TAXATION

CLASS XI

STUDY MATERIAL

INDEX

UNIT: 1 –: INTRODUCTION TO INCOME TAX AND IMORTANT DEFINITIONS

Unit Code:	**UNIT TITLE: INTRODUCTION TO INCOME TAX AND IMORTANT DEFINITIONS**			
	Duration:			
Location:	**SESSION 1: INTRODUCTION TO INCOME TAX AND IMORTANT DEFINITIONS**			
Classroom	**Learning Outcome**	**Knowledge Evaluation**	**Performance Evaluation**	**Teaching and Training Method**
	1. Introduction to income tax	1. Become aware of the Income Tax Law of India 2. Become familiar with the concept of tax and history of taxation in India	1. List out the various components of the Income Tax Law in the country 2. Understand the history of taxation system in the country	**Interactive Lecture:** Discussion on the Income Tax Law of India and history of taxation system in the country
	2. Basis of charge of income tax (section 4)	1. List out various concepts under section 4	1. Understand the basic principles of charge of income tax 2. Understand the various concepts under section 4, viz., tax year, person, assessee, income, etc.	**Interactive Lecture:** Discussion on basis of charge of income tax and Various concepts under section 4

(Note: The location would be the classroom for the theoretical interactions. Students can visit website like incometaxindia.gov.in)

UNIT-1

***Learning Objectives*:**

After studying this unit, the students will be able to:

1. list out the various components of the Income Tax Law in the country and determine the scope of total income of various persons;
2. understand the history of taxation system in the country;
3. understand the various terms that are used in Income Tax Law.

INTRODUCTION

The Central Government has been empowered by Entry 82 of the Union List of Schedule VII to Article 246 of the Constitution of India to make laws on taxes on all income other than agricultural income. The Income Tax Law comprises The Income Tax Act 2025, Income Tax Rules 2026, Notifications and Circulars issued by Central Board of Direct Taxes (CBDT), Annual Finance Acts and Judicial pronouncements by Supreme Court and High Courts.

SESSION 1: INTRODUCTION TO INCOME TAX AND IMORTANT DEFINITIONS

The origin of the word "Tax" is from "Taxation" which means an estimate. Hence, **'income tax'** refers to "income estimate", which helps the Government to determine the actual economic strength of individuals. It also helps the Government understand the distribution of income among the people of the country.

Income Tax has been in force in different forms for many years. If we go through the history of India, we find relevant information regarding the taxation system in the country. In ancient history, references are made to systems of taxation imposed on income, expenditure, and other subjects. Information about such systems is also found in the *Manu Smriti* and the *Arthashastra*, which confirms their existence during that period.

A systematic income-tax system was first introduced in **1860** by Sir James Wilson to meet the financial losses incurred by the British Government after the Indian Rebellion of 1857. This tax was introduced as a temporary measure and remained in force for a few years. Thereafter, several modifications were made in the taxation system from time to time. Subsequently, more structured legislation was introduced, including the Income Tax Act, 1886, which provided a more organised framework for the levy of income tax. Over the years, the tax system continued to evolve through various legislative changes. At present, income tax in India is governed by the Income-tax Act, 2025. Income tax is a direct tax paid by individuals and other entities to the Central Government on their income, and it plays an important role in generating revenue for the Government and supporting the economic development of the country.

BASIS OF CHARGE OF INCOME TAX (SECTION 4)

Here are some basic principles of charge of income tax:

1. Tax is charged on every person as defined in section 2(77).
2. Income tax is an annual tax on income.
3. Income-tax is to be charged at the rate or rates prescribed for the tax year by the annual Finance Act or the Income-tax Act, 2025 or both.
4. The levy is on the total income of the assessable entity computed in accordance with and subject to the provisions of the Act.
5. Income tax is to be deducted or collected at the source or paid in advance as provided under the provision of the Act.

IMPORTANT DEFINITIONS

(i) Tax year: Section 3

"Tax year" means the twelve months period of the financial year commencing on 1st April. In the case of a business or profession newly set up, or a source of income newly coming into existence in any financial year, the tax year shall be the period beginning with—

(a) the date of setting up of such business or profession; or

(b) the date on which such source of income newly comes into existence,

and ending with the said financial year.

(ii) Person: Section 2(77)

Income-tax is charged on every person. The term "person" as defined under the Income-tax Act, 2025 covers in its ambit natural as well as artificial persons.

For the purpose of charging Income-tax, the term "person" includes Individual, Hindu Undivided Families [HUFs], Association of Persons [AOPs], Body of individuals [BOIs], Firms including LLPs, Companies, Local authority and any artificial juridical person not covered under any of the above.

Thus, from the definition of the term "person" it can be observed that, apart from a natural person, i.e., an individual, any sort of artificial entity will also be liable to pay income-tax.

(iii) Assessee: Section 2(11)

Normally the term "Assessee" is considered as one who is supposed to pay tax under Income-tax Act, 2025. However, it is advisable to understand complete meaning of the term as envisaged under the Income Tax Act, 2025. To better understand the term "assessee", we need to understand the following as well:

a. Normal Assessee

- A person by whom any tax or any other sum of money is payable under the Act.
- Any person in respect of whom any proceedings under the Act has been taken for the assessment of his income.
- Any person in respect of whom any proceedings under the Act has been taken for the assessment of loss sustained by him.
- Any person in respect of whom any proceedings under the Act has been taken for the assessment of refund due to him.

b. Representative Assessee

A person may not be liable only for his own income or loss but he may also be liable for the income or loss of other persons e.g. agent of a non-resident, guardian of minor or lunatic etc. In such cases, the person responsible for the assessment of income or loss or refund due to such other person is called representative assesses.

c. Deemed assessee

Every person who is deemed to be an assessee under the Act.

d. Assessee-in-default

A person is deemed to be an assessee-in-default if he fails to fulfill his statutory obligations. In case of an employer paying salary or a person who is paying interest, it is their duty to deduct tax at source and deposit the amount of tax deducted in Government treasury. If he fails to deduct tax at source or deducts tax but does not deposit it in the Government treasury, he is known as assessee-in-default.

(iv) Income: Section 2(49)

This is very important term as income tax is charged on the income of a person. The definition of income as per the Income-tax Act, 2025 begins with the words "Income includes". Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. At present, the following items of receipts are specifically included in income:—

(i) profits and gains;

(ii) dividends;

(iii) the value of any perquisite or profit in lieu of salary.

(iv) any special allowance or benefit, other than perquisite specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;

(v) any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;

(vi) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

(vii) Profits and gains of business or profession chargeable to income-tax;

(viii) the value of any benefit or perquisite taxable under the Act;

(ix) any capital gains chargeable under the Act;

(x) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society.

(xi) any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

(xii) any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 or any other fund for the welfare of such employees.

(xiii) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(xiv) Non-compete fees;

(xv) The fair market value of inventory on the date of its conversion into or treatment as a capital asset;

(xvi) Any sum of money received as advance if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset;

(xvii) Any sum of money or value of property received without consideration or for inadequate consideration;

(xviii) Any compensation or other payment due to or received by any person in connection with the termination or the employment or the modification of its terms and conditions;

(xix) any assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset;

(v) Gross Total Income:

A person may earn income from many sources. The income received from different sources is grouped under five heads of income.

Aggregate of incomes computed under the five heads (Salary, Income from house property, profits and gains from business or profession, capital gains, Income from other sources) of income after applying clubbing provisions and making adjustments of set off and carry forward of losses is known as gross total income.

(vi) Total income:

Total income means the total amount of income referred to in section 5, computed in the manner as laid down in the Act;

(vii) Casual Income:

Casual income refers to an income that is occasional, accidental, or non-recurring in nature, and which does not arise from a regular business, profession, or employment.

In other words, it is an income received by chance or unexpectedly, without any regular source or continuity.

The casual income includes winning from lotteries, crossword puzzles, races, card games, gambling, betting, etc.

The tax treatment of casual incomes is:

- It is taxable under the head 'income from other sources'.
- Expense incurred to earn such income is not allowed as deduction.
- The benefit of basic exemption limit is not allowed. In other words, if you earn Rs. 50,000 from casual income which is the total income in a tax year then also tax will be calculated irrespective of basic exemption limit.
- Tax on casual income is deducted at flat rate of 30% for all assesses. Net winnings from online games are also chargeable to tax at 30%.
- Losses cannot be set-off against casual income. Even casual losses cannot be set-off against casual income.
- No deduction is allowed under chapter VIII against casual income.

(viii) Agricultural Income: Section 2(5)

Agriculture income is exempt under the Act. This means that income earned from agricultural operations is not taxed. However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as partial integration of agricultural income with non-agricultural income.

What does the term Agricultural Income mean?

As per the Act, income derived from any of the following three sources is regarded as agricultural income:

(i) Any rent or revenue derived from land situated in India and used for agricultural purpose.

(ii) Any income derived from such land by agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit for the market, or sale of such produce.

(iii) Income attributable to a farm building subject to the condition that building is situated on or in the immediate vicinity of the land and is used as a dwelling house, store house etc.

(iv) Income earned from carrying nursery operations.

In order to consider income as agricultural income certain points have to be kept in mind:

(i) There must be a land and it must be situated in India.

(ii) The land is being used for agricultural operations.

(iii) Agricultural operation means that efforts have been induced for the crop to sprout out of the land.

(iv) If any rent is being received from the land, then in order to assess that rental income as agricultural income there must be agricultural activities on the land.

(v) In order to assess income of farm house as agricultural income, the farm house building must be situated on the agricultural land itself only and is used as a store house/dwelling house.

Certain income which is treated as agriculture income:

(a) Income from sale of replanted trees.

(b) Rent received for agricultural land.

(c) Income from growing flowers and creepers.

(d) Income derived from sale of seeds.

Certain income which is not treated as agricultural income:

(a) Income from poultry farming.

(b) Income from bee hiving.

(c) Income from dairy farming.

(d) Dividend paid by a company out of its agriculture income.

(e) Royalty income from mines.

(f) Income from butter and cheese making.

(g) Receipts from TV serial shooting in farmhouse.

Tax, Surcharge and Cess

Core Tax Components

- **Income Tax:** It is charged on every person at the rates prescribed for the year by the Annual Finance Act or the Income-tax Act, 2025 or both.
- **Surcharge:** Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. Surcharge is presently being levied beyond a particular threshold of income for different persons. Also, higher rates of surcharge are prescribed for higher thresholds of income.
- **Health and Education Cess:** This is an additional charge calculated at a rate of 4% on the total of income tax and surcharge. It is leviable to fulfill the commitment of the Government to provide and finance quality health services and universalised quality basic education and secondary and higher education.

Choosing the Tax Regime (Default vs. Optional)

Individual/HUF/AoP/BoI and Artificial Juridical Persons can pay tax at concessional rates under the default tax regime under section 202(1). However, such person has to forego certain exemptions and deductions under this regime. Alternatively, he/it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

Default tax regime [Section 202(1)]

Individual/HUF/AoP/BoI and Artificial Juridical Persons paying tax under default tax regime has to forgo certain deduction/exemptions or set-off of losses while computing total income. He/ it also has to choose the regime whether he wants to pay tax under default tax regime and shifted out of the default tax regime.

(i) **Certain deductions/exemptions not allowable:** While computing total income, certain deductions and exemptions would not be allowed. For Example:

Exemption/Deduction
Leave travel concession
House rent allowance
Exemption in respect of special allowances or benefit to meet expenses relating to duties or personal expenses (other than those as may be prescribed for this purpose) Accordingly, travelling allowance, transfer allowance, daily allowance, conveyance allowance and transport allowance to an employee, who is blind or deaf and dumb or orthopaedically handicapped would be exempted even under default tax regime, to the extent and conditions specified, thereof.
Professional tax
Interest on loan in respect of self-occupied property
Deduction in respect of contribution to - notified approved research association/ university/ college/ other institutions for scientific research or for research in social science or statistical research - approved Indian company for scientific research - An approved National laboratory/university/IIT/ specified person for scientific research undertaken under an approved programme
Investment linked tax incentives for specified businesses

(ii) Time limit for exercising the option to shift out of the default tax regime

A. In case of an assessee having no income from business or profession:

- Individual/HUF/AoP/BoI or Artificial Juridical person can choose to opt out of the default tax regime every single year.
- This choice must be made on or before the due date of filing the return of income for that specific year.

B. In case of an assessee having income from business or profession:

- Individual/HUF/AoP/BoI or Artificial Juridical person can opt out of the default tax regime, and this choice will apply to all subsequent years.

- This choice must be made on or before the due date of filing the return of income for that specific year.
- If they have opted out, they can withdraw that option and return to the default tax regime **only once**.
- Once they return to the default tax regime, they can **never** exercise the option to shift out again as long as they have business or professional income.

Knowledge Assessment - I

1. The term "income" includes the following types of incomes:
   a. Legal
   b. Illegal
   c. Legal and illegal both
   d. None of the above

2. Which of the following income is not included in the term "income" under the Income-tax Act, 2025:-
   a. Profits and gains
   b. Profit in lieu of salary
   c. Dividend
   d. Reimbursement of travelling expenses.

3. Income tax in India is charged at the rate prescribed by:
   a. The Finance Act
   b. The Income Tax Act
   c. The Central Board of Direct Taxes
   d. Both a. and b.

4. Which of the following is agricultural income?
   a. Income from bee hiving
   b. Income from dairy farming.
   c. Royalty income from mines
   d. Income earned from carrying nursery operations

Answers

1.c, 2.d, 3. d, 4.d

SUMMARY

- "Tax year" means the twelve months period of the financial year commencing on 1st April. In the case of a business or profession newly set up, or a source of income newly coming into existence in any financial year, the tax year shall be the period beginning with—

  (a) the date of setting up of such business or profession; or

  (b) the date on which such source of income newly comes into existence,

  and ending with the said financial year.

- For the purpose of charging Income-tax, the term "person" includes Individual, Hindu Undivided Families [HUFs], Association of Persons [AOPs], Body of individuals [BOIs], Firms including LLPs, Companies, Local authority and any artificial juridical person not covered under any of the above.

- Normally the term "Assessee" is considered as one who is supposed to pay tax under Income-tax. It can be a normal assessee, a representative assessee, deemed assessee or an assessee-in-default.

- As per the Act, income derived from any of the following three sources is regarded as agricultural income -

  (i) Any rent or revenue derived from land situated in India and used for agricultural purpose.

  (ii) Any income derived from such land by agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit for the market, or sale of such produce.

  (iii) Income attributable to a farm building subject to the condition that building is situated on or in the immediate vicinity of the land and is used as a dwelling house, store house etc.

  (iv) Income earned from carrying nursery operations.

EXERCISE QUESTIONS

Short Answer Questions

1. What is a tax year.
2. Who is the person under Income-tax Act, 2025?

Long Answer Questions

1. Describe the different types of assessees.
2. Define the concept of agricultural income according to Income-tax Act, 2025.
3. Describe the basic principles of charge of income tax under section 4.

UNIT:2– Exempted Incomes and Residential Status & Incidence of Tax Liability.

Unit Code:	RESIDENTIAL STATUS, INCIDENCE OF TAX LIABILITY AND EXEMPTED INCOMES			
	Duration:			
Location:	SESSION 1: RESIDENTIAL STATUS AND INCIDENCE OF TAX			
Classroom	**Learning Outcome**	**Knowledge Evaluation**	**Performance Evaluation**	**Teaching and Training Method**
	1. Residential status and tax liability	1. Explain the concept of residential status of a person 2. List out the conditions to be satisfied by various persons to be ROR, RNOR, and NR	1. Understand the concept and importance of the residential status a person in calculating taxable income 2. Determine the residential status of various persons by applying the specified conditions	**Interactive Lecture:** Discussion on the concept of residential status and determination of residential status of various persons
	1. Scope of total income 2. Income received, income deemed to be received, income deemed to accrue or arise in India	1. Explain the meaning and scope of total income of various persons on the basis of residential status 2. Explain the concept of income received, income deemed to be received, income deemed to accrue or arise in India	1. Understand the various items of total income of various persons on the basis of residential status 2. Apply the concept of income received, income deemed to be received, income deemed to accrue or arise in India while determining the taxable income of various persons	**Interactive Lecture:** Discussion on the scope of total income and items to be included in the total income of different persons

	SESSION 2: EXEMPTED INCOMES			
	1. Items of exempted incomes	1. Explain the meaning of exempted incomes and deductions 2. List out the various exempted incomes	1. Describe the provisions related to various exempted incomes 2. Find out the taxable income of persons after determining the residential status, scope of total income and various exemptions available	**Interactive Lecture:** 1. Discussion on the various exemptions

(Note: The location would depend upon the topic under discussion, wherein it will be the classroom for the theoretical interactions, the student will be required to interact with various assesses and ask them about their residential status in various years, scope of their taxable income and various exemptions available to them. Students can visit website like incometaxindia.gov.in)

***Learning Objectives*:**

After reading this unit, the students will be able to:

1. find out the residential status of various persons;
2. determine the scope of total income of various persons;
3. understand the concept of income received, income deemed to be received and income deemed to accrue or arise in India;
4. understand various exemptions available to tax payers;
5. determine taxable income of various persons after determining residential status and exemptions available.

SESSION 1: RESIDENTIAL STATUS AND INCIDENCE OF TAX

The basis of charging income tax is the taxable income of every person. To determine taxable income, it is essential to find out residential status of the person and scope of total income. There are two types of taxpayers from residential point of view – Resident in India and Non-resident in India. Indian income is taxable in India whether the person earning income is resident or non-resident. Conversely, foreign income of a person is taxable in India only if such person is resident in India. Foreign income of a non-resident is not taxable in India. Therefore, the tax liability of a person is dependent upon the residential status of a person.

RESIDENTIAL STATUS (SECTION 6)

According to the residential status, the assessee can either be;

- Resident in India, or
- Non-resident in India

However, a resident individual and a resident HUF can further be classified as:

- Resident and ordinarily resident in India (ROR) or
- Resident but not ordinarily resident in India (RNOR).

It must be noted that only an individual or a HUF can be resident, not ordinarily resident or non-resident in India. All other assesses can be either resident or non-resident in India but cannot be not ordinarily resident in the matter of their residential status for all purposes of income tax. Section 6 of the Income-tax Act, 2025 prescribes the conditions to be fulfilled by various taxpayers to determine their residential status.

RESIDENIAL STATUS OF INDIVIDUALS

An individual first needs to satisfy basics condition in order to become resident in India. If a resident individual satisfies additional conditions, he becomes resident and ordinarily resident (ROR), otherwise he is resident but not ordinarily resident (RNOR).

Basic conditions for an individual to be resident

An individual is said to be resident in India in any tax year if he:

1. has been in India for a total period of 182 days or more in that tax year; or
2. has been in India cumulatively for 60 days or more during the tax year and has been in India cumulatively for 365 days or more in the four years preceding such tax year.

Exceptions to above conditions

In the following two cases, second condition is not applicable, i.e., if condition (1) is satisfied then an individual is resident otherwise he will be non-resident:

i. the individual being a citizen of India, who leaves India in any tax year as a member of the crew of an Indian ship, or for the purpose of employment outside India, or

ii. the individual being a citizen of India or person of Indian origin who being outside India comes on a visit to India in any tax year.

Therefore, in the above two exceptional cases, only basic condition (1) needs to be checked. If it is satisfied, then the individual is treated as a resident, otherwise he will be treated as non-resident.

Further, in case of Indian citizen or person of Indian origin who, being outside India comes on a visit to India in any tax year and if the total income of such person, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India] exceeds ₹ 15 lakhs during the tax year, then such person will be treated as resident in India if -

- the period of his stay during the relevant tax year amounts to 182 days or more, or
- he has been in India during the 4 years preceding the tax year for a total period of 365 days or more and has been in India for 120 days or more in the tax year.

NOTE:

A person is deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in Undivided India. It may be noted that grandparents include both maternal and paternal grand parents

Deemed Resident

An Indian citizen, having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the tax year would be deemed to be resident in India in that tax year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

Non-resident

If an individual does not satisfy any of the above two basic conditions, then he will be treated as non-resident.

It must be noted that the fulfilment of any one of the above conditions (1) or (2) will make an individual resident in India since both these conditions are alternative and not cumulative in their application.

Additional conditions for an individual to be resident and ordinary resident (ROR)

An individual may become a resident and ordinarily resident in India if he satisfies both the following conditions besides satisfying any one of the above-mentioned basic conditions:

1. he is a resident in atleast any two out of the ten tax years preceding the relevant tax year, and
2. he has been in India cumulatively for 730 days or more during the seven tax years preceding the relevant tax year.

Resident and not ordinary resident (RNOR)

If a resident individual is not able to satisfy both the additional conditions or satisfies only any one condition, then he will be resident but not ordinary resident (RNOR). Further following cases shall also be covered under RNOR category –

1. If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any tax year) having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (other than income derived from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the tax year, who has been in India for 120 days or more but less than 182 days during that tax year, or
2. If such individual is a deemed resident in India.

STEPS TO SOLVE RESIDENTIAL STATUS OF AN INDIVIDUAL

1. Determine whether the person falls under exception to second basic condition.
2. If yes, apply only first basic condition, if satisfied, then he will be resident otherwise check whether he is a deemed resident or not.
3. If individual is deemed resident, then he will be resident but not ordinarily resident otherwise non-resident.
4. If the person does not fall under exception to second basic condition, then apply both the basic conditions. Individuals become resident on satisfaction of any one condition.
5. Resident Individual will be called ROR if satisfies both the additional conditions, otherwise he will be called RNOR.

Important Points to be considered while determining Residential Status

The residential status of the assessee should be determined for each year separately. This is because a person resident in one year may become non-resident or not ordinarily resident in another year and vice versa.

1. The residential status of an individual for tax purposes does not depend upon his citizenship, nationality and place of birth or domicile. This is because for tax purposes, an individual may be resident in more than one country in respect of the same year.
2. The period of stay required in each of the conditions need not necessarily be continuous nor is the purpose of stay is insignificant in determining the residential status.
3. It is not required that the stay should be at the usual place of residence, business or employment of the individual. The stay may be anywhere in India and for any length of time at each place.
4. India means territory of India, its territorial waters, continental shelf, Exclusive Economic Zone and airspace above its territory and territorial waters.
5. For the purpose of counting number of days stayed in India, the day he comes to India and the day he leaves India is counted as stay in India.

Illustration 1

Mr. Kishore is a foreign citizen. Determine his residential status for the tax year 2026-27 on the assumption that during tax years 2012-13 to 2026-27, he was present in India as follows:

Tax year	Days	Tax year	Days
2026-2027	187	2018- 2019	295
2025-2026	85	2017- 2018	150
2024-2025	270	2016- 2017	205
2023- 2024	76	2015- 2016	175

2022- 2023	201	2014- 2015	25
2021- 2022	89	2013- 2014	35
2020- 2021	145	2012- 2013	300
2019- 2020	35		

Solution

a. Stay of Mr. Kishore during the tax year 2026-27 is 187 days, therefore he is a resident in the tax year 2026-27.

b. Mr. Kishore is resident in India in two out of ten tax years preceding the relevant tax year.

c. Stay of Mr. Kishore in India is also more than 730 days in 7 tax years preceding the relevant tax year.

Hence, Mr. Kishore shall be a resident and ordinarily resident for the tax year 2026-27.

Illustration 2

Mr. Raj is a foreign citizen. His father was born in Delhi in 1953 and mother was born in USA in 1960. His grandfather was born in Mumbai in 1929. He visited India on 15^{th} December, 2026 for 200 days to visit historical places. He had never come to India before. Determine his residential status for tax 2026-27.

Solution

Mr. Raj falls in exception to basic conditions as he is a Person of Indian Origin (as his grandfather was born in undivided India) and he visited to India during relevant tax year. Therefore, only first basic condition of 182 days during relevant tax year needs to be checked.

Stay in India during relevant tax year 2026-27 = 15^{th} Dec, 2026 to 31st March, 2027 = 17+31+28+31 = 107 days. Thus, Mr. Raj is a non-resident in India for tax year 2026-27 as he does not satisfy first basic condition.

RESIDENTIAL STATUS OF HINDU UNDIVIDED FAMILIES

An HUF can be a resident or non-resident. Similar to an individual, resident HUF can further be classified as a resident and ordinarily resident (ROR) or resident but not ordinarily resident (RNOR).

Basic condition to be resident/non-resident

A HUF is said to be resident in India in any tax year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant tax year, it is considered to be a non-resident.

Meaning of place of control and management

The control and management is situated at that place where policy decisions are taken not the places from where the business is carried on. Policy decisions should be related to finance, marketing, production, advertising, personnel etc. It does not mean day to day operations of the concern/assessee. Control and Management of HUF lie with Karta.

Additional condition for a HUF to be resident and ordinary resident (ROR)

If the Karta of a resident HUF satisfies both the following additional conditions (as applicable in case of Individual) then Resident HUF will be ROR, otherwise it will be RNOR, i.e., if the

1. karta of resident HUF is resident in India in atleast 2 tax years out of 10 tax year preceding relevant tax year, and
2. stay of Karta during 7 tax years preceding relevant tax year is 730 days or more,

then the HUF is an ROR, otherwise an RNOR.

> ***NOTE:***
>
> *It is immaterial whether Karta is resident or non-resident during relevant tax year, for the purpose of determining whether HUF is ROR or RNOR. If Karta satisfies both the additional conditions, then HUF will be ROR, otherwise RNOR.*

RESIDENTIAL STATUS OF FIRMS/AOP/BOI/OTHER ARTIFICIAL JUDICIAL PERSONS

Firms, association of persons, body of individuals, local authorities and other artificial juridical persons can be either resident or non-resident in India but they cannot be not ordinarily resident in India. These are said to be resident in India in any tax year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant tax year, it is considered to be a non-resident.

Illustration 3

ABC HUF's whole affairs of business are completely controlled from India. Determine its residential status for tax year 2026-27 (a) if Karta is ROR in India for that year (b) if Karta is NR in India but he satisfies both the additional conditions (c) if Karta is RNOR in India.

Solution

HUF would be resident in India as Control and Management is wholly situated in India.

Determination of whether HUF is ROR or RNOR:

(a) Since Karta is ROR, he would be satisfying both the additional conditions. Therefore, HUF is ROR.

(b) HUF is ROR in India as Karta is satisfying both the additional conditions. Karta's residential status during relevant tax year (i.e. resident/non-resident) is irrelevant.

(c) Since Karta does not satisfy both the additional conditions, HUF is RNOR.

Illustration 4

Mehta and Sons is a partnership firm whose operations are carried out in India. However, all meetings of partners take place in England as all the partners are settled there. Determine residential status of firm for tax year 2026-27.

Solution

Mehta and Sons is non-resident in India during relevant tax year as control and management (place where policy decisions are taken, here it is the place where meetings are held) is wholly situated outside India.

RESIDENCE FOR COMPANIES

All Indian companies are always resident in India regardless of the place of control and management of its affairs.

A non-Indian company (foreign company) would be resident in India only if its place of effective management, in that year, is in India.

MEANING AND SCOPE OF TOTAL INCOME (SECTION 5)

The scope of total income and consequently the liability to income-tax depends upon the following facts:

a. whether the income accrues or is received in India or outside,

b. the exact place and point of time at which the accrual or receipt of income takes place, and

c. the residential status of the assessee.

Scope of Total income has been defined on the basis of Residential status

1. Resident and Ordinarily Resident

The total income of a resident and ordinarily resident would consist of:

i. income received or deemed to be received in India during the relevant tax year;

ii. income which accrues or arises or is deemed to accrue or arise to him in India durimg the relevant tax year;

iii. income which accrues or arises to him outside India during the relevant tax year.

In simpler terms, an ROR has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India in the tax year.

2. Resident but Not Ordinarily Resident

The total income in case of resident but not ordinarily resident in India would consist of:

i. income received or deemed to be received in India during the relevant tax year;

ii. income which accrues or arises or is deemed to accrue or arise to him in India during the relevant tax year;

iii. income which accrues or arises to him outside India during the relevant tax year if it is derived from a business controlled in or a profession set up in India.

3. Non-Resident

The total income of a non-resident would comprise of:

i. income received or deemed to be received in India during the relevant tax year;

ii. income which accrues or arises or is deemed to accrue or arise to him in India during the relevant tax year.

Residential Status and Scope of Total Income:

Whether the following incomes are to be included in Total Income?

Scope of total Income	Resident and Ordinarily Resident (ROR)	Resident but not Ordinarily Resident (RNOR)	Non-Resident
Income received or deemed to be received in India in tax year	Yes	Yes	Yes
Income accruing or arising or deeming to accrue or arise in India in tax year	Yes	Yes	Yes
Income accruing or arising outside India in tax year	Yes, even if such income is not received or brought into India in tax year	Yes, but only if such income is derived from a business controlled in or profession set up in India; Otherwise, No.	No

INCOME RECEIVED

Income received in India is taxable regardless of the assessee residential status therefore it has great significance.

1. The receipt contemplated for this purpose refers to the first receipt of the amount in question as the income of the assessee.

   For instance, if A receives his salary at Delhi and sends the same to his father, the salary income of A is a receipt for tax purposes only in the hands of A; his father cannot also be said to have received income when he receives a part of the income of A. In the hands of A’s father it is only a receipt of a sum of money but not a receipt of income.

2. The taxable income of an assessee shall be calculated according to the method of accounting (cash system or mercantile system of accounting) that the assessee follows.

3. Receipt by some other person on behalf of the assessee should be treated as receipt by the assessee for being taxed in his hands.

4. The question of taxability of a particular income received by the assessee depends upon the nature of income. For instance, income from salaries and interest on securities would attract liability to tax immediately when it falls due to the assessee regardless of its actual receipt by or on behalf of the assessee.

INCOME DEEMED TO BE RECEIVED

In addition to the income actually received by the assessee or on his behalf, certain other incomes not actually received by the assessee and/or not received during the relevant tax year, are also included in his total income for income tax purposes. Such incomes are known as income deemed to be received. Some of the examples of such income are:

i. The transferred balance in a Recognised Provident Fund to the extent of the amount transferred from unrecognised provident fund to recognised provident fund (being the employer's contribution and interest thereon)

ii. the annual accretion in that year to the balance at the credit of an employee participating in a recognised provident fund, to the extent of interest credited in excess of 9.5% p.a (Annual accretion to the credit of RPF)

iii. the contribution made by the Central Government or any other employer in that year to the account of an employee under a pension scheme.

For inclusion in the total income of an assessee,—

(a) any dividend including deemed dividend declared by a company or distributed or paid by it shall be deemed to be the income of the tax year in which it is so declared, distributed or paid, as the case may be;

(b) any interim dividend shall be deemed to be the income of the tax year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

According to section 9 of the Act, certain incomes are deemed to accrue or arise in India which are discussed below:

1. Income accruing or arising directly or indirectly through or from -

(a) any asset or source of income in India; or

(b) any property in India; or

(c) any business connection in India; or

(d) the transfer of a capital asset situated in India,

2. Income from salaries

Income which is chargeable under the head Salaries is deemed to accrue or arise in India in all cases when earned in India. For this purpose, income is said to be earned in India if the services are rendered in India and for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment.

