

**Marudhar Kesari Jain College for Women Vaniyambadi**  
**PG Department of Commerce CA**  
**E-Notes**

**Subject Name: Income Tax Law and Practice- I**

**Subject Code: CECP55C**

**Unit I**

**BASIC CONCEPTS**

Taxes are financial charges imposed by the government on earnings, commodities, services, activities, or transactions. The term “tax” comes from the Latin term “taxo.” Taxes are the government’s primary source of income, and they are used to benefit the citizens of the nation through government policies, regulations, and practices.

Income tax in India is a tax paid by individuals or entities depending on the level of earnings or gains during a financial year. The earnings may be both actual and notional. The Government of India decides the rate of income tax as well as income tax slabs on which individuals are taxed.

**A brief overview of the Income Tax Act, 1961**

Sir James Wilson implemented income tax in India for the first time in 1860 in order to compensate for the damage suffered by the military mutiny in 1857. A distinct Income Tax Act was created in 1886, and it remained in effect for a long period, subject to different revisions from time to time. A new Income Tax Statute was enacted in 1918, however, it was quickly repealed by a new act enacted in 1922. The Act of 1922 grew extremely difficult as a result of several modifications. This statute is still in effect for the fiscal year 1961-62. The Law Commission was referred to by the Indian government in 1956 to clarify the law and combat tax cheating.

In September 1958, the Law Commission delivered its findings in collaboration with the Ministry of Law. This legislation is now controlled by the Act of 1961, also known as the Income Tax Act of 1961, which came into effect on April 1, 1962. It is applicable across India, including the state of Jammu & Kashmir.

Any legislation, in and of itself, is insufficient until the loopholes are addressed. The Income Tax Act of 1961 governs income tax legislation in India, along with the help of certain income tax rules, notifications, circulars, and judicial pronouncements, including tribunal judgments.

## **Elements of Indian Income Tax Law**

The fundamental components of Indian income tax legislation are as follows:

- The Income Tax Act of 1961
- The Act comprises the majority of Income Tax laws in India.
- Income Tax Regulations, 1962
- The Central Board of Direct Taxes (CBDT) is the authority in charge of Direct Tax administration. The CBDT has the authority to enact regulations to carry out the purposes of this Act.
- Finance Act Every year, the Finance Minister delivers the budget in Parliament. When the financial bill is passed by the parliament and signed by the President of India, it becomes an Act.
- Circulars and notifications

### **TYPES OF TAXES:**

There are four ways to classify different types of taxes in India:

1. Taxes Levied by the Central Government and State Governments
2. On the Basis of Relationship between Tax Base and Tax Rates
3. On the Basis of Method of Assessment
4. On the Basis of Incidence and Impact of Taxes

### **TYPES OF TAXES:**

#### **Taxes Levied by the Central Government and State Governments**

- By the Central Government: These include Income taxes, GST, Customs duties, Corporation taxes, Excise duties, Estate duty and more
- By the State Government: These include State GST, Excise on Liquor, VAT(value Added Tax) on Petrol & Diesel, Tax on Agricultural Income, land revenues, tolls and more.
- By the Local Civic Bodies: Municipal corporations and other local governing bodies collect taxes like property taxes, Water Taxes, etc.

#### **On the Basis of Relationship between Tax Base and Tax Rates:**

On this basis the Taxes are classified into Four types, such as;

- Proportional Tax: A proportional tax, also referred to as a flat tax, impacts low-, middle-, and high-income earners relatively equally. They all pay the same tax rate, regardless of income. Taxes which vary in direct proportion to the change in Tax Bases. The Tax base could be income, Value of Goods and Value of Wealth or Property. Example: Wealth Tax and Sales Tax.
- Progressive Taxes: A progressive tax has more of a financial impact on higher-income individuals and businesses than on low-income earners. That means A progressive tax

imposes a greater percentage of taxation on higher income levels, operating on the theory that high-income earners can afford to pay more. Example: Income Tax TYPES OF TAXES:

### **On the Basis of Relationship between Tax Base and Tax Rates**

- **Regressive Taxes:** Low-income individuals pay a higher amount of their incomes in taxes compared to high-income earners under a regressive tax system because the government assesses tax as a percentage of the value of the asset that a taxpayer purchases or owns. This type of tax has no correlation with an individual's earnings or income level. Example: Taxes on Goods & Services, Such as GST, Excise Duty, etc.
- **Digressive Taxes:** A tax is called Digressive when the rate of progression in taxation does not increase in the same proportion as the income increases. In this case, the rate of tax increases up to certain limit, after that a uniform rate is charged and become constant.

### **On the Basis of Method of Assessment**

On this basis, taxes are classified into two types, Such as;

- **Specific Duty:** Taxes levied according to some unit of a product is called as Specific Duty. For example, Excise Duty on cigarettes are levied on the basis of length of the cigarettes.
- **Ad-Valorem Tax:** Taxes levied on the basis of value of the goods is called as Ad-Valorem Duty. It is generally expressed in percentage form.

### **On the Basis of Incidence and Impact of Taxes:**

Before discussion on the types of taxes in this basis, you have to understand the meaning of two important terms, i.e. 'Incidence' and 'Impact' of Tax are as follows; Incidence of Tax:

- **Incidence of Tax** means the first burden of tax. Incidence of tax falls on a person on whom the tax levied for the first time. Incidence of tax can be shifted to another person. **Impact of Tax:**
- **Impact of tax** means the ultimate/final burden of tax. Impact of tax falls on the person who ultimately bears the burden of tax, i.e. the Consumer.

### **On the basis of incidence and impact of tax, a tax can be either, 'Direct Tax' or 'Indirect Tax'**

On the Basis of Incidence and Impact of Taxes

- **Direct Taxes:** The individuals directly pay these taxes to the respective governments. In this case the both Incidence and Impact will fall in a single person, i.e. an assessee. The most notable examples include Income tax, Capital gains tax, Corporate tax, Wealth Tax and Securities transaction tax.

- Indirect Taxes: These taxes are not directly paid to the governments but are collected by the intermediaries who sell or arrange products and services. In this case, the incidence and impact of taxes will fall on two different persons. GST (Goods and Service Tax), Service tax, sales tax, octroi, customs duty, value-added tax, and excise duty, customs duty, are some of the top examples.

### **Purpose of the Income Tax Act**

The Income Tax Act's goals can be described as follows:

- To reduce income and wealth distribution inequalities.
- To accomplish the twin goals of better yields.
- To quicken the pace of the country's economic growth and development.
- To preserve appropriate economic stability and security of long-term inflationary pressures and short-term foreign price fluctuations.
- To make funds available for economic development.
- Minimize excessive wealth, income, and consumerism inequality through indeterminate productivity gains, offence, justice, and peace and stability.
- To encourage the purchase of new capital goods.
- To direct investment toward the industries that yield the most to growth in the economy.

