THE INCOME TAX ACT, 1961

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WHAT IS INCOME TAX?

Income-tax is a form of direct tax that needs to be borne by a taxpayer. Income-tax is controlled and charged by the Central Government of India and it is applicable to the taxpayer's income, which was earned in the previous year.

What do you mean by Tax?

Tax is a mandatory fee or financial charge levied by the government on an individual or an organization to collect revenue for public works to provide the best facilities and infrastructure.The Collected funds then are used for different public expenditure programs.

What is income?

'Income' in general terms is any earnings, earned by a person. 'Income' is defined under **section 2 (24)** of the Income-tax Act. The definition of income is an inclusive definition, with 32 sub-sections. It describes various types of earnings by a person in various forms. Due to paucity of time and space constraints, it is not reproduced.

Tax definition in **Section 2(42)** reads as follows

"tax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date and in relation to the assessment year commencing on the 1st day of April, 2006, and any subsequent assessment year includes the fringe benefit tax payable under section 115WA"

The Income-tax Act, 1961, governs taxation in India and includes key provisions such as tax slabs, (specifies income brackets and corresponding tax rates), Deductions and Exemption /Exclusions. Tax is charged on various incomes from different sources such as salaries, investments, properties. etc.

Income of an individual or person is **“assessed”** to tax under the Income-tax Act.

The individual or person whose income is **“assessed”** is called an **“Assessee”**.

An Assessee is defined under section 2(7) of the Income-tax Act:

“2(7) *"assessee" means a person by whom any tax or any other sum of money is payable under this Act, and includes—*

(a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;

(b) every person who is deemed to be an assessee under any provision of this Act;

(c) every person who is deemed to be an assessee in default under any provision of this Act;”

Definition of “assessee” refers to the word “person”. Person is defined under Section 2(31) which is also an inclusive definition.

“2(31) "person" includes—

(i) an individual,

(ii) a Hindu undivided family,

(iii) a company,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,

(vi) a local authority, and

(vii) every artificial judicial person, not falling within any of the preceding sub-clauses.”

The period during which the income of an individual or person is assessed is called an "assessment year", which is defined under **Section 2(9)**.

The question that arises is, What is an Assessment Year (A.Y.)?

In the Income-tax Act, the income tax year is described as "assessment year" i.e. the year in which the income of the "previous year" which ended before the commencement of the year, is to be assessed. Therefore, as per the definition of assessment year under section 2(9), if the assessment year commences on 1st April, 2025 and ends after 12 months on 31st March, 2026 (A.Y. 2025-26), the income of previous year i.e. for the period 1st April, 2024 and ending on 31st March, 2025 will be assessed in this assessment year.

Previous year is defined under **section 2(34)**, as defined under **Section 3** of the Income-tax Act. Previous year means the financial year (F.Y.) immediately preceding the assessment year.

As per the proviso to Section 3, in case of newly set up business or profession during the financial year, the previous year will end on 31st March, even though the period comprised in the previous year may be less than 12 months.

"Assessment of income" of a person is computation of income of the person from various sources in accordance with the Income-tax Act. Such computation or assessment is made after allowing various exemption, deduction, etc. as provided in the Act.

An assessment therefore, comprises of two stages (1) computation of total income; (2) determination of tax payable thereon.
When both these stages are completed, an assessment is deemed to have been made.

BASIS OF CHARGE

The Income-tax Act does not prescribe the rate at which the tax is to be charged. **Section 4** of the Income-tax Act lays down that Income tax shall be charged for any assessment year in respect of total income of the previous year computed under the Income-tax Act. The rate is prescribed by the Finance Act, which is passed every year by the Parliament. Every year, Finance Bill is presented in the Parliament by the Finance Minister, specifying the rates of taxation, which becomes effective from 1st April of that year. The budget is proposed by the Finance Minister and presented before the Parliament in February or March. If passed that becomes the law. It not only suggests the rate of tax, but also any amendments in the Income-tax Act for the next financial year commencing on 1st April..

RESIDENTIAL STATUS OF AN ASSESSEE

Taxation of a person is based on **“residential status”** of the person, which is divided into three categories:

(1) Ordinarily resident of India;

(2) Resident but not ordinarily resident in India;

(3) Non- Resident Indian

ORDINARY RESIDENT OF INDIA

Section 6 deals with the residence of a person in India. It is different for individuals and for other entities like firms, association of persons (AOP), HUF and companies.

An Individual will be treated as a resident in India in any previous year if he fulfils any of the following two conditions:

(a) He is in India in that year for a period of 182 days or more or
(b) Within the four preceding years, he has been in India for a period of 365 days or more and has been in India for 60 days or more in that year.

An individual who is abroad, either working abroad or is a resident abroad, but of Indian Origin, he would be treated as a resident of India if he stays in India in that year for 182 days or more (instead of 60 days). Therefore, if he stays abroad for 182 days or more, he will be treated as non-resident Indian. However, if the total income of such person, other than his income from foreign source exceeds Rs.15 Lakhs during the previous year, he will be regarded as resident in India, if his stay in India is for more than 120 days (instead of more than 60 days). An Indian citizen or person who permanently reside outside of India and only visits India in any previous year, will be treated as resident in India if his stays in India for 182 days or more, otherwise he is a non-resident.

Residence of a firm and/or AOP or HUF will depend on the control and management of its affairs. If the control and management of affairs of AOP is within India, it will be treated as resident in India.

For a company it would be treated as resident in India if the following two conditions are met:

1. It is an Indian Company or
2. It's place of effective management in that year, is in India.

Resident, but not ordinarily resident in India is accorded only in respect of an individual or HUF.

An individual will be treated as not ordinarily resident in India in any previous year, if an individual has been a non-resident in India in 9 out of 10 previous years preceding that year, or has during the 7 previous years preceding that year, been in India for a period less than 730 days i.e. 729 days or less. HUF is treated as resident but not ordinarily resident if the manager of the HUF has been non-resident in India for 9 out of 10 previous years preceding that year or is during the 7 previous years preceding that year, been in India for a period less than 730 days.

Non-resident

An individual who does not satisfy the conditions for being a resident in India or resident but not ordinarily resident in India is a non-resident.

HUF, firm or other AOP is treated as non-resident in India in any previous year if the control and management of affairs is situated wholly outside India during that year.

A company will be treated as non-resident in India in any previous year if it is not an Indian company and also if its place of effective management in that year is not in India.

Scope of Total Income as per Section 5

Persons who are resident and ordinarily resident are chargeable to tax on all incomes

(a) which is received or is deemed to be received in India;

(b) which accrues or arises or is deemed to accrue or arise in India; and

(c) which accrues or arises outside India.

In case of person who is a resident but not ordinarily resident, the scope is the same as in case of person who is a resident and ordinarily resident **except** that the income, which accrues or arises outside India is not includible in his total income unless it is derived from a business controlled in or a profession set up in India.

