

DIRECT TAX

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Basic concepts

Income tax Act, 1961.

Income Tax Act is divided into Chapters (From I to XXIII i.e. 1 to 23) Each Chapter is divided into 298 sections. Each Section deals with a specific matter ("provision") and is further divided into sub-section, clauses and sub-clauses.

e.g. 17(2)(c)(i) means Section 17, Sub-section 2, Clause c, sub-clause (i)
Definition Previous Year Sec (3)

The year in which income is earned is known as Previous Year and the next year in which income is assessed is known as Assessment Year. It is mandatory for all assesses to follow financial year (from 1st April to 31st March) as previous year for Income-Tax purpose.

Assessment years(2(9)) Assessment year means the period of 12 months commencing on the 1st day of April every year.

E.g., A.Y. 2020-21 is a year, which commences on April 1, 2020 and ends on March 31, 2021. Income of an assessee earned in the Previous year 2019-2020 is assessed in the A.Y. 2020-21.

Income[Sec. 2(24)]

- It includes:
- Profit & Gains
- Dividends
- Voluntary Contribution received by Church, Masjid and Mandir
- Income from Salary: Bonus, Gratuity, Compensation, Provident Fund, House Rent Allowance, Travelling Allowance
- Income from House Property : Rent from House Sub-letter
- Income from Business & Profession
- Income from Other Sources : Horse Race, Gambling, Lottery
- Income from Capital Gain: Sale of Assets

Person[Sec.2 (31)]

The term person includes the following:

- (i) an Individual;
- (ii) a Hindu Undivided Family (HUF);
- (iii) a Company;
- (iv) a Firm;
- (v) an Association of Persons (AOP) or a Body of Individuals (BOI), whether incorporated or not;

(vi) a Local Authority; &

(vii) Artificial Juridical Person not falling within any of the preceding categories.

- Individual The word 'individual' means a natural person, i.e. human being. "Individual" includes a minor or a person of unsound mind. Trustee of a discretionary trust shall be assessed as an individual

- Hindu Undivided Family (HUF): It consists of all persons lineally descended from a common ancestor & includes their wives & unmarried daughters. The laws of a Company [Sec. 2(17)] means:

a. any Indian Company; or

b. any body corporate, incorporated under the foreign country;

c. any institution, association or body which is or was assessable or was assessed as a company for any assessment year on or before April 1, 1970;

- Firm Persons: who enter into such business, are individually known as Partners and such business is known as a Firm. Firm has separate entity in the eyes of Income-tax Act

- Association of Persons (AOP): An AOP means a group of persons (whether Individuals, HUF, Companies, Firms, etc.) who join together for common purpose.

- Body of Individual: BOI means a group of individuals (individual only) who join together for common purpose whether or not to earn income.

- Local Authority: As per Sec. 3(31) of the General Clause Act, a local authority means a Municipal Committee, District Board, Body of Port Commissioners, Panchayat, and Cantonment Board.

- Artificial Juridical Person are entities – which are not natural person; has separate entity in the eyes of law; may not be directly sued in a court of law but they can be sued through person(s) managing them E.g.: Deities, Idols, University, Bar Council, etc.

Resident Individual Sec 6

(1) Basic Condition: Individual is said to Resident of India, in any previous year, if he satisfy any one of the following two basic conditions 1) He is India, during that previous year, for a period of 182 days or more OR

2) a) he is in India, for 365 days or more during the 4 years immediately preceding the previous year AND

b) He is in India during the previous year for a period of 120 days or more

Exception of Sec 6(1)

Following person have to satisfy only First Condition of 182 days only

- A Citizen of India, or an Indian member of a crew of an Indian Ship, who leaves India for the purpose of Employment
- A Citizen of India, or a person of Indian Origin, who being outside India, comes on a visit to India

Resident & Ordinary Resident Individual Sec 6(6)

Basic Condition:

Individual is said to Ordinary Resident of India, in any previous year, if he satisfy any one of the following two basic conditions

1) He has been a resident in India for at least 1 out of 10 year immediately preceding the previous year AND

2) A) he has been in India for a period of 730 days or more during the 7 years immediately preceding the previous year

Note: If Individual does not satisfy the above condition, then he is NON Resident of India during previous year

Scope of Total Income – Sec(5)

Nature of Income	Resident & Ordinary Resident	Resident But Not Ordinary Resident	Non Resident
Income received in India	Taxable	Taxable	Taxable
Income which accrues or arises in India	Taxable	Taxable	Taxable
Income deemed to be received in India	Taxable	Taxable	Taxable
Income deemed to accrue in India	Taxable	Taxable	Taxable
Business controlled from India/ Profession set up in India	Taxable	Taxable	Taxable
Any other Income which Accrues outside India	Taxable	Not Taxable	Not Taxable

Introduction of Salaries Salary means a fixed payment made periodically as compensation for regular services rendered .It covers wages paid for manual work , salary paid for clerical jobs and remuneration paid to executives and managers

Who is Taxable?

Employer – Employee

Relationship

Boss - Worker Relationship

What is included in Salary?

According to Section 17(1) Salary includes-

- Wages and salaries including advance of salary
- Annuity or pension
- Gratuity
- Fees and commission
- Perquisites
- Profits in lieu of salary or in addition to salary or wages

Computation of Income from Salary

Name of Assess: Previous

Year: Status: Assessment

Year:

Particulars	Amount
1. Salary a. Gross = Net + Deduction b. Due/ Deemed to Accrue in India c. Advance/ Arrears Received	
2. Allowance a. Dearness Allowance b. Entertainment Allowance c. Leave Travel Allowance house Rent Allowance Allowance	

Pension

Particulars	Amount
3. Annuity (Less Exempt u/s 10(13))	

<p>4. Pension</p> <p>a. Uncommuted Pension (monthly) commuted Pension</p> <p>Less: Exempt u/s 10 (10A)</p> <p>1. Government Employee ----- Fully Exempt</p> <p>2. Non- Government Employee</p> <p>a. With Gratuity , 1/3 of full commuted value</p> <p>b. Without Gratuity, 1/2 of full commuted value</p>	<p>Taxable</p>
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Gratuity

Particulars	Amount
<p>5. Gratuity (Gross – Exempt u/s 10(10))</p> <p>Less Exempt</p> <p>1. Government Employee – Fully Exempt</p> <p>2. Employee under Payment of Gratuity Act- Least of</p> <p>a. Salary p.m. X 15/26 X Completed year of Service</p> <p>b. Max limit – Rs 20,00,000</p> <p>c. Gratuity actually received</p> <p>3. Employee not covered under Payment of Gratuity Act- Least of</p> <p>a. 1/2 X Average Salary of last 10 month X Completed year of Service (Nos of Day should be 30 days)</p> <p>b. Max limit – Rs 20,00,000</p> <p>c. Gratuity actually received</p>	

Perquisites

Particulars	Amount

<p>6. Fees & Commission</p> <p>7.1. Perquisites Taxable for all Employees</p> <ul style="list-style-type: none">a. Rent – free Accommodationb. Concession in Rentc. Payment of Employee Obligations (Light Bill, Gas Bill, Water Bill and House Tax)d. LIC Premiume. Prescribed Amenities (Interest Free Loan/ Transfer of Property) <p>7.2. Perquisites not Taxable for all Employees</p> <ul style="list-style-type: none">a. Medical Treatment in Employer Hospitalb. Medical Treatment in Govt/ Approved Hospitalc. Premium on Employee Health Insuranced. Premium on Medi-claim Insurancee. Medical Treatment, Travel and Stay Abroad *	
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Profit in Lieu of Salary

- a. Compensation of Termination of Employment
- b. Compensation for modification of Terms of Employment
- c. Employer Contribution to PF + Interest
- d. Keyman Insurance Policy