### **Features of the Income Tax Act**

The amount payable when the government assesses taxes on the direct income of its residents under its authority is known as income tax. Income tax in India has a myriad of complexity, impediments, difficulties, and characteristics. Even if the entire procedure may appear to be challenging, effective treatment of the situation may have ramifications for the residents of the country. Income tax is a means by which the government guarantees that community activities and public tasks are carried out properly and in a timely way.

The basic features of the act are as follows:

- Income tax is levied on the preceding year's income at the rate specified by the Finance Act for the current assessing year.
- Income tax is imposed on a person based on his or her previous year's earnings.
- The responsibility of the taxpayer is calculated based on his residence status in the prior year.
- Income tax liability occurs only when overall revenue in the financial year exceeds the threshold tax-free amount established by the Finance Act for that relevant year.
- Income tax rates are progressive, which means that the tax burden increases as income rises.

- It is mandatory to deduct taxes at the source and deposit them in the government's treasury.

## **Important Concepts of the Income Tax Act, 1961**

### **Assessee- Section 2(7)**

According to Section 2(7) of the Income Tax Act of 1961, an assessee is a person who is required to pay taxes under any provision of the Act. The term 'assessee' refers to somebody who has been evaluated for his income, another person's income for which he is assessable, or the profit and loss he has experienced. A person or an individual under any provision of this Act is referred to as an assessee.

They may also be referred to as each and every person for whom:

- Any processes under the statute for the assessment of his income are now underway;
- Income of another individual for which he is liable to be taxed;
- Any loss incurred by him or any other person, or
- A person who is eligible for a tax refund.

Understanding the definition of a person is vital because an assessee is a person who pays a specific amount to the government. According to the Income Tax Act, they are grouped into the following categories:

1. **Normal assessee:** A normal assessee is a person who is required to pay taxes on income generated during the fiscal year. In addition, any individual who is required to pay interest or penalties to the government or is entitled to a refund under the act is termed a typical assessee.
2. **Assessee representative:** A person who is obligated to pay taxes on income or losses caused by a third party. It usually occurs when the individual obligated to pay taxes is a non-resident, a juvenile, or a lunatic.
3. **Deemed assessee:** A person who is legally obligated to pay taxes. It can be anybody who is regarded to be an assessee under the Act or anyone for whom an action has been brought under the Act to assess the income/loss of any other person in respect of whom he is assessable or the amount of refund due to him or such other person. Furthermore, this group includes a person who pays taxes on behalf of another person in certain circumstances.
4. **Assessee-in-default:** Individuals become assesseees in default when they fail to satisfy their statutory obligations of paying tax. For example, before paying his employees, an employer should deduct tax from their pay. Furthermore, the employer is required

to pay deducted taxes to the government on time. If, however, the employer fails to deposit this tax, he becomes an assessee-in-default.

### **Assessment- Section 2(8)**

Assessment under Section 2(8) is a process of assessing the validity of the assessee's claimed income and computing the amount of tax payable by him, followed by the practise of imposing that tax responsibility on that individual.

### **Assessment year – Section 2(9)**

An "Assessment year" is defined in Section 2(9) as "twelve months beginning on the first day of April each year." Every year, an assessment year commences on April 1st and finishes on March 31st of the following year. For instance, the Assessment year 2021-22 is a one-year period beginning on April 1, 2020, and concluding on March 31, 2021. In an assessment year, the assessee's income from the previous year is taxed at the rates specified in the appropriate Finance Act. As a result, it is also known as the "Tax Year."

### **Income – Section 2(24)**

Even though income tax is a tax on earnings, the act does not establish a comprehensive definition of "income." Instead, the term "income" has been defined broadly by providing an inclusive meaning. It comprises not only income in its broadest meaning, but also income mentioned in Section 2(24).

In general, the term "income" refers to the following:

- Any illicit money earned by the assessee;
- Any income earned at sporadic periods;
- Any taxable income obtained from a source outside of India;
- Any advantage that may be quantified in monetary terms;
- Any type of assistance, aid, or reimbursement;
- An individual or HUF makes a gift worth more than INR 50,000 without any consideration.;
- Any kind of award;
- Causal earnings include winnings from lotteries and horse racing betting, among other things.

### **Previous Year (P.Y.)**

As per Section 3 of the Income Tax Act, 1961, Previous Year is ***the Year immediately preceding the assessment year***. Previous year is also known as Financial Year. It basically means the period starting from April 1 and ending on March 31 of the next year

As per the Income Tax law the income earned in current year is taxable in the next year. The year in which income is earned is known as the previous year. **The current financial year is known as the previous year.** The financial year starts from 1st April and end on 31st March of the next year.

For Instance, for the salary income earned from 1 April 2017 - 31st March 2018 .The previous year would be 2017-18.

All the assessee's are required to follow the financial year (April 1 to March 31) as previous year for all types of incomes. In case, of a newly set-up business/profession or first job then your first previous year will be less than 12 months. **Remember your previous year can never exceed 12 months.**

## **Income Tax Slab Rates for Individual**

### **Income Tax Slab for Individual who are below 60 years**

<b>Income Tax slab</b>	<b>Tax Rate</b>
Up to Rs.2.5 lakh	Nil
Above Rs.2.50 lakh - Rs.5.00 lakh	5% of the total income that is more than Rs.2.5 lakh + 4% cess
Above Rs.5 lakh - Rs.10 lakh	20% of the total income that is more than Rs.5 lakh + Rs.12,500 + 4% cess
Above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,12,500 + 4% cess

### **Income Tax Slab between 60-80 years (Senior Citizen)**

<b>Income Tax slabs</b>	<b>Tax Rate</b>
Up to Rs.3 lakh	Nil
Above Rs.3.00 lakh - Rs.5.00 lakh	5% of the total income that is more than Rs.3 lakh + 4% cess
Above Rs.5.00 lakh - Rs.10 lakh	20% of the total income that is more than Rs.5 lakh + Rs.10,500 + 4% cess
Above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,10,000 + 4% cess

### Income Tax Slabs for individual above 80 years (super senior citizen)

Income Tax slabs	Tax Rate
Up to Rs.5 lakh	Nil
Above Rs.5 lakh - Rs.10 lakh	20% of the total income that is more than Rs.5 lakh + 4% cess
Above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,00,000 + 4% cess

For domestic companies, the tax-slabs depend on the turnover, and it is mentioned below:

Turnover	Tax Rate
Gross turnover can be a maximum of Rs.250 crore for the previous year	25%
Gross turnover is more than Rs.250 for the previous year	30%

Apart from the above-mentioned tax rate, an additional surcharge and cess are levied. Given below are the details of the surcharge and the cess that will be levied:

- Cess: 4% of corporate tax
- Surcharge: In case the taxable income is more than Rs.1 crore but less than Rs.10 crore, the surcharge that will be levied is 7%. In case the taxable income is more than Rs.10 crore, the surcharge that will be levied is 12%.
- Non-resident Indians: For non-resident Indians, irrespective of their age, the exemption limit is up to Rs.2.5 lakh.

