(ii) **Long-term Capital Assets :–** Long term Capital Asset means a Capital asset (other than shares in a Company) held by an assessee for more than 36 months immediately preceding the date of transfer. Capital gain arising from the transfer of long-term Capital asset is called Long-term Capital Gain. In the case of shares held in a company, long-term Capital assets will mean shares held by the assessee for more than 12 months.

Mode of Computing Capital Gains :–

The income chargeable under the head "Capital Gains" shall be computed by deducting from the full value of the consideration received or according as a result of the transfer of the capital assets of the following amount :–

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

(ii) The cost of aquisition of the capital assets and cost of any improvement thereto.

(b) From the figure of Capital Gain arrived at as per (a) above following further deduction will be made in the case of Long Term Capital Gains to arrive at the Net Taxable Capital Gains :–

(i) Where the amount of long-term Capital gain arrived at per (a) above does not exceed Rs. 10,000 the whole of such amount;

(ii) Where the amount of such capital gain exceeds Rs. 10,000 following further deductions shares be made :–

Status of Assessee	Rates of deductions in respect of long term Capital gains relating to buildings or lands, gold, bullion or jewellery.	Rates of deductions in respect of long term Capital gains relating to other Capital Assets.	Rates of deduction in respect of long term Capital gains relating to equity shares of venture Capital Undertakings.
(1) Company other than venture Capital Company	Rs. 10000 + 10% of the balances	Rs. 10000 + 30% of the balances	Rs. 10,000 + 30% of the balances.
(2) Venture Capital Company	Do	Do	Rs. 10,000 + 60% of the balance.
(3) Any other assessee	Rs. 10000 + 50% of the balances	Rs. 10,000 + 60% of the balances	Rs. 10,000 + 60% of the balances.

Provided that where the long-term Capital gain relates to both categories of Capital assets referred to above in clause (b) the deduction of Rs. 10,000 shares first be allowed against the long-term Capital gain relating to buildings or lands or gold or bullion or jewellery and thereafter, the balance, if any of the land Rs. 10,000 shall be allowed as deduction against long-term Capital gain relating to other Capital assets.

Long-term Capital Losses :–

Long-term Capital losses will also be scaled-down as per the above deductions (i.e. these deductions will be made from long term Capital lossess also in the same manner as from long-term Capital gains) and the net unabsorbed long-term Capital losses will be allowed to be carried forward for 8 years as business losses. For example, suppose Mr. A. sustain a long-term Capital loss of Rs. 40,000 in respect of land and building. The amount of Capital loss to be set off against any other income of the assessee will be Rs. 40,000 – (10,000 + 50% of the balances of Rs. 30,000) = Rs. 15,000. If it cannot be set off against any other income in the same year on account of insufficiency of such other income, the balance of Rs. 15,000 remaining unabsorbed shares be carried forward for 8 years as business loss.

Cost of Acquisition :–

The cost of acquisition of Capital asset is determined in the following manner.

1. Cost to the previous owner :–

If the asset is acquired in the following manners, the cost of acquisition shall be deemed to be the cost for which the previous owner acquired it, plus any improvement made in it :–

(a) Any distribution of assets on partition of Hindu undivided family; or

(b) Under gift or will; or

(c) succession, inheritance of devolution; or

(d) on any distribution of assets on the dissolution of a firm, body of individuals or other association of person; at any time before 1st, April, 1987. It means that with effect from assessment year 1988-89, the cost of assets distributed by the firm, etc. will not be the cost to the previous owner; but to the firm and the gain of the firm will be determined by deducting its cost from the fair market value of the asset on the date of distribution and it will be taxable in the hands of the firm under section 45 (4); or

(e) on any distribution of assets on the liquidation of a company; or

(f) under a transfer to a revocable or on irrevocable trust; or

(g) on transfer by a parent company to its Indian subsidiary company, which is wholly owned by the parent company; or

(h) on the transfer by a subsidiary company to its Indian holding company, which owns the whole of the share capital of the subsidiary company; or

(i) on the transfer of capital asset by the amalgamating company to the amalgamated company or the amalgamated company is an Indian company; and

(j) on throwing his property into the joint family hotchpotch. (The cost of the property to the H.U.F. will be taken as the cost of the property to the individual throwing the property.)

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 of the date on which capital asset became the property of the previous owner.

Further, where the capital assets became the property of the previous owner before 1st April, 1974, the cost of acquisition of the asset may, at the option of the assessee, be taken to be any one of the following :–

(i) The cost of the asset to the previous owner; or

(ii) The fair market value of the asset on 1st April, 1974.

2. Share in amalgamated company :– If the shares in an amalgamated company, which is an Indian company, became the property of the assessee due to transfer of shares, the cost of acquisition of the asset shall be deemed to be the cost of acquisition to him.

3. Conversion of shares :– Where the capital asset, being a share in the company, became the property of the assessee on the consolidation and division of shares, the cost of acquisition shall be the cost of the original shares held by him.

4. Cost of acquisition of goodwill :–

(a) In the case of acquisition of goodwill by purchase from a previous owner, the cost of acquisition means the purchase price, and

(b) In any other case the cost of acquisition shall be the nil.

5. Cost of acquisition of an asset acquired before April, 1, 1974 :– Under section 55(2) (i) where the capital asset (other than asset on which depreciation has been allowed) became the property of the assessee before 1st April, 1974, the cost of acquisition of the asset may, at the option of the assessee, be taken to the any one of the following–

(i) The cost of acquisition of the asset to the assessee; or

(ii) The fair market value of the asset on 1st April, 1974.

6. Cost of acquisition of an asset acquired and distribution of capital assets of a company on its liquidation :– Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to income-tax under the head 'Capital Gains' in respect of the asset under section 46, the cost of acquisition to him shall be the fair market value of the asset on the dose of distribution.

7. Cost of acquisition in case of devaluation of the rupees :– Under section 43A. the purpose of computing the capital gains arising to the assessee on the sales or transfer of a capital asset acquired by him from abroad on deferred payment terms or against a foreign loan, the additional rupee liability incurred by him in repaying the instalment of the cost or the foreign loan, as the case may be, after the date of devolution of the rupees, will be added to the original actual cost of the asset and the result out amount will be taken as the cost of acquisition of the capital asset.

8. Cost acquisition of bonus shares :– Where bonus shares ran pari passce, the cost of bonus shares, shall be determined by the process of averaging, i.e. by spreading the cost of original shares to the assessee over the old shares and the new bonus shares taken together. Where bonus shares do not rank pari passce, the cost of bonus shares may be determined on the basis of market price of the share before and after the issue of bonus shares.

Capital gains exempt from tax :–

1. Capital gains arising on the transfer on a long-term residential house (Sec. 53) :– Any capital gain arising to an individual or to a Hindu Undivided Family on the transfer of a long-term residential houses (including land appurtenent thereto,) the income of which is chargeable under the land 'house property' is fully exempted on the consideration received or accuring as a result of the transfer does not exceed Rs. 2,00,000. In case, where such consideration exceeds Rs. 2,00,000 the capital gain is exempted proportionately.

The term 'Capital gains' means gross capital gains without allowing any statutory deduction [Under Section 48(2)]. the exemption under section 53 is allowed first. On the balance amount of capital gains, statutory deduction is allowed, the exemption applies only to residential houses i.e., self occupied or let out. Non-residential properties e.g., business premises, hotel, godowns etc., are outside the purview of the exemption.

The exemption is not available if the assessee owns any other residential house on the date of such transfer.

2. Capital gain on transfer of house property used for residence (Sec. 54):– Any capital gain arising on the transfer of a house or land appartment thereto is exempted subject to the following conditions–

(i) The building is owned by an individual or Hindu Undivided Family;

(ii) Such property was being used as basis. There the date of receipt, of interest is immaterial for the purpose of taxation. But, however of any arrears of interest not charged to tax earlier, are received such interest is chargeable to tax on receipt basis.

Sale of securities and chargeability of interest :– Interest on securities does not accruese from day to day but it accures on specific period date i.e., yearly, half-yearly or quarterly. Therefore, the interest on securities is chargeable to tax in the hands of one who holds the securities on the due date of interest. The rule remains unaffected by the sale of securities, where securities are sold before the date of interest the price as paid to the seller by the purchaser may include the interest due to the seller up to date of sales. But for the purpose of taxation the amount of interest is not apportionable on a time basis between the sellers and the purchaser. The purchaser is assessable on the whole interest as he holds the securities on the due date of interest.

