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Lesson No.

UNIT-2

- 2.1 INCOME UNDER THE HEAD PROFITS AND GAINS FROM BUSINESS AND PROFESSION
- 2.2 INCOME UNDER THE HEAD CAPITAL GAINS
- 2.3 INCOME FROM OTHER SOURCES
- 2.4 DEPRECIATION
- 2.5 CARRY FORWARD AND SET OFF OF LOSSES AND CLUBBING OF INCOME

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**INCOMES UNDER THE HEAD
PROFITS AND GAINS FROM BUSINESS AND PROFESSION**

Structure of the Lesson :

- 2.1.0 Objective
- 2.1.1 Introduction
- 2.1.2 Definitions
- 2.1.3 Basis of charge under the head Profits and Gains from Business or Profession
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2.1.0 OBJECTIVE

The objective of this lesson is to introduce the students with the third head of income that is, incomes under the head "profits and gains of business and profession". Further, income computed under this head is separately chargeable to tax as per the current provisions mentioned in this lesson.

2.1.1 INTRODUCTION

Under Section -14 of the Income Tax Act, all incomes, have to classify under the five heads. Out these five heads, income under the head profits and gainsof business and profession, are covered in this lesson.

The provisions of incomes under the head profits and gains of business and profession are contained in section-28 to 44D. And any profits and gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income tax under the head capital gains. Any taxable income or profits and gains which are not chargeable to income tax under any of the first four heads are covered under the residuary head, that is, 'Income from other sources'.

2.1.2 DEFINITIONS

Before going into calculation of income under this head, it is necessary to understand the meaning of terms used in this head.

1. **Business** : Section 2(3) has defined the terms as "any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture."

In this connection it is not necessary that there should be a series of transactions in a business and also it should be carried on permanently. So, neither repetition nor continuity of similar transactions is necessary.

2. **Profession** : A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, e.g. lawyer, accountant, engineer, surgeon, author etc. so, it refers to those activities where the livelihood is earned by the person through their intellectual or manual skill. As per section 2 (3b) profession also includes vocation, which means any type of activity in which a person is engaged and he earns his livelihood from such activity.

2.1.3 BASIS OF CHARGE UNDER THE HEAD PROFITS AND GAINS OF BUSINESS OR PROFESSION [Section-28]

Following nine types of incomes are chargeable to tax under this head:-

- (a) Profit and gains of any Business or Profession;
- (b) Any compensation or other payments due to or received;
- (c) Income by a trade, professional or other associations from specific services performed for its members;
- (d) Profit on sale of import, entitlement licenses, drawback of duty;
- (e) the value of any benefit or perquisite;
- (f) any salary, bonus, commission or remuneration received by a partner of firm from such firm;
- (g) any sum whether received or receivable, in cash or in kind, under an agreement for not carrying out any activity in relation to any business or not to share any know-how, patent, copyright, trade mark, licence etc.;
- (h) any sum received under keyman insurance policy;
- (i) Profits and gains of managing agency;

(j) Income from speculative transaction.

2.1.4 DEDUCTIONS EXPRESSLY ALLOWED IN RESPECT OF EXPENSES

Sections 30 to 37 enumerate deductions expressly allowed in respect of expenses and allowance.

1. Rent, rates, taxes, repairs and insurance of buildings used for the purpose of assessee business. [Section-30].
2. Repairs and insurance of machinery, plant and furniture etc. used in business or profession. [Section-31].
3. Depreciation [section-32]
4. Tea/Coffee/rubber development account [Section-33AB]
5. Expenditure on scientific research [Section-35]
6. Expenditure on acquisition of patent rights and copyrights [Section-35A]
7. Deduction in respect of expenditure on know-how [Section-35AB]
Note: If expenditure on know-how incurred after 31st March, 1998, depreciation is available u/s 32.
8. Amortisation of telecom licence fee [Section-35ABB]
9. Expenditure on eligible projects or schemes [Section-35AC].
10. Payment to the associations and institutions for carrying out rural development programmes [Section-35CCA].
11. Amortisation of preliminary expenses [Section-35B].
12. Amortisation of expenditure in case of amalgamation or demerger [Section-35DD].
13. Amortisation of expenditure under voluntary retirement scheme [Section-35DDA].
14. Discount on zero coupon bonds [Section-36(i) (iiia)]
Note: This deduction is applicable from the AY 2006-07.
15. Employer's contribution to recognized Provident Fund and approved superannuation fund [Section-36(i) (iv)].
16. Contribution towards approved gratuity fund [Section-36(i) (v)].
17. Employees contribution towards staff welfare scheme [Section-36 (i)(va)].
18. Write off allowance for animals [Section-36(i)(vi)].
19. Bad debts [Section-36(i)(vii)].
20. Transfer to special reserve [Section-369i)(vii)].
W.e.f. Assessment year 2008-09, deduction under this section, relating to special reserve created by certain financial corporations and public companies has been reduced from 40% to 20%. However, the overall limit of the deduction, which is 200% of the paid-up share capital and general reserve remains the same.
21. Family Planning Expenditure [Section-36(i)(ix)].

22. Contribution towards exchange risk administration fund [Section-36(i)(x)].
23. Revenue expenditure incurred by entities established under any Central, State or Provincial Act [Section-36(i) (xii)].
24. Banking cash transactions tax [Section-36(i) (xiii)].
Note: This will be deductible from the AY 2006-07.
The amendment provides that w.e.f. A.Y. 2008-09, the deduction shall be allowed only if such corporation or body corporate is notified by the Central Government in the official Gazette under the said clause.
25. Deduction in respect of any provision for bad and doubtful debts is also to be allowed to the co-operative banks u/s 36(i) (viiia) w.e.f. assessment year 2007-08.
26. General Deduction [Section-37 (1)]
Note: For claiming deduction of any expenditure u/s 37 (i), it should be ensured that the expenditure is not in the nature described by Sections 30 to 36.

2.1.5 AMOUNTS EXPRESSLY DISALLOWED UNDER THE ACT

Section 40, 40A and 43B enumerate deductions expressly disallowed while computing taxable income of an assessee.

1. Interest, royalty, fee for technical services payable to a non-resident [Section-40(a)(i)].
2. Compliance of TDS provisions in case of a resident [Section-40(a)(ia)].
3. Securities Transaction Tax [Section-40(a)(ib)].
4. A fringe benefit tax [Section-40(a)(ic)].
5. Income Tax [Section 40(a)(ii)].
6. Wealth Tax [Section-40(a)(ia)].
7. Salary payable outside India without tax deduction [Section-40(a)(iii)].
8. Provident Fund payment without TDS [Section-40(a)(iv)].
9. Tax on perquisite paid by the employer [Section-40(a)(v)].
10. Amount not deductible in the case of partnership firm [Section-40(b)].
11. Amount not deductible in the case of AOPs or BOI [Section-40(ba)].
12. Payment to relative [Section-40A(2)].
13. Payments exceeding Rs. 10,000 paid otherwise than by crossed cheques or bank drafts [Section-40A(3)].
14. Expenditure on payment of salary or perquisite to employees [Section-40A(5)].

15. Provision for payment of gratuity [Section-40A(7)].
16. Restriction on contributions by employers to non-statutory funds [Section-40A(9)].
17. Disallowance of unpaid liability [Section-43(B)].

2.1.6 DEEMED PROFITS

The following receipts are chargeable to tax as business income:-

1. Recovery against any deduction [Section-41(1)].
2. Sale of assets used for scientific research [Section-41(3)].
3. Recovery of bad debts [Section-41(4)].
4. Amount withdrawn from special reserve [Section-41(4A)].
5. Adjustment of loss [Section-41(5)].
6. Recovery after discontinuance of business or profession [Section-176(3A),(4)].

2.1.7 SPECIAL PROVISION IN CASE OF RETAIL BUSINESS

Following provisions are applicable on the retail business's Profit and gains as per section 44 AF :

1. A person should be engaged in retail trade in any goods or merchandise.
2. The turnover during the previous year does not exceed Rs. 40 lakhs.
3. Assessee shall pay tax on deemed profits to be calculated @ 5% of total turnover or on actual profits as declared by him.
4. It shall be deemed that assessee has claimed all the expenses as given u/s 30 to 38.
5. In case assessee is PFAF, the remuneration allowed u/s 40 (b) shall be deducted out of income computed under section 44 AD(1).
6. It shall be deemed that W.D.V. of the asset has been calculated after allowing and adjusting full depreciation as is admissible.
7. Provisions of section 44 AA and 44 AB shall not be applicable and the income from such business shall be excluded for computing total turnover.

Illustration-I Smt. Jyoti is a registered medical practitioner. She keeps her books on cash basis and for the ended 31st March, 2023 her summarized cash account is as under:

	Rs.		Rs.
Opening Balance	2,700	Cost of Medicines	20,000
Bank Loan	6,000	Surgical Equipment	6,000

Sale of Medicines	30,500	Motor-Car	12,000
Consultation Fees	10,000	Car expenses	1,200
Visiting Fees	8,000	Rent of Dispensary	1,200
Interest on investments	9,000	General expenses	600
Rent from Property	7,200	Personal expenses	4,200
Sale of house Building	15,000	Life insurance premium	2,000
Sale of furniture	5,000	Interest on Bank loan	360
		Salary	1,200
		Property Income	400
		Fixed Deposit in Bank	30,000
		Closing Balance	14,240
	<u>93,400</u>		<u>93,400</u>

Keeping in view the following additional information, compute her income from profession for the PY 2022-23.

- 1/3rd car expenses for personal use.
- written-down value of the house property on April 1, 2023 was Rs. 20,000 and that of furniture was Rs. 4,000. There were no other assets in these books.
- Rate of depreciation on the new car is 20% and on surgical equipment the rate of depreciation is 25%.

Solution:

Computation of Income from Profession of Smt. Jyoti for the A.Y. 2023-24

	Rs.	Rs.
Sale of Medicines	-	30,500
Consultation Fees	-	10,000
Visiting Fees	-	<u>8,000</u>
Less : Expenses:		48,500
Cost of Medicines	20,000	
Car expenses	1,200	
Salary	1,200	
Rent	1,200	
General expenses	600	
Interest on Bank Loan	360	
(Assumed taken for professional purposes)		
Depreciation on Car Rs. 2,400 (Deductible 2/3 of 2,400)	1,600	
Depreciation on surgical equipment	<u>1,500</u>	<u>27,660</u>
Income from Profession		<u>20,840</u>

Note: I- Profit or loss on sale of furniture is short-term capital gain/loss.

STCL = 5000-4000 = Rs. 1,000

II- Loss on sale of Building is Rs. 5000 (15000-20000)

(i.e. sale price- written down value of house Building)

2.1.8 DEPRECIATION

Depreciation is one of the important items treated under the head Profit and Gains of Business or Profession. The Income tax Act 1961 nowhere defines the term depreciation. In simple language depreciation is the decrease in the value of an asset due to its wear and tear and passage of time.

Depreciation can be charged out of (1) Profits and gains of Business or profession carried on by the assessee; or (2) Income from other sources in case of assets let out for a certain period of time and letting is not the regular business of assessee.

Conditions for Depreciation : Following conditions are either laid down in law or Income tax rules 1962 or as per case decisions:

1. Depreciation is allowed only on capital assets
2. Asset must be used as during the year, for the same business.
3. Block of assets is the base for charging depreciation.
4. Asset must be owned by the assessee.
5. Deduction of depreciation is not allowed in the year of sale of asset.
6. Full particulars of the asset, on which depreciation is to be charged must be furnished to the A.O.
7. Depreciation is allowed on the basis of written down value of the asset.
8. In case of succession or amalgamation depreciation will be calculated and allocated on the basis of number of days for which assets were used by predecessor and successor company respectively. (For more detail see lesson no.10)

2.1.9 SUMMARY

The Income from all activities of business, profession or vocation are taxable under the same head i.e. Profits and gains of business or profession. As discussed in this lesson, section 29 states that profits and gains of business or Profession chargeable to tax u/s 28, shall be computed in accordance with the provisions contained in section 30 to 43D.

Further, where an assessee made a claim for a deduction which is not specified in sections 30 to 37, the claim was held to be allowable in respect of the expenditure or loss incurred by the assessee which was incidental to carrying on the business.

2.1.10 KEY WORDS

1. Illegal Business: Business which is not allowed under existing law.

2. Profession: An occupation requiring purely intellectual or normal skill.
3. Hundi : An Instrument used to borrow or repay the money.
4. Vocation : Any activity on which a person spends a major part of his time in order to earn his livelihood.
5. Mercantile or cash system : Methods of accounting to record the business transactions.

2.1.11 EXERCISE

(A) Short Questions:

- Q1. What do you mean by income under five heads?
- Q2. Define the term income under the head profits or gains from Business or Profession.
- Q3. List the deductions described under section 37.

(B) Long Questions:

- Q1. Which deductions expressly allowed in respect of expenses made under the head profit and gains from business or profession.
- Q2. Write a detailed note on the amounts expressly disallowed under the Act.
- Q3. From the following P & L A/c of a merchant for the year ended 31st March, 2023. Calculate his taxable profit from business and house property:

	Rs.		Rs.
Office Salary	4,800	Gross Profits	1,35,532
General Expenses	2,550	Commission	1,205
Bad debts written off	2,100	Discount	751
Reserve for Bad debts	3,000	Sundry Receipts	202
Fire insurance premium	450	Rent of building	52,640
Advertisement	2,500	Capital Gain	3,000
Interest on Capital	1,000		
Interest on Bank Loan	1,550		
Donations	3,875		
Depreciation	1,200		
Net Profit	1,70,305		
	1,93,330		1,93,330

The Amount of depreciation allowable is Rs. 1000.

