Basic Pay	32,600
Dearness Allowance	4,320
Medical Allowance	2,608
	39,528

Value of rent-free accomodation will be 15% of Rs. 39,528	5928
Add 10% of cost of furniture	1300
Value of rent-free furnished accomodation=	7228

(ii) As the salary becomes due on the first of the next month, the assessee will be taxable from March to February. His scale of pay will be determined as under–

1-1-2003 to 31-12-2003	2,400
1-1-2004 to 31-12-2004	2,500
1-1-2005 to 31-12-2005	2,600
1-1-2006 to 31-12-2006	2,700
1-1-2007 to 28-02-2007	2,800

The assessee will be taxed for ten months from 1-3-2006 to 31-12-2006 at the rate of Rs. 2,700 per month and for two month from 1-1-2007 to 28-2-2007 at the rate of Rs. 2,800 per month.

Hints– (i) As the expenses relating to only official use of the car are borne by the employer, the perquisite of car will be taken at the rate of Rs. 100 per month plus Rs. 150 per month for driver's remuneration.

(ii) As the house is owned by the employer, the perquisite of gardener is not taxable, but the wages paid to him are included in the fair rental value of the house.

(iii) As the house is owned by the employer and the watchman is provided by the employer, this perquisite will be taxable on adhoc basis, i.e..., 50% of actual wages or Rs. 60 per month whichever is less. The perquisite of any other servant provided by the employer is taxable in full i.e..., his entire wages paid by the employer are taxable.

Questions

1. Mr. X is employed in Delhi office of the Industrial Finance Corporation. He received during the financial year 2006-07 basic pay Rs. 2,500 per month, dearness allowance Rs. 200 per month, Commission Rs. 1,500, bonus Rs. 2,900. He has been provided with rent-free accomodation of the fair value of Rs. 1,000 per month along in the furniture costing Rs. 10,000. Compute his income under the head salaries.

2. Shri Ram is employed as an Accountant on Rs. 1,500 per month. He contributes 15% to a Provident Fund to which an equal amount is added by the employer. During the year interest at 8% amounting to Rs. 2,400 were credited to his provident fund. He also gets a house rent allowance of Rs. 100 per month. Actual rent paid by him Rs. 200 per month. Compute his total income in case the provident fund is a (a) statutory (b) recognised by (c) unrecognised.

3. Shree Ram is an employee of Tisco getting a monthly basic salary of Rs. 4,000 plus Dearness Allowance of Rs. 500 per month (under the terms of employment.) He contributes 15% of his basic salary to the Company's Recognised Provident Fund to which his employer contributes an equal amount. Interest on provident fund is determined at the rate of 18% per annum which amounts to Rs. 600 for the previous year. He has also been provided a furnished house by his employer, the fair rent of which is Rs. 15,000 per annum, the value of furniture provided in the house is worth Rs. 10,000. But the company has been charging from the assessee Rs. 500 per month as rent of the said house.

   Find out the taxable income from salaries of Shree Ram for the Assessment year 2007-08.

INCOME FROM HOUSE PROPERTY -(I)

The income from houses, buildings, bungalows, godowns etc. is to be computed and assessee to tax under the head "Income from house property." The income under this head is not based upon the actual income from property but upon national income or the annual value of that building.

Section 22 to the Income-Tax Act states :–

"The annual value of property consisting of any building or lands appurtenant there to of which the assessee is the owner, other than such portions of such property as he may occupy for the purpose of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head. "Income from house property".

For income to be taxed as 'income from house property' the following points should be noted carefully :–

(1) **Building or Land Appurtenant there to :–** The scope of this head of income of limited to the income from buildings or lands appurtenant to buildings only. Buildings include residential houses, bungalows, docks, warehouses, any block of bricks or stone work covered by a roof etc.

(2) **Annual value :–** The meaning of word 'Annual value' is very significant because the annual value of the building or land appurtenant there is to be taxed and not the rent received.

(3) **The Assessee should be the owner of the house property :–** It is only the owner of the house property who can be taxed under this head of income. The tax under this section is in respect of the legal or beneficial owner and not the occupation or possession of house property, there of income from sub-letting will be chargeable under the head 'Income from other sources' and not under this head,

(4) **It is not used for purpose of assessee business or profession :–** Where the assessee is carrying on business or profession in his own house, building or in a portion of it and the income of such business or profession, is taxable under the head, Profits or Gains of Business or Profession, the annual value in respect of such property or portion of it is not taxable under this head of income.

(5) **Quarters let to Employee's of Assessee's own Business :–** In case a portion of the business premises is let out to employee or employee of the business for residence and the letting out is incidental or is essential for the efficient running of the business of the assessee, the rent received from such employee or employees will not be taxable as 'Income from house property. Similarly, if the assessee constructs residential houses and

lets out to such employees of his business whose stay there is essential or incidental to the efficient and proper conduct of his business, the rental income from such quarters would be outside the purview of this source of income and it will be considered as business income.

Exempted House Property Incomes :– The income exempted from tax of house property is divided into two parts :–

(A) wholly exempted income.

(B) Partially exempted income,

(A) **Wholly exempted income** :– The following incomes are neither included in gross total income nor they are taxable :–

(1) The annual value of any place in the occupation of a Ruler.

(2) Income from house property belonging to the registered Trade Union.

(3) Income from house property held by a trust wholly for religious and charitable purposes.

(4) If any residential house remained vacant throughout the year on account of his employment at any other place, the annual value of his house shall be nil.

(5) Income from house property used for purpose of his business or profession.

(6) Income from house property belonging to a local authority.

(7) The income of any building located in the immediate vicinity of an agricultural land and occupied by the cultivator as a dwelling house.

(8) Income derived from letting of godowns for storage or processing the marketing of commodities by an authority.

(B) Partially Exempted Income :– It includes the following :–

(1) Income of co-operative society derived from house property, if the gross total income of the society does not exceed by Rs. 20,000 and the society is not a housing society.

(2) Income of a co-operative society derived from the letting of godowns or warehouse for storage or marking the commodities.

Annual Value of House Property :– Tax is levied on the 'annual value' of house property. The whole topic of 'Income from House Property' revolves round 'annual value of the property. As such it is very important to understand 'annual value'.

Section 23(1) of Income-Tax Act has defined the word 'annual value' as "the sum for which the property might reasonably expected to be let from year to year. " The annual value is the value which any house can fetch from the market under the prevailing circumstances such as local conditions, the demand for house municipal valuations, types and standard of construction, rent for similar type of house in the similar type of locality, etc. From the explanation it should be clearly understood that the annual value does not mean the rent derived or rental value of the house but the national rent at which the house can reasonably be let out. A property can be let out at a rent which is lower than reasonable rent but its annual value will be its reasonable rent.

The Taxation Laws (Amendment) Act 1975 has changed the term 'Annual value' as under :–

The annual value of any property shall be deemed to be–

(a) The sum for which the property might reasonably be expected to let out from year to year; or

(b) Where the property is let out and the annual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a) the amount so received or receivable.

House properties are classified into three categories for purpose of determining the annual value.