#### **Important Points**

- In case your net income is more than Rs.50 lakh but less than Rs.1 crore, apart from a 4% cess, a 10% surcharge is also levied. If the net is above Rs.1 crore, a 15% surcharge is levied.
- Compared to last year's budget, cess has increased from 3% to 4%.



## Heads of Income

There are 5 Major Heads / Sources of Income to be taxed under Income Tax Act

1. **Income from salary/pension:** This includes basic salary, taxable allowances, perquisites, and profit in lieu of salary, as well as pension received by the person who himself/herself has retired from the service. Incomes from salary and pension are included in the computation of taxable income.
2. **Income from house property:** An income tax assessee can own one or more house properties. These house properties can be self-occupied or rented out or even vacant. This head describes the rules relating to such ownership. The rules under this head describe how rent from one or more house properties is to be treated for the purpose of calculation of taxable income. It also describes how interest on home loan is to be accounted for in the case of self-occupied, rented out and vacant properties. An income tax assessee can claim certain deductions such as municipal taxes and a standard deduction for house maintenance in certain cases. The final net income or loss under this head is then added to or deducted from the income from the other heads.
3. **Income from business/profession:** This includes actual and presumptive incomes from business and professions that individuals do in their personal capacity and is added to taxable income after adjustment of the deductions allowed.
4. **Capital Gain:** Capital gains arise at the time of selling capital assets like gold, house properties, stocks, securities, mutual fund units etc. Depending on the types of capital assets and the period of holding, gains on the sale of such assets are categorised as short-term and long-term capital gains. Although capital gains are part of income tax, they are not added to taxable income, because except short-term capital gains on the sale of debt funds, other gains are taxed at different rates.
5. **Income from other sources:** This includes incomes like interest from a savings account, fixed deposits (FDs), family pension etc, which are included in the taxable income. Casual Income such as **Income from Lottery, Betting, Race Horse etc:** Such incomes are included in the total income, but excluded from taxable income as different tax rates are applicable on these types of income.

## Who is eligible for income tax?

As income tax is based on one's ability to pay it, different tax rates are applied to different income slabs, which is revised by the government from time to time. Currently, there is zero per cent tax on taxable income up to Rs 2,50,000, 5 per cent tax is levied on taxable income between Rs 2.5 lakh and Rs 5 lakh, 20 per cent tax is levied on taxable income between Rs 5 lakh to Rs 10 lakh. For taxable income above Rs 10 lakh, 30 per cent is the applicable rate.

On the tax payable, 4 per cent Health and Education cess is also charged. Moreover, 10 per cent surcharge is levied on income between Rs 50 lakh and Rs 1 crore and 15 per cent surcharge is levied on income over Rs 1 crore. Tax rebate (under section 87A) up to Rs 12,500 is provided to the assessee having total income after Deductions up to Rs 5 lakh. However, usual tax computation will be applied in case the taxable income exceeds Rs 5 lakh limit.

### Classification of Income

Income has been further classified and referred to by various names in India such as

- Exempt Income
- Taxable Income
- Total income
- Gross Total Income

### Gross Total Income

As the name suggests Gross Total Income is the aggregate of all the income earned by you during a specified period. According to Section 14 of the Income Tax Act 1961, the income of a person or an assessee can be categorised under these five heads,

- Income from Salaries
- Income from House Property
- Profits and Gains of Business and Profession
- Capital Gains
- Income from Other Sources

And, Gross Total income is arrived at when your earnings from all these five heads of income is taken together.

## Total Income

Total income is your gross income from all sources less certain deductions, such as expenses, allowances and reliefs

## Calculation of Gross Total Income and Total Income

Gross Total Income is calculated foremost by adding your income under all five heads of income. Now, to arrive at the Total income you must subtract from it the deductions under chapter VI A of the Income Tax Act 1961. I.e the deduction ranging from section 80C to 80U . Which means

Income From Salary	xx
Add: Income Under the Head House Property	xx
Add: Profits and Gains of Business and Profession	xx
Add: capital gains Income	xx
Add: Income from Other Sources	xx
Gross Total Income	xxx
Less: Deductions under Section 80C to 80U	xx
Total Income	xxx

## Total Income

Total income is your gross income from all sources less certain deductions, such as expenses, allowances and reliefs.

## RESIDENTIAL STATUS IN INCOME TAX

Residential status refers to a **person's status with reference to the question of how long the person has stayed in India for the past five years**. The income tax liability of a taxpayer is based on the residential status in the financial year, and four years preceding the financial year.

The income tax law in India classifies taxable persons as:

1. A resident
2. A resident not ordinarily resident (RNOR)
3. A non-resident (NR)

The taxability differs for each of the above categories of taxpayers. Before we get into taxability, let us first understand how a taxpayer becomes a resident, an RNOR or an NR.

### **Determination of Residential Status of an Individual**

The *Residential Status* of an Individual is to be determined on the basis of period of stay of the taxpayer in India and is computed separately for each year. If an individual satisfies any one of the following conditions, he is said to be Resident in India for that financial year. The conditions are:-

- ✓ He is in India for a period of 182 days or more in that financial year
    - OR
  - ✓ He is in India for 60 days or more during that financial year and has been in India for 365 days or more during 4 previous years immediately preceding the relevant financial year.
- If any one of the above conditions is satisfied, the individual is said to be resident in India. However, if none of the conditions is satisfied, he is said to be a Non Resident Indian (NRI)

### **Exceptions to Residential Status**

There are 2 exceptions to the above rule of classification of Residential Status:-

- In case of an individual, who is a citizen of India and who leaves India in any financial year for the purpose of employment outside India, the 2<sup>nd</sup> condition stated above shall not be applicable and only the 1<sup>st</sup> condition of 182 days or more would be applicable
- In case of an individual (whose Indian income is less than Rs. 15 Lakhs) who is a citizen of India or is a person of Indian origin and who being outside India comes on a visit to India in any financial year, the 2<sup>nd</sup> conditions stated above shall not be applicable and only the 1<sup>st</sup> condition of 182 days or more would be applicable. In case the Indian income is more than 15 lakhs – then the no. of days in the 2<sup>nd</sup> condition would be considered as 120 instead of 60)

## **Classification of Ordinary Resident & Non Ordinary Resident**

If an individual qualifies as a resident, the next step is to determine if he/she is a Resident ordinarily resident (ROR) or an RNOR. He will be a ROR if he meets both of the following conditions:

✓ Has been a resident of India in at least 2 out of 10 years immediately previous years  
and

✓ Has stayed in India for at least 730 days in 7 immediately preceding years

Therefore, if any individual fails to satisfy even one of the above conditions, he would be an **Non Ordinary Resident**

### **Non-resident**

An individual satisfying neither of the conditions stated in (a) or (b) Below would be an NR for the year.