2.1.12 SUGGESTED READINGS

1. Income Tax Law and Practice : Gaur and Narang
2. Direct Taxes : B.B. Lal and N. Vashist
3. Income Tax Law : H.C. Mehrota
4. The Income Tax law : Shailinder Sekhon
(A.Y. 2023-24)

INCOME UNDER THE HEAD CAPITAL GAINS

Structure of the Lesson :

- 2.2.0 Objective
- 2.2.1 Introduction
- 2.2.2 Meaning of Capital asset
 - 2.2.2.1 Types of Capital assets
- 2.2.3 Meaning of Transfer
 - 2.2.3.1 Transactions not regarded as transfer
- 2.2.4 Computation of Capital Gain
 - 2.2.4.1 Computation of short term Capital gain
 - 2.2.4.2 Computation of long term Capital gain
- 2.2.5 Meaning and determination of cost of acquisition
- 2.2.6 Indexed cost of acquisition
- 2.2.8 Exempted Capital Gains
- 2.2.8 Loss under the head Capital Gains
- 2.2.9 Tax on long term Capital gains
- 2.2.10 Illustration
 - Self- Check Exercise
- 2.2.11 Summary
- 2.2.12 Answers to self-check Questions
- 2.2.13 Exercise
- 2.2.14 Suggested Readings

2.2.0 OBJECTIVE

The main objective of the lesson is to introduce the students with the current provisions of the income tax law under the head capital gains, that is,

- (1) computation of short term and long term capital gain;
- (2) determination of cost/Index cost of acquisition; and
- (3) tax on long term Capital Gains.

2.2.1 INTRODUCTION

Section 45 of the Income Tax Act, 1961 provides that any gain arising from the transfer of a capital asset during the previous year is chargeable to tax under the head 'Capital Gains' in the following assessment years. In other words, liability under the head capital gains arises only when the following conditions are satisfied:

- (i) There should be a capital asset.

- (ii) The capital asset should be transferred by the assessee.
- (iii) Such transfer takes place during the previous year.
- (iv) The gain arises as a result of transfer.
- (v) Such gain is not exempt from tax section 54 to 54G.

2.2.2 MEANING OF CAPITAL ASSET [U/S 2(14)]

The term capital asset means property of any kind held by the assessee, whether fixed or circulating, movable or immovable, tangible or intangible. The following assets are, however, excluded from the definition of capital asset :

- (i) Any stock-in-trade, consumable stores or raw material used for the purposes of business or profession.
- (ii) Personal effects or belongings of the assessee that is to say movable property including wearing clothes and furniture held for his personal use for the use of any member of his family. However, jewellery is treated as a capital asset even though it is meant for personal use of the assessee.
- (iii) Agricultural land in India, provided it is not situated :
 - (a) In any area within the territorial jurisdiction of a Municipal Committee of a Cantonment Board, having a population of 10,000 or more, or
 - (b) In any notified area.
- (iv) 6.5% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National defense Gold Bonds, 1980 issued by the Central Government.
- (v) Special Bearer Bonds, 1991.
- (vi) Gold Deposit Bonds issued under Gold Deposit Scheme, 1999.

Note: The items covered under clauses IV and V are only of academic significance, as these instruments do not exist now.

2.2.2.1 Types of Capital Assets:

Capital assets are of two types :

1. Short-term capital assets.
2. Long-term capital assets.

Short Term Capital Asset: u/s 2(42A)

It means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. However, the following assets shall be treated as short-term capital assets if they are held for not more than 12 months (instead of 36 months) immediately preceding the date of its transfer :

- (a) Equity or preference shares of a company held by the assessee.
- (b) Securities listed in a recognised stock exchange in India.
- (c) Units of the Unit Trust of India or units of a notified Mutual Fund.

Long-Term Capital Asset:

The Asset which is not covered u/s 2(42A) is known as LTCA. So, any asset, which is held by the assessee for more than 36 months (or 12 months) immediately preceding the date of its transfer is a long-term capital assets.

2.2.3 MEANING OF TRANSFER

According to section 2(47) of the Income Tax Act transfer in relation to capital asset means and includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights there in. Transfer also includes the compulsory acquisition of the asset under any law.

Whether any asset is converted by the owner into stock-in-trade of a business carried on by him, such conversion amounts to transfer. For example, where an investor in shares starts a business of dealing in shares and treats his existing investments as the stock-in-trade of the new business, such conversion is regarded as a transfer.

Where, under a contract for transfer of an immovable property, the purchaser has paid the price and has taken the possession of property, there is transfer even though there is no registration of the deed.

The member of a co-operative society is the deemed owner of the flat or house even though the legal owner is the co-operative society. So, any transaction by the member which has the effect of transferring the enjoyment of the flat will be regarded as transfer.

2.2.3.1 Transactions not regarded as transfer: In the following transactions although there is a transfer but these are not considered to be transfer for the purpose of capital gain u/s 47.

- (i) Any distribution of assets of a company to its shareholders on liquidation. (ii) Any distribution of capital assets on the total or partial partition of Hindu family.
- (iii) Any transfer of a capital asset under a gift or will or an irrevocable trust.
- (iv) Any transfer of a capital asset by a company to its 100% subsidiary company provided the subsidiary company is an Indian company.
- (v) Any transfer of a capital asset by a 100% subsidiary company to its holding company, if the holding company is an Indian Company.
- (vi) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company.
- (vii) Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.
- (viii) Any transfer or issue of shares by the resulting company, in a scheme

of demerger, to the shareholders of a demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

- (ix) Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company if :
- (a) the transfer is made in consideration of the allotment to him of any shares in the amalgamated company, and
 - (b) the amalgamated company is an Indian company.

2.2.4 COMPUTATION OF CAPITAL GAIN (SECTION 48)

Capital gains are of two types.

- (i) Short term capital gain which arises on the transfer of a short term capital asset.
- (ii) Long term capital gain which arises on the transfer of a long term capital asset.

2.2.4.1 Computation of Short Term Capital Gain :

Step I : Take the figure of the full value of consideration received on the transfer of the asset.

Step II : Less : Cost of transfer (expenses incurred wholly and exclusively in connection with such a transfer) Balance will be net sale consideration.

Step III : Less : Cost of Acquisition/Cost of improvement.

Step IV : The balance (Step II - Step III) is short term capital gain.

2.2.4.2 Computation of Long Term Capital Gain :

Step I : Take the full value of consideration received on the transfer of the asset. (Long term)

Step II : Less : Cost of transfer. Balance will be net sale consideration.

Step III : Less : (a) Indexed cost of acquisitions.

(b) Indexed cost of improvement.

Step IV : The balance (Step II - Step III) is long term capital gain.

Note:- Indexed cost =
$$\frac{\text{Cost of Acquisition / Improvement} \times \text{Index number of the year of sale}}{\text{Index Number of the year of acquisition / Improvement}}$$

Cost of transfer (Expenses on transfer): In computing capital gain, any expenditure incurred wholly and exclusively in connection with the transfer shall be allowed as transfer. Expenditure incurred on payment of legal fees, brokerage, commission, registration etc. will be allowed as deduction from value of consideration.

2.2.5 MEANING AND DETERMINATION OF COST OF ACQUISITION

Cost of acquisition of an asset is the price, which the assessment has paid for acquiring the asset. Expenses incurred for completing the title are a part of the

acquisition. For example, interest paid on money borrowed to purchase an asset is a part of cost of acquisition.

- (i) Cost to the previous owner (Section 49(I) -Where the capital asset became the property of the assessee in any of the manner mentioned below, the cost of acquisitions of the asset shall be deemed to be the cost for which the previous owner acquired it :
 - (a) On the distribution of the assets on total/partial partition of Hindu Undivided Family :
 - (b) Under a gift or will;
 - (c) By succession, inheritance or devolution;
 - (d) On any distribution of assets on the liquidation of a company;
 - (e) Under a transfer to a revocable or irrevocable trust;
 - (f) On a transfer by a wholly owned Indian subsidiary company to its holding company or vice versa;
 - (g) On any transfer in a scheme of amalgamation of two Indian companies subject to certain conditions u/s 47 (vi);
 - (h) On any transfer in a scheme of amalgamation of two foreign companies subject to certain conditions;
 - (i) On conversion of self-acquired property of a member of a Hindu Undivided Family to the joint family property.

2. Adoption of fair market value as on 1.4.2001 as cost of acquisition:

An option is given to the assessee to beat the effect of inflation when the asset purchased is very old, say purchased before 1.4.2001. The assessee can substitute the fair market value of the asset as on 1.4.2001 for the actual cost of acquisition.

Again, when the capital asset has become the property of the assessee by any mode specified in section 49 (I) and the previous owner had acquired the asset prior to 1.4.2001, the cost of the asset to the assessee is the cost of the asset to the previous owner or the fair market value as on 1.4.01 at the option of the assessee.

3. Cost of assets on which depreciation has been claimed (Section 50):

Where such assets are sold during the previous year and there is gain, it will be short term capital gain taxable under this head. Section 50 provides the procedure for computation of capital gain or loss in case of depreciable assets, this section provides for two different situations.

- (a) Transfer of one or more assets in the block of assets [Section 50(1)]:
Where the full value of the consideration received or accruing due to transfer to one or more assets belonging to same block of assets exceeds the aggregate of the following amounts :
 - (i) expenditure incurred in connection with such transfer;

- (ii) the W.D.V. of such block of assets at the beginning of previous year; and
- (iii) the actual cost of any asset falling within that block of assets acquired during the year.

- (b) Transfer of all the assets within same block of assets and the block ceases to exist [Section 50(2)]:

In such event the written down value of such block plus cost of any new asset acquired during the year is taken as actual cost and if it is less than total consideration received, the income, if any as a result of such transfer or transfers shall be deemed to be short-term capital gain.

In case the W.D.V. of the block of assets and cost of new asset acquired during the year added together is more than the total consideration received, the difference is called as short-term capital loss.

Section 50 introduces modification in the mode of computation of capital gain. The excess of consideration or value realised on transfer over the aggregate of opening written down value, addition and expenditure in connection with transfer shall be the amount of short term capital gain notwithstanding that the asset transferred was held by the assessee for more than thirty six months.

- (4) Cost of acquisition in case of bonus shares and right issue :

The Finance Act 1995 has made a major change in determining the cost of bonus shares to be called "financial asset". As per new amendment the cost of financial assets allowed to the assessee without any payment and on the basis of holding of any other financial asset, shall be taken as NIL. The cost of bonus shares allotted before 1-4-2001 is their fair market value as on 1-4-2001.

In case of rights issue, where right is renounced, the sale price of such right is the price received from renounce and cost is nil.

In case shares are acquired under right issue by the renouncer, the cost shall be the amount paid to the company.

- (5) Cost on conversion of capital assets into stock-in-trade:

Where a capital asset is converted into a trading asset, then the cost of the capital asset so converted into stock-in-trade of assessee's business shall be the market value of those assets on the date of such conversion.

- (6) Cost of acquisition for shares in a scheme of amalgamation:

Where capital asset being the shares in an amalgamated company became the property of the assessee in a scheme of amalgamation, in consideration of his transferring shares in amalgamating company to the amalgamated company, the cost of acquisition of shares in amalgamated company means the cost of acquisition of shares in amalgamating company.

- (7) Cost of acquisition to be reduced by amount of advance money forfeited (Section 51):

Where the capital asset transferred during the previous year was subject of negotiation in any previous occasion or occasions and any advance money received in relation to such negotiation had been retained by the assessee (by way of forfeiture), the cost for which the asset was acquired shall be reduced by the amount of advance retained.

Cost of Improvement [Section 55 (1) (B)]:

Another deduction allowed in computation of capital gains is the cost of improvement. Cost of improvement is the capital expenditure resulting in addition of alteration in the capital asset. Routine expenses on repairs and maintenance do not form part of cost of improvement.

2.2.6 INDEXED COST OF ACQUISITION

As already mentioned, in the case of short term Capital Gain, cost of acquisition and cost of improvement are deducted from the full value of consideration for computation of capital gain. But in the case of long-term capital gain indexed cost of acquisition and indexed cost of improvement are deducted. Indexed cost of acquisition means an amount which bears to the cost of acquisition the same proportion as lost in inflation index for the year in which the asset is transferred, bears to the cost inflation index for the first year in which the asset was held by the assessee or the year beginning on 1.1.2001 whichever is later.

Cost Inflation Index as notified by the Central Government is as under :

Sr. No.	Financial Year	Cost Inflation Index (CII)
1.	2001-2002	100
2.	2002-2003	105
3.	2003-2004	109
4.	2004-2005	113
5.	2005-2006	117
6.	2006-2007	122
7.	2007-2008	129
8.	2008-2009	137
9.	2009-2010	148
10.	2010-2011	167
11.	2011-2012	184
12.	2012-2013	200
13.	2013-2014	220
14.	2014-2015	240
15.	2015-16	254
16.	2016-17	264
17.	2017-18	272

18.	2018-19	280
19.	2019-20	289
20.	2020-21	301
21.	2021-22	317
22.	2022-23	331
23.	2023-24	348

Computation of indexed cost of acquisition and indexed cost of improvement:

As mentioned earlier, while determining long term capital gains, it is the cost of acquisition and cost of improvement which has to be indexed.

$$\text{Indexed cost of acquisition} = \text{cost of acquisition} \times \frac{\text{CII of the year of transfer}}{\text{CII of the year of acquisition}}$$

However, there will be no indexing for bonds and debentures. But cost of Capital Index Bonds shall be indexed.

Indexed cost of improvement =

$$\text{Capital expenditure on improvement} \times \frac{\text{CII of the year of transfer}}{\text{CII of the year of acquisition}}$$

2.2.7 EXEMPTED CAPITAL GAINS

Income tax Act grants total/partial exemption of capital gains under sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB 54H, 10(33), 10(36), 10(37), 10(38) and 10(40) and 10(41). These provisions are explained in the following paras :

(1) Capital gain arising on the transfer to a residential house property [Section 54]:

Capital gain on the transfer of a house property is exempt from tax if the following conditions are satisfied :

- (i) The tax payer is either an individual or a Hindu undivided family. In other words, no other person is eligible for claiming exemption under section 54.
- (ii) The capital property, which is transferred, is a residential house property.
- (iii) The house property which is transferred is a long-term capital asset.
- (iv) Long-term capital gain on the transfer of house property will exempt if

it is invested in -

- (a) The purchase of a built-up house within one year before the date of transfer or within two years after the date of transfer, or
- (b) The construction of a new house within three years from the date of transfer, or
- (v) Deposit in capital gains scheme.
- (vi) The new house (Purchased or constructed) is not transferred in the next three years.

The capital gain which is not utilised by the assessee towards the purchase or construction of the new house shall be deposited in a special account called capital gain deposit account in any urban branch of the public sector bank before the due date of furnishing return under section 139. The amount of deposit shall be treated as the cost of new asset.

2. Capital gain on transfer of self-cultivated agricultural land [section 54B]:

When on the transfer of agricultural land, which was being used for agricultural purpose by the assessee or his parents for a period of at least two year immediately preceding the year of a transfer and there occurs some capital gains such capital gain is reinvested in the purchase of agricultural land within a period of 2 years from the date of such transfer, the amount of capital gain so invested shall be exempted from tax.