Non-residents are liable in respect of income received or deemed to be received in India or accrues or arises or is deemed to accrue or arise in India. They are not liable for income arising outside India even if it is remitted to India.

Irrespective of residential status, all income accrued or arising, whether directly or indirectly through or from:

(a) any business connection in India; or

(b) any property in India; or

(c) any assets or source of income in India; or

(d) the transfer of a capital assets situate in India, shall be deemed to accrue in India and chargeable to tax in India under Section 9(1)(i).

However, no income shall be deemed to accrue or arise in India to a non-resident news agencies or film makers, where their operations in India are confined to gathering and transmitting news outside India or shooting films in India.

In case of persons or individuals, governed by the system of community of property owned under the **Portuguese Civil Code**, which is in force in the State of Goa and in the Union territories of Dadra and Nagar Haveli and Daman and Diu the income of husband and wife, except salary income, is to be apportioned equally between the husband and wife and assessed separately in their respective hands after giving rebates/ reliefs, etc. to each one of them **(section 5A)**.

Salary income irrespective of residential status, shall be deemed to accrue or arise in India or chargeable to tax in India, if it is earned in India.

Salary paid to crew members in India will depend if he is in India for **182 days** or more. If he is in the waters in the territory outside in a year for more than **182 days**, he will be treated as a non-resident, even if he in India.

Government servant who is a citizen of India and working in a foreign country, the salary paid to him in a foreign country is deemed to accrue or arise in India **(sec.9(1)(iii))**, however, any allowance or perquisites given to him when he is posted in a foreign country, are specifically exempt under **section 10(7)**.

The following incomes are deemed to arise in India:

a. Dividend paid by an Indian Company;

b. Interest payable on monies borrowed and brought into India;

c. Royalty and technical service fees payable for any technical services used for any business or profession in India; However, any such technical service fees in respect of computer software supplied by a non-resident manufacturer along with a computer or computer based equipment, would be exempt.

For non-resident, the income shall be deemed to accrue or arise in India and shall be included in the total income of the non-resident, whether or not (a) the non-resident has a resident or place of business or any business connection in India or (b) the non-resident has rendered services in India.

Chapter III

Exemptions from total income under **Section 10**. This section provides for exempted income under various categories. Questions are asked to quote some of them or any specific exemptions.

Charitable Trust

Income of charitable and religious trust under section **2(15), 2(24), 11, 12, 12(A), 12(AA), 12(AB), 13**.

Section 2(15) defines charitable purpose to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility.

The **proviso to section 2(15)** states that advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity. The proviso however, does not apply when the income or aggregate receipts from such activity, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities in the previous year.

If a voluntary contribution is made with specific direction to form part of the corpus of the Trust, then it is excluded from the total income of the trust. **Section 115BBC** provides that any anonymous donation will be included in the income of the charitable trust and taxed at **30%**.

Income derived from property held under trust wholly for charitable or religious purpose is exempted provided

(i) **85%** of its income is applied for charitable purpose.

(ii) Income in the form of voluntary contributions made with a specific direction, that they shall form part of corpus of trust/institution subject to the condition that such voluntary contributions are invested in one or more of the forms under section 11(5);

(iii) Trust has made an application in **Form No.10A** for registration with the Principal Commissioner within one year from the day of creation of the Trust and such trust is registered under **section 12AA**.

Apart from registering the trust under the **Public Charitable Trust Act**, it is also required to be registered under the **Income-tax Act**. Registration of the trust was earlier governed by **Section 12(A)** and with effect from 1.04.1997, registration is now **Section 12AA**. Fresh registration is now under **Section 12AB** **w.e.f A.Y 2022-23**.

Old Tax Regime and New Tax Regime

The Government of India introduced the New Tax Regime in the 2020 Budget to vary the tax structure. Taxpayers can choose between the old tax regime and the new tax regime.

What is the old tax regime?

The old tax regime is the traditional tax system in India where a taxpayer can take benefit from various deductions and exclusions to reduce the taxable income. The exclusions are mainly under **section 10** and deduction are mainly under **section 80**.

The tax slabs under the old regime were as follows:-

Upto income of Rs. 2.5 lakhs	No tax
Income between 2.5 lakhs to 3 lakhs	5% (for senior citizen and super- senior citizen- no tax
Income between 3 lakhs to 5 lakhs	5% (for super- senior citizen, above 80 years- no tax)
Income between 5 lakhs to 10 lakhs	20% income
Income above 10 lakhs	30% income

What is the new tax regime?

The new tax regime was introduced in 2020 with lower tax rates across various income levels. Under the new tax regime, most exemptions and deductions have been removed and cannot be claimed. The tax slabs under the new tax regime w.e.f. 1.4.2025 are as follows:-

Upto 12 lakhs	No tax
Between 12 lakhs to 16 lakhs	15%
Between 16 lakhs to 20 lakhs	20%
Between 20 lakhs to 24 lakhs	25%
Above 24 lakhs	30%

Key differences between Old Tax Regime and New Tax Regime:

Parameter	**Old Tax Regime**	**New Tax Regime**
Tax Slabs	Higher Tax Rates	Lower Tax Rates
Deductions/ Exemptions	Multiple deductions and exemptions for various investments,expenses, and savings. These include deductions under Sections 80C,80D, 80E, and house rent allowances.	Limited major deductions/ exemptions.
Complexity	Complex due to various deductions.	Simplified Tax filing
Tax Planning	Requires structured tax planning	Considerably reduced tax planning needed
Savings Encouragement	Encourages savings through tax benefits	No incentives for opting for savings plans or schemes like PPF and NPS

Heads of Income

Section 14

For computation of total income, income from various sources is to be computed under the following heads:

1) SALARIES

2) INCOME FROM HOUSE PROPERTY

3) PROFITS AND GAIN OF BUSINESS OR PROFESSION

4) CAPITAL GAINS

5) INCOME FROM OTHER SOURCES (RESIDUARY INCOME)

Section 15 - SALARIES

Income under the heads “Salaries” comprises of remuneration in any form due for personal service under an express or implied contract of employment of service.

There has to be a relationship between an employer and an employee. A partner who receives salary or remuneration is not an “employee” of the firm and there is no contractual relationship between them as“employer” and “employee”, hence, salary and remuneration paid to a partner of a firm is not included in the head “Salaries”.

Explanation to Section 9 (1)(ii) clarifies that income under the head “salaries” for service rendered in India shall be regarded income earned in India, even it is paid abroad.

What is Salary?

Salary includes salary received during previous year whether paid or not, advance salary, arrears of salary, wages, any annuity or pension, gratuity, any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages, leave salary, any amount paid by employer to employee towards contribution to EPF in excess of 12% of salary, interest exceeding 9.5%, dearness allowance, commission, bonus, compensatory allowance and fringe benefits.