✓ He is in India for a period of 182 days or more in that financial year

○ OR

✓ He is in India for 60 days or more during that financial year and has been in India for 365 days or more during 4 previous years immediately preceding the relevant financial year.

## **Determination of Residential Status of HUF (Hindu Undivided Family)**

### **HUF said to be a Resident in India**

A HUF is said to be resident in India in any previous year in every case except where during that year *the control and management of its affairs is situated either wholly or partly in India.*

Once the HUF is a resident in India, it is to be further determined whether it is:

- Resident and ordinarily resident in India; or
- Resident but not ordinarily resident in India.

### **HUF said to be a Resident and Ordinarily Resident in India**

The HUF shall be said to be resident and ordinarily resident in India if the karta of the HUF satisfies both the following conditions:

- a. He (Karta) must be resident in at least 2 out of 10 previous years immediately preceding the relevant previous year; and
- b. He must be in India for at least 730 days during 7 previous years immediately preceding the relevant previous year.

### **HUF said to be Resident but Not Ordinarily Resident in India [Section 6(6)(b)]:**

A HUF, which is resident in India, is said to be resident but not ordinarily resident in India during the relevant previous year, if the manager (Karta) of the HUF does not satisfy any one, or both, of the conditions mentioned in clauses (a) and (b) above.

### **HUF said to be a Non-Resident**

A HUF is said to be non-resident in India if during the previous year, the control and management of its affairs is situated wholly outside India. In other words it will be non-resident in India if no part of the control and management of its affairs is situated in India.

### **Determination of the residential status of a firm or association of persons [Sec. 6(2)]**

A partnership firm and an association of persons are said to be resident in India if the control and management of their affairs are wholly or partly situated within India during the relevant previous year. They are however, treated as non-resident in India if the control and management of their affairs are situated wholly outside India.

A firm or an association of persons cannot be ordinarily or not ordinarily resident. The residential status of the partners/ members of the firms/ association are not relevant in determining the status of the firm/ association.

- While in the case of a firm, control and management is vested in partners,
- in case of an association of persons it is vested in the principal officer.

Control and management means de facto control and management and not merely the right to control or manage. Control and management is usually situated at a place where the head, the seat and the directing power are situated.

### **Determination of Residential status of a company [Sec 6(3)]**

A company is said to be a resident in India in any previous year, if—

- it is an Indian company; or
- its place of effective management, in that year, is in India place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made

- ✓ An Indian company is always resident in India
- ✓ A foreign company is resident in India only if during the previous year, place of effective management is situated wholly in India. Conversely, a foreign company is treated as non-resident if during the previous year, place of effective management is either wholly or partly situated out of India.

**Ordinary or Not Ordinary resident**

A company can never be ordinarily or not ordinarily resident in India. In case of a foreign company even the slightest place of effective management is exercised from outside India, it would be treated as a non-resident.

# EXEMPTED INCOMES

## List of Exempted Incomes (Tax-Free) Under Section-10

### 1. Agriculture Income [Section 10(1)]

As per section 10(1), agricultural income earned by the taxpayer in India is exempt from tax. Agricultural income is defined under section 2(1A) of the Income-tax Act. As per section 2(1A), 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. Any income attributable to a farm house subject to satisfaction of certain conditions specified in this regard in section 2(1A). Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

### 2. Any sum received by a Co-parcener from Hindu Undivided Family (H.U.F.) [Section 10(2)]

As per section 10(2), 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.

Example-1. HUF earned ` 5,00,000 during the previous year and paid tax on its income. Mr. A, a co-parcener is an employee and earns a salary of `20,000 p.m. During the previous year Mr. A also received `1,00,000 from HUF. Mr. A will pay tax on his salary income but any sum of money received from his HUF is not chargeable to tax in Mr. A's hands.

### 3. Share of Income from the Firm [Section 10(2A)]

As per section 10(2A), 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. Interest paid to Non-Resident [Section 10(4)(i)]



As per section 10(4)(i), in the case of a non-resident any income by way of interest on certain notified securities or bonds (including income by way of premium on the redemption of such bonds) is exempt from tax.

As per section 10(4)(ii), in the case of an individual, any income by way of interest on money standing to his credit in a Non-Resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999, and the rules made thereunder is exempt from tax.

Exemption under section 10(4)(ii) is available only if such individual is a person resident outside India as defined in clause (q) of section 2 of the said Act or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account.

#### **5. Interest to Non-Resident on Non-Resident (External) Account [Section 10(4)(ii)]**

Any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account in any bank in India shall be exempt from tax in case of an individual who is a person resident outside India or is a person who has been permitted by the RBI to maintain the aforesaid account. The person residing outside India shall have the same meaning as defined under Foreign Exchange Regulation Act, 1973, FEMA, 1999. This exemption shall not be available on any income by way of interest paid or credited on or after 1-4-2005.

#### **6. Interest paid to a person of Indian Origin and who is Non-Resident [Section 10(4 B)]**

In case of an individual, being a citizen of India or a person of Indian origin, who is nonresident, any income from interest on such savings certificates issued by the Central Government, as Government may specify in this behalf by notification in the Official Gazette, shall be fully exempt. The exemption under this section shall not be allowed on bonds or securities issued on or after 1-6-2002.

This exemption shall be allowed only if the individual has subscribed to such certificates in Foreign Currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exchange Act, 1973, FEMA, 1999 and any rules

made there under. For this purpose, a person shall be deemed to be of Indian origin if he or either of parents or any of his grandparents, was born in India or in undivided India.