Bond washing transactions and chargeability of interest :– The holder of securities of normally assessable on the whole interest which falls due on the date of interest. But this rule does not apply to bond washing transactions. A bond washing transaction consists of selling of securities just on the eve of due date of interest and buying back some or similar securities after the due date of interest is over. Thus, a high income group assessee may avoid or reduce his tax liability by transferring the securities before the due date of interest to a person generally a friend or relative) who has no taxable income or whose rate of tax is quite low. As a result the whole interest is includible in the income of the transferee who holds the securities on the due date of interest. Thus the tax may be wholly avoided or substantially reduced depending upon the total income of the transferree. To prevent this it has been provided under section 94 (1) that the whole interest in respect of above washing transaction is deemed to be the income of the transferer and not that of transferee.

Profit on Sales of Securities :– If securities are held as stock-in-trade, profit on sale of such securities is chargeable to tax under the head "Profit and gains of business or profession." If securities are held as investment, any profit on the sale of such securities is chargeable to tax under the head "Capital gains."

Kinds of securities :– From the point of view of taxation, securities are of four types :–

(i) Securities exempt from tax,

(ii) Tax-free Government Securities,

(iii) Tax-free Commercial Securities

(iv) Less-tax Securities.

Securities exempt from tax :– Interest on following securities does not form part of the total income of an assessee. Interest on these securities is exempted from tax :–

(i) Monthly payment on the 15 year Annuity certificate;

(ii) Annual payment on National Defence Gold Bonds, 1980;

(iii) Premium on redemption of Special Bearer Bonds, 1991;

(iv) Treasury Savings Deposit Certificate;

(v) Post Office Cash Certificate ;

(vi) Post Office National Plan Savings Certificate;

(vii) National Plan Certificates;

(viii) 12– Year National Plan Savings Certificate;

(ix) Interest on such capital investment bonds as the Central Government may notify;

(x) Interest on Securities held by the issue department of the Central Bank of Ceylon;

(xi) 10– year Defence Deposit Certificate;

(xii) Government of India Defence Certificates;

(xiii) 2– Year National Defence Certificates;

(xiv) Seven-year National Savings Certificate (II and III issue)

(xv) Tax-free Bonds being issued by Government Companies or Public Sector Undertakings.

The rest three types of securities, methods of crossing up of interest and expenses as admissible deductions from income from securities will be discussed in the next lesson.

Questions

1. Explain clearly the meaning of the term "Dividend" as defined in the Indian Income tax Act and point out the law relating to the assessment of the dividend income.

2. Describe the method of computing income under the head "Income from other sources."

3. Write short notes on :–

   (i) Bond Washing Transactions;

   (ii) Profits or loss on sale of Securities.

"CAPITAL GAINS" – II

We explained the terms, capital gains, transfer of assets, short-term capital asset and long-term capital asset and cost of acquisition in the previous lesson. We further explained the exemption granted under section 53 and 54 from Capital Gains Tax. In this lesson we shall continue to explain the exemption granted to an assessee from Capital Gains Tax under sections 5'B, 5.E, 54F and 54G.

1. Capital gain on transfer of agricultural land (See 54B) :– Where any capital gain arises on the transfer of agricultural land, used by the assessee or his parents at least for the period of two years before the date of its transfer and where the assessee has purchased any other agricultural land wihtin a period of two years after the date of its transfer, such capital gain is to be treated as under:–

(i) The capital gain arising on the transfer of old agricultural land is exempt to the extent it is reinvested in the purchase of any other agricultural land within the aforesaid period. If whole capital gain is reinvested, it is fully exempt from income-tax. If only a part of it has been re-invested, the balance of it is chargeable under income-tax.

(ii) New agricultural land so purchased should not be transferred within three years of its purchase.

(iii) where the amount of capital gain which is not utilised by the assessee for the purchase of agricultural land before the date for furnishing the return of his income, the unutilised amount is to be deposited on or before the due date of furnishing the return of income in an account opened under the Capital Gains Account Scheme, 1988 and utilised in accordance with the scheme. The amount already utilised for reinvestment together with the amount of deposit shall be deemed to be the cost of new agricultural land.

If this new land is transferred within three year of its purchase, then the capital gain arising from the transfer of new land together with exempted capital gain of the old land shall be the chargeable capital of the pevious year in which the new land is transferred.

If the amount deposited is not fully utilised for acquiring the new agricultural land within two years, the amount not so utilised shall be treated as the long-term capital gain of the previous year in which the period of two year expires.

2. Capital gain on the transfer of long-term asset (54E) :– Any capital gain arising on the transfer of a long-term capital asset is treated as under :–

(i) Such long-term capital gain is fully exempt of the whole net consideration from such transfer is invested or deposited in the specified financial assets within a period of six months after the date of such transfer. If only a part of the net consideration is so invested or deposited, the exemption from capital gains is granted proportionately.

Where the asset is transferred after 31.3.89, the exemption will be available if the amount is invested in :–

(a) Securities of the Central Government specified by that government in this behalf;

(b) Special series of units of the Unit Trust of India specified by the Central Government in this behalf;

(c) Notified National Rural Development Bonds;

(d) Such debentures issued by the Housing and Urban Development Finance Corporation Limited, as the Central Government may specify in this behalf;

(e) Notified Bonds issued by any public sector company;

(f) Notified debentures or bonds issued by the National Housing Bank.

An important condition of exemption is that the assessee will be required to hold the new Bonds for a period of three years from the date of its acquisition, the exemption will be forfeited if the assessee transfers the Bonds before the end of the aforesaid period of three years, and the exempted capital gain will be taxed as long-term capital gain in the year in which the Bonds are transferred.

3. Capital gain on the transfer of certain assets to be exempt if not consideration arising on such transfer is invested in a residential house (Sec. 54F) :– long-term capital gains are exempt under this section if the following conditions are satisfied :–

(i) The assessee is either an individual or a Hindu Undivided Family;

(ii) The assessee has transferred a long-term capital asset which is not a residential house;

(iii) The assessee does not own any other residential house except as mentioned in (iv) below;

(iv) The tax-payer purchases within a year before or within two year after the date on which the transfer took place or constructs within a period of three year after the date of transfer a residential house, the capital gain arising from the transfer will be treated in a concessional manner as under :–

(a) If the cost of the new house (new asset) that has been purchased or constructed is not less than the net consideration in respect of the capital asset transferred the entire capital gain arising from the transfer will be exempt from tax;

(b) If the cost of newly acquired house is less than the net consideration in respect of the asset transferred, the exemption from long term capital gain will be granted proportionately;

(v) Where the assessee purchases or constructs any other residential house (other than the new assets mentioned in (iv) above) within the aforesaid period of two years, three years the exemption under this section if allowed shall stand forefeited and shall be deemed to be the long-term capital gain of the previous year in which such residential house is purchased or constructed.

The provision relating to Capital Gain Account Scheme apply to this section also.

If a tax-payer transfers the newly acquired residential house within three years of its purchase or construction, then the amount of capital gain arising from the transfer of the original asset which was not changed to tax shall be deemed to be the long-term capital gain of the year in which the new asset is transferred.

4. Exemption of capital gains on transfer of asset in cases of shifting of industrial undertakings from urban area (Sec. 54 G) :– Capital gain on shifting of industrial undertaking from urban area to non-urban area are exempt if the following conditions are satisfied :–

(a) The assessee transfers a long-term or short-term capital asset in the nature of plant, machinery, building or land or any right in building or land.

(b) Such asset should have been used for the purposes of business of industrial undertaking situated in urban area;

(c) The asset should have been transferred in connection with the shifting of the undertaking to a non-urban area;

(d) The amount of capital gain should be utilised within a period of one year before or three years after the date of transfer for the following purpose :– (i) Purchases of new machinery or plant and acquires land or building or constructs building for the purposes of his business in the area to which the undertaking is shifted or (ii) Incur expenses on shifting of the original asset and transferring the establishment of the undertaking to such area and (iii) Incurs expenses on such other purposes as may be specified in the scheme framed by the Central Government. The capital gain arising from such transfer shall be exempt to the extent such gain has been utilised for the aforesaid purposes.

The provisions relating to Capital Gain Account Scheme apply to this section also.

Where the new asset is transferred within three years of its being purchased, acquired, constructed or transferred, the cost of the new asset shall be taken as nil. Where the capital gains were more than the cost of the new asset the unutilised capital gains shall be put to tax under section 45.