If the new asset is transferred within a period of three years of its purchase, then the previously exempted gain will be taxable alongwith the new capital gain, if any.

3. Capital gain on compulsory acquisition of land and building forming part of an industrial undertaking (section 54D):

Following conditions must be satisfied to get exemption under section 54D-

- (a) The taxpayer may be an individual, HUF, firm, company or any other person.
- (b) The asset may be short-term/long-term.
- (c) Capital gain arises on transfer by way of compulsory acquisition of land or building which forms a part of an industrial undertaking belonging to the taxpayer.
- (d) Such land or building was used by the assessee for the purposes of the industrial undertaking for at least two years preceding the date of compulsory acquisitions.
- (e) Assessee has purchased any other land or building within such period.
- (f) Newly-acquired land or building should be used for the purposes of shifting or re-establishing the said undertaking or setting-up another industrial undertaking.

The amount of capital gain invested in the purchase of new asset shall be

exempt from tax. If the amount invested is less than the capital gain earned, the balance shall be taxable.

The new asset so purchased cannot be transferred within a period of three years from the date of acquisition.

4. Capital gain on transfer of any long term capital asset (section 54EC):

Following conditions must be satisfied for claiming exemption under section 54EC:

1. A long term capital asset is transferred by an assessee (who may be an individual, firm, company, or any other person) during the previous year.
 2. Within 6 months from the date of transfer of the asset, the assessee should invest the whole (or any part of) capital gain in long term specified assets. "Long term specified assets" means any bond redeemable after 3 years issued by the
 - (a) National Bank of Agriculture and Rural Development (NABARD); or
 - (b) National High ways Authority of India; or
 - (c) Rural Electrification Corporation of India; or
 - (d) National Housing Bank; or
 - (e) Small Industries Development Bank of India.
 3. If the cost of specified asset is not less than the capital gain, the whole of the capital gains shall be exempt from tax. If however, the amount invested in specified assets is less than the capital gain, then the amount of exemption is equal to the amount invested in specified asset.
 4. If the specified assets are transferred (or converted into money or any loan/advance is taken on the security of specified assets) within 3 years from the date of their acquisitions, the amount of capital gain arising from the transfer of original asset which was not charged to tax, will be deemed to be the income by way of long-term capital gains of the previous year in which specified assets are transferred.
 5. The cost of specified assets which is considered for the purpose of section 54EC shall not be eligible for tax rebate under section 88.
5. Capital gain on Investment in units of a specified fund (section 54EE):
- From assessment year 2017-18 exemption is given on capital gain on investment in units of a specified funds subject to following conditions:
1. For getting benefits under this section a long term asset is needed to be transferred.
 2. Whole or any part of capital gain earned on this transferred (sold) of asset should be invest to finance start-ups.
 3. This investment should be made on or after April 1st, 2016 by the assessee, but the investment amount can't exceed Rs. 50 Lakh.

4. Such new assets should not be sold within 3 years or loan is taken against them, otherwise exemption granted will be revoked.
5. Amount of exemption is the lower of 1) the amount invested in specified long term assets; or 2) the actual amount of capital gains.
6. Capital gain on transfers of a long-term capital asset other than a house property (Section 54F):

The following conditions have to be satisfied for claiming exemption under section 54F.

- (a) The assessee is an individual or a Hindu Undivided Family.
- (b) The asset transferred is any long-term capital asset other than a residential house (for instance, it may be plot of land, commercial house property, gold, share or any asset but not a residential house property).
- (c) The assessee has purchased, within one year, before the date of transfer or 2 years after the date of transfer or constructed within 3 years after the date of transfer, a residential house.
- (d) The assessee should not own on the date of transfer of original asset more than one residential house (other than the new house). He should also not purchase within a period of two years after such date (or complete construction within a period of 3 years after such date) any residential house (other than the new house).
- (e) Amount of Exemption: If the above conditions are satisfied, then capital gain will be exempt as under :
 - (i) If the cost of the new house is not less than the net sale consideration in respect of the capital asset transferred, the entire capital gain arising from the transfer will be exempt from tax.
 - (ii) If the cost of the new house is less than the net consideration in respect of the asset transferred, the exemption from long term capital gain will be granted proportionately with the help of following formula :

$$\text{Exemption : } \frac{\text{Total Capital Gain} \times \text{Amount Investment}}{\text{Net sale consideration}}$$

The new house (purchased or constructed) will not be transferred in the next three years.

- (f) The amount of the net consideration which is not utilized by the assessee towards the purchase of the new asset made within one year before the date on which the transfer of the original asset took place, or which is not

utilized by him for the purchase of construction of the new asset before the date of furnishing the return of income under section 139, shall be deposited by him before furnishing such return [such deposit being made in any case not later than the due date applicable in the case of the assessee for furnishing the return of income under sub-section (1) of sec 139] in an account in any such bank as may be specified.

7. Capital gain on shifting of industrial undertaking from urban areas to non-urban areas (Section 54G):
- (i) Capital asset (plant and machinery, land, building or any right therein) is transferred due to shifting of industrial undertaking from urban areas to rural areas; and
 - (ii) Capital gain is reinvested within a period of 1 year before or 3 years after the date in which :
 - (a) Purchase of new machinery or plant for the purpose of business of the industrial undertaking in the area to which the said undertaking is shifted.
 - (b) Acquiring building or land or construction of building the purpose of his business in the said area;
 - (c) Shifting the original asset and transferring the establishment of such undertaking to such area; and
 - (d) Incurred expenses on such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section.
 - (iii) Amount of Exemption: If the aforesaid conditions are satisfied, the gains will be dealt as follows:
 - (a) If the amount of the capital gain greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in (a) to (d) above, the entire capital gain shall be exempt.
 - (b) If the amount of the capital gain is equal to, or less than the cost of the new asset, the capital gain shall not be charged under section 45.
8. Exemption of Capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area to any special Economic Zone (Sec. 54GA) : This section has been inserted to give exemption in case of shifting of an industrial undertaking from urban area to a special economic zone, subject to following conditions :
- Conditions : 1) A capital asset (like Plant & Mach, Land etc.) used for the purpose of an industrial undertaking situated in an urban area is transferred.
- 2) The transfer is effected in the course of shifting of such industrial undertaking

to any SEZ.

- 3) The assessee within a period of one year before or 3 years after the date on which transfer took place :
- Purchased machinery or plant for the purpose of business in the SEZ.
 - Acquired building or land or constructed building for the purpose of business in the SEZ.
 - Shifted the original asset and transferred the establishment to SEZ;
 - Incurred expenses on such other purpose as specified by the Central Govt.

Amount of Exemption : If the above mentioned conditions are satisfied, the amount of exemption is equal to -

- (a) the amount of capital gain generated on transfer of capital assets in the case of shifting of an industrial undertaking; or
 - (b) the cost and expenses incurred in relation to all or any of the purposes mentioned in point no. 3.
- whichever is lower.

If the new asset transferred within three years from the date of its purchase/construction/acquisition, the amount of exemption given earlier u/s 54GA would be taken back.

9. Exemption of capital gain on transfer of residential house property (section- 54 GB):d

An Individual or HUF can claim exemption on transfer/sale of long term residential house property subject to following conditions-

1. The transfer of house or plot should made during 1-4-2012 to 31-3-2017.
2. In case the sale proceed invested in eligible start up, such transfer is allowed upto 31-3-2017
3. Assessee has to buy equity shares in an eligible company on or after 1st April but before the due date of filing ITR u/s 139 (1) w.r.t. such transfer.
4. The amount of exemption will be computed as per following formula-

Amount Invested in new assest

X Capital gain

Net sale consideration

5. This exemption can be revoked if an equity shares bought by an assessee and/or
 - a) new asset purchased with this received amount by a company is sold within 5 years of its acquisition.
 - b) to get benefit amount is deposited in account by eligible company but within one year whole or partly amount from such account is not used for buying new asset.

10. Investment of compensation received (Section 54H):

In case there is transfer of asset due to compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, the period available for depositing or investing the amount under any of the section 54, 54B, 54D, 54EC and 54F, in relation to such compensation shall be reckoned from the date of receipt of such compensation.

11. Capital Gain on transfer of Units of US 64 exempt if transfer takes place on or after 1-4-02 u/s 10(33): Any income arising from the transfer of a capital asset, being a unit of the unit scheme, 1964 where the transfer of such asset takes place on or after 1-4-02 shall be exempt.

12. Capital gain on the sale of shares [Section 10 (36)]:

Any income arising from the transfer of a long term capital asset, being an eligible equity share, in a company purchased on or after 1.3.2003 before 1.3.2004 and held for a period of 12 months or more shall be exempt from tax.

13. Exemption of Capital gains on compensation received on compulsory acquisition of agricultural land situated within specified urban limits u/s 10(37): With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, the Finance Act, 2004 has inserted a new clause (37) so as to exempt the capital gains (whether short term or long term) arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition which is received on or after 1-4-04.

14. Exemption of Long-term capital gain arising from sale of shares and units u/s 10(38): Any income arising on or after 1-10-04 from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund shall exempt provided.

(a) such transaction is chargeable to securities transaction tax;

(b) such shares are sold through recognised stock exchange.

15. Exemption of Capital gain on transfer of an asset of an undertaking engaged in the business of generation etc. of power u/s 10(40): (w.e.f. A.Y. 2006-07): Any income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation, transmission or distribution of power shall be exempt where such transfer is effected on or before 31-3-06 to the Indian company notified u/s 80-1A (4) (v) (a).

2.2.8 LOSS UNDER THE HEAD CAPITAL GAINS

Set off: Short term capital loss can be set off from either short term capital gain or long term capital gain.

Long term capital loss can be set off only from Long Term Capital Gain.

Carry forward: Unadjusted capital losses can be carried forward separately for 8 succeeding previous years to be set off in following manner :

(a) Short term capital loss can be set off from either short Term Capital Gain or Long Term Capital Gain.

(b) Long Term Capital Loss can be set off only from Long Term Capital Gain.

2.2.9 TAX ON LONG TERM CAPITAL GAINS [SECTION 112]

From assessment year 1993-94 long term capital gain is to be assessed to tax not on normal scheduled rates but on special rates given below :

1. For individual and H.U.F.
 - a) Total income shall be reduced by the amount of long term capital gain included in the total income and on balance.
 - b) On long term capital gain tax is to be calculated at the rate of 20% of such long term capital gain.
2. Cases of Long Term Capital gains covered u/s 115AB, 115AC, 115AD or 115E. Rate of tax is 10%.
3. Computation of tax on long term capital gain from securities with effect from assessment year 2000-01.

The assessee has been given the option to choose either.

- (a) 10% tax on long term capital gain from securities without applying the 2nd proviso of section 48 (i.e. indexing), or
 - (b) 20% tax on long term capital gain from securities after applying the 2nd proviso of section 48 (i.e. indexing).
4. Section 111A and 115 AD provide for special tax rate of 15% on short term capital gain arising from the transfer of a short-term capital asset, being an equity share in a company or a unit of an equity oriented fund, where such transaction is chargeable to securities transaction tax.

2.2.10 ILLUSTRATION

Mr. Barua, a rich man of Calcutta, had sold the following properties during the year ended on 31st March, 2022.

1. A house property (he owned only this residential house) sold for Rs. 9,70,000 in Oct. 2021 was actually purchased for Rs. 1,50,000 in 2001- 02, he spent Rs. 1,00,000 for the construction of another room in 2004- 05. Expenses incurred in the execution of sale deed were Rs. 10,000 which were borne by him.
2. On the death of his father in Nov. 2005, few shares were transferred to him which he sold in March, 2022 for Rs. 90,000. His father purchased those shares for Rs. 10,000 in May 2005.
3. To meet business loss, he had to sell jewellery for Rs. 2,50,000 in October 2021. The cost of his jewellery is estimated at Rs. 80,000 Jewellery was actually purchased in July 2007 at the time of his marriage.
4. He also sold a piece of agricultural land at Durgapur in October, 2021 for Rs. 90,000 and invested the full sale price within 6 months to buy another agricultural land at Hugli, where he wants to settle now. Land was purchase in December 2020 at cost of Rs. 30,000 and was cultivated by tenants.

5. He also sold his furniture (Household) for Rs. 10,000. The original cost of furniture was Rs. 6,000. The furniture was purchased in 2009 and was sold in December 2021.

Cost inflation index for the various years are as under :

2001-02	100
2004-05	113
2005-06	117
2007-08	129
2021-22	317

Computer his taxable Capital Gains.

Solution :

Computation of Total Income of Mr. Barua for the A.Y. 2021-22 :

1.	Short term Capital Gain :		
	Agricultural land at Hugli	Rs.	Rs.
	S.P.	90,000	
	Cost	30,000	
	Short term capital gain		60,000
2.	Long term capital assets :		
	House Property : SP	<u>9,70,000</u>	
	Less : Expenses on sale	<u>10,000</u>	
	Net Consideration	9,60,000	
	Less Indexed Cost		
	(2,00,000×317/100)	6,34,000	
	Cost of Improvement (+)		
	(1,00,000 × 317/113)	<u>2,80,531</u>	
	Capital gain		45,469
3.	Share : SP	90,000	
	Less : expenses on sale	<u>Nil</u>	
	Net consideration	90,000	
	Less : Index Cost of acquisition		
	(10,000 × 317/117)	<u>27,094</u>	
	Capital Loss		62,906
4.	Jewellery : S.P.	250,000	
	Cost of (80,000×317/129)	<u>1,96,589</u>	
	Capital Gain		53,411
5.	Furniture (House hold)		
	Exempted as it is not capital asset		<u>Nil</u>
	Total Income/LTCG		2,21,786

SELF CHECK EXERCISE

Computation of capital gain u/s 112A (Taxation on transfer of Equity shares and certain units):

Q.1 Compute long-term capital gain u/s 113A for A.Y. 2022-23,

Actual cost of acquisition on 1-4-2016	Rs. 100
FMV as on 31-1-2022	Rs. 200
Sale price as on 15-4-2021	317

Q.2 A joint Family purchased a house on 1-5-1995 in Bombay for Rs. 4,60,000. It sold the house on 10-6-2021 (CII-317) for 20 lakh. On 14-7-2021 it purchased another house at Hardwar at a total cost of Rs. 4 lakhs. Compute the income chargeable to tax under the head 'Capital Gains'.