#### **7. Leave Travel Concession or Assistance (LTC/LTA) to an Indian Citizen Employee [Section 10(5)]**

The employee is entitled to exemption under section 10(5) in respect of the value of travel concession or assistance received by or due to him from his employer or former employer for himself and his family, in connection with his proceeding—

- a. on leave to any place in India.
- b. to any place in India after retirement from service or after the termination of his service.

*The exemption shall be allowed subject to the following:*

- i. where journey is performed by air — Maximum exemption shall be an amount not exceeding the air economy fare of the National Carrier by the shortest route to the place of destination;
- ii. where places of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air — Maximum exemption shall be an amount not exceeding the air-conditioned first class rail fare by the shortest route to the place of destination; and
- iii. where the places of origin of journey and destination or part thereof are not connected by rail and the journey is performed between such places — The amount eligible for exemption shall be:
  - A. where a recognised public transport system exists, an amount not exceeding the 1st class or deluxe class fare, as the case may be, on such transport by the shortest route to the place of destination; and
  - B. where no recognised public transport system exists, an amount equivalent to the airconditioned first class rail fare, for the distance of the journey by the shortest route, as if the journey had been performed by rail.

## **8. Remuneration or Salary received by an individual who is not a citizen of India [Section 10(6)]**

The following incomes are exempt when received by an individual who is not a citizen of India:

(i) Remuneration [U/s 10(6)(ii)].

- a. The remuneration received by an ambassador or other officials of the Embassy, High Commission or Legation of a foreign State in India.
- b. The remuneration by a consular officer of a foreign State in India.
- c. The remuneration received by a trade commissioner or other official representative in India of a foreign State, provided corresponding officials of the Government of India in that country are given a similar concession.
- d. The remuneration received by a member of the staff of any of the officials referred to in (a), (b) and (c) above.

If the person mentioned above in (a) to (d) is a subject of the country represented, is not engaged in any business, profession or employment in India (otherwise than as a member of such staff), and the country represented gives similar concession to the members of the staff of corresponding officials of the Government of India.

(ii) Remuneration received by him as an employee of foreign enterprise [U/s 10(6)(vi)]

(e.g., technician deputed by a foreign firm to work in India), for service rendered by him during his stay in India provided the following conditions are fulfilled—

1. the foreign enterprise is not engaged in any trade or business in India ;
2. his stay in India does not exceed in the aggregate a period of 90 days in such previous year ; and
3. such remuneration is not liable to be deducted from the income of the employer chargeable under the Act.

## **9. Tax paid by Government or Indian concern on Income of a Foreign Company [Section 10(6A), (6B), (6BB) and (6C)]**

1. Where a foreign company renders technical services to Government of India or to a State Government or to an Indian enterprise and for such services a foreign company is paid income by way of royalty or fees.

2. Such fees or royalty is paid by an India concern in pursuance of an agreement entered into before 1-6-2002 and such agreement is approved by Government of India and it is in accordance with the Industrial Policy of the Government of India.
3. Since royalty or fees paid to a foreign company accrues in India, so such income is liable to be taxed in India and as per agreement the payer of income in India pays tax liability of the foreign company.
4. Tax so paid by Government of India or a State Government or an Indian enterprise will be exempted i.e., it will not be grossed up with the income of the foreign company.

### **Exemption available only in respect of two children**

The exemption relating to LTC shall not be available to more than two surviving children of an individual after 1.10.1998.

Exception: The above rule will not apply in respect of children born before 1.10.1998 and also in case of multiple birth after one child.

### **10. Perquisites and Allowances paid by Government to its Employees serving outside India [Section 10(7)]**

Any allowances or perquisites paid or allowed, as such, outside India by the Government to a citizen of India, for rendering services outside India, are exempt.

The following conditions have to be satisfied before such income is treated as deemed to accrue or arise in India:

- i. Income should be chargeable under the head 'Salaries';
- ii. The payer should be Government of India;
- iii. The recipient should be an Indian citizen — whether Resident or Non-Resident;
- iv. The services should be rendered outside India.

### **11. Employees of Foreign Countries working in India under Cooperative Technical Assistance Programme [Section 10(8)]**

The persons who are working in India under co-operative technical assistance programmes in accordance with an agreement entered into by the Central Government and the Government of a foreign State, the following incomes of such individuals shall be exempt provided the terms of agreements provide for such exemption

1. the remuneration received by him directly or indirectly from the Government of the foreign State for such duties rendered in India ; and
2. any other income of such individual which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which individual is required to pay any income or social security tax to the Government of that foreign State.

## **12. Income of a Consultant [Section 10(8A)]**

Any remuneration or fee received by a consultant from an international organisation who derives its fund under technical assistance grant agreement between such organisation and the Foreign Government, and any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country, shall be fully exempted. The agreement of the service of consultant must be approved by the competent authority.

The consultant means :

1. an individual who is (a) not a citizen of India; or (b) if citizen but is not ordinarily resident in India ; or
2. any person who is non-resident ; and is rendering technical services in India in connection with any technical assistance programme or project.

### ***Conditions laid down for Tax Exemption U/s 10(8A)***

- A. The fees or remuneration is paid for technical services rendered in India under the technical assistance programme or project.
- B. The sum is paid directly or indirectly out of funds made available to international organization as per agreement between such organization & government of foreign state.
- C. The technical assistance provided is in accordance with such agreement.
- D. Any agreement for appointment of consultant shall have to be approved by the authorities prescribed.
- E. Any other income which accrues or arises outside India is subjected to any income or social security tax in other state.

### **13. Income of Employees of Consultant [Section 10(8B)]**

In case of an individual who is assigned duties in India under technical assistance programme—

1. the remuneration received by him directly or indirectly from any consultant as referred u/s 10 (8A) above and
2. any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country. shall be fully exempted provided
3. such individual is not a citizen of India ; or
4. if citizen but is not ordinarily resident and
5. the contract of service is approved by the competent authority.

### **14. Income of any member of the family of individuals working in India under co-operative technical assistance programmes [Section 10(9)]**

As per section 10(9), the income of any member of the family of any such individual as is referred to in section 10(8)/(8A)/(8B) accompanying him to India, which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State or country of origin of such member, as the case may be, is exempt from tax.

### **15. Gratuity [Section 10(10)]**

Gratuity is a payment made by the employer to an employee in appreciation of the past services rendered by the employee. Gratuity can either be received by:

- (a) the employee himself at the time of his retirement; or
- (b) the legal heir on the event of the death of the employee.

Gratuity received by an employee on his retirement is taxable under the head "Salary" whereas gratuity received by the legal heir of the deceased employee shall be taxable under the head "Income from other sources". However, in both the above cases, according to section 10(10) gratuity is exempt upto a certain limit. Therefore, in case gratuity is received by employee, salary would include only that part of the gratuity which is not exempt under section 10(10).