(1) House which is let out :– Let out houses are divided into two parts:–-

(a) House which is not covered by the Rent Control Act, and

(b) the house which is covered by the Rent Control Act,

(a) House which is not covered by the Rent Control Act :– For the purpose of determining the annual value of the house let out, the actual rental value of the house let out, the actual rental income is compared with the rent as which it might be expected to be let out i.e, fair rent. If the property is situated in urban areas, the actual rental income shall be compared with the municipal valuation, where it is not covered by the Rent Control Act. The greater of the above two sums is taken to be the gross annual value of that house property, any municipal tax or tax levied by any local authority in respect of the house property to the extent to which such taxes are borne by the owner shall be deducted from the gross annual value of the property.

(b) House which is covered by the Rent Control Act :– In this case, the annual value will be the actual rent received or standard rent, whichever is higher. If the house is not actually let out there will be no actual rent and hence in that case only standard rent will be the gross annual value, from the gross annual value thus arrived at, any municipal tax or a tax levied by any local authority in respect of the house property shall be deducted to the extent to which such taxes are borne by the owner.

Following rules regarding Annual value will be taken into consideration under this case.

(A) If Actual Rent is higher than standard Rent, the actual rent will be the Gross annual value of the house.

(B) If Actual Rent is less than standard rent under this situation out of given municipal value, FRV and Actual Rental Value whichever is greater may be treated as GAV provided that it should not exceed Std. Rent. It means that GAV is never more than Std. Rent.

Where a house or part of a house is occupied by the owner for his residential purposes, the annual value of such a house or part thereof shall be taken to be nil, provided it is not actually let out during any part of the previous year and no other benefits is derived there from.

If the full house is self occupied by the owner for full previous year, the annual value of the house will be nil.

In a part of the house is self occupied by the owner for full previous year, the annual value of the house will be nil.

The Gross Annual value is required to be adjusted as per the vacancy period and with the amount of unrealised rent in order to compute Net Annual Value.

Municipal tax paid by the house owner is also required to be deducted from GAV to get the NAV.

From the foregoing paragraphs it must have been clear to you as to–

(a) What types of income from house property are chargeable under the head 'Income from house property and as to what types of income from house property are chargeable under the head. ' Income from business or profession, or, income from other sources;

(b) What are totally tax-exempt income from house property;

(c) What are partially tax-exempt income from house property and

(d) What is annual value.

In the next lesson we shall discuss various deductions which are admissible in computing the income from house property.

Questions

1. What is meant by the annual value of property ? How would you determine the annual value of house property which is self-occupied for a part of the year only and let out for the remaining part.
2. Mention the items of income from house property which are liable to tax.
3. Describe the tax-concessions for newly constructed house properties which are let out for residential purpose.
4. Mention the criteria for determining annual value of house property.

INCOME FROM HOUSE PROPERTY -(II)

The previous lesson has been devoted mainly to discuss : (a) income from house property liable to be taxed under the above head, (b) incomes from house property fully exempted from tax, (c) incomes from house property, partially exempt from tax, and (d) annual value of house property. This lesson will discuss expenses which are admissible for deductions from income from house property. With this discussion the theoretical aspect of this chapter will be completed and we shall then solve some practical problems from this chapter.

Admissible Deductions :

(1) Statutory Deductions 30% of Net Annual value.

(2) Interest on loan taken for the construction/ purchase of the house. The amount of interest for pre acquisition period is deductible in five equal instalments. In the case of self occupied house property the intt. is deductible upto Rs. 1,50,000 only. But if the loan has been taken before 1-4-1999 under this situation the maximum deduction for interest on loan is Rs. 30,000.

If the rent payable by a tenant can not be recovered by the owner of the house, such unrealised rent is deductible from GAV to calculate NAV. Subject to the following conditions–

(a) The tenancy is bonafide.

(b) The defaulting tenant has vacated or steps have been taken to compel him to vacate the property.

(c) The defaulting tenant is not in occupation of any property of the assessee.

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

(e) The annual value of the property to which the unpaid rent relates has been included in the assessed income of the previous year during which that rent was due and tax has been duly paid on such assessed income. In other words, the deduction of unrealised rent cannot be allowed in the previous year to which it pertains. Such deduction is allowed in subsequent years.

Practical Problems :

Problem No..1.–

Mr. Ram owns a house property, its annual lettering value is Rs. 8,000. During the previous year it was let out to a tenant on monthly rent of Rs. 600, he claimed the following expenses actually incurred by him.

(i) Municipal taxes Rs. 800,

(ii) Expenses for the recovery of rent Rs. 600

(iii) Maintenance Allowance paid to the step-mother Rs. 1,000 annually which was a charge on the property according to his father's will.

The house remained vacant for one month during the previous year. Find out the income from house property for the assessment year 2007-08.

Solution –

Computation of taxable income from house property of Mr. Ram for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Annual letting value		8,000
Less Municipal taxes		800
Adjusted Annual deduction		7200
Less Admissible deductions–		
Statutory deduction 30%		2160
Taxable Income from house property		5040

Hints : –

(a) The house has been let out on monthly rent of Rs. 600 per month. According to actual rent, the annual value should have been Rs. 200. But the rule is that the annual value will be fixed higher of the two, that is fair rent and actual rent. Since fair rent is higher than the actual rent in this problem, the annual value of the let out house has been determined as Rs. 8000.

(b) The admissible ceiling for the collection charges is 1/6 th of the net annual value or actual collection expenses whichever is less. In this problem 6% of the net annual value 7200 is Rs. 432 which is less than Rs. 600, hence Rs. 432 only will be allowed as admissible expenses for recovery of rent.

(c) Maintenance allowance paid to the step mother is an annual charge, have admissible expenses and will be allowed.

(d) Vacancy allowance is admissible in proportion to the period during which the house remained vacant. The proportionate amount is calculated with reference to the net annual value of the property and not with reference to the actual rent received. Hence vacancy allowance will be calculated 1/12 th of net annual value Rs. 7200=600.

Problem No. 2–

During the financial year 2006-07, Raja Ram owned four houses. Their municipal valuations are Rs. 5000, Rs. 5500 and Rs. 10,000 respectively. The municipality levies 10% tax which has been paid during the year. The first house is occupied by him for his own residence. Hari Ram is residing in the second house on a monthly rent of Rs. 600. The third house is occupied by a business firm on an annual rent of Rs. 6,000. In the fourth house, Raja Ram is carrying on his own business which has yielded a net taxable income of Rs. 10m, 145 during the previous year. The construction of the second and third house was started during the financial year 1983-84 and they were completed on 31.3.86.

He claims the following deductions–

(i) Interest on mortgage of the first house, Rs. 200.

(ii) The second house was gifted to him by his father in 1984 on the condition that he will pay a sum of Rs. 100 per month to his mother out of the income of the house. He paid Rs. 1200 to his mother during the year.

(iii) Rs. 600 paid as salary to a gardener in respect of the third house. His other incomes are Rs. 1200 for the year.

Compute the total income of Raja Ram for the assessment year 2007-08.

Solution–

Computation of Taxable Income from House Property of Shri Raja Ram for the assessment year 2007-08.