Less : Exempt/ Spent on Compensation

Leave Encashment

(Gross - Exempt u/s 10(10AA))

- I. Government Employee – Fully Exempt
- II. Non – Government Employee – Least of
 - a. Encashment of Earned Leave (@30day pea)
 - b. 10 X Average Salary for last 10 months
 - c. Max Limit – Rs 300000
 - d. Amount actually received

Deduction under Sec16

- 10. Gross Taxable Salary (1 to 9)
- 11. Deduction under Sec 16
 - I. Standard Deduction (up to Rs 50000)
 - II. Professional Tax

III. Entertainment Allowance

Government Employee – least of

- a. 1/5 of Basic Salary
- b. Max Limit – Rs 5000
- c. Actual Allowance (paid)

Net Taxable Salary

12. Net Taxable Salary

(Gross – Deduction)

Section

Gratuity u/s 10(10)

Leave Travel allowance 10(5)

Pension 10(10A)

Encashment of Leave Salary 10(10AA)

Retrenchment Compensation 10(10B)

Amount	Statutory PF	Recognised PF	Unrecognised PF
Employers contribution during prev. yr.	Exempt	Exempt up to 12% of basic salary, Excess is taxable	Exempt
Interest Credited during prev. yr.	Exempt	Exempt if rate up to 9.5% p.a. excess is taxable	Exempt
Lumpsum payment on retirement etc.	Exempt	Exempt subject to rules	Employers contribution & interest, Taxable U/S 17(3)

Allowance & Pension

- a. Children education allowance (@100p.m per child for up to 2 children)
- b. Children Hostel expenses allowance (@300 p.m. per child for up to 2 children)
- c. Transport allowance for travelling between home and office in case of a blind or deaf or dumb or handicapped Rs 3200p.m

Income from House Property

CHARGING SECTION (Sec. 22)

The Annual value of Property consisting of any buildings or lands appurtenant thereto of which the “Assessed” is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to Income-tax under the head "Income from house property".

ANNUAL VALUE

- “Annual Value” is also known as “Gross Annual Value (GAV)”
- Annual value is the rental income which is received or deemed to be received on a particular “House property” for a particular Assessment year.
- It is also applicable even if the assessee runs a business of renting properties.

DEFINITION OF PROPERTY

- It should be a property consisting of building or land appurtenant thereto
- The property should be owned by the Assessee
- The property should not be used by the owner for his own business or profession, the profit of which is chargeable to Income tax.

MEANING OF PROPERTY

- A house property can be a home, an office, a shop or a parking lot
- I-Tax Act doesn't differentiate between commercial and residential property
- However, if the owner himself is using such a property for business or profession, then it will be charged under the head “Income from Business or Profession”

CLASSIFICATION OF PROPERTY

The house properties can be classified mainly in 3 parts –

1. Self – Occupied property (SOP)
2. Let Out Property (LOP)
3. Deemed to be Let Out property (DLOP)

SOP	LOP	DLOP
House property which is occupied by the Assessee for his own residence	house property which is given on rent by the Assessee	House property which is not let out but still assumed to be let out
2 house properties can be claimed as SOPs unless any rent is charged on that property	Any property on which rent is charged will be an LOP	It's the 3 rd house property which cannot be claimed as an SOP
The G.A.V for such properties will always be “Zero”	The G.A.V. is calculated by comparing the Actual Rent and Expected Rent	The G.A.V. is calculated just like an LOP

No.	PARTICULARS	SOP	LOP/DLOP
1	Municipal value		XX
2	Fair rent		XX
3	(Higher of 1. & 2.)		XX
4	Standard Rent		XX
5	Expected Rent (Lower of 3. & 4.)		XX
6	Actual Rent Received		XX
7	Gross Annual Value (GAV) (Higher of 5. & 6.)		XX

RENT FOR VACANCY PERIOD

- While computing “Actual Rent”, rent pertaining to the period of vacancy is not to be deducted from the Actual rent.
- It is a benefit given to the Owner as he has lost rent because of vacancy.
- However the GAV will be only the amount of rent actually received.