Illustration 1.

Mr. P. sold his residential house for Rs. 3,00,000 on 31.8.2003. Indexed cost of the house was Rs. 1,20,000. He paid 2% on sale as brokerage. He purchased another house on 12.11.2003 for Rs. 1,30,000. Compute his Taxable Capital Gain.

Solution :–

Computation of Capital Gain

	Rs.	Rs.
Selling Price of residential house		3,00,000
Less : Selling expenses	6,000	
Indexed cost	1,20,000	1,26,000
LTCG		1,74,000
Less : Cost of new house		1,30,000
Taxable LTCG		44,000

Illustration 2.

From the following information of an assessee compute the chargeable capital gains :

(a)	(i)	Cost of acquisition of residential house in 1981-82	2,00,000
	(ii)	Sale consideration on 2.6.2003	13,00,000
	(iii)	Cost of new house purchased for residential purposes by due date of filing the return	2,50,000
	(iv)	Amount deposited in Capital Gains A/c Scheme by the due date of filing the return for A.Y. 2004-05	1,00,000

The cost inflation index in 1981-82 was 100 and in 2003-04 it was 463.

(b) Would it make any difference if the assessee deposits Rs. 3,00,000 in Capital Gains A/c Scheme by the due date of filing the return for Assessment Year 2004-05 but does not utilise the amount of acquisition of residential house before 2.6.2006.

Solution : (a) **Computation of Capital Gains for the A.Y. 2004-05**

Sale Consideration		13,00,000
Less : Indexed cost of acquisition 2,00,000 × 463 ÷ 100		9,26,000
		3,74,000
Less : (i) Cost of new house	2,50,000	
(ii) Amount deposited in the scheme	1,00,000	3,50,000
Capital Gain Liable to Tax		24,000

(b) **Computation of Capital Gains**
for the A.Y. 2004-05

Sale Consideration	13,00,000
Less : Indexed cost of acquisition	9,26,000
	3,74,000
Less : Exemption u/s 54 regarding deposit under Capital Gains Account Scheme, 1988	3,00,000
Capital Gain Liable to Tax	74,000

In (b), it is assumed that he has not purchased any house as given in clause (iii) of (a) part of the question, hence deduction for deposit only has been allowed. If the amount of the deposit is not utilised for construction of new residential house before 2.6.2006, Rs. 3,00,000 shall be deemed to be long-term capital gain for A.Y. 2007-08.

Illustration 3.

Mr. P owns a residential house at Agra which he acquired in May 1989 for Rs. 3,00,000. He sells the house for Rs. 23,00,000 on August 18, 2003. He purchases a residential house at Kanpur on February 14, 2004, for Rs. 5,00,000 for use by his daughter for her residence. On July 31, 2004 (being the due date for furnishing return of his income for the assessment year 2004-05) he deposits Rs. 8,00,000 in State Bank of India, Agra, under the Capital Gains Account Scheme.

Suppose he gets constructed a residential house at Agra on September 30, 2005, for Rs. 7,00,000. This house was to be used by him for his own residence. The entire cost of construction of this house is financed by withdrawing from the aforesaid deposit account. The unutilised amount in the deposit account is withdrawn by him after 18th August, 2006. Find out the amount of capital gains chargeable to tax for the assessment year 2004-05 and 2007-08. Besides, the above house properties he owns a premises used for his business since 1968. The cost inflation in 1989-90 and 2003-04 is 172 and 463.

Solution : **Computation of Capital Gains**
for the Assessment year 2004-05

		Rs.
Sale Proceeds		23,00,000
Less : Indexed cost of acquisition 3,00,000 × 463 ÷ 172		8,07,558
Balance		14,92,442
Less : Exemption u/s 54		
Cost of new house	5,00,000	
Amount deposited in Capital Gains Account Scheme within the prescribed time	8,00,000	13,00,000
Taxable Capital Gain		1,92,442

Computation of Capital Gains
for the Assessment year 2007-08

(Stipulated period of 3 years for utilisation of deposit amount expires in the previous year relevant to the Assessment year 2007-08)

	Rs.
Deposit made on 31st July, 2004	8,00,000
Less : Amount utilised for the construction of house property within 3 years	7,00,000
Unutilised amount treated as capital gain (Long-term)	1,00,000

Illustration 4.

Mr. Ram had been living in a house which he purchased in 1981-82 for Rs. 2,00,000. The house was acquired by the Government in July, 2003 and compensation of Rs. 11,70,000 was paid to him. He purchased a residential house in Feb., 2003 at Rs. 4,40,000. The additional compensation of Rs. 70,000 was given to him in March, 2005. If he sells the new residential house in October, 2004 at Rs. 5,60,000, compute the amount of capital gain, chargeable to tax for the assessment year 2004-05 and 2005-06 . The cost inflation index in 1981-82 was 100 and in 2003-04 it was 463.

Solution :–

Computation of Capital Gains
for the Assessment year 2004-05

	Rs.
Compensation received	11,70,000
Less : Indexed cost of house $2,00,000 \times 463 \div 100$	9,26,000
Capital Gain	2,44,000
Cost of the new house purchased in February, 2003	4,40,000

Capital gain chargeable to tax– Nil, as the cost of new house is more than the amount of capital gain.

Computation of Capital Gains
for the Assessment year 2005-06

	Rs.
Selling price of the new house	5,60,000
Less : Cost of the new house purchased in February, 2003 (Rs. 4,40,000 – Rs. 2,44,000 Capital Gain)	1,96,000
Short-term Capital Gain	3,64,000
Additional Compensation	70,000
Capital Gain	4,34,000

Illustration 5.

S, an owner of three houses, sells a residential house in Chennai for Rs. 11,90,000 on May, 23, 2003. This house was purchased by him on April 1, 1987 for Rs. 2,90,000 ; on May 30, 2003, he purchased a flat in Mumbai for Rs. 8,70,000 for the purpose of the residence of his son-in-law. On March 1, 2004, S sells the house in Mumbai for Rs. 12,10,000.

Compute the capital gains arising on the two transactions. Is S eligible for exemption u/s 54 in respect of the second sale ? (Cost Inflation Index for the financial years 1987-88 and 2003-04 are 150 and 463).

Solution :–

Computation of Capital Gains

for the Assessment year 2004-05	Rs.
Sale Proceeds of house in Chennai	11,90,000
Less : Indexed cost of the house	
$2,90,000 \times 463 \div 150$	8,95,133
First Transaction's Capital Gain (Long-term)	2,94,867

The whole of the Capital gain would be exempt as the cost of the new house purchased is more than the amount of capital gain. But since the new house purchased in May, 2003, has also been sold in March, 2004 (i.e., before the expiry of three years) the exemption granted earlier in the same year shall be withdrawn and the exempted capital gain of Rs. 2,94,867 shall be taxed. Thus,

Sale of house in March, 2004	12,10,000
Less : Cost of the house purchased in May, 2003	8,70,000
Second Transactions Capital Gain (Short-term)	3,40,000

Taxable Capital Gain = Rs. 3,40,000 + Rs. 2,94,867 = Rs. 6,34,867

(Old exempted capital gain being withdrawn)

Hence Rs. 6,34,867 will be taxed as Short-term Capital Gain.

S is not eligible for exemption u/s 54 in respect of the second sale.

Hints :– To find out long-term capital loss provisions of section 48(2) will be applicable in the same manner as these are applied when long-term capital gains are calculated.

Questions

1. Discuss the rules regarding exemptions of Capital Gains.

2. P sold a house property (shop) on 30th November 2006 for Rs. 1,10,000. He had acquired this property from O under a will on 1st January, 2004 and expended Rs. 15,000 on its improvement in 2007 . Compute P.S. income under the head 'Capital Gains' for the Assessment year 2007-08 assuming that O had acquired this property at a cost of Rs. 40,000 in 1978 and further spent Rs. 5,000 during the same year on the improvement.

3. From the following information of Mr. X compute the Capital Gain liable to tax in the assessment year 2007-08.

		Rs.
(i)	Cost of acquisition of residential house in 1983.	3,00,000
(ii)	Sale consideration on 2.9.2006	10,00,000
(iii)	Cost of construction of the new house by the due date of filing the Return of Income for Assessment year 2007-08. The house is to be Mr. X's sister for her residence	4,00,000
(iv)	Mr. X does not own any other residential house.	