First House – Self occupied

Particulars	Amount Rs.	Amount Rs.
Annual value		Nil
Income from first House		Nil

Second House – Let out

Annual Rent		Rs. 7,200
Less Municipal taxes 10% of Rs. 6000		600
Gross Annual value		6,600
Less Admissible deductions–		
Statutory deduction 30%		1980
Income from Second House		4,620

Third House – Let out

Annual Rent	6,600	
Less (i) Municipal taxes 10% of		
Municipal value Rs. 5500	550	
(ii) Salary of Gardener	600	1150
		5450
Less Admissible deduction– 30%		1635
Income from Third House		3,815

Total Income from House Properties

	Rs.
First House	Nil
Second House	4,620
Third House	3,815
Rs.	8,435

Total Income of Mr. Raja Ram

	Rs.
(i) Income from Property	8,435
(ii) Income from Business or profession	10,145
(iii) Income from other sources	1,200
Total Income Rs.	19,780

Hints : (i) The annual value of the first house is taken to be nil because from the financial year 2006-07. On house property which is used for self occupied is allowed to the assessee as tax-free.

(ii) Statutory allowance will not be allowed in respect of the third house because it has not been let out for residential purposes. It has been let out for business purpose.

(iii) The annual value of the fourth house will be nil because it is used for self-business purpose.

Questions

1. What deduction are allowed from annual value in computing the taxable income from house property ? Discuss.

2. Mr. X is the owner of two houses which he uses for his residential purpose. Compute his taxable income from house property for the assessment year 2007-08 from the following information–

First house – Fiar Rental value Rs. 20,000.

Second house – Fair Rental value Rs. 12,000 Municipal tax paid at the rate of 10% of fair Rental value.

Interest paid on the loan taken for the construction of the first house Rs. 7000 and the second house Rs. 4000.

Fire Insurance Premium paid Rs. 400 and 200 on the first and the second house respectively.

The assessee specific the first house for exemption under section 23(2). The construction of the second house was completed in June 1988.

INCOME FROM HOUSE PROPERTY -(III)

Some simple practical problem have been solved in the previous lesson. A few advanced but difficult problems will be solved in this lesson.

Problem No.1.

Mr. X is the owner of three house properties, particulars in respect of which for the year ended 31st March, 2007 are as below :–

	Particular	First House	Second House	Third House
1.	Construction started on	1-4-1985	1-8-1985	1-7-1973
2.	Construction completed on	31-12-1987	31-1-1987	31-12-1973
		Rs.	Rs.	Rs.
3.	Actual rent received	4,500	900	Dwelling house
4.	Standard Rent Under Rent Control Act	3,500	1,000	No standard Rent fixed
5.	Municipal valuation	4,200	900	17,800
6.	Total municipal tax	420	90	1600
7.	Municipal Tax paid by Mr. X	420	45	1600
8.	Municipal tax paid by the tenant		45	
9.	Cost of repairs borne by	owner	owner	owner
10.	Vacancy period	–	–	3 months
11.	Colleion charges	50	30	
12.	Insurance Premium	10	10	260
13.	Interest on Loan taken for renewing the house	150	300	6000
14.	Unrealised rent allowed in the past recovered during the year	2000		

Mr. X resided in Delhi 3 months during the previous year in connection with his business and for all these three months his dwelling house remained vacant. During the period of his stay in Delhi he did not occupy any other house of his own.

Compute Mr. X's income from house property for the assessment year 2007-08.

Solution :–

Computation of taxable income of Mr. X from House Property for the assessment year 2007-08.

First House

Particulars	Amount Rs.	Amount Rs.
Actual Rent being higher than Standard Rent		4500
Less Municipal taxes		420
Less Statutory Deduction 30%	1224	4080
Interest on loan	150	1374
Income from First House		2706

Second House

Particulars	Amount Rs.	Amount Rs.
Annual Value Standard rent being higher than actual rent		1,000
Less Municipal taxes		45
Gross Annual Value		955
Less Statutory Deduction 30%	286	
Interest on loan	300	586
Income from Second House		369

Third House

Particulars	Amount Rs.	Amount Rs.
Annual Value (Self occupied)		Nil
Net Annual Value		Nil
Less Admissible deductions–		
Interest on loans up to Rs. 5000		5000
Loss from third House		5000

Income from All House Properties

Income from first House		2706
Recovery of unrealised rent		2000
Income from IInd House		369
		5075
Loss from Third House		5000
Taxable income from House Property		75

Hints : –

(i) Construction allowance in respect of first and second houses will be allowed because these properties have been let out for residential purposes. It will not be allowed in respect of third house, because it is self occupied.

(ii) In respect of second house, construction allowance will be restricted to Rs. 955 because gross annual value is less than Rs. 3600 that is Rs. 955.

(iii) Interest on loan up to Rs. 5,000 is admissible in respect of self occupied property.

Problem No. 2 :–

Mr. A is the owner of a house in Mumbai completely let out for residential purposes consisting of two flats of different sizes. They are let out at Rs. 500 per month and Rs. 700 per month respectively. Municipal value of the house is Rs. 10,000. The rate of municipal tax is at the rate of 15% per annum. The other particulars of the houses are as under :–

(a) The house is newly constructed, construction was completed on 1st April, 1989.

(b) Interest on loan of Rs. 10,000 taken on 1-4-1986 at the rate of 10 per cent per annum to construct the house, is Rs. 1,000 for the year. Interest for the preceding three year was also paid but not claimed as deduction.

(c) The second flat was vacant for 3 months during the year.

(d) Collection charges claimed by him were Rs. 700 but actual expenses were Rs. 500 for the year.

Compute his income from house property for the Assessment year 2007-08.

Solution –

Computation of Taxable Income of Mr. X from House Property for the assessment year 2007-08

First House

Particulars	Amount Rs.	Amount Rs.
Annual Value Rs. 500 × 12		6,000
Less Municipal taxes		625
Gross Annual Value		5375
Second House		
Annual Value Rs. 700 × 12		8,400
Less Municipal taxes		875
Gross Annual Value		7525
First House		5375
Second House		7525
Adjusted Annual Value of both houses :		12,900
Less Admissible deduction		
Statutory Deduction 30%	3870	
Interest on loans Current year Rs. 1000		
Preceding year 1/5 × 3000 = 6000	1600	5470
Taxable Income from House Properties		7430

Hints : –

(i) Construction allowance will be allowed in respect of both flats because each flat is an independent unit.

(ii) Municipal tax is Rs. 1500 (15% of Rs. 10,000). It will be distributed between the two flats in proportion to their annual values.

(iii) Interest on loan in respect of previous years is admissible in five instalments. Hence 1/5 of Rs. 3000 has been allowed.

Problem No. 3 :–

Shri Sukumar Roy has furnished the following particulars of his income for the period ended of 31st March, 2007.

	Rs.	Rs.	Rs.
(i) Salary received (Gross)			26,000
(ii) Income from House Property			
Property A (9 months)		1,800	
Property B		1,800	
Property C		1,200	
		4,800	
Less (a) Municipal taxes paid in respect of all the four properties A,B,C, and D at 20% of the annual value as per municipal records	1,600		
(b) Interest on loans taken for the construction of property D	600		
(c) Annual Charge in respect of Property B	720		
(d) Repairs to Properties Rs.			
Property A 150			
Property B 400			
Property 500	1050		
(e) Ground Rent – Rs.			
Property A 10			
Property B 8			
Property C 10	28	3988	802
Rs.			27,202

Hints : –

(1) The construction of properties A and C began in April, 1985 and were completed in the months of October 1988.