Perquisites and Fringe benefits

Various perquisite and fringe benefits are classified under **Section 17 (2)** such as reimbursement of medical expenses, house rent allowance, residential accommodation, motor car, transport, cook, sweeper, gardner, watchman and personal attendant, gas, electricity, water supply, educational facilities for family members, etc.

Section 10(14)

Excludes certain allowances paid to a employee.

Section 10(10B)

Excludes retrenchment compensation.

Section 10(10C)

Excludes certain voluntary retirement benefits.

Section 10(10D)

Excludes superannuation fund payment

Section 10(10AA)

Encashment of unutilized leave salary.

Deductions from salary

Standard deduction under **section 16(ia)** of Rs.75,000/- is permitted w.e.f. 1.4.2025.

Under section 16(iii)

Any tax paid on employment such as professional tax is allowable as a deduction.

Tax Deducted at Source (TDS) on salaries will be part of second lecture on tax.

Income from House Property

“House Property” consists of a building or land appurtenant thereto, the land may be in form of a courtyard and compound forming part or parcel of building. Such land is to be distinguished from just open plot of land.

Any rent received from a vacant plot of land and agricultural land is not assessable as “Income from House Property”, but it could be “income from other sources” and chargeable under **section 56**.

Section 22 read with section 27

Deals with income from house property and excludes any house property or any portion thereof which is occupied by the Owner for the purpose of his business or profession. Expenditure incurred on repairs, municipal tax, etc. can be claimed as deductions against income from business or profession by such person and even depreciation can be claimed.

In case, an owner lets out his/her property to an employee for residence and such letting out is incidental to carrying on his/her business, then the income from such letting out would be assessable as **“Profits and Gains from Business or Profession”** and not under the head **“Income from House Property”**.

Person liable to pay tax under the head “Income from House Property”

Under **section 22**, it is the owner of the house property, who is chargeable to tax in respect of any income earned from owning any house property such as rent, license fees, etc.

Under section 27 there are some other owners, who would be deemed to be owners of house property and charged to tax under the head “Income from House Property” such as:

1. If an individual transfers, without adequate consideration, a house property to his/her spouse or to a minor child, not being a married daughter, the income from such property so transferred would be deemed to be included in the income of the person who transferred the property, despite he/she not being the owner.

2. A holder of an impartible estate is deemed to be an individual owner of the property comprised in the estate.

3. A member of a co-operative housing society or company or other association of persons who has been allotted or leased a building or part thereof under a house building scheme, is deemed to be an owner of such building or part thereof.

4. A person who is allowed to take or retain possession of the building or part thereof in part performance of a contract to buy under section 53A of the Transfer of Property Act would be deemed to be the owner of the house property, despite the title not being transferred.

5. A person who acquires any right in or with respect to any building or part thereof by way of sale or exchange or lease for a term not less than 10 years, but excluding any right by way of lease for month to month or period not exceeding 1 year, is deemed to be an owner.

For purpose of charging tax under the head, “Income from Home Property”, Annual Value of the property is to be computed under **Section 23(1)**.

Annual value of the property is the sum for which the property could reasonably be expected to be let out from year to year i.e. to give it on rent or hire, including giving it on leave and license basis.

If the home property is given on leave and license basis, the license fees is taken into consideration for fixing municipal valuation.

If the actual rent or license fees is higher than the municipal valuation or stamp valuation, bonafide Annual value would ordinarily be determined with reference to the municipal rateable value on the basis of which municipal tax is levied.

- Under **Section 23(5)**, if the Builder or Developer retains any building or land appurtenant or any part thereof as stock-in-trade and does not let out the same during the whole or any part of the previous year, the annual value of such property will be “nil” for period of 2 years from the end of the financial year in which the certificate of completion of construction of building is obtained from the Competent Authority.
- If the property is self-occupied, under **section 23(2)**, **23(3)** and **23(4)**, the annual value of such house or part of house is deemed as “nil”
  a) if it is in the occupation of the owner for the purpose of his residence; or
  b) if it cannot actually be occupied by the owner due to his employment business or profession carried on elsewhere and he has to reside in that place in a building not belonging to him.
- Interest on any loan taken by any person to either construct or purchase a house property is available as deduction from his income from house property under **Section 24**.

Maximum of two houses are permitted to be held by an owner for his occupation without it being charged under the head **“Income from House Property”**. Any additional house or houses other than two houses, even if not occupied by the owner or not let out, will be deemed to be let out and charged to tax on the basis of annual valuation.

Any loss of income i.e. in case the expenses towards taxes or repairs, etc. are more than the income for the house property, such loss can be set off under **section 71** against other heads of income in the same assessment year and in case it could not be set off, it can be carried forward and set off against other heads of income for maximum of succeeding 8 assessment years. Loss arising on account of interest on borrowing funds for purpose of acquiring the property is also allowed to be set off in the same year of assessment. In case of self occupied property, however, maximum deduction allowable is Rs.30,000/-

Property owned by co-owners – **section 26** provides that if a property is co-owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not be assessed as an association of persons, but share of each co-owner will be included in his total income and if it is occupied throughout the year by such co-owner for his self occupation, the annual value will be taken as 'nil' for each co-owner.

Section 24 provides for various deductions under the head **`Income from House Property'.**

Profits and Gains of Business or Profession Sections 28 to 44 (DB)

Business:

As defined in **section 2(13)** of the Income-tax Act, "Business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. **Universal Plast Ltd. vs CIT, (1999) 5 SCC 189 : (1999) 237 ITR 454**

For the purpose of computing business income, speculation business, if any, carried on by an assessee will be treated as distinct and separate from any other business carried on by him **(*Explanation* 2 to section 28)**.

***Explanation* 3 to section 28** clarifies, from assessment year 2025-26 and onwards, that any income from letting out of a residential house or part of the house by the owner will not be chargeable under the head "Profit and gains of business or profession" and will be chargeable as "Income from house property".

Profession:

Under section 2(36), "Profession" is defined to include vocation. Income from the exercise of any profession or vocation which calls for an intellectual or manual skill, falls under this head. It covers cases of doctors, lawyers, chartered accountants, architects, consulting engineers, artists, sculptors, musicians, singers, etc.

Business or Professional Income:

Section 28 refers to various incomes as accessible income from business or profession, which is carried on in the previous year. Section 28 also provides for certain receipts which are deemed to be profits chargeable to tax even though the business or profession to which they relate seized to be in existence in the year of the receipt.