2.2.11 SUMMARY

The head 'capital gains' deals with the gain arising on the transfer of a capital assets in the previous year. The term 'capital asset' includes all types of assets owned by the assessee whether movable or immovable, tangible or intangible, connected with business or not. Capital assets are of two types namely, short term capital asset or long term capital asset. There should be a transfer of assets in the previous year. The procedure for computation of short term capital gain and long term capital gain have been explained. Capital gain which are exempt from tax have also been explained.

2.2.12 ANSWERS TO SELF CHECK QUESTIONS

ANS.1. Full amount of Consideration Rs 250

Less: cost of acquisition- cost of acquisition	Rs. 100
or	
Sale or FMV on 31-1-21	Rs. 250
(Rs. 250 or Rs. 200, whichever is less)	<u>200</u>
(whichever is more from cost of acquisition or sale or FMV)	
so long term capital Gain	<u>50</u>

ANS.2.(a) Indexed cost Rs. 14,58,200

(b) Exemption u/s 54 Rs. 4,00,000

(c) Capital Gain Rs. 1,41,800

2.2.13 EXERCISE

(A) Short Questions :

- Q.1. Define the term 'Capital Gain'.
- Q.2. Discuss the procedure for computation of Capital gain as prescribed by the Income-Tax Act, 1961.
- Q.3. What is the meaning of term, 'Cost of acquisition' as used in the head 'Capital Gain'? What rules are given for the determination of cost of acquisitions ?

(B) Long Questions :

- Q.1. Write short notes on : (i) Transfer, (ii) Capital Gain exempted from Tax, (iii) Long Term and Short Term capital assets and gains.
- Q.2. Mr. X owns a residential house at Bangalore. From the following information, compute the amount of capital gain.

	Rs
Cost of construction (during 2001-02)	4,00,000
Cost of Additions and Improvement (during 2005-06)	2,00,000
Sale consideration (sale made on 10.10.2022)	28,00,000
Expenses on transfer	20,000
Cost of new house purchase in Hyderabad (on 15.1.2023) (House is half finished)	6,00,000
Amount deposited in capital gain deposit scheme in SBI on 25-7-2023	4,00,000
An amount of Rs. 3,00,000 withdrawn from capital gain deposit scheme on 12 May 2023 and utilized for the completion of the house.	
Cost Inflation index for 2001-02 is 100,	
for 2005-06 is 117, and	
for 2022-23 is 321	

Q.3. State whether the following are "Capital assets or not" with reasons for your answer :

- (1) A car owned by an assessee and used by him and his family.
- (2) An air-conditioning plant owned by a company and installed at the residence of its Managing Director.
- (3) Silverware belonging to a Hindu unlimited Family which are placed before the family deity (Goddess Lakshmi) at the time of Pooja or worship on special occasions.

2.2.14 SUGGESTED READINGS

1. Income Tax Law and Practice : Gaur & Narang
2. Direct Taxes : B.B. Lal and N. Vashisht
3. Income Tax Law : H.C. Mehrota.
4. The Income Tax Law : Shailinder Sekhon
(A.Y. : 2023-24)

INCOME FROM OTHER SOURCES**Structure of the Lesson :**

- 2.3.0 Objective
- 2.3.1 Introduction
- 2.3.2 Methods of Accounting
- 2.3.3 Specific Incomes included under 'Income from other Sources'
 - 2.3.3.1 Taxability of Dividend
 - 2.3.3.2 Winning from Lotteries, Crosswords Puzzles, Horse Race and Card Games
 - 2.3.3.3 Interest on Securities
 - 2.3.3.4 Amount received as gift to be treated as income
 - 2.3.3.5 Income from letting out of Machinery, Plant or Furniture
 - 2.3.3.6 Family Pension received by the Legal Heirs of a deceased employees
- 2.3.3.7 Contribution of Employee towards his Welfare Fund
 - 2.3.3.8 Any other Income taxable under this head
- 2.3.4 Amounts not deductible under the head Income from other sources
- 2.3.5 Deemed Income chargeable to tax
- Self Check Exercise
- 2.3.6 Illustrations I and II
- 2.3.7 Answer to self-check Question
- 2.3.8 Exercise
- 2.3.9 Suggested Readings
- 2.3.0 **OBJECTIVE**

The main focus of this lesson is on the

- (a) Specific incomes included under the head 'Income from other sources', and
- (b) Expenses which are not deductible from the incomes taxable under the head 'Income from other sources'.

The deemed incomes chargeable to tax under section 59 of this head is also discussed in this lesson.

2.3.1 INTRODUCTION

As per section 56(1) income of every kind, which is not exempt under this, Act, shall be chargeable to Income tax under the head 'Income from Other Sources'. If

it is not chargeable to Income tax under any of the first four heads specified in section (14). In other words, the following conditions must be satisfied before an income can be taxed under the head 'Income from other sources' :

- (i) There must be an income;
- (ii) Such income is not exempted under the provision of this Act;
- (iii) Such income is not chargeable to tax under any first four heads;

Income from other sources is, therefore a residuary head of income.

2.3.2 METHODS OF ACCOUNTING

As per section 145, income chargeable under this head, is to be computed in accordance with the method of the accounting regularly employed by the assessee. If the books of accounts are maintained on mercantile system, income is to be computed on due basis. On the other hand, if the books of accounts are maintained on cash system, income is taxable on receipt basis and expenditure shall be allowed as a deduction on payment basis.

2.3.3 SPECIFIC INCOMES INCLUDED UNDER 'INCOME FROM OTHER SOURCES' [SECTION 56(2)]

- (i) Dividends from cooperative societies/foreign companies.
- (ii) Winnings from lotteries, crossword puzzles, horse races, card games and other games of any sort, or from gambling or betting of any form or nature otherwise. These can be called as casual incomes.
- (iii) Income by way of interest on commercial and government securities provided if the income is not chargeable to income tax under the head profits and gains of business or profession.
- (iv) Income from machinery, plant or furniture belonging to the assessee and let on hire, provided the incomes is not chargeable to income tax under the head profits and gains of business or profession.
- (v) Any Sum received under a Keyman Insurance policy, including the sum allocated by way of bonus on such policy, if such income is not taxable under the head 'Salaries' or 'Profits and Gains of Business or Profession', Other Income which are normally includes under the head 'Income from Other Sources.'
 - (i) Income from sub-letting of a house property;
 - (ii) Casual Income;
 - (iii) Insurance Commission;
 - (iv) Family Pension received by legal heirs of employee;
 - (v) Directors sitting fees attending board meeting;
 - (vi) Interest on Deposit;
 - (vii) Interest on Loans;
 - (viii) Income from undisclosed Sources;

- (ix) Remuneration received by Members of Parliament;
- (x) Interest on Securities of Foreign Investments;
- (xi) Examinership Fees received by a teacher from an institution other than his employer;
- (xii) Total Interest till date on employee's contribution to an unorganised provident fund at the time when the payment of lumpsum amount from the unrecognised provident fund is due.
- (xiii) Rent from letting out a plot.
- (xiv) Agriculture Income from agriculture land situated outside India;
- (xv) Interest received on excess payment of advance tax and delayed refund.
- (xvi) Income from Royalty if it is not income from business or profession.
- (xvii) Directors Commission for standing as guarantor to bankers;
- (xviii) Directors Commission for underwriting shares of a new company; and
- (xix) Gratuity received by a Director who under the relevant contract, is not an employee or servant of company, is assessable as income from other sources [CIT v Lady Navajabi R.J. tata (1947) 15 ITR 8 (Bombay)]
- (xx) Any Annuity or Pension received from LIC or other Insurer u/s 80CCC.

2.3.3.1 Taxability of dividend [(section 56) (2) (1)]

Dividend can be of three types -

- (a) Dividends declared by a domestic company.
- (b) Dividends declared by a foreign company.
- (c) Dividends declared by a body corporate or undertaking other than covered under clauses (a) and (b) above like Unit Trust of India.

Any amount declared, distribution or paid by a domestic company by way of dividends. (Whether interim or otherwise) after March 31, 2003 shall be exempt in the hands of shareholder u/s 10(34) except 'demand Dividend', But w.e.f. A.Y. 2017-18 exemption of dividend is restricted upto Rs. 10,00,000. In case dividend received is more than Rs. 10,00,000, excess amount is taxable in the hands of assessee.

Deemed Dividend

As per the definition given in section 2(22), the following disbursements by the company, etc. to the shareholders, to the extent of accumulated profits, are deemed to be dividend for the purpose of income tax -

- (a) Any distribution by a Company to the extent of accumulated profits involving the release of the asset of company [section 2(22) (a)].
- (b) Distribution of Debenture/Deposit Certificates to shareholder and bonus shares to preference shareholder [section 2 (22) (b)].
- (c) Distribution to shareholder on liquidation of the company [section 2 (22)(c)].

- (d) Distribution on reduction of share capital [section 2(22) (d)].
- (e) Loans/Advances to certain shareholders/concern [section 2(22) (c)].

Dividends paid by a domestic company to the shareholder is exempt from tax under section 10(34). On such dividend, the company declaring dividend will pay dividend tax under Section 115-0. Tax will not be deducted at source.

Since dividends received from a domestic company shall be exempt, no deduction of any expenses shall be allowed from such dividends.

2.3.3.2 Winnings from Lotteries, Crossword puzzles, Horse Race and Card Games [Section 56 (2) (b)]

- (i) Lotteries,
- (ii) Crossword Puzzles
- (iii) Races including Horse Races
- (iv) Card Games and other games of any sort
- (v) Gambling or betting of any form or nature whatever are chargeable to tax as 'Income from other Sources'

As per section 56(4), in case of an assessee having from winning from lotteries, crossword puzzles, etc., the deduction in respect of any expenditure or allowance in connection with such income shall not be allowed while computing such income. In other words, the entire income of winning, without any expenditure or allowance, will be taxable.

Grossing up Lottery Income:

As in the case of some other incomes, there is also a provision for tax to be deducted at sources from income from winning of lotteries, horse races and crossword puzzles. The rate of TDS, in case, of such income is 30% (plus surcharge), if the income exceeds Rs. 5,000 (or Rs. 2,500 in case of races). Grossing up of the net lottery receipts will be done as under -

$$\text{Gross Amount} = \text{Net Amount} \times \frac{100}{100 - (30 + \text{Surcharge} + \text{Education cess})}$$

Special Rate of Income Tax in case of winning Lotteries, Crossword Puzzles, Races, etc. (section 155BB)

Although, winning from lotteries etc. is part of total income of the assessee, such income is taxable at a special rate of tax, which at present is 30% + surcharge.

2.3.3.3 Interest on securities [56(2) (id)]

Income by way of interest on securities is chargeable under this head, if such income is not chargeable to income tax under the head, 'Profit and Gains of Business or Profession.' According to Section 2(28 B) 'Interest on Securities' means:

- (i) Interest on any security of the Central Government or a State Government.

(ii) Interest on Debenture or other Securities for Money issued by, or on behalf of a Local Authority or a Company or a Corporation established by Central, State or Provincial Act. Thus securities may be divided into following categories -

- (i) Securities issued by Central/State Governments.
- (ii) Debentures/Bonds issued by a Local Authority.
- (iii) Debentures/Bonds issued by Companies.
- (iv) Debentures/Bonds issued by a Corporation established by a central, state or provisional Act, i.e. autonomous and Statutory Corporation.

Interest on securities may be taxed on receipt basis or on due basis, depending upon the system of accounting, if any, adopting by the assessee.

Accrual of Interest

Interest on securities accrues or becomes due on a specified date and not on a day-to-day basis. The date on which the interest shall become due is specified by the issuing authority.

Grossing up of Interest

For Income Tax purposes what is to be charged to tax is the gross amount of interest. Therefore, if the net-interest is given, it has to be grossed up to arrive at the taxable amount.

Grossing up is required in the following securities :

- (i) Tax free non-government securities; (Interest shall always be grossed)
 - (ii) Less-tax non-government securities; (Interest shall be grossed up only when net interest has been given.)
- Net interest can be grossed up as under -

$$\frac{\text{Net Interest} \times 100}{100 - \text{Rate of TDS}}$$

The following deductions will be allowed from the gross interest on securities u/s 57 (i) & (iii) -

- (a) Collection charges.
- (b) Interest on loan/money borrowed for investment in securities.
- (c) Any other expenditure, not being a expenditure of a capital nature.

2.3.3.4 Amount received as gift to be treated as income : (Section 2(24) (xiii) and Section 56(2) (v):

Where any sum of money, the aggregate value of which exceeds Rs. 50,000 is received without consideration by an individual or HUF from any person or persons on or after 1-4-2008, the whole of such sum shall be deemed as income of the previous year in which it is received and taxable under the head 'Income from other sources'. Provided that this clause shall not apply to any sum of money

received :

- (a) from any relative; or
- (b) on the occasion of marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer, or
- (e) from any fund or foundation, a university or other educational institution or hospital or other medical institution or any trust or institution referred in sec-10 (23c); or
- (d) from any trust or institution registered u/s 12AA.

2.3.3.5 Income from letting out of Machinery, Plant or Furniture [Section 56(2) (ii)]

Income from machinery, plant or furniture belonging to the assessee and let on hire, is chargeable as income from other sources, if the income is not chargeable to income tax under the head 'Profits and Gains of Business or Profession'. The following deductions are allowable u/s 57 (ii) & (iii) -

- (a) Current repairs, rates and taxes of the building, if given to others on composite rent.
- (b) Insurance premium.
- (c) Repairs and insurance of machinery, plant or furniture.
- (d) Depreciation based upon block of assets.
- (e) Any other expenditure not being a expenditure of a capital nature.

2.3.3.6 Family Pension Payments received by the Legal Heirs of a deceased employees

After the death of employee, if there is any family pension received by the legal heirs of the deceased, it will deemed to be the income of the legal heir and will be taxable under the head 'Income from Other Sources'. On such pension, a standard deductions shall be allowed to the legal heir at 33.1/3% of such pension or Rs. 15,000 p.a. whichever is less.

2.3.3.7 Contribution of the employee towards his welfare fund [section 56(2) (ic)] This is an income of the employer to be taxed under this head, if such income is not chargeable under the head "Profit and Gains of Business and Profession". However, if the contribution was deposited under the welfare scheme, for which it was deducted, the amount so deposited shall be allowed as a deduction u/s 57 (ia).