*A. Death-cum-retirement gratuity received by Government servants [Section 10(10)(i)]*

Section 10(10)(i) grants exemption to gratuity received by Government employee (i.e., Central Government or State Government or local authority).

*B. Gratuity Received by a Non-Government Employee covered by Payment of Gratuity Act, 1972 [Section 10(10)(ii)]*

*Minimum of the following 3 limits:*

- (1) Actual gratuity received, or
- (2) 15 days salary for every completed year, or part thereof exceeding six months 7 days salary for each season in case of employee in seasonal establishment; or
- (3) ₹. 10,00,000

*Meaning of Salary:*

- (i) *Basic salary plus dearness allowance.*
- (ii) *Last drawn salary. Average salary for preceding 3 months in case of piece rates employees*
- (iii) *No. of days in a month to be taken as 26*

**C. Any other Employee**

Minimum of the following 3 limits:

- (1) Actual gratuity received
- (2) Half months average salary of each completed year of service.
- (3) ₹. 10,00,000

**16. Retrenchment Compensation received by Workmen [Section 10(10B)]**

Any compensation received by a workman at the time of his retrenchment, under the Industrial Disputes Act, 1947 or under:

1. any other Act or rules or any order or notification issued there under; or
2. any standing order; or
3. any award, contract of service or otherwise,

shall be exempt to the extent of minimum of the following limits:

1. Actual amount received;
2. 15 days' average pay for every completed year of service or part thereof in excess of 6 months;
3. Amount specified by the Central Government, i.e. ₹. 5,00,000.

**17. Payment received under Bhopal Gas Leak Disaster (Processing of Claims) Act 1985 [Section 10 (10BB)]**

Any amount received under the provision of such Act or any scheme framed there under shall be fully exempted but in case payment is received against a loss or damage, for which deduction has been claimed earlier, it shall be taxable.

**18. Compensation received in case of any disaster [Section 10(10BC) ]**

Any amount received from the Central Government or State Government or a Local Authority by an individual or his legal heirs as compensation on account of any disaster is exempt from tax. However, no deduction is available in respect of the amount received or receivable to the extent such individual or his legal heirs has been allowed a deduction under the Act on account of loss or damage caused due to such disaster. Disaster here means any disaster due to any natural or man-made causes or by accident/negligence which results in substantial loss of human life or damage to property or environment and the magnitude of such disaster is beyond coping capacity of community of the affected area

**19. 'Retirement Compensation' from a Public Sector Company or any other Company [Section 10(10C)]**

The compensation received or receivable by the employee of the following, on voluntary retirement, under the golden hand shake scheme, is exempt under section 10(10C):

1. a public sector company; or
2. any other company; or
3. an authority established under a Central, State or Provincial Act; or



4. a local authority; or
5. a co-operative society; or
6. a University established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a University under section 3 of the University Grants Commission Act, 1956; or
7. an Indian Institute of Technology within the meaning of clause (g) of section 3 of the Institutes of Technology Act, 1961; or
8. such institute of management as the Central Government may, by notification in the Official Gazette, specify in this behalf;
9. State Government;
10. Central Government;
11. Institutions having importance throughout India or in any State or States as may be notified.

**20. Tax on Non-monetary Perquisites paid by Employer [Section 10(10CC)]**

The income-tax actually paid by the employer himself on a non-monetary perquisite provided to the employee shall be exempt in the hands of the employee..

**21. Any sum received under a Life Insurance Policy [Section 10(10D)]**

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, is wholly exempt from tax. However, the following sum received are not exempt under this section:

**22. House Rent Allowance-HRA [Section 10(13A) Read with Rule 2A]**

Quantum of Exemption: Minimum of following Three limits:

	<i>Mumbai/Kolkata/Delhi/Chennai</i>	<i>Other Cities</i>
(i)	Allowance actually received	Allowance actually received
(ii)	Rent paid in excess of 10% of Salary	Rent paid in excess of 10% of Salary
(iii)	50% of Salary	40% of Salary

### **23. Scholarship [Section 10(16)]**

The full amount of scholarship granted to meet the cost of education is exempted.

‘Cost of education’ includes not only the tuition fees but all other expenses which are incidental to acquiring education. Scholarship may have been given by Govt., University, Board, Trust, etc. The exemption is irrespective of actual expenditure incurred by the recipient to meet the cost of education.

### **24. Allowance of M.P./M.L.A. or M.L.C. [Section 10(17)]**

Following allowances are exempt from tax in the hands of a Member of Parliament and a Member of State Legislature—

- Daily allowance received by a Member of Parliament or by a Member of State Legislature or by member of any committee thereof.
  - Any Constituency allowance received by a Member of State Legislature

### **25. Awards Instituted by Government [Section 10(17A)]**

Any payment received in pursuance of following (whether paid in cash or in kind) is exempt from tax:

- Any award instituted in the public interest by the Central Government or State Government or by any other body approved by the Central Government in this behalf.
- Any reward by the Central Government or any State Government for such purpose as may be approved by the Central Government in this behalf in the public interest.

### **26. Pension received by certain winners of gallantry awards [Section 10(18)]**

1. Any amount received by an individual as pension shall be exempt if:
  - >> such individual has been in the service of the Central or State Government, and
  - >> he/she has been awarded ‘Param Vir Chakra’ or ‘Mahavir Chakra’ or ‘Vir Chakra’ or such other notified gallantry awards.
2. Also, any amount received as family pension by any member of the family of an individual referred above shall be fully exempted.

### **27. Family pension received by family members of armed forces including para military forces [Section 10(19)]**

With effect from the 1st day of April, 2005 family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including paramilitary forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions, as may be prescribed shall be fully exempted

## **28. Income of a Local Authority [Section 10(20)]**

The following income of a local authority is exempt from tax:

1. Income which is chargeable under the head “Income from house property”, “Capital gains” or “Income from other sources” or
2. Income from a trade or business carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its own jurisdictional area or
3. Income from business of supply of water or electricity within or outside its own jurisdictional area

## **29. Income of Scientific Research Association [Section 10(21)]**

Any income of a research association, approved under section 35(1)(ii)/(iii) is exempt from tax, if following conditions as specified in section 10(21) are satisfied:

1. Income should be applied or accumulated wholly and exclusively for the objects for it established.
2. Funds should not be invested or deposited for any period during the previous year otherwise than in any one or more of the forms/modes specified in section 11(5). However, this condition is not applicable in respect of the following:-
  - any assets held by the research association where such assets form part of the corpus of the fund of the association as on the 1st day of June, 1973;
  - Debentures of a company acquired by the research association before the 1st day of March, 1983;
  - any accretion to the shares, forming part of the corpus of the fund mentioned in sub-clause (i) by way of bonus shares allotted to the research association;
  - voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify,

## **30. Income of a pension fund set up by LIC or other insurer [Section 10(23AAB)]**

Income of an institution constituted as a public charitable trust or society which is established for the development of khadi and village industries (not for profit purpose) is exempt from tax, if following conditions are satisfied:

1. Income is attributable to the business of production, sale, or marketing, of khadi or products of village industries.

2. Institution applies its income, or accumulates it for application, solely for the development of khadi or village industries or both
3. Institution is approved by the Khadi and Village Industries Commission.

