SHIVAJI UNIVERSITY, KOLHAPUR

CENTRE FOR DISTANCE EDUCATION

B. Com. Part-III

Advanced Accountancy

(Auditing & Taxation)

Semester-V : Paper-II (DSE-A2)
Semester-VI : Paper-IV (DSE-A4)

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Preface

We assure that this SIM will be helpful to the students of B. Com. III on distance mode, for their academic endevour. In the entire gamut of accountancy, the elements like audit and taxation are of prime importance. The present study material introduces the basic concepts as well as some practical applications of audit and taxation to the students. The first section (Sem. V) starts with basic concepts, nature and scope of audit through unit 1. The 2nd unit describes audit of specific items in financial statements. This provides practical approach of audit. Unit 3 describes the provisions of company audit. 4th unit explains various types of reports and also includes special audit. The second section (Sem. VI) is devoted to taxation. In 1st unit of 2nd section, basic concepts and definitions about income tax have been elaborated. The second unit focusses on provisions of the Income Tax Act, 1961 about exemptions and deductions. The third unit elaborates various heads of income and also illustrates computation of total income and tax liability. This units gives practical approach towards computation of income and tax liability. The fourth units briefly introduces the GST (Goods and Service Tax) to the students.

In this books we the unit writers and editorial board have taken reasonable care to give maximum theoretical and practical knowledge to the students. Hope it will enable the students to get the adequate knowledge.

We are thankful to Hon. Vice-Chancellor Prof. Dr. D. T. Shirke, Hon. Pro-Vice-Chancellor Prof. P. S. Patil, Director Dr. D. K. More all the members of the Board of Studies, unit writers and the authorities of Centre for Distance and Online Education, Shivaji University, Kolhapur for the support.

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B. Com Part-III

Semester V and VI

ADVANCED ACCOUNTANCY PAPER II AND IV

INDEX

Each Unit begins with the section 'Objectives' -

Objectives are directive and indicative of :

1. What has been presented in the Unit and
2. What is expected from you
3. What you are expected to know pertaining to the specific Unit once you have completed working on the Unit.

The self check exercises with possible answers will help you to understand the Unit in the right perspective. Go through the possible answer only after you write your answers. These exercises are not to be submitted to us for evaluation. These are provided to you as Study Tools to help keep you in the right track as you study the Unit.

Unit-1

Nature and Scope of Audit

Structure of Unit

1.0 Objectives

1.1 Introduction

1.2 Presentation of Subject Matter

- 1.2.1 Meaning of Audit
- 1.2.2 Nature and Scope of Audit
- 1.2.3 Objectives of Audit
- 1.2.4 Relationship of Audit with other disciplines
- 1.2.5 Difference between Audit and Investigation
- 1.2.6 Basic Principles of Governing Audit (AAS-1)
- 1.2.7 Statutory Audit
- 1.2.8 Internal Audit
- 1.2.9 Cost Audit
- 1.2.10 Tax Audit
- 1.2.11 Management Audit
- 1.2.12 Concept of Vouching
- 1.2.13 Verification and Valuation

1.3 Summary

1.4 Terms to Remember

1.5 Answers to Check your progress

1.6 Exercise

1.7 Reference for further study

1.0 Objectives:

1. To understand the basic concept of audit and its nature and scope.
2. To distinguish between audit and investigation.
3. To understand the basic principles of governing audit (AAS-1).
4. To explain the concepts related to audit such as statutory audit, internal audit, cost audit, tax audit, management audit, concept of vouching, verification and valuation.

1.1 Introduction:

When the size of organization increases, the owner and other stakeholders may not aware of the true and fair view of their business. So, the financial statements represents all accounts of the organization should have true and fair view. To understand this matter, any such organization want to appoint the auditor to examine whether their financial statements reveals true and fair view. Audit in the present form came into existence after the Industrial Revolution during the 18th century when age of large scale production commenced. The organization of business was limited to sole proprietor activities, however, after the Industrial Revolution, due to large scale production, scope of business organization enhanced and many stakeholders involved especially investors. Such stakeholders are interested to know what happen with their resources involved in the specific business organization, hence, audit become important. In new forms of organization like a company, owners (shareholders) and management (board of directors and managers) are different. Here, the management who is handling capital and accounts of a company. It is not possible to every shareholder to check the accounts of the company. So they appoint a person, on their behalf, who will check the accounts, here is a need of auditor and auditing by him. Luca Pacialo who first published his treatise on double entry system of book-keeping for first time in 1494, he described the duties and responsibilities of an auditor.

1.2.1 Meaning of Audit:

At the beginning, let us see the meaning of audit. The word "audit" is derived from the Latin word "audire" which means "to hear". As the changes took place in duties and responsibilities of auditor, the change in the meaning of audit came and hence, various definitions of audit are given by distinct authors, thinkers and organizations which we are going to see in this section.