Deductions from business or professional income:

Business expenditure is allowable only when any business or profession was carried on by Assessee at any time during the previous year and no deduction is admissible if the business or profession has been discontinued and not been carried on at any time during the previous year. Some of the important deductions admissible in computing the income from business or profession are as follows:-

1. Rent, rates, taxes, repairs and insurance for premises where business or profession is carried on [Section 30 r/w. Section 38];
2. Repairs and Insurances of machinery, plant and furniture [Section 31];
3. Depreciation [Section 32]
4. Incentive for acquisition of new plant/ machinery by manufacturing company [Section 32AC];
5. Investment in new plant or machinery in notified backward areas in certain states [Section 32AD]
6. Expenditure on scientific research [Section 35];
7. Expenditure on acquisition of Patent rights or Copyrights [Section 35AD];
8. Expenditure of Capital nature on specified business [Section 35AD];

   CIT v. Geoffrey Manners and Co. Ltd., 2009 SCC OnLine Bom 208 : (2009) 315 ITR 134
9. Amortization of Preliminary expenses [Section 35D];
10. Bonus or commission paid to the employees [Section 36(1)(ii0];

    Shriram Pistons and Rings Ltd. v. CIT, 2008 SCC OnLine DEl 522: (2008) 307 ITR 363

11. Interest on borrowed capital [Section 36 (1)(iii)];
12. Contribution towards recognized Provident Fund or approved superior annuation fund [Section 36(1)(iv)];
13. Contribution towards approved gratuity fund [Section 36 (1)(v)]
14. Bad Debts [Section 36(1)(vii) and Section 36(2)];

    CIT v. HP Mineral and Industrial Development Corporation Ltd. 305 ITR 111
15. Entertainment Expenditure [Section 37(1)];
16. Advertisement Expenditure [Section 37(1) and Section 37(2B)];
17. Professional Expenditure [Section 37(1)];
18. General Deduction [Section 37(1)];

    This is not an exhaustive list, but a few examples

    CIT v. Hoshiari Lal Kewal Krishan, 2006 SCC OnLine P&H 2082 : (2009) 311 ITR 336

Provisions relating to Demerger of Company

[Section 2(19AA), Section 2(19AAA), Section 2(41A), Section 32(1), Section 35A(7), Section 35ABB(7), Section 35D95A, Section 35BD, Section 41(1), Section 43(1) and Section 43(6)].

"Demerger" in relation to companies is defined in **section 2(19AA)** to mean de-merger pursuant to a scheme of arrangement under **section 391 to 394** of the Companies Act, 1956 by a de-merged company' of its one or more undertakings to any `resulting company' subject to the conditions specified therein.

De-merged company is defined under **section 2(19AAA)** to mean the company whose undertaking is transferred, pursuant to the demerger to a resulting company.

Resulting Company is defined under **section 2(41A)** to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the de-merged company is transferred to the resulting company and in consideration of such transfer of undertaking, the resulting company issues shares to the shareholders of demerged company.

Deductions in respect of such demerger are as follows:

- Normal depreciation under **section 32(1).**
- Capital expenditure incurred for acquisition of the Patent Rights or Copyrights.
- Amortization of certain expenses including expenditure in case of amalgamation/demerger.
- Receipts deemed to be profits and gains of business or profession.
- Actual costs of assets.

Taxation of Foreign Exchange Fluctuation [Section 43AA]

Any gain or loss arising on account of any changes in foreign exchange rates will be treated as income or loss as case may be.

Special provisions for computing profits and gains of business on presumptive basis **(Section 44AD)** and of profession on presumptive basis **(Section 44ADA)**. Both these provisions are for computing profits and gains on presumptive basis which is simplified method of computing income or any business or income of any profession. The computation is based on total turnover or gross receipts and tax is payable at a fixed percentage on the said presumption of income based on such total turnover or gross receipts. In such cases, deductions allowable under **section 30 to 38** are be deemed to have been allowed and no further deduction under those sections are allowed. In case of a firm, interest or salary paid to any partner or working partner by firm which is normally allowed as deduction under **section 40(b)**, will also not be allowed to the firm.

Compulsory Audit of accounts of certain persons carrying on business or profession (Section 44AB);

Section 44AB makes it compulsory for persons carrying on business to get accounts audited before the specified date by an accountant, if the total sales or turnover or gross receipts exceeds Rs.1 Crore in any previous year in case of business and Rs.50,00,000/- in case of profession. Proviso to the section mentions that if the aggregate of all amounts received during the previous year in "cash" does not exceed 5% of total amount of receipts and aggregate of all amount paid, including amount incurred for expenditure in "cash" during the previous year does not exceed 5% of the total payments made, then such person is not required to get the accounts audited where the total sales, turnover, gross receipts does not exceed Rs.10 Crores.

Second Proviso mentions that payments or receipts by cheque or bank draft which is not account payee, will be deemed to be payment or receipt in "cash". The Return of Income filed by the due date is to be accompanied by an Audit Report under **section 44AB.** Failure to comply with **Section 44AB** results in levy of penalty.

Capital gains

Section (45 to 55A)

This is one of the most important and useful topics of conveyancing practice. “Capital Gains” means any profits or gains arising from transfer of a capital asset effected in the previous year.

2(14).The term “capital asset” means:

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor [as defined in the Explanation (a) to section 115AD] which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992; and

(c) any unit linked insurance policy to which exemption u/s. 10(10D) does not apply on account of the applicability of the 4th and 5th proviso thereof, in relation to assessment year 2021-22 and onwards.

The term "capital asset" does not include inter alia:

(1) Any stock-in-trade (other than the securities);

(2) Personal effects such as wearing apparel, furniture, motor car, air conditioner, refrigerator, etc. held for personal use by the assessee or by any member of his family dependent on him.

However, definition of the term capital asset shall include jewellery, archaeological collections, drawings, paintings, sculptures and any work of art, even though these assets are personal effects and transfer of such personal effects will attract tax on capital gains [Section 2(14(ii)];

(3) 6½ % Gold Bonds, 1977, 7% Gold Boards, 1980, National Defence Gold Bonds, 1980; Special Bearer Bonds, 1991; Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government [240 ITR (St)1]; deposit certificates issued under the Gold Monetisation Scheme, 2015 notified by the Central Government; and

(4) Agricultural land in India, not being land situate :

***(a)** in any area within the jurisdiction of a municipality whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or a cantonment board which has a population of not less than 10,000; or*

***(b)** in any area within the distance, measured aerially:*

(1) not being more than 2 kilometres, from local limits of any municipality or cantonment board referred to in item (a) above and which has a population of more than 10,000 but not exceeding 1,00,000; or

(2) not being more than 6 kilometres, from the local limits of any municipality or cantonment board referred to in item (a) above and which has a population of more than 1,00,000 but not exceeding 10,00,000; or

(3) not being more than 8 kilometres, from the local limits of any municipality or cantonment board referred to item (a) above and which has a population of more than 10,00,000. 'Population' means the population according to the last preceding census of which the relevant figures have been published before the 1st day of the previous year [Section 2(14)(iii) read with Explanation thereto]"

The definition is therefore not only inclusive, but also excludes certain assets as not being capital assets.

Capital gain is charged on the basis of the period of holding of the capital asset by the assessee or by the previous owner and the assessee under certain circumstances. The period of holding capital assets is computed from the date of acquisition to the date immediately preceding the transfer.