Income from salaries payable by the Government to a citizen of India outside India for his services rendered outside India, is deemed to accrue or arise in India even though the income is actually accruing outside India and is also received outside India.

3. Taxability of Dividend

Dividend paid by any Indian company outside India is deemed to accrue or arise in India and the income is consequently chargeable to income-tax irrespective of the fact whether the dividend is interim dividend or a final dividend.

4. Taxability of Interest

Interest payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Interest payable by:

i. the Government; or

ii. a resident in India, except where interest is payable in respect of any debt incurred or moneys borrowed and used for the purpose of business or profession carried outside India or making or earning any income from any source outside India (i.e. Interest payable by a resident for loan used in India for any purpose, whether for business or profession or otherwise);

iii. a non-resident in India provided interest is payable in respect of any debt incurred or moneys borrowed and used for a business or profession carried on in India (i.e. Interest payable by a non-resident for loan used for only business or profession in India)

5. Taxability of Royalty

Royalty payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Royalty payable by:

i. the Government; or

ii. a resident in India except where royalty is payable in respect of any right/ information/ property used or services utilized for the purpose of a business or profession carried on outside India or making or earning any income from any source outside India (i.e. Royalty payable by a resident for right/information/property used in India for any purpose whether business or profession or for earning other incomes);

iii. a non-resident in India provided royalty is payable in respect of any right/ information/ property used or services utilized for the purpose of the business or profession carried on in India or making or earning any income from any source in India (i.e. Royalty payable by a non-resident for right/information/property used for any purpose in India whether business or profession or for earning other incomes).

6. Taxability of Fees for Technical Services:

Fees for technical services payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Fees for technical services payable by:

i. the Government; or

ii. a resident in India except it is payable in respect of services utilized for a business or profession carried on outside India or making or earning any income from any source outside India (i.e. Fees for technical services payable by a resident for services utilised for any purpose in India whether business or profession or for earning other incomes);

iii. a non-resident in India provided fee is payable in respect of services utilized for a business or profession carried on in India or making or earning any income from any source in India (i.e. Fees for technical services payable by a non-resident for services utilised for any purpose in India whether business or profession or for earning other incomes).

Illustration 5

Mr. Naqvi earns the following income during the tax year ended 31st March, 2027. Determine the income liable to tax for the tax year 2026-27 if Mr. Naqvi is (a) resident and ordinarily resident in India, (b) resident and not ordinarily resident in India, and (c) non-resident in India during the tax year ended 31st March, 2027.

1. Capital gains on sale of a building in India but received in USA- Rs. 35,000
2. Pension from former employer in India received in USA- Rs. 24,000 (Computed)
3. Interest on U.K. Development Bonds (1/3rd received in India) - Rs. 30,000
4. Rental income from property in England and received in Canada - Rs. 25,000 (Computed)
5. Profits earned from a business in Australia which is controlled from Denmark (Rs. 40,000 received in India) - Rs. 80,000
6. Dividend on shares of an Indian company but received in USA - Rs. 10,000
7. Profits not taxed previously brought into India - Rs. 40,000
8. Profits from a business in Punjab which is controlled from USA Rs. 17,000

9. Income from agriculture in Korea, being invested there - Rs.12,000

10. Income from business in Sri Lanka, being controlled from India- Rs. 10,000

Solution

Computation of income liable to tax

Particulars	Resident & Ordinarily Resident	Resident but not Ordinarily Resident	Non-Resident
Capital gains on sale of a building in India but received in USA	35,000	35,000	35000
Pension from former employer in India received in USA (Computed)	24,000	24,000	24,000
Interest on U.K. Development Bonds	30,000	10,000	10,000
Rental income from property in England and received in Canada (Computed)	25,000	Nil	Nil
Profits earned from a business in Australia which is controlled from Denmark	80,000	40,000	40,000
Dividend on shares of an Indian company but received in USA	10,000	10,000	10,000
Profits not taxed previously brought into India	Nil	Nil	Nil
Profits from a business in Punjab which is controlled from USA	17,000	17,000	17,000
Income from agriculture in Korea, being invested there	12,000	Nil	Nil
Income from business in Sri Lanka, being controlled from India	10,000	10000	Nil
Total income	**2,43,000**	**1,46,000**	**1,36,000**

Knowledge Assessment - I

1. R Ltd. is an Indian company whose place of effective management is outside India. R Ltd., shall be:

   a. resident in India

   b. non-resident in India

   c. not ordinarily resident in India

   d. resident and ordinarily resident only
2. Every year, the residential status of an assessee —
   a. May change
   b. Will certainly change
   c. Will not change
   d. None of the above.
3. Foreign income received in India during the tax year is taxable in the case of –
   a. Resident
   b. Not-ordinarily resident
   c. Non-resident
   d. All of the above.
4. Income accruing in India in tax year is taxable for –
   a. Resident
   b. Not ordinarily resident
   c. Non-resident
   d. All of the above.
5. Income accruing from agriculture in a foreign country is taxable in the case of an assessee who is -
   a. Resident
   b. Not-ordinarily resident
   c. Non-resident
   d. None of the above.

Answers

1.a, 2. a, 3.d, 4.d, 5.a

SESSION 2: EXEMPTED INCOMES

For providing relief to the tax payers from payment of tax, income tax law provisions contains concept of exemption and deduction. Exempted income means the income, which is not at all charged to any taxes, while calculating the Gross Total Income. Whereas deduction means the amount which needs to be included in the income first then it is allowed for deduction in full or in part on fulfilment of certain conditions.

The items of exemptions specified in section 11 are explained as follows:

Section 11 provides that certain incomes specified in schedules shall not be included in computing the total income of any person and do not enter into the computation process at all.

1. AGRICULTURAL INCOME

Agricultural income as defined in section 2(5) is exempt from income tax in the case of all assesses. As per section 2(5), agricultural income generally means:

a. Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

b. Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

c. Income attributable to a farm building subject to the condition that building is situated on or in the immediate vicinity of the land and is used as a dwelling house, store house etc.

d. Any income derived from saplings or seedlings grown in nursery.

2. AMOUNT RECEIVED BY A MEMBER OF THE HUF

Amount received out of family income, or in case of impartible estate, amount received out of income of family estate by any member of such HUF is exempt from tax in the hands of the member, because that has been taxed in hand of H.U.F.

3. SHARE OF PROFIT RECEIVED BY A PARTNER FROM THE FIRM

Share of profit received by a partner from a firm is exempt from tax in the hands of the partner. Further, share of profit received by a partner of LLP from the LLP will be exempt from tax in the hands of such partner. This exemption is limited only to share of profit and does not apply to interest on capital and remuneration received by the partner from the firm/LLP.

4. CERTAIN INTEREST TO NON RESIDENTS

Any income by way of interest on money standing to his credit in a Non-Resident (External) Account in any bank in India as per the Foreign Exchange Management Act, 1999, and the rules made thereunder is exempt from tax, in the case of an individual, who is a resident outside India as per FEMA, 1999 or an individual who has been permitted by the RBI to maintain said account.

5. REMUNERATION RECEIVED BY OFFICIALS OF EMBASSIES ETC. OF FOREIGN STATES

The remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official, for service in such capacity is exempt.

Conditions

(a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.

(b) The above-mentioned member of the staff are subjects of the respective countries and are not engaged in any other business or profession or employment in India.

6. REMUNERATION RECEIVED FOR SERVICES RENDERED IN INDIA BY A FOREIGN NATIONAL EMPLOYED BY FOREIGN ENTERPRISE

The remuneration received by a foreign national as an employee of a foreign enterprises, for services rendered by him during his stay in India is exempt from tax.

Conditions

(a) The foreign enterprise is not engaged in any business or trade in India:

(b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such tax year, and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 2025.

7. SALARY RECEIVED BY A NON-CITIZEN FOR SERVICES RENDERED IN CONNECTION WITH EMPLOYMENT ON FOREIGN SHIP

Any income chargeable under the head "Salaries" received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed in the aggregate a period of 90 days in the tax year.

8. REMUNERATION RECEIVED BY FOREIGN GOVERNMENT EMPLOYEES DURING THEIR STAY IN INDIA FOR SPECIFIED TRAINING

Any remuneration received by employee, not being an Indian citizen, of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by-

(a) the Government; or

(b) any company owned by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments; or

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

9. ROYALTY INCOME FROM OR FEES FROM TECHNICAL SERVICES RENDERED IN OR OUTSIDE INDIA TO, THE NATIONAL TECHNICAL RESEARCH ORGANISATION (NTRO)

Any income arising to a non-resident or a foreign company by way of royalty from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO) is exempt from tax.

KEY WORDS

1. **Resident:** An individual becomes a resident when he satisfies any one of the basic conditions. Other persons become resident on the basis of control and management.
2. **Resident and ordinarily resident:** An individual or an HUF become ROR when the individual or the Karta of HUF satisfies both the additional conditions.
3. **Resident but not ordinarily resident**: An individual or an HUF becomes RNOR when the individual or the Karta of HUF does not satisfy both or satisfies any one of the additional conditions.
4. **Person of Indian origin:** A person is deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in Undivided India. It may be noted that grandparents include both maternal and paternal grandparents.
5. **Income deemed to accrue or arise in India:** The incomes mentioned in section 9 of the Act are deemed to accrue or arise in India.

SUMMARY

- To determine taxable income, it is essential to find out residential status of the person and scope of total income.
- An individual or a HUF can be resident, not ordinarily resident or non-resident in India. All other assesses can be either resident or non-resident in India but cannot be not ordinarily resident in the matter of their residential status.

- Section 6 of the Income-tax Act prescribes the conditions to be fulfilled by various taxpayers to determine their residential status.
- The scope of total income and consequently the liability to income-tax depends upon (a) whether the income accrues or is received in India or outside, (b) the exact place and point of time at which the accrual or receipt of income takes place, and the residential status of the assessee.
- Scope of total income has been defined on the basis of residential status
- Section 9 describes the various incomes which are deemed to accrue or arise in India.
- Exempted income means the income which is not at all charged to any taxes, while calculating the Gross Total Income. Whereas deduction means the amount which needs to be included in the income first then it is allowed for deduction in full or in part on fulfilment of certain conditions.

EXERCISE QUESTIONS

Short Answer Questions

1. Describe the concept of agricultural income as defined under section 2(5) of the Income-tax Act, 2025.
2. Distinguish between:
    a. Resident and not ordinary resident
    b. Domestic company and Foreign company
    c. Resident and non-resident

Long Answer Questions

1. What are the different categories into which the assessees are divided regarding residence and how is the residence of assessees determined for income-tax purposes? Explain.
2. What tests would you apply to determine the residence of:
    a. a Hindu Undivided family,
    b. a firm,
    c. a limited company,
    d. an individual.
3. Describe the concept of income deemed to accrue or arise in India.
4. Describe various incomes which are exempted under section 11 of Income-tax Act, 2025.

Numerical Questions

Mr. Pandey earns the following income during the tax year ended on 31st March, 2027. You are required to determine the income of Mr. Pandey liable to tax for the tax year 2026-27 if he is (a) resident and ordinarily resident (b) resident and not ordinarily resident, and (c) non-resident in India during the tax year ended on 31st March, 2027.

a. Honorarium received from Government of India - Rs.40,000

b. Profits earned from a business in Jalandhar controlled from USA - Rs.70,000

c. Profits earned from a business in Australia controlled from Mumbai- Rs. 30,000

d. Rental income from a property in U.K, received in India - Rs. 10,000 (Computed)

e. Agricultural income from Sri Lanka not remitted to India - Rs. 40,000

f. Pension for services rendered in India but received in Sri Lanka - Rs. 30,000 (Computed)

g. Profits earned from a business in Australia controlled from USA and amount deposited in a bank there - Rs.40,000

h. Past untaxed foreign income brought into India during the year - Rs. 25,000

i. Dividends from an Australian company credited to his account in USA- Rs.35,000

(Answer: ROR - Rs. 2, 95,000; RNOR - Rs. 1, 80,000; NR - Rs. 1, 50,000)

UNIT III: (I) INCOME FROM SALARY

Learning ***Objectives*****:**

After reading this unit, the students will be able to:

1. Explain the meaning of term "salary".
2. List the items included under the head "salaries".
3. Define the term "allowances".
4. State the different types of allowances and their taxability as per provisions of Income tax act.
5. Define the term "perquisites".
6. List different types of perquisites made available to salaried employees.
7. Compute the value of such perquisites.
8. Explain the provisions of Income-tax Act, 2025 in relation to benefits received by an employee after retirement from employer.
9. Name different types of Provident funds and their tax treatment for tax purposes.

SESSION 1: INTRODUCTION TO SALARY

Salary refers to the total monetary and non-monetary consideration received by an individual from an employer in return for services rendered under an employer–employee relationship. It is a comprehensive term that goes beyond just basic pay and includes various forms of compensation provided periodically or otherwise.

As per section 16, salary includes-

- Wages;
- Any annuity or pension;
- Any gratuity;
- Any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
- Any advance of salary;
- Any payment received by an employee in respect of any period of leave not availed by him;
- Annual accretion to the balance of recognized provident fund to the extent chargeable to tax
- Aggregate of all sums comprised in the transferred balance of an employee participating in recognized provident fund to the extent chargeable to tax
- The contribution made by the Central Government or any other employer in the tax year, to the account of an employee under a notified pension scheme.

- the contribution made by the Central Government in the tax year, to the Agniveer Corpus Fund account of an individual enrolled in the Agnipath Scheme referred to in section 125.

All these incomes are included in the Gross Salary and then deductions under section 19 are deducted.

BASIS OF CHARGE [SECTION 15]

As per section 15, the following income shall be chargeable to income-tax under the head "Salaries":

a. Any salary due from an employer in the tax year, whether paid in that tax year or not;

b. Any salary paid in the tax year , before it became actually due, ie advance salary

c. Any arrears of salary paid in the tax year by the employer , if not charged to income-tax in any earlier tax year.

BASIC RULES GOVERNING SALARIES

1. **Employer and employee relationship:** Any payment made by an employer to an employee for the work done is taxed under the head "Salaries." However, for this income to be taxed as salary, there must be an employer–employee relationship between the person who pays and the person who receives the payment.

   Example:
   Ravi works in a company and receives ₹30,000 per month as salary from his employer. Since there is an employer-employee relationship, this income is taxed under "Salaries."

   Example:
   Ravi also does some freelance work for another company and gets ₹10,000. Here, there is no employer–employee relationship, so this income is not taxed as salary. It will be taxed under "Profits and Gains of Business or Profession" or "Income from Other Sources," depending on the situation.

2. **Place of accrual of salary:** According to the Income-tax Act, salary is deemed to accrue at the place where the services are rendered. Hence, when services are rendered in India, salary is deemed to accrue or arise in India though it may have been paid outside India.

3. **Advance salary:** It is common practice of employees to receive salary in advance under conditions of emergency. Tax is chargeable to all salaries which are due whether actually paid or not and also on those which are paid whether due or not to the employee during the financial year.

4. **Arrears of salary:** Although salary is taxable on "due" or "receipt" basis whichever is earlier, if there are any arrears of salary which have not been taxed in the past, such arrears will be taxed in the tax year in which these arrears are paid to the employee.

5. **Foregoing of salary:** Once salary has been earned by an employee, it becomes taxable in his hands though he may subsequently waive the right to receive the same from the employer.

Salary so waived by the employee would be taxable in his hands.

6. **Tax-free salary:** When the employee receives tax-free salary from his employer, it normally means that the employer himself pays the tax which is due on the salary of such employee. The amount of tax, so paid by the employer, is also to be considered as the income of the employee and will be added to his salary.

SESSION 2: BASIC KNOWLEDGE ABOUT TAXABILITY OF ALLOWANCES

Allowance is defined as a fixed quantity of money or allowance given regularly in addition to salary for meeting specific requirements of the employees. These allowances are generally taxable unless some specific exemption has been provided in respect of such allowance. Allowances can be categorized as follows:

a) House Rent Allowance (HRA):

HRA is a special allowance specifically granted to an employee by his employer towards payment of rent for residence of the employee. HRA granted to an employee is exempt to the extent of least of the following,

1) Actual HRA received by the employee.

2) Rent paid *less* 10% of the salary

3) 40% of the salary (50% of salary in case of Mumbai, Kolkata, Delhi, Chennai, Hyderabad, Ahmedabad, Bengaluru, Pune)

"Salary" for this purpose means basic salary, dearness allowance forming part of retirement and commission as a fixed percentage of turnover.

Note – Exemption in respect of HRA is not allowed under the default tax regime.

Illustration 1

Mr. Viplav is entitled to a salary of ` 30,000 per month and Dearness Allowance of ` 8,000, 60% of which forms part of retirement benefits. He is also entitled to a House Rent Allowance of ` 12,000 per month. He actually pays `15,000 for a house in Chennai. Compute his Gross Salary.

Solution

Particulars	Amount (`)	Amount (`)
Basic salary (30,000 X 12)		3,60,000
Dearness Allowance (8,000 X 12)		96,000
House Rent Allowance (12,000 X 12)	1,44,000	
Less: Exemption [Refer W.N below]	(1,38,240)	5,760
GROSS SALARY		4,61,760

Working Notes

1. DA is fully taxable.

2. Salary (for calculation of HRA) = 3,60,000 + 57,600 (basic + 60% of DA forming part of retirement) = ` 4,17,600

3. HRA is exempt minimum of the following three amounts:

   i. ` 1,44,000 (actual HRA received)

   ii. ` 1,80,000 - ` 41,760 = ` 1,38,240 (rent paid – 10% of salary)

   iii. ` 2,08,800 (50% of salary because he lives in Chennai)

Illustration 2

Mr. Pawan is employed with XYZ Ltd. on a basic salary of ` 40,000 per month. He is also entitled to a Dearness Allowance of 35% of basic salary. 50% of the dearness allowance is included in salary for retirement benefits. The company gives him HRA of ` 20,000 per month. With effect from 01-10-2026, he receives an increment of ` 8,000 in his basic salary. During the tax year 2026-27, he has received arrears of salary pertaining to earlier years amounting to ` 50,000. He was staying with his parents till 31-10-2026 and from 01-11-2026 he took an accommodation on rent in Mumbai and pays ` 18,000 per month as rent. Compute his Gross salary for the tax year 2026-27.

Solution

Particulars	**Amount (`)**	**Amount (`)**
Basic salary (2,40,000 + 2,88,000)		5,28,000
Dearness Allowance (5,28,000 X 35%)		1,84,800
Arrears of salary		50,000
House Rent Allowance (20,000 X 12)	` 2,40,000	
Less: Exemption	` (61,800)	1,78,200
GROSS SALARY		**9,41,000**

Working Notes

1. Calculation of Basic Salary:

   40,000 X 6 = ` 2, 40,000

   48,000 X 6 = ` 2, 88,000

2. DA is fully taxable and 35% of basic (given).

3. No exemption with respect of HRA received for the period for which he stays with his parents is available.

4. HRA exemption shall be computed from 1.11.2026 to 31.03.2027 (i.e., 5 months)

Least of the following shall be exempt:

i. ` 20,000 x 5 = ` 1,00,000 (actual HRA received)

ii. [` 18,000 x 5 - ` 28,200] = ` 61,800 (rent paid – 10% of salary)

iii. ` 1,41,000 (50% of salary because he lives in Mumbai).

iv. Hence HRA of ` 61,800 shall be exempt.

5. Salary (for calculation of HRA) = [(48,000 + 8400) x 5] = ` 2,82,000

b) <u>Special Allowances related to duties:</u> The following are special allowances given to an employee to cover expenses that are fully and necessarily spent for doing their job duties.

(i) Travelling Allowance: Allowance granted to meet the cost of travel on tour or on transfer.

(ii) Conveyance Allowance: Allowance granted to meet the expenditure incurred on conveyance in performance of official duties.

(iii) Daily Allowance: Allowance granted to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty.

iv) Helper Allowance: Allowance granted to keep a helper in performing duties.

v) Academic /Research Allowance: Allowance granted to encourage the academic, research and training pursuits in educational and research institutions.

vi) Uniform Allowance : Allowance granted to meet the expenditure incurred on the purchase or maintenance of uniform for wear.

These above allowances are exempt as follows:

Least of the following two amounts:

i. Actual allowance received

ii. Actual amount spent for the purposes of duties of office or employment.

It means the amount of allowance received shall be compared with the actual expense incurred for duty and the balance, if any , shall be taxable in the hands of the employee.

c) <u>Special allowances to meet personal expenses or for performing duties of special nature</u>

Special allowances granted to an employee to meet personal expenses at the place where duties are performed or where he ordinarily resides, or to compensate for the increased cost of living, are exempt to the prescribed extent. These are exempt to the extent of amount received or the limit specified whichever is less.

S. No.	Name of Allowance	Extent to which allowance is exempt
1.	Any Special Compensatory (Remote locality) Allowance. Places covered under Tough Location Allowance -I	INR 7,000 per month
2	Any Special Compensatory (Remote locality) Allowance. Places covered under Tough Location Allowance -II	INR 4,500 per month
3.	Any Special Compensatory (Remote locality) Allowance. Places covered under Tough Location Allowance -III	INR 1,500 per month
4.	Compensatory Field Area Allowance [Specified areas in Specified States]	INR 13,500 per month
5.	Compensatory Modified Field Area Allowance [Specified areas in Specified States]	INR 8,000 per month
6.	Any allowance granted to an employee **working in any transport system** to meet his personal expenditure during his duty performed in the course of running such transport from one place to another, provided that such employee is not in receipt of daily allowance	70% of such allowance upto a maximum of INR25,000 per month
7	**Children Education Allowance**	INR 3,000 per month per child upto a maximum of two children
8.	Any allowance granted to an employee to meet the **hostel expenditure** on his child	INR 9,000 per month per child upto a maximum of two children
9.	Any special allowance in the nature of **counter insurgency allowance** granted to the members of the armed forces operating in areas away from their permanent locations.	INR 22,000 per month
10	**Transport allowance granted to an employee, who is blind or deaf and dumb or orthopaedically handicapped** with disability of lower or upper extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty	(i) Metro Cities: ₹ 15,000/ +DA DA thereon per month (ii) Other Cities: ₹ 8,000/- + DA thereon per month
11.	Any special allowance in the nature of **high-Altitude allowance** granted to the member of the armed forces operating in high altitude areas	

S. No.	Name of Allowance	Extent to which allowance is exempt
	For altitude of 9,000 to 15,000 feet and altitude below 9000 feet with uncongenial climate For altitude above 15,000 feet All locations of Jammu & Kashmir, Ladakh, Sikkim and Uttarakhand	INR 4,500 per month INR 7,000 per month INR 30,000 per month
12	**Underground Allowance** granted to an employee who is working in uncongenial, unnatural climate in underground mines.	15% of basic pay
13.	Any special allowance in the nature of **special compensatory highly active field area allowance** granted to the member of the armed forces	INR 22,000 per month
14.	Any special allowance in the nature of **Island (duty) allowance or Island special duty allowance** granted to the member of the armed forces in **Andaman & Nicobar and Lakshadweep Group of Islands**	Areas around capital town (Port Blair, Kavarattii and Agatti) 10% of Basic Pay Difficult Areas 16% of Basic Pay More difficult areas 20% of Basic Pay
15.	Siachen Allowance granted to the member of the armed forces	INR 42,500 per month in Siachen area of Ladakh

Note – Exemptions available under default tax regime:

Under the default tax regime, the exemption in respect of the above allowances is not allowed except in respect of the following:

i) Travelling Allowance

ii) Transfer Allowance

ii) Daily Allowance

iii) Conveyance Allowance

iv) Transport Allowance to blind / deaf/ dumb or orthopedically disabled employee subject to limits as given in table above.

Thus, the allowances from (i) to (v): Rest all the allowances received by an employee are fully taxable under default tax regime.

d) Certain allowances are fully taxable such as

(i) dearness allowance,

(ii) city compensatory allowance,

(iii) entertainment allowance,

(iv) medical allowance,

(v) overtime Allowance,

(vi) servant allowance ,

(vii) any other cash allowance etc.

e) Certain allowances are exempt such as

(i) Allowances to High Court Judges

(ii) Salary and Allowances paid by the United Nations Organization

(iii) Sumptuary allowance granted to High Court or Supreme Court Judges are exempt.

(iv) Allowance granted to Government employees outside India.

Illustration 3

X, a resident and an employee of a private company, furnishes the following particulars of his remuneration for the tax year 2026-27:

Basic salary	` 28,000 per month
DA	` 17,000 per month (100% forms part of salary)
House Rent Allowance	` 3,000 per month
Hostel allowance	` 10,000 per month
Transport allowance	` 1,200 per month
Entertainment allowance	` 500 per month

He lives in Delhi and has a single child staying in hostel for studies. He pays a monthly rent of ` 15,000 for his stay.

You are required to compute his gross salary assuming he has opted to shift out of the default tax regime provided under section 202(1).

Solution

Basic salary (28,000 X 12)		3,36,000
Dearness Allowance (17,000 X 12)		2,04,000
House Rent Allowance (3,000 X 12)	36,000	
Less: Exemption	(36,000)	
Hostel Allowance (10,000 X 12)	1,20,000	
*Less: E*xemption (9000 X 12)	(1,08,000)	12,000
Transport Allowance (1,200 X 12)		14,400
Entertainment Allowance (500 X 12)		6,000
GROSS SALARY		5,72,400

Working Notes

1. DA is fully taxable.
2. HRA exemption:

Least of the following three amounts is exempt:

i. ` 36,000 (actual HRA received)

ii. ` 1,80,000 - ` 54,000 = ` 1,26,000 (rent paid – 10% of salary)

iii. ` 2,70,000 (50% of salary because he lives in Delhi)

3. Hostel Allowance is exempt upto ` 9000 per month, per child, up to a maximum of two children or actual amount received; whichever is less.
4. Transport Allowance is fully taxable.
5. Entertainment allowance is fully taxable.

Illustration 4

Mr. Ravi furnishes you the following information for the year ending 31.03.2027:

Basic salary	`20,000 per month
Dearness Allowance	`5,000 per month (60% forms part of salary)
Bonus	One month of basic salary
Entertainment allowance	`500 per month

Education allowance for 2 children	`4000 per month per child
Transport allowance	`1,000 per month
Medical allowance	`1,200 per month
House Rent Allowance	`5,000 per month
Lunch allowance	`300 per month

He spends ` 8,000 per month as rent for staying in Delhi, ` 800 per month as transport expense for commuting from residence to office and back, ` 5,000 for his medical treatment in the tax year, and ` 1,500 for his lunch in the office. Compute his gross salary for the tax year 2026-27 if he decides to shift out of the default tax regime provided under section 202(1).

Solution

Basic salary	(20,000 X 12)		` 2,40,000
Dearness Allowance	(5,000 X 12)		` 60,000
Bonus	(20,000 X 1)		` 20,000
Entertainment Allowance	(500 X 12)		` 6,000
Education Allowance	(4000 X 12 X 2)	` 96,000	
Less: Exemption	(3000 X 2 X 12)	` (72,000)	24,000
Transport Allowance	(1,000 X 12)		` 12,000
Medical Allowance	(1,200 X 12)		` 14,400
Lunch Allowance	(300 X 12)		` 3,600
House Rent Allowance	(5,000 X 12)	` 60,000	
Less: Exemption		` (60,000)	Nil
GROSS SALARY			**` 3,80,000**

Working Notes

1. Bonus, Dearness allowance, medical allowance, and Lunch allowance are fully taxable.
2. Education allowance of ` 3000 per month per child is exempt.
3. Transport allowance is fully taxable.
4. HRA exemption: Least of the following is exempt -
   i. ` 60,000 (actual HRA received)

ii. ` 96,000 - ` 27,600 = ` 68,400 (rent paid – 10% of salary)

iii. ` 1, 38,000 (50% of salary because he lives in Delhi).

5. Entertainment allowance is fully taxable.

Illustration 5

Mr. Satish is employed as a pilot in Air India. He is in receipt of the following during the tax year 2026-27:

Basic salary	`50,000 per month
Bonus	One month of basic salary
Entertainment allowance	`1,500 per month
Uniform allowance	`1,200 per month

He has spent ` 8,000 for purchase and maintenance of uniform for official purposes. He has been given ` 6,000 per month as allowance to meet personal expenses during the performance of his duties in the transport system.

Compute his income under the head salary for the tax year 2026-27 assuming he pays tax under the default tax regime provided under section 202(1).

Solution

Basic salary	(50,000 X 12)	` 6,00,000
Bonus	(50,000 X 1)	` 50,000
Entertainment Allowance	(1,500 X 12)	` 18,000
Uniform Allowance	(1,200 X 12)	` 14,400
Transport Allowance	(6,000 X 12)	` 72,000
GROSS SALARY		**` 7,54,400**

Working Notes

1. Bonus is fully taxable.
2. Uniform allowance is fully taxable for an employee paying tax under default tax regime.
3. Transport allowance given to meet personal expenses during the performance of his duties in the transport system, is fully taxable for an employee paying tax under default tax regime.
4. Entertainment allowance is fully taxable.

Knowledge Assessment – I

(A) Match the exemption in the following case:

1. Children Education Allowance	(A) ₹ 9000 per month per child for maximum of two children
2. Hostel Expenditure Allowance	(B) ₹ 3000 per month per child for maximum of two children
3. Tough Location Allowance II	(C) ₹ 13,500 per month
4. Transport Allowance to disabled employee in metro city	(D) ₹ 4,500 per month
5. Compensatory Field Area Allowance	(E) ₹ 15,000 plus DA thereon per month
6. Allowance to transport employee	(F) ₹ 22,000 per month
7. Counter insurgency allowance	(G) 70% of allowance, maximum ₹ 25,000 p.m.

Answers

1. (B); 2. (A); 3. (D); 4. (E); 5. (C); 6. (G) 7. (F)

SESSION 3: TAXABILITY OF PERQUISITES

Perquisite is a facility provided by employer in kind to the employee for official use or for personal benefit or partly for official purpose and partly for private purpose. Section 17 defines perquisite under the Income-tax Act. Examples of perquisites are:

1. House accommodation with or without furniture
2. Furniture
3. Servants
4. Gas or electricity or water service
5. Telephone or mobile phone
6. Use of computers, laptops, i-Pad, tablets and other electronic devices
7. Sale of assets to employees at concessional rates
8. Loans to employees without interest or at lower interest

9. Club membership
10. Car facility or other vehicles
11. LTC- Leave travel concession
12. Medical facility
13. Education facility
14. Health club or recreational facility
15. Food or snacks provided by employer
16. Contribution to provident fund or pension fund or other welfare fund for the purpose of employee.
17. Monetary obligations of employee paid or reimbursed by the employer
18. Income tax paid on behalf of employee (not TDS)
19. Professional tax paid for employee
20. Reimbursements of any of the above expenses by the employer which is used by the employee or his family members.
21. Gift, whether in cash or kind exceeding Rs. 15,000

Perquisite Taxable only in the hands of a Specified Employee

An employee is referred to as a specified employee **[Section 17(1)(c)]** if,

- Employee is Director in the employer company
- Employee has substantial interest in the employer company
- Employee has income under the head "Salary" exceeding ` 4,00,000 during the tax year.