(2) Property A consists of office accomodation. It remained vacant from March, 2006 to June 2006 and has now been let out to M/s Anand Traders on 1.7.2006 at Rs. 200 per month.

(3) Properties B and C have been let out for residential purpose, whereas property D is used by Shri Roy for his own residence.

(4) According to municipal record the annual value of the properties A, B, C and D are Rs. 3,000, Rs. 1,600, Rs. 1,000 and Rs, 2,400 respectively.

Compute his income from house property and Gross Total Income for the assessment year 2007-08.

Solution :–

Computation of Taxable Income of Shri Sukumar Roy from House property for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Property A		
Annual Value – Municipal value being higher than actual rental value		3,000
Less Municipal Taxes 20% of Rs. 3,000		600
		2,400
Less Loss for Vacancy Period		600
Net Annual value		1,800
Less Statutory deduction 30%		540
Income from Property A		1,260
Property B		
Annual value– Actual rental value being higher than Municipal value–		1,800
Less Municipal Taxes 20% on Rs. 1600		320
Net Annual Value		1,480
Statutory Deduction 30%		444
Income from Property B		1036
Property C		
Annual value– Rental value being higher than Municipal value		1200
Less Municipal tax 20% on 1,000		200
Gross Annual Value		1000
Statutory Deduction 30%		300
Income from Property C		700
Property D		
Annual Value – being self occupied house		Nil
Net Annual value		Nil
Less Admissible deduction		
Interest on loans		600
Loss from Property D		600

Total Income from House Properties

Income from Property A		1260
Income from Property B		1036
Income from Property C		700
		2996
Less : Loss from Property 'D'		600
Total income from House Properties		2396

Statement showing the Gross Total Income

Salary received (Gross)		26,000
Taxable Income from salary		26,000
Taxable Income from House Property		2396
Gross Total Income		28,396

Hints : (i) Construction allowance will not be allowed in respect of property A because it has not been let out for residential purpose. It has been let out to M/s Anand Traders for office accomodation.

(ii) In respect of property B construction allowance has not been allowed, because it has not been stated as to when the construction of the property was computed.

Questions

1. Mr. Ram owns a house property. Its annual letting value is Rs. 9000. During the previous year it was let out on a monthly rent of Rs. 700. He claimed the following expenses actually incurred by him.

		Rs.
(a)	Municipal Taxes	900
(b)	Expenses for recovery of rent	600
(c)	Annual charges	1,000

The house remained vacant for one month during the previous year. Find out his income from house property for the assessment year 1991-92.

2. Shri Ramesh is the owner of two houses, one of which the Municipal valuation is Rs. 1,000 is occupied by him for his own residence and the other, of which the Municipal valuation is Rs. 1,800 is let out at Rs. 200 per month, the expenses for both the houses are–

Municipal taxes Rs. 280, land revenue for the house let out Rs. 150, interest on loan taken to repair the house let Rs. 300, fire insurance premium for the house Rs. 560

Find out his income from house property for the assessment year 1991-92.

INCOME FROM BUSINESS OR PROFESSION -(I)

Previous lesson have made it clear to you as to how income from salary and income from house property are taxed under Indian Income Tax Act. This lesson will discuss provisions of Indian Income Tax Act in relation to income from business or profession.

Meaning of Business and profession :

Business simply means any economic activity carried on for earning profits. Section 2 (3) has defined the term as any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture." In the words of Justice S.R. Dass the word "business" connotes some real, substantive and systematic or organised course of activity or conduct with a set purpose.

In this connection it is not necessary that there should be a series of transaction in a business and also it should be carried on permanently. Neither repeatition nor continuity or similar transactions is necessary. As already defined under section 2 (3), the income derived from any adventure in the nature of trade is also treated as business income.

A profession is an occupation requiring purely intellectual skill or normal skill controlled by the intellectual skill of the operator, e.g. lawyer, accountant, engineer, surgeon, author etc. So profession refers to those activities where the livelihood is earned by the persons through their intellectual or normal skill. Under section 2 (36) profesion include vocation.

Vocation means activities which are performed in order to earn livelihood, e.g. brokerage, insurance agency, music, dancing etc. As the rule for assessment of business, profession or vocation are the same, there is no importance of making any distinction between them from the Income-tax point of view.

Charging provision :–

The following are the incomes which are chargeable to income-tax under the head, profits and gains of Business or Profession.

(i) Business or profession income :

The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year are assessed under this head, the business or profession should be carried on in the previous year and it is not necessary that it should continue throughout the year.

(ii) Compensation :

Any compensation or other payment due to or received by the following persons is assessable as business income–

(a) Any person by whatever name called, managing the whole of substantially the whole of the affairs of an Indian Company at or in connection with the termination of his management or the modification of the terms and conditions relating thereto.

(b) Any person managing the whole or substantially the whole of the affairs on India or any other company in connection with the termination of his office or the modification of the terms and conditions relating thereto.

(c) Any person, holding an agency in India for any part of the activities relating to the business of any person in connection with the termination of agency or the modification of terms and the conditions relating thereto.

(d) 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.

(iii) Income derived by a trade, professional or similar association from specific services performed for its members.

(iv) The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of a profession e.g. where a lawyer in consideration of his services to a company gets free accomodation, the value will be assessable in the hands of the assessee as his income under the head 'Profits and Gains of Business or Profession.'

(v) Interest on securities, if the business of the assessee is to invest in securities, otherwise interest on securities shall be chargeable to income-tax under the head 'income from other sources.'

Where speculative transactions carried on by an assessee one of such a nature as to constitute a business, the business shall be called speculative business' and it shall be deemed to be distinct and separate from any other business.

Under section 43 (5) 'Speculative transactions means transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of commodity or scrips.

Computation of profits of business or profession :–

Under section 29 the profits and gains of business or profession shall be computed in accordance with the provision contained in section 30 to 43 C. Section 30 to 37 contain those deductions which are expressely allowed while computing profits of business or profession while section 40 provides those expenses which are expressely disallowed. Besides these, there are some other deductions which are allowed on the basic of general commercial principles while computing profits of business or profession. The general commercial principles are –

1. Profits should be computed according to the method of accounting regularly employed by the assessee, provided that the actual profit can be ascertained by this method.

2. Only that expenses and losses are allowed as deductions which were incurred or sustained during the relevant accounting year.
3. These losses should be incidental to the operation of the business. For example, embezzlement by on employee during the course of business is a loss incidental to the business. Similarly, loss from dacoity in a bank is also a loss incidental to the business of a bank.
4. Only the expenses incurred in connection with the business of the assessee are allowed as deduction.
5. If a business has been discontinued before the commencement of the accounting year, its expenses cannot be allowed a deduction against the income of any other running business of the assessee.
6. There are some essential expenses though neither expressely allowed nor disallowed, but are deductible while computing the profit of business or profession on the basis of general commercial principles produced that these are not expenses or losses of a capital nature.