2.3.3.8 Any other income taxable under this head

If there is any other income, which is not discussed above, but is taxable under the head 'Income from Other Sources' the deduction will be allowed on account of any expenditure incurred to earn such income provided the conditions prescribed are satisfied.

2.3.4 AMOUNTS NOT DEDUCTIBLE UNDER THE HEAD 'INCOME FROM OTHER

SOURCES' [SECTION 58]

The following payments shall not be deductible in computing the income chargeable under this head -

- (a) Personal expenses of the assessee;
- (b) Interest paid outside India on which tax has not been deducted at source;
- (c) Salaries paid outside India on which tax is not deducted at source.
- (d) Income Tax/Wealth Tax paid;
- (e) Any Expenditure referred to in section 40(A) like excessive payments to the relatives [Section 40 A (3)].

2.3.5 DEEMED INCOME CHARGEABLE TO TAX (SECTION 59)

Where an allowance or deduction has been made in the assessment year for any year under the head 'Income from other Sources', in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year he has obtained, whether in cash or in any other manner, any amount or a remission of any such liability, the amount obtained or the value of benefit, shall be deemed to be the income under the head 'Income from Other Sources' of the previous year in which the amount is received. These provisions are applicable even in case of succession and inheritance.

SELF CHECK QUESTIONS

Ques. The following assesseees are employed in business and hold certain securities as investment. You are required to compute the amount of interest which will be taxed under the head 'Income from Other Sources'.

- I. A received Rs. 9,000 as interest in respect of Government Securities.
- II. R held Rs. 20,000 6% Karnataka Government Securities during the financial year 2021-22.
- III. B received Rs. 10,000 as interest on securities which are mentioned in section 10(15).
- IV. C held Rs. 20,000 14% debentures in J.K. Synthetics Ltd. which are listed on the Calcutta Stock Exchange.
- V. D received Rs. 7,960 as interest on securities which are not listed on any Stock Exchange.

2.3.6 ILLUSTRATIONS I AND II

I. Shri Swami Prasad furnishes the following particular of his income for the previous year ending on 31st March, 2023.

- (i) Dividend from a tea company in June, 2022 Rs. 2,500 (gross) (60% of the income of the company is agricultural income).
- (ii) Amount won on 1st November 2022 from a horse race Rs. 6,500.
- (iii) Interim Dividend declared by the Directors of K. Co. Ltd. in January,

2022 but the payment was received in June, 2023 for which dividend warrants were dispatched in May, 2022. The amount received as dividends was Rs. 8,000.

- (iv) Dividend declared by P.Co. Ltd. in January, 2021 dividend warrants were dispatched in April, 2022 and the payment was received in June, 2022 amounting to Rs. 4,000 (gross).
- (v) Amount won in February, 2023 in connection with winning from a lottery Rs. 34,550.
- (vi) Interest (gross) on deposit with a firm Rs. 5,600.
- (vii) Dividend received from a Co-operative Society, Rs. 450.
- (viii) Income from non-agricultural land Rs. 1,500.

Shri Swami Prasad claims the following expenses :

Bank commission Rs. 100 for collecting interest and Rs. 500 on winnings from horse race and winnings from lotteries; on loan taken to purchase share in tea company Rs. 800; and expenses incurred for purchasing lottery tickets Rs. 2,000.

Compute the taxable income of Sh. Swami Prasad under the head 'Income from Other Source'

SOLUTION :

Computation of Income from Other Sources

	Rs.	Rs.
General incomes 56 (1)		
Interest on deposits with firm	5,600	
Income from non-agricultural land	<u>1,500</u>	
		7,100
Specific Income 56 (2)		
Dividend :-		
(a) Tea Company - Exempted u/s 10(34)	NIL	
(b) Interim Dividend not received u/s 10(34)	NIL	
(c) Dividend for P.Co. - Exempted u/s 10(34)	NIL	
(d) Dividend from Co-operative society		
	<u>450</u>	450
Casual Incomes :-		
Race Winnings	6,500	
Winnings from Lottery Rs.	<u>50,000</u>	<u>56,500</u>
Gross Income		64,050
<i>Deduction</i>		
Collection charges	100	
Interest on Loan - Not allowed	NIL	
Collection charges for lottery (Not allowed)	NIL	

Purchase of lottery tickets (Not allowed)	<u>NIL</u>	<u>100</u>
Income from Other Sources		<u>63,950</u>

II. As assessee had the following investments as on 1st April, 2022 :

- (i) Rs. 40,000, 12% Central government Loan;
- (ii) Rs. 30,000, 10% government Securities;
- (iii) Rs. 20,000, 9% Preference Shares of Paper Mill Company;
- (iv) Rs. 50,000, 11% Bombay Port Trust Bonds;
- (v) Rs. 20,000, 15% Debentures of a Limited Company (unlisted);
- (vi) Rs. 10,000, 10% Securities issued by government of England;
- (vii) Rs. 10,000, 10% Securities issued by government of England;
- (viii) Rs. 20,000, 14% Municipal Debentures;
- (ix) Interest accrued on NSC VIII issue purchased on 11-03-2022 Rs. 1,130.
- (x) Rs. 15, 920, 10% (Tax-free) Debentures of a Limited Company (unlisted).

On 1st September, 2022 he bought Rs. 50,000, 12% Maharashtra government Bonds for Rs. 60,000 the interest on which is payable on 30th June and 31st December. For this purpose he took a loan from his Bankers for Rs. 40,000 @15% p.a. and the Balance of Rs. 20,000 were financed out of previous loan taken for purchase of a motor car @9% p.a.

Bank charged 2% of interest and dividend as collection fees and 3% commission on purchase of securities.

Calculate the income other sources.

SOLUTION

Computation of Income from Other Sources

	Rs.	Rs.
<i>Interest on securities:</i>		
Rs. 40,000, 12% Central Govt. Loan	4,800	
Rs. 30,000, 10% Govt. Securities	3,000	
Rs. 50,000, 11% Bombay Port Trust Bonds	5,500	
Rs. 20,000, 15% Debentures of a Company (unlisted)	3,000	
Rs. 20,000, 14% Municipal Debentures	2,800	
Rs. 15, 920, 10% (Tax-free) Debentures of a Company (unlisted) Net $1592 \times \frac{100}{79.6}$	2,010	
50,000, 12% Maharashtra Govt. Bonds (Half Yearly)	3,000	
Interest accrued on NSC VIII issue	<u>1,130</u>	25,240
<i>Dividend:</i>		

20,000, 9% Preference Shares of Paper Mill (exempted u/s 10(34) upto Rs. 10,00,000 <i>Interest</i>		NIL
10,000, 10% Securities issued by a Foreign Govt.		<u>1,000</u>
Gross Income		26,240
<i>Deductions:</i>		
Collection Charges @2% of [26,230 - 1,130]	502	
Interest on Borrowed Money (40,000 × 15/100 × 7/12)	<u>3,500</u>	<u>4,002</u>
		<u>22,238</u>

- Notes: (a) Commission on Purchase of Securities shall not be allowed as deduction as it is capital expenditure.
- (b) Interest on Money borrowed for some other purposes shall not be allowed as deduction out of interest on securities.
- (c) No collection charges on accrued interest of N.S.C. VIII issue.
- (d) Interest on National Plan Certificate is exempted u/s 10(15).

2.3.7 ANSWERS TO SELF CHECK QUESTIONS

- Ans. Hints: (a) Fully Taxable (d) Rs. 2,800 taxable for Mr. C
(b) Rs. 1,200 (e) Rs. 10,000.
(c) Fully Exempted

2.3.8 EXERCISE

(A) Short Questions:

- Q.1. What do you understand by 'Income from Other Sources'? State the main incomes which are included under this head.
- Q.2. Write notes on - (a) Less-tax securities
(b) Grossing up of income from lotteries
(c) Deemed Dividend.

(B) Long Questions:

- Q.1. Define the term 'Dividend'. How is the dividend income put to tax under the provisions of this Act ?
- Q.2. Do you agree that deductions are provided under the Income from other sources head? If yes then discuss in details.

2.3.9 SUGGESTED READINGS

1. Systematic Approach to Income Tax : Ahuja and Gupta
2. Income Tax-Law & Practice : Gaur and Narang.
3. The Income Tax Law : Shailinder Sekhon
(A.Y. 2023-24)

LESSON NO. : 2.4

AUTHOR : DR. SUMAN KUMAR JAIN
VETTED BY: DR. SHAILINDER**DEPRECIATION**

Structure of the Lesson :

- 2.4.0 Objective
- 2.4.1 Introduction
- 2.4.2 Principles governing Grant of Depreciation Allowance
- 2.4.3 Actual cost of an Asset [Section 43(1)]
- 2.4.4 Written-down value of the Asset [Section 43(6)]
 - 2.4.4.1 Computation of written down value in the Block of Assets
 - 2.4.4.2 Written down value of the Asset partly used for business or profession
 - 2.4.4.3 Additional depreciation [Section 32 (1) (iiA)]
- 2.4.5 Rates of Depreciation
- 2.4.6 Unabsorbed Depreciation Allowance [Section 32(2)]
- 2.4.7 Tea Development Account [Section 33 (AB)]
 - 2.4.7.1 Quantum of Deduction
 - 2.4.7.2 Withdrawal from the Deposit
 - 2.4.7.3 Disallowance of Expenditure
 - 2.4.7.4 Withdrawal chargeable to Tax in certain cases
 - 2.4.7.5 Restrictions on sale or transfer of assets
- Self Check Exercise
- 2.4.8 Summary
- 2.4.9 Answer to self-check questions
- 2.4.10 Exercise
- 2.4.11 Suggested Readings
- 2.4.0 **OBJECTIVE**

The main objective of the lesson is to introduce the students with the following provisions of Depreciation :

1. Principles governing Grant of Depreciation
2. Actual cost or written-down value of an asset
3. Rates of Depreciation, and
4. Unabsorbed Depreciation Allowance.

2.4.1 INTRODUCTION

The term 'depreciation' has not been defined anywhere in the income tax. It is a term of accountancy, which means diminution in the value of an asset due to wear and tear and passage of time. Therefore, an allowance is made for the wear and tear of fixed assets to facilitate replacement of asset. Under section 32 (IA) allowance

for depreciation is available only in respect of building, machinery, plant, furniture and some intangible assets owned by the assessee and used for the purpose of the business or profession subject to the provisions of Section 34 at the rates prescribed in the Act. Such allowance is available in respect of structure of work constructed by the assessee after 31st March, 1970 by way of capital expenditure in relation to and by way of renovation or extension of or improvement to the building used for the purposes of business or profession.

The term 'building' does not include the land or site on which the building is erected. The term 'plant' has been defined in Section 43 (3) which includes ships, vehicles, books, scientific apparatus and surgical equipments. 'Plant' in its ordinary sense includes whatever apparatus is used by a businessman for carrying on his business but not his stock-in-trade which he buys or makes for sale, but all goods and chattels fixed or moveable, which he uses for employment in his business, with some degree of durability. Machinery is the complex combination of steel mechanical parts which help in production.

2.4.2 PRINCIPLES GOVERNING GRANT OF DEPRECIATION ALLOWANCE

1. Assets eligible for Depreciation

- (a) Tangible assets : (i) Building (ii) Machinery or plant, (iii) Furniture.
- (b) Intangible assets: (i) Know-how, (ii) Patents (iii) Copy-right, (iv) Trademarks (v) License, franchise or any other business or commercial rights.

The term 'building' includes roads, bridges, culverts, wells and tube-wells and it refers to building used for the purpose of business or profession.

2. Assets must be owned by the Assessee : Subject to provisions under Section 32 depreciation allowance can be granted only in respect of property owned by the assessee. An assessee would not be entitled to depreciation allowance if he is not the owner of the building, machinery, plant or furniture, as the case may be. Assets bought under hire- purchase agreements are also entitled for full depreciation allowance with the buyer. Where, however under a lease agreement the lessee has to deliver back the building in its original condition, he will be allowed depreciation in respect of any addition made by him (Addl. C.I.T. Vs. Lawlys Enterprises (P) Ltd.) A partnership firm can claim depreciation on immovable property brought by the partners (as their contribution towards capital) even though such property has not been registered in the name of the firm. In fact, the property brought in by the partners in the common stock of the firm is treated as a part the firm property. (Amber Corporation Vs. C. I.T. (1981) 5 Taxman 56).

Where the assessee takes a building on lease or other rights to occupancy

for his business or profession and incurs capital expenditure on renovation, extension or improvement to such building, he is deemed to be the owner of said structure of work entitled to depreciation.

3. Use of the Assets must have been for the purpose of Assessee's Business: As already stated depreciation is allowed only in respect of those buildings, machinery, plant and furniture which is used for the purpose of the assessee's business, the profits of which are being charged. Thus no depreciation is allowed in the case of an asset lying idle. But the word 'used' embraces passive as well as active user and depreciation may be allowed in certain cases even though the machinery has not been actually worked during the accounting year. For example, stand by buses kept in readiness by a transport company to be provided against breakdown of other buses are also entitled for full depreciation allowance even though they are not used throughout the year. (Capital Bus Service Pvt Ltd. Vs. C.I.T. (1980) ITR 404). Where the major part of the asset was worked for the year and only a small parts remained idle, depreciation should be allowed in full. Where, however, an asset is not exclusively used for business purposes but is also used for other purposes, the assessee would be entitled to only a proportionate part of the depreciation allowance (Sec. 38 (2)). Generally, an asset used partly for business purposes and partly for private purposes will be entitled for proportionate depreciation allowances as can be attributed to business use.

4. Use of asset during the previous year: In case any asset falling within in a block is used for a period of less than 180 days in the relevant previous year for the business or profession, depreciation shall allowed at the rate of 50% of the amount calculated at the prescribed rate.

In case asset is used for 180 days or more, full depreciation shall be allowed.

2.4.3 ACTUAL COST OF AN ASSET-[SEC. 43 (1)]

Section 43 (1) of the Acts defines 'actual cost' which means the actual cost of assets to the assessee, as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. For the purpose of determining depreciation allowance, the actual cost of an asset to the assess means :

- (a) The price paid by the assessee for the purpose. If an asset is bought by the assessee for Rs. 50,000 but he is reimbursed by the Government to the extent of Rs.20,000 for this purpose, the actual cost to him is Rs. 30,000 only. He can claim depreciation on Rs. 30,000 and not on the actual price of the asset.
- (b) Where the assessee acquires an asset by way of gift or right of inheritance or succession, the actual cost to the assessee will be actual cost to the previous owner as reduced by (i) the amount of depreciation

actually allowed in respect of any previous year relevant to the assessment year commencing on or after 1.4.1988 ; and (ii) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after 1.4.1988 as if the asset was the only asset in the relevant block of assets.