**31. Income of State Level Khadi and Village Industries Board [Section 10(23BB)]**

Any income from an authority (whether known as the Khadi and Village Industries Board, or by any other name) established in a State by or under a State or Provincial Act for the development of Khadi or Village Industries in the State, shall be exempted from tax

**32. Income of certain Authorities set up to manage Religious and Charitable Institutions [Section 10(23BBA)]**

Any income of any body or authority established, or appointed by or under any Central, State or Provincial Act which provides administration of any of the following institutions

1. Public, Religious or Charitable Trusts
2. Endowments (including Maths, Gurudwaras, Temples, Wakfs etc.) ; or
3. a society for religious or charitable purposes registered under Societies Act 1860, shall be exempted from tax.

**33. Income of European Economic Community [Section 10(23BBB)]**

Any income of European Economic community derived in India by way of interest, dividend or capital gain from investments made out of its funds under such scheme as the Central Govt. may notify is fully exempted.

**34. Income of a SAARC Fund for regional projects [Section 10(23BBC)]**

Any income of a fund set up as SAARC Fund for Regional Projects set up by Colombo Declaration issued on 21<sup>st</sup>. Dec. 1991 by Heads of State or Government of the Member Countries of South Asian Association for Regional Co-operation shall be fully exempted.

**35. Any income of Insurance Regulatory and Development Authority [Section 10(23BBE)]**

Any income of Insurance Regulatory and Development Authority established under Insurance Regulatory and Development Authority Act 1999 shall be fully exempted

**36. Income of Prasar Bharti [Section 10(23BBH)] [Inserted by the Finance Act 2012, w.e.f. 2013-14]**

Any income of the Prasar Bharti (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharti (Broadcasting Corporation of India) Act, 1990, shall be exempt.

### **37. Any income received by a person on behalf of following Funds [Section 10(23C)]**

Any income received by any person on behalf of the Prime Minister's National Relief Fund, the Prime Minister's Fund (Promotion of Folk Art) or the Prime Minister's Aid to Students Fund is exempt from tax under clause (i), (ii) and (iii) of section 10(23C) respectively.

1. Any income received by any person on behalf of :
2. the Prime Minister's National Relief Fund ; or
3. the Prime Minister's Fund (Promotion of Folk Art) ; or
4. the Prime Minister's Aid to Student's Fund ; or
5. The National Foundation for Communal Harmony
6. Any educational institution which is
7. a non profit earning body and is wholly or substantially financed by the Government;
8. a non profit earning body whose aggregate annual receipts do not exceed the prescribed limits (to be notified) ; or
9. a non profit earning body other than those mentioned at (a) and (b) above but are approved by the prescribed authority.
10. any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or reception and treatment of persons during convalescence or of persons requiring medical attention and existing solely for philanthropic purposes and which:
11. is wholly or substantially financed by the Government ; or
12. whose aggregate annual receipts do not exceed the prescribed limits (to be notified); or
13. other than those mentioned a) and (b) above but is approved by the prescribed authority.
14. any other fund established for charitable purposes which may be notified by Central Government ; or
15. any trust or institution set up wholly for religious purposes or purpose which may be notified by the Central Government.

### **38. Income of Mutual Fund [Section 10(23D)]**

Any income of following mutual funds (subject to provisions of sections 115R to 115T) is exempt from tax:

- A mutual fund registered under the Securities and Exchange Board of India Act or regulation made thereunder.
- A mutual fund set-up by a public sector bank, or a public financial institution or authorised by RBI (subject to conditions notified by the Central Government).

### **39. Exemption of income of a securitisation trust [Section 10(23DA)] [w.e.f. A.Y. 2014-15]**

Any income of a securitisation trust from the activity of securitisation shall be exempt.

#### **40. Income of Investor Protection Fund [Section 10(23EA)]**

Any income by way of contributions received from recognised stock exchanges and the members thereof, of a notified Investor Protection Fund set up by recognised stock exchanges in India is exempt from tax.

Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a recognised stock exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax

#### **41. Exemption of income of investor protection fund of depository [Section 10(23ED)] [w.e.f. A.Y. 2014-15]**

Any income, by way of contributions received from a depository, of notified Investor Protection Fund set up by a depository in accordance with the regulations made under the SEBI Act and Depository Act is exempt from tax

Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

#### **42. Income of Registered Trade Unions [Section 10(24)]**

The following incomes of registered trade unions are exempt from tax :

1. Income from house property.
2. Income from other sources.

The trade union must be a registered one and formed primarily for the purpose of regulating the relations between workmen and employer or between workmen and workmen. This benefit shall also be available to an association of registered trade unions.

#### **43. Income of Provident and Superannuation Funds [Section 10(25)]**

1. Interest on securities which are held by or are the property of any provident fund to which Provident Funds Act, 1925 applies and any capital gains of the fund arising from the sale, exchange or transfer of such securities.
2. Any income received by the trustees on behalf of a recognised provident fund.

3. Any income received by the trustees on behalf of an approved superannuation fund

**44. Income of Employee's State Insurance Fund [Section 10 (25A)]**

Income of such fund is fully exempted.

**45. Regulating the marketing of agricultural produce [Section 10(26AAB)]**

Any income of an agricultural produce market committee or board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce shall be exempted.

**46. Income of a corporation set-up for promoting the interests of Scheduled Castes, Scheduled Tribes or Backward Classes [Section 10(26B)]**

Income of such corporation or body, institutions or associations which are wholly financed by govt. and which have been set-up to promote the interest of above mentioned communities shall be fully exempted.

**47. Income of a corporation set-up to protect the interests of Minorities [Section 10(26BB)]**

Any income of a corporation established by the Central Government or State Government for promoting the interests of the members of such minority community as notified by the Central Government from time-to-time, is exempt from tax under Section-10(26BB).