Some perquisites ae taxable in the hands of specified employees only. For e.g. where the employer provides motor car for use by employee or his family members for personal use or both personal as well as official use, this perquisite is taxable only in the hands of specified employees. The following is the list of perquisites which are taxable in the hands of specified employees:

a) Use of motor car

b) provision of the facility of sweeper, watchman, servant etc.

c) Free or concessional education facility for members of employee household

d) Supply of gas, electric energy or water for employee's household by the employer

e) Free or concessional transport facility to employee or his family members (other than railway or airline employee)

However, it is important to note that the above perquisites shall become taxable in the hands of non-specified employees also, if these are allowed in the nature of employee's obligation being discharged by the employer. It means that the engagement of the servant is done by employee himself or taking of gas/ water connection is in the name of employee and the employer is merely fulfilling the obligation of employee. If not paid/ reimbursed by the employer, the employee would have to discharge the obligation on his own. In such cases, the value of the servant facility or gas facility shall be taxable in the hands of a non specified employee also.

VALUATION OF PERQUISITE

Now, we shall discuss the provisions relating to taxation of perquisites in detail:

VALUE OF HOUSING ACCOMMODATION

Housing accommodation may be provided by the employer to the employee. The house may be

- Furnished or unfurnished
- Rent free or at a concessional rate
- Owned by employer or hired by employer

Computation of taxable value of house –

i. **If house accommodation is provided by government to its employees,** taxable value shall be the License fee determined by Central or State Government in respect of accommodation in accordance with the rules framedby that government for allotment of houses to its officers.

ii. **If house accommodation is owned by any other employer** and provided to employees:

(Population of city as per 2001 census)	**Taxable value**
Up to 15 lakhs	5% of salary
Above 15 lakhs and up to 40 lakhs	7.5% of salary
Above 40 lakhs	10% of salary

iii. **If house accommodation is hired by employer on rent** and provided to employee, taxable value is minimum of the two –

- Actual rent paid by employer;
- 10% of salary

Notes –

(1) If the accommodation is provided by the government or by any other employee **at a concessional rate**, the value of perquisite shall be reduced by the rent actually recovered from the employee.

(2) If the accommodation is furnished, calculate the value as above and increase the calculated value by 10% of the cost of furniture or by the actual hire charges paid or payable for such furniture (if the furniture is hired from outside).

(3) Salary for this purpose = Basic Salary + DA (forming part of salary) + all other taxable allowances + bonus and commission + monetary obligation of employee paid by employer. Thus, salary should exclude the taxable value of perquisites, all retirement benefits, and advances or arrears of salary.

VALUE OF FURNITURE

Furniture provided by the employer to employee for personal use with or without house accommodation may be owned by the employer or hired by the employer. Computation of taxable value of furniture –

- If the furniture is owned by the employer: taxable value is 10% of original cost of the furniture to employer per annum.
- If the furniture is hired by the employer: taxable value is actual hire charges paid by the employer.

Illustration 6

Mr. Yash furnishes the following particulars of his remuneration for the year ending 31.03.2027:

Basic salary	` 35,000 per month
Dearness Allowance	` 12,000 per month
	(40% forms part of salary)
City Compensation Allowance	` 8,000 per annum
Lunch allowance	` 500 per month
Children Education Allowance	` 3,500 per month each for 2 children
Medical allowance	` 500 per month

He is provided with a rent-free accommodation in Delhi at the beginning of the tax year. The cost of the furniture provided is ` 1,00,000 and two air-conditioners, which have been taken on hire by the company, have also been provided in the accommodation. The hire charge of each air-conditioner is ` 2,000 per annum.

Compute the value of the rent-free accommodation provided by the Reserve Bank of India and the accommodation has been taken on rent by the RBI at ` 15,000 per month. Assume he opts to shift out of the default tax regime provided under section 202(1).

Solution

If house accommodation is hired by employer on rent and provided to employee, taxable value is minimum of the two:

- ` 1,80,000 (Actual rent paid by employer)
- ` 50,960 (10% of salary)

Thus, the value of perquisite shall be ` 50,960 + ` 14,000 (10% of 1,00,000 + 4,000) = ` 64,960

Working Note -

Salary for this purpose shall include the following:

Basic salary	(35,000 X 12)	` 4,20,000
Dearness Allowance	(12,000 X 12 X 40%)	` 57,600
CCA		` 8,000
Medical Allowance	(500 X 12)	` 6,000
Education Allowance (3,500 X 2 X 12)	` 84,000	
Less: Exemption (3,000 X 2 X 12)	` (72,000)	12,000
Lunch Allowance	(500 X 12)	` 6,000
Salary for calculating value of Rent-free Accommodation		**` 5,09,600**

Illustration 7

R furnishes the following particulars regarding his salary income for the tax year 2026-27:

Basic salary	`15,000 per month
Dearness Allowance (DA)	40% of basic salary
	(100% forms part of salary)
City Compensatory Allowance (CCA)	` 36,000 per annum
Transport Allowance	`1,000 per month

He is provided with a rent free unfurnished accommodation at the beginning of the tax year which is owned by the employer. The fair rental value of the house is ` 24,000 per annum.

Compute the value of rent free accommodation assuming accommodation is provided in a city having population:

i. Not exceeding 15 lakhs

ii. Exceeding 15 lakhs but not exceeding 40 lakhs

iii. Exceeding 40 lakhs

Solution

Calculation of rent-free unfurnished accommodation

Situations	Taxability	Amount (`)
1) Not exceeding 15 lakhs	5% of salary	15,000

2) Exceeding 15 lakhs but not exceeding 40 lakhs	7.5% of salary	22,500
3) Exceeding 40 lakhs	10% of salary	30,000

Salary for the purpose of Rent free accommodation	
Basic salary	` 1,80,000
DA	` 72,000
CCA	` 36,000
Transport Allowance	**` 12,000**
	3,00,000

VALUE OF SERVANT

Cook, watchman, cleaner, sweeper, gardener or security guard provided by the employer to employee for personal use is taxable only in the hands of specified employees. Taxable value of servant is actual expenses incurred on servant by the employer. Deduct any amount recovered from the employee for providing servant.

VALUE OF GAS/ELECTRICITY/WATER SERVICE

Computation of taxable value of gas/electricity/water service for the employee's household when –

- It is purchased from an outside agency – perquisite value= amount paid by the employer to the agency as reduced by amount paid by the employee in respect of such services.
- Supply is made from resources owned by the employer without purchasing from outside agency -- perquisite value= amount of manufacturing cost per unit incurred by the employer as reduced by any amount paid by the employee.

VALUE OF FREE OR CONCESSIONAL EDUCATION

- If free or concessional education facility is provided to any member of employee's household – The amount of expenditure incurred by employer as reduced by any amount paid or recovered from the employee
- **If free or concessional education facility is provided to any member of employee's household and educational institution is maintained and owned by the employer -** Cost of such education in a similar institution in or near the locality as reduced by any amount paid or recovered from the employee shall be considered as the taxable value of the perquisite. If the value of benefit per child is upto ` 3,000 per month, nothing shall be taxable.
- **If free or concessional education facility is provided to any member of employee's household in any other educational institution -** Cost of such education in a similar institution in or near the locality as reduced by any amount paid or recovered from the employee shall be considered as the taxable value of the perquisite. If the value of benefit per child is upto ` 3,000 per month, nothing

shall be taxable.

VALUE OF FREE OR CONCESSIONAL TRANSPORTATION

If the employer (who is engaged in carriage of passengers or goods) provides free or concessional fare for transport of passengers or goods of employee (not being an airline employee or railway employee), then the value at which such benefit is offered to the public as reduced by the amount recovered from the employee shall be considered as the taxable value of the perquisite.

VALUE OF FREE OR CONCESSIONAL LOAN

If loan is provided by employer to employees at a concessional rate or at interest free rate. The perquisite shall be the amount equal to the interest computed -

- at the annual rate charged by the State Bank of India, as on the 1st day of the relevant tax year in respect of loans for the same purpose advanced by it on the maximum outstanding monthly balance
- as reduced
- by the interest, if any, actually paid by him or any such member of his household.

However, value of the perquisite shall be nil if -

- Loan amount is up to ` 2,00,000 or
- Loan is given for meeting out expenses on medical treatment of specified diseases.

VALUE OF TRAVELLING, TOURING, ACCOMMODATION ETC.

Where travel, tour, accommodation for holiday is provided by employer , the value of perquisite shall be the amount of expenditure incurred by the employer. If this facility is made uniformly available to all employees, the perquisite value shall be nil.

VALUE OF FOOD AND SNACKS BY THE EMPLOYER

TYPE OF MEAL	TAX TREATMENT
Free food and non alcoholic beverages during working hours	Perquisite value shall be nil to the extent of ` 200 per meal.
Paid vouchers usable only at eating joints	Perquisite value shall be nil to the extent of ` 200 per meal.
Tea or snacks provided during working hours	Perquisite value shall be nil
Free food and non alcoholic beverages during working hours provided in remote area or off shore installation	Perquisite value shall be nil

VALUE OF GIFT VOUCHERS

Value of gift or voucher from an employer is taxable in the hands of an employee. However, value would be Nil, where aggregate value does not exceed ` 15,000.

VALUE OF CREDIT CARD EXPENSES

Value of any membership fee and annual fee incurred by employee and charged to a credit card which is provided by the employer or reimbursed by the employer shall be the amount of expense incurred by the employer as reduced by any amount recovered from the employee. If the same is used for official purpose, then the value of the perquisite shall be nil.

VALUE OF CLUB MEMBERSHIP FEE

If the club membership is for official use, it is not taxable but if it is for personal use, the amount of expenses paid or reimbursed by the employer is fully taxable. Use of health club, sports and similar facilities shall not be taxable perquisite if it is provided uniformly to all employees.

USE OF MOVABLE ASSETS (other than motor car)

Use of computers, laptops, tablets and mobile phones, allowed to the employee are **not taxable** perquisite.

In case use of other assets is allowed to the employee, then 10% per annum of the actual cost of such asset or the rent paid by the employer (if asset is hired), shall be the perquisite value. It shall be reduced by any amount recovered from the employee.

TRANSFER OF MOVABLE ASSET

Movable asset	Value of the perquisite
Computers, electronic items are transferred by employer	Actual cost to employer *Less*: 50% for normal wear and tear on WDV method for each completed year of use *Less:* Any amount recovered from employee = Perquisite Value
Motor car transferred by employer	Actual cost to employer *Less:* 20% for normal wear and tear on WDV method for each completed year of use *Less*: Any amount recovered from employee = Perquisite Value
Any other asset	Actual cost to employer *Less:* 10% for normal wear and tear of actual cost of asset for each completed year of use

	Less: Any amount recovered from employee = Perquisite Value

VALUE OF OTHER MONETARY OBLIGATIONS OF EMPLOYEE

Any monetary obligation of employee, which is directly paid or reimbursed by the employer, is taxable in the hands of all employees.

Illustration 8

X is employed with ABC Ltd. on a monthly salary of ` 25,000 per month. The company provides him with the following benefits:

1. A company owned accommodation is provided to him in Delhi.
2. The company has given him a housing loan of ` 5, 00,000 on 01-04-2026 on which interest is charged @ 6% per annum. The entire loan is still outstanding. (Assume the interest charged by SBI is 10% p.a.)
3. The company gave him a gift worth `15,900 on his anniversary on 21-10-2026.
4. He is allowed to use the video camera belonging to the company. The company had purchased this camera for ` 60,000 on 1.4.2023 and X used it for four months after which it was sold to him for ` 30,000 on 1.12.2026.
5. The company pays the telephone bills of ` 22,000 for the telephone installed at the residence of X.
6. Domestic servant was provided at the residence of X. Salary of domestic servant is ` 1,200 per month. The servant was engaged by him and the salary is reimbursed by the company.

Compute the Gross Income from salary of X for the tax year 2026-27.

Solution: **Computation Of Gross Salary for Tax Year 2026-27**

Basic Salary (25,000 X 12)	` 3,00,000
Value of accommodation (10% of salary)	` 30,000
Value of housing loan (4% of 5,00,000)	` 20,000
Gift in kind	` 15,900
Value of use of video camera for 4 months (60,000 X 10% X 4/12)	` 2,000
Benefit of sale of camera (60,000 – 18,000 – 30,000)	` 12,000
Telephone facility	NIL
Servant facility	` 14,400

Gross salary	` 3,94,300

Working Notes

1. Valuation of housing loan is (10% - 6%) of the loan amount.
2. Gift value exceeds ` 15,000, hence it is taxable.
3. Depreciation on camera as per straight line method for 3 complete years = 10% of 60,000 for 3 years = ` 18,000
4. Benefit of sale of camera is purchase amount after deducting depreciation of 3 years and the amount recovered.
5. Telephone expenses are fully exempt.
6. The expenses of servant are fully taxable.

VALUE OF CAR

Computation of taxable value of car when –

1. **Car is owned or hired by employer and is used by employee:**
   - **Only for official use :** Not taxable, if specified documents are maintained.
   - **Only for personal use by him and his family:** Taxable Value = All running and maintenance expenses on car paid or reimbursed by the employer + depreciation @ 10% (if car is owned by the employer) + Salary of driver (–) amount recovered from employee
   - **Partly for personal use by him and his family, and partly for official use** – Taxable value shall be computed as follows –
     - **If running and maintenance expenses are incurred by employer**

SPECIFICATIONS OF CAR	TAXABLE VALUE
Cubic capacity upto 1.6 litres or car is an electric vehicle	` 5000 per month + ` 3000 for driver
Cubic capacity more than 1.6 litres	` 7000 per month + ` 3000 for driver

     - **If running and maintenance expenses are incurred by employee**

SPECIFICATIONS OF CAR	TAXABLE VALUE
Cubic capacity upto 1.6 litres or car is an electric vehicle	` 2000 per month + ` 3000 for driver
Cubic capacity more than 1.6 litres	` 3000 per month + ` 3000 for driver

2. **If car is owned or hired by the employee and running and maintenance expenses are incurred by the employer and car is used by employee**

- **Only for official use:** Not taxable
- **Partly for official use and partly for personal use by him and his family:** Taxable value shall be computed as follows :

SPECIFICATIONS OF CAR	TAXABLE VALUE
Cubic capacity upto 1.6 litres or car is an electric vehicle	Actual running and maintenance expenses incurred by the employer – (` 5000 per month + ` 3000 for driver)
Cubic capacity more than 1.6 litres	Actual running and maintenance expenses incurred by the employer – (` 7000 per month + ` 3000 for driver)

Illustration 9

During the tax year 2026-27, Mr. Nitin enjoyed the following allowance/perquisites in addition to a basic salary of ` 30,000 per month:

1. Car facilities (1.6 litre) for private and official purposes. All expenses which are ` 1,50,000 (including salary of the driver) borne by the employer. Mr. Nitin was made to pay a token amount of ` 500 per month for the same. Car is owned by the employer.
2. Loan of ` 5,00,000 (for personal purposes) @10% p.a. received on 01-06-2026. It was repayable in 5 half yearly installments of equal amount starting from 31-12-2026. SBI charges 16% p.a. for similar loans.

Compute Gross Salary of Mr. Nitin for tax year 2026-27.

Solution

Basic salary	(30,000 X 12)	` 3,60,000
Car Facility	((5000 + 3000) X 12)	` 96,000
Less: Amount recovered from employee	(500 X 12)	` (6,000)
Concessional interest on loan	(17,500 + 6,000)	` 23,500
GROSS SALARY		**` 4,73,500**

Working Notes

1. Car facility when expenses are paid by the employer and car is used by employee both for official and personal purposes, the taxable amount is ` 5000 per month and ` 3000 per month, if driver is also provided.
2. Interest on loan is taxable as per the rate fixed by SBI in excess of the concessional rate at

which the employee gets the loan. Therefore, in this case the interest will be calculated at 6% (16-10).

3. Calculation of interest on loan (01-06-2026 to 31-03-2027):

   7 months interest = 5,00,000 @ 6% X 7/12 = ` 17,500

   3 months interest = 4,00,000 @ 6% X 3/12 = ` 6,000

VALUE OF LEAVE TRAVEL CONCESSION (LTC)

Where an employer provides leave travel assistance to an employee or to his family for travel to any place in India, the amount incurred on travel is exempt.

Leave travel concession is exempt for 2 journeys in a block of four years and concession is for the employee and his family members (spouse, children of employee and parents, brothers and sisters who are wholly or mainly dependent on employee). The exemption is provided as follows:

Mode of journey	**Amount of exemption**
Travel by air	Exemption shall not exceed the fare by the shortest route, admissible for the class of travel to which the employee is entitled
Travel by rail	Air conditioned first class rail fare by the shortest route
Travel where there is no rail connectivity	a) where recognised public transport system exists, first class or deluxe class fare by the shortest route b) where no recognised public transport system exists, ` 30 per km for the distance of the journey by the shortest route.

If an employee does not avail leave travel concession during a particular block, they can carry over **one** journey to the first year of the immediately succeeding block. For this purpose, block shall consist of year from 2022 to 2025 and from 2026 to 2029.

Also, the exemption shall not be available to more than two surviving children of an individual after 1.10.1998. However, this rule does not apply to those born before 1.10.1998 and also in case of multiple births after one child.

Note - This exemption is available only if the employee exercises the option of shifting out of the default tax regime.

VALUE OF CONTRIBUTION TO PROVIDENT FUND OR PENSION FUND OR OTHER WELFARE FUNDS

If the total contribution by the employer to Recognised Pension Fund + Notified Pension Scheme + Approved Superannuation Fund exceeds ` 7,50,000 in a year, the excess is taxable as a perquisite.

VALUE OF MEDICAL FACILITY

i. **Value of medical treatment in any hospital maintained by the employer:** The value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer; shall not be a taxable perquisite.

ii. **Reimbursement of expenditure actually incurred on medical treatment:** Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family

- in any hospital maintained by the Government/local authority/any other hospital approved by the Government for the purpose of medical treatment of its employees;
- in respect of the prescribed disease or ailments in any hospital approved by the Principal Chief Commissioner or Chief Commissioner having regard to the prescribed guidelines.

shall not be a taxable perquisite.

iii. **Premium paid to effect an insurance on the health of employee:** Any premium paid by an employer in relation to an employee to effect an insurance on the health of such employee. However, any such scheme should be approved by the Central Government or the Insurance Regulatory Development Authority (IRDA).

iv. **Reimbursement of premium paid to effect an insurance on the health of employee or for the family of an employee:** Any sum paid by the employer in respect of any premium paid by the employee to effect an insurance on his health or the health of any member of his family under any scheme approved by the Central Government or the Insurance Regulatory Development Authority (IRDA)for the purposes of section 126.

v. **Amount paid towards expenditure incurred outside India on medical treatment:** Any expenditure incurred by the employer or any sum paid by the employer on any expenditure actually incurred by the employee on the following:

(a) medical treatment of the employee or any member of the family of such employee outside India;

(b) travel and stay abroad of the employee or any member of the family of such employee for medical treatment;

(c) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment.

Conditions:

1. The perquisite element in respect of expenditure on medical treatment and stay abroad will be exempt only to the extent permitted by the RBI.
2. The expenses in respect of traveling of the patient and the attendant will be exempt if the employee's gross total income as computed before including the said expenditure does not exceed ` 8,00,000.

Note: For this purpose, family means spouse and children of the individual. Children may be dependent or independent, married or unmarried. It also includes parents, brothers and sisters of the individual if they are wholly or mainly dependent upon him.

Hospital includes a dispensary or a clinic or a nursing home.

Illustration 10

Mr. Raghav employed in XYZ Co. Ltd. as Finance Manager, gives the list of perquisites provided by the company to him for entire tax year 2026-27:

1. Medical facility given to his family in a hospital maintained by the employer company. The estimated value of benefit derived from such facility is ` 30,000.
2. Domestic servant was provided at the residence of Mr. Raghav. Salary of domestic servant is ` 1,200 per month. The servant was engaged by him and the salary is reimbursed by the company.
3. Free education was provided to his two children in a school maintained and recovered by the company for such education facility from Raghav. (` 3,200 p. m. of one child and ` 800 of the other)
4. The employer has provided movable assets such as television, refrigerator and air conditioner at the residence of Raghav. The actual cost of such assets provided to the employee is ` 1,50,000.
5. A gift voucher worth ` 20,000 was given on the occasion of his marriage anniversary. It is given by the company to all employees above certain grade.

Compute the total value of taxable perquisites of Mr. Raghav for the tax year 2026-27.

Solution

Computation of total value of taxable perquisites

Medical facility	Fully exempt
Servant facility (1,200 X 12)	` 14,400
Education facility (3200 X 12)	` 38,400
Movable assets (10% of 1,50,000)	` 15,000
Gift	` 20,000
Total	**` 87,800**

Working Notes

1. Medical facility is fully exempt from tax if expenses are reimbursed by the employer and the treatment is taken in a hospital maintained by the employer itself.
2. The salary of the servant which is paid or reimbursed by the employer if fully taxable.

3. Education facility of children in excess of ` 3,000 p.m. per child is taxable. Since the education expenses of one child is less than ` 1,000 it is exempted.
4. Taxable value of movable assets is 10% of the cost.
5. Gift exceeding `15,000 is taxable.

Illustration 11

Compute the taxable value of the perquisite in respect of medical facilities availed of by X from his employer in the following situation:

i. The employer maintains a hospital for the employees where they and their family members are provided free treatment. The expenses on treatment of X and his family members during the tax year 2026-27 were as under –

   a. Treatment of X ` 8,000

   b. Treatment of X"s widowed sister `3,500 (Dependent upon him)

   c. Treatment of X"s uncle ` 5,000

   d. Treatment of X"s major son `4,200 (Dependent upon him)

   e. Treatment of Mrs. X ` 4,800

   f. Treatment of X"s handicapped nephew ` 1,300

ii. The following expenses on treatment of X"s major son outside India were paid by the employer.

	Actual Expenses	Expenses permitted by RBI
a. Actual medical expenses	` 64,000	` 58,000
b. Travelling expenses of X"s son and X"s brother	` 1,40,000	-
c. Expenses on staying abroad of X"s son and brother who accompanied the patient	` 65,000	` 45,000

iii. The employer pays an insurance premium of ` 3,000 under a health insurance scheme on the health of X.

iv. Expenses on cancer treatment of married daughter of X at R.M.L Hospital (an approved hospital for this purpose) paid by the employer ` 50,000.

v. The employer reimburses the following medical expenses –

   a. Treatment of X"s mother (dependent upon him) ` 1,500 by a private doctor

   b. Treatment of X"s grandfather (dependent upon him) ` 2,400

c. Treatment of X by his family physician ` 3,100

d. Treatment of X"s brother (not dependent on him) ` 1,000

e. Treatment of Mrs. X in a private nursing home ` 4,200

Solution

i. The expenses of medical treatment of the employee and his family members in a hospital maintained by the employer are tax-free. Therefore, an expense on treatment of X, X"s widowed sister, Mrs. X and X"s major son is not taxable. Only the following expenses are taxable –

- Treatment of X"s uncle ` 5,000
- Treatment of X"s handicapped nephew ` 1,300

Thus, taxable perquisite = ` 6,300 (5,000 + 1,300)

ii. In respect of medical treatment outside India, the expenses on actual treatment and on staying abroad (of the patient and one attendant) are exempt from tax to the extent permitted by R.B.I. i.e., up to ` 58,000 and ` 45,000 respectively. Therefore, balance ` 6,000 and ` 20,000 shall be taxable perquisite. Expenses of travel are exempt only if the gross total income of the employee is up to ` 8,00,000.

iii. Payment of insurance premium on the health of the employee is a tax-free perquisite.

iv. Expenses on medical treatment of the employee/family members in respect of prescribed diseases, in any hospital approved by the Chief Commissioner of Income-tax, are tax free.

v. Any sum paid by employer in respect of any amount actually incurred by the employee for obtaining his or his family member"s medical treatment either in any hospital, nursing home, clinic or otherwise is taxable. Hence entire expenditure reimbursed by the employer i.e., ` 12,200 is taxable in the hands of Mr. X.

Illustration 12

Ms. Nitu, a software engineer in WIPRO, submits the following particulars of her income and contribution, etc., for the year ending 31.03.2027. Compute income under the head salary for the tax year 2026-27:

1. Basic salary of ` 40,000 per month.
2. Dearness Allowance of 30% of salary (60% forming part of retirement benefits).
3. Children education allowance of `3,200 per month per child, for two children.
4. Free lunch for 300 days in office during office hours; @`260 per meal.
5. Gift of washing machine of ` 20,000 (purchased price).
6. Rent free unfurnished accommodation provided at New Delhi. Its lease rent is ` 25,000 per month.

7. Motor car of 1800 CC with driver was provided both for official and private use throughout the year. It costs the company ` 2,00,000 annually.

8. Telephone facility provided at her residence which cost the employer ` 24000 annually.

9. Cost of medical facility provided to Ms. Nitu and her family at a private nursing home amounted to ` 40,000 were borne by the employer.

10. Her employer provided her with interest free loan of `18,000 for personal use.

Assume that the employee has decided to opt out of the default tax regime u/s 202(1).

Solution

Basic salary	(40,000 X 12)	` 4,80,000
Dearness Allowance	(30% of 4,80,000)	` 1,44,000
Education allowance	(3200 X 2 X 12)	` 76,800
Less: Exemption	(3000 X 2 X 12)	` (72,000)
Free lunch	(260 X 300)	` 78,000
Less: Exemption	(200 X 300)	` (60,000)
Value of gift in kind		` 20,000
Motor car	(7000 + 3000) X 12)	` 1,20,000
Telephone facility		NIL
Rent free unfurnished accommodation		` 57,120
Medical facility		` 40,000
Interest free loan		**NIL**
GROSS SALARY		` 8,83,920
Less: Deduction u/s 19(1)		(50,000)
Income under the head salary		` 8,33,920

Working Notes

1. Dearness allowance is fully taxable.
2. Education allowance of ` 3000 per month per child is exempted.
3. Lunch of `200 per meal is exempted.
4. Gifts above ` 15,000 are taxable.
5. Telephone facility is a tax free perquisite.

6. Reimbursement of medical treatment in a private nursing home is taxable .

7. Loan provided to employee is exempt from tax since the amount of loan is less than ` 200,000.

8. Salary (for calculation of RFA) = 4,80,000 + 86,400 + 4,800 (basic + DA forming part of retirement benefits + education allowance) = ` 5,71,200

9. Rent free unfurnished accommodation is taxable value minimum of the two limits –

   i. ` 3,00,000 (Actual rent paid by employer)

   ii. ` 57,120 (10% of salary, where salary is basic + DA forming part + allowance)

Illustration 13

Compute the income under the head "Salaries" of Sohan for the tax year 2026-27 from the following information:

1. Basic salary of ` 38,000 per month.
2. Dearness Allowance of `12000 per month (60% of which is part of retirement benefits).
3. Children Education Allowance `3,200 per month each for two children.
4. Free lunch for 300 days in the office during office hours of `275 per meal.
5. Reimbursement of expenses incurred on credit card for personal use provided by the employer of ` 10,000.
6. Gift of Rolex watch of ` 20,000.
7. Rent free unfurnished accommodation at Pune, the rent paid by employer is ` 2,40,000 per annum.
8. Motor car of 1.8 litre with driver both for official and private purposes.
9. Servant facility by the employer. Wages of servant paid by employer is ` 2,500 per month.
10. Telephone facility at his residence. The employer has incurred expenses of ` 24,000 for the same.
11. Assume he opts to shift out of the default tax regime.

Solution

Basic salary	**(38,000 X 12)**	**` 4,56,000**
Dearness Allowance	(12,000 X 12)	` 1,44,000
Education allowance	(3200 X 2 X 12)	` 76,800
Less: Exemption	(3000 X 2 X 12)	` (72,000)

Free lunch	(275 X 300)	` 82,500
Less: Exemption	(200 X 300)	` (60,000)
Credit card expenses reimbursed		` 10,000
Value of gift in kind		` 20,000
Motor car	[(7000 + 3000) X 12]	` 1,20,000
Servant facility	(2,500 X 12)	` 30,000
Telephone facility		NIL
Rent free unfurnished accommodation		` 54,720
GROSS SALARY		**` 8,62,020**
Less: Standard deduction u/s 19(1)		50,000
Income under the head Salary		**` 8,12,020**

Working Notes

1. Dearness allowance is fully taxable.
2. Education allowance of `3000 per month per child is exempted.
3. Lunch of `200 per meal is exempted.
4. Credit card expenses reimbursed are taxable.
5. Gifts above ` 15,000 are taxable.
6. Expenses incurred for servant facility by employer is taxable.
7. Telephone facility is a tax-free perquisite.
8. Rent free unfurnished accommodation is taxable value minimum of the two limits –
   i. ` 2,40,000 (Actual rent paid by employer)
   ii. ` 54,720 (10% of salary, where salary is basic + DA forming part + allowance)

PROFITS IN LIEU OF SALARY [SECTION 18]

Profit in lieu of or in addition to salary or wages is the extra monetary benefit related to employment, especially given at the time of joining, leaving or modifying the terms of employment. Even if the amount is received after leaving the employment, it can still be taxed as salary, if it arises from employment.

Example - If an employee receives Rs. 5,00,000 as compensation for early termination of employment, it will be treated as profit in lieu of salary and taxed under the head "Salaries".

Knowledge Assessment – II

(A) Choose the correct answer:

1. R Ltd. provides the facility of cook to its employee for which it paid ₹ 1,000 per month as salary to the cook. The valuation of this perquisite shall be –

   a) ₹ 120 per month

   b) ₹ 1,000 per month

   c) ₹ 60 per month

2. The employer has provided a motor car of 1.5 litre capacity to his employee that the employee is allowed to use for official purpose. The expenses of running and maintenance of motor car are met by the employer. The value of this perquisite shall be –

   a) ₹ 1,800 per month

   b) NIL

   c) ₹ 2,400 per month

3. The employer provides free facility of Watchman, Sweeper and Gardener to his employees. It will be a perquisite for –

   a) Specified employee only

   b) Employees other than specified employees

   c) Specified employees and other employees, if their obligation is discharged by employer.