- (c) Where a capital asset is transferred by a holding company to its 100 percent subsidiary company, or vice-versa, the actual cost of the transferred asset to the transferee company, an Indian company, will be the same as it would have been if such company had continued to hold it for the purposes of its business.
- (d) Where the business asset is transferred by the assessee to any other person and is reacquired by him, the actual cost to the assessee shall be :
 - (i) actual cost to him when he first acquired the asset less the amount of depreciation actually allowed upto assessment year 1987-88 and that would have been allowable from assessment year 1988-89 onwards as if the asset was the only asset in the relevant block of assets; or
 - (ii) the actual price for which the asset is reacquired, whichever is less.
- (e) In a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamating company is Indian Company, the actual cost of the transferred capital assets to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for its own business u/s 43 (1).

Any amount paid or payable as interest in connection with acquisition of an asset, such interest, as is related to any period after such asset is first put to use, will not be included in the actual cost of the asset.

Where loan is taken to purchase machinery and a part of loan is written off subsequently, actual cost of machinery to be reduced for depreciation purposes (Cochin Co- (PI Ltd. Va. C.I.T. (1980) 184, I.T.R. ; p 230).

The cost of an asset may increase after the year of installation or erection as a result of further liabilities later (Habit Hussein Vs. C.I.T.). But where a factory is shifted to a new site, the mere expense of transporting the plant cannot be treated as part of its cost and would not qualify for depreciation allowance (Sitalpur Sugar Works Ltd. Vs. C.I.T.)

Where on the partition of a joint family, the properties are divided among the

members at a genuine valuation, the cost to the member who thereafter brings the assets into his business is the valuation at which he took them over (Kalooram Govindram Vs.C.I.T.).

2.4.4 WRITTEN DOWN VALUE OF THE ASSET [SEC. 43 (6)]

The written down value of an asset is significant for the purposes of determination of depreciation allowance. In simple accounting language, written down value means the actual cost of the asset minus depreciation allowance determined according to rules laid down in this behalf. It is immaterial as to how much of the depreciation allowance could actually be absorbed by the available business profits. For example, the original cost of an asset is Rs. 20,000 and the amount of depreciation allowance in the previous year is Rs. 4,000. But only an amount of Rs. 1,500 could actually be set off due to insufficient profits leaving a balance of Rs. 2,500 an unabsorbed depreciation. In such a case the written-down value for the succeeding year will be Rs. 16,000 and not Rs. 18,500.

2.4.4.1 Computation of Written-down value in the Block of Assets :

The written-down value shall be computed as under w.e.f. the assessment year 1988-89:

- (i) The aggregate of the written-down of all assets falling within a 'block'.
- (ii) The aggregate of the written-down value arrived in (i) shall be increased by the actual cost of the asset falling in that block which was acquired during the previous year.
- (iii) The sum arrived at in (ii) above shall be reduced by the moneys payable (together with scrap value) in regard to any asset falling within that block which is sold, discarded, demolished or destroyed during the previous year.
- (iv) The balance under (iii) shall be the written down value for computation of depreciation for that year.

2.4.4.2 Written-down value of the Asset partly used for Business or Profession : If an asset is used both for business as well as personal purposes., it becomes quite significant to determine the written-down value in such a case. However, depreciation allowance proportionate to the use for business is allowed for income- tax purposes and notional depreciation is ignored. For example, the assessee used a motor car equally for both the purposes. The actual cost of car is Rs. 70,000 and depreciation allowable on it for the year is Rs. 14,000. The actual depreciation allowed from the business profits will be Rs. 7,000. So the written-down value of the car for the succeeding year will be Rs. 63,000 and not Rs. 56,000.

2.4.4.3 Additional Depreciation [Section 32(1) (iiA)] :

With effect from assessment year 2006-07 an additional depreciation @ 20% of actual cost of Plant and Machinery is allowed if following conditions are fulfilled :

- (a) The assessee is engaged in the business of manufacture or production of any article or thing or goods.
- (b) In case any new plant and machinery is acquired and installed on or after 1.4.2005, it shall qualify for additional/initial depreciation. In case new plant and machinery is acquired before 1.4.2005 but installed on or after 1.4.2005, then additional depreciation is not available.
- (c) It is allowed in addition to normal depreciation and shall be taken into consideration for calculating written down value.
- (d) To claim additional depreciation @ 20% of actual cost the condition of use for 180 days during the relevant previous year shall be applicable for this depreciation also. If used for less than 180 days additional depreciation shall also be allowed @ 10% (i.e., for half year).
- (e) The plant and machinery is new and it has not been used earlier either in India or outside India.
- (f) The plant and machinery is not eligible to be written off @ 100% of its actual cost in any India.
- (g) The plant and machinery is not in the nature of office appliances or road transport vehicles.
- (h) The return of income must be accompanied by the details of plant and machinery and expansion of installed capacity.

The return of income must be accompanied by a report by the chartered accountant that the deduction has been correctly claimed.

Additional depreciation is not allowed in case of following assets :

- (i) Ships and aircrafts.
- (ii) Old plant and machinery used either in India or outside India by any other person.
- (iii) Any plant and machinery installed in office premises, residential accommodation and guest house.
- (iv) Office appliances or road transport vehicles.
- (v) Any other plant and machinery the whole of cost of which is going to be debited to his profit and loss account by way of depreciation or otherwise in any one previous year.

2.4.5 RATES OF DEPRECIATION

Depreciation is allowed on any block of assets at the prescribed rates on the written down value of such block of assets.

The term 'block of assets means a group of assets falling within a class of assets comprising.

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

The prescribed rates for different blocks of tangible and intangible assets are given below :

Rates of Depreciation - W.D.V. Method

Block No. Assets	Rate of Depreciation
A. TANGIBLE ASSETS	
Group I Buildings	
1. All buildings used mainly for residential purposes except hotels and boarding houses.	5%
2. All non-residential buildings.	10%
3.(a) All buildings acquired on or after 1-9-2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing information facilities.	40%
(b). Purely temporary erections such as wooden structures	40%
Group II Furniture	
4. Furniture and fittings including electric installations.	10%
Group III Plant and Machinery	
(1) I. Plant and Machinery (except given above)	
II. Motor Car except use as taxi	
III. Scooter, Motor Cycle, Bus Truck	
IV. Air Conditioners	
V. Surgical Equipment	15%
(2) I. Motor Buses, motor lorries and motor taxies used in a business of running them on hire	
II. Moulds used in rubber and plastic goods industry	30%
(3) I. Aircraft, Aero engines.	
II. Lifesaving medical equipment	40%
(4) I. Containers made of glass and plastic used as refills.	
(5) I. Computers	
II. Gas Cylinder including valves, burners, direct fire glass melting, furnaces	
III. Books other than annual publications for professional use.	
IV. Mineral Oil concerns	
(6) I. Energy saving devices.	
(7) I. Books owned by assessee carrying on business	

in lending libraries.	
II. Books being annual publications.	
III. Pollution control equipment for air, water or solid pollution.	
<u>Group IV</u>	
Ocean going ships, inland water ships etc.	40%
B. <u>INTANGIBLE ASSETS</u>	
Know-how, patents, Copyrights, trademarks, licences, franchises, or any other business or commercial rights.	25%

ILLUSTRATION-I

A new industrial undertaking set up on 1-4-2022 has acquired following assets as per dates mentioned against each :

Asset	Date of acquisition	Date of Use	Cost	Rate of depreciation
Machinery	31-3-22	5-9-22	6,00,000	15%
Electric Motor	1-7-22	1-10-22	78,000	15%
Plant	12-11-22	15-12-22	12,00,000	15%

Calculate amount of admissible depreciation and written down value as on 1-4-23.

Solution : Computation of depreciation and WDV :

	WDV Rs.	Depreciation Rs.
Plant and Machinery (15% Block)		
W.D.V. as on 1-4-22	Nil	
Add : actual cost of new assets put into use during the year		
Machinery-put into use from 5-9-22	6,00,000	
Electric motor-put into use from 1-10-22	78,000	
Plant-put into use from 15-12-22	<u>12,00,000</u>	
	18,78,000	
Less : Money realised	<u>Nil</u>	
W.D.V. as on 31-3-23	<u>18,78,000</u>	

Depreciation:

(1) Assets purchased during the year but used less than 180 days : Plant	90,000
Initial/Additional depreciation for ½ year	1,20,000
Other assets for full year	

(18,78,000-12,00,000)	6,78,000 × $\frac{15}{100}$	1,01,700
Initial/Additional depreciation for full year (6,78,000 × 20%)		1,35,600
	Total depreciation	4,47,300

W.D.V as on 1-4-23 = 14,30,700/- (i.e. 18,78,000 - 4,47,300 = 14,30,700)

Illustration – II M/s Arun and Bros. have following assets on 1-4-2022

Sr. No.	Assets	WDV on 1-4-2022	Additions during the year	Scrap value of asset put out of use during the year	Rate of depreciation
		Rs.	Rs.	Rs.	
1.	Plant & Machinery	42,20,000	6,90,000	2,10,000	15%
2.	Aircraft	34,50,000	-	-	40%
3.	Motor Buses and Lorries (used for hiring)	6,40,000	2,80,000	4,15,000	30%
4.	Imported car	NIL	3,60,000	-	15%
5.	Patent Rights	NIL	8,00,000	NIL	25%
6.	Technical Know-how	NIL	6,00,000	NIL	25%

Calculate the amount of depreciation which firm can claim for the assessment year 2023-24 and also calculate the WDV on 1-4-2023. New Bus was brought into use from 1-12-2022, Plant & Machinery on 1-7-2022 and Patent Rights and Technical Know-how on 1-11-2022 and imported car on 1-6-2022.

Solution

Sr. No	Block of Assets	Depreciation Rs.	WDV/cost Rs.
1.	Cars 15% Block		NIL
	WDV as on 1-4-2022		
	Add : actual cost of new imported car	3,60,000	

	Less : money realised		<u>NIL</u>
	WDV as on 31-3-2023		3,60,000
	Depreciation @ 15% on 3,60,000=	54,000	54,000
	WDV as on 1-4-2023		<u>3,06,000</u>
2.	Plant and machinery 15% Block		
	WDV as on 1-4-2022		42,20,000
	Add cost of new P & M		<u>6,90,000</u>
	Total		49,10,000
	Less : money realised scrap value of asset destroyed		<u>2,10,000</u>
	WDV as on 31-3-2023		47,00,000
	Depreciation(@15%of totalRs4700000	7,05,000)	
	Additional depreciation	<u>1,38,000</u>	8,43,000
	on 6,90,000@20%		
	WDV as on 1-4-2023		<u>38,57,000</u>
3.	Plant and machinery 30% Block [motor lorries and buses]		
	WDV as on 1-4-2022		6,40,000
	Add cost of new bus acquired on 1-12-2022		<u>2,80,000</u>
	Total		9,20,000
	Less money realised : On discarding the bus		<u>4,15,000</u>
	WDV as on 31-3-23		5,05,000
	Depreciation @ 30% of Rs. 2,80,000 for 42,000 ½ year		
	Depreciation on balance WDV	67,500	1,09,500
	(5,05,000 – 2,80,000) @ 30%		
	WDV as on 1-4-2023		<u>3,95,500</u>
4.	Plant and machinery 40% Block [Aircraft]		
	WDV as on 1-4-2023		34,50,000
	Add cost of new asset		<u>NIL</u>
	Total		34,50,000
	Less : money realised on discarding the bus		<u>NIL</u>
	WDV as on 31-3-2023		34,50,000
	Depreciation @ 40% on 34,50,000	<u>13,80,000</u>	<u>13,80,000</u>
	WDV as on 1-4-2023		<u>20,70,000</u>
5.	Intangible assets – 25% Block		
	Cost of Patent rights on 1-11-2022		8,00,000
	Cost of Technical know-how on 1-11-2022		<u>6,00,000</u>

	14,00,000
Less money realised	NIL
WDV on 31-3-2023	<u>14,00,000</u>
Dep. @ 25% for ½ years on 14,00,000 =1,75,000	<u>1,75,000</u>
WDV as on 1-4-2023	<u>12,25,000</u>
Total depreciation	<u>25,61,500</u>
(54,000+8,43,000+ 1,09,500+13,80,000+1,75,000)	

2.4.6 UNABSORBED DEPRECIATION ALLOWANCE [SEC. 32 (2)]

While dealing with unabsorbed depreciation the following points should be kept in mind:

- (1) Depreciation allowance of the previous year is first deductible from the income chargeable under the head “Profits and Gains of Business or Profession”.
- (2) If depreciation allowance is not fully deductible under the head “Profits and Gains of Business or Profession” because of absence or inadequacy of profits, it is deductible from income chargeable under other heads of income for the same assessment year.
- (3) If depreciation allowance is still unabsorbed, it can be carried forward to the subsequent assessment year (s). No time limit is fixed for the purpose of carrying forward of unabsorbed depreciation; it can be carried forward for indefinite period, if necessary. In the subsequent year (s), unabsorbed depreciation can be set off against any income whether chargeable under the head “Profits and Gains of Business or Profession” or under any other head. Continuity of business is not relevant. In the matter of set off, the following order to priority is followed in the subsequent year (s) :
 - a. Current depreciation.
 - b. Brought forward business loss.
 - c. unabsorbed depreciation.

2.5.7 TEA DEVELOPMENT ACCOUNT [SECTION-33 (AB)]

Whereas assessee is carrying on the business of growing and manufacturing tea in India and has, before the expiry of six months from the end of previous year or before furnishing the return of income whichever is earlier, deposited with the National Bank of Agriculture and Rural Development (NABARD), any amount in a Special Account maintained by him in the bank in accordance with the scheme approved in this behalf by the Tea Board, then the assessee will be entitled to a deduction.

2.4.7.1 Quantum of Deduction:

- (a) a sum equal to the amount or the aggregate of the amounts so deposited; or

- (b) a sum equal to 40% of the profits of such business (computed under the head 'Profits and gains of business and profession; before making any deduction under the section 72 i.e. before set off any loss brought forward from earlier year; whichever is less.