Capital assets are divided into “short term” and “long term” on the basis of holding of the capital asset. Shares and certain securities which are listed in a recognized stock exchange or certain UTI securities, etc., if held for less than 24 months are regarded as “short term capital assets” and such shares and securities held for more than 24 months are regarded as “long term capital assets”. For all other capital assets, if the capital asset is held for less than 24 months, it is treated as “short term capital asset” and beyond 24 months, it is treated as “long term capital asset”. **(Section 2(42A) and 2 (29AA) respectively)**

Capital gain arising on transfer of short term capital asset is **“short term capital gain”** as defined in **section 2(42B)** and gain arising on transfer of “long term capital asset” is “long term capital gain” as defined in **section 2(29B)**.

Capital gain arises on account of transfer of capital asset and is the difference between the sale price and the cost price.

Section 2(47) defines transfer in the following manner:

"2(47) "Transfer", in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law or in a case where the asset is converted by the owner thereof into or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or the maturity or redemption of a zero coupon bond.

Transfer includes possession of immovable property given without registration of conveyance deed; and also transactions in agreements to buy or sell any immovable property or any rights thereon.

Transfer of movable property is complete when delivery of possession is complete. Transfer of immovable property, normally, is complete only when the conveyance deed is registered. However, for the purposes of capital gains, the transfer is treated as a complete with delivery of possession and when agreement to sell/buy immovable property is entered into or when such agreement is itself a subject matter of transaction."

Chaturbhuj Dwarkadas Kapadia vs CIT, 2003 SCC OnLine Bom 161 : (2003) 260 ITR 491
Dr. Arvind S Phake vs CIT 2017 SCC OnLine Bom 9654 : (2018) 401 ITR 96
CIT v. Balbir Singh Maini, (2018) 12 SCC 354 : (2017) 398 ITR 531

CHARGE OF CAPITAL GAIN (Section 45, 46 and 47)

Shortly speaking, capital gain is chargeable as income of the previous year in which the transfer (see 2(47)) takes place. **Section 45** also refers to various other modes of transfer such as monies or other assets received from insurance company on account of destruction, conversion of a capital assets by the owner or treating it as stock-in trade of business, any profits and gains arising from transfer of capital assets by a partner or member of a firm or any AOP or body of individuals by way of capital contribution or otherwise, etc.

A very important inclusion is **Section 45(4)** w.e.f. A. Y. 2021-22 onwards which provides that if a specified person receives during the previous year any money or capital asset or both from specified entity in connection with reconstitution of such specified entity then profits and gains arising from receipt of such money by the specified person is chargeable as to income-tax as income of such specified entity as capital gain and will be deemed to be income of such specified entity and will be determined as per the following formula:-

"*A= B+ C+D*

Where, A means capital gains chargeable as income of the specified entity'

B means value of money received by the specified person on the date of receipt;

C means the amount of fair market value of capital asset received by the specified person from the specified entity on the date of receipt; and

D means the amount of balance in the capital account (represented in any manner) of the specified person in the books of accounts of the specified entity at the time of its reconstitution."

Section 45(4) correlates with **section 9B**, which was inserted w.e.f. 1.4.2021 which provides for taxation of specified person receiving during the previous year, any money or capital asset or both from specified entity in connection with dissolution or reconstitution of such specified entity. Therefore, if there is a dissolution of firm or retirement of a person from the firm or constitution of the firm is changed or new partner is appointed and there is a transfer of any capital assets, the firm is required to pay tax on the basis of deemed income on capital assets so transferred on the fair market value of the capital asset on the date of transfer.

"Specified entity", "**specified person"**, and **"reconstitution of specified entity"** are defined in Explanation to **Section 9B** as follows :

"**9B** *Explanation – For the purposes of this section, -*

(i) "reconstitution of the specified entity" means, where-

(a) One or more of its partners or members, as the case may be of such specified entity ceases to be partners or members; or

(b) One or more new partners or members, as the case may be, are admitted in such specified entity in such circumstances that one or more of the persons who were partners or members, as the case may be, of the specified entity, before the change, continue as partner or partners or member or members after the change; or

(c) All the partners or members, as the case may be, of such specified entity continue with a change in their respective share or in the shares of some of them;

(ii) "specified entity" means a firm or other association of person or body of individuals (not being a company or a co-operative society);

(iii) *"specified person" means a person, who is a partner of a firm or member of other association of persons or body of individuals (not being a company or a co-operative society) in any previous year."*

Another important section introduced is **section 45 (5A)** w.e.f. 1.4.2018

"Section 45(5A) provides that where capital gain arises to an assessee, being an individual or a HUF, from the transfer of a capital asset, being land or building or both, under a specified agreement, the capital gains will be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority; and for the purposes of section 48, the stamp duty value, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by, from assessment year 2024-25 and onwards, any consideration received in cash or by cheque or draft or by any other mode [upto assessment year 2023-24, the consideration received in cash, if any] will be deemed to be the full value of consideration received or accruing as a result of transfer of capital asset. However, proviso to section 45(5A), provides that provisions of section 45(5A) will not apply where the assessee transfers his share in the project on or before the date of issue of said certificate of completion and capital gains will be deemed to be the income of the previous year in which such transfer takes place and the provisions of the income-tax Act, other than section 45(5A), will apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer. For the definition of 'competent authority' and 'stamp duty value', refer Explanation (i)/(iii) to section 45(5A)[Section 45(5A)]."

Section 45 also deals with the other kinds of the transfers, which are chargeable to tax under the head "Capital gains"

Transactions not regarded as transfer

Section 46(1) and section 47 deal with “transfers which are not considered as transfers” and therefore, capital gains if arising from such transaction are totally exempted from tax.

Section 48 provides that, from the full value of consideration received or accruing as a result of transfer of capital asset, certain amounts are deductible to arrive at capital gains, such as :

1. Expenditure incurred wholly and exclusively in connection with the transfer of the capital asset, such as stamp duty, registration charges, legal fees, brokerage, etc.;
2. The cost of acquisition of capital asset or cost of any improvement thereto;
3. The Income chargeable to income-tax of the specified entity where is attributable to the capital asset being transferred by it under section 45(4);
4. Cost of Acquisition and Cost of Improvement are provided in Sections 49, 51 and 55. Explanation to section 48 refers to Cost Inflation Index commonly known as “indexation value”. This is the average rise of consumer price index. The provision for calculation of capital gain has been amended and now, cost of assets are to be taken as the fair market value of the assets as on date of 01/4/2001, if the asset was owned by the assessee prior thereto and the Cost Inflation Index is multiplied to arrive at the cost of the asset as on date of transfer in the previous year in which it is transferred. e.g. if the price of the capital asset as on 01/04/2001 is Rs.100/-, in the current year it will be Rs.363/- as per cost inflation index.
5. Cost of acquisition of different types of assets is provided in Section 49.
6. Section 50 provides for computation of capital gain in respect of depreciable assets.

SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION IN CERTAIN CASES (Section 50C)

"Section 50C, provides that where the stamp valuation authority (SVA) has adopted or assessed or assessable a value higher than the said declared price in the transfer (sale) deed for the purposes of stamp duty, the value so adopted or assessed or assessable by the SVA will be taken to be full value of consideration received or accruing as result of transfer (sale) [Section 50C91)]

1st proviso to section 50C(1) provides that where the date of the agreement fixing the amount of consideration and the date of registration for the transfer of the capital asset are not the same, the value adopted or assessed or assessable by the SVA on the date of agreement may be taken for the purposes of computing full value of consideration for such transfer, 2nd proviso to section 50C(1), provides that the provisions of 1st proviso shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, on or before the date of the agreement for transfer.

3rd proviso to section 50C(1) provides that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed 110% [in relation to years 2019-20 & 2020-21 does not exceed 105%] of the consideration received or accruing as a result of transfer (sale), the consideration so received or accruing as a result of the transfer (sale), for the purposes of section 48, will be taken to be the full value of consideration."

FAIR MARKET VALUE Section 2(22B)

In many provisions relating to "Capital gains", reference is made to "fair market value" of a capital asset, which is defined as:

"***Section 2(22B)*** **:**

i. *The price that the capital asset would ordinarily fetch on sale in open market on the relevant date; and*
ii. *Where the price referred to in (i) is not ascertainable, such price as may be determined in accordance with the rules to be framed by the Board."*

"**Section 50D** provides that where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer."

EXEMPTIONS FROM CAPITAL GAIN TAX

i) **Section 10(37) and Section 10 (38)** provide for exemption from capital gains in certain cases.

ii) **Section 54** provides for exemption from capital gain tax if an individual or HUF transfers a residential house provided such residential house is held by the individual for more than two years and the Assessee purchases within a period of one year before or two years after the date of transfer or constructs within a period three years after the date of transfer, another residential house in India.

W.e.f. A.Y. 2024-25 onwards such exemption is limited to maximum amount of Rs.10 Crores. Such new residential house purchased by the assessee is to be held for another period of 3 years and if not, the exempted capital gain is chargeable as capital gain tax in the previous year in which the same is sold.

iii) Exemption in case investment in residential house under **section 54(F)**

The difference between **section 54 and 54(F)** is that in case of Section 54, capital gain arises on transfer of a residential house owned by the assessee and the sale proceeds are reinvested in another residential house, whereas, in case of Section 54(F), long term capital gain arising from transfer of any other capital asset, not being a "**residential house**", will be exempted from tax, if the sale proceeds are reinvested in one residential house in India.

The condition under **section 54(F)** are as follows :

1. Assessee must be an individual or HUF. This benefit is not available to any other person such as firm, company, AOP, society, trust, etc.;
2. Capital gain arises on account of transfer of long term capital asset other than residential house;
3. Assessee purchases another residential house within a period of 1 year before or 2 years after the date of transfer or within 3 years after the date of transfer, constructs a residential house in India;
4. If the amount of net consideration is not utilized for acquisition of a new residential house before the due date of furnishing the return of income, it should be deposited by the Assessee in a specific bank account;
5. Cost of purchase or construction of new house is not less than the net consideration in respect of capital asset transferred;
6. On the date of transfer, the assessee (i) does not own more than one residential house other than new asset, (ii) does not purchase within one year or constructs within three years after that date of any residential house and (iii) the income from the residential house is chargeable under the head "income from house property". The maximum limits specified is Rs.10 Crores.

Tax on Long term capital gain is also exempted in case of investment in certain specified bonds or specified funds under **Section 54(EC) and 54(EE)** to the maximum extent of Rs.50 Lakhs. Capital gain tax is charged under section 112. For transfers which took place before 23/7/2024, the tax charged was 20% and thereafter, it has been reduced to 12.5%. Option is available to an assesse to choose one of the methods. If the assessee chooses to take benefit of indexation (cost inflation index) as explained above, the tax charged is 20% on the capital gain arising after deduction of cost of acquisition, cost of improvement and other expenses. Alternatively, the assessee can choose to pay tax at 12.5% capital gain without taking benefit of indexation. An assessee can calculate both the methods and pay tax or reinvest as per benefits available to the assessee.

Section 281 CERTAIN TRANSFERS TO BE VOID

This is an important section for conveyancing practice. This section provides that if an assessee creates a charge on or parts with possession by way of sale, mortgage, gift, exchange or any other mode of transfer whatsoever, of any of his assets in favour of any other person when any taxation proceedings under the Income-tax Act are pending or after completion thereof, but before the service of notice, such charge or transfer shall be **VOID** as against any claim in respect of tax or a sum payable by the Assessee on completion of the proceeding or otherwise. The purpose of the section is that no Assessee should fraudulently transfer his asset when any tax is due under the Income-tax Act. The section applies in case movable property is worth more than Rs.5,000/- and in case of immovable property more than Rs.10,000/-.

"Assets" means any land, building, machinery, plant, shares, securities and fixed deposit in bank so long as all these assets do not form part of stock-in trade of the business of the assessee.

Proviso to this section states that such charge or transfer of the assets by the Assessee shall not be void if it is made for

1) adequate consideration and without notice of pendency of any proceeding or without notice of any tax or other sum payable by the Assessee; or

2) with previous permission of Assessing Officer.

In sale transactions, therefore, as matter of abundant caution when the consideration is high, the purchaser's Solicitors insist on the seller obtaining certificate under section 281 from the Assessing Officer so that the transaction is not treated as void later on. Many years back, the registration authorities would require such certificate to be produced for registering documents and would keep the document till such certificate is obtained but now the registration authorities do not insist on this certificate.

INCOME FROM OTHER SOURCES (Section 56 to 59)

Section 50C and 56

Both these sections are in a manner correlated and important. Section 50C is applicable to the transferor of the capital assets whereas section 56 is applicable to a receiver of income or assets including a transferee. Section 56 is the last head of income known as “income from other sources”. Since we are dealing with the head capital gain, look at the provision of section 50C. We have looked at the provision of Section 50C which provides that if consideration for transfer received or accrued as a result of capital assets declared or mentioned in the sale transfer document is less than the valuation adopted or assessed or assessable by the stamp valuation authority (Ready Recknor price) then the value adopted or assessed or assessable by the stamp valuation authority will be taken full consideration received or accrued as a result of the transfer. Tax is levied on that basis. The employment of this section is that the transferor of a capital asset is liable to pay tax on the valuation arrive at or adopted by the stamp valuation authority notwithstanding the Assessee has received less amount as mentioned in the Agreement or Sale Deed or Transfer Deed. The purpose and intent insertion of section 50C is to ensure that no undisclosed income goes untax and unaccounted means transfer are curved.