4. Salary of an employee is ₹ 2,00,000. Rent paid by the employer for the unfurnished house provided to employee at Mumbai is ₹ 3,000 per month. The employer charges ₹ 2,000 per month as rent from the employee. The valuation of this perquisite shall be –

   a) ₹ 16,000

   b) ₹ 6,000

   c) ₹ 12,000

   d) NIL

Answers: 1 (b), 2 (b), 3 (c), 4 (d)

(B) Fill the correct answer:

1. The gardener, sweeper and the watchman are employed by the employee but their salary of ₹ 500 per month per person is paid by the employer. The valuation of this perquisite shall be ₹ _____________.

2. Where gas or electricity is provided by the employer to the employee free of cost, the value of such perquisite shall be _____________.

3. Leave travel concession is exempt to the maximum of _____________________journeys in a block of _________________________________ years.

4. Meal provided to employee in the office by the employer shall be exempt up to a maximum of ___per meal.

Answers

1) 18,000 2) expenses incurred by employer 3) Two, Four 4) ₹ 200

SESSION 4: BENEFITS RECEIVED AFTER RETIREMENT FROM EMPLOYER AND OTHER DEDUCTIONS UNDER SECTION 19(1)

To ensure that employee and his family live a reasonable standard of life, employer makes several provisions and pay benefits to the employee after retirement. Such benefits are:

- Salary in lieu of leave/Leave encashment
- Gratuity
- Pension
- Provident fund
- VRS compensation
- Retrenchment compensation

Important Points:

- Leave salary means salary received for leave not availed by the employee.
- Gratuity means a lump sum amount paid by employer to employee on retirement or resignation or retrenchment or death, as a reward for sincerity and continuous service rendered by him. Payment of gratuity is compulsory for certain class of establishments under the Payment of Gratuity Act, 1972.

- Pension is received by employee after retirement. It is a regular payment made by the employer. It may be payable monthly or quarterly or annually or it may be commuted by employee to get a lump sum amount.

  Note - *In respect of retirement benefits such as gratuity, pensions, leave salary deduction is available from gross salary, which we will be discussing in the part pertaining to Deductions from Gross Salary under section 19.*

- Provident fund is an account where employee and employer contribute every month a specific percentage of salary for the benefit of employee. This amount is invested monthly in the designated securities which earn interest. Every month this amount accumulates and increases and at the time of retirement, this amount is paid to the employee. This has four components –
  - Employer"s contribution
  - Employee"s contribution
  - Interest on employer"s contribution
  - Interest on employee"s contribution

PROVIDENT FUND

Provident Fund is a fund which is created to help an individual in future i.e. after retirement or death. The employee contributes certain amount every month out of his salary and an equal amount is contributed by the employer. The contributions of both are invested in gilt-edged securities. Interest earned is also credited to the provident fund account of employee. There are four types of provident fund accounts –

1) Statutory Provident Fund (SPF)
2) Recognized Provident Fund (RPF)
3) Unrecognized Provident Fund (URPF)
4) Public Provident Fund (PPF)

Statutory Provident Fund (SPF)

This fund is mainly for Government/University/Educational Institutes (affiliated to university) employees.

Recognized Provident Fund (RPF)

This scheme is applicable to an organization which employs 20 or more employees. An organization can also voluntarily opt for this scheme. All RPF schemes must be approved by the approving authority of the Income Tax.

Unrecognized Provident Fund (URPF)

Such schemes are those that are started by employer and employees in an establishment, but are not approved by the approving authority of Income Tax. Since they are not recognized, URPF schemes have a different tax treatment as compared to RPFs.

Public Provident Fund (PPF)

This is a scheme under Public Provident Fund Act, 1968. In this scheme even self-employed persons can make a contribution. This fund is made by the Government of India for the purpose of promoting savings among the general public. It has no relation with any employee or employer or salary. Every person opens an account for himself. The individual gets every year deduction u/s 123 on the amount deposited in this fund account, where an employee exercises the option of shifting out of the default tax regime. Interest is credited to the account every year on rates fixed by the government. This amount is repayable along with interest after minimum specified period (15 years). The whole amount received at the time of withdrawal is fully exempt from tax.

Type of PF	Employer's contribution	Employee's contribution	Interest on employer's contribution	Interest on employee's contribution	At the time of withdrawal of amount, at the time of retirement or resignation
SPF	Exempt from tax in the hands of employee. Not to be included in his gross salary.	Employee gets deduction u/s 123 on his contribution within the limits of section of `1,50,000, if employee opts out of the default tax regime	It is exempted at the time of credit into account and not included in taxable salary of employee.	Exempt subject to certain conditions **(Refer note below)**	Entire amount is exempt from tax in the hands of employees.
RPF	Not taxable except when aggregate employer's contribution in RPF, approved super annuation fund and notified	Employee gets deduction u/s 123 on his contribution within the limits of section of `1,50,000, if employee	It is exempted up to 9.5% per annum at the time of credit into account and not Included in taxable salary of employee. Excess credit is taxable as	Same as interest on employer"s contribution.	Entire amount is exempt from tax subject to certain conditions.

	pension scheme exceeds ` 7,50,000 in a tax year	opts out of the default tax regime	salary income. This interest is calculated as percentage of amount invested. (Refer note below)		
URPF	It is totally exempt at the time of deposit into the account	Employee does not get deduction u/s 123 on his Contribution, since it unrecognized by the income tax department, even if employee opts out of the default tax regime	It is totally exempted at the time of credit into account and not included in taxable salary of employee.	Same as Interest on employer‟s contribution	**Employer's contribution:** This amount is fully taxable at the time of withdrawal from fund as salary income. **Employee's contribution:** since this amount is already part of taxable income, it is exempted at the time of withdrawal from fund. **Interest on employer's contribution:** this amount is fully taxable at the time of withdrawal from fund as salary income. **Interest on employee's contribution:** this amount is fully taxable at the time of

					withdrawal from fund as interest income under the head "income from other sources".

Note: *However, where employee's/persons yearly contribution made on or after 1.4.2021 exceed Rs 5,00,000 (where no contribution is made by employer) and ` 2,50,000 in other cases, entire interest accrued during the tax year on such exceeding contribution would be taxable.*

NEW PENSION SCHEME (NPS)

NPS is applicable to new entrants to Government service or any other employer. As per scheme, it is mandatory for persons entering the service on or after 1st January, 2004, to contribute 10% of salary every month towards NPS. Similarly, same amount is contributed by the employer to the employee NPS account.

DEDUCTION FROM GROSS SALARY

Section 19(1) provides deductions from the gross salary in respect of the following:

PROFESSIONAL TAX

1. Any sum paid by the assessee upto Rs.2,500 on account of tax on employment is allowable as deduction.

2. In case professional tax is paid by employer on behalf of employee, the amount paid shall be included in gross salary as a perquisite and then deduction can be claimed.

Note - Deduction would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 202(1).

STANDARD DEDUCTION

Under default tax regime u/s 202(1), a deduction upto ` 75,000 or the amount of salary, whichever is lower is allowed from the gross salary computed.

Where an assessee opts to shift out of the default tax regime u/s 202(1), a deduction upto ` 50,000 or the amount of salary, whichever is lower is allowed from the gross salary computed.

LEAVE SALARY OR SALARY IN LIEU OF LEAVE

Leave salary received during the service or employment is fully taxable as part of salary income. If leave is accumulated and salary in lieu of leave is received at the time of retirement and the employee is a –

- **Government employee** (Employee of Central and State government employees) : fully allowed as deduction

- **Non-government employee** – least of the four amounts is allowed as deduction:
  - Actual amount received of salary in lieu of leave on retirement
  - ` 25,00,000
  - 10 months * average salary of last 10 month immediately preceding retirement.
- Cash equivalent of leave salary to his credit at the time of retirement – Earned leave entitlement cannot exceed 30 days for each year of actual services rendered for the employer
- Salary for this purpose shall include Basic + DA (forming part of salary) + commission (as percentage of turnover achieved by the employee).
- Last incomplete year of service for the fourth amount, for counting completed years is ignored.

GRATUITY

Gratuity means a lump sum amount paid by employer to employee on retirement or resignation or retrenchment or death, as a reward for sincerity and continuous service rendered by him.

Gratuity received during the service or employment is fully taxable as part of salary income. If gratuity is received at the time of retirement, then deduction in respect of gratuity would be as follows:

Payment of retiring gratuity received under the Pension Code or Regulations applicable to the members of defence services	**Employees covered under Gratuity Act, 1972**	**Other employees, not covered in Gratuity Act – Gratuity received on retirement, employee becoming incapacitated before such retirement or termination of employment -**
Fully allowed as deduction	Minimum of the following three amounts will be deductible – 1) Gratuity received 2) `20,00,000 (Statutory limit) 3) Salary last drawn * Number of completed years * 15/26	Minimum of the following three amounts will be deductible – 1) Gratuity received 2) ` 20,00,000 (Statutory limit) 3) Average salary * number of completed years * 1/2

For this purpose, salary shall include	Basic + DA	Basic + DA (forming part of salary) + commission as a fixed percentage of turnover

- For employees covered by Gratuity Act, incomplete year of service is considered as full year only if more than six months is completed.

  For example: If a person retires after serving for 16 years and 7 months, then completed years of service will be taken as 17 years.

- For employees not covered by Gratuity Act, incomplete year of service is not considered even if more than six months is completed.

  For example: If a person retires after serving for 16 years and 9 months, then completed years of service will be taken as 16 only.

- **For employees not covered by Gratuity Act,** average salary means average salary for the ten months immediately preceding the month in which the employee has retired.

- **Death-cum-retirement gratuity received:** Entire amount allowed as deduction.

Illustration 14

Mr. Ram Bahadur retires on 04-01-2027 after serving ABC Ltd. for a period of 16 years and 11 months. At the time of retirement his basic salary was ` 44,000 per month and he was also entitled to Dearness Allowance of ` 8,000 per month. On his retirement, he received ` 6,00,000 as gratuity. Compute the amount of deduction in respect of gratuity. He is covered under the Payment of Gratuity Act.

Solution

The deduction shall be to the extent of the least of the following three amounts –

i. ` 6,00,000 (amount of gratuity received)

ii. ` 5,10,000 (15 days salary for every year of service i.e., 52000/26 X 15 X 17)

iii. ` 20,00,000

Therefore, ` 5,10,000 shall be deductible.

Illustration 15

X has been working with two companies: ABC Ltd. and PQR Ltd. The following particulars are given to you:

ABC Ltd.	
Date of retirement	During tax year

Service	30 years
Gratuity received	` 3,00,000
Salary	Total salary during 10 months prior to the month of retirement has been ` 1,50,000

X is not covered under the Payment of Gratuity Act, 1972 and the act is not applicable in this case. Compute deduction in respect of gratuity for the current tax year 2026-27.

Solution

Deduction for gratuity is least of the following:

Half month"s average salary for each year"s completed service, i.e. (15,000/2 X 30)	` 2,25,000
The maximum limit of ` 20,00,000	` 20,00,000
Actual gratuity received	` 3,00,000

Hence, ` 2,25,000 (least of the three) is the deduction in respect of gratuity.

Working notes:

Salary = average salary of 10 months immediately preceding the month of retirement

= total salary received during 10 months / 10

= 1, 50,000 / 10

= ` 15,000

PENSION

Sometimes employer agrees to pay commute pension. Commutation means payment of one-time lump sum amount in place of regular payment. Full or part of pension may be commuted.

- Uncommuted pension is fully taxable in the hands of all employees.
- Commuted pension is fully allowed as deduction in the hands of government employees.
- Taxability of commuted pension, in case of non-government employees, depends upon whether employee has received gratuity at the time of retirement –
  - If employee has received gratuity at the time of retirement, commuted pension is exempted to the limit of 1/3rd of commuted value of full pension.
  - If employee has not received gratuity at the time of retirement, commuted pension is exempted to the limit of ½ of commuted value of full pension.

TAXABILITY OF RETRENCHMENT COMPENSATION

Deduction for Retrenchment compensation shall be minimum of the following:

- 15/26 * average salary of last 3 months * number of completed years of service and part thereof in excess of six months [this amount is calculated in accordance with the provisions of the Industrial Disputes Act, 1947]
- ` 5, 00,000 or such sum as may be notified by the Central Government.
- Compensation received

TAXABILITY OF VOLUNTARY RETIREMENT SCHEME (VRS) COMPENSATION

This compensation is based on the remaining part of service and the deduction is minimum of the following four amounts –

- Actual amount received as VRS compensation.
- ` 5,00,000

For this purpose, salary = Basic + DA (if it forms part of salary for retirement benefits) + commission (as fixed percentage on turnover)

Illustration 16

Mr. Manoj is getting a pension of ` 3,000 per month from a company. During the tax year he got his two-third pension commuted and received ` 1,40,000. He is not a government employee. Compute the amount of deduction in respect of pension, if

(a) he also received gratuity

(b) he did not received gratuity, for the tax year 2026-27.

Solution

b. When Mr. Manoj received gratuity:

Commuted value of 2/3 pension	= ` 1,40,000
Commuted value of full pension (1,40,000 X 3/2)	= ` 2,10,000
Commuted value of 1/3 pension	= ` 70,000

Hence, deduction will be ` 70,000 and the balance of ` 70,000 (1, 40,000 – 70,000) is taxable.

c. When Mr. Manoj does not receive gratuity:

Commuted value of 2/3 pension	= ` 1,40,000
Commuted value of full pension (1,40,000 X 3/2)	= ` 2,10,000
Commuted value of ½ pension	= ` 1,05,000

Hence, deduction will be ` 1, 05,000 and the balance (1, 40,000 – 1, 05,000) ` 35,000 is taxable.

Illustration 17

Mr. Jagan is a manager of a company in Delhi. He retires from service on 31st December 2026 after 28 years and 9 months of service. Other details are as follows for the tax year 2026-27:

1. Basic salary of ` 25,000 per month.
2. House Rent Allowance of ` 8,000 per month. Rent paid by him ` 10,000 per month.
3. Lunch allowance ` 100 per day for 100 days.
4. Reimbursement by the company of salary of a cook and a watchman ` 3,000 per month each who are provided to Mr. Jagan
5. He receives ` 20,00,000 as gratuity. He was drawing a salary of ` 25,000 since 1st January, 2026. He is not covered under the Payment of Gratuity Act.
6. After retirement he is in receipt of pension @ ` 10,000 per month. On 1st March 2027 he gets one half pension commuted for `12,00,000.
7. During the tax year he deposited ` 80,000 in PPF. He paid the life insurance premium ` 5,000 (sum assured ` 1, 00,000) on the policy taken on the life of his married son.

Compute his salary income chargeable to tax for the tax year 2026-27, assuming he pays tax under the default tax regime provided under section 202(1).

Solution

		Amount (`)
Basic salary	(25,000 X 9)	2,25,000
Lunch Allowance	((100 X 100)	10,000
House Rent Allowance	(8,000 X 9)	72,000
Cook, watchman facility	**((3,000 + 3,000) X 9)**	**54,000**
Gratuity		20,00,000
Commuted pension		12,00,000
Uncommuted pension	(10,000 X 2 + 5000 X 1)	25,000
Gross Salary		**35,86,000**
Deductions u/s 19(1):		
Standard Deduction		(75,000)
Deduction for pension		(8,00,000)
Deduction for gratuity		(3,50,000)
Income chargeable as salary		**23,61,000**

Working note

1. HRA is fully taxable under default regime.
2. Least of the following is deductible in respect of gratuity –

(a) ` 20,00,000 (actual gratuity received)

(b) ` 3,50,000 (half month's salary x 28)

(c) ` 20,00,000 (maximum limit)

3. Least of the following is deductible in respect of commuted pension –

   (a) ` 12,00,000 (actual pension received)

   (b) ` 8,00,000 (1/3rd of full pension, since gratuity is received)

4. Since pension received of ` 12,00,000 is ½ of full pension, total pension is (12,00,000 X 2) = ` 24,00,000.

Knowledge Assessment – III

Choose the correct answer:

1. The maximum deduction in case of leave encashment shall be –
   a) ₹ 2,40,000
   b) ₹ 3,50,000
   c) ₹ 25,00,000
2. Gratuity shall be fully deductible in the case of –
   a) Central and State Government employee
   b) Central and State Government employee and employees of local authorities
   c) Gratuity received under Pension Code or by members of defence services.
3. Commuted pension received shall be fully deductible in case of –
   a) Government employee
   b) Government employee and employees of local authorities
   c) Government employee, employees of local authorities and members of Civil services and members of Defence services
4. For the purpose of calculating deduction of gratuity, salary shall include –
   a) Fixed commission
   b) Commission if it is a fixed percentage on turnover
   c) None of these two
5. Encashment of leave salary at the time of retirement is fully deductible in the case of –
   a) Central government employee
   b) State government employee

c) Both Central and State government employees

Answers: 1 (c), 2 (c), 3 (c), 4 (b), 5 (c)

KEYWORDS

1. **Salary:** Salary refers to the total monetary and non-monetary consideration received by an individual from an employer in return for services rendered under an employer–employee relationship. It is a comprehensive term that goes beyond just basic pay and includes various forms of compensation provided periodically or otherwise.
2. **Allowance:** Allowance is defined as a fixed quantity of money given regularly in addition to salary for meeting specific requirements of the employees.
3. **Gratuity:** Gratuity means a lump sum amount paid by employer to employee on retirement or resignation or retrenchment or death, as a reward for sincerity and continuous service rendered by him.
4. **Pension:** Pension is received by employee after retirement. It may be a lump sum amount or a regular payment made by the employer or both..
5. **Leave encashment:** Leave encashment means salary received for leave not availed by the employee.
6. **Specified employee:** An employee is referred to as a specified employee if,
   - Employee is Director in the employer company
   - Employee has substantial interest in the employer company
   - In case of any employer (company or not), employee has income under the head salary by way of monetary payment exceeding `4,00,000 during the tax year.
7. **Perquisites:** Perquisite is a facility provided by employer in kind to the employee for official use or for personal benefit or partly for official purpose and partly for private purpose**.**
8. **SPF:** Provident fund is an account where employee and employer contribute every month a specific percentage of salary for the benefit of employee. SPF is a provident fund which is mainly for Government/University/Educational Institutes (affiliated to university) employees.
9. **RPF:** This scheme is applicable to an organization which employs 20 or more employees. An organization can also voluntarily opt for this scheme. All RPF schemes must be approved by the approving authority of Income Tax.
10. **URPF:** Such schemes are those that are started by employer and employees in an establishment, but are not approved by the approving authority of Income Tax.
11. **PPF:** This is a scheme under Public Provident Fund Act, 1968. In this scheme even self-employed persons can make a contribution. This fund is made by the Government of India for the purpose of promoting savings among the general public. It has no relation with any

employee or employer or salary. Every person opens an account for himself

SUMMARY

- Section 16 of the Income-tax Act defines salary.
- The two main components of salary are allowances and perquisites.
- Allowance is a fixed quantity of money given regularly in addition to salary for meeting specific requirements of the employees.
- Specific exemptions in respect of allowances are provided for
  i. House Rent Allowance
  ii. Prescribed special allowances
- HRA is exempt under the optional tax regime to the extent of the minimum of the following three amounts -
  i. Actual HRA received by the employee in respect of the relevant period.
  ii. Excess of rent paid over 10% of the salary of the relevant period.
  iii. 40% of the salary (50% of salary in case of Mumbai, Kolkata, Delhi, Chennai, Pune, Ahmedabad, Bengaluru and Hyderabad)

  Salary for this purpose = Basic + D. A. (forming part of salary for retirement benefits + commission if fixed percentage of turnover)
- Special allowances include:
  i. Transfer aLLOWANCE
  ii. Travelling allowance
  iii. Daily allowance
  iv. Conveyance allowance
  v. Helper allowance
  vi. Academic allowance
  vii. Uniform allowance
- These special allowances are exempt as the minimum of the following two amounts:
  - Actual allowance received
  - Actual amount spent for the purposes of duties of office or employment
- Under the default tax regime, only a limited number of allowances are exempt, rest all are taxable.
- Allowances which are fully taxable are –

    i. Dearness Allowance (DA)
    ii. City Compensatory Allowance (CCA)
    iii. Medical Allowance
    iv. Lunch Allowance / Tiffin Allowance
    v. Non-practicing Allowance
    vi. Overtime Allowance
    vii. Warden Allowance
    viii. Servant Allowance

- Perquisite is any casual emolument or benefit attached to an office or position in addition to salary or wages. It is a facility provided by employer in kind to the employee for official use or for personal benefit or partly for official purpose and partly for private purpose.
- Taxable value of housing accommodation is based on several factors –
    i. Whether the house is furnished or unfurnished
    ii. Whether the house is provided rent free or at a concessional rate
    iii. Whether the house is owned by employer or hired by employer from outside
    iv. Whether the house is provided by government or not
- Taxable value of furniture is calculated in the following manner –
    i. If the furniture is owned by the employer – taxable value is 10% of original cost of the furniture to employer per annum.
    ii. If the furniture is hired by the employer – taxable value is actual hire charges paid by the employer.
- Taxable value of motor car facility to employee depends on several factors –
    i. Use of the car (official, private or both)
    ii. Cubic capacity of the car
    iii. Whether running and maintenance expenses are incurred by employer or employee.
    iv. Whether the car is owned by employee or is hired from outside
- Leave travel concession is exempt for two journeys in a block of four years and concession is for travel tickets for the employee and his family members.
- Education facility to children of employee in the school or college maintained by employer, cost of education in similar institution in or near the locality. Up to `3,000 per month per child is exempt.

- Interest credited to RPF in excess of 9.5% per annum is taxable.
- Any monetary obligation of employee, which is directly paid or reimbursed by the employer, is taxable in the hands of all employees.
- If medical treatment expenses of employee or his family member is reimbursed or directly paid by the employer and treatment is in a –

  i. Government or government approved hospital – fully exempt from tax

  ii. Hospital maintained by employer – fully exempt from tax

  iii. Private hospital or nursing home – taxable perquisite

- If medical treatment expenses of employee or his family member is reimbursed or directly paid by the employer and treatment is outside India –

  i. Cost of treatment – exempt up to amount permitted by the RBI

  ii. Lodging and boarding expenses of patient and one attendant – exempt up to amount permitted by the RBI

  iii. Cost of travel to and fro, of patient and one attendant – if GTI of employee is up to ` 8 lakhs, it is fully exempt and if it is more than ` 8 lakhs, it is fully taxable.

- Leave salary received during the service or employment is fully taxable as part of salary income. If leave is accumulated and salary in lieu of leave is received at the time of retirement and the employee is a –

  a. Government employee – fully deductible

  b. Non-government employee – least of the following amounts is deductible –

     i. Actual amount received as salary in lieu of leave on retirement

     ii. Amount fixed by the government i.e., ` 25,00,000

     iii. 10 months*average salary of last 10 month immediately preceding date of retirement.

     iv. Cash equivalent of earned leave for each completed year of service, not exceeding 30 days in a year.

- Taxability of gratuity depends on several factors –

  i. Whether employees are government employees or not

  ii. Whether employees are covered under the Gratuity Act, 1972 or not.

- Commuted pension is fully deductible in the hands of government employees.
- Taxability of commuted pension, in case of non-government employees, depends upon whether employee has received gratuity at the time of retirement –

  i. If employee has received gratuity at the time of retirement, commuted pension is deductible upto the limit of 1/3rd of commuted value of full pension.

ii. If employee has not received gratuity at the time of retirement, commuted pension is deductible upto the limit of ½ of commuted value of full pension.

- There are four types of provident fund accounts –

  i. Statutory Provident Fund (SPF)

  ii. Recognized Provident Fund (RPF)

  iii. Unrecognized Provident Fund (URPF)

  iv. Public Provident Fund (PPF)

EXERCISE QUESTIONS

Short Answer Questions

1. Define the term “Salary” as per Income Tax Act.
2. Salary is taxable either on due basis or on receipt basis. Discuss
3. Define perquisites.
4. Name some perquisites which are tax free.
5. Explain the deduction relating to standard deduction under both regimes.
6. What do you mean by “profit in lieu of salary”?
7. Briefly explain the retirement benefits available to an employee.
8. Mention any five allowances which are fully taxable under both default tax regime and optional tax regime.

Long Answer Questions

1. State different types of Provident Funds of which a salaried person may be a member and related provisions of each.
2. Write short notes on:
   (a) Provisions regarding gratuity
   (b) House Rent Allowance
   (c) Perquisites taxable only in case of specified employee
3. Discuss the mode of computation of taxable value of rent free accommodation.
4. Discuss the provisions regarding taxability of:
   i. Pension
   ii. Leave salary
5. Discuss the provision regarding valuation of motor car taxable in the hands of specified employees.

Numerical Questions

1. Mr. Raman receives the following incomes from A Ltd. during the year ending 31st March 2027:

Salary (@ ` 30,000 per month)	` 3,60,000
Leave travel concession (actual expenditure on rail fare: ` 14,100)	` 13,800

Tiffin Allowance (actual expenditure: ` 1,700)	` 2,000
Dearness Allowance	`12,000 per month (40% forms part of salary)
City Compensation Allowance	` 8,000 per annum
Medical allowance	`500 per month
Children Education Allowance	` 3500 per month each for 2 children

Besides, Raman enjoys the following perquisites:

- Rent free unfurnished house at Lucknow (population: 24 lakhs). House is owned by the employer.
- The employer provides two watchmen (salary ` 1,000 per month each)
- Interest free loan for purchasing home appliances (amount: ` 1,20,000; date of taking loan: 1st March, 2026. Amount outstanding between 1st April, 2026 and 30th November, 2026: ` 76,000 and after 30th November, 2026: ` 50,000). The SBI lending rate for similar loan on 1st April, 2026 is 16.75%.

Find out net income chargeable under the head salary for Raman for the tax year 2026-27 assuming he decides to opt out of the default tax regime.

(Answer: ` 5,50,698)

2. Mr. Suyash is Assistant Manager of a Textile Company of Mumbai, since 2005. He has submitted the following particulars of his income for the financial year 2026-27:

(i) Basic salary: ` 3,60,000

(ii) DA: ` 2,000 per month: 50% forms part of salary

(iii) Education Allowance: ` 2500 per month each for two children.

(iv) Entertainment Allowance: ` 700 per month

(v) Travelling Allowance for his official tours ` 30,000. The entire amount is spent on the official tour.

(vi) Gift voucher: ` 2,500

(vii) He resides in the flat owned by the company. Its market rent is ` 15,000 per month. A watchman and a cook have been provided by the company at the bungalow who are paid ` 1,000 per month each.

(viii) He has been provided with a motor car of 1.8 litre engine capacity for his official as well as personal use. The running and maintenance costs are borne by the Company.

(ix) Employer"s contribution to RPF is ` 40,000 and Contribution by Suyash to RPF is

` 40,000

(x) The interest credited to this fund at 13% rate amounted to ` 16,250.

(xi) Rent of house recovered from Suyash: ` 1,500 per month

Compute income from salaries for the tax year 2026-27. Assume the population of Mumbai is 46 lakhs and he pays tax under default scheme.

(Answer: ` 5,15,815)

3. Ms. Suman is an employee of a private college in Allahabad (whose population is 20 lakhs). She is in the grade of ` 14,500-400-16,500-600-19,500 since 01-01-2025. She gets ` 5,000 per month as DA (100% forms part of salary) and ` 500 per month as CCA. She has been provided with a furnished accommodation by the college. The college is not the owner of this house. The rental value of the house is ` 5,000 per month and the furniture costing ` 3,000 has been provided by the college. She has been given car of engine capacity of 1.8 litre which in addition to college work is used by her for private purposes. The driver"s remuneration and all the expenses relating to the use of the car are borne by the college.

She has been provided with the facility of a watchman and a servant who are paid by the college ` 500 per month each. She contributes 10% of her pay to the SPF to which the college also contributes 10%. She paid employment tax of ` 500 during the financial year 2026-27. Determine net income taxable under the head salary for the tax year 2026-27, assuming she pays tax under default scheme.

(Answer:* ` 3,15,900*)

4. Ujjwal, furnishes the following details of his salary income for his salary income for the financial year 2026-27

(i) Salary	` 20,000 per month
(ii) DA (50% forms of salary)	` 2,000 per month
(iii) Entertainment Allowance	` 2,000 per month
(iv) Employer"s and his own contribution to the RPF	10% of basic salary
(v) Interest on accumulated balance of RPF @13% p.a.	` 52,000
(vi) City Compensatory Allowance	` 200 per month
(vii) Medical Allowance	`10,000 per annum
(viii) He is provided with a car of 1.8 litre engine cubic capacity. Its expenses excluding driver's salary are met by him. The car is used for official as well as private purposes	

(ix)	He is also provided with an unfurnished accommodation in Delhi for which the employer charges ` 500 per month. The fair rent of house is ` 24,000 per annum. The house is owned by the employer.	
(x)	The employer reimburses the salary of a sweeper and a gardener @ ` 1,200 per month each. engaged by him.	
(xi)	He has also been given a loan of ` 1,00,000 @ 7% p.a. on 01-05-2026 for construction of his house. SBI rate for such loan as on 01-04-2026 is 12% p.a.	

Compute his taxable income from salary for the tax year 2026-27 assuming he pays tax under default scheme.

(Answer:* ` 3,31,623*)

5. Mr. Rocky retires on 01.01.2027 after 27 years and 9 months of service. He. has been drawing salary @ ` 10,000 per month since 01.01.2026. Dearness allowance, forming part of pay for superannuation benefits, is paid @ 10% of his salary and gets HRA of ` 2500 p.m. and pays a rent of ` 2,000 p.m.. for a flat in Delhi. He contributed to the fund 10% to the URPF and the employer contributes @ 20%. The employer also reimburses his personal club bills amounting to ` 10,000. Besides, he is paid ` 1,000 per month as transport allowance. He gets ` 75,000 as accumulated balance from the unrecognized provident fund. It consists of ` 14,000 as his contribution and ` 12,000 interests thereon. The employer's contribution is ` 27,000 and interest thereon is ` 22,000. He also gets a gratuity (not covered under the Gratuity Act) of ` 2,00,000. After retirement, he gets pension @ 5,000 per month. On 01.03.2027, he surrenders one half pension for a consolidated amount of ` 1,20,000.

   From above information you are required to compute his total income under the head Salary for the tax year 2026-27, assuming he opts to shift out of the default tax regime.