"INCOME FROM OTHER SOURCES" – I

The fifth and residuary head of income is "Income from Other Sources". Every income which does not specifically fall under any of the preceding four heads shall be included under this head. Under section 56(1) every kind of income which is included in the total income under this Act, and which is not chargeable to tax. Under any of the four heads specified in section 14 is chargeable to income-tax under the head "Income from Other Sources".

Chargeable Incomes :– Incomes chargeable to tax under this head may be divided under two sub-heads :–

(i) Specific incomes;

(ii) Other incomes.

Specific income :– The following incomes are specifically provided to be taxable under this heads :–

1. Dividends ;
2. Any annuity due or commuted value of any annuity paid under the provisions of "Annuity Deposit Scheme".
3. Any winnings from lotteries, cross-word puzzles, races including horse races card games and other games of any sort or from gambling or betting of any form or nature whatever.
4. Contribution received by the assessee-employer from his employees to any provident fund or superannuation fund or any fund set up under the provisions of the Employees. State Insurance Act 1998 or any other fund for the welfare of the employees, if such income is not chargeable under the head "Profit and gains of business or profession."
5. Interest on securities if it is not chargeable to tax under the head "Profit and gains of business or profession."
6. Income from letting of machinaries, plant or furniture belonging to the assessee, if the same is not chargeable to income-tax under the head, "profits and gain of business or profession."

If the machinery, plant or furniture do not belong to the assessee, the rental income therefrom is always to be business income. So, in a case where the assessee is himself a hirer of the machinery, plant or furniture, the income derived by him from sub-letting of machinery, plant or furniture is a business income.

7. Income from letting of machinery, plant or furniture belonging to the assessee alongwith the building under an inseparable letting, if the same is, not chargeable to tax under the head, " profits and gains of business or profession."

Other Income :– Besides the aforesaid seven incomes, the following income are chargeable under the head as they are not covered under any other head :–

1. Director's fee and Director's commission for under writing shares of a new company;
2. Income derived by sub letting a house by a tenant;
3. The salaries of a Member of Parliament;
4. Examinership fee received by a lecturer from a University;
5. Unexplained investments in the construction of house property;
6. Interest or own contributions to an unrecognised provident fund;
7. Interest on loans, bank deposits or current account, and interest payable under a decree;
8. Interest received on excess payment of advance tax or interest received on delayed refunds;
9. Interest under National Deposit Scheme;
10. Interest on cumulative deposit scheme;
11. Income from subletting any vacant plot of land;
12. Ground rent;
13. Insurance Commission;
14. Beneficiary getting income portion from wakf;
15. Income from market rights, fisheries, rights of ferry of moorings or grazing rights;
16. Mining rent and royalties;
17. Annuity payable under will;
18. Income from forest produce;
19. Interest on foreign government securities;
20. Casual income in excess of Rs. 5,000.

Deductions :– Under section 57 the income chargeable under the head, "Income from other sources' shall be computed after making the following deductions :–

1. In the case of dividends or interest on securities, any reasonable sum paid by way of commission, remuneration of a banker or any other person for the purpose of realising such divident or interest on behalf of the assessee. In the case of foreign company, no deduction will be allowed in computing its income by way of dividends.
2. Where employee's contribution to Provident Fund etc. are treated as the income of the assessee (employer) it is included in his income from other services and a deduction of the sum, credited by the assessee to the employee's account in the relevant fund on or before the due date will be allowed under this head.
3. In the case of income from letting of machinery, plant or furniture alongwith letting of buildings, which is chargeable to tax under the head "Income from other sources", the deductions in respect of the following shall be allowed in the same manner as they are allowed under the head "Profits and Gains of Business or Profession"–

(i) Expenditure incurred regarding current repairs of machinery, plant, furniture and building.

(ii) Insurance premium paid regarding building, machinery, plant or furniture against rise of damage or destruction of the assets.

(iii) Depreciation on buildings, machinery, plant or furniture.

4. In the case of income in the nature of family pension received by the widows of heirs of deceased employee, a deduction of a sum equal to $33\frac{1}{3}\%$ of such income or Rs. 12,000 whichever is less, will be allowed.

5. Any other expenditure (not being a capital expenditure) incurred wholly and exclusively for the purpose of earning such income. It should not be in the nature of personal expenses, of the assessee.

Amount not deductible :– Following amount shall not be deductible in computing the income chargeable under the head, "Income from Other Sources"–

1. Personal expenses of the assessee cannot be allowed.

2. Expenses incurred for income-tax proceedings in excess of Rs. 10,000 cannot be allowed.

3. If any interest, chargeable to tax is payable outside India, without deduction of tax, such interest cannot be deducted. But this conditions is not applicable if the interest is paid on a loan issued for public subscription before 1st April, 1938, or there is a person in India who may be treated on an agent of the recipient of interest.

From the assessment year 1989-90 and subsequent years interest payable outside India without deduction of tax at source is not to be deducted even if there is an agent of the recipient in India.

4. If any payment chargeable to tax under the head "Salaries" is payable outside India without deduction of tax at source, such payment cannot be deducted.

5. No deduction can be allowed in respect of wealth-tax payable by the assessee.

6. From the assessment year 1987-88 and subsequent years no deduction is allowed in respect of any expenditure incurred in earning such income by way of winning from lotteries, cross word, puzzles, races including horse races and card games and other games of any sort or from gambling or betting of any form or nature whatever. The prohibition does not apply in respect of the assessee who is the owner of the house maintained by him for running in house races.

7. Any payment which is not deductible in computing taxable profits of business or profession is also not deductible in computing income from other source.

Dividend :– In ordinary language dividend means the sum received by a share holder of a company on the distribution of its profits; but under section 2(22) dividend includes the following :–

(a) Any distribution by a company of accumulated profit if such distribution entails the release by the company to its shareholders of all or any of the assets of the company;

(b) Any distribution to its share holders by a company of debentures of deposit certificates in any form, and any distribution to its preference share holders of shares by way of bonus, to which the company possesses accumulated profits.

(c) Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation;

(d) Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessses accumulated profits;

(e) Any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a shareholder being a person who is the beneficial owner of shares holding not less than 10% of the voting power or to any c ncern in which such shareholder is a member or a partner and in which he has a substantial interest, to the extent to which the company possesses accumulated profits.

Rules regarding taxation of dividends :–

1. Under section 8(a), for the purpose of inclusion in the total income of an assessee any dividend declared by a company shall be deemed to be the income of the previous year in which it is so declared, distributed or paid as the case may be.

2. Under section 8(b) any interim dividend shall be deemed ... to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it. It means that the date of declaration of such dividend is immaterial so long as the amount is not released for disburse rent.

3. Under section 9 (1) (iv), dividend paid by an Indian Company outside India shall be deemed to accrue or arise in India.

4. The entire amount of dividend received by a shareholder is taxable in his hands, even if the company had distributed this dividend out of non taxable income.

5. In the case of dividend received from a foreign company, if the foreign company has deducted tax at sources and nothing is paid out of it to the Government of India, the amount deducted as tax at source shall not be included in the dividend income of the Indian shareholder.

6. Formerly the income-tax paid by a company or its profits was deemed to have been paid on behalf of its shareholder; but now this process has been given up. The present process is like this. The income-tax deducted at sources from the dividend declared for the shareholders is to be included in the dividend income of the shareholders and as such the net amount of dividend received by a shareholder has to be grossed up and the shareholder gets credit in his assessment for the amount of tax deducted at sources from the dividends declared by the company.

Deduction of tax sources :– In respect of dividends payable by an Indian Company or a company which has made the prescribed arrangement for declaration and payment of dividends in India to persons who are resident in India income-tax at 21.6% shall be deducted at sources during the financial year 1990-91 provided the dividend has been declared or paid up to 14th January, 1991. If dividend is declared or paid after 14th January, 1991 tax has to be deducted at source at the rate of 22.4%.

However, the tax will be deducted at source from dividends payable to an individual who is resident in India by a company in which the public are substantially interested up to Rs. 2,500, provided it is paid by an Account Payee cheque.

Interest on Securities :– Prior to assessment year 1989-90, interest on securities was charged to tax under a specific head, named "Interest on Securities". But from the assessment year 1989-90 and subsequent years the specific head "Interest on securities" has been deleted and now the relevant provision is that if the securities are held as steckin-trade, the interest from such securities will be taxable as business income. If the securities are held as investment, the interest from such securities will be taxable as income from other sources.