NET INCOME FROM H.P

PARTICULARS	SOP	LOP/DLOP
Gross Annual Value (G.A.V.)	Nil	XX
Less – Municipal Taxes (If paid by the owner)	Nil	(XX)
Net Annual Value (N.A.V.)	Nil	XX
Less – Deductions u/s 24		
a) Standard Deduction (30%) of NAV	Nil	(XX)
b) Interest payable on loan for property	(XX)	(XX)
NET INCOME FROM HOUSE PROPERTY	(XX)	XX

INTEREST u/s 24(b)

- As you know, the Annual value (NAV) of SOP is always NIL
- For such properties, there is a limit for claiming Interest deduction –
 1. Interest on loan for repairs, renewal, etc. – Rs. 30,000
 2. Interest on loan for construction and Acquisition – Rs. 2,00,000

UNREALIZED RENT

- Unrealized rent is that rent which the owner is not able to collect from the tenant.
- This can be because the tenant has absconded or is not able to pay the rent.
- The tenant also must have taken adequate steps to collect this rent.

ARREARS OF RENT

- Arrears of rent is generally due to retrospective increase of rent.
- This is basically the rent that I could not collect in the previous years because of some dispute or ambiguity.
- It is basically the expected rent that I haven't received.

TAXABILITY OF UNREALIZED AND ARREARS OF RENT

- If Unrealized rent or Arrears of rent are actually received then –
 1. Both of them will be taxed in the previous year they are received.
 2. It will be taxable even if the assessee is no longer the owner of the property.
 3. Unrealized Rent won't be eligible for standard deduction, provided it is already deducted in the relevant previous year.

PRE - CONSTRUCTION INTEREST

- The interest on loan for property can be claimed only when the property is owned by the assessee.
- However, the owner may also take a loan before he is the owner of the property.
- The I-Tax Act, also provides the owner with the benefit for the interest he has paid before acquiring or constructing the house property.

PRE - CONSTRUCTION INTEREST

- It is the interest paid from the date of loan till the previous year immediately before acquiring or constructing the house property.
- This interest can be claimed as deduction in 5 consecutive years (PY) from the year of acquisition or construction.
- It can be claimed in 5 equal instalments.
- For an SOP, the limit is Rs. 2,00,000/- including such interest

Capital Gains

Meaning & Basic Charges of

Capital Gain Sec 45(1)

- Capital Gains means any profit or gains arising from the transfer of a Capital Assets.
- Income is Charged under the head of "Capital Gains: if following condition is satisfied:

1. There should be a Capital Assets
2. There should be transfer of Assets
3. It should be take place in the previous year
4. There should be Profits or Gains

Example of Capital Assets

- Gold Coin for Puja
- House
- Agricultural Land
- Goodwill of a Business
- Vacant Land
- Jewellery
- Share of AB Ltd
- Debenture of XY Ltd
- Notes: Things of Business Effect/ Uses, Immovable Property

Example of Not a Capital Assets

- Refrigerator
- Utensil of Home
- Personal Scooter

Notes: Things of Personal Effect/ Uses,

Movable Property

Types Of Capital Gains

- Short Term Capital Gain
- Share = Share held Less than 12 months
- Assets = Assets held Less than 36 months

Long Term Capital Gains

- Long Term Capital Gain
- Share = Share held more than 12 months
- Assets = Assets held more than 36 months

Calculation of Short Term Capital Gain(Sec48)

Step	Particular	Amount	Amount
1.	Full Value of Consideration		XXX
2.	Less: Transfer Expenses		(XX)
3.	Less: Cost of Acquisition		(XX)
4.	Less: Cost of Improvement	(XX)	(XXX)
5.	Short Term Capital Gains		XXX