(Answer:* ` 2,35,400*)

UNIT: 3 (ii) - INCOME FROM HOUSE PROPERTY

<table>
<tr><td rowspan="2">Unit Code:</td><td colspan="4">INCOME FROM HOUSE PROPERTY</td></tr>
<tr><td colspan="4">Duration:</td></tr>
<tr><td rowspan="4">Location:
Classroom or internet</td><td colspan="4">SESSION 1: INTRODUCTION TO HOUSE PROPERTY AND COMPUTATION OF NET ANNUAL VALUE</td></tr>
<tr><td>Learning Outcome</td><td>Knowledge Evaluation</td><td>Performance Evaluation</td><td>Teaching and Training Method</td></tr>
<tr><td>1. Meaning of House Property</td><td>1. Explain the meaning of House Property
2. Explain the meaning of appurtenant lands
3. Explain the chargeability of rent received under different heads.
4. State the conditions under Section 20 to be satisfied for the income of a property to be charged under the head Income from House Property</td><td>1. Analyse the meaning of House Property
2. Differentiate between rent received for a property charged under different heads
3. Analyse the conditions to be satisfied for the income of a property to be charged under the head Income from House Property</td><td>Interactive Lecture: Introduction of House Property</td></tr>
<tr><td>2. Deemed Ownership</td><td>1. State the various cases under mentioned in Section 21, under which a person who is not the legal owner of a house property is deemed to be the owner of property</td><td>1. Explain the meaning of deemed ownership
2. Explain the various cases of deemed ownership</td><td>Interactive Lecture: Discussion of the various cases of deemed ownership

Activity:
Collection and analysis of the statement of tax paid in respect of Income from House Property by different assesses.</td></tr>
</table>

	3.Computation of Net Annual Value of House Property	1. Explain the various terms to be used for calculating the Net Annual Value of House Property 2. State and explain the procedure to calculate NAV of the House Property 3. State the categories of House Properties for the purpose computation of net annual value	1. Identify the category of House Property so as to calculate its NAV 2. Calculate the NAV in different categories	**Interactive Lecture:** Acquaint the students with the various terms and the procedure used in calculating NAV
	SESSION 2: DEDUCTIONS FROM INCOME UNDER THE HEAD HOUSE PROPERTY [SEC 22] AND OTHER PROVISIONS			
	1. Deductions under Section 24	1. State the deductions available for a House Property under Section 22	1. Calculate the standard deduction 2. Calculate the amount of interest allowed to be deducted from NAV 3. Calculate the income from House Property	**Interactive Lecture:** Acquaint the students with the deductions available under Section 22
	2. Other provisions	1. Explain the meaning of unrealized rent 2. Explain the meaning of co-ownership Explain the tax treatment of losses under the head Income from House Property	1. Explain the provisions regarding recovery of unrealized rent and treatment of arrears of rent 2. Calculate NAV in case of unrealized rent arrears of rent 3. Explain the provisions related to co-ownership	**Interactive Lecture:** Discussion provisions of unrealized

			4. Calculate Income from House property in case of co- ownership 5. Explain the set-off and carry forward of losses under the head Income from House Property through numerical questions	

(Note: The location would depend upon the topic under discussion. Major portion of the unit will be covered in classroom. The students can contact different assessees to collect and analyze the statement of tax paid in respect of Income from House Property. The students may also visit the website www.incometaxindia.gov.in to collect more information regarding the provisions for charging any income under the head Income from House Property.)

UNIT: INCOME UNDER THE HEAD HOUSE PROPERTY

***Learning Objectives*:**

After reading this unit, the students will be able to:

1. explain the meaning of house property;
2. state the cases of deemed ownership;
3. calculate the NAV of house properties under different categories;
4. calculate the deductions under Section 22 and income from house property;
5. explain the provisions of unrealized rent and arrears of unrealized;
6. explain the provisions of co- ownership;
7. explain the meaning of certain keywords.

SESSION 1: INTRODUCTION TO HOUSE PROPERTY AND COMPUTATION OF NET ANNUAL VALUE

House property consists of any building or land appurtenant thereto of which the assessee is the owner. The buildings include residential buildings (whether self- occupied or let out *for any purpose*), office building, factory building, godowns, flats, etc. as long as they are not used for business or profession by the owner.

The appurtenant lands may be in the form of approach roads to and from the public streets, motor garage, courtyard or compound forming part of the building. But such land is to be distinguished from a separate open plot of land, which is not charged under this head but under the head Income from Other sources or Profits and gains of Business and Profession, as the case may be.

It is pertinent to note that any income from letting out of a residential house or part of it by the owner shall always be chargeable under the head "Income from house property".

If a tenant sub-lets the house property, the rent received by him from the sub- tenant in respect of such house property shall be charged under the head Income from Other sources or Profits and gains of Business and Profession, as the case may be.

The situation of property is immaterial. It may be situated in India or abroad.

Example: Mr. A has a house property. It includes vast open area within its boundaries. This house has been let out at a rent of Rs. 1,00,000 p.m., out of which rent of Rs. 25,000 p.m. is attributable to the open land. In this case, entire rental income is taxable under the head house property.

BASIS OF CHARGE

Section 20 of the Act provides as follows:

"The annual value of a property consisting of any buildings or lands appurtenant thereto owned by the assessee shall be chargeable to income tax under the head "Income from House Property".

The provisions shall not apply to such portions of the property, as the assessee may occupy for his business or profession, the profits of which are chargeable to income tax."

Thus, the annual value of a property is taxable under this head if *all* the following conditions are satisfied:

1. The property should consist of any building or land appurtenant thereto.
2. The assessee should be the owner of the property.
3. The property should not be used by the owner for the purpose of any business or profession carried on by him, the profits of which are chargeable to income tax.

Unless all the aforesaid conditions are satisfied, the property income cannot be charged to tax under the head "Income from House Property".

DEEMED OWNERSHIP

As per section 25, the following persons, though not the legal owners of a property are included in the definition of "owner" for the purpose of sections 20 to 24 :

1. ***Transfer to a spouse or a minor child (a child below 18 years of age)***

If an individual *transfers* any house property to his or her spouse/ minor child without adequate consideration, the transferor in that case is considered as the owner of the transferred property. However, this would not cover cases where property is transferred to a spouse under an agreement to live apart or to a minor married daughter.

2. ***Holder of an impartible estate***

The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate. The impartible estate, as the word itself suggests, is a property which is not legally divisible.

3. ***Member of a Co-operative Society, etc.***

A member of a co-operative society, company or other AoP to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/company/association, is considered as owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building. For e.g., a flat is allotted by a cooperative society to its members who enjoy the flat. Technically the co-operative society may be the owner. However, in such situations the allottees are considered as the owners and it is the allottees who will be taxed under this head.

4. ***Person in possession of a property***

The person who acquire a house without registration in part performance of a contract under section 53A of Transfer of Property Act, 1882 shall be considered as the owner of that house property although it is not registered in his name**.**

5. ***Person having right in a property for a period not less than 12 years***

The lessee of a building is considered as owner if the building is leased out to him for 12 years or more.

COMPOSITE RENT

When the owner of the building gets along with the rent of the building, rent or hire of other assets (like furniture) or charges for different services provided in the building (e.g. charges for security, lift, air-conditioning, electricity, water, etc.), the total amount so received is called 'composite rent'. The tax treatment of composite rent is as follows:

- When composite rent is *inseparable*, i.e. the other party will not accept the letting of one without the other, then such income is taxable as 'Profits and gains of business or profession' or 'Income from other sources'.

- When composite rent is *separable*, the rent of building is taxable as 'Income from house property' and rent or hire of other assets and charges for different services is taxable under the head 'Profits and gains of business or profession' or 'Income from other sources'.

COMPUTATION OF NET ANNUAL VALUE OF HOUSE PROPERTY

The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression 'annual value' has been defined in section 21 of the Income-tax Act.

The annual value of any property would be the higher of the following -

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

(b) the actual rent received or receivable by the owner, if the property or any part of it is let.

To determine the Annual Value or Net Annual Value, the following points must be understood:

Expected Rent- This is the sum for which the property might be reasonably expected to be let out from year to year. It can be said to be the most likely rent for a house property. The Expected Rent (ER) is the higher of fair rent (FR) and municipal value (MV) but restricted to standard rent (SR).

Municipal Value - It is the value determined by the municipal authorities for levying municipal taxes on house property.

Fair Rent- It is the amount which a similar property can fetch in the same or similar locality, if it is let out for a year.

Standard Rent- It is the sum fixed under Rent control Act. The standard rent is the maximum rent, which would be permissible under the law to be charged to a tenant.

Actual Rent received or receivable - It is the rent received/receivable for the let out period.

Municipal Taxes - These include service taxes (fire tax, water tax, etc.) levied by any municipality or local authority. Deduction in respect of municipal taxes in determining the net annual value of house property will be allowed only if the following conditions are satisfied:

- The property is *let out* during the whole or any part of the tax year (The taxes are not deductible in respect of a self-occupied house property).
- These taxes must be *borne by the landlord*. (There is no such deduction if the municipal taxes are borne by the tenant).
- The municipal taxes must be *paid during the year*. (Where the municipal taxes have become due but have not been actually paid, these will not be deductible. The municipal taxes may be claimed on payment basis i.e., only in the year they were paid even if the taxes belonged to a different year).

Net Annual Value shall be computed in the following manner:

Step - 1 Determine the Gross Annual Value of the property.

Step - 2 Deduct the municipal taxes actually paid by the owner during the tax year from the Gross Annual Value to arrive at Net Annual Value.

For the purpose of computing of net annual value, properties can be classified into 3 categories:

A. Properties let out.

B. Properties occupied by the owner for residential purposes or unoccupied properties.

C. Partly let out and partly self-occupied.

D. House property held as stock-in-trade

A. PROPERTIES LET OUT

When the property is let out, the following situations may arise:

i. The property is let out for the whole of the tax year

ii. The property is let out for a part of the tax year and remains vacant for the other part.

Case 1. ***Property is let out for the whole year:***

The Gross Annual Value shall be the higher of

a) Expected Rent

b) Actual rent received or receivable

Expected rent is the higher of Municipal value and Fair Rental value but subject to Standard rent.

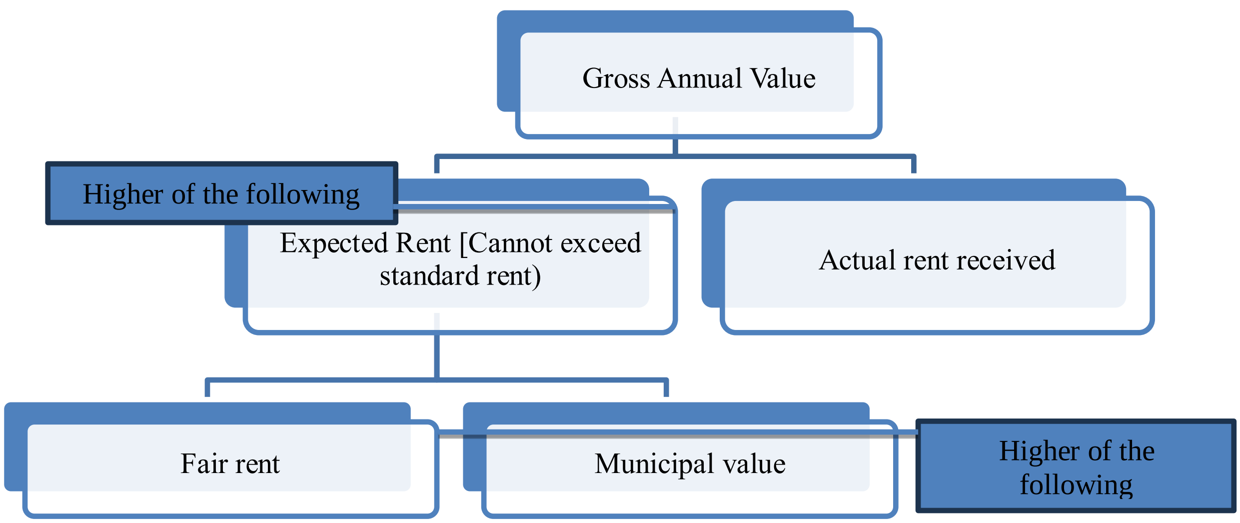

Illustration 1: Mr. A is the owner of three houses, which are all let out and not governed by Rent Control Act. Find out the GAV of each house from the given information:

Particulars	**I** **Rs.**	**II** **Rs.**	**III** **Rs.**
Municipal Value	15,000	40,000	35,000
Fair Rent	18,000	48,000	32,000
Actual Rent	16,000	56,000	30,000

Solution:

Expected Rent: Higher of Municipal Valuation or Fair Rent

House I: Rs. 18,000

House II: Rs. 48,000

House III: Rs. 35,000

Gross Annual Value (GAV): Higher of Expected or Actual Rent

House I: Rs. 18,000

House II: Rs. 56,000

House III: Rs. 35,000

Illustration 2: Mr. A is the owner of following four houses, all let out and covered under Rent Control Act. From the information given below, find the NAV in each case:

Particulars	**I** **Rs.**	**II** **Rs.**	**III** **Rs.**	**IV** **Rs.**
Municipal Value	52,000	70,000	29,000	15,000
Actual Rent	60,000	64,000	24,000	16,000
Fair Rent	56,000	60,000	36,000	18,000
Standard Rent	70,000	72,000	30,000	20,000
Municipal Taxes	10,000 (including Rs. 2,000 for an earlier year)	15,000	10,000	5,000

Solution:

All the houses are covered under Rent Control Act. Thus, Expected Rent will be higher of Municipal Value or Fair Rent but subject to Standard Rent.

Particulars	**I** **Rs.**	**II** **Rs.**	**III** **Rs.**	**IV** **Rs.**
Expected Rent	56,000	70,000	30,000	18,000
Actual rent	60,000	64,000	24,000	16,000
GAV	**60,000**	**70,000**	**30,000**	**18,000**

Less: Municipal Taxes	10,000	15,000	10,000	5,000
NAV	**50,000**	**55,000**	**20,000**	**13,000**

Case 2. ***Property is let out for a part of the tax year and remains vacant for the other part***

When the property is let out for a part of the tax year and remains vacant for the other part and the annual value declines due to such vacancy then such decline in value shall be considered and actual rent received or receivable will be the GAV of the property.

Illustration 3: Find the gross annual value of the following house property:

Expected Rent	Rs. 85,000
Rent per month	Rs. 8,000
Let out period	9 months

Solution:

Expected Rent	Rs. 85,000
Annual Rent	Rs. 96,000
Loss due to vacancy	Rs. 24,000
Actual Rent	Rs. 72,000
Gross Annual Value	Rs.72,000

In this case, the annual rent is more than the expected rent. But because of the vacancy of three months, the actual rent has fallen below the expected rent. Thus, GVA will be taken as actual rent.

B. PROPERTIES OCCUPIED BY THE OWNER FOR RESIDENTIAL PURPOSES OR UNOCCUPIED PROPERTIES

Where the property consisting of a house or any part thereof is self-occupied for **own residence** or **unoccupied due to any reason**, its Annual Value will be Nil.

But the NAV shall be considered to be nil only in respect of two of such properties as specified by the assessee if,

- The property is not actually let out during any time of the tax year, or
- No other benefit is derived from such property by the owner.

In respect of such house, the only deduction permissible against this nil income is interest on borrowed capital which can be upto Rs. 30,000 or Rs. 2,00,000, as the case may be. This point is explained later in the chapter under the heading “Deductions from Income from house property”. No other deduction (municipal taxes or standard deduction) is permissible for self-occupied property.

DEEMED LET OUT PROPERTIES

If there are more than two self-occupied houses, then the assessee may exercise an option to treat any two of the houses to be self-occupied. The other house(s) will be deemed to be let out and annual value of such house(s) will be determined as in the case of let out property. The assessee in this case, should exercise his option in such a manner that his taxable income is the minimum.

Illustration 4: Y has two houses, both of which are self-occupied. The particulars of the houses are as under:

Particulars	**Ist House Rs.**	**IInd House Rs.**	**IIIrd House Rs.**
Municipal Value	Rs.70,000	Rs.1,00,000	Rs.1,20,000
Fair Rental Value	Rs.82,000	Rs.1,30,000	Rs.1,10,000
Standard Rent	-	Rs.1,10,000	Rs.1,30,000
Municipal taxes	Rs.7,000 paid during the year	Rs.10,000 paid during the year	Rs.8,000 paid during the year

Suggest which house should be chosen by Y to be assessed as self-occupied on the basis of net annual value.

Solution:

Assume both houses to be let out

Particulars	**Deemed let out house I**	**Deemed let out house II**	**Deemed let out house III**
Gross Annual Value	Rs. 82,000	Rs.1,10,000	Rs.1,20,000

Less: Municipal Taxes	Rs.7,000	Rs.10,000	Rs.8,000
Net Annual Value	Rs.75,000	Rs.1,00,000	Rs.1,12,000

If House I and II are opted to be self-occupied, the income from house III of Rs.1,20,000 shall be taxable. If House II and III are opted to be self-occupied, the income from house I of Rs.75,000 shall be taxable. If House I and III are opted to be self-occupied, the income from house II of Rs.1,00,000 shall be taxable.

Y should opt to treat House II and III as self-occupied and House II as deemed to be let out. His income from house property would be Rs.75,000.

C. PARTLY LET OUT AND PARTLY SELF-OCCUPIED

a) A portion let out and a portion self-occupied

When a portion of the property is self-occupied for residence for the whole year and the other portion is let out for the whole year, the annual value of such property shall be determined as follows:

i. Income from any portion or part of a property which is let out shall be computed separately under the "let out property" category and the other portion or part which is self-occupied shall be computed under the "self-occupied property" category.

ii. Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion either on plinth area or built-up floor space or on such other reasonable basis.

iii. Property taxes, if given on a consolidated basis, can be bifurcated as attributable to each portion or floor or on a reasonable basis.

b) Property is let-out for part of the year and self-occupied for part of the year

The valuation of such property shall be done as if let out throughout the tax year.

Note: Actual Rent is taken only for the period it is actually let out while expected rent is always taken for the entire tax year and the gross annual value shall be higher of these two. However, municipal tax for the whole year is allowed as deduction provided it is paid by the owner during the tax year.

D. HOUSE PROPERTY HELD AS STOCK-IN-TRADE

In case of builders/construction companies, when the building or land appurtenant thereto is held as stock in trade and not let wholly or partly at any time during the tax year, then the annual value of such property or part thereof shall be Nil.

This benefit would be available upto **two** years from the end of the financial year in which certificate for completion of construction is obtained from the competent authority.

After 2 years, the property would be considered as deemed let out and charged to tax accordingly.

Illustration 5: Mr. X let out his house for 8 months for Rs. 2,000 p.m. For the remaining months it was self-occupied. Find the GAV of the house if the Expected rent of the house is Rs. 1,500 p.m.

Solution:

Actual rent (8 x Rs. 2,000)	Rs.16,000
Expected rent (12 x Rs.1,500)	Rs. 18,000
GAV	Rs. 18,000

Knowledge Assessment – I

Fill in the blanks:

1. Income from letting out of vacant land is taxable under the head Income from _______.

2. If an individual transfers any house property to his or her spouse/ minor child without adequate consideration, the ___________, in that case, is considered to be the owner of the house property so transferred.

3. Municipal taxes are allowable as deduction from the GAV if it is paid by the ______.

4. When annual value of self-occupied house is nil, the assessee will be entitled to the standard deduction @ ________________________

5. In case of multiple self occupied houses, the number of houses that can be treated as self occupied houses is (are) ___________.

Answers

1. Other sources, 2. Transferor, 3. Owner, 4. Nill, 5. Two

SESSION 2: DEDUCTIONS FROM INCOME UNDER THE HEAD HOUSE PROPERTY [SECTION 22] AND OTHER PROVISIONS

DEDUCTIONS FROM INCOME UNDER THE HEAD HOUSE PROPERTY

Income chargeable under the head 'Income from house property' is computed after making the following deductions from the Net Annual Value:

a) Standard deduction

A sum equal to 30% of NAV shall be deducted for repairs, maintenance, collection charges, etc. This sum is deducted irrespective of the actual amount paid for repairs, collection, etc. The deduction is allowed even if the actual amount paid is nil.

The assessee will not be entitled to deduction of 30%, in the following cases, as the annual value itself is nil.

(i) In case of self-occupied properties or

(ii) In case of property held as stock-in-trade and is not let wholly or partly at any time during the tax year, upto 2 years from the end of the financial year in which certificate for completion of construction is obtained from the competent authority.

b) Interest on borrowed capital

Where the property is acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such borrowed capital shall be allowed as deduction from NAV to compute the income from house property.

Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.

Interest for pre-construction period: Sometimes it happens that money is borrowed earlier and acquisition or completion of construction takes place in any subsequent year. Meanwhile interest becomes payable. In such a case interest paid/payable for the period prior to tax year in which the property is acquired/ constructed will be aggregated and allowed in five equal instalments for the said tax year and for each of the four immediately succeeding tax years. Interest will be aggregated from the date of borrowing till the end of the tax year prior to tax year in which the house is completed and not till the date of completion of construction.Interest for the year in which construction is completed/ property is acquired:

Interest relating to the year of completion of construction/ acquisition of property can be fully claimed in that year irrespective of the date of completion/ acquisition.

However, the following points must be considered in respect of interest on borrowed capital:

i. The interest is deductible on *accrual basis*. Hence it should be claimed on yearly basis even if no payment has been made during the year.

ii. Deduction of interest for self-occupied properties or unoccupied properties where annual value is NIL –

Under Default Tax regime - No deduction on account of interest on loan allowed

Under Optional Tax Regime - Assessee will be allowed a deduction on account of interest **(including 1/5th of the accumulated interest** of pre-construction period) as under –

Conditions	Amount of Deduction
(a) Where the property is acquired or constructed with borrowed capital and such acquisition or construction is completed within 5 years from the end of the tax year in which the capital was borrowed (b) the assessee furnishes a certificate from the person to whom interest is payable on such capital	Actual interest payable in aggregate for **one or two self-occupied properties**, subject to maximum of Rs. **2,00,000**
In any other case	Actual interest payable in aggregate for **one or two self-occupied properties**, subject to a maximum of Rs. **30,000**.

Illustration 6: The assessee took a loan of Rs 6,00,000 on 01/04/2024 from a bank for construction of a house. The loan carries an interest @10% p.a. The construction is completed on 15/06/2026. The entire loan is outstanding. Compute the interest allowable for the tax year 2026-27.

Solution:

- **Interest for the tax year** (in which the construction was completed, i.e. 01/04/26-31/03/27 on Rs 6,00,000 @ 10% = Rs. 60,000
- **Interest for the pre-construction period** (period from the date of borrowing till the end of the tax year prior to tax year in which the house is completed) i.e. from 01/04/2024 to 31/03/2026 (for 2 years) = Rs. 1,20,000

  1/5th is allowed for the year = Rs 24,000

  Total interest allowable = Rs. 84,000

Interest when not deductible from 'income from house property'

Interest on borrowed money which is payable outside India shall not be allowed as deduction, unless the tax on the same has been paid or deducted at source and in respect of such interest, there is no agent in India.

TREATMENT OF UNREALISED RENT IN DETERMINING ANNUAL VALUE

Unrealised rent (which was payable but not paid by the tenant) shall be excluded from rent received/receivable.

Rules for unrealised rent:

The unrealized rent shall be excluded from the rent received or receivable only if the following conditions are satisfied:

a. the tenancy is *bona fide*;

b. the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;

c. the defaulting tenant is not in occupation of any other property of the assessee;

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

Illustration 7:

Expected Rent	Rs. 1,000 p.m.
Actual Rent	Rs.1,500 p.m.
Unrealized Rent (All conditions satisfied)	For 2 months

Find GAV for the above particulars.

Solution:

Expected Rent (Rs.1,000 x 12) = Rs.12,000

Actual Rent (Rs.1,500 x 10) = Rs.15,000

GAV = Rs.15,000

ARREARS OF RENT AND UNREALIZED RENT RECEIVED SUBSEQUENTLY

Unrealised rent subsequently recovered will be deemed as income under the head 'Income from house property' and would be taxable in the year of receipt. It has been mentioned earlier that basic requirement for assessment of property income is the ownership of the property. However, in cases where unrealised rent is subsequently realised, it is not necessary that the assessee continues to be the owner of the property in the year of receipt also.

Tax treatment of arrears of rent

The amount received on account of arrears of rent (not charged to tax earlier) will be charged to tax after deducting a sum equal to 30% of such arrears. It is charged to tax in the year in which it is received. Such amount is charged to tax whether or not the taxpayer owns the property in the year of receipt.

Illustration 8: During the tax year 2026-27, Mr. X received a sum of Rs. 1,50,000 (Rs. 50,000 p.a.) by way of arrears for the last 3 years as the rent was increased with retrospective effect. Will this sum be taxable in the Tax Year 2026-27? Can it be spread over the last 3 years?

Solution:

The arrears of rent shall be taxable in the tax year in which such arrears are received. Therefore, the sum of Rs. 1,50,000 shall be taxable in the Tax Year 2026-27. The assessee shall be allowed the deduction @ 30% of such arrears. Thus, the net amount of Rs. 1,05,000 (i.e., Rs. 1,50,000 – Rs. 45,000) shall be taxable under the head 'Income from House Property'. It is not necessary that the taxpayer owns the property in the year of receipt.

CO- OWNERSHIP

Sometimes the property consisting of buildings or the buildings and land appurtenant thereto is owned by two or more persons, who are known as co-owners. In such cases, if their representative shares are definite and ascertainable, such persons shall not be assessed as an AOP in respect of such property, but the share of each such person in the income from the property, as computed, shall be included in his total income. In such cases, the relief admissible under section 21 (for self-occupied properties) shall also be separately allowable to each such person.

LOSS FROM HOUSE PROPERTY

When the aggregate amount of permissible deduction exceeds the net annual value of the property, there will be a loss from that property. This loss shall be treated in the following manner:

1. As per section 108, if any person has loss from any house property, such loss can be set off from income of any other house property. It is called inter-source adjustment or intra-head adjustment.

   For e.g., Mr. Kumar has two houses; there is loss of Rs. 43,000 from one house and income of Rs. 90,000 from other house, in this case, loss from one source (house) can be set off from income of the other source (house).

2. As per section 109**,** if even after the set-off, there is an unabsorbed balance of the loss from house property, unadjusted loss can be set off from income of other heads to the extent of Rs. 2,00,000. It is called inter-head adjustment. However, if the assessee pays tax under default tax regime, loss under the head "Income from House Property" is not allowed to be set off against income under any other head.

   For e.g., Mr. Naqvi has loss from house property of Rs. 6,00,000 and income from business/profession of Rs. 8,00,000. In this case, loss is allowed to be set off under optional tax regime but if he has any casual income, loss cannot be set off from casual income.

3. As per section 110**,** the further unadjusted loss is allowed to be carried forward to the subsequent years but for a maximum period of 8 years starting from the subsequent to the year

in which the loss was incurred and in the subsequent years, loss can be set off only from income under the head house property.

For e.g., Mr. X has loss under the head house property of the tax year 2020-21 of Rs. 5,00,000 and income under the head house property of Rs. 6,00,000 in tax year 2026-27. In this case, loss shall be allowed to be set off because it was allowed to be carried forward upto a period of 8 years starting from tax year 2020-21.

Knowledge Assessment – II

1. Sunil purchased a house for his residential purpose after taking a loan on 21st January, 2024. During the tax year 2026-27, he paid interest on loan Rs. 2,07,000. While computing income from house property under optional tax regime, the deduction is allowable to the extent of ––

    a. Rs. 30,000

    b. Rs. 1,00,000

    c. Rs. 2,07,000

    d. Rs. 2,00,000

2. Mr. A had one self-occupied house property in Mumbai for residence. Fair rent of that property is Rs. 56,000 per annum. Municipal valuation is Rs. 28,000. Municipal taxes paid are Rs. 5,000 including Rs. 1,000 for an earlier year. The house was constructed in December, 2024 with a loan of Rs. 12,00,000 from a bank taken in November, 2023. During the tax year 2026-27, the assessee paid interest of Rs. 3,30,000. Compute the income from house property for tax year 2026-27 under default tax regime?

    a. Loss of Rs. 30,000

    b. Loss of Rs. 1,68,000

    c. Nil

    d. Loss of Rs. 2,00,000

3. Which out of the following is not a case of deemed ownership of house property?

    a. Transfer to a spouse for inadequate consideration

    b. Co-owner of a property

    c. Holder of an impartible estate

    d. Transfer to a minor child for inadequate consideration

4. Standard deduction is allowed at the rate of

    a. 10%

    b. 20%

    c. 30%

    d. 25%

5. Deduction under section 22 is available on account of ______

   a. Municipal taxes paid by the owner

   b. Capital expenditure incurred by the owner

   c. Revenue expenditure incurred by the owner

   d. Interest on capital borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property

6. For how many subsequent years, the unadjusted loss is allowed to be carried forward:

   a. 9 years

   b. 8 years

   c. 10 years

   d. 12 years

Answers

1. d, 2. c, 3. b, 4. c, 5. d, 6. b

CHART SHOWING COMPUTATION OF TAXABLE INCOME FROM HOUSE

Gross Annual Value of the house		XXX
Less: Municipal Taxes paid by the owner during the tax year		XXX
Annual Value/ Net Annual		XXX
Less: Deductions under section 22		
i. Standard Deduction (for repair and collection charges) @ 30% of Annual Value	XXX	
ii. (a) Interest on loan taken for purchase, construction or repair of the house, relating to tax year	XXX	
(b) Interest on loan for the period prior to the tax year in which the house is completed is also allowable in five equal	XXX	
		XXX
Taxable Income from House		XXX

Illustration 9: M took a loan on 01/04/23 of Rs. 1,00,000 @ 12% p.a. for construction of a house. She repaid the entire loan on 31/03/25. Construction of the house was completed on 01/01/27. Compute the deduction of interest for the tax year ending 31/03/27.

Solution:

Deduction of interest will start from the tax year 2026-27. Interest for the pre-construction period (period from the date of borrowing till the date of repayment) i.e., from 01/04/23 to 31/03/25 (for 2 years) = Rs. 24,000

1/5th is allowed for the tax year 2026-27 = Rs. 4,800

Illustration 10: Mr. A owns two houses. The expected rent of the house one is Rs. 65,000. This house was let out for Rs. 7,500 p.m. But the rent for the months of Feb. and March 2027 could not be realized. The expected rent of another house is Rs. 1,50,000. This house was let out for Rs. 12,000 p.m. But the rent for the last three months could not be realized. In the both cases, Mr. A fulfills the conditions of Rule 21. You are required to compute the Gross Annual Value of both the houses.

Solution:

	House I **Rs.**	**House II** **Rs.**
Expected Rent	65,000	1,50,000
Annual Rent	90,000	1,44,000
Unrealized Rent	15,000	36,000
Actual Rent (After deducting unrealized rent)	75,000	N.A
Gross Annual Value	75,000	1,50,000

Note: In respect of House II, the Expected Rent is already higher than the Actual Rent for the whole year before deducting unrealized rent. So, Expected Rent will be taken.

Illustration 11: Mr. A is the owner of the following four houses. The following particulars are available:

Particulars	**I** **Rs.**	**II** **Rs.**	**III** **Rs.**
Standard Rent	10,00,000	5,00,000	20,00,000
Municipal Valuation	16,00,000	5,60,000	24,00,000
Rent (Actual)	-	6,80,000	20,00,000
Municipal taxes	40,000	30,000	1,20,000
Annual Charges	-	-	36,000
Interest on borrowed capital	80,000	1,00,000	-
Repairs and collection charges	20,000	46,000	50,000

Fire Premium	14,000	-	20000
Ground Rent		6,000	-

House I is self-occupied. House II is let out for residential purposes for the whole year. House III is ¾ used for own business and ¼ let out to manager of the business. Find the income of Mr. A from house property for the tax year 2014-15 under optional tax regime.