Interest payable on the following securities is chargeable to tax under the head "Income from other sources."

(i) Securities of the Government.

(ii) Securities on debentures of a local authorities in India.

(iii) Securities or debentures of a company.

(iv) Securities or debentures of a statutory corporation.

Basis of charge :– Interest on securities is chargeable under this Act on due as residential house.

(i) The income of such house property is chargeable under the head "Income from House Property".

(ii) The exemption will be available only in relation to a house property which had been held by the tax-payer for a period exceeding 36 months before transfer.

(iii) The assessee has within a period of one year before or two years after the date of transfer purchased a residential house, or he has within a period of three years after the date of transfer constructed a residential house, where on assessee starts construction of a new building before sale but completes it after the sale of old building the assessee is entitled to exemption.

(iv) The capital gains arising from the transfer of such residential house is exempt to the extent of the cost of new residential house purchased or constructed within the specified period. It means that of the whole capital gain is re-invested in the cost of new house it is fully exempt from tax. Where the amount of capital gain is spent partly of purchase of house property and partly on further construction of it, exemption is available in respect of both the amounts;

(v) Where the amount of capital gain is rest utilised by the assessee for acquisition of new house before the date of furnishing the rent of income under section 139, it shall be deposted by him on or before the due date of furnishing the return of income in an account opened under the Capital Gains Account Scheme, 1988, with State Bank of India or any of its subsidiaries or with any nationalised bank authorised by the Central Government in accordance with the scheme and utilised in accordance with the scheme. The amount already utilised for re-investment together with the amount of deposits shall be deemed to be the cost of the new house.

The new house (Purchased or constructed) should not be transferred within a period of three years of its purchase or construction. It is transferred within these years, the old exempted capital gains and new capital gains (if any) arising on the transfer of the new residential houses, shall be chargeable to tax as the income of the previous year in which the new residential house is transferred.

If the amount deposited is not utilised fully for acquiring the new house within the period of three years, the amount not so utilised shall be treated as the long term capital gain of the previous year in which the period specified expires.

The effect of Capital Gains Account Scheme is that the assessee must utilise the capital gain for acquisition of new house on or before the due date for furnishing the return of income or deposit under this scheme. After such deposit he must utilise the deposit for acquiring the new house within three years.

Capital gains exempted from tax under sections 54B, 54D, 54E and 54F will be discussed in the next lesson.

Questions

1. What do you understand by the term 'Capital Gains' used in the Income-tax Act ? What are the rules regarding exeption of Capital Gains ? Discuss.
2. Explain the following :–
   (i) Capital Assets,
   (ii) Short-term Capital Assets,
   (iii) Cost of Acquisition of Capital Assets ; and
   (iv) Capital Gains Account Scheme.
3. How will you distinguish between capital gain and income ? Why is it important to make this distinction ?

"INCOME FROM OTHER SOURCES" – II

Among other things, previous lesson discussed securities exempt from tax. In this we shall discuss the remaining three types of securities i.e., Tax-free Government Securities, Tax-free Commercial Securities and Less-tax Securities. Then we shall state and explain the expenses discuss which can bė claimed as deduction from income of securities. Solution of practical problems will follow thereafter.

Tax-free Government Securities :– These securities can either be of the Central Government or a State Government. Interest from such securities is always includible in the total income of the security holders. But such interest is included only for rebate purposes. The assessee is entitled to a rebate of tax on such interest. Tax rebate is allowed on the amount of such interest either at the average rate of income tax or $27\frac{1}{2}\%$ of such interest whichever is less.

Tax-free Commercial Securities :– Such securities are issued by companies. No tax is deducted from the interest payable to a security-holder. The security-holder gets this gross amount of interest due to him. But the company has to pay income tax on the amount of such interest to the Central Government. The amount of income-tax so paid by the company is deemed to be the income of the Security-holder. Therefore, the amount of interest receivable from such securities is always to be grossed up.

Less tax Securities :– In the case of these securities, income-tax is deducted at source on the amount of interest calculated at the percentage stated on the securities and balance of the amount of interest left after deduction of the aforesaid income-tax is paid to the security holder. Less-tax securities are also of two kinds viz., Government and commercial. In both the cases if the rate percent of interest is given it is not grossed up as it is already the gross amount of interest, and income-tax is to be deducted therefrom. If in the case of these securities, the net amount of interest received is given, it has got to be grossed up. In any case, it is the gross amount of interest that is included in the total income of an assessee. In practice, the word "less-tax" is not used and such securities are also called as "general securities." Securities are always presumed to be "less-tax" unless they are specified to be "tax-free".

Growing up of interest :– It is always the gross interest which is includable in the total income if an assessee. Where interest is paid after deduction of tax at source it is to be grossed up because the amount of tax deducted at source is a part of the income of the assessee. Following points may be taken into account in this connection :–

(i) Interest from tax-free government securities is not to be grossed up in the case of a resident person as no tax is deductable at source in such a case. In the case of a non-resident person, the interest is to be grossed up as the provisions of deduction of tax apply to him.

(ii) Interest from tax-free commercial securities is always to be grossed up even though no tax has been deducted at source. If security is listed in any stock exchange and will be grossed up in accordance with following formula :–

$$\frac{\text{Net Interest} \times 100}{89.8}$$

If security is not listed in any stock exchange, formula for gross up is :–

$$\frac{\text{Net Interest} \times 100}{79.6}$$

(iii) Interest from less tax securities is to be grossed up if only the amount of interest is given. If the rate percent of interest is given it is not grossed up as it is already the gross amount of interest, and income-tax is to be deducted therefrom. The grossing up formula is the same as it is in the case of tax-free commercial securities.

Deductions from Interest on Securities :– An assessee is entitled to the following deductions in computing the taxable income under the head, "Interest on Securities."

1. **Collection Charges :–** Reasonable collection charges paid to a third party for the purpose of realising the interest are fully deductible. An assessee is not entitled to charge a fee for his own labour in collecting the interest and claim deduction, therefore, from the gross amount of interest. Collection charges are deductible for all types of securities-tax free or less tax.

2. **Interest on money borrowed for investment on securities** :– Any interest payable (whether paid or not) on money borrowed for the purpose of investment in the securities by the assessee is fully deductible even if it results into loss. The deductibility depends upon the purpose of borrowing. Where money is borrowed for the purpose of business and not for investment in securities any interest payable on such a borrowing is not deductible under this head of income.

Where a loan is taken specifically for the purpose of investment in tax-free government securities any interest payable on such loan is deductible only from the interest on such tax-free securities. If the interest payable on such loan exceeds the interest receivable on such securities, such excess cannot be deducted from interest on other taxable securities, However, where the borrowings are for general investment and it is not possible to allocate a borrowing to any particular investment, no part of the interest can be disallowed.

Practical Problems :

Problem No. 1 :– From the following particulars submitted by Shri Ram Kumar. Compute his income for other sources for the assessment year 2007-08 :–

1. As Director of X Co. Ltd., he received Rs. 2,000 per month as salary and Rs. 200 per month as entertainment allowance. The company provides him a car for both official and personal use. The personal use is estimated to be 50%. The company incurs an expenditure of Rs. 6,000 on running and maintenance of the car (for both official and personal use) and depreciation of the car may be taken at Rs. 4,000.

2. He was also a director in another company from which he received Rs. 3,000 as director's fees.
3. Interest received as deposits with a Co-operative Bank Ltd. Rs. 2,000.
4. Dividends received from a foreign company Rs. 1,000.
5. Winnings from lottery Rs. 25,000.
6. Income from agriculture in England Rs. 8,000.
7. Honorarium for delivering lectures in a registered society Rs. 1,200.

Solution :– Computation of Taxable Income of Shri Ram Kumar from "Income from Other Sources" for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	Director's Fees		3,000
2.	Interest on deposits with a Co-operative Bank		2,000
3.	Dividends from a foreign company		1,000
4.	Winnings from Lottery being casual income	25,000	
	Less exempt	5,000	20,000
5.	Income from agriculture in England		8,000
6.	Honorarium for delivering lactures in a registered society		1,200
	Income from other sources.		35,200

Hints :– (1) Salary and perquisites relating to entertainment allowance and car are taxable under the head "Salary" and not under the head "Income from other sources."

(2) Dividend received from a foreign company is not grossed up.

(3) Winnings from lottery is casual income, hence Rs. 5,000 is exempt.