Calculation Of Long Term Capital Gain (Sec48)

Step	Particular	Amount	Amount
1.	Full Value of Consideration		XXX
2.	Less: Transfer Expenses	(XX)	
3.	Less: Index Cost of Acquisition	(XX)	
4.	Less: Index Cost of Improvement	(XX)	(XXX)
5.	Long Term Capital Gains		XXX

Calculation Of Index Cost of Acquisition

Before 1-4-2001

- Index Cost of Acquisition
- = Higher of (COA or FMV) X CII for year of Transfer

100

After 1-4-2001

- Index Cost Of Acquisition
- = Cost of Acquisition X CII for year of Transfer CII for year of Acquisition

Calculation Of Index Cost of Improvement

Before 1-4-2001

- Index Cost Of Improvement = Nil After 1-4-2001
- Index Cost Of Improvement
- = Cost of Improvement X CII for year of Transfer

CII for year of Improvement

Profits and Gains from Business or Profession

INTRODUCTION

- The charging section for this head is Section 28.
- The charge under this head depends on the following 3 conditions –
 1. There should be a business or profession
 2. It should be carried on by the assessee
 3. It should be carried on during the previous year.

BUSINESS

- Sec 2(13) defines “business” as “business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.”
- Trade – Exchange of goods for money or any other goods.
- Commerce – A regular activity of trading in a large scale including related activities.
- Manufacture – Making articles (Finished goods) by converting raw materials.

PROFESSION OR VOCATION

- Both these activities involve provision of services and not goods.
- Profession – An occupation involving intellectual work requiring special knowledge or personal qualifications. For e.g. – CA, Lawyer, Doctor, Architect, etc.
- Vocation – Vocation involves manual or technical work which does not require any specific qualification. For e.g. – Hair cutting, Typing, Repair work, Spiritual talks, etc.

PROFITS

- Profits under PGBP should arise from a business. However there are 2 exceptions for this rule. The following 2 will not be charged to PGBP even though they are businesses.
 1. Rent from House property is always charged under “Income from House Property”
 2. Winning from Lottery, races etc. is always taxed under “Income from Other Sources”
- “Net Profits” are charged under income tax and not Gross profits.

PROFITS

- These profits should be earned in the previous year to be taxed in the Assessment year.
- The relevant P.Y. is 2019-20 and the relevant A.Y. is 2020-21.
- Profits should be computed according to the standard accounting principles and practices.

- Revenue losses regarding to the business, incurred in the PY are allowed to be deducted.

METHOD OF ACCOUNTING

- The profits of the business can be computed through any method of accounting.
- There are basically 2 methods of accounting and the profits are to be computed according to the method employed by the businessman to maintain his books of Accounts.
- The 2 methods are –
 1. Mercantile system (Accrual basis)
 2. Cash system (Cash basis)

COMPUTATION OF BUSINESS INCOME

- The Net profit in the P&L Account of the assessee is not always the Taxable income.
- The income according to Income Tax Act could be different as certain expenses are allowed or disallowed by the Income Tax Act.
- So to get the taxable income, we need to focus on 3 things –
 1. Ignore Exempt amounts
 2. Deduct amounts which are expressly allowed
 3. Add back amounts which are expressly disallowed.

DEDUCTIONS EXPRESSLY ALLOWED

- The following specific deductions are allowed while computing taxable profits –
 - a) Rent, rates, taxes and insurance of building (sec. 30)
 - b) Repairs and insurance of machinery and furniture (sec. 31)
 - c) Depreciation (sec. 32)
 - d) Specific expenses and allowances (sec. 36)
 - e) Other expenses, not specifically covered in above sections (sec. 37)
- These deductions are allowed subject to the following rules –
 - 1) The expenditure must be “paid” according to the method of accounting.
 - 2) The expenditure must be related to the business carried on by the assessee.