Where the assessee is a firm or an association of persons or body of individuals, the deduction under this section shall not be allowed again in the computation of the income of any partner or member as the case may be.

The deduction under this section is allowed subject to the production of the audit report of the business of the assessee, alongwith the return of income.

Prohibition of utilisation of the Deposits: No deduction shall be allowed under this section if the amount is utilised for the purchase of :

- (i) any machinery or plant to be installed in office premises or residential accommodation including a guest house.
- (ii) any office appliances (not being computers).
- (iii) any machinery or plant, the whole of the actual cost of which is allowed as a deduction in any one previous year in computing the income chargeable under the head 'Profits and Gains of Business or Profession.'
- (iv) any new machinery or plant installed in an industrial undertaking for the purpose of business of construction, manufacture or of production of any article or things specified in the Eleventh Schedule.

2.4.7.2 Withdrawal from the Deposit:

Any amount standing to the credit of the assessee in the Special Account shall not be allowed to be withdrawn except for the specified purposes in the scheme or in the following circumstances :

- (i) Closure of business ;
- (ii) Death of an assessee;
- (iii) Partition of a H.U.F.;
- (iv) Dissolution of a firm;
- (v) Liquidation of a company.

Where the amount from the Special Account is withdrawn in any previous year on the closure of business or dissolution of firm before 8 succeeding previous years the whole amount so withdrawn shall be deemed to be the income of that previous year and chargeable to income-tax.

2.4.7.3 Disallowance of Expenditure:

Where any amount of the special account is utilised by the assessee for the purpose of any expenditure in connection with the business in accordance with the scheme, such expenditure shall not be allowed in computing the income.

2.4.7.4 Withdrawal Chargeable to Tax in certain cases :

Where any amount is released out of the Special Account for being utilised

by the assessee for purposes specified in the scheme or at the time of closure of the account is not utilised in accordance with the scheme and within that previous year either wholly or in part, the amount not so utilised shall be deemed to be the profits of the business or profession and accordingly charged on tax. However, if the amount is released on the death of an assessee or partition of a H.U.F. or liquidation of a company it shall not be chargeable to tax.

2.4.7.5 Restriction on sale or transfer of assets

The assets in respect of which deduction has been allowed must not be sold or transferred by the assessee to any other person for a period of 8 years immediately following the previous year in which the asset was acquired. However this restriction of 8 years will not apply in the following cases:

- (i) Where the asset has been sold or transferred to the Government, a local authority, statutory corporation or a Government Company:
- (ii) Where the sale or transfer of an asset is made in a scheme of succession of a firm by a company provided the following conditions are satisfied.
 - (a) all the assets and liabilities of the firm relating to the business immediately before succession become the assets and liabilities of the company.
 - (b) all the shareholders of the company were the partners of the firm immediately before the succession.

If the asset is sold or transferred otherwise than mentioned above, such part of the cost of such asset as is relatable to the deduction allowed under this section shall be deemed to be the profits of the business of the previous year in which the asset is sold.

SELF CHECK EXERCISE

From the following particulars of Fixed Assets of West Bengal Paper Mills Ltd., you are required to work out the amount of depreciation allowable :

Fixed Assets	WDV on 1-4-2022 Rs.	Additions during the year Rs.	Rate of Depreciation
Building (Non-residential)	10,20,000	Nil	10%
Building (Residential)	2,25,000	Nil	5 %
Plant & Machinery	30,28,000	4,30,000	15%
Motor cars (acquired before 1-4-22)	65,000	Nil	15%
Furniture	18,300	Nil	10%

Part of the Residential building was completely destroyed by fire on 5-6-2022 and Rs. 95,000 was received from the insurance company in respect thereof.

The additions to the plant and machinery and motor vehicles were all new and installed on 1-10-2022.

2.4.10 SUMMARY

Depreciation is the diminution in the value of an asset due to normal wear and tear and due to obsolescence. There are different methods for calculation of depreciation under financial accounting, such as, straight line method and written down value method. But the system of claiming depreciation under the Income tax Act is quite different from financial accounting. To claim depreciation under section 32 of Income tax Act. The asset must be owned by the assessee, wholly or partly and it must be used for the purpose of the business or profession during the previous year.

2.4.11 ANSWER TO SELF CHECK QUESTIONS

[Hints: Factory building Rs. 1,02,000, Non-Factory Building Rs. 6500, Furniture Rs. 1830, P&M Depreciation Rs. 5,28,480, Additional Depreciation Rs. 86,000].

2.4.12 EXERCISE

(A) Short Questions

Q.1. Write short Notes on :

- (a) Tangible Assets (b) Intangible Assets
(c) W.D.V.

Q.2. Discuss the concept of Actual Cost as given u/s 43 (1)

Q.3. Give in brief the current provisions about unabsorbed depreciation allowance.

(B) Long Questions:

Q.1. What do you mean by the term depreciation ? What are the rules for the availing deduction of depreciation ?

Q.2. Write in detail the new method of charging depreciation.

2.4.13 SUGGESTED READINGS

1. Income Tax (Law and Practice) : V.P. Gaur & D.B. Narang
2. The Income Tax Law : Shailinder Sekhon
3. Income Tax Law : H.C. Mehrotra.
4. Student's Guide to Income Tax : By V.K. Singhania
(A.Y. 2023-24)

**CARRY FORWARD AND SET OFF OF LOSSES
AND CLUBBING OF INCOME**

Structure of the Lesson :

- 2.5.0 Objective
- 2.5.1 Introduction
- 2.5.2 Set Off of Losses (Intra-head Adjustment)
 - 2.5.2.1 Loss from Speculation Business
 - 2.5.2.2 Long-term Capital Loss
 - 2.5.2.3 Loss from the Activity of owning and maintaining race horses
 - 2.5.2.4 Loss from winnings from Lotteries, Crossword Puzzles
 - 2.5.2.5 Loss on sale of Shares, Securities or Units
- 2.5.3 Set Off of Losses (Inter-head Adjustment)
 - 2.5.3.1 Business loss not to be set off from Salary Income
 - 2.5.3.2 Set Off of losses from Casual Income
 - 2.5.3.3 Loss from source whose Income is exempted
 - 2.5.3.4 Share of loss from Firm or AOP
- 2.5.4 Carry Forward and set off of Losses
 - 2.5.4.1 Carry forward and set off of Business losses
 - 2.5.4.2 Carry forward and set off of Speculation loss
 - 2.5.4.3 Carry forward of losses under the head Capital Gains
 - 2.5.4.4 Carry forward of loss from activity of owning and maintaining of Race Horses
 - 2.5.4.5 Carry forward and set off of the accumulated losses and unabsorbed depreciation in certain cases of amalgamation and demerger
 - 2.5.4.6 Carry forward and set off losses in case of certain Companies
- 2.5.5 Illustration I
- 2.5.6 Exercise-I
- 2.5.7 Clubbing of Income
 - 2.5.7.1 Transfer to Income without transfer of assets
 - 2.5.7.2 Revocable transfer of assets
 - 2.5.7.3 Income of an individual to include income of spouse
 - 2.5.7.4 Income from assets transferred to the spouse
 - 2.5.7.5 Income from assets transferred to son's wife

- 2.5.7.6 Income from assets transferred to any other person for the benefit of the spouse of the transfer
- 2.5.7.7 Income from assets transferred to any other person for the benefit of the Son's wife
- 2.5.7.8 Clubbing of income of a minor child
- 2.5.7.9 Income from self-acquired property converted into joint family property
- 2.5.8 Liabilities of person in respect of income included in the income of another person
- 2.5.9 Benami Transactions
- 2.5.11 Summary
- 2.5.11 Exercise-II
- 2.5.12 Suggested Readings
- 2.5.0 OBJECTIVE

To achieve the main objective of this lesson, it will give the students detailed and current information about

1. Intra-head adjustment of losses;
2. Inter-head adjustment of losses;
3. Carry forward and set off of losses;
4. Clubbing of Income, and
5. Benami Transactions.

2.5.1 INTRODUCTION

Income tax is a Composite Tax on the total income of a person earned during the previous year. There might be cases where an assessee has different sources of income under the same head of income. Similarly, he may have income under different heads of income. It might also happen that the net result from a particular source/head may be a loss. This loss can be set off against other sources/head in a particular manner. The provisions for set off and carry forward of losses are contained in sections 70 to 80 of the Income Tax Act.

2.5.2 (A) SET OFF OF LOSSES (INTRA HEAD ADJUSTMENT)

Set off of Loss from one source against Income from another source under the same head of Income (Section 70)

Where the net result for any assessment year in respect of any source, falling under any head of income, is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head. This may also be referred to as inter-source adjustment.

However, there are certain exceptions to this rule. In the following cases, loss from one source cannot be adjusted against income from another source of income although it falls under the same head :-

2.5.2.1 Loss from a Speculation Business :

As per section 73, any loss, in respect of a speculation business carried on by assessee, shall be set off only against income of another speculation business. It cannot be set off from non-speculative business income.

2.5.2.2 Long-term Capital Loss :

Long term capital loss can be set off only against the long term capital gain.

2.5.2.3 Loss from the Activity of owning and maintaining Race Horses :

As per section 74-A, the loss incurred by the assessee, in the activity of owning and maintaining race horses, shall only be set off against the income of such activity i.e. stake (prize) money. It cannot be set off against the income from any other source under the head 'Income from Other Source', although income from this activity also falls under this head.

2.5.2.4 Loss from winnings from Lotteries, Crossword Puzzles etc. :

By virtue of Section 58(4) a loss can't be set off against winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any other form or nature.

11.2.5 Loss on Sale of Shares, Securities or Units [Section 94 (7) and 94(8)]:

This section is applicable if the following conditions, are satisfied :

- (1) Any person buys or acquires any securities/shares/units within a period of 3 months before the record date.
- (2) Such person sells or transfers such securities/shares/units within the period of 3 months (9 months in the case of units from FY 2005-06) after the record date.
- (3) The dividend or income on such securities/shares/units received (or receivable) by such person is exempt from tax.

If this section is applicable then loss arising to the tax payer on account of purchase and sale of securities/shares/units, to the extent such loss doesn't exceed the amount of dividend received or receivable on such securities/shares/units shall be ignored for the purpose of computing the income chargeable to tax.

Further, loss incurred by an assessee from a source, income from which is exempt such loss cannot be set off against income from a taxable source.

2.5.3 (B) SET OFF OF LOSSES (INTER HEAD ADJUSTMENT): Set off of Loss from one head against income from another head (Section 71)

Where in respect of any assessment year the net result of the computation under any head of income, other than 'Capital Gains' is a loss, the assessee shall be entitled to have the amount of such a loss set off against his income, if any, assessable for that assessment year under any other head but subject to certain exceptions.

- (a) Speculation loss - as explained earlier.
- (b) Expenses on maintenance of horses for race purposes - as explained earlier.

(c) Loss under the head capital gains - Short term capital loss can be set off from income under short term capital gain or from long term capital gain, but long term capital loss can be set off only from long term capital gain.

2.5.3.1 Business Loss not to be set off from Salary Income: The loss under the head 'Profits and Gains of Business or Profession' cannot be set off from Income under the head 'Salaries' w.e.f. 1st April 2005 where in respect of any FY.

2.5.3.2 Set off of Losses from Casual Income: Like lottery, race winnings, winnings from crossword puzzles, card games and gambling etc.

2.5.3.3 Loss from Source whose Income is exempted: Such loss can't be set off out of any taxable income.

2.5.3.4 Share of Loss from Firm or AOP: Such loss will be assessed u/s 184 or 185 can't be set off from the individual income of partners/members.

2.5.4 CARRY FORWARD AND SET OFF OF LOSSES

The following losses are only allowed to be carried forward and set off in the subsequent assessment years :-

- (a) Loss under the head income from house property;
- (b) business loss;
- (c) speculation loss;
- (d) capital loss;
- (e) loss on account of owning and maintaining race horses.

Carry forward and set off of loss from House Property (Section 71-B).

Where the assessee incurs any loss under the head 'Income from House Property' and such loss is not fully adjusted under other heads in the same assessment year, then the balance of loss (from the assessment year 1999-2000) shall be allowed to be carried forward and set off in subsequent years, subject to a limit of 8 assessment years, against income from House Property only.

2.5.4.1 Carry Forward and Set off of Business Losses (Section 72)

Where the loss under the head 'Profits and Gains of Business or Profession' other than loss from speculation business, could not be set off in the assessment year because either the assessee had no income under any other head or the income was less than the loss and such loss can be carried forward to the following assessment years and it shall be set off against the profit and gains of business or profession subject to the following conditions :

(I) Business losses can be adjusted only against Business Income :-

When the loss is to be carried forward to the subsequent year, it can be adjusted only against business income. Business income may be from the same business in which the loss was incurred or may be any other business.

(II) Losses can be set off only by the assessee who has incurred loss [section 78(2)]:-

The brought forward business losses can be set off only by the same assessee.

But following are the exceptions :-

- (a) Where a business carried on by one person, is acquired by another person through inheritance.
- (b) Business losses of an amalgamating company can be set off against the income of the amalgamated company if the amalgamation is within the meaning of section 72 A of the Income Tax Act.

(III) Period of Carry Forward:-

Each year's loss is a separate loss and no loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

(IV) Order of set off:-

The order to set off should be as under :

- i. current year depreciation;
- ii. current year expenditure on scientific research and capital expenditure on family planning to the extent allowed;
- iii. current loss of another business;
- iv. brought forward business or profession losses of earlier years;
- v. brought forward unabsorbed depreciation;
- vi. brought forward expenditure on Family Planning;
- vii. brought forward unabsorbed capital expenditure on scientific research.

(V) Return of Losses:-

The return of losses must have been furnished before the date prescribed u/s 139 (1), otherwise the loss cannot be carried forward.

2.5.4.2 Carry forward and Set off of Speculation Loss [Section 73]

If a speculation loss could not be set off from the income of another speculation business in the same assessment year, it is allowed to be carried forward to be claimed as a set off in the subsequent year, but only against the income of any speculation business. Such loss is also allowed to be carried forward for eight assessment years. The loss of speculation may also include the loss on account of bad debts, irrecoverable profits and interest on borrowing.

2.5.4.3 Carry Forward of Losses under the head 'Capital Gains' [Section 74]

Where in respect of any assessment year the net-result of the computation under the head 'Capital Gains' is a loss to the assessee, whether short-term or long-term such a loss shall be carried forward to the following assessment years and set off against the income under the head 'Capital Gains' of the subsequent years. STCG can be set off against STCG as well as LTCG, but LTCG can be set off against LTCG only.