Deductions Expressely Allowed :

Section 30 to 37 expensely provide for certain deductions to be made while computing profits of business or profession –

1. Expenses in respect of business promises :

Under section 30 the following deductions shall be allowed in respect of rent, rates, taxes, repairs and insurance for premises used for the purpose of the business or profession.

(a) Rent :

(i) The full amount of rent will be an admissible deduction in case the building premises are taken on rent.

(ii) In case no rent is paid or the assessee owns the business premises then no deduction shall be allowed because the landlord cannot be tenant also. If it is so, the assessee will not be taxed for the building income under the head, 'House property'.

(iii) If business premises belong to one of partners of the firm the rent paid to the land-lord partner shall be an admissible expense of the firm's business or profession.

(b) Repairs :

(i) In case the assessee is a tenant, and the agreement of rent provides that the tenant will bear the cost of repairs, the amount paid or spent on account of such repairs is allowed as deduction.

(ii) Otherwise than as a tenant e.g., the assessee is the owner of the premises the amount which the assesee spends on repairs will again be allowed as deduction.

(c) Local Taxes etc.

Any sum paid on account of land revenue local rates or municipal taxes in respect of the premises used for the assessee's business, if the assessee is the owner of the building. In case the building is on the rent then such part of these expenses which the assessee is supposed to pay under the contract of rent entered between the land lord and the assessee are also allowed.

(d) Insurance Premium :

The amount of any premium paid on respect of insurance against risk of damage or destruction on the premises of the assessee used for his business or profession is allowed as expenditure.

2. Repairs and insurance of machinery, plant and furniture :

Under section 31, the following deductions shall be allowed in respect of repairs and insurance of machinery, plant and furniture used for the purpose of the business or profession.

(i) The amount paid on account of current repairs thereto.

(ii) The amount of any premium paid in respect of insurance against rise of damage or destruction thereto.

3. Depreciation on fixed Assets :

Depreciation on fixed assets such as plants, machinery, furniture and fittings etc, in business expense and is allowed as admissible deduction at the rates specified in the Act.

4. Expenditure incurred in the field of Scientific Research :

Under section 35, the following deductions shall be allowed in respect of expenditure on scientific research.

(i) Any revenue expenditure laid out or expended on scientific research related to the business.

Where any such expenditure is incurred during the three years immediately preceding the commencement of the business on payment of salary to an employee engaged in such scientific research or purchase of materials used in such scientific research, the aggregate of such expenditure so incurred in the previous year in which the business commenced.

(ii) Any sum paid to scientific research association, whether or not the scientific research in related to the business, which has as its object the undertaking of scientific research or to a University, College or other institution to be used for scientific research provided that such association, university, college or institution is approved for the purpose by the prescribed authority by notification in the official Gazette.

(iii) Any sum paid to a university, college or other institution to be used for research in science or statistical research related to the class of business carried on provided the university or college or the institution is approved for this purpose by the prescribed authority.

Capital Expenditure on Scientific Research :-

Expenditure of a capital nature on scientific research related to the business carried on by the assessee is allowed in full for the relevant previous year, provided that no deduction shall be admissible under this clauses in respect of any expenditure on the acquisition of any land whether the land is acquired as such or as part of any property after 29th February, 1984.

Where any capital expenditure has been incurred during the three years immediately preceding the commencement of the business the aggregate of the expenditure so incurred shall be deemed to have been incurred in the previous year in which the business commenced.

5. Expenditure incurred on the acquisition of patent rights or copyrights :

Under section 35A, any capital expenditure incurred after 26th February, 1966 on the acquisition of a patent right or copyright used for the business shall be allowed as a deduction in 14 equal annual installments over a period of 14 previous years commencing from the previous year in which expenditure is incurred.

6. Expenditure on know-how :

Under section 35 AB any lump sum consideration paid by the assessee for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it equally over six years, namely, the year in which the lump sum consideration is paid and the five immediately succeeding years. Where the know-how is developed in a laboratory, owned or financed by the Govt. or a laboratory owned by a public sector company or a university or by an institution recognised in this behalf by the prescribed authority, the consideration shall be spread equally over the three years.

Other deductions :

Following expenditures are also admissible deductions from profits and gains of business or profession.

(a) Expenditure by way of payment to associations and institutions for carrying out rural development programmes.

(b) Expenditure by way of payment to associations and institutions for carrying out programmes of conservation of natural resources.

(c) 1/10th of preliminary expenses.

(d) Expenditure on prospecting etc. for certain minerals.

(e) The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purpose of business or profession.

(f) The amount of any premium paid by a federal milk co-operative society to effect on insurance on the life of the cattle owned by a member of a primary co-operative society.

(g) The amount of any premium paid by an employer by cheque for insurance on the health of his employees.

(h) Bonus or commission.

(i) The amount of interest paid in respect of capital borrowed.

(j) Contribution to provident fund by the employer.

(k) The amount of contribution to gratuity fund by the employer.

(l) Depreciation on animals.

(m) Bad debts.

(n) Expenditure on family planning.

(o) Entertainment expenditure.

(p) Expenditure on advertisement.

(q) Expenditure on holiday homes.

(r) Expenditure in connection with travelling by employees and other persons.

General Admissible Deductions Under Section 7 :

The following are the few examples of admissible general deductions under section 37–

1. Expenditure incurred in the purchase, manufacture and sale of goods.
2. General expenses incurred in the day to day running of the business.
3. Expenditure incurred in defending a case for damages for breach of contract.
4. Amount of sales-tax paid and expenses incurred in connection with sale-tax proceedings including appear.
5. Compensation paid to an undesirable employee for the retrenchment of his surces or to a director to get rid of his sources.
6. Compensation paid to employees in connection with injury sustained by them or accident met by them while on duty.
7. Royalties paid in connection with mines, patents and copy rights.
8. Insurance premium paid under a policy insuring its employees against injury or against liability for compensation in respect of accident to its workmen.
9. Reasonable expenses incurred on the occasion of Dussehra, Diwali, commencement of the business etc.
10. Compulsory subscription or a subscription given to an association the interest of the business.

11. Legal expenses incurred in connection with the business or profession.
12. Under executive instructions, cost of installing new machines.
13. Penalty paid by the assessee for saving from confiscetion of goods which was purchased from third party without knowing that they had been illegally procured.
14. Amount paid by a director of a company in liquidation for compounding misfeasonce proceeding started against him by the liquidator.
15. Welfare expenditure incurred by the assessee.
16. Present to employees by way of gifts which do not fall in category of perquisites.
17. Guarantee fee paid to the Govt. for loan obtained for purchase of machinery.
18. Annual listing fee paid to Stock Exchange by public limited company.
19. Expenditure incurred on inauguration ceremony.
20. Expenditure incurred on foreign tour of director for purpose of expansion of business managed company.
21. Losses due to robbery, dacoity, embezzlement, theft, non-recovery of advances provided such losses occur in normal course of business.

