ 9,000 for 4 months | ₹ 540 |
|                                                                           | ₹ 860 |

- Such interest should be paid before furnishing the statements in accordance with section 200(3).
- Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a payee and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such payee, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such payee. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

**However, where an order is made by the assessing officer for assessee-in-default, the interest shall be paid by the person in accordance with such order.**

- Where the tax has not been paid after it is deducted, the amount of the tax together with the amount of simple interest thereon shall be a charge upon all the assets of the person or the company, as the case may be.

#### Advance Payment of Tax



## Unit 19.5 - Liability For Payment Of Advance tax

- Tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219, in respect of an assessee's current income i.e., the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year [Section 207].
- Under section 208, obligation to pay advance tax arises in every case where the advance tax payable is ₹ 10,000 or more.

**Note-** An assessee who is liable to pay advance tax of less than ₹ 10,000 will not be saddled with interest under sections 234B and 234C for defaults in payment of advance tax. However, the consequences under section 234A regarding interest for belated filing of return would be attracted.

- In case of senior citizens who have passive source of income like interest, rent, etc., the requirement of payment of advance tax causes genuine compliance hardship. Therefore, in order to reduce the compliance burden on such senior citizens, exemption from payment of advance tax has been provided to a resident individual:
  - Not having any income chargeable under the head "profits and gains of business or profession"; and
  - Of the age of 60 years or more. Such senior citizens need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

## Unit 19.2 - Direct Payment [Section 191]

- An assessee has to estimate his current income and pay advance tax thereon. He need not submit any estimate or statement of income to the assessing officer, except where he has been served with notice by the assessing officer.
- Where an obligation to pay advance tax has arisen, the assessee shall himself compute the advance tax payable on his current income at the rates in force in the Financial year and deposit the same, whether or not he has been earlier assessed to tax.
- In the case of a person who has been already assessed by way of a regular assessment in respect of the total income of any previous year, the assessing officer, if he is of the opinion that such person is liable to pay advance tax, may serve an order under section 210(3) requiring the assessee to pay advance tax.
- For this purpose, the total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or the total income returned by the assessee in any return of income for any subsequent previous year, whichever is higher, shall be taken as the basis for computation of advance tax payable.
- The above order can be served by the assessing officer at any time during the financial year but not later than the last date of February.
- If, after sending the above notice, but before 1st of March of the financial year, the assessee furnishes a return relating to any later previous year or an assessment is completed in respect of a later return of income, the assessing officer may amend the order for payment of advance tax on the basis of the computation of the income so returned or assessed.

- If the assessee feels that his own estimate of advance tax payable would be less than the one sent by the assessing officer, he can file estimate of his current income and advance tax payable thereon.
- Where the advance tax payable on assessee's estimation is higher than the tax computed by the assessing officer, then, the advance tax shall be paid based upon such higher amount.
- In all cases, the tax calculated shall be reduced by the amount of tax deductible at source.

(As per the provisions of section 209, the amount of advance tax payable by a person is computed by reducing the amount of income tax which would be deductible at source during the financial year from any income which has been taken into account in computing the total income.)

- The amount of advance tax payable by an assessee in the financial year calculated by:
- The assessee himself based on his estimation of current income; or
- The assessing officer as a result of an order under section 210(3) or amended order under section 210(4) is subject to the provisions of section 209(2), as per which the net agricultural income has to be considered for the purpose of computing advance tax.

## Unit 19.7 - Instalments of Advance Tax and Due Dates

- Common advance tax payment schedule for both corporates and non-corporates [other than assessee computing profits on presumptive basis under section 44AD(1) or section 44ADA(1)]:

| Due date of instalment      | Amount payable                                                                                                                          |
|-----------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| On or before 15th June      | Not less than 15% of advance tax liability                                                                                              |
| On or before 15th September | Not less than 45% of advance tax liability, as reduced by the amount, if any, paid in the earlier instalment.                           |
| On or before 15th December  | Not less than 75% of advance tax liability, as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments. |
| On or before 15th March     | The whole amount of advance tax liability as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments.   |

**Note - Any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year ending on 31st March.**

Advance tax payment by assessee computing profits on presumptive basis under section 44AD(1) or section 44ADA(1)

An eligible assessee, opting for computation of profits or gains of business on presumptive basis in respect of eligible business referred to in section 44AD(1) or for computation of profits or gains of profession on presumptive basis in respect of eligible profession referred to in section 44ADA(1), shall be required to pay advance tax of the whole amount in one instalment on or before 15th March of the financial year. However, any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year ending on 31st March.