Solution:

House I

Since the house I is self-occupied throughout the tax year, its annual value is deemed to be nil.

NAV	Nil
Less: Interest on borrowed capital	Rs. 80,000
Loss from house property	Rs. 80,000

House II

Expected Rent (higher of MV or FMV subject to SR)	Rs. 5,00,000
Rent (Actual)	Rs. 6,80,000
GAV (higher of expected rent or actual rent)	Rs. 6,80,000
Less: Municipal Taxes	Rs. 30,000
Net Annual Value	Rs. 6,50,000
Less: 30% of Annual Value as Standard Deduction	Rs. 1,95,000
Less: Interest on borrowed capital	Rs. 1,00,000
Income from house property	Rs. 3,55,000

House III

Since house III is used for own business, the income from this house is not taxable under the head 'Income from house property' but under 'Profits and gains of business or profession'. Also, the ¼ portion of the house which is let out to the manager is assumed to be incidental to the business and hence not assessable under the head 'Income from house property'.

Thus, total income from house property of Mr. A: (Rs. 80,000) + Rs. 3,55,000 = Rs.2,75,000

Illustration 12: Mr. Lal is the owner of a house property. Its municipal valuation is Rs. 80,000. It has been let out for Rs. 1,20,000 p.a. The local taxes payable by the owner amount to Rs.16,000 but as per agreement between the tenant and the landlord, the tenant has paid the amount directly to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

	Rs.
Water charges	1,500
Lift maintenance	1,500
Salary of gardener	1,800
Lighting of stairs	1,200
Maintenance of swimming pool	750

The landlord claims the following deductions:

Repairs paid by tenant	7,500
Land revenue paid by tenant	1,500
Insurance premium paid by owner	6,000
Interest on borrowed capital for payment of municipal tax of house property	1,000

Compute the taxable income from the house property for the tax year 2026-27.

Solution:

Computation of income from house property for the tax year 2026-27

Gross annual value: To be higher of the following:		
(a) Municipal valuation (Rs. 80,000) or		
(b) De facto rent (Rs. 1,20,000 *less* value of amenities)		
Rent Received	Rs. 1,20,000	
Less: Value of the amenities provided by the assessee:		
(i) Water charges	Rs. 1,500	
(ii) Lift maintenance	Rs. 1,500	

(iii) Salary of gardener	Rs. 1,800	
(iv) Lighting of stairs	Rs. 1,200	
(v) Maintenance of swimming pool	Rs. 750	
	Rs. 1,13,250	
Gross annual value		Rs. 1,13,250
Less: Local tax Rs. 16,000 [No deduction is permissible as the taxes have been paid by the tenant]		Nil
Net annual value		Rs. 1,13,250
Less: Standard deduction from net annual value:		
30% of Net Annual Value		Rs. 33,975
Income from house property		Rs. 79,275

NOTES:

1. *Interest on borrowed capital for payment of municipal tax is not allowed as deduction under section 22 of the Act.*
2. *The landlord also cannot claim the other deductions as only a standard deduction @ 30% of NAV is allowed irrespective of actual amount paid.*
3. *The composite rent is separable. Therefore, the rent for amenities is deducted as it will be taken under 'Income from other sources'.*

KEY WORDS

1. **House property:** House property consists of any building or land appurtenant thereto of which the assessee is the owner. The buildings include residential buildings (whether self- occupied or let out *for any purpose*), office building, factory building, godowns, flats, etc. as long as they are not used for business or profession by the owner.

2. **Appurtenant lands:** The appurtenant lands may be in the form of approach roads to and from the public streets, motor garage, courtyard or compound forming part of the building.

3. **Deemed owner:** As per section 25, some persons are treated as the owners of a house property even if they are not the legal owners of the property. The cases are:

   a. Transfer to a spouse or a minor child (a child below 18 years of age)

   b. Holder of an impartible estate

   c. Member of a Co-operative Society, etc.

   d. Person in possession of a property

   e. Person having right in a property for a period not less than 12 years

4. **Composite Rent:** When the owner of the building gets along with the rent of the building, rent or hire of other assets (like furniture) or charges for different services provided in the building (e.g. charges for security, lift, air-conditioning, electricity, water, etc.), the total amount so received is called 'composite rent'.

5. **Unrealized Rent:** Unrealised rent is the rent which was payable but not paid by the tenant. The amount of unrealized rent shall be excluded from rent received/receivable.

6. **Co- ownership:** When the property consisting of buildings or the buildings and land appurtenant thereto is owned by two or more persons, the owners are known as co-owners.

SUMMARY

- **Charging Section:** Section 20 of the Act provides that the annual value of a property is taxable under the head 'Income from House Property' if *all* the following conditions are satisfied:

  1. The property should consist of any building or land appurtenant thereto.

  2. The assessee should be the owner of the property.

3. The property should not be used by the owner for the purpose of any business or profession carried on by him, the profits of which are chargeable to income tax.

- **Deemed Owner:** As per section 25, the following persons though not the legal owners of a property are deemed to be the owners:

  (a) Transfer to a spouse or minor child (b) Holder of an impartible estate (c) Member of a co-operative society (d) Person in possession of a property (e) Person having right in a property for a period not less than 12 years

- **Gross annual value** shall be higher of

  (a) Expected Rent

  (b) Actual rent received or receivable.

  The higher of Municipal value and fair rental value shall be **Expected rent**. However, expected rent shall not exceed the Standard rent.

- **Net annual value** shall be computed in the following manner:

  i. Determine the Gross Annual Value

  ii. Deduct municipal tax actually paid by the owner during the tax year from the Gross Annual Value.

- **Deduction from Annual Value (Section 22):** Income chargeable under the head 'Income from house property' shall be computed after making the following deductions, namely:

  i. Standard deduction,

  ii. Interest on borrowed capital.

EXERCISE QUESTIONS

SHORT ANSWER QUESTIONS

1. What do you mean by House Property? What are appurtenant lands?
2. What are the conditions to be satisfied by a house property so that its income can be charged under the head 'Income from House Property'?
3. Explain the provisions of unrealized rent.

4. State the conditions to be satisfied for claiming the deduction in respect of municipal taxes while calculating NAV.

5. Distinguish between standard rent and actual rent.

6. Write short notes:

   a. Standard rent

   b. Co-ownership

   c. Deemed ownership

   d. Composite rent

   e. Deemed let out properties

LONG ANSWER QUESTIONS

1. What is 'annual value' of house property? How is it computed?

2. In computing the income from house property, what deductions are allowed from the net annual value?

3. What is the basis of computation of income from House property? How would you arrive at?

NUMERICAL QUESTIONS

1. Mr. X owns a house property. Following are the details about the property:

   Fair rent of house: Rs.33,000 per annum. Municipal value of house: Rs.36,000 per annum. Standard rent of house: Rs.30,000 per annum. The house was let out at Rs.3,000 per month but was sold on 1st January, 2027. Find out income from house property for the tax year 2026-27.

   ***(Answer:** Rs. 18,900)*

2. Mr. A owns a house in Indore. Its municipal valuation is Rs.24,000. He incurred the following expenses in respect of the house property: Municipal tax @ 20%, fire insurance premium Rs.2,000 and land revenue Rs.2,400. He took a loan of Rs.25,000 @16% per annum on 1st April, 2023. The whole amount is still unpaid. The house was completed on 1st April, 2026. Find out the income from house property for the tax year 2026-27 if the house is used by the assessee throughout the tax year for his residential purpose.

   ***(Answer:** Loss of Rs.6400)*

3. Mr. X owns two houses, the particulars of which are given below:

	House-A	***House-B***
	Rs.	**Rs.**

Municipal value	1,20,000	1,00,000
Fair rent	1,00,000	1,10,000
Monthly rent	9,000	12,000
Rent collection charges	10,000	6,000
Repair expenses	6,000	4,000
Interest on loan:		
– For construction	—	—
– For marriage of son	30,000	—
– For repairs	—	8,000
Commencement of construction	04.01.2021	04.07.2022
Completion of construction	30.06.2023	31.12.2024
Use by tenant	Office	Residential

Municipal tax is charged @ 10%. Mr. X did not pay municipal tax of House-A. The tenant paid the municipal tax of House-B which remained vacant for 3 months. Compute income from house property of Mr. X for the tax year 2026-27.

*(**Answer:** Rs. 84,000, Rs. 67,600)*

4. Rohan has three houses. Both houses are self-occupied. Particulars of the houses for the tax year 2026-27 are as follows:

Particulars	House I	House II	House III
Municipal valuation p.a.	8,00,000	12,00,000	10,00,000
Fair rent p.a.	6,00,000	14,00,000	12,00,000
Standard rent p.a.	7,20,000	14,80,000	11,80,000
Date of completion	31.03.2019	31.03.2022	31.03.2023

Municipal taxes paid during the year	10%	9%	10%
Interest on money borrowed for construction of house	1,00,000	1,50,000	1,20,000

Compute Rohan's income from house property for the Tax Year 2026-27 under optional tax regime. Suggest which house should be chosen as self-occupied so that the tax liability is minimum.

(Answer: Rs. 3,48,000; House II and III should be chosen as self-occupied)

Study Material

UNIT: 3 (iii) INCOME FROM BUSINESS PROFESSION

<table>
<tr><td rowspan="2">Unit Code:</td><td colspan="4">UNIT TITLE: INCOME FROM BUSINESS PROFESSION</td></tr>
<tr><td colspan="4">Duration:</td></tr>
<tr><td rowspan="3">Location: Classroom or the place of practice by any professional or place of business of any entrepreneur</td><td colspan="4">SESSION 1: CONCEPT OF BUSINESS AND PROFESSION AND COMPUTATION OF NET INCOME TAXABLE IN CASE OF BUSINESS/PROFESSION</td></tr>
<tr><td>Learning Outcome</td><td>Knowledge Evaluation</td><td>Performance Evaluation</td><td>Teaching and Training Method</td></tr>
<tr><td colspan="4">SESSION 1:</td></tr>
<tr><td></td><td>1. Meaning of Business and Profession</td><td>1. Explain the meaning of Business and Profession
2. Explain the chargeability of Income under the head Income from Business and Profession</td><td>1. Differentiate between Business and Profession
2. List out various incomes which are chargeable to tax under the head Income from Business and Profession</td><td>Interactive Lecture: Introduction to the head “Income from Business and Profession”</td></tr>
<tr><td></td><td>1. Computation of net income taxable</td><td>1. Understand the process of Calculating the net income taxable in case of business/ profession</td><td>1. Learn the process of calculating the net income taxable in case of business/ profession
2. Identify the expenses expressly allowed/ disallowed while calculating the net income
3. Identify the losses allowed while calculating the net income
3. Understand the conditions to be satisfied for an expense to be</td><td>Interactive Lecture:
1. Discussion of the process of calculating the net income taxable in case of business/ profession
2. Contact any professional or entrepreneur to get details of his income from his business or profession</td></tr>
</table>

			allowed as deduction	

(Note: The location would depend upon the topic under discussion, wherein it will be the classroom for the theoretical interactions; the student will be required to contact any professional or entrepreneur and also the websites like www.incometax.gov.in)

UNIT: PROFIT AND GAINS FROM BUSINESS AND PROFESSION

Learning Objectives:

After studying this unit, the students will be able to:

1. Understand the meaning of business and profession
2. Identify the incomes chargeable under the head Business and Profession
3. Learn the process of calculating the net income taxable in case of business/profession
4. Identify the expenses expressly allowed while calculating the net income
5. Identify the expenses expressly disallowed
6. Identify the expenses and losses allowed while calculating the net income
7. Explain the meaning of certain keywords.

SESSION 1: CONCEPT OF BUSINESS AND PROFESSION AND COMPUTATION OF NET INCOME TAXABLE IN CASE OF BUSINESS/PROFESSION

Introduction:

As we know that a person's income can be divided under five heads like Salary, House property, Capital gains, Profits and gains of Business or Profession and Income from other sources . Out of these heads "Profits and gains of Business or Profession" is one of the most important and the major head. The income from business in respect of which a person is chargeable under this head represents not the gross receipts from the business but the profits and gains derived from that business. For instance, in the case of a businessman, the gross sale proceeds would not be the basis for levying tax but it is net profit or the profit or gain as determined in accordance with the provisions relating to the profits and gains from business or profession contained under the Income Tax Act, 2025.

The chargeability to tax under Section 26 is based primarily upon the condition that the assessee must have carried on a business or profession at any time during the accounting year, though not necessarily throughout the accounting year. There are two parts of this head one is business and second is profession. These two are explained below:

Meaning of Business and Profession:

Business: The meaning of the term "Business" has been defined in Section 2(20) of the Income-tax

Act. According to this definition, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The concept of business presupposes the carrying on of any activity for profit, the definition of business given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time and it is not necessary that the business is run personally by the owner, but it should be under his direction and control .

Example: *If a person comes from his village to a city and buys 20 tonnes of corn during the winter season and sold it during the three winter months and then went back to his place, after the venture had come to an end, this activity would constitute "business" for the purposes of Income Tax Act.*

Profession: The term "Profession" has been defined in Section 2(86) of the Act. It includes vocation. In general terms, we can say profession is an occupation requiring specialised knowledge, skill, and often formal qualification, where services are rendered and it also include vocation. Vocation refers to an activity carried on by a person mainly based on personal skills, talent, or interest, often without formal professional qualifications.

Example - *A painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and even an astrologer are persons who can be said to be carrying on a profession but not business.*

Act does not clearly specify what activities constitute profession and what activities do not. However, "Profession" is generally understood to involve the concept of an occupation requiring use of either intellectual skill or manual skill or both.

The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income or to make profit. The process of making the profit would be the main area of difference between the two while the ultimate object is common to both.

The meaning of "Profits"

1. **Profits may be in cash or in kind**. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind.

2. **Voluntary receipts:** Payment voluntarily made by persons who were under no obligation to pay anything at all, would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation.

   Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service would be assessable as the lawyer's income. Similarly, any presents or gifts received by a doctor from his patients voluntarily shall be included in his income from profession.

3. **Application of gains of trade is immaterial**, this means that after the profit has been earned, the assessee may apply it as per his wish, even charity as well. However, it would still be liable to tax. Hence, if his profit and loss account shows debit for donations, charity etc. it should be added back to compute his profit from business or profession.

4. **The profits of each distinct business** must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the businesses carried on by the assessee.

5. **Profit should be computed after deducting certain expenses** and losses incurred for doing the business or profession, this means that only those expenses/ losses which are allowed to be deducted under the provisions of the Act, would be deducted.

6. For application of tax, it does not matter whether, the business/profession carried on by the assessee is illegal or legal. Thus, income tax is not restricted in its application to lawful business only. However, expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law would not be allowable as deduction while computing profits of such business.

Chargeability of income under this head [Section 26]

The incomes referred to in section 26(2) shall be chargeable to tax as income under the head 'profits and gains of business or profession'. These incomes are as under:

- **Taxability of income under this head**: Profits and gains arising from any business or profession carried on by the assessee during the tax year are chargeable under this head. However, where the assessee is engaged in the business of letting out residential houses, the income derived from letting out a residential house or any part thereof shall not be taxable under the head "Profits and Gains of Business or Profession", but shall instead be chargeable under the head "Income from House Property".
- Any compensation received by a person in connection with termination of his work of
    - managing the affairs of a company or
    - for holding agency in India for business activities of any other person or
    - for any business contract.
- Any compensation or payment due to or received by any person, for vesting of the management of any property or business, in the Government including any corporation owned or controlled by the Government under any law in force.
- Income derived by any trade, professional or similar associations from specific services rendered by them to their members.

(5) Incentives received or receivable by assessee carrying on export business**:** Following incentives received or receivable by an assessee:

- Profits on sale of import licence,
- Cash assistance against export,
- Duty drawback,
- Duty remission, or
- any other export incentive

(6) **Value of any benefit or perquisite:** The value of any benefit or perquisite arising from business or the exercise of any profession.

(7) Any interest, salary, bonus or commission which is due to or received by a partner of a firm from such firm will be deemed to be income from business.

(8) Any sum whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession.

(9) Any sum received under a Keyman Insurance Policy including bonus on such policy.

(10) Fair market value of inventory as on the date on which it is converted into or treated as a capital asset, would be chargeable to tax as business.

(11) Any sum received when a capital asset (other than land or goodwill or financial instrument) refereed under section 46 is damaged or destroyed and the whole of such expenditure is allowed as deduction.

(12) Profits and gains derived from any speculation business are also chargeable to tax under the head PGBP.

Section 26(3) specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 113 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business.

The speculation business consist of the transactions which satisfy the following conditions:

(a) The Transaction should be a contract for the purchase or sale of stocks, shares or commodities.

(b) This contract is periodically or ultimately settled.

(c) The settlement would not be by actual delivery or transaction or commodities or script, generally, it is settled through exchanging the difference in prices on the date of delivery.

<u>Method of Accounting and Taxability of Income</u>

As per section 276(1), income chargeable under the heads "Profits and Gains of Business or Profession" or "Income from Other Sources" is to be computed in accordance with the method of accounting regularly employed by the assessee, i.e., either:

- Cash system, or
- Mercantile system.

(i) Manner of computation when mercantile system of accounting is followed by the assessee: Under mercantile system of accounting, the assessee maintains profit and loss account or income and expenditure account, wherein incomes are recorded as they are earned and expenses are recorded when they are incurred. In such cases, it does not matter whether the income is actually received or the expenditure is actually paid during the tax year.

Let us discuss the performa for computation of income when mercantile system of accounting is followed:

Computation of profits and gains from business or profession

Balance as per profit and loss or Income - expenditure account		**xxx**

Add:		
(i) Expenses expressly disallowed but debited to P& L A/c	xxx	
(ii) Expenses not allowed but debited to P&L A/c	xxx	
(iii) Incomes or receipts taxable under this head but not credited to P& L A/c	xxx	
(iv) Capital expenses debited to P & L A/c	xxx	
(v) Personal expenses debited to P & L A/c	xxx	
(vi) Expenses in excess of the allowed amount, debited to P & L A/c	xxx	
(vii) Losses not allowed but debited to P & L A/c	xxx	
(viii) Expenses not relating to the tax year but debited to P & L A./c	xxx	
(ix) Under-valuation of closing stock or over-valuation of opening stock	xxx	xxx
		xxx

Less:		**xxx**
(i) Expenses expressly allowed but not debited to P & L A/c	xxx	
(ii) Expenses relating to the tax year but not debited to P & L A/c	xxx	
(iii) Losses allowed but not debited to P & L A/c	xxx	
(iv) Incomes or receipts not taxable under this head but credited to P & L A/c	xxx	
(v) Capital receipts credited to P & L A/c	xxx	
(vi) Incomes or receipts taxable under other head but credited to P & L A/c	xxx	
(vii) Over-valuation of closing stock or under-valuation of opening stock	xxx	
(viii) Profits taxable under the head incomes from business or profession.	xxx	xxx
Net Income		**xxxx**

(ii) Manner of computation when cash system of accounting is followed by the assessee: Under cash system of accounting, the assessee maintains cash book or receipts and payments account, wherein cash (or bank) receipts and cash (or bank) payments are recorded. In such cases, only taxable cash receipts and cash payments in respect of expenditures allowed as deduction are considered while computing income under the head profits and gains from business or profession.

Let us discuss the proforma for computation of income when cash system of accounting is followed:

Gross Receipts

(a) In case of a Doctor

(i)	Sale of Medicine	xxx	
(ii)	Consultation fee/Visiting fee	xxx	
(iii)	Examining fee	xxx	
(iv)	Operation fee	xxx	
(v)	Nursing home charges	xxx	
	Gift from Patients	xxx	xxx

(b) In case of an Advocate or Chartered Accountant

(i)	Fee from clients	xxx	
(ii)	Consultation fee	xxx	
(iii)	Audit fee	xxx	
(iv)	Income from accounting work	xxx	
(v)	Gift from clients	xxx	
(vi)	Fee from training institute	xxx	xxx

Less: Admissible Expenses

(i)	Rent of Dispensary	xxx	
(ii)	Salaries to compounder's	xxx	
(iii)	Cost of Medicines	xxx	
(iv)	General expenses	xxx	
(v)	Telephone expenses	xxx	
(vi)	Motor car expenses (if used for profession)	xxx	
(vii)	Depreciation on Motor car/Surgical equipments	xxx	

(viii)	Laboratory expenses	xxx	
(ix)	Interest on Loan	xxx	
(x)	Expenses on professional Magazines/ Journals	xxx	xxx
Net Income			**xxx**

ADMISSIBLE DEDUCTIONS/INADMISSIBLE DEDUCTIONS

(1) Admissible Deductions

(i) Rent, Rates, Taxes, Repairs and insurance

Section 28 provides the following deductions for building, plant & machinery, furniture used for the purpose of business/ profession of the assessee while computing profits from business/profession-

(a) Insurance premium paid for insurance against risk of damage / destruction to building, plant & machinery, furniture

(b) Land revenue, local rates or municipal taxes

(c) Rent and repairs of the premises by the assessee, as a tenant of the premises is allowed but the nature of repairs should not be capital in nature.

(d) Repairs of the premises by the assessee, otherwise than as a tenant of the premises is allowed and the nature of repairs shall not be capital in nature.

Note - *Where the premises, building, plant and machinery or furniture is partly used for business or profession and partly used for some other purpose, deductions mentioned above (a to d) shall be proportionately allowed having regard to the usage for the purpose of business or profession.*

Example: If a doctor rents two floors and one is used for his clinic while the other is used for his residence, the rent allowed for deduction shall be half of the total rent incurred.

(ii) Deduction related to employee welfare: Section 29 provides the following deductions while computing profits from business/profession-

(a) Employer's contribution to provident fund and superannuation funds.

(b) Employer's contribution to National Pension Scheme is allowed but the deduction is allowed upto 14% of salary

(c) Employer's contribution to an approved gratuity fund is allowed as a deduction, only if the fund is meant exclusively for the benefit of employees. A provision for gratuity is allowed only when the gratuity has actually become payable during the tax year. Therefore, any provision made for future gratuity (not yet due) is not allowed as a deduction.

(d) Amount received by assessee-employer as contribution from his employees towards their welfare fund such as ESIC contribution, employee contribution to PF is allowed only if such amount is credited by the employer in the account of the employee on or before due date of filing of return.

(iii) Deduction related to insurance premium

Section 30 provides the following deductions while computing profits from business/ profession-

(a) Insurance premium on insurance policy taken against risk of damage or destruction of stock/ stores where stock/ stores relate to business/ profession of the assessee.

(b) Insurance premium paid for insuring health of employees in accordance with an approved scheme but the premium should be paid through any mode other than cash.

(iv) Deduction related to bad debts: Section 31 provides the deduction of Bad debts written off as irrecoverable in the accounts of the assessee. Such debt should have been taken into account while computing business income earlier. Provision for bad and doubtful debts is not allowed.

(v) Other Deductions – Section 32

(a) Bonus and Commission to Employees: Deduction in respect of bonus or commission paid to employees is allowed only if such amount is **actually paid on or before the due date of filing the return of income** for the relevant tax year. If it is not paid within this time, the deduction shall be allowed in the **year of actual payment**.

(b) Interest on Borrowed Capital: Interest on capital borrowed for the purposes of business or profession is allowable as a deduction. However, the **interest for the period up to the date on which the asset is put to use** is required to be **capitalised** and added to the cost of the asset. Accordingly, deduction is allowed only for the **interest relating to the period after the asset is put to use**. Further, any **interest paid on capital to the proprietor** is not allowable as a deduction and must be **added back** to the profits.

(c) Securities Transaction Tax (STT) and Commodities Transaction Tax (CDT): STT and CDT paid by the assessee is allowable as a deduction only if the income arising from such transactions is chargeable under the head "Profits and Gains of Business or Profession".

(vi) Depreciation:

Section 33 provides for deduction on account of depreciation on various assets and also lays down the method of its computation. It is important to note that the depreciation charged in the profit and loss account may differ from the depreciation computed as per this section. Therefore, the depreciation debited to the profit and loss account should be added back, and depreciation computed in accordance with section 33 should be allowed as deduction.

Depreciation in respect of buildings, plant and machinery, furniture, and intangible assets used for the purposes of business or profession is computed using the block of assets method. For example, depreciation for a block of building assets is computed based on the prescribed method under this section.

Particulars	Amount
WDV of the building block on 1.4.2026	XXX
Add: New building acquired during tax year 2026-27	XXX
Less: Building sold from the block during 2026-27	XXX
WDV of the block on 31.03.27 (A)	XXX

On this value (A), prescribed rate will be applied to compute depreciation. If the asset is used for less than 180 days during the year, then half of the prescribed rate is allowed.

Note - *If WDV of the block, reduces to zero in any tax year, depreciation shall not be provided for that block of asset in that tax year.*

(vii) **Deduction of Expenditure on Scientific Research**: Section 45 provides for the deduction of Expenditure on Scientific Research in two ways:

(a) Both revenue and capital expenditure on scientific research incurred by the assessee are allowed as deduction, if the research relates to business of the assessee. Expenditure on acquisition of land is not allowed.

(b) Amount paid to

- approved Indian companies for Scientific research,
- Notified Universities, institutions etc. for scientific or social science or statistical research or
- to approved labs /University/IIT etc. for scientific research under an approved programme

is allowed, whether the research is related or unrelated to the business of the assessee.

Note – Deduction in respect of (b) above is not allowed under the default tax regime.

(viii) **Deduction for capital expenditure incurred on specified business**: Section 46 allows a deduction in respect of capital expenditure incurred wholly and exclusively for carrying on certain specified businesses. Unlike the general rule where capital expenditure is not allowed as a deduction, this section provides a special benefit by permitting such expenditure to be claimed as a deduction, subject to prescribed conditions.

Such specified businesses include activities like setting up and operating cold chain facilities, warehousing facilities, 2-star or above category hotels, hospitals with 100 beds or more, specified housing projects, fertilizer production, etc.

However, the following restrictions apply:

(a) Expenditure on acquisition of land, goodwill, etc., is not allowable as deduction.

(b) Capital expenditure shall not be allowed where payment to a person in a day exceeds ₹10,000 and such payment is not made through prescribed banking or electronic modes.

(ix) Amortisation of expenditure incurred on VRS: Section 52 provides for the amortisation of expenditure incurred by an employer in the form of payments made to employees under a Voluntary Retirement Scheme (VRS).

The deduction is allowed as follows:

- One-fifth (1/5th) of the amount paid is allowed as a deduction in the tax year in which the payment is made; and
- The remaining amount is allowed in four equal annual instalments in the subsequent years.

Thus, the total expenditure is spread over five years, beginning with the year of payment.

(x) General Conditions for Allowable Deduction

Section 34 provides that any expenditure shall be allowed as a deduction while computing income under the head "Profits and Gains of Business or Profession" if it is not covered under specific sections, is not capital or personal in nature, and is incurred wholly and exclusively for the purposes of business or profession.

However, certain expenditures are specifically not allowable, even if incurred for business purposes. These include expenses incurred for any purpose which is an offence or prohibited by law and expenses on advertisement in any souvenir, brochure, or similar publication of a political party.

Further, expenditure incurred for any purpose which is an offence or prohibited by law includes expenses relating to illegal activities (in India or outside India), providing benefits or perquisites in violation of law.

Example: Legal expenses incurred with respect to the following is allowed as deduction:

- to avoid a business liability, e.g. for alleged breach of a trading contract;
- to defend the assessee's title to his assets, e.g. land, building, etc.;
- to secure the termination of a disadvantageous trading relationship, e.g. removal of an undesirable employee;
- to protect the capital asset of the business which has already been acquired;
- by a company in resisting a winding up petition by some shareholders;
- for defending monopoly rights;
- incurred in restraining another company from using assessee's trade mark.
- However, the expenses incurred in criminal proceedings are not allowable. Legal expenses relating to acquisition of capital asset for a business are capital expenses and

as such, not allowable.

Examples of expenditures allowed as business expenses

- Labour welfare expenses
- Daily operational expenses of business
- Gratuity and pension paid to employees
- Expenses related to sales tax and sales tax appeal
- Reasonable expenses on festivals like Deepawali and Holi etc.
- Commission paid to obtain order
- Expenses incurred on taking loans
- Fines paid to save goods from seizure
- Market research expenses
- Payment made to a director for removing him
- Loss of cash due to theft
- Travelling expenses related to business
- Expenses related to overdraft facility
- Loss of stock due to fire
- Interest on delayed payments
- Compensation paid for breaking contract
- Expenses on foreign tour for the betterment of the business
- Expenses related to guest house
- Compensation to a customer in case of defect in goods
- Premium paid on insurance policy of loss f profit
- Expenses incurred on Article of Association and Memorandum of Association
- Expenses related to trademark
- Compensation paid for contract left incomplete
- Payment made to employee on retrenchment
- Premium paid on Keyman Insurance Policy is allowed.

(2) Inadmissible deductions:

The following amounts are expressly disallowed by the Act. Hence, any expenditure incurred on these purposes shall not be taken into account while computing allowed business expense.

(i) Section 35 provides that

(a) Tax paid on income by the assessee is not allowed. It means **deduction for**

income tax shall not be allowed to the assessee.

(b) **Tax paid by employer on non monetary perquisite** of employees is also not allowed. It means if the employer pays tax on behalf of his employees, he cannot get a deduction for that expense.

(c) If any **sum is paid to any resident, without deducting tax at source** or without paying the deducted tax at source, 30% of such sum shall be disallowed. If it is paid upto the date of filing return of income, it shall be allowed.

(d) If any **sum is paid to any non-resident assessee (not company) or outside India, without deducting tax at source** or without paying the deducted tax at source, 100% of such sum shall be disallowed. If it is paid upto the date of filing return of income, it shall be allowed.

(e) Any contribution to a provident fund or the fund established for the benefit of employees shall be disallowed. If the employer has made effective arrangements to make sure that tax shall be deducted at source from payments made from that fund which are chargeable to tax as Salaries, then it is allowed.

(f) **Salary payable outside India or to a non-resident without deducting tax** at source or after deducting not deposited with the Government shall be disallowed.

(ii) Section 36 provides that,

(a) **payments to relatives and associates** is not allowed to be deducted, if the it is excessive or unreasonable having regard to the fair market value of the goods or services.

"Relative" in case of an "individual " means spouse, brother or sister or any lineal ascendant or descendant of that individual.

Note that the portion of expenditure which is found excessive or unreasonable is disallowed.

(b) **payments in excess of ` 10,000 in a day to a person**, made otherwise than through prescribed banking or online modes are disallowed. It means if the aggregate **cash payment** in a single day to a person exceeds ` 10,000, it shall be disallowed.