Questions

1. Explain clearly the deductions that are expressely allowed in computing the income from business under the Indian Income-Tax Act, 1961.
2. Under what circumstances are following items allowed as deduction is the computing income from business–

   (i) Repairs, (ii) Insurance premium, (iii) Interest, (iv) Legal charges,

   (v) Depreciations or investment.

INCOME FROM BUSINESS OR PROFESSION -(II)

The main object of this lesson is to discuss the expenses which have been expressely disallowed in computing the profits and gains from business or profession and the applications of income tax provisions in solution of practical problems.

Expenses expressely disallowed :

Section 40 expressely provides that the following expenses shall not be deducted in computing the profits and gains of business or profession.

(i) Payments outside India :

Any interest, royalty, fees for technical services or other sums chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted at source shall not be allowed as deduction.

(ii) Wealth tax :

Wealth tax chargeable under Wealth-tax Act shall not be allowed as a deduction.

(iii) Tax on Profits and Gains :

Any sum paid on current of any tax levied on the profits and gains of any business or profession or otherwise on the basis of any such profits or gains shall not be allowed as a deduction.

(iv) Salaries payable outside India :

Any payment which is chargeable under the head 'Salaries'. If it is payable outside India and if the tax has not been paid there or not deducted at source shall not be allowed as deduction.

(v) Payment to Provident Fund etc.

Any payment to a provident fund or other fund established for the benefit of the employees of the assessee shall not be allowed as a deduction, unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head, "Salaries."

Besides above mentioned expenses, following expenses, allowances and losses are also not allowed as deduction while computing income under the head 'profit and gains of business or profession.'

(i) Drawings, private or personal expenses of the proprietors, partners etc.

(ii) Any expenditure in the nature of capital expenditure.

(iii) The amount paid as charity and presents.

(iv) Any provision or reserve except the special reserve of the approved financial corporation.

(v) Any other expenditure which was incurred not necessarily, wholly and exclusively for the purpose of the business or profession of the assese.

(vi) Any provision for bad debts, taxation etc.

(vii) Depreciation in excess of the admissible amount under the provision of Income-tax Act.

Expenses of payments not deductible in certain circumstances :

(1) Excessive Payments :

Section 40 (A) (2) provides that where the assessee incures any expenditure in respect of which payment has been or is to be made to relative or to an associate concern, so much of the expenditure as is considered by the Assessing Officer to be excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him there from, shall not be allowed as a deduction.

(2) Payments in cash :

Section 40 A(3) provides for the disallowance of any expenditure in respect of which payment is made in a sum exceeding Rs. 10,000 otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft.

In such cases or in such places where banking facilities are inadequate or where exigencies of business demand payment in cash or otherwise there may arise some practical difficulties in observing the aforesaid rule, if any payment of a sum exceeding Rs. 10,000 is made otherwise than by crossed cheque drawn on a bank or by a crossed bank draft, the expenditure in respect of such payment shall not be disallowed.

(3) Provision of gratuity :

Provision made for the payment of gratuity to the employees on retirement or on termination of services will not be allowed as a deduction in computing taxable profits of the business or profession.

But provision made for gratuities payable during the current previous year will not be disallowed.

(4) Expenses in relation to income-tax proceedings :

Any expenditure in excess of Rs. 10,000 for any Assessment year incurred by the assessee by way of fee or other reumuneration paid to any person (other than an employees of the assessee) for services (not being services by way of preparation of return of income) in connection with any proceeding under the Income-Tax Act before any Income-Tax Authority or settlement commission or the competent authority or the Appellate Tribunal or any court or for services in connection with any other proceeding before any court relating to tax penalty, interest or any other matter under the Act and for any advice in connection with tax, penalty, interest or any other matter under the Act, shall not be allowed as a deduction.

PRACTICAL PROBLEMS

Problem No. 1 :

Mr. Z running a cloth business, has prepared the following Profit and Loss Account for the year ended 31st March, 2007. You are required to compute his income from business and his gross total income for the assessment year 2007-08.

Profit and Loss A/c

	Rs.		Rs.
Trade Expenses	450	Gross Profit	21,892
Establishment charges	2,500	Dividend (Gross)	2,600
Rent, Rates and Taxes	1,400		
		Interest on Non-Govt.	
Household Expenses	1,850	Securities (Net)	
Discount allowed	200	(Not Listed)	1,568
Income-tax	700		
Advertisement	450		
Postage and Telegrams	100		
Gift and Presents	125		
Fire Insurance Premium	250		
Donation to Prime Minister's			
Relief Fund	800		
Repairs etc.	1,600		
Life Insurance Premium	850		
Wealth-tax	600		
Interest on Capital	400		
Audit Fees	250		
Net Profit	13,835		
Rs.	26,060	Rs.	26,060

Solution : Computation of Taxable Income from Business of Mr. Z for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Net Profit as per Profit and Loss Account–		13,835
Add Expenses not admissible		
(i) House hold expenses	1,850	
(ii) Income-tax	700	
(iii) Donation to Prime Minister's National Relief Fund	800	
(iv) Life Insurance Premium	850	
(v) Wealth-tax	600	
(vi) Interest on capital	400	5,200
		19,035
Less Non-business Income–		
(i) Dividend (Gross)	2,600	
(ii) Interest on Non-Govt. Securities (Net)	1,568	
		4,168
Taxable Income from Business		14,867
Dividend (Gross)		2,600
Interest as Non-Govt. Securities $\frac{1568 \times 100}{784}$		2,000
Income from other Sources		4,600

Gross Total Income

Income from Business		14,867
Income from other sources		4,600
Gross Total Income		19,467

Hints – (i) House hold expenses and Life-Insurance Premium are not admissible expenses because these are personal expenses of the assessee.

(ii) Interest on borrowing is admissible expenses but interest on capital is not admissible expenses.

(iii) Divident will not be grossed up because gross figure is given in the question but interest on govt. securities will be grossed up because net figure has been given in the question.

Problem No. 2– Shri Prem Prakash is the proprietor of a business. His Profit and Account for the year ended 31st march, 2006 is as follows–

	Rs.		Rs.
Establishment	4,800	Gross Profit	50,840
Rent, Rates and Taxes	2,900	Interest on Gent	
		Seemities (Gross)	5,400
General charges	750		
House-hold expenses	1,730	Rent from house property	5,400
Commission	1,500		
Discount and Allowances	450		
Provision for the Bad Debts	1,200		
Postage and Telegrams	270		
Law charges	450		
Advertising	1,550		
Gifts and Presents	150		
Life Insurance premium (for goods)	360		
Sales Tax	1,450		
Repairs and Renewals (not for business premises)	480		
Loss on sale of motor car (used for private purpose)	1,800		
Life Insurance premium	1,790		
Wealth-tax	740		
Interest on Capital	350		
Audit fee	300		
Interest on Bank Loan	1,380		
Provision for depreciation	2,500		
Provision for income-tax	3,900		
Net Profit	30,840		
Rs.	61,640	Rs.	61,640

Following further information is given–

(a) Actual bad debts written off during the year amount to Rs. 550.

(b) Amount of income-tax actually paid during the year is Rs. 4700.

(c) Depreciation allowable is Rs. 1,703 as per income-tax rules.