(4) Income from agricultural land situated in foreign country is taxable income from other sources.

Problem No. 2 :– Mr. P. has the following investments in the previous year ended on 31st March, 2007.

1. Rs. 11,000 10% Central Government Securities.
2. Rs. 31,360 10% Tax-free Commercial Securities.
3. Rs. 3,136 received interest out tax-free Public Ltd. Company Securities.
4. Rs. 3,538 received as interest on U.P. Government Securities.
5. Rs. 3,568 received as interest on tax-free Company Securities (Listed).
6. Rs. 30,000 13% Securities of a Cement Company (Unlisted)
7. Rs. 35,000, 11% Securities of a Paper Mill Company (Listed).
8. Rs. 10,000, 15% Jaipur Municipal Corporation Bonds, received from his father on 1st April, 2006.

9. Rs. 10,000, 11% (Compound Interest) Savings Certificates purchased on 1st April, 1989 maturing after six-year.

For purchasing Cement company's Securities he took a loan of Rs. 25,000 at the rate of 12% per annum. This loan was taken from his friend in Bahrein. The interest had been paid in Bahrein but no deduction of tax at source is made.

The Bank charged 1 ½ % permission on gross interest as collection charges.

Interest on all securities is payable half yearly on 1st July and 1st January every year except on Saving Certificates where it is due (but not payable) on yearly basis. Find out his taxable income from interest on securities under the head "Income from other sources " for the Assessment year 2007-08.

Solution :– Computation of Taxable Income of Mr. P. under the head "Income from other source" for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	Rs. 11,000 10% Central Government Securities		1,100
2.	Rs. 31,360 10% Tax-free Commercial Securities		4,000
3.	Rs. 3,136, received interest on tax-free Public Ltd. Company Securities $\frac{3136 \times 100}{79.6}$		3,940
4.	Rs. 3,568 received as interest on U.P. Government Securities		3,568
5.	Rs. 3,568 received as interest on tax-free Company Securities (Listed) $\frac{3568 \times 100}{89.8}$		3,973
6.	Rs. 30,000, 13.5% Securities of a Cement Company (Unlisted)		4,000
7.	Rs. 35,000 11% Securities of a Paper Mill Company (Listed)		3,850
8.	Rs. 10,000, 15% Jaipur Municipal Corporation Bonds- received from his father on 1st April, 2005		1,500
9.	Rs. 10,000, 11% (Compond Interest) Savings Certificates purchased on 1st April, 2005		1,211
	Gross Income		27,142
	Less Bank Commission		398
	Income from other sources		26,744

Hints :– 1. No deduction wil be allowed for interest on loan paid in Bahrein as tax has not been deducted at sources.

2. On Saving Certificates, interest is calculated for first year as under

$$\frac{10000 \times 11}{100} = \text{Rs. } 1,100$$

3. Bank collection charges are not allowed on Saving Certificates as interest on them has not actually been received but it is only due every year and will be paid on maturity.

Problem No. 3 :– From the following particulars of Mr. X, compute the income from other sources for the assessment year 2007-08.

		Rs.
(a)	9% Government Securities	35,000
(b)	8% Preference Shares of a Company	40,000
(c)	12% Debentures of a Company	30,000
(d)	11% Government Bonds	20,000
(e)	9.5% Agra Municipal Bonds	45,000

He paid Rs. 120 as Commission for collecting interest on securities and Rs. 1,200 as interest on loss which he had taken to purchase Government Bonds.

Solution :– Computation of Taxable Income of Mr. X from income from other sources for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	9% Government Securities – Rs. 35,000		3,150
2.	8% Preference shares of a company – Rs. 40,000		3,200
3.	12% Debentures of a company – Rs. 30,000		3,600
4.	11% Government Bonds– Rs. 20,000		
	Interest on	2,200	
	Less loans taken to purchase Government Bonds	1,200	1,000
5.	9.5% Agra Municipal Bonds– Rs. 45,000		4,275
			15,225
	Less Commission paid for collecting interest		120
	Income from other sources		15,105

Problem No. 4 :– Mr. Krishna's investments during the year ended 1st March, 2007 consisted of the following :–

		Rs.
(a)	7% Government Securities	25,000
(b)	8% Agra Municipal Bonds	15,000
(c)	9% Bombay Port Trusts Bonds	20,000
(d)	7 - year N.S.C. (III Issue)	10,000
(e)	7% Government Bonds	18,000
(f)	7% National Plan Certificates	5,000
(g)	6% Securities of a Foreign Government	15,000

He paid Rs. 60 as commission for collecting the taxable interest on securities and Rs. 1.20 as interest on loan when he had taken for the purpose of purchasing the Bombay Port Trust Bonds.

Find out his taxable income from other sources for the assessment year 2007-08.

Solution :– Computation of Taxable Income of Mr. Krishna From income from other sources for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
(a) 7% Government Securities – Rs. 25,000		1,750
(b) 8% Agra Municipal Bond – Rs. 15,000		1,200
(c) 9% Bombay Port Trust Bonds – Rs. 20,000	1,800	
Less Interest on Loan	1,200	600
(d) 7% Government Bonds– Rs. 18,000		1,260
(e) 6% Securities of a Foreign Government Rs. 15,000		900
		5,710
Less Collection Charges		60
Income from other sources		5,650

Hints :– 7- year National Saving Certificate (III Issue) and 7% National Plan Certificate are exempt securities for tax under section 10 (15).

Problem No. 5 :– Shri Hari Gopal is a Member of Parliament from Agra, during the previous year 2006-07 he had the following income–

1. As a member of Parliament he received a salary of Rs. 500 per month and daily allowance of Rs. 5,100 for attending the various sessions.
2. He held the following investments–
   (a) 10% Preference Shares in Agra Sugar Works Limited, of the face value of Rs. 5,000.
   (b) 1,000 equity shares of Rs. 10 each in Tata Finlay Ltd. The company declared interim dividend of 15% on 15th Feb., 2007 but paid on 1st May, 1991 and a final dividend of 10% on 30th March, 2007.
   (c) A 10% fixed deposit of Rs. 10,000 is held by him in Indian Ponds, interest is credited annually.
   (d) He received dividend of Rs. 50 from a Co-operative society.
3. He won Rs. 8,000 in cross-word puzzles and horse races.
4. On 1st September, 2006 he purchased a plot of land for constructing his house. On account of shortage of funds he could not get his house constructed and hence let out the plot at Rs. 150 per month from 1st November, 2006.
5. He has let out machinery and furniture and also building to Mr. Krishna Gopal at monthly rent of Rs. 5,000. He spent Rs. 1,500 on the repair of machinery, furniture and building during the previous year. Depreciation allowed in respect of these assets for the previous year was Rs. 10,000.

   The Bank charged Rs. 17 as commission on collection of dividends.

   Compute the taxable income of Shri Hari Gopal under the head "Income from other sources."

Solution :– Computation of Taxable Income of Shri Hari Gopal from Income from other sources for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	Salary as Member of Parliament Rs. 500 × 12 =		6,000
2.	Dividend on Preferences Share 10% on Rs. 5000		500
3.	Final Dividend on equity shares 10% on Rs. 10,000 =		1,000
4.	Dividend from Co-operative Society		500
5.	Interest on Fixed Deposit 10% on Rs. 10,000 =		1,000
6.	Winnings from Cross-word puzzles and horse race	8,000	
	Less exempt being casual Income	5,000	3,000
7.	Income from land for 5 months Rs. 150 × 5 =		750
8.	Rental income from machinery, furniture and building Rs. 5,000 × 12		60,000
			72,750
	Less Admissible Expenses–	Rs.	
	(a) Bank Commission	17	
	(b) Repair expenses	1,500	
	(c) Depreciation	10,000	11,517
	Income from other sources		61,233

Hints :- (i) Daily allowance for attending session is exempt under section 10 (17).

(ii) Interim dividend on equity shares has been received during the year 2007-08 hence not taxable in the assessment year 2007-08.It will be taxable in the assessment year 2008-09.

Questions

1. Asha Anand a resident invidual, received in cash the following income as interest (net) on securities during the previous year ending 31st March, 2007–
   - (i) Rs. 3,568 as interest on less-tax Government Securities.
   - (ii) Rs. 7,136 as interest on debentures issued by a local authority.
   - (iii) Rs. 3,528 as debentures of Meghdoot Limited (not listed).
   - (iv) Rs. 3,528 as interest on tax-free debentures of Gujral Electrical Ltd. (not listed)

Determine the interest on securities under the head Income from other Sources for the assessment year 2007-08. In case cash interest is payable on 30th June and 31st December.