Such capital losses can also be carried forward to a maximum of eight

assessment years, immediately succeeding the assessment year for which the loss was first computed.

Here also, it is necessary that a return of loss is furnished before the due date.

2.5.4.4 Carry Forward of Loss from activity of owning and maintaining Race Horses [Section 74A]

Any loss from the activity of owning and maintaining race horses, if could not be set off in the same assessment year, shall be carried forward and set off only against the income from the activity of owning and maintaining race horses. The loss can be carried forward for a maximum of four assessment years, immediately succeeding the assessment year for which the loss was first computed.

2.5.4.5 Carry Forward and set off of the accumulated losses and unabsorbed depreciation in certain cases of amalgamation and demerger [Section 72A]

(A) As per the provisions of the Income Tax Act, there has been amalgamation of company owning an industrial undertaking or a ship which another company and the Central Government on the recommendation of the specified authority, is satisfied that the following conditions are fulfilled, such loss and the unabsorbed depreciation of the amalgamating company will be allowed to be set off by the amalgamated company:-

- (a) the amalgamated company continues to hold at least $3/4^{\text{th}}$ in book value of assets of amalgamating company for a minimum period of five years.
- (b) the amalgamated company continues to carry on the business of amalgamating company for 5 years from the date of amalgamation.
- (c) it fulfils all other conditions as prescribed.

In case the conditions prescribed above are not satisfied then amount of loss or unabsorbed depreciation earlier adjusted by amalgamated company shall be deemed to be the income of the previous year in which such breach takes place.

(B) In case of a demerger, the accumulated loss of the demerged company is allowed to be carried forward by resulting company as under -

- (a) any amount of loss or unabsorbed depreciation which is directly attributable to the demerged unit shall be deemed to be the loss of such demerged entity and this allowed to be carried forward and set off.
- (b) any amount of loss or unabsorbed depreciation not directly attributable to the demerged entity, shall be allowed to be carried forward and set off in proportionate from the subsequent profits or demerged unit.

$$\text{Loss of demerged company} \times \frac{\text{Value of assets transferred under demerger}}{\text{Total Value of Assets of demerged company}}$$

The Central Government may specify the conditions for ensuring the genuine demerger.

Note : The brought forward loss of a business referred to in section 35AD (i.e. Expenditure on Specified Business) can be set off in a subsequent year only against income from the business referred to in section 35AD (no time limit). This is applicable from the A.Y. 2010-12 onwards.

2.5.4.6 Carry Forward and set off Losses in case of certain Companies (section 79)

In the case of closely held companies, not loss incurred in previous year shall be carried forward and set off against the income of the subsequent previous year unless atleast 51% share of the company are held on the last day of the previous year in which the loss is set off by the same shareholders who held at atleast 51% of the shares of the last day of the year in which the loss was incurred.

2.5.5 ILLUSTRATION I

Mr. A furnishes the following particulars of his income for the previous year 2022-23 :

	Rs.
1. Income from salary (Computed)	68,000
2. Income from house X	36,000
3. Loss from house Y	24,000
4. Loss from house Z	22,000
5. Profit from business X	60,000
6. Profit from business Y	70,000
7. Profit from shares (Speculative)	82,000
8. Loss from silver business (Speculative)	94,000
9. Long-term capital gains on sale of shares	22,000
10. Short-term capital loss on sale of land	44,000
11. Income from card gains	22,000
12. Winnings from lotteries (gross)	60,000
13. Income from horse races in Delhi (gross)	40,000
14. Loss from horse races in Bangalore	21,000

Compute the Gross Total Income of Mr. A for the assessment year 2023-24.

Solution:	Rs.	Rs.	Rs.
<u>Income from Salary</u>			68,000
<u>Income from House Property</u>			
Income from House X		36,000	

Loss from House Y		-24,000	
Loss from House Z		<u>-22,000</u>	-10,000
Income from Business			
Business X		60,000	
Business Y		<u>70,000</u>	1,30,000
Profit (Speculation Business)	82,000		
Less: Loss (Speculation)	<u>-94,000</u>		
Balance to be Carried forward	<u>-12,000</u>		
<u>Capital Gains</u>			
Long-term	22,000		
Less: Short-term capital loss	<u>-44,000</u>		
Balance Capital loss to be carried forward	<u>-22,000</u>		
<u>Income from other sources</u>			
Income from card games		22,000	
Winnings from Lotteries		60,000	
Income from Horse races		<u>40,000</u>	<u>1,22,000</u>
Gross Total Income			<u>3,10,000</u>

Note: Loss from horse race in Bangalore cannot be set off against any income.

EXERCISE-I

1. Discuss in detail provisions regarding set off and carry forward of losses under different heads.

Self-Check Exercise

Write notes on :

1. Carry forward of business losses.
2. Set off of gambling losses
3. Carry forward of Capital losses.

2.5.6 CLUBBING OF INCOME

Income Tax is levied on a slab system on the total income of an individual. There are progressive rates of tax and as the income goes up, the rates of tax also go up. There is a tendency amongst the tax-payers in higher tax-brackets to divert a part of their income in the hands of their relatives, in order to reduce the burden of tax. In order to curb such practice of tax avoidance, provisions have been incorporated in the Income Tax Act. These provisions are contained in section 60 to 64 of the Income Tax Act.

In the following cases, income of others will be included in the total income of the individual.

2.5.6.1 Transfer of Income without Transfer of Assets [Sec. 60]

Where there is a transfer of an income by a person to another person without the transfer of the asset from which the income arises, such income shall be included in the total income of the transferor.

2.5.6.2 Revocable Transfer of Assets [Section 61]

Where there is a revocable transfer of an asset by a person to another person, any income derived from such asset shall be included in the total income of the transferor. A transfer as per section 63, shall be deemed to be revocable if -

- (a) It contains any provisions for the re-transfer, directly or indirectly of the whole or any part of the income or assets to the transferor, or
- (b) It gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income of assets.

Transfer includes any settlement, trust, covenant, agreement or arrangement. As per section 62, the provisions of revocable transfer, discussed or section 61 shall not apply to any income arising to any person by virtue of transfer.

- (a) by way of trust which is not revocable during the life time of the beneficiary;
- (b) in case of any other transfer, which is not revocable during the life time of the transferee;
- (c) Made before 1.4.1961, which is not revocable for a period exceeding 6 years.

2.5.6.3 Income of an Individual to include Income of Spouse [Section 64]

Remuneration of spouse from a concern in which the other spouse has substantial interest [Section 64 (i) (ii)]. Any remuneration derived by a spouse from a concern in which the other spouse has a substantial interest, shall be clubbed in the hands of the spouse who has a substantial interest in that concern. If the husband and wife both have substantial interest in the concern and both are in receipt of remuneration from the concern, then the remuneration of both shall be clubbed in the hands of that spouse whose total income, before including such remuneration, is greater.

The clubbing will be done for the first time in the previous year in which the following three conditions are satisfied

- (a) One or both the spouse(s) has/have a substantial interest in the concern.
- (b) One or both of the spouse (s) get remuneration from such a concern.
- (c) The relationship of husband and wife subsists at the time of accrual of such income.

An individual shall be deemed to have substantial interest in the concern.

- (i) If the concern is a company - If he at any time during the previous year owns beneficially, along with his relatives, equity shares carrying not less than 20% of the voting power.
- (ii) In any other case - If he along with his relatives is entitled to at least 20% of the profits of such concern.

2.5.6.4 Income from Assets transferred to the Spouse [Sec 64 (i) iv]]

As per this provision, if an individual transfers any asset other than house property to his/her spouse, the income from such an asset shall be included in the total income of the transferor. The income from the transferred assets shall not be clubbed in the following cases -

- (i) If the transfer is for adequate consideration.
- (ii) The transfer is under an agreement to live apart.
- (iii) If the relationship of husband and wife does not exist either at the time of transfer or at the time of accrual of the income.

2.5.6.5 Income from Assets transferred to Son's Wife [Sec. 64 (i) (vi)]

Any income which arises from assets transferred directly or indirectly by an individual to his sons wife after 1st June, 1973 otherwise than for adequate consideration, shall be included in the income of the transferor.

If such transferred assets are invested by the transferee in any business then the part of business income received by assessee calculated as below shall be clubbed with the income of the transferor of such assets.

$$\frac{\text{Business Income} \times \text{Value of Asset on 1st day of Previous year Total}}{\text{Investment in the business on 1st day of the Previous year}}$$

In case the amount invested by transferee is in the nature of capital contribution as a partner in a firm, then any amount of interest received by transferee which is attributable to amount invested out of transferred asset shall be deemed to be the income of the transferor of the asset.

2.5.6.6 Income from Assets transferred to any person for the benefit of Spouse of the transferor [Sec 64 (i) (viii)]

Where an individual transfers an assets to any person or association of persons, otherwise than for adequate consideration, the income from such assets, shall be included in the income of the transfer or to the extent to which the income is for the immediate or deferred benefit of his or her spouse.

2.5.6.7 Income from assets transferred to any person for the benefit of Son's Wife [Section 64(i)(viii)]

Where an individual transfers any assets to any person or association of persons, otherwise than for adequate consideration, the income from such assets, shall be included in the income of the transferor to the extent to which the income is for the immediate or deferred benefit of his or her son's wife.

2.5.6.8 Clubbing of income of a Minor Child [Section 64 (1A)]

The income of the minor child shall be clubbed in the hands of that parent

whose total income (excluding the income of the minor) is greater. If the marriage of his parents does not subsist, the income shall be clubbed in the hands of that parent who maintains the minor child in the previous year. The following income of a minor shall not be clubbed and will be taxable in the hands of minor himself.

- (i) Income of a minor child suffering from any disability of the nature specified in Section 80U.
- (ii) Income which accrues or arises to the minor child on account of any manual work done by him.
- (iii) Income which accrues or arises to the minor child on account of any activity involving application of his skills, talent or specialised knowledge and experience.

Where the income of a minor child has been included in the total income of a parent, such parent shall be entitled to an exemption to the extent of such income or Rs. 1500 whichever is less u/s 10(32), in respect of each minor child whose income is so included.

2.5.6.9 Income from Self-acquired Property converted to Joint Family Property [Section 64(2)]

If self-acquired property of an individual is treated/converted into joint family property without adequate considerations, the income derived by the joint family on account of such property shall be included in the total income of the individual who was the owner of such self-acquired property.

Where the converted property has been subject matter of partition amongst the members of the family, the income derived from such, converted property as is received by the spouse on partition shall be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and the income from the portion, received by the spouse, shall be clubbed in the hands of the transferor. As per the provisions discussed above, income of another person is to be included in the total income of the individual. However, such an income will first be computed in the hands of the recipient as it is was his income and such recipient will compute this income under the relevant head, will be included in the total income of the individual under the same head of income. Since income of the head is computed and included in the same head of individual, the deduction from Gross Total Income u/s 80C to 80U or the rebate of Income Tax u/s 88 E will be allowed only to the individual in whose hands it is included and not to the recipient of such income.

2.5.7 LIABILITIES OF PERSON IN REPECT OF INCOME INCLUDED IN THE INCOME OF ANOTHER PERSON [Section 65]

Section 65 provided that the notice of demand in respect of tax on such

income may also be served upon the person to whom such asset has been transferred. On service of such notice, the transferee shall be liable to pay the portion of the tax levied on the transferor or which is attributable to the income so included.

In case the asset is transferred to joint owners, then such joint owners shall be jointly and severally liable to pay the tax which is attributable to the income, from the asset so included.

Similar provisions will be applicable for deemed ownership or house property u/s 27 (1).

2.5.8 BENAMI TRANSACTIONS

If a transaction is considered to be Benami Transaction, the income from such transaction shall be taxable in hands of the real person and so the benamidar is not taxed for the income arising from such transaction.

2.5.9 SUMMARY

The provisions for set off or carry forward of losses are contained in sections 70 to 80 of Income-tax Act and it involves the three steps, that is, adjustment of losses under the same head of income, adjustment of losses under different heads and carry forward of unadjusted losses to the subsequent assessment years.

In another part of this lesson the provisions of clubbing of Income (Income of other Persons included in Assessee's total Income) are also discussed in this lesson.

2.5.10 ANSWERS TO SELF CHECK QUESTIONS

Ans. 1 Carry Forward of business loss: In case losses can't be self-off fully in the current financial year then business (non-speculative) can be carry forward upto 8 years. Against to this speculation loss (other than unabsorbed depreciation) can be carry forward upto 4 years.

Ans. 2 In case losses from gambling activities can be set off only against the income earned from the gambling activities. Therefore a loss can't be set off against the income of winnings from lotteries, crossword puzzles, races, card games and gambling or betting.

Ans.3. In case capital loss can't be set off fully in the current financial year then short term all well long term capital can be carry forward upto 8 years.

2.5.11 EXERCISE-I

(A) Short Questions:

- Q.1. Write a short note on the income of a minor child.
- Q.2. What are provisions for inclusion of income of a minor child and the wife in the total income of the assessee.

(B) Long Questions:

- Q.1. Write notes on -
 (a) Clubbing of Income
 (b) Aggregation of Income
 (c) Revocable Transfer of Assets.
- Q.2. From the following particulars of income of Assessee A, B and C, how the capital losses shall be set-off and carried forward for the previous year ending on 31-3-2022.

	Rs.
Assessee 'A' :	
Business Income	15,000
Short-term Capital loss	1,200
Long-term Capital gain (shares)	7,200
Assessee 'B' :	
Business Income	30,000
Short-term Capital loss	40,000
Assessee 'C' :	
Business Income	60,000
Short-term Capital loss	20,000
Long-term Capital gain (land)	17,000
Carry forward loss (Short-term Capital assets)	50,000
Note : Assessee 'A'	21,000
Assessee 'B'	30,000
Assessee 'C'	60,000

- Q.3. Discuss in details provisions regarding set off and carry forward of losses under different herds.

2.5.12 SUGGESTED READINGS

1. Income Tax-Law : By H.C. Mohrotra.
2. Income Tax-law and Practice : By - Gaur and Narang
3. The Income Tax Law : By - Shailinder Sekhon
A.Y. 2023-24

Mandatory Student Feedback Form

<https://forms.gle/KS5CLhvpwrpgjwN98>

Note: Students, kindly click this google form link, and fill this feedback form once.