(d) Advertising expenses include Rs. 550 spent on special advertising compaign to open a new shop in the market.

(e) Law charges are in connection with a trade mark.

(f) Shri Prem Prakash carries on his business from a rented premises, half of which is used as his residence. Rent, rates and taxes include Rs. 2,400 paid as rent of the premises during the year.

Compute the business income of Shri Prem Prakash and his total income for the assessment year 2007-08.

Solution–

Computation of Taxable Income of Shri Prem Prakash from business for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Net Profit as per Profit and Loss Account		30,840
Add expenses in admissible–		
(i) Rent of one-half premises	1,200	
(ii) House-hold expenses	1,730	
(iii) Provision for bad debts	1,200	
(iv) Loss on sale of motor-car	1,800	
(v) Repairs and renewals	480	
(vi) Life Insurance premium	1,790	
(vii) Wealth-tax	740	
(viii) Interest on capital	350	
(ix) provision for depreciation	2,500	
(x) Provision for income-tax	3,900	
		15,690
		46,530
Less Admissible expenses but not charged to P & L A/c–		
(i) Bad debts	550	
(ii) Depreciation	1,700	2,250
		44,280
Less Income out taxable under Business Income head–		
(i) Interest on Govt. Securities	5,400	
(ii) Rent from house property	5,400	10,800
Income from Business		Rs. 33,480

Income from House Property		
Annual value		5,400
Less Repairs		900
Taxable Income from House Property		4,500

Statement of Total Income for the assessment year 2007-08		
Income from House Property		4,500
Income from Business		33,480
Income from other sources (Interest on securities)		5,400
Gross total income		43,380
Less deduction under section 80 L		5,400
Taxable total income		37,980

Hints – 1. Expenses incurred on special advertising compaign to open a new shop in market are admissible as these are incurred for better marketing.

2. Law charges are assumed to have been incurred for the maintenance of an existing trade mark and hence they are allowed.
3. Deduction under section 80L is in respect of interest on government securities, the maximum limit of which is Rs. 7,000.
4. Repairs and renewals are not for business, hence assumed to be for house property and is, therefore, not allowable as business expenditure.
5. Gifts and presents assumed to be not in the nature of advertisement, hence disallowed.

Questions

1. Enumerate expenses which are not allowed in computing taxable profits of a business.
2. Give a list of expenses that are expressely allowed and expressely disallowed.
3. State with reasons whether the following are admissible deductions in the case of an individual business man–
   (i) Wealth-tax paid
   (ii) Interest paid on account of inadequate advance payment of tax
   (iii) Sales-tax paid
   (iv) Secret payment to Excise Inspector
   (v) Donation to Punjab University and
   (vi) Purchase of a typewriter for the office for Rs. 4,000.

INCOME FROM BUSINESS OR PROFESSION -(III)

Theoretical aspects of and a few practical problems from the chapter "Profits and Gains of Business or Profession" have been discussed and solved in the preceding lesson. In this lesson, a few more difficult practical problems will be solved.

Problem No. 1

From the following statement, compute the income from profession of Dr. S.K. N. Sinha –

	Rs.		Rs.
To Dispensary Rent	6,000	By visiting fees	15,000
To Electricity and water charges	3,000	By Consultation fees	25,000
To Telephone Expenses	2,000	By Sale of Medicines	12,000
To Salary to Nurse and Compounder	6,000	By Dividends	5,000
To purchase of surgical Equipments	6,000		
To Depreciation on X-ray machines	1,000		
To Income-tax	1,500		
To Donation to Ram Krishna Mission	1,000		
To Motor-car expenses	3,600		
To Depreciation on Car	1,800		
To Net Income	19,100		
	57,000		57,000

Notes :–

1. Electricity and water charge include domestic bill of Rs. 1,500.
2. Half of motor car expenses are for professional use.

Solution –

Computation of Taxable Income of Dr. S.K. N. Sinha from Profession for the Assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Net Income as per Income and Expenditure Account		19,100
Add Expenses inadmissible–		
(i) Electricity and water charges (domestic)	1,500	
(ii) Purchase of Surgical Equipment	1,000	
(iii) Income-Tax	1,500	
(iv) Donation to Ram Krishna Mission	1,000	
(v) Motor Car Expenses (for personal use)	1,800	
(vi) Depreciation (one half for personal use)	900	7,700
		26,800
Less Income not chargeable under this head		5,000
Taxable Income from profession		21,800

Hints –

(i) One-half of electricity and water charges are inadmissible expenses because these relate to domestic use.

(ii) Half of the motor car expenses and half of depreciation charges which relate to personal use of car are inadmissible expenses.

(iii) Purchase of surgical equipment up to Rs. 5000 per equipment is admissible expenses and any sum exceeding this limit is inadmissible expense.

(iv) Dividend income is not income from profession, hence not included under the head. It is chargeable to tax under the head. "Income from other sources."

Problem No. 2

Shri Mohan Kumar is a leading lawyer of Bombay. He deposits in the Bank all the receipts and always pay all the expenses by cheque, the analysis of his Bank Account for the year ending 31st March, 2007 is as under–

	Rs.		Rs.
Balance b/d	7,500	Salaries	14,000
Professional fees	1,40,000	Rent of Chamber	4,500
Dividend (gross Rs. 10000)	7,840	Telephone Expenses	1,000
House Rent	22,500	Magazine Subscription	3,000
		Motor car expenses	8,000
Income from House Rent (Gross Rs. 15000)	10,680	Miscellaneous office Expenses	5,500
Share of Income from Hindu undivided family	6,590	Purchase of Motor Car	15,000
		Advance payment of income-tax	40,000
		Donation to Bombay University	10,000
		Personal Expenses	45,500
		House Property Expenses	
		Rs.	
		(i) Taxes 5,000	
		(ii) Repairs 1,500	
		(iii) Insurance 1,500	
		(iv) Collection charges 2,000	
			10,000
		Balance C/o	38,610
Rs.	1,95,110	Rs.	1,95,110

Compute his gross total income after taking into account the following information–

(i) 1/4th of the motor car expenses relate to personal use.

(ii) Rate of depreciation on motor car is 20%.

(iii) Shri Mohan Kumar stays in his house, the gross annual value of which is Rs. 9,800.

The following are the expenses which have been included in the above account in respect of his house–

Insurance Premium Rs. 5000, Municipal Taxes Rs, 2,400.