2. Explain clearly the meaning of the following–
   - (a) Tax-free Commercial Securities.
   - (b) Less-Tax Government Securities.
3. Discuss the methods of grossing up of interest and dividends.

"ASSESSMENT OF INDIVIDUALS"

An 'Individual' means a natural person i.e. human being, individual would include a male, female, minor child and a lunatic. In case of a minor or lunatic, the assessment is made on the guardian or trustee of the minor or lunatic in representative capacity.

An individual is taxed not only of his total income but in certain cases he may also be assessable on incomes of other persons (under sections 60 to 64). In order to compute taxable income of an individual, three types of incomes are aggregated :–

1. Income earned by him in his individual capacity under different heads e.g., income from salary, interest on securities, income from house property, income from business or profession, capital gains and income from other sources.
2. Income by virtue of his membership in other institutions in the following cases :–
   - (i) As a member of HUF.
   - (ii) As a member of registered firm.
   - (iii) As a member of an unregistered firm.
   - (iv) As a member of an association of person.
   - (v) As a member of a company.
3. Incomes of other persons but included in his total income. Such incomes include the following:–
   - (i) Transfer of income without transfer of the assets. [see 60]
   - (ii) Income arising from recovocable transfer of assets [see 61]
   - (iii) Share income of the spouse from a firm carrying on business. [see/ 64(1) i Explanation 1]
   - (iv) Remuneration to the spouse from a concern where the other spouse has got substantial interest. [see 64 (i) (ii), Explanation 2]
   - (v) Income of a minor child from the admission to the benefit of partnership. [see 64 (1) (iii), Explanation 1]
   - (vi) Income arising to the spouse from an asset transferred without adequate consideration. [see 64 (1) (iv), Explanation 3]
   - (vii) Income securing to the minor child from an asset transferred without adequate consideration. [see 64 (1) (v), Explanation 3]
   - (viii) Income arising to the son's wife or son's minor child from the assets transferred without adequate considerations by the father/mother-in-law and grand parents respectively. [see 64 (1) (vi)]

(ix) Income from the transfer of assets for the benefit of spouse or minor child.

[see 64 (1) (vii)]

(x) Transfer of assets for the benefit of son's wife or son's minor child.

[see 64 (1) (viii)]

(xi) Income from gross-transfers.

Procedure for computing total income –

1. First of all ascertain the various incomes which are to be included in total income on the basis of residence.
2. These incomes will be computed according to the various sections of the Act under the heads salaries income from house properties, profits and gains of business or profession, capital gains and income from other sources.
3. Then the effect will be given to the unabsorbed losses and allowances brought forward from earlier years.
4. From the gross total income [2 minus 3] deductions allowed under section 80 CCA to 80U will be deducted.
5. The balance [under-4] will be the total income. This will be rounded off as under–

Under section 288 A the amount of total income computed in accordance with the provisions of the Act shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of paise shall be ignored and thereafter if such amount is not multiple of ten, then if the last figure in the amount is five or more, the amount shall be increased to the neat higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten and the amount so rounded off shall be deemed to be the total income of the assessee.

Practical Problem No. 1 :– The following are the particulars of the income of Shri P.K. Dutta, Government Servant, for the year ended 31st March, 2007–

(a) Salary at Rs. 1,750 per month and his travelling allowance for going on tours for the year amounts to Rs. 1,800.

(b) He contributed at the rate of 10% to his provident fund to which the Government contributed an equal amount. The interest on his provident fund amounted to Rs. 450.

(c) He owns two bungalows one of which is let out at Rs. 120 per month and the other is occupied by him for his residence, the annual rental value of the same being Rs. 900. He has paid Rs. 200 as ground rent and insurance charges in respect of the first bugalows and Rs. 150 in respect of the second. The municipal taxes paid by him in respect of the two bungalows amounted to Rs. 150 and Rs. 120 respectively, and he spent Rs. 3,000 on white-washing and petty repairs in respect of both the bungalows.

(d) He received in cash in December 2006 Rs. 758.20 as interest on Government Securities and 627.20 as dividend from a limited company. He has insured his life and pays annual premium of Rs. 2,009 on his policies.

Solution :– Computation of Total Taxable Income of Shri P.K. Dutta for the assessment year 2007-08.

Particulars		Amount Rs.	Amount Rs.
1.	Income from salary	21,000	
			21,000
2.	Income from House Property–		
	Anual value of the house property let out	1,440	
	Less Municipal Taxes	150	
	Annual value	1290	
	Statutory Deduction 30%	387	
		903	
	Annual value of self-occupied House	Nil	903
3.	Income from other sources–		
	(i) Dividends Gross	exempted	
	(ii) Interest on Securities Gross	758.20	758.20
	Gross total Income		22,661.20

Hints :- (i) Travelling allowance for tour is exempt under section (14) (i).

(ii) Although the amount of dividend is not more than Rs. 2500 and interest on securities is not more than Rs. 2,500 but since these have not been received by account payee cheque they have been grossed up.

(iii) Interest and dividend on Government Security have been grossed up at the rate of 10.8% and 21.6% respectively because they have been received before 15th January, 2007.

(iv) The assessee will be allowed rebate of tax under section 88 in respect of his contribution to Providend fund and Life Insurance premium.

Problem No. 2 :– Dr. Sharma an Indian citizen and a senior Professor of Economics in a Government College in India, was posted as Economic Advisor to the Indian Embassy at Washington for a period of three years commencing from 1st April, 2006. Under the terms of employment, he was to receive from the Government a salary of Rs. 7,250 per month, house allowance of Rs. 1,000 per month and the actual fare by air from Bombay to Washington which amounted to Rs. 12,500 only, and was paid to him when he reached there. He remained in Washington throughout the year ended on 31st March, 2007 and never came to India in that year.

During this period he was sending Rs. 4,000 per month to his family for their maintenance and deposited his saving at the average rate of Rs. 500 per month in a bank of Washington. The interest credited to his account on 31st March, 2007 was Rs. 480.

He was also provided with a free car by the Government which he used both for personal and office purposes.

During the previous year 2006-07 he has the following other incomes which was deposited to his local bank account in India as per his instructions.

Royalty received on a book which he completed in 18 months Rs. 9,000. This book is in Hindi and is prescribed for the degree classes in several Universities.

He has a residential house in India, half of which was let out and half was used by his family. Rent received amounted to Rs. 300 per month. Municipal taxes paid during the year Rs. 600. He deposits Rs. 5,000 under National Savings Scheme.

Compute Dr. Sharma's total income for the assessment year 2007-08.

Solution :– Computation of Total Income of Dr. Sharma for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	Income from salary	87,000	
			87,000
2.	Income from House Property–	3,600	
	Less Municipal Taxes	300	
	Annual value	3,300	
	Less Statutory Deduction 30%	990	
		2310	2310
	Annual value of self-occupied portion of the House	Nil	
3.	Income from other sources–		
	(i) Examinership	2,500	
	(ii) Royalty	9,000	11,500
	Gross total Income		1,00,810
	Less Amount deposited in National Savings Scheme u/s 80 C		5,000
	Total Income		95,810

Hints :-1. Dr. Sharma is non-resident for the Assessment year 2007-08 as he did not at all came to India during the previous year 2006-07.

2. Salary paid by Government to a citizen of India for service outside India is deemed to accrue or arise in India, hence fully taxable.
3. All allowance or perquisites paid or allowed to such an employee outside India are not to be included in his total income. As such house allowance and free car are excluded from his total income.
4. Air fare is not to be included in total income as it is granted to meet expenses incurred in the performance of his duties.
5. Income on savings abroad is not taxable being foreign income.

Problem No. 3 :– From the following information Compute the total income of an individual for the Assessment year 2007-08 :–

(a) Salary after deduction of provident fund contribution and income-tax Rs. 46400.

(b) Income-tax deducted from salary Rs. 4,000.

(c) His contribution to recognised provident fund Rs. 5,000.

(d) Employees contribution to the provident fund Rs. 5,500.

(e) Interest credited to provident fund Rs. 6,200 at the rate of 12%.

(f) Dvididend received Rs. 6272.

(g) Life Insurance Premium paid Rs. 18,000.