**48. Income of Child Clubbed U/s 64 (IA) [Section 10(32)]**

In case income of a minor child is clubbed with the income of his parent, the parent can claim exemption upto actual income of child clubbed or 1,500 whichever is less in respect of each minor child whose income is included.

**49. Income by way of dividend from Indian company [Section 10(34)]**

Dividend received from a domestic company is **exempt** in the hands of the shareholders provided such dividend has already suffered Dividend Distribution Tax (DDT) under **section 115-O**

**50. Exemption of income from Units [Section 10(35)]**

Like in case of dividend, section 10(35) provides that any income received in respect of—

1. units from the Administrator of the specified undertaking, or
2. the specified company, or

3. a Mutual Fund specified under clause (23D)

shall be Exempt.

**51. Exemption of income from Securitisation Trust [Section 10(35A)] [w.e.f A.Y. 2014-15]**

Any income received by any person being an investor of the Securitisation Trust from such a trust, by way of distributed income referred to in section 115TA shall be exempt.



# **CAPITAL AND REVENUE EXPENDITURES AND RECEIPTS**

## **INTRODUCTION**

Income Tax is levied on income of assessee and not on every receipt which he receives. The method of charging tax on different types of receipt is different. Income tax Act, 1961 provides a separate head “ CAPITAL GAINS” for levying tax on capital receipts. Similarly, while calculating net taxable income of an assessee only revenue expenses are allowed to be deducted out of revenue receipts. Particularly while calculating business profit or professional gain only revenue receipts and revenue expenses are considered. This makes the distinction between capital and revenue of vital importance. For this distinguish capital and revenue items can be divided into 3 sub-parts :

1. Capital Receipts vs Revenue Receipts
2. Capital Expenses vs Revenue Expenses
3. Revenue Losses vs Capital Losses

## **CAPITAL RECEIPT VS REVENUE RECEIPTS**

As discussed above the capital receipts are to be charged to tax under “ Capital Gains” and revenue receipts are taxable under other heads, it is of vital importance to understand which receipt is a capital receipt and which one is a Revenue. Some tests, however, can be applied in particular cases. These Tests are :

- On the basis of nature of Assets : If a receipt is referred to Fixed Asset, it is capital receipt and if it is referable to circulating asset it is revenue receipt.
- Fixed assets is that with the help of which owner earns profit by keeping it in this possession, e.g. Plant , Machinery, Building or factory etc.
- Circulating Asset is that with help of which owner earns profits by parting with it and letting others to become its owner, e.g. Stock-in Trade.
- Profit on the sale of Motor Car used in business by an assessee is Capital Receipt whereas the profit earned by an automobile dealer, dealing in cars, by selling a car is his revenue receipt.
- Termination of source of income : Any sum received in compensation for the termination of source of income is capital receipt, e.g. compensation received by an employee from its employer on termination of his services is capital receipt.
- Amount received in substitution of income : Any sum received in substitution of income is revenue receipt, e.g. ‘A’ company purchased the right to produce a Film from its earlier producer with the condition that no other produce will be given these rights. Afterwards, it is found that the rights for producing this film had already been sold. The ‘A’ Company claimed damages and was awarded Rs.50,000. It was held that damages received are the compensation for the profits which were to be earned. Hence, this is Revenue Receipt.

Compensation received on termination of Lease or surrender of a Right. Any amount received as compensation on surrendering a right or termination of any Lease is Capital Receipt whereas any amount received for loss of future income is a revenue receipt.

e.g. An Author gives up his right to publish a book and receives Rs. 1,00,000 as compensation. It is capital receipt but if he receives it as advance Royalty for 5 years it is Revenue receipt.

### **3. CAPITAL EXPENSES VS REVENUE EXPENSES**

To distinguish a Revenue Expenditure from a Capital Expenditure, the following tests can be applied for this purpose :

**(i) Nature of the Assets :** Any expenditure incurred to acquire a Fixed Assets or in connection with installation of Fixed Assets is Capital Expenditure.

Whereas..

any expenditure incurred as price of goods purchased for resale along with other necessary expenses incurred in connection with such purchase are Revenue Expenses.

**(ii) Nature of Liability :** A payment made by a person to discharged a capital liability is a capital expenditure.

Whereas..

An expenditure incurred to discharged a revenue liability is Revenue Expenditure, e.g. Amount paid to a contractor for cancellation of contract to construct a factory building is capital expenditure.

**(iii) Nature of Transaction :** if an Expenditure is incurred to acquire a source of income, it is Capital Expenditure e.g. purchase of patents to produce picture tubes of T.V. sets.

Whereas..

An Expenditure incurred to earn an income is revenue expenditure , e.g. salary to staff, advertisement expenses. Etc.

**(iv) Nature of Payment in the hands of payer :** If an expenditure is incurred by an assessee as a Capital Expenditure, it will remain a capital expenditure even if the amount may be revenue receipt in the hands of receiver ,

e.g. purchase of Motor Car by a businessman is capital expenditure in his hands although it is revenue receipt in the hands of car dealer.

### **4. CAPITAL LOSSES VS REVENUE LOSSES**

Distinction has to be made between revenue losses and capital losses of the business because under the provisions of this Act Capital Losses are dealt with under the Chapter “ Capital Gain” whereas Revenue Losses are treated as Business Losses and as such are treated under the head “ Profit and Gains of Business or Profession”.

Distinguish has to be made between Revenue Losses and Capital Losses of the business because under the provisions of this Act, Capital Losses can be set off against the Income from Capital Gain only, whereas the Revenue Losses are business losses and as such can be set off against

any other income of the assessee.

It is very difficult to distinguish between a Capital Loss and a Revenue Loss on the basis of certain principles. On the basis of court judgment, following decisions have become distinguishing points :

**(i) Loss due to sale of Assets :** Where there is loss on selling a Capital Assets, it is a Capital Loss whereas any loss incurred during the sale of Stock-in-Trade is a Revenue Loss.

**(ii) Loss due to embezzlement :** Where there is embezzlement done by an employee and this causes loss to the business, it is of Revenue Loss.

**(iii) Loss due to withdrawal of money from bank :** Once the amount is deposited in Bank and then it is withdrawn by an employee and is misappropriated , is a Capital Loss.

**(iv) Loss due to liquidation of company :** Amount deposited by a person with manufacturing industry to get its agency and lost due to company being liquidated is a Capital Loss.

**(v) Loss due to Theft by an employee :** Losses occurring due to theft or embezzlement of misappropriation committed by an employee is Revenue Loss.