Computation of Taxable Income of Shri Mohan Kumar from profession for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Professional fees as per his Bank Account		1,40,000
Less Admissible Expenses –		
(i) Salaries	14,000	
(ii) Rent of chamber	4,500	
(iii) Telephone expense	1,000	
(iv) Magazine subscription	3,000	
(v) Motor-Car expenses (3/4)	6,000	
(vi) Miscellaneous office expenses	5,500	
(vii) Depreciation on Motor Car (3/4)	2,250	
		36,250
Income from Profession		1,03,750

Income from House Property

	Rs.	Rs.
Annual Value		22,500
Less Municipal Taxes		2,600
Net Annual value		19,900
Less Admissible Expenses– Statutory Deductions 30%		5,970
Income from House Property		13,930

Income from other sources

	Rs.	Rs.
Income from House rent (Gross)	15,000	
Less Exempt being casual income	5,000	
		10,000
Dividend (Gross)		10,000
Income from other sources	Rs.	20,000

Statement Showing Gross Total Income

Particulars	Amount Rs.	Amount Rs.
Income from Profession		1,03,750
Income from House Property		13,930
Income from other sources		20,000
Gross Total Income		1,37,680

Problem No. 3–

From the following Profit and Loss Account of M/s Singh and Jha firm, Calculate the income under the head "Profit and Gains of business"–

	Rs.		Rs.
General Expenses	5,000	Gross Profit	40,000
Fire Insurance Premium	1,000	Bad debts recovered but disallowed earlier	4,000
Bad Debts	1,000		
Salaries	5,000	Interest from Govt. Securities	4,000
Advertisement	2,250		
Proprietor's salary	2,500		
Interest on Capital	2,000		
Income-tax	1,000		
Depreciation	2,000		
Sales-tax	5,000		
Advance Income-tax paid	1,000		
Donations	500		
Motor-car Expenses	750		
Net Profit	19,000		
	48,000	Rs.	48,000

General expenses includes Rs. 440 paid as compensation to an old employee whose services were terminated in the interest of the business and Rs. 200 by way of help to a poor student. Depreciation calculated according to the rates given comes to Rs. 2,900. 50% of motor car expenses are for proprietor's personal use.

Solution –

Computation of Taxable Income of M/s. Singh and Jha firm from business for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Net Profit as per P & L A/c		19,000
Add Inadmissible Expenses–		
(i) General Expenses (charity)	200	
(ii) Proprietor's Salary	2,500	
(iii) Interest on capital	2,000	
(iv) Income-tax	1,000	
(v) Depreciation	2,000	
(vi) Advance Income-tax paid	1,000	
(vii) Donation	500	
(viii) Motor Car's expenses (1/2 for personal use	375	9,575
		28,575
Less Admissible expenses not charged to P&L A/c		2,900
Depreciation		25,675
Less Income not chargeable under this head		
(i) Bad debts recovered	4,000	
(ii) Interest from Govt. Securities	4,000	8,000
Income from Business		17,675

Hints –(i) Help to a poor student is a charity hence inadmissible.

(ii) Depreciation according to the provisions of the Act amounting to Rs. 2,900 is admissible.

(iii) Only 50% of motor-car expenses which relates to business is admissible.

(iv) Bad debts recovered is not income from business because it has been disallowed in earlier year.

Questions

1. Shri R.K. Nair is a leading lawyer of Patna. He deposits all receipts in the bank and pays all expenses by cheque. Following is the analysis of his bank account for the year ending 31st March, 1991–

	Rs.		Rs.
By Balance b/d	7,460	Salaries	14,000
Professional Income	1,40,000	Rent of Chamber	4,500
Dividend (Gross Rs. 10,390)	8,052	Telephone Expenses	1,000
House Rent	22,500	Professional Expenses	3,000
Race Course Income	7,950	Motor-car Expenses	8,000
Shares of Income from H.U.F.	6,538	Miscellaneous Office Expenses	5,500
		Purchase of car	15,000
		Advance Income-tax	40,000
		Donation to Patna University	10,000
		Personal Expenses	45,500
		House Property Expenses–	
		Municipal Tax	5,000
		Repairs	1,500
		Insurance	1,500
		Collection Charges	2,000
		Balance C/o	36,000
Rs.	1,92,500	Rs.	1,92,500

Compute Shri Nair's total income after taking into account the following–

(a) 1/4 of the motor-car expenses relates to personal use.

(b) Allowable rate of depreciation on motor-car is 20%.

(c) Shri Nair stays in his house, the municipal value of which is Rs. 9,800. Following are the expenses which have been included in the above account in respect of this house–

Insurance Premium Rs. 500, Municipal Tax Rs. 2,400.

Q. 2. Shri Nemi Kumar of Mumbai submits the following Trading and Profit and Loss Account for the year ended 31st March, 2006. He is also in employment with a cinema company in Bombay. Compute his gross total income according to the provision of Income-Tax Act, 1961 for the Assessment year 2007-08.

Trading and Profit and Loss Account for the year ended 31st March, 1992.

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	60,000	By sales	4,20,000
To Purchases	3,90,000	By closing stock	80,000
To freight	15,000		
To Gross Profit	35,000		
Rs.	5,00,000	Rs.	5,00,000
To Salaries and wages	16,000	By Gross Profit	35,000
To Rent and Taxes	2,600	By Divident on shares (Gross)	2,000
To Household expenses	2,400	By rent from building let out	4,800
To Income-Tax	600		
To Postage and Telegrams	400		
To Donations	500		
To Life Insurance Premium	1,800		
To Audit fees	200		
To Reserve for doubtful debts	680		
To Bad debts			
Miscellaneous Expenses			
To Depreciation	500		
To Net profit	15,100		
Rs.	41,800	Rs.	41,800

The following information is also available–

(1) He has received salary of Rs. 12,000 from the Cinema Company in Bombay and has contributed 15% of his salary towards the recognised Provident fund.

(2) Parchases includes Rs. 5,000 advance to suppliers in March, 2006 against goods to be delivered on April 2007.

(3) Rent and Taxes include Rs. 1,800 being Municipal taxes paid for the building let out.

(4) The Life Insurance Policy is for Rs. 15,000.

(5) Donation is paid to the charitable institution recognised under section 80C of Income Tax Act, 1961.

(6) Miscellaneous expenses include Rs. 400 being the purchase of books for his employment.

(7) Depreciation permissible is Rs. 400.

CAPITAL GAINS – I

This is the fourth head of income chargeable to tax. The first three heads were income from salaries, income from house property and income from business or profession.

The Capital gains tax is levied on any profit or gains occuring on the transfer of a capital asset. Section (14) defines capital assets as : "property of any kind held by on assessee whether or not connected with his business or profession."

The definition has a very wide coverage as it eludes all types of properties whether movable or immovable, tangible or intangible, fixed or flating. Such asset may represent not only actual ownership but also any right in relation to any property which is capables of being transferred. The goodwill, the lease hold rights, right to subscribe for shares and share of partner in partnership etc. are also considered as capital assets for the purpose of this head.

Under section 2 (14) following assets have been specifically excluded from the scope of the definition of capital assets :–

(i) Any stock in trade, raw materials, consumable stores held by the assessee for the purpose of his business or profession.

(ii) Personal effects (movable property) including wearing apparel, motor-car, electrical appliances, refrigerator, furniture etc., ornaments excluding jewellery held for personal use by the assessee or any other member of his famiy dependent upon him.

(iii) Agricultural land in rural India.

(iv) 6% Gold Bonds 1977 or 7% God Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government.

(v) Special Bearer Bonds, 1991.

Types of Capital Assets :–

For computing Capital gains, assets have been divided into two categories :–

(i) Short-term Capital Assets : – Short-term Capital Asset means a Capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. Capital gains arising from the transfer of short-term Capital asset is called short-term Capital Gains.

In the case of share held in a company, short-term Capital asset will mean a share held by the assessee for not more than 12 months instead of 36 months in the case of other assets.