DEPRECIATION (Sec. 32)

- According to sec. 32, depreciation is allowed towards in respect of –
 - 1. Specified tangible assets like – Buildings, machinery, plant or furniture.
 2. Specified intangible assets like – Know-how, patents, copyrights, trademarks etc.

- This asset should be owned, wholly or partly by the assessee.
- Such asset should be used for the purpose of his business or profession.
- This depreciation needs to be allowed at a prescribed rate.
- It is to be applied on the written down value for a particular block of assets.

SPECIAL CASES IN DEPRECIATION

- While normally, depreciation is computed at the prescribed rates on the WDV.
- There are certain special cases where the depreciation is computed differently -
 1. 50% of Depreciation for Assets used for Less than 180 days.
 2. No depreciation when W.D.V of a block of asset becomes negative.

SCIENTIFIC RESEARCH (Sec. 35)

SIMPLE DEDUCTION (100%)

- Deduction for expense incurred for scientific research related to business.
- Sum paid to a company to conduct a research.
- Any sum paid to a research association for a research in social science or statistics.
- Any Capital expenditure incurred towards scientific research

SCIENTIFIC RESEARCH (Sec. 35)

WEIGHTED DEDUCTION (150%)

- Sum paid to a research organization to conduct scientific research
- Any sum paid to a National Laboratory, University or IIT for conducting scientific research.
- Expenditure on scientific research on in-house R&D facility incurred by a company engaged in the business of bio-technology.

AMORTISATION OF PRELIMINARY EXPENSES (Sec. 35D)

- This section applies to Indian Companies or Resident non – corporate assesseees.
- It is related to expenses incurred before the commencement of the business.
- It can also be related to any new operation to be commenced by an existing business.
- Such Preliminary expenses can be “amortised” (claimed) in 5 consecutive years
- 20% of such expenditure is allowable for deduction in each year

SPECIFIC DEDUCTIONS (Sec. 36)

- Insurance premium on stocks
- Insurance on Health of Employees (If paid by any Non – Cash Method)

- Bonus or Commission paid to employees
- Interest on Capital Borrowed
- Discount on Zero Coupon Bonds
- Employer's Contribution to RPF / Superannuation fund / Pension
- Employee's Contribution to P.F. paid in time
- Bad Debts written off

GENERAL EXPENDITURE (Sec. 37)

- This is a residual section for expenses which are not covered in the previous sections
- Expenses should NOT be Capital Expenditure
- Expenses should NOT be Personal Expenses of the Assessee
- These expenses must be used exclusively and wholly used for business purpose.
- Such expense should NOT be for a purpose which is an offence or is illegal

EXPENSES EXPRESSLY DISALLOWED

- Advertisements in Political Souvenir
- Sums payable outside India without TDS
- Securities Transaction Tax / Fringe Benefit Tax / Income Tax
- Remuneration (Salary) paid by Partnership firm to partners above the limits
- Interest on Capital paid to a partner above 12% p.a.
- Any Revenue Expenditure exceeding Rs. 20,000/- paid in Cash

COMPUTING TAXABLE INCOME FROM PGBP

- Consider - the receipts related to business or profession
- Deduct - business expenses and other expenses expressly deductible
- Ignore - Capital Receipts, Exempt Income or Income from other heads
- Ignore - Capital expenses, personal expenses, expenses related to other heads
- Ignore - Appropriations like Income tax, Drawings and expenses expressly disallowed

RECEIPTS AND PAYMENTS ACCOUNT

COMPUTING TAXABLE INCOME FROM PGBP

- Start off with the Net profit which is given in the P&L Account.
- Additions to be made to the Net Profit

1. Unrelated items debited to the P&L Account

2. Expenses expressly disallowed
 3. Items expressly chargeable as business income
- Deductions to be made from the Net Profit
1. Unrelated items credited to the P&L Account
 2. Depreciation allowable under the Income tax Act
 3. Deductions expressly allowable