There are certain exceptions to this rule. Payments to banks, payment to government, payment made through book entries, payment made for purchase of agricultural, forest produce, fish products, horticulture products, payment made to cottage industry for its products produced without aid of power etc.

(iii) Section 37 provides that,

For certain payments, deduction shall be allowed only in the tax year in which such sum is actually paid. These include:

- Tax, duty, cess, surcharge or fee, levied under any law for the time being in force
- Employer's Contribution to a provident fund or superannuation fund or gratuity fund.
- Amount payable by employer in lieu of any leave at the credit of the employee or bonus or commission to the employees
- Interest on loans or advances or borrowings from specified financial entities
- Amount payable to the Indian Railways for use of railway assets,
- Amount payable by the assessee to a micro or small enterprise beyond the specified time limit, i.e., beyond 45 days from the date of acceptance in case of a written agreement and 15 days in any other case.

If these amounts are paid after the end of tax year in which the liability was incurred but on or before the due date of filing return of income for such tax year, the deduction for such sum is allowed in that tax year itself. However, if payment to MSME are made beyond the specified time limit, then deduction would be allowed in the year in which actual payment is made.

Amortisation of certain preliminary expenses

As per section 44, if an Indian company or a person living in India spends money on certain preliminary expenses (like starting a business or expanding it), they cannot claim the full amount as a deduction in one year. Instead, this expense is divided into five equal parts.

The assessee can claim one part (i.e., one-fifth of the total expense) as a deduction every year for five years.

If the expense is incurred **before starting the business**, the deduction begins from the year in which the business starts.

If the expense is incurred **after starting the business** for expanding the business or setting up a new unit, the deduction begins from the year in which the expansion is completed or the new unit starts working.

Tax Audit [Section 63]

(i) It is obligatory for the following persons carrying on business or profession, to get the accounts audited before the one month prior to due date for filing return of income i.e., 30th September of the financial year succeeding the tax year, by a Chartered Accountant,

(A) Person carrying on business has to get tax audit done if his total sales, turnover or gross receipts in business **exceed ` 1 crore in the tax year.**

(B) Person carrying on business where not more than 5% of the aggregate payments and not more than 5% of the aggregate receipts are in cash, during the tax year, has to get tax audit done if his total sales, turnover or gross receipts in business **exceed ` 10 crore in the tax year.**

(C) Person carrying on profession has to get tax audit done if his gross receipts in the profession **exceed ` 50 lakhs in the tax year.**

Maintenance of Accounts: It is mandatory to maintain certain accounts to run a business or profession. For this purpose profession is divided in to following two groups.

(A) **Specific Profession**- This includes like doctors, engineers, Lawyers, Chartered Accountant, Technical Advisors, Tax Advisors, Company Secretaries, Film Artist etc.

Professional whose gross receipts in the profession in any one of the three years before current tax year is less than ` 1,50,000 and for newly established profession, his total gross receipt in the profession is not likely to exceed ` 1,50,000 it is not mandatory to keep specific books of accounts. They are required to keep such books as will enable the Assessing Officer to compute the total income.

For professionals having gross receipts more than ` 1.5 lakh, it is mandatory to keep specific books of account like Cash Book, Journal, Ledger, original bills and copies of bills and receipts exceeding ` 250 and payment vouchers where the expenditure incurred does not exceed ₹ 250 etc.

(B) **Non-specified profession or Business**: Any individual or HUF, carrying on business or any profession, (not being a specified profession mentioned above), is required to keep and maintain such books of accounts and other documents to enable the Assessing Officer to compute his total income.

<u>In relation to business or profession</u>: Where the income from the business or profession exceeds ₹ 2,50,000 or likely to exceed ` 2,50,000 (in case of newly set up business or profession) or

its total sales, turnover or gross receipts exceed ₹ 25,00,000 in any one of three years immediately preceding the tax year; or likely to exceed ` 25,00,000 (in case of newly set up business or profession),

then it should keep such books of account as would allow the Assessing Officer to compute his total income.

Knowledge Assessment – I

State whether the following statements are true or false

(i) Objective of business is to earn profit only

(ii) Household expense are allowable expenses

(iii) Preliminary expenses are written off in 5 equal annual instalments.

(iv) Cash payments in excess of ` 10,000 are allowed as deduction.

(v) Gift taken by a doctor from his patient is an income of profession.

(vi) Interest payable on the owner's capital is disallowed expense.

(vii) 30% of the payment made .to residents without deducting tax at source would be disallowed.

Answers

(i). False, (ii). False, (iii). True, (i v) . False, (v). True, (vi). True, (vii). False

Knowledge Assessment – II

Fill in the blanks:

(i) Expenses of business are not allowed as deduction

(ii) Payment in cash or through bearer cheque in excess of Rs is disallowed.

(iii) Expenses on advertisement in any souvenir, brochure, or similar publication of a ....

(iv) Loss of stock due to fire will be an .... deduction

(v) Prizes won by a professional player will be treated as.........................

(vi) It is mandatory to get the accounts audited if gross receipts or total sales are more than Rs............in the tax year in case of business (other than business in which not more than 5% of payments and receipts are in cash) and Rs....................in case of profession

(vii) If total income of a business carried on by an individual in any one of the three years immediately preceding the current tax year is more than ` ....then it is essential to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

Answers

1. Illegal, 2. 10,000 3. Political Party, 4. Admissible, 5. Income from Profession, 6. 1 Crore, 50 lakh, 7. 2.5 lakh

Illustration 1

Sri Ram Gopal is the owner of a business. His Profit & Loss Account for the year ended on 31st March, 2027 is given below:

		₹			₹
To	Establishment Charges	5,110	By	Gross Profit	80,870
To	Salaries	10,000	By	Interest on Govt. Securities (Net)	5,352
To	Rent, Rates & Taxes	2,900	By	Rent from House Property	5,400
To	Sundry Expenses	7,050			
To	Household Expenses	1,380			
To	Provision for Bad Debts	1,200			
To	Loss on Sale of Motorcar (used for private purpose)	1,800			

To	Insurance Premium (including life insurance ` 1,790)	2,880		
To	Interest on Bank Loan	1,380		
To	Provision for Depreciation	6,400		
To	Advertisement in a Magazine of Political Party	500		
To	Net Profit	51,022		
		91,622		91,622

Following additional information are given:

(i) Bad debts written-off during the year ` 650.

(ii) Admissible depreciation as per I.T. rules ` 1,600.

(iii) Sri Ram Gopal is running his business in rented property, half of which is used by him for his own residence. Rent of `2,400 in respect of this house is included in Rent, Rates and Taxes.

(iv) Salary of ` 2,000 was paid to Shri Ram Gopal. It has been recorded in the item salaries.

Computer Sri Ram Gopal‘s income chargeable under the head “Profits from business or profession” for the tax year 2026-27.

Solution

COMPUTATION OF BUSINESS INCOME OF SRI RAM GOPAL

(for the Tax Year 2026-27)

Particulars	**(Amount in `)**	**(Amount in `)**
Net Profit as per Profit & Loss Account		51,022
Add: **Expenses disallowed but debited to P. & L. A/c:**		
Salary to Proprietor	2,000	
Rent (for half portion)	1,200	
Household Expenses	1,380	
Provision for Bad Debts	1,200	
Loss on Sale of Car	1,800	
Life Insurance Premium	1,790	
Provision for Depreciation	6,400	
Advertisement in a Magazine	500	16,270
		67,292
Less: **Expenses allowed but not debited to P. & L. A/c/ Income credited but taxable under other heads of income**		
Bad Debts	650	

Depreciation	1,600	
Interest on government securities [Taxable as income from other source]	5,352	
Rent received from house property [Taxable under the head "Income from House Property"]	5,400	(13,002)
Income from Business		**54,290**

Illustration 2

From the following Profit & Loss Account of Mr. Raj Kumar for the year ended 31st March, 2027, compute income from business or profession:

	`		`
General Expenses	4,000	Gross Profit	1,10,000
Bad Debts	2,500	Commission	10,000
Bad Debts Provision	1,500	Brokerage	15,000
Fire Insurance	750	Winning from Crossword Puzzles	10,000
Staff Salary	20,000	Interest on 7% National Plan Certificates	1,000
Discount to Dealers	2,500		
Salary of Raj Kumar	5,000		
Interest on Overdraft	5,000		
Interest on Loan of Smt. Raj Kumar	2,500		
Interest on Capital of Mr. Raj Kumar	3,500		
Depreciation on Machinery	8,000		
Advertisement Expenses	7,500		
Office Chairs	4,000		
Contribution of Employees' Provident Fund	5,000		
Theft by Cashier	1,000		
Net Profit	77,250		
	1,46,000		**1,46,000**

Other information is as follows:

(a) Depreciation allowed on machinery is ` 6,500

(b) Advertisement expenses ` 1,000 in respect of an advertisement for the lost papers of Mr. Raj Kumar's residential house. Rate of depreciation for plant and machinery applicable to the assessee is 15% and that applicable for furniture is 10%.

(c) Income of ` 750 accrued during the tax year is not recorded in Profit & Loss Account.

(d) General expenses include an amount of ` 1,100 spent on the party of a friend.

Solution

INCOME OF MR. RAJ KUMAR FROM BUSINESS OR PROFESSION

(for the Tax Year 2026-27)

	`	`
Net Profit as per Profit & Loss Account		77,250
Add: **Expenses disallowed but debited to P. & L. A/c:**		
(1) Expenses of Party	1,100	
(2) Provision for Bad Debts	1,500	
(3) Exp. on office Chairs	4,000	
(4) Advertisement for private purpose	1,000	
(5) Salary of Raj Kumar	5,000	
(6) Interest on Capital of Raj Kumar	3,500	
(7) Excess Depreciation (` 8,000-6,500)	1,500	17,600
Add: Incomes accrued but not credited to P. & L. A/c		750
		95,600
Less: Incomes or receipt not taxable under this head but credited to P. & L. A/c:		
(1) Winning from Crossword Puzzles	10,000	
(2) Interest on 7% National Plan Certificates	1,000	11,000
		84,600
Less: Depreciation @ 10% on office chairs		400
Income from Business		**84,200**

Notes: (1) Capital expenditure on office chairs is not deductible. This expenditure is subject to depreciation @ 10% taking it in the Block of furniture.

(2) Winning from crossword puzzles is taxable under head "Income from Other Sources".

(3) Interest on 7% National Plan Certificates is not taxable under this head.

(4) Theft by cashier is allowed.

(5) Notional expenditure of interest on capital and salary to proprietor is not allowed.

Illustration 3

Dr. Suresh is a medical practitioner. Besides his own practice, he works as a part-time physician in a private hospital for which he receives monthly remuneration. He is a consulting physician of XYZ Co. Ltd. on a monthly retainer fee. The doctor maintains a record of his receipts and payments and for the year ended 31st March 2027 the following information is abstracted therefrom:

Receipts	`
Consultation fee received	80,000
Gross remuneration from Nursing Home	1,60,000
Retainer Fee received from XYZ Co. Ltd.	6,000
Interest on Bank Deposit (Nationalized Bank)	20,000
Payments:	
Rent and Electricity Charges for the Clinic	14,000
Telephone Charges	3,000
Printing and Stationery	1,500
Car Maintenance Expenses	12,000
Wages for Clinic Assistant	3,600
Life Insurance Premium	2,400
Car Insurance Premium	2,000

The written down value of the car and the furniture of the Clinic as on 1-4-2026 were ` 40,000 and ` 3,000 respectively. 20% of the use of the car and the telephone is attributable to personal and private purpose. Prepare a statement showing the Gross Total Income of Dr. Suresh for the Tax year 2026-27 assuming he is paying tax under default scheme under section 202(1).

Solution

COMPUTATION OF GROSS TOTAL INCOME (for the Tax year 2026-27)

		`	`	`
1.	Salaries:			
	Gross remuneration from Nursing Home		1,60,000	
	Less: Deduction u/s 19(1) for standard deduction		75,000	85,000
2.	**Profits and Gains of Profession:**			
	Consultation Fee		80,000	
	Retainer Fee from XYZ Co. Ltd.		6,000	
	Gross Fee Received			**86,000**
	Less: Admissible Expenses:			
	Rent & Electricity		14,000	
	Telephone Charges	3,000		

	Less: Attributable to Personal Use (20%)	600	2,400	
	Printing and Stationery		1,500	
	Car Maintenance	12,000		
	Less: Personal Use (20%)	2,400	9,600	
	Wages of Clinic Assistant		3,600	
	Depreciation on Car @ 15% on ` 40,000	6,000		
	Less: 20% Attributable to Personal Use	1,200	4,800	
	Car Insurance (80% of ` 2,000)		1,600	
	Depreciation on Furniture (10%)		300	37,800
	Income from Profession			**48,200**
3.	**Income from other Sources**:			
	Interest on Bank Deposit			20,000
	Gross Total Income `			**1,53,200**

Illustration 4

Smt. Rambha is a registered Gynaecologist. She has prepared the following Income and Expenditure Account for the year ending 31st March, 2027. You are required to prepare a statement showing her income from profession:

	`		`
Household Expenses	20,000	Consultation Fee	40,000
Car Purchased	30,000	Visiting Fee	20,000
Travelling Expenses (Personal)	4,000	Gain on Race (Gross)	10,000
Charity and Donation	1,000	Sale Proceeds of an Ancestral House	34,000
Income-tax	3,000	Profit on Sale of securities	6,000
Salaries	8,000	Dividend on Shares (Gross)	5,000
Gift to Daughter	7,000	Interest from P.O. Saving Bank	600
Establishment Expenses	1,000	Gift from Father –in-law	2,000
Surgical Equipments	4,000	Interest on Fixed Deposits (Gross)	1,300
Books	1,200	Bad Debts recovered (Not allowed in earlier years)	2,000
Life Insurance Premium	2,000		
Interest on Capital	1,000		
Net Surplus	38,000		
	1,20,900		**1,20,900**

Rate of depreciation allowable on car is 15% and on surgical equipments and books it is 40%.

Solution

COMPUTATION OF INCOME FROM PROFESSION

(For the Tax year 2026-27)

Consultation Fee		40,000
Visiting Fee		20,000
Gross Receipts		**60,000**
Less: Admissible Expenses:	`	
Salary	8,000	
Establishment Expenses	1,000	
Depreciation 40% on Surgical Equipments	1,600	
Depreciation on Books 40%	480	
Depreciation on Car 15%	4,500	15,580
Income from Profession		**44,420**

Note:

1. Household expenses, personal travelling expenses, charity and donation, gift to daughter, life insurance premium, Income-tax and interest on capital shall be disallowed.

2. Gains on races, sale of house, profit on sale of securities, dividend on shares, interest from PO savings bank, gift from father-in-law and interest on fixed deposits are incomes which are not chargeable under this head.

3. Bad debts recovered during the tax year shall not be taxable because they were disallowed in earlier years.

Illustration 5

Shri Patni, a leading tax consultant, who maintains books of account on cash basis, furnishes the following particulars of income and expenditure for the tax year 2026-27:

	`		`
Balance b/d	12,400	Purchase of a Typewriter	6,000
Fee from Clients: of 2024-25	1,30,500	Car Expenses	18,000
of 2025-26	11,500	Office Expenses	40,000
of 2026-27	13,000	Salary of Staff: of 2025-26	32,000
Presents from Clients	24,000	of 2026-27	11,000
Loan from a Client	38,000	Repairs	12,000

		Interest on loan for official purpose	10,000
		Income-tax Payment	2,000
		Life Insurance Premium	6,000
		Balance c/d	92,000
	` 2,29,400		**` 2,29,400**

Depreciation on car (if used for professional purpose entirely) allowed as per income tax rules is ` 6,000. Car is partly used for official purposes (40%) and partly for private purposes (60%). Depreciation on typewriter is 15%. Determine the income from "Business and Profession" head of Shri Patni for the tax year 2026-27.

Solution:

COMPUTATION OF INCOME FROM PROFESSION

(for the Tax year 2026-27)

Receipts	`	`
Fee from Clients (`1,30,500+11,500+13,000)	1,55,000	
Presents from Clients	24,000	
Gross Receipts		**1,79,000**
Less: Admissible Expenses:		
Depreciation on Typewriter (15% on ` 6,000)	900	
Car Expenses (40% of ` 18,000)	7,200	
Office Expenses	40,000	
Salary to Staff (` 32,000 + 11,000)	43,000	
Repairs	12,000	
Depreciation on Car (40% of ` 6,000)	2,400	
Interest on Loan	10,000	1,15,500
Income from Profession		**` 63,500**

Note: Accounts are kept on cash basis; hence computation of taxable income is done on cash receipt and cash payment basis.

KEY WORDS

1. **Business:** It includes business, profession and vocation. Manufacture or sale-purchase of goods with the objective of earning profit is called business.
2. **Vocation:** Vocation refers to an activity carried on by a person mainly based on personal skills, talent, or interest, often without formal professional qualifications.
3. **Profession:** Activities requiring intellectual skills, application and ability of mind with usually some specialized knowledge.

4. **Capital expenses:** These are the expenses which are non-recurring in nature and the benefits of such expenses is derived over a number of years.
5. **Allowed expense:** These are the expenses which are related to the business/ profession and allowed as deduction while calculating the income of business/profession.
6. **Disallowed expenses:** These are the expenses which are not related to the business/ profession are not allowed as deduction while calculating the income of business/ profession
7. **Preliminary expenses**: These are the expenses which are incurred prior to the commencement of business.

SUMMARY

Meaning of business or profession: It includes trade, commerce or manufacture. Profession means the activities of earning livelihood which require intellectual skills or manual skills. It includes vocation. In general terms, we can say profession is an occupation requiring specialised knowledge, skill, and often formal qualification, where services are rendered and it also include vocation. Vocation refers to an activity carried on by a person mainly based on personal skills, talent, or interest, often without formal professional qualifications.

The profit and gains of business or profession include the following: (i)Revenue profits, (ii) amount due or received as compensation for termination of management or agency or modification of its terms and conditions, (iii) profit on sale of import licence, (iv) cash assistance received from the government for exports, (v) income from speculative transactions.

Important Rules: (i) The assessee carries on the business or profession, (ii) tax is levied on the aggregate income from all businesses or professions, (iii) losses of speculative business cannot be set off against profit of any other business, (iv) the business or profession is carried on at any time during the tax year, (v) only legal ownership is necessary and no tax is payable on anticipatory profits, (vi) revenue expenses relating to the business or profession for relevant tax year are allowable as deduction, (vii) sums deducted in an earlier year as loss and recovered during the current tax year is taxable.

Expenses expressly allowed: Expenditure in respect of business premises its rent, repair, insurance, depreciation on assets, land revenue, local tax. expenditure on scientific research, expenditure on voluntary retirement, amortization of preliminary expenses etc.

Expenses expressly disallowed: (i) 30% of expenditure is disallowed if payment is made without TDS

(ii) 100% of the expenditure is disallowed if payment is made outside India without TDS,

(iii) payment in cash over and above ` 10000 in a day to a single person is disallowed.

(iv) unreasonable or excessive payment to relatives or associates is disallowed.

Computation of Profits: The taxable profit is determined by deducting admissible expenses from the gross receipts or gross incomes of the business or profession. If certain expenses charged in profit and loss account are disallowed, they are added back in the net profit as per profit and loss account. Similarly there are certain incomes which are not taxable under this head but have been credited to the profit and loss account then such incomes are deducted from the net profit as per profit and loss account. After making these adjustment, profit and loss is ascertained for income tax purpose.

Maintenance and audit of accounts: For specified professions, If total income of any one of the three years immediately preceeding the current tax year is more than ` 1.5 lakh, then it is essential to maintain the specified books of accounts and if it is less than 1.5 lakh then it is not necessary to maintain such accounts as will enable the Assessing Officer to compute the total income.

Specified professions include profession of technical advisors, engineers, Lawyers, doctors, company secretaries etc.

Non specified professionals are required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

Businessman, being an individual whose total income of any one of the three years immediately preceding the current tax year exceed Rs. 2.5 lakh and total sales is more than Rs. 25 lakh, are required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

It is mandatory to get the accounts audited from chartered accountant if gross receipts or total sales is more than Rs 1 crore in the tax year in case of business and Rs. 50 lakh in case of profession. This limit would be Rs. 10 crores for a business, where aggregate of cash receipts and aggregate cash payments does not exceed 5% of to total receipts and total payament, respectively.

EXERCISE QUESTIONS SHORT ANSWER QUESTIONS

1. Which types of activities are included in Business and profession?
2. Name the deductions expressly allowed under the Act.
3. When is the audit of accounts of a business assessee compulsory? Explain in brief.
4. Name the expenditures which are specifically disallowed under the Act.

LONG ANSWER QUESTIONS

1. Describe deductions available at the time of calculating profit of business or profession.
2. Explain the payments that are expressly disallowed in computing the income from business or profession.
3. Explain the incomes that are chargeable under the head business or profession.
4. What is the procedure of computing the profit in case of business/profession? Give a proforma of corrected profit and loss account.
5. Write notes on the following:
   (i) Expenditure on Scientific research
   (ii) Business, profession and vocation

NUMERICAL QUESTIONS

Questions No. 1

The following is the Profit and Loss Account of Mr. Vivek for the year ended on 31st March, 2027. Compute his taxable income from business for that year:

	`		`
Opening Stock	15,000	Sales	80,000
Purchases	40,000	Closing Stock	20,000
Wages	20,000	Gift from Father	10,000
Rent	6,000	Sale of Car	17,000
Repairs of Car	3,000	Income-tax Refund	3,000

Income-tax paid	2,000		
Medical Expenses	3,000		
General Expenses	10,000		
Depreciation on Car	3,000		
Advance Income-tax paid	1,000		
Profit for the year	27,000		
`	1,30,000	`	1,30,000

Following further information is given:

(1) Mr. Vivek carries on his business in rented premises, half of which is used as his residence.

(2) Mr. Vivek bought a car during the year for ` 20,000. He charged 15% depreciation on the value of car. The car was sold during the year for ` 17.000. The use of the car was 1/4th for personal purposes.

(3) Medical expenses were incurred during sickness of Mr. Vivek for his treatment.

(4) Wages include ` 250 per month on account of Mr. Vivek's driver for 10 months

[Ans. Taxable Income from Business ` 10,375]

Question No. 2

Mr. Suresh is owner of a business. His profit and loss account on 31st March, 2027 is as follows:

Salary	12,000	Gross Profit	1,05,670
Establishment Expenses (Net.)	5,000	Interest on Govt. Securities	5,352
Rent	3,000	Income from House Property	5,400
Miscellaneous Expenses	7,100		
Household Expenses	1,900		
Provision for Gratuity	20,000		20,000
Provision for Bad Debts	2,000		
Loss on sale of Motor Car (Car used for personal purposes)	2,000		
Insurance Premium (Including Life Insurance ` 1,800)	3,000		
Interest on Bank Loan	1,500		
Compensation to retrenched employee	1,500		
Provision for Depreciation	6,400		
Net Profit	**51,022**		
	1,16,422		**1,16,422**

Additional Information:

(i) Actual Bad Debts Written off ` 700.

(ii) Allowed Depreciation ` 1,600.

(iii) Mr. Suresh is running his business in a rented premises half of which he uses as his residence. Rent includes ` 2,400 of the premises.

(iv) Mr. Suresh has been paid ` 2,000 as salary which has been recorded in salaries.

Compute Mr. Suresh's income from business for the Tax Year 2026-27.

(**Ans.** Income from business ` 75,270)

Question No. 3

Profit and Loss Account of Mr. Govind on 31st March, 2027 is given below: Compute his income from business or profession

	`		`
General Expenses	15,000	Gross Profit	2,48,000
Bad Debts	2,000	Commission	8,000
Provision for Bad Debts	12,000	Brokerage	14,000
Fire Insurance premium	1,000	Winnings from Crossword Puzzles	11,000
Goods and services tax	26,000	Interest on 7% National Plan Certificate	1,000
Staff Salary	29,750		
Discount	11,500		
Mr. Govind's salary	6,000		
Interest on overdraft	4,000		
Cost of expansion of office premises	54,000		
Interest on loan from Mrs. Govind	3,500		
Interest on Mr. Govind's Capital	3,500		
Depreciation on machinery	8,000		
Securities Transaction Tax on sale of shares	2,000		
Advertisement Expenses	11,500		
Contribution to Recognized Provident Fund (deposited by due date)	15,000		
Net Profit	**77,250**		
	2,82,000		**2,82,000**

(i) Depreciation allowed on machinery ` 6,500 as per Income Tax Act. Depreciation allowable as per Act on expansion of office premises and furniture is 10%.

(ii) General Expenses include expenses ` 1,200 of a party in honour of his friend.

(iii) Accrued income of tax year ` 850 not shown in Profit and Loss Account.

(Ans. Income from business ` 1,40,900)

Question No. 4. Shri Pandey is a reputed lawyer. He has prepared the following Income and Expenditure Account for the year ended 31st March 2027:

	`		`
Household Expenses	12,000	Legal Fee	1,26,000
Office Expenses	7,000	Special Commission Appointment Fee	1,400
Charity	500	Cash Gifts received from clients	2,000
Telephone Expenses	500	House Rent	15,000
Income-tax	900	Interest on Govt. Securities	3,000
Rent	4,000	Salary as Part-time Lecturer in Law	6,000
Gift to Daughter	2,000		
Electricity Charges	1,000		
Donation to National Defence fund	1,000		
Contribution to Public Provident Fund	2,400		
Magazine Subscription for his home	3,000		
Salaries	15,000		
Purchase of Motor-car	60,000		
Purchase of Furniture	2,000		
Life Insurance Premium	5,000		
Motor-car Expenses	6,000		
Purchase of Typewriter	6,000		
Excess of Income over Expenditure	25,100		
`	1,53,400	`	1,53,400

Following other particulars were received:

(i) Shri Pandey lives in one-half of the house and the other half is used for office, Rent and electricity charges are in respect of this house.

(ii) One-half of car expenses are for personal use.

(iii) Depreciate Motor-car @ 15%, Typewriter @ 15% and Furniture @10%.

Compute his taxable income from business and profession for the tax year 2026-27.

Ans.: (Income from Profession ` 95,800).

Question No. 5

Dr. Meena is a Gynecologist. She has prepared following Income and Expenditure Account for the year ending 31st March, 2027. Compute her income from profession for the Tax Year 2026-27.

	`		`
Household Expenses	10,000	Consultation Fee	50,000
Purchase of Car	40,000	Visiting Fee	10,000
Travelling Expenses (Personal)	4,500	Profit from Race (Gross)	10,000
Donation and Subscription	500	Proceeds from sale of ancestral property	30,000
Income Tax	1,500		
Salaries	9,000	Profit on sale of securities	10,000
Gift to Son	6,000	Dividend on shares (Gross)	5,000
Establishment Expenses	2,000	Interest on Post Office Savings A/c	600
Surgical Equipment Purchased	4,000	Gift from Father-in-Law	2,300
Books	1,200	Recovery of Bad Debts (Not allowed last year)	2,000
Life Insurance Premium	2,500	Interest on Fixed Deposit (Gross)	1,000
Interest on Capital	1,000		
Net Surplus	**38,700**		
	1,20,900		**1,20,900**

Depreciation allowed on motor car is 15% and on books and surgical equipment's is 40%.

Ans.: (Income from Profession ` 40,920).

Question No. 6

Dr. Malhotra is registered doctor. He keeps his books on cash basis. His cash a/c for the tax year 2026-27 is as under:

	`		`
To Balance b/d	1,22,000	By Cost of medicine	10,000
To Private Loan from bank	3,000	By Surgical Equipments	8,000
To Sales of medicines	25,250	By Motor Car	1,20,000
To Consultation Fees	1,55,000	By Car expenses	6,000
To Visiting fees	24,000	By Salaries	4,6000
To Interest on Govt. Securities	4,500	By rent of Dispensary	1,600

To Rent from Property	3,600	By General Expenses	300
		By Personal Expenses	1,11,800
		By Life Insurance Premium	3,000
		By Interest on Loan from Bank	300
		By Insurance of Residential Property	200
		By Balance c/d	71,550
	3,37,350		3,37,350

Compute his income from profession for the tax year 2026-27 considering the following information:

(i) 1/3rd of motor car are used for personal purpose.

(ii) Depreciation on surgical equipment @ 40%.

Ans.: (Income from Profession ` 1,27,150).

UNIT:3 (IV) - INCOME FROM OTHER SOURCES

<table>
<tr><td rowspan="2">Unit Code:</td><td colspan="4">UNIT TITLE: INCOME FROM OTHER SOURCES</td></tr>
<tr><td colspan="4">Duration:</td></tr>
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<tr><td>Learning Outcome</td><td>Knowledge Evaluation</td><td>Performance Evaluation</td><td>Teaching and Training Method</td></tr>
<tr><td>1. Basis of charge</td><td>1. Explain the basis of charging an income under the head of “income from other sources”</td><td>1. Differentiate the basis of charging an income under the head of “income from other sources” from basis of charging an income under other heads</td><td>Interactive Lecture: Introduction of the residuary head of charging the incomes under income tax Act, 2025, i.e., “income from other sources”</td></tr>
<tr><td>2. Income chargeable under the head “income from other sources”</td><td>1. Describe the various incomes which are chargeable under “income from other sources”</td><td>1. Identify the incomes which are specifically chargeable under “income from other sources” and which are chargeable under other sources if not chargeable under “profits from Business and profession”
2. Identify other Examples of incomes chargeable under “income from other sources”</td><td>Interactive Lecture:
2. Discussion of the various incomes which are chargeable under “income from other sources”
Activity:
Identify the incomes which charged under “income from other sources“ from the information collected from different assessees</td></tr>
<tr><td>3. Tax treatment of certain items</td><td>1. Explain the meaning of dividend under sec. 2(40) and various provisions related to the taxation of</td><td>1. Calculate the income from dividend which is chargeable to tax
2. Calculate the total amount of gifts charged to tax.</td><td>Interactive Lecture: Acquaint with the taxation of dividends, different kinds of gifts and amount received under life insurance policy</td></tr>
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		dividend 2. Explain various provisions related to taxation of different types of gifts 3. Explain the provisions related to taxation of amount received from life insurance policy	3. Calculate the taxable amount received from life insurance policy	
	SESSION 2: DEDUCTIONS UNDER INCOME FROM OTHER SOURCES AND TAX CONCESSIONS			
	1. Deductions under "income fromother sources"	1. List out various deductions available under income from other source 2. List out various items which are not deductible under income from other source.	1. Explain various items which are available for deduction and the conditions to be satisfied to avail the deductions 2. Explain various items which are not available for deduction 3. Calculate the income from other sources after providing for the available deductions	Interactive Lecture: Discussion of the various deductions available and not available under the head of income from other sources
	2. Tax concessions	1. List out various securities the interest from which is exempt from tax 2. List out various persons whose interest income is exempt from tax	1. Identify various tax concessions available in respect of different securities and assesses and then calculate the amount taxable under the head of other sources	Interactive Lecture: Discussion of various tax concessions available

(Note: The location would depend upon the topic under discussion. For the theoretical interactions, it will be the classroom and the student will be required to contact different assesses to collect information about their income from other sources.)