If the last day for payment of any instalment of advance tax is a day on which the receiving bank is closed, the assessee can make the payment on the next immediate following working day, and in such cases, the interest leviable under sections 234B and 234C would not be charged.

Where advance tax is payable by virtue of the notice of demand issued 11 by the assessing officer, the whole or the appropriate part of the advance tax specified in such notice shall be payable on or before each of such due dates as fall after the date of service of notice of demand.

Where the assessee does not pay any instalment by the due date, he shall be deemed to be an assessee in default in respect of such instalment.

## Unit 19.8 - Interest for non-payment or short-payment of advance tax [Section 234B]

- Interest under section 234B is attracted for non-payment of advance tax or payment of advance tax of an amount less than 90% of assessed tax.
- The interest liability would be 1% per month or part of the month from 1st April following the financial year up to the date of determination of income under section 143(1) and where a regular assessment is made, up to the date of such regular assessment.
- Such interest is calculated on the amount of difference between the assessed tax and the advance tax paid.
- Assessed tax is the tax calculated on total income determined under section 143(1) and where a regular assessment is made, the tax on the total income determined under such regular assessment less:
  - Tax deducted or collected at source.
  - Any relief of tax allowed under section 89
  - Any tax credit allowed to be set off in accordance with the provisions of section 115JD
- However, where self-assessment tax is paid by the assessee under section 140A or otherwise, interest shall be calculated up to the date of payment of such tax and reduced by the interest, if any, paid under section 140A towards the interest chargeable under this section. Thereafter, interest shall be calculated at 1% on the amount by which the tax so paid together with the advance tax paid falls short of the assessed tax.

## Unit 19.9 - Interest Payable for Deferment of Advance tax [Section 234C]

- Manner of computation of interest under section 234C for deferment of advance tax by corporate and non-corporate assessees:

In case an assessee, other than an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1), who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by such assessee on its current income on or before the dates specified in column (1) is less than the specified percentage [given in column (2)] of tax due on returned income, then simple interest @1% per month for the period specified in column (4) on the amount of shortfall, as per column (3) is leviable under section 234C.

| Specified date | Specified % | Shortfall in advance tax                                                    | Period   |
|----------------|-------------|-----------------------------------------------------------------------------|----------|
| 15th June      | 15%         | 15% of tax due on returned income (-) advance tax paid up to 15th June      | 3 months |
| 15th September | 45%         | 45% of tax due on returned income (-) advance tax paid up to 15th September | 3 months |
| 15th December  | 75%         | 75% of tax due on returned income (-) advance tax paid up to 15th December  | 3 months |
| 15th March     | 100%        | 100% of tax due on returned income (-) advance tax paid up to 15th March    | 1 month  |

**Note – However, if the advance tax paid by the assessee on the current income, on or before 15th June or 15th September, is not less than 12% or 36% of the tax due on the returned income, respectively, then, the assessee shall not be liable to pay any interest on the amount of the shortfall on those dates.**

- Computation of interest under section 234C in case of an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1):

In case an assessee who declares profits and gains in accordance with the section 44AD(1) or section 44ADA(1), as the case may be, who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by the assessee on its current income on or before 15th March is less than the tax due on the returned income, then, the assessee shall be liable to pay simple interest at the rate of 1% on the amount of the shortfall from the tax due on the returned income.

- Non-applicability of interest under section 234C in certain cases:

Interest under section 234C shall not be leviable in respect of any shortfall in payment of tax due on returned income, where such shortfall is on account of under-estimation of or failure to estimate:

- The amount of capital gains;
  - Income of nature referred to in section 2(24)(ix) i.e., winnings from lotteries, crossword puzzles etc.;
  - Income under the head "profits and gains of business or profession" in cases where the income accrues or arises under the said head for the first time.
  - The amount of dividend income u/s 2(22)(a)/(b)/(c)/(d)
- However, the assessee should have paid the whole of the amount of tax payable in respect of such income referred to in (i), (ii), (iii) or (iv), as the case may be, had such income been a part of the total income, as part of the remaining instalments of advance tax which are due or where no such instalments are due, by 31st March of the financial year.