Similar is the intention of **section 56(2)(x)**. The definition of income under **section 2(24)** has been amended to include sub-section (xxvii(a)) to include any sum or money or value of property referred to in section 56 (2)(x) in the total income of the Assessee w.e.f. 01/04/1970.

Section 56(2)(x) provides that the value of any sum of money or moveable or immoveable property received without consideration (gift) or for any adequate consideration is chargeable to income tax in the assessment of the recipient Assessee i.e. Donee under the head “Income from other sources.”

The maximum permissible limit is Rs.50,000/- and beyond that, any sum of money or property moveable or immoveable received by any person exceeding Rs.50,000/- is treated as without consideration or inadequate consideration and is chargeable to tax in his hand. Again, the concept of value of immovable property based on market value determined by the stamp valuation authority (Ready Reckoner) arises in this case. Therefore, if the consideration amount paid by the person acquiring the property mentioned in the agreement or sale deed is less than stamp valuation, the difference is to be treated as income from other sources in the hands of the purchaser who is deemed to have received a property which is for an inadequate consideration.

The proviso to **sub-section 56(2)(x)** states that this clause shall not apply to any sum of money or property received from a relative as defined in the explanation to **section 56(2)(vii)** that in case of gift from relative as defined would not be taxable as income from other sources. Similarly, there are other exemptions such as receipt of gifts on occasion of marriage of an individual or under a Will or by way of inheritance or in contemplation of death, receipt of any charitable trust or institution or any university or local authority or trust etc. are all exempted from this section. Any transfer of any monies or assets, moveable or immoveable, by an individual to a trust created or established solely for the benefit of individual is also exempted from tax.

Apart from **Section 56(2)(x)**, **section 56(1)** lays down income of every kind, which is not to be excluded from the total income and which is not chargeable under any of the heads specified in **section 14** shall be chargeable to income tax under the residuary head, “income from other sources”

Section 56(2) defines that other sources of income to be included in the head “income from other sources” such as dividends, interest on securities (on security held on investment and not on stock), winnings from lotteries, crossword puzzles, races, card games, etc. income from letting out machinery, plant or furniture on hire, forfeiture of money received as advance for sale of capital assets, compensation in connection with the termination of employment and any sum received under life insurance policy, interest on bank deposit, director’s fees, income from ground rents, royalty etc.

Section 57 provides for deductions to be made from “Income from other sources”

Section 58 provides for amounts which are not deductible under the head “Income from other sources” such as personal expenses of Assessee, interest payable outside India, salaries payable outside India etc.

Clubbing of Income (Section 60 to Section 64)

Normally, an Assessee is taxed in respect of his own income only, but in some exceptional cases this principle is deviated by Income Tax Act. Under **Section 60 to 64** of the Act, an assessee may be taxed in respect of an income which legally belongs to someone else. Inclusion of an income of one person in the income of another person is known as `Clubbing of Income'.

Clubbing provisions are governed by **Section 60 to Section 64** of the Act and are normally applicable to those transactions, wherein an assessee tries to reduce his/her own tax liability by transferring either an asset or an income to his family members or tries to make such arrangements, wherein the ultimate benefit of such transferred asset or income is received back by him/her.

There are nine such transactions to which clubbing provisions are applicable. Except of these nine transactions, clubbing provisions shall not be applied anywhere.

Clubbing Provisions were basically introduced to curb the tax evasion practices followed by many assessees. But they are applicable even if they are beneficial to the assessee, i.e. if application of clubbing provisions result in reduction of tax liability of the assessee, then also they shall be made applicable, whether they are prejudicial to the interest of the Income Tax Department or not.

The following Incomes are clubbable:-

1. Transfer of an Income without transferring the Asset **[Section 60].**
2. Revocable Transfer of an Income generating Asset **[Section 61]**.
3. Remuneration of Spouse **[Section 64(1)(ii)]**.
4. Transfer of an Income yielding Asset, other than a House Property to Spouse, without adequate consideration **[Section 64(1)(iv)]**.
5. Transfer of an Income yielding asset to Son's Wife without an adequate consideration **[Section 64(1)(vi)]**.
6. Transfer of an income yielding asset by Assessee without an adequate consideration to any person for the benefit of Spouse **[Section 64(1)(vii)]**.
7. Transfer of an income yielding asset by Assessee without an adequate consideration to a person for the benefit of Son's Wife **[Section 64(1)(viii)]**.
8. Income of a Minor Child **[Section 64(1A)]**.
9. Transfer of an Asset by a member of an H.U.F. to H.U.F. **[Section 64(2)].**

Other Common Points to be noted about Clubbing Provision

- **Clubbing of a `Negative Income':** The term `Income' includes `Loss' also, hence, not only a positive income, but even a negative income can also be clubbed. For e.g.: If a Minor Child has suffered a Speculative Loss in the Stock Market, then even this loss can also be clubbed in the hands of either of Minor Child's parents.

- **Head of Income:** Clubbable income will be clubbed under the same head of income under which it otherwise could have been taxable, had there been no clubbing. This Rule is however, applicable irrespective of the fact whether the income is a Negative income or a Positive income.

- **Deductions Under Chapter VI A:** All the Deductions under Chapter VI A i.e. deductions under **Section 80C to Section 80U**, shall be available on Gross Total Income computed after clubbing all the clubbable incomes and all the deductions shall be subject to the maximum ceiling limits prescribed.

Aggregation of Incomes [Section 68 to 69D]

1. **Section 68:** Unexplained Cash Credit.
2. **Section 69:** Unexplained Investments.
3. **Section 69A:** Unexplained Money, Bullion, Jewellery, etc.,
4. **Section 69B:** Amount of Investment or Bullion, Jewellery, etc., not fully disclosed in the Books of Accounts.
5. **Section 69C:** Unexplained Expenditure.
6. **Section 69D:** Amount borrowed or repaid on Hundi, otherwise by an A/c payee cheque:

Set off and carry forward of losses

Mode of set off and carry forward:-

The process of setting off of losses and their carry forward may be covered in the following 3 steps:

Step 1: Inter-source adjustment under the same head of income.

Step 2: Inter-head adjustment in the same assessment year. Step 2 is applied only if a loss cannot be set off under Step 1.

Step 3: Carry forward of a loss. Step 3 is applied only if a loss cannot be set off under steps 1 and 2.

Inter Source adjustment – [Section 70]:

- **General Rule -** If the net result for any assessment year, in respect of any source under any head of income, is a loss, the assessee is entitled to have the amount of such loss set off against his income from any other source under the same head of income for the same assessment year.
- **Exceptions –** The following are the *5 exceptions* to the aforesaid rule –

  Loss from speculation business – Loss from a speculation business can be set off only against the profit from a speculation business.

  Loss from `Specified Business' u/s 35AD - Loss from one specified business can be set off only against profit from another specified business and against no other income. (Just like loss from speculative business).

  Long-Term capital loss – Long-term capital loss can be set off only against long-term capital gain.