UNIT: INCOME FROM OTHER SOURCES
Learning Objectives:

After reading this unit, the students will be able to:

1. explain the basis of charging an income under the head income from other sources,
2. list out various incomes which are chargeable under this head,
3. explain the meaning of dividend,
4. explain the tax treatment of dividend received by an assessee,
5. explain the provisions regarding gifts received by an assessee,
6. explain the tax treatment of amount received from life insurance policy,
7. list out the deductions available and not available in computing income from other sources
8. list out the various tax concessions available in respect of specified securities and specified assesses.

SESSION 1: INTRODUCTION TO INCOME FROM OTHER SOURCES AND TAX TREATMENT OF CERTAIN ITEMS

BASIS OF CHARGES

As per section 92, "Income from other sources" is the last and residual head of income and, hence, income chargeable under Income-tax Act, which does not specifically fall for assessment under any other head, must be charged to tax as "income from other sources". Therefore, an income which is not income from "Salaries", "House property", "Profits and gains of business or profession" or "Capital gains", is to be computed and brought to charge under the head "Income from Other Sources".
In addition to the taxation of income not covered by the other heads, Section 92(2) specifically provides certain items of incomes as being chargeable to tax under the head.

Sections 92 list out the incomes which are taxable under this head. While section 93 provides for deductions available against the income included under this head and section 94 specified the amounts not deductible.

INCOME CHARGEABLE UNDER THE HEAD 'INCOME FROM OTHER SOURCES

There are certain incomes which are always taxed under this head. These incomes are as follows:

1. **Dividends**

Dividends are always taxed under this head. Income by way of dividend is always taxable under the head "Income from other sources". Dividend and deemed dividend are taxable in the hands of shareholders under this head, regardless of the fact whether shares are held by the assessee as investment or as stock in trade.

Meaning of the term 'Dividend' [Section 2(40)]

The ordinary meaning of the term dividend is the profits distributed by a company to its shareholders. As per section 2(40) provide an inclusive definition of dividend. Accordingly, dividend include the following:

(a) **Any distribution by a company of accumulated profits, whether capitalised or not**, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company shall be deemed as dividend.

(b) **Any distribution, by a company to its shareholders, of debentures debenture stock or deposit certificates in any form,** with or without interest and any distribution to its preference shareholders of shares by way of bonus to the extent to which the company possesses accumulated profits, whether capitalised or not shall be deemed as dividend

(c) **Any distribution made to the shareholders of a company on its liquidation,** to the extent to which such distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not shall be deemed as dividend. However, any distribution made in respect of shares issued for full cash consideration, where the shareholder is not entitled to participate in the surplus assets in the event of liquidation shall not be considered as dividend.

(d) **Any distribution to its shareholders by a company on the reduction of its share capital,** to the extent to which the company possesses accumulated profits, whether capitalised or not shall be deemed as dividend. However, any distribution made in respect of shares issued for full cash consideration, where the shareholder is not entitled to participate in the surplus assets in the event of liquidation shall not be considered as dividend.

(e) **Any payment made by a company, in which the public are not substantially interested** to any shareholder who is the beneficial owner of shares having 10% or more of the voting power of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

In simple terms, it means that if a closely held company gives an advance or loan to shareholder holding 10% or more voting power, it shall be considered as dividend to the extent of accumulated profits of the company.

Note: Subsequent repayment of loan or charge of interest at market rate does not make any difference while considering loan as deemed dividend.

Advance or loan by a closely held company to a specified concern – If a closely held company gives an advance or loan to a concern in which shareholder holding 10% or more voting power holds substantial interest (20% or more income), it shall be considered as dividend to the extent of accumulated profits of the company.

Exceptions:

(i) If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder or to the specified concern is not deemed to be dividend.

(ii) Where a loan had been treated as dividend and subsequently, the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again treated as a dividend.

(iii) Loan would not be deemed as dividend in case of trade advances. Trade advances mean advance which is in the nature of commercial transaction.

2. Winnings from lotteries

Winnings from lotteries, crossword puzzles, races including horse races, card game and other game of any sort, gambling or betting of any form, are always taxed under this head. Such income is taxable under this head even if the assessee claims to carry on any trade or adventure in these activities as part of his business.

The entire income of winnings will be taxable. However, expenses relating to the activity of owning and maintaining racehorses are allowable. Further, the rate of income-tax on such income is 30% + surcharge, if applicable + health and education cess @ 4%.

3. Income by way of interest received on compensation or on enhanced compensation

Income by way of interest received on compensation or on enhanced compensation shall be chargeable to tax under the head "Income from other sources". Such income shall be deemed to be the income of the year in which it is received, irrespective of the method of accounting followed by the assessee.

However, a deduction of a sum equal to 50% of such income shall be allowed from such income. Apart from this, no other deduction shall be allowed from such an income.

4. Gifts

Gifts received by an individual or HUF (which are chargeable to tax) are also taxed under this head.

In addition to above, following incomes are charged to tax under this head, *if not taxed under the head "Profits and gains of business or profession"*:

1. Any contribution to a fund for welfare of employees received by the assessee from his employees in his capacity as an employer. But if the employer deposits such amount on or before due date of filing of return of income, he will be allowed a deduction on account of the same.
2. Any sum received under a Keyman Insurance Policy including bonus.
3. Income by way of interest on securities.
4. Income from letting out or hiring of plant, machinery or furniture.
5. Income from letting out of plant, machinery or furniture along with building; both the lettings are inseparable.

Beside the above, there are some other incomes which are also chargeable under the head "Income from Other Sources‟. For example:

1. Any fees or commission received by an employee from a person other than his employer.
2. Any annuity received under a Will. It does not include an annuity received by an employee from his employer.
3. All interest other than interest on securities, e.g. interest on bank deposits, interest on loan, etc.
4. Income of a tenant from sub-letting the whole or a part of the house property.
5. Remuneration received by a teacher or a lawyer for doing examination work.
6. Royalty.
7. Director's fees.
8. Rent of land not appurtenant to any building.
9. Agricultural Income from land situated outside India.
10. Income from markets, ferries and fisheries, etc.

RELEVANCE OF METHOD OF ACCOUNTING

An assessee can choose either the Cash System or the Mercantile (Accrual) System. This method must be followed consistently for the entire head of income. Under Mercantile system, income and expenditure are recognized when they accrue, regardless of the date of actual receipt or payment. Whereas under cash system, income and expenditure are recognized only upon actual receipt or payment. If no method of accounting is regularly employed, Interest on Securities is chargeable to tax in the year in which it becomes due (Mercantile basis). However, if it was already taxed in an earlier year on a receipt basis, it won't be taxed again when due.

Interest on Compensation/Enhanced Compensation (Section 278): Such interest is always taxable in the year of receipt, even if the assessee follows the mercantile system.

Illustration 1

The following incomes are received by Mr. Kumar during financial year 2026-27

i.	Dividend from Indian company	10,000
ii.	Interest on securities (gross)	5,000
iii.	Director's fees	10,000
iv.	Income from agricultural land in Nepal	30,000
v.	Rent from Let out land in Pathankot	40,000
vi.	Interest on fixed deposit with HDFC Bank	2,000
vii.	Rent from sub-letting a house	56,000
viii.	Other expenses on sublet house	2,000
ix.	Rent payable by Mr. Kumar for the sublet house	24,000
x.	Winning from horse race (gross)	30,000

You are required to calculate income from other sources of Mr. Kumar for the tax year 2026-27.

Solution

	Dividend from Indian company		10,000
	Interest on securities (gross)		5,000
	Director's fees		10,000
	Income from agricultural land in Nepal		30,000
	Rent from Let out of land in Pathankot		40,000
	Interest on fixed deposit with HDFC Bank		2,000
	Rent from sub-letting a house	56,000	
	Less: Rent payable for the sub-let house	24,000	
	Less: Other expenses	2,000	
			30,000
	Winning from horse race (gross)		30,000
Income from other sources of Mr. Kumar			**1,57,000**

TAX TREATMENT OF GIFTS [SECTION 92(2)(m)]

The provisions related to taxation of gifts are as follows:

Where an individual or a Hindu undivided family receives, in any tax year, from any person

a. any sum of money, without consideration, the total of which exceeds ` 50,000, the whole of such sum shall be chargeable to tax under this head. In simple terms, it means gift of money aggregating to more than ` 50,000, shall be considered income under this head.

b. any immovable property

(i) If gift of immovable property is received, where stamp duty value is more than ` 50,000, the stamp duty value (SDV) shall be considered as income under this head.

(ii) If immovable property is received (not as a gift) for a value lesser than its stamp duty value and SDV (–) consideration > [50,000 or 10% of consideration, whichever is higher], then (SDV (–) consideration) shall be considered as income under this head.

Value of property to be considered where the date of agreement is different from date of registration: Taking into consideration the possible time gap between the date of agreement and the date of registration, the stamp duty value on the date of agreement may be taken if whole or part of the consideration has been paid in banking or online mode on or before the date of agreement.

Banking or online mode means account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through prescribed electronic modes.

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) and Aadhar Pay.

c. any property, other than immovable property

(i) If gift of movable property is received, where aggregate fair market value is more than ` 50,000, the whole of aggregate fair market value shall be considered as income under this head.

(ii) If movable property is received (not as a gift) for a value lesser than its fair market value (FMV) and aggregate FMV (–) consideration > ` 50,000, then [aggregate FMV (–) consideration] shall be considered as income under this head.

The gift of any sum or value of any property will not be taxable in the hands of recipient if such sum of money, or any property received:

a. from any relative; or

b. on the occasion of the marriage of the individual; or

c. under a will or by way of inheritance; or

d. in contemplation of death of the payer or donor, as the case may be; or

e. from any local authority; or

f. from or by any registered non-profit organisation; or

g. from an individual by a trust created or established solely for the benefit of relative of the individual.

Meaning of certain terms

a. "Property" means the following capital asset of the assessee, namely:

   (i) immovable property being land or building or both;

   (ii) shares and securities;

   (iii) jewellery;

   (iv) archaeological collections;

   (v) drawings;

   (vi) paintings;

   (vii) sculptures; or

   (viii) any work of art or

   (ix) bullion or

   (x) virtual digital asset

b. "stamp duty value" means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property;

c. "relative" means, –

   1. in case of an individual

      (i) spouse;

      (ii) brother or sister;

      (iii) brother or sister of the spouse;

      (iv) brother or sister of either of the parents;

      (v) any lineal ascendant (maternal as well as paternal) or descendant;

      (vi) any lineal ascendant (maternal as well as paternal) or descendant of the spouse;

      (vii) spouse of any of the persons referred in items (ii) to (vi) above.

   2. In case of Hindu Undivided Family, any member thereof

TREATMENT OF AMOUNTS RECEIVED FROM LIFE INSURANCE POLICY

Amounts received from life insurance policy shall be treated as follows:

(1) If any sum is received from life insurance policy on the death of a person, it is exempt irrespective of the annual premium payable on the policy.

(2) In respect of policies issued on or after 1.4.2023, exemption of amount received from the policy is available if

(i) the premium to sum assured ratio is ≤ 15% for "special policies". Special policies are those which are taken in the name of persons suffering from disability or severe disease or ailments as specified.

(ii) the premium to sum assured ratio is ≤ 10% for other policies.

(iii) Further, the aggregate of premium for all such policies should ≤ ` 5,00,000 in any of the tax years during the term of all such policies.

Illustration 2

During the year 2026-27, Mr. Kumar received following gifts. Ascertain the total amount of gift charged to tax.

1. ` 10,82,000 received on account of will of his grandfather.
2. Gift of ` 15,100 received from his friend on his birthday.
3. ` 10,000 received from his friends on the occasion of marriage anniversary.
4. Gift of ` 1,14,000 from his father.

Solution

The tax treatment of various items in the hands of Mr. Kumar will be as follows:

1. Money received on account of 'Will' is exempted from tax and, hence, nothing will be charged to tax.
2. Gift received from the friends is not covered in any of the exemptions and, hence, ` 15,100 received from his friend on his birthday will be charged to tax.
3. Money received on account of marriage of an individual is exempted from taxation. However, the benefit is not available in respect of money received on marriage anniversary. Hence, ` 10,000 received from his friends on account of marriage anniversary will be charged to tax.
4. Gift received from father will not he charged to tax (since father is covered in the definition of relative), hence, ` 1,14,000 will not be charged to tax.

Therefore, the total amount of gift not covered in any of the specified exemptions will come to ` 25,100 (i.e., ` 15,100 + ` 10,000). If the gift not covered in specified exemptions does not exceed ` 50,000 then nothing is charged to tax. In this case, the amount of gift not covered in the exemptions comes to ` 25,100 (which is less than ` 50,000), hence, nothing will be charged to tax.

Illustration 3

From the following information provided by Mrs. Verma, ascertain the tax treatment of various items.

1. Gold jewellery worth ` 2,84,000 received from her mother.
2. Shares valuing ` 20,000 received by way of gift from her brother.

3. A painting worth ` 2,50,000 received from a friend on the occasion of her marriage.
4. A diamond necklace amounting to ` 60,000 received from a friend on the occasion of her friend's marriage.
5. Gold bangles purchased for ` 64,000; the fair market value of gold jewellery is ` 1,34,000.
6. Bullion purchased for ` 5,70,000; the fair market value of the bullion is ` 5,40,000.
7. A refrigerator purchased for ` 38,000, the fair market value of refrigerator is ` 90,000.

Solution:

The tax treatment of various items in the hands of Mrs. Verma will be as follows:

1. Gift received from mother will not be charged to tax (since mother is covered in the definition of relative). Hence, gift of gold amounting to ` 2,84,000 received from her mother will not be charged to tax.
2. Gift received from brother will not be charged to tax (since brother is covered in the definition of relative). Hence, gift of shares amounting to ` 20,000 received from her brother will not be charged to tax.
3. Gift received on the occasion of marriage of an individual is covered in exemptions. Hence gift of painting amounting to ` 2,50,000 received from a friend on the occasion of her marriage will not be charged to tax.
4. Gift received on occasion of marriage of an individual is not charged to tax. But, in this case the gift is received on the occasion of marriage of a friend of Mrs. Verma. Hence, gift of diamond necklace amounting to ` 60,000 received from friend on the occasion of her friend's marriage will not be covered in the exemptions prescribed above.
5. The gold bangles are purchased at ` 64,000 while the fair market value is ` 1,34,000. The excess of fair market value over the purchase price will amount to ` 70,000 (i.e., ` 1,34,000 – ` 64,000). Hence, ` 70,000 will be charged to tax in respect of purchase of gold jewellery.
6. The fair market value of bullion is ` 5,40,000. However, the same is purchased for ` 5,70,000 which is more than the fair market value. In other words, in this case the purchase price is more than the fair market value and, hence, nothing will be charged to tax.
7. Refrigerator does not come under the definition of specified movable property, hence, nothing will be taxed in respect of purchase of refrigerator.

Considering above discussion, the total amount of gift not covered in any of the specified exemptions will come to ` 1,30,000 (60,000 + 70,000). If the gift not covered in specified exemptions exceeds ` 50,000 then the entire amount of such gift is charged to tax. Hence, taxable amount of gift will come to ` 1,30,000.

Illustration 4

On 25-2-2027, Mr. Kumar sold his personal house to his friend Mr. Sharma for ` 1,00,000. The market value of the building was ` 20,60,000 and the value of the building adopted by the Stamp Valuation Authority for charging stamp duty was ` 21,00,000. What will be the tax implications of the above items in the hands of Mr. Sharma?

Solution:

The house has been transferred by Mr. Kumar to his friend Mr. Sharma. Since a friend is **not** a "Relative" as defined under the Income-tax Act, this transaction triggers tax implications.

In the hands of Mr. Sharma (The Receiver): As per **Section 92(2)(m)**, the Stamp Duty Value exceeds the sales consideration of ` 1,00,000,

SDV – Consideration = ` 21,00,000 – ` 1,00,000 = ` 20,00,000

Comparing the excess amount i.e., ` 20,00,000 with ` 50,000 or 10% of consideration i.e., Rs 10,000, whichever is higher. Since ` 20,00,000 exceeds ` 50,000, therefore the excess amount of ` 20,00,000 shall be taxable as income from other sources in the hands of Mr. Sharma.

Knowledge Assessment - I

1. Mr. Rizvi received a rent of ` 2,00,000 in respect of letting out of residential building and rent of ` 50,000 in respect of providing other amenities like lift services, power back up and society parks during the tax year 2026-27. Hence, rent of ` 50,000 is taxable under the head

   a. Income from other sources

   b. Income from house property

   c. Profits and gains from business or profession

   d. None of the above

2. Mr. Raja received a sum of ` 1,68,000 during the tax year 2026-27 from the Government as interest on compensation for compulsory acquisition of industrial land. In this case, what will be the amount chargeable to tax under the head “Income from other sources”?

   a. Nil

   b. ` 1,68,000

   c. ` 84,000

   d. Any amount as per the choice of Mr. Raja

3. Mr. Raja won from lotteries a sum of ` 1,84,000 (after deducting the tax @ 30%) during the tax year 2026-27. What is the amount chargeable to tax under the head "Income from other sources"?

   a. ` 1,84,000

   b. ` 1,28,800

   c. ` 2,62,857

   d. Nothing will be taxable as "Income from other sources"

4. On 1st April, 2026, Mr. Soham held 8% debentures (non-listed) of SM Ltd. of ` 52,000. He received interest of ` 3,744 (net of tax deducted at source @ 10%). What will be the amount chargeable to tax in the hands of Mr. Soham while computing income chargeable to tax under the head "Income from other sources"?

   a. ` 3,744

   b. ` 4,160

   c. ` 52,000

   d. Nil

5. Money/property received in contemplation of death of the payer is charged to tax under which of the following head?

   a. Profits and Gains of business or profession

   b. Income from other sources

   c. Capital gains

   d. It is not charged to tax

6. "Property" means which of the following capital assets of the assessee?

   a. Shares and securities

   b. Jewellery

   c. Drawings

   d. All of the above

7. As per section 2(40), dividend does not include_____.

   a. Loan granted by a closely held company to its shareholder in the ordinary course of business

   b. Any distribution if such distribution entails the release of all or any part of the assets of the company to the extent of accumulated profits of the company

c. Any distribution made on liquidation of a company to the extent of accumulated profits of the company

d. Any distribution on the reduction of capital of a company to the extent of accumulated profits of the company

8. During the year 2026-27, Mr. Naqvi received painting of ` 52,000 from his friend. What will be the amount chargeable to tax under the head “Income from other sources”?

   a. ` 52,252

   b. ` 52,000

   c. ` 50,000

   d. Nil

Answers

1. a; 2. c; 3. c; 4. b; 5. d; 6. d; 7. a; 8. b;

SESSION 2: DEDUCTIONS UNDER INCOME FROM OTHER SOURCES AND TAX CONCESSIONS

DEDUCTIONS ALLOWABLE IN COMPUTING INCOME FROM OTHER SOURCES [SECTION 93]

Following deductions are available while calculating the income chargeable under the head "Income from other sources":

1. Interest on securities**:** Any reasonable sum paid as commission or remuneration to banker or any other person for the purpose of realizing such interest is deductible.
2. Where the income to be charged under this head is from letting **on hire of machinery, plant and furniture, with or without building:** The following items of deductions are allowable in the computation of such income:
   - (i) the amount paid on account of any current repairs to the machinery, plant or furniture.
   - (ii) land revenue, local rates or municipal taxes paid.
   - (ii) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.
   - (iii) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.
3. Income in the nature of family pension**:** A deduction of a sum equal to one third of such income or ` 15,000 (in case of optional regime), whichever is less, or one third of such income or ` 25,000 (in case of default regime), whichever is less, is allowable.

   For the purposes of this deduction "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.
4. From interest on compensation or enhanced compensation: A deduction of a sum equal to 50% of such income shall be allowed as deduction. No other further deduction for any other expenditure shall be allowed.
5. Other deductions**:** Any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income during the relevant tax year shall be allowed.

Note: In respect of dividend income, no deduction shall be allowed.

AMOUNTS NOT DEDUCTIBLE [SECTION 94]

Under section 94, following expenditures are not deductible while computing income chargeable to tax under the head "Income from other sources":

(1) No deduction shall be allowed in computing the "Income from other sources" for

  (i) any personal expense of the assessee;

  (ii) any interest payable outside India on which tax has not been paid or deducted at source.

  (iii) any salary payable outside India on which tax has not been paid or deducted at source.

(2) No deduction shall be allowed where payment is made to a related person and the same is considered excessive or unreasonable by the Assessing Officer, having regard to the fair market value of the goods or services.

(3) No deduction shall be allowed where payment exceeding ` 10,000 is made to a person in a day, through any mode other than account payee cheque or draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM and Aadhar Pay.

(4) 30% of expenditure shall not be allowed, in respect of a sum which is payable to a resident and on which tax is deductible at source, if

- such tax has not been deducted or;
- such tax after deduction has not been paid up to the due date of return specified in section 263(1).

(5) No deduction in respect of any expenditure in connection with winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, from the activity of owning and maintaining race horses.

TAX CONCESSIONS

A. Exempted Interest

Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Govt and deposits are exempt subject to such conditions and limits as specified therein.
Examples of exempted interest include:

(1) Interest on Post Office Savings Bank Account would be exempt from tax to the extent of:

  (a) ` 3,500 in case of an individual account.

  (b) ` 7,000 in case of a joint account.

(2) Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015 notified by the Central Government would be exempt.

Knowledge Assessment – II

State whether the following statements are true or false:

1. Capital expenditure can be allowed as a deduction from the income chargeable under the head "income from other sources".
2. Only current repairs are allowed as deduction from the income from letting of plant, machinery, etc. chargeable under other sources.
3. Family pension is taxable as income from other sources.
4. In respect of income chargeable to tax under the head "Income from other sources", no deduction will be available on account of any sum paid on account of income-tax.
5. A deduction of lower of ` 15,000 or 33 1/3% of the income is available in case of income in the nature of family pension, if the assessee opts for paying tax under optional regime.
6. In respect of rental income from plant, machinery, furniture and building chargeable to tax under the head "Income from other sources", deduction is available on account of premium paid on life insurance of the owner of the property.
7. Commission or remuneration paid to earn interest income which is chargeable to tax under the head "Income from other sources", deduction is allowed under the head "Income from other sources".
8. A deduction of a sum equal to 30% of interest on compensation or enhanced compensation is allowed and no further deduction shall be allowed.

Answers

1. False, 2. True, 3. True, 4. True, 5. True, 6. False, 7. True, 8. False

KEYWORDS

1. **Dividend:** Dividend has been defined in section 2(40) which gives an inclusive but not exhaustive definition of dividend.
2. **Gift:** From the taxation angle, a gift is a sum of money or property received by an individual or HUF without consideration or without adequate consideration.
3. **Property:** "Property" means the following capital asset of the assessee, namely: immovable property being land or building or both; shares and securities; jewellery; archaeological collections; drawings; paintings; sculptures; or any work of art or bullion or virtual digital assets.
4. **Relative:** "Relative" means, in case of an individual,
   (i) spouse of the individual;
   (ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant (maternal as well as paternal) or descendant of the individual;

(vi) any lineal ascendant (maternal as well as paternal) or descendant of the spouse of the individual;

(vii) spouse of the person referred in (ii to vi) above;

and in case of a Hindu undivided family, any member thereof.

5. **Stamp duty value:** It means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property

6. **Family pension:** It is a regular monthly amount payable by an employer to a person belonging to the family of an employee in the event of his death.

SUMMARY

- Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as "Income from other sources".
- Section 92(2) specifically provides for the certain items of incomes as being chargeable to tax under the head such as dividend, winnings from lotteries, interest received from compensation or enhanced compensation, and gifts. Some income are taxable under this head if not charged under Profits from Business and Profession like contribution to provident fund, income by way of interest on securities, income from hiring machinery etc., hiring out of building with machinery etc.
- The basis of charge on income by way of interest on securities is on "receipt" basis if books of account are maintained on cash basis. If the assessee does not maintain books of account or, when he maintains books of account on the basis of "mercantile system", it is taxable on "due" basis.
- Dividend is taxable in the hands of shareholders under this head. Section 2(40) gives an inclusive definition of dividend.
- The provisions related to taxation of gifts are given in Section 92(2)(m). From the taxation angle, gifts received by an individual can be classified into 5 categories:-
    - Sum of money received without consideration (commonly known as monetary gift).
    - Specified movable property received without consideration (commonly known as non-monetary gift).
    - Specified movable property received without adequate consideration.

- Immovable property received without consideration.
- Immovable property received without adequate consideration.

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

  (i) sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising interest;

  (ii) Current (not capital) repairs, insurance premium and depreciation in respect of plant, machinery, furniture and buildings are deductible from rent income, where income is chargeable under this head.

  (iii) a sum equal to one third of the income or ` 15,000, whichever is less, is allowable as a deduction from family pension under optional regime and one third of the income or ` 25,000, whichever is less, is allowable as a deduction from family pension under default regime;

  (iv) a deduction of a sum equal to 50% from interest on compensation or enhanced compensation, and

  (v) any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. However, no deduction shall be allowed in respect of dividend income.

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

  (i) any personal expenses of the assessee.

  (ii) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.

  (iii) any payment taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.

  (iv) any expenditure incurred in connection with casual income such as winnings from lotteries, card games, horse races etc.

EXERCISE QUESTIONS

Short Answer Questions

1. Which incomes are charged to tax under the head Income from Other Sources if not charged under the head Profits from Business and Profession?
2. Which items are excluded from the definition of dividend under section 2(40)?
3. What expenses are not allowed to be deducted under the head "Income from other sources"?
4. Whether the method of accounting followed by the assessee has any relevance while computing income chargeable to tax under the head "Income from other sources"?
5. Explain the exemption available in respect of interest on securities.

Long Answer Questions

1. Explain the tax treatment of maturity amount received from life insurance policy.
2. What expenses are allowed to be deducted under the head "Income from other sources"?
3. What are the incomes chargeable under the head "Income from other sources"?
4. Explain the taxation of gifts under section 92(2) (m).
5. Explain the term "dividend" under section 2(40).

Numerical Questions

1. Ascertain the head of taxability of the incomes given below:
   a. Dividend of ` 64,000 received by Mr. Kumar from an Indian company.
   b. Rental income of open plot of land of ` 56,200 received by Mr. Kumar.
   c. ` 4,600 won by Mr. Kumar from a crossword puzzle.
   d. ` 1,64,000 received by Mr. Kumar from the friends of his wife on his wedding anniversary.
   e. Rent of ` 2,67,000 for building let out (` 1,50,000 relates to building and ` 1,17,000 to other amenities) received by Mr. Kumar.
   f. Interest on enhanced compensation amounting to ` 1,53,200 received by Mr. Kumar from the Government for compulsory acquisition of Industrial land.
   g. Interest of ` 8,462 received by Mr. Kumar on a bank deposit.

   (Answer: a, b, c, d, f, g- taxable under the head "income from other sources"; e- ` 1,50,000 taxable under the head "income from house property" and ` 1,17,000 taxable under the head "income from other sources")

2. On 25-2-2027, Mr. Kaushal gifted a building to his friend Mr. Amar for ` 8,40,000. The value of the building adopted by the Stamp Valuation Authority for charging stamp duty is ` 18,40,000. What will be the tax implications of the above transaction in the hands of Mr. Amar?

   (Answer: ` 10,00,000 will be charged to tax as income from other sources)

3. Mr. Ashok who draws a salary of ` 35,000 p.m. received the following gifts during the tax year 2026-27. What shall be the taxable income for the tax year 2026-27, assuming he pays tax under the default scheme u/s 202(1).

   a. Gift of ` 5,000 on July 23, 2026 from his friend.

   b. Jewellery worth ` 15,000 on Oct. 3, 2026 from his fiancee.

   c. An antique item of ` 21,000 each from his two friends on March 29, 2027 on his marriage.

   d. Gift of ` 18,000 on Oct. 2, 2026 from the brother of his father.

   e. Gift of ` 35,000 on March 21, 2027 from friend of his wife on the occasion of his marriage.

   f. Gift of ` 16,000 on Jan. 27, 2027 from father in law of his brother.

   g. Gift of ` 11,000 on September 9, 2026 from his friend.

   h. Gift of ` 30,000 from his employer.

   (Answer: income from salary- ` 3,75,000; income from gifts- Nil)

4. During the year 2026-27, Miss Shikha received following gifts:

   a. Painting received from her friend without consideration. Fair market value of the painting is ` 64,000.

   b. Archaeological collection received from her mother. Fair market value of such archaeological collection is ` 1,25,000.

   c. Jewellery received from her friends on her birthday. Fair market value of the jewellery is ` 2,82,000.

   d. Shares purchased for ` 3,84,000, the fair market value of the shares is ` 4,35,000.

   e. Sculptures purchased for ` 3,85,000; the fair market value of the sculptures is ` 4,00,000.

   f. A bike purchased for ` 84,000; the fair market value of bike is ` 30,000. Advise her regarding the tax treatment of above items.

   (Answer: taxable income- ` 3,97,000)

5. During the year 2026-27, Miss Nikita purchased the following assets:

   a. A plot of land for ` 9,00,000. The Stamp Value is ` 17,52,000.

   b. A residential building from her friend, Miss Shikha for ` 10,00,000. The value adopted by the Stamp Valuation Authority for charging stamp duty is ` 5,00,000.

   c. A plot of land (being a urban agricultural land) for ` 8,40,000; the fair market value of the land is ` 12,52,000.

   Apart from above, she also received rural agricultural land (fair market value of the land is ` 25,52,000) by way of gift from her mother. Advise her regarding the tax treatment of above assets.

   (**Answer:** ` 12,64,000)

6. On 4-8-2026, Mr. Sharma takes a life insurance policy. Sum assured is ` 30,00,000 and annual premium is ` 84,000. The policy will mature in 2028. Maturity value will be ` 18,00,000. Advise him regarding the tax treatment of amount to be received from above policy.

   (**Answer:** Nothing will be charged to tax in respect of amount received by Mr. Sharma; since the annual premium of the policy is less than 10% of the capital sum assured.)

7. Mr. Kumar submits the following particulars of income for the tax year ending March 31, 2027:

   Dividend from Satyam Finance Ltd. ` 3,700; interest paid on capital borrowed for investment in shares of Satyam Finance Ltd. ` 1,200; charges for collection of dividend ` 370.

   Winnings from lottery net amount `1,40,000. TDS was ` 60,000.

   Winnings from card games were ` 13,500.

   Interest on bonds issued by the Government of Singapore was ` 20,570.

   What will be the income of Mr. X under the head 'Income from other sources' for the tax year 2026-27?

   (Answer: ` 2,37,770)