## Unit 19.10 - Tax Collection at Source – Basic Concept

- Applicability and Rates
- Sale of certain goods under section 206C(1), sellers of certain goods are required to collect tax from the buyers at the specified rates. The specified percentage for collection of tax at source is as follows:

| Nature of Goods                                                | Percentage |
|----------------------------------------------------------------|------------|
| (a) Alcoholic liquor for human consumption                     | 1%         |
| (b) Tendu leaves                                               | 5%         |
| (c) Timber obtained under a forest lease                       | 2.5%       |
| (d) Timber obtained by any mode other than (c)                 | 2.5%       |
| (e) Any other forest produces not being timber or tendu leaves | 2.5%       |
| (f) Scrap                                                      | 1%         |
| (g) Minerals, being coal or lignite or iron ore                | 1%         |

- Lease or a licence of parking lot, toll plaza or mine or a quarry Section 206C(1C) provides for collection of tax by every person who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any:
  - Parking lot or
  - Toll plaza or
  - A mine or a quarry

To another person (other than a public sector company) for the use of such parking lot or toll plaza or mine or quarry for the purposes of business. The tax shall be collected as provided, from the licensee or lessee of any such licence, contract or lease of the specified nature, at the rate of 2%.

- Sale of motor vehicle of value exceeding ₹ 10 lakhs  
Section 206C(1F) provides that every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding ₹ 10 lakhs, shall collect tax from the buyer @1% of the sale consideration.
- Overseas remittance or an overseas tour package Section 206C(1G) provides for collection of tax by every person:
  - Being an authorized dealer, who receives amount, under the Liberalised Remittance Scheme of the RBI, for overseas remittance from a buyer, being a person remitting such amount out of India;
  - Being a seller of an overseas tour programme package who receives any amount from the buyer who purchases the package at the rate of 5% of such amount.

Tax has to be collected at the time of debiting the amount payable by the buyer or at the time of receipt of such amount from the said buyer, by any mode, whichever is earlier.

## Unit 19.11 - Rate Of TCS In Case Of Collection By an Authorized Dealer

| Sr.No. | Amount and purpose of remittance                                                                                                                                                                                                                                                      | Rate of TCS                                                    |
|--------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------|
| I      | (a) Where the amount is remitted for a purpose, other than purchase of overseas tour programme package; and<br>(b) the amount or aggregate of the amounts being remitted by a buyer is less than ₹ 7 lakhs in a financial year                                                        | Nil (No tax to be collected at source)                         |
| II     | (a) Where the amount is remitted for a purpose other than purchase of overseas tour programme package; and<br>(b) the amount or aggregate of the amounts in excess of ₹ 7 lakhs is remitted by the buyer in a financial year                                                          | 5% of the amt or aggregate of amts in excess of ₹ 7 lakh       |
| III    | (a) Where the amount being remitted out is a loan obtained from any financial institution as defined in section 80E, for the purpose of pursuing any education; and<br>(b) the amount or aggregate of the amounts in excess of ₹ 7 lakhs is remitted by the buyer in a financial year | 0.5% of the amt or aggregate of amounts in excess of ₹ 7 lakhs |

Cases where no tax is to be collected

|       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (i)   | No TCS by the authorized dealer on an amount in respect of which the sum has been collected by the seller.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| (ii)  | No TCS, if the buyer is liable to deduct tax at source under any other provision of the Act and has deducted such tax.                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| (iii) | No TCS, if the buyer is the central government, a state government, an embassy, a high commission, a legation, a commission, a consulate, the trade representation of a foreign state, a local authority or any other person notified by the central government, subject to fulfilment of conditions stipulated thereunder.<br><br><b>Accordingly, the CBDT has, vide notification no. 20/200 dated 30th March, 2022, notified that the provisions of section 206C(1G) would not apply to an individual who is not resident in India as per section 6(1) and 6(1A), and who is visiting India.</b> |

Sale of goods of value exceeding ₹ 50 lakhs

- (a) As per section 206C(1H), tax is also required to be collected by a seller, who receives any amount as consideration for sale of goods of the value or aggregate of such value exceeding ₹ 50 lakhs in a previous year [other than exported goods or goods covered under sub-sections (1)/(1F)/(1G)].
- (b) Tax is to be collected at source @ 0.1% u/s 206C(1H) of the sale consideration exceeding ₹ 50 lakhs, at the time of receipt of consideration.
- (c) Tax is, however, not required to be collected if the buyer is liable to deduct tax at source under any other provision of the Act on the goods purchased by him from the seller and has deducted such tax.