Solution :– Computation of Total Income of an individual for the assessment year 2007-08.

	Particulars	Amount Rs.	Amount Rs.
1.	Income from salary		56,000
2.	Dividend (Gross)		exempted
	Total Income		56,000

Hints :- (i) Salary gross is taxable salary for this purpose will include income-tax and provident fund contribution by employee.

(ii) Employers contribution to provident fund up to 12% or salary is not taxable.

(iii) Interest credited to Recognised Provident Fund Account up to the rate of 1% is not taxable.

(iv) Dividend received from Indian Co. is exempt.

Problem No. 4. Shri Narain Singh submit the following particulars of his income for the year ending 31st March 2007 :–

(1) He owns a house which is used as under :–

(a) 1/4 by dependent parents for their residence;

(b) 1/4 by dependent children for their residence;

(c) 1/4 by his major son for his residence, who is employed in a company.

(d) 1/4 by him for is own residence.

The fair rental value of the House is Rs. 12,000 per annum, Municipal taxes paid are Rs. 1200 for the current year and Rs. 1200 for the preceding year.

(2) He, his wife and a minor son are members of an unregistered firm from which each of them received Rs. 5,000 as their 1/4 share of profit.

(3) He earned an income of Rs. 15,000 from modelling in various advertisement.

(4) He started a factory in 2003 at Mathura, a notified backward area of Uttar Pradesh, for production of an article not included in Schedule XI. For the year ended on 31st March, 2007, its entire production was exported out of India, which fetched an amount of Rs. 25,00,000 as sale proceeds and was brought into India in convertible foreign currency in May 1911. On this sale he earned a profit of Rs. 2,50,000.

(5) He owns another factory at Agra. The profits of this factory for the year ended 31.3.07 amounted to Rs. 1,00,000 including a profit of Rs. 30,000 on sale of a machine for Rs. 50,000 which was purchased for Rs. 40,000 in 2003 and whose written down value (W.D.V.) on 1.4.2006 was Rs. 20,000. The W.D.V. of machines of this block on 2.4.06 was Rs. 6,00,000 on which depreciation at the rate of 33.3% has been charged to Profit and Loss Account.

Compute his total income for the assessment year 2007-08.

Solution :– Computation of Total Income of Shri Narain Singh for the assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
1. Income from House Property :–		
Fair Rental value of 1/4 house		3,000
(1/4 portion occupied by major son employed is deemed		
to be let out and remaining 3/4 this self/occupied.		
Less Municipal Taxes paid for two years		600
		2,400
Annual value 3/4th portion of self-occupied		2,000
2. Income from Business :–		
(a) Own share in Unregistered firm	5,000	
(b) Wife's share in Unregistered firm	5,000	
(c) Minor Son's share in Unregistered firm	5,000	
Income from modelling	15,000	30,000
Factory at Agra :–		
Profit as per P & L A/c	1,00,000	
Less profit on sale of machine	30,000	
	70,000	
Add excess depreciation Charged	16,665	86,665
Profit from Factory at Matura		2,50,000
Gross Total Income		3,68,665
(20% of Rs. 2,50,000)	50,000	
Less Deduction under section 80 (I)		
(20% of Rs. 1,50,000)	50,000	
Less Deduction under section 80 HHC		
(100% of Rs. 2,50,000)	2,50,000	3,50,000
Total Income		18,665
Rounded off to nearest Rs. 10 = Rs. 18670.		

Hints :-

(i) Municipal taxes are allowed for deduction on payment basis. Hence municipal taxes will be allowed as deduction for two years paid during the current year.

(ii) The total profit of unregistered firm is Rs. 29,000. It is not taxable in the hand of unregistered firm because it is below the taxable limit. Hence, Rs. 15,000 will be included in Shri Narayan's income and will be taxed in his hand. He will not be allowed rebate and tax on this personal income.

(iii) Mathura factory is located in notified backward area of Uttar Pradesh. Hence 20% of profit from this factory will be allowed as deduction under section 80 HH. Further 20% of profit will be allowed as deduction under 80 I. 100% of profit is allowed as deduction under section 80 HHC if entire production is exported and the sale proceeds are brought in India within six months. 100% of profit from Mathura factory will be allowed as deduction because this factory fulfils all the conditions mentioned in section 80 HHC.

Problem No. 5 :- Find out the taxable income of Shri Shyam Sundar Lal under different heads on the basis of the following heads :-

PROFIT AND LOSS ACCOUNT

For the year ended 31st March, 2007.

	Rs.		Rs.
Interest	1,800	GrossProfit	1,22,700
Repair and Renewal	2,200		
Insurance	4,200	Interest on Debentures	
Depreciation	5,600	of or institution on Gross	
Compensation	10,200	(Notified)	10,000
Law charges	5,100		
Labour welfare			
Expenditure	3,800	Rent from House	
Subscription	5,800	Property	63,000
Net Profit	1,30,000		
	1,68,700		1,68,700

(A):- (i) Interest includes Rs. 200 on loan taken for purchasing debentures of company and Rs. 300 on loan taken for reconstruction of house property let out.

(ii) The expenses relating to house property let out at 40% of the repair and renewal expenses.

(iii) Depreciation includes Rs. 1,200 on house property let out.

(iv) Compensation was paid to an employee whose dismissal was in business interest.

(v) Insurance includes 30% for fire insurance of the house property let out. 30% for worker accident insurance and the balance and the balance for life insurance.

(vi) Laws charges include Rs. 2000 relating to a petition filed against breach of a contract and the balance regarding sale-tax appeal.

(vii) Subscriptions include Rs. 2,000 given for election purpose to political parties and the balance is of subscriptions given in business interest.

(B) :– The amount not debited to Profit and Loss Account are as follows :–

(i) Expenses incurred on the occasion of Deepawali Rs. 500.

(ii) Theft of cash from iron safe Rs. 1500.

(iii) Expenses for new telephone connection in the business Rs. 2,000.

Solution :– Computation of Total Income of Shri Shyam Sundar Lal for the Assessment year 2007-08.

Particulars	Amount Rs.	Amount Rs.
Net Profit as per Profit and Loss Account		1,30,000
Add Expenses not allowed :–		
(i) Interest	500	
(ii) Repairs of House Property	880	
(iii) Depreciation on house property let out	1200	
(iv) Insurances of the house property let out and life insurance premium	2940	
(v) Subscription given for election purpose	2,000	7,520
		1,37,520
Less Expenses allowed but not debited to Profit and Loss Account :–		
(i) Deepawali Expenses	500	
(ii) Theft of cash from safe	1,500	
(iii) Expenses on installation of new telephone	2,000	4,000
		1,33,520

	Less Income not chargeable under this head :–		
(i)	Interest on Debentures	10,000	
(ii)	Income from House Property	36,000	46,000
	Income from Business		87,520
	Annual Value		36,000
	Less (i) Statutory Deduction 30%	10,800	
	(ii) Interest on loans taken for reconstruction of house property	300	11,100
	Income from House Property		24,900
	Income from other sources :		
	Interest on Debentures	10,000	
	Less Interest paid on loan taken for purchase of Debentures	200	9,800
	Income from other sources		9,800
	Total Income		87,520
	Income from House Property		24,900
	Income from other Sources		9,800
	Gross Total Income		1,22,220
	Less interest on Notified Debentures		7,000
	Total Income		1,15,220

Hints :– (i) Theft of cash from iron safe is admissible expenses.

(ii) Expenses of new telephone connection in the business are also admissible expenses.

(iii) Interest on notified debentures is admissible for deduction under section 80L.

(iv) The assessee is entitled to be allowed deduction of tax in respect of his contribution to Life Insurance Premium paid under section 88.

Problem No. 6 :– Mr. P.G. Patil is a technical director with Home Products Ltd. on a salary of Rs. 3000 per month. He lives in house hired by the Company on an annual rent of Rs. 27,600. It has also provided necessary furniture and fitting amounting to Rs. 20,000. The company bears the electric charges of Rs. 1800.

Mr. Patil has been provided with a big car alongwith a chauffeur. He draws entertainment allowance of Rs. 500 per month, out of which he spends Rs. 6000 on the medical expenses of his family which is reimbursed by the company. The treatment is done in a recognised public hospital in India. During the year, he goes on leave for two months and the company pays him the railway fare for his entire family of going to his native place, the amount being Rs. 4500.

Mr. Patil is a member of Recognised Provident Fund and he contributes 11% of salary thereto