  Loss from the activity of Owning and Maintaining Race Horses – Loss incurred from the activity of owning and maintaining race horse cannot be set off against any income except income from such activity.

  Loss cannot be set off against winnings from lotteries, crossword puzzles, etc. – By virtue of ***Section 58(4)***, No loss can be set off against winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature.

Other points –

1. Barring the aforesaid cases, any other loss can be set off against any other income **within the same head** of income.

   (a) Loss from a House Property can be set off against income from any other house property;

   (b) Loss from a non-speculation business can be set off against income from speculation or non-speculation business;

   (c) Short-term capital loss can be set off against any capital gain (whether long-term or short-term);

   (d) Under the head "Income from other sources" loss from an activity (other than the activity of owning and maintaining race horses) can be set off against any income but other than winnings from lotteries, crossword puzzles, etc.

2. It is a well established position of law that if income from a particular source is exempt from tax, e.g., income exempt from tax under **Section 10,** then the loss from such source cannot be set off against an income which is chargeable to tax.

Inter-Head adjustment – [Section 71]:

- **General Rule** – Where the net result of computation made for any assessment year in respect of any head of income is a loss, the same can be set off against the income from other heads.

- **Exceptions** – The following are the exceptions to the aforesaid rule:-
  - **Loss in a Speculation Business:** Loss from a Speculation Business cannot be set off against any other income.
  - ***Loss from `Specified Business' u/s 35AD*:** Loss from one specified business can be set off only against profit from another specified business and against no other income. (Just like loss from speculative business).
  - **Loss under the head "Capital Gains":** Losses under head "Capital Gains" cannot be set off against income under other heads of income.
  - **Loss from the activity of owning and maintaining race horses:** Losses from the activity of owning and maintaining race horses cannot be set off against any other income.
  - **A loss cannot be set off against winnings from lotteries, etc.:** By virtue of **Section 58(4)** No loss can be set off against winning 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.

Carry forward of Loss:

If a loss could not be set off either under the same head or under the different heads because of absence or inadequacy of the income of the same year, it may be carried forward and set off against the income of the subsequent year. Under the Act, the following losses can be carried forward:

a. Loss under the head “Income from House Property” **[Sec. 71B]**.
b. Non-Speculative Business Loss under the head “Profits and gains of Business or Profession” **[Sec.72]**
c. Speculative Business Loss under the head “Profits and gains of Business or Profession” **[Sec. 73]**.
d. Loss from a Business specified u/s. 35AD **[Sec. 73A]**.
e. Loss under the head “Capital Gains” (i.e., short-term or long-term capital loss) **[Sec. 74]**.
f. Loss from the activity of owning and maintaining Race Horses **[Sec.74A]**.

Other remaining losses cannot be carried forward, i.e. Loss under the head `Income from Other Sources’ other than loss from the activity of owning and maintaining Race Horses cannot be carried forward.

The following losses cannot be carried forward:

a. Loss of a non-Speculative business (not being unabsorbed depreciation);
b. Loss of a Speculative business.
c. Short or Long-Term Capital Loss;
d. Loss from the activity of owning and maintaining race horses; and
e. Loss from a business specified u/s. 35AD of Act (w.e.f. A.Y. 2017-18)

Right to carry forward the aforesaid losses will be lost if Return of income is not filed in time for the year in which the loss was incurred.

Carry forward and set off of Business Loss other than Speculation Loss

The right of carry forward and set off of loss arising in a business or profession is to be understood in the light of the following propositions:

SUCH LOSS CAN BE SET OFF ONLY AGAINST BUSINESS INCOME – The following points should be noted:

1. It is not necessary that business loss of year one should be set off against income from the same business in year two. In other words, loss of Business – A of year one can be set off against profit of `Business -A' or some `other business' in year two.
2. Business income of Spouse or minor child, clubbed under the provision of **Section 64**, with the income of assessee can be set off against a loss brought forward by assessee in respect of a business carried on by him.

Notes

1. Effect of Amalgamation on `Set off and Carry Forward of Losses': **Section 72A(1)**.
2. Effect of Demerger on `Set off and Carry Forward of Losses': **Section 72A(4)**.
3. **Section 79 (a):** Set off of Brought Forward Losses of a Company other than a Company in which Public are substantially interested.
4. **Section 79(b):** (w.e.f. A. Y. 2018-19)

Section 78:

a) **Section 78(1):** Losses (other than Unabsorbed Depreciation) attributable to an outgoing partner (whether retired partner or a deceased partner) cannot be carried forward by the firm.

b) **Section 78(2):** If there's a succession in Business/Profession (otherwise than by way of death), then Losses (other than Unabsorbed Depreciation) of the predecessor cannot be set off or carried forward by the successor against his income (except as otherwise provided).

However, according to **Section 72A**, in case of following types of business re-organisations, the ***Non-Speculative Business Loss*** and ***Unabsorbed Depreciation*** of the predecessor can be set off and carried forward by the successor in business reorganisation:-

a) **Section 72A(1):** Losses of ***Amalgamating Company*** can be set off and carried forward by ***Amalgamated Company*** (with fresh 8 years' period) subject to conditions given in Section 72A(2) (already discussed above);

b) **Section 72A(4):** Proportionate Losses of ***Demerged Company*** can be set off and carried forward by ***Resulting Company*** (but without availing fress 8 year's period);

c) **Section 72A(6):** Losses of ***a Partnership Firm*** can be set off and carried forward by ***a Company*** upon conversion of a Firm into a Company (with fresh 8 years' period) subject to fulfillment of certain conditions given in **Section 47(xiii)** [Refer to Capital Gains chapter for conditions];

d) **Section 72A(6):** Losses of ***a Sole Proprietary Concern (SPC)*** can be set off and carried forward by a ***Company*** upon conversion of SPC into a Company (with fresh 8 years' period) subject to fulfilment of certain conditions given in **Section 47(xiv)** [Refer to Capital Gains chapter for conditions];

e) **Section 72A(7):** Losses of ***a Private Company/Unlisted Company*** can be set off and carried forward by ***an LLP*** upon conversion of such Private Company/Unlisted Company into an LLP (with fresh 8 years' period) subject to fulfillment of certain conditions given in Section 47(xiiib) [Refer to Capital Gin's chapter for conditions].

Note

However, except in case of Demerger, in all the above mentioned situations, namely:

a) Amalgamation,

b) Conversion of a Firm into a Company,

c) Conversion of a SPC into a Company,

d) Conversion of a Private Company/Unlisted Company into an LLP,

if the conditions laid down in **Section 72A(2)/47(xiii)/47(xiv)/47(xiiib)** are not fulfilled/violated, then the losses and unabsorbed depreciation of the predecessor:

(i) which is yet to be set off by the successor – will lapse

(ii) which is already set off by the successor – will be deemed to be the income of such successor in the year of violation of condition.

THANK YOU