## Unit 19.12 - Higher rate of TCS for non-furnishers of PAN [Section 206CC]

- The provisions of section 206CC require tax collection at the higher of the following two rates, in case of failure by the person paying any sum or amount on which tax is collectible at source (collectee) to furnish PAN [PAN or Aadhar number in case of section 206C(1H)] to the person responsible for collecting tax at source (collector):
  - At twice the rate specified in the relevant provision of the Act
  - At 5% [1%, in case tax is required to be collected at source u/s 206C(1H)]
- Tax would be collectible at the rates mentioned above also in case where the person furnishes a declaration under section 206C(1A) but does not provide his PAN.
- Both the collectee and the collector have to compulsorily quote the PAN of the collectee in all correspondence, bills, vouchers and other documents exchanged between them.
- If the PAN provided to the collector is invalid or it does not belong to the collectee, it shall be deemed that the collectee has not furnished his PAN to the collector. Accordingly, tax would be collectible at the rate specified in (i) above.
- The provisions of section 206CC does not apply to a non-resident who does not have a permanent establishment in India.

## Summary

Advance Tax, TDS (Tax Deducted at Source), and TCS (Tax Collected at Source) are critical components of the Indian Income Tax system aimed at collecting tax incrementally to reduce taxpayer burden at the end of the fiscal year. Advance Tax is paid by taxpayers who have a tax liability exceeding ₹10,000 in a financial year, requiring them to pay income tax in installments as per prescribed due dates, rather than a lump sum at year-end. TDS is a method where tax is automatically deducted at the source of income, such as salaries, interest payments, and professional fees, ensuring a steady flow of revenue to the government throughout the year. Similarly, TCS is collected by the seller from the buyer at the point of sale on certain goods specified under the tax laws. Both TDS and TCS are aimed at minimizing tax evasion by collecting tax at the generation point of income and ensuring that tax compliance is built into the financial transactions. These mechanisms help in regulating the flow of funds to the government and easing the final tax computation process for taxpayers.

## Exercise

What is the threshold limit above which advance tax payment is mandatory?

- A) ₹5,000
- B) ₹10,000 (Correct Answer)
- C) ₹15,000
- D) ₹20,000
- Explanation: Taxpayers whose tax liability exceeds ₹10,000 in a year must pay Advance Tax.

TDS stands for:

- A) Tax Deduction at Source (Correct Answer)
- B) Tax Deduction at Supply
- C) Tax Demand at Source
- D) Tax Dividend at Source
- Explanation: TDS refers to Tax Deducted at Source.

Which of the following incomes is not subject to TDS?

- A) Salary
- B) Agriculture Income (Correct Answer)
- C) Interest from Banks
- D) Commission
- Explanation: Agricultural income is exempt from TDS under the Income Tax Act.

Advance Tax is applicable to which of the following categories of taxpayers?

- A) Salaried Employees
- B) Businessmen
- C) Freelancers
- D) All of the above (Correct Answer)
- Explanation: All categories of taxpayers with a tax liability over ₹10,000 need to pay Advance Tax.

When is the final installment of Advance Tax due for individual taxpayers?

- A) 15th March (Correct Answer)
- B) 15th June
- C) 30th September
- D) 31st December
- Explanation: The final installment of Advance Tax is due on 15th March for individuals.

TCS is collected primarily from the buyer by the seller on the sale of which of the following items?

- A) Books
- B) Jewelry (Correct Answer)
- C) Software
- D) Educational Services
- Explanation: TCS is applicable on items like jewelry, among others specified by the Income Tax Act.

Under which section of the Income Tax Act is TDS on salary covered?

- A) Section 192 (Correct Answer)
- B) Section 194A
- C) Section 195
- D) Section 196
- Explanation: TDS on salary is governed by Section 192 of the Income Tax Act.

What is the purpose of collecting TDS?

- A) To increase government revenue
- B) To ensure tax is collected at the point of income generation (Correct Answer)
- C) To penalize the taxpayers
- D) To provide subsidies
- Explanation: TDS ensures that tax is collected as the income is generated.

Which of the following is not a benefit of TDS?

- A) Prevents tax evasion
- B) Reduces the burden of lump sum tax payment
- C) Increases the refund amount
- D) Ensures steady revenue for the government (Correct Answer)
- Explanation: The primary benefits of TDS include preventing tax evasion and spreading the tax payment throughout the year.

If TDS is deducted in excess, what can the taxpayer do?

- A) File for bankruptcy
- B) Request immediate cash reimbursement from the employer
- C) Claim a refund in the income tax return (Correct Answer)
- D) There is no recourse available
- Explanation: If TDS is deducted in excess, the taxpayer can claim a refund when filing their income tax return.



## Notes

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.This image shows a completely blank white rectangular area, which appears to be a scanned piece of paper or a digital canvas. It is surrounded by a thin, uniform orange border. There are no markings, text, or illustrations on the surface.



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