According to Spicer and Pegler, an audit is 'such an examination of the books, accounts and vouchers of a business, as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as give a true and fair view of the state of affairs of the business, and whether the Profit and Loss Account gives a true and fair view of the profit earned or loss suffered for the financial period, according to the best of his information and the explanations given to him and as shown by books, and if not, in what respects he is not satisfied."

L. R. Dicksee has defined an audit in the words "An audit is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they puport to relate. In some instance it may be necessary to ascertain whether the transactions are supported by proper authority."

As per the opinion of F. R. M. de Paula, the term "Audit denotes something much wider, namely, the examination of a balance sheet and profit and loss account prepared by others. As a result of his examination of the books, accounts, vouchers etc. and of his inquiries, the auditor must satisfy himself that such balance sheet and profit and loss account are properly drawn up so as to exhibit true and fair view of the state of affairs and of the earnings of a particular concern."

The Institute of Chartered Accountants of India has said about auditing that "It is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report."

According to Montegomery, "Auditing is a systematic examination of books and records of a business or other organization, in order to ascertain or verify, and to report upon, the facts regarding its financial operations and results thereof."

J. R. Batliboi has defined auditing as "an intelligent and a critical scrutiny of the books of account of a business with the documents and vouchers from which they are written up, for the purpose of ascertaining whether the working results for a particular period, as shown by the Profit and Loss Account, as also the exact financial condition of that business, as reflected in the balance sheet are truely determined and presented by those responsible for their compilation."

On the basis of analysis of all the definitions of auditing we can come to the conclusion that the auditing has the following characteristics:

1. It is a systematic and independent examination of financial data
2. It ensures the correctness of Trading, Profit and Loss Account and Balance Sheet which makes a verification of true and fair view presented in financial statements.
3. An examination of books of accounts with motive is to detect errors and frauds in the books of accounts and financial statement.
4. An intelligent and a critical scrutiny of the books of account.
5. Through process of audit, an auditor collect the evidences, vouchers for transactions.
6. Auditor express an opinion on the quality of financial statements after ensuring the compliance of financial statements with the accounting standards.
7. Auditing concludes with audit report.

We can conclude on the basis of above definitions and characteristics of auditing that the audit means a critical and intelligent examination of facts-financial or otherwise, to give in the form of certificate or report an attestation, an expert opinion or an expert advice.

1.2.2 Nature of Audit:

Auditing is the examination of books, accounts and vouchers of the business. This examination means to watch, to observe, to study, to think about it, to compare, to analyze and so on.

1. It is examination of books. Then questions comes which books. Here, books of accounts i.e. both primary books and secondary books. In the present days these books include loose leaf, bound books as well as digital books.
2. An examination of accounts is also a part of auditing. Auditing includes examination of all types of accounts i.e. personal accounts and impersonal (real and nominal) accounts.
3. Auditing includes an examination of vouchers for cash transactions and trading (or credit) transactions. Such vouchers are considered as a documentary evidence which supports an entry recorded into all books.

4. True and fair view is confirmed by an audit. The financial statements which are presented they have true and fair view is required to be satisfied.
5. Profit or Loss must be pertaining to the concerned accounting period. For this purpose, the compliance of specific accounting principles and accounting standards is needed.
6. Auditors' satisfaction depends upon few things such as information whichever required, explanations regarding transactions and availing books for auditing.
7. Manual accounting is done the auditing is also on the same way. Now accounting is made through digital tools, similarly auditing is consequently becoming digital gradually.

1.2.3 Scope of Audit:

The scope of audit is determined by the auditor having regard to following: (a) Terms of the Audit Engagement, (b) Requirement of Relevant Statute and (c) Pronouncements of the ICAI. However, the terms of engagement cannot supersede the requirements of statute or pronouncements of ICAI.

According to ICAI, the following points are merit considerations as far as scope of audit is concerned:

1. Audit should cover the examination of all aspects of an entity relevant to financial statements being audited.
2. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements.
3. In forming his opinion, the auditor should also decide whether the relevant information is properly disclosed in the financial statements subject to statutory requirements, where applicable.
4. The auditor assesses the reliability and sufficiency of the information contained in the underlying accounting records and other source data by:
    (a) making a study and evaluation of accounting systems and internal controls and

(b) carrying out such other tests, enquires and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.

5. The auditor determines whether the relevant information is properly disclosed in the financial statements by:

   (a) comparing the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein; and

   (b) considering the judgments that management has made in preparing the financial statements accordingly, the auditor assess the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

6. The auditor is not expected to perform duties which fall outside the scope of his competence. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.

7. Constraints on the scope of the audit of financial statements that imair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.

1.2.4 Objectives of Auditing:

As per SA 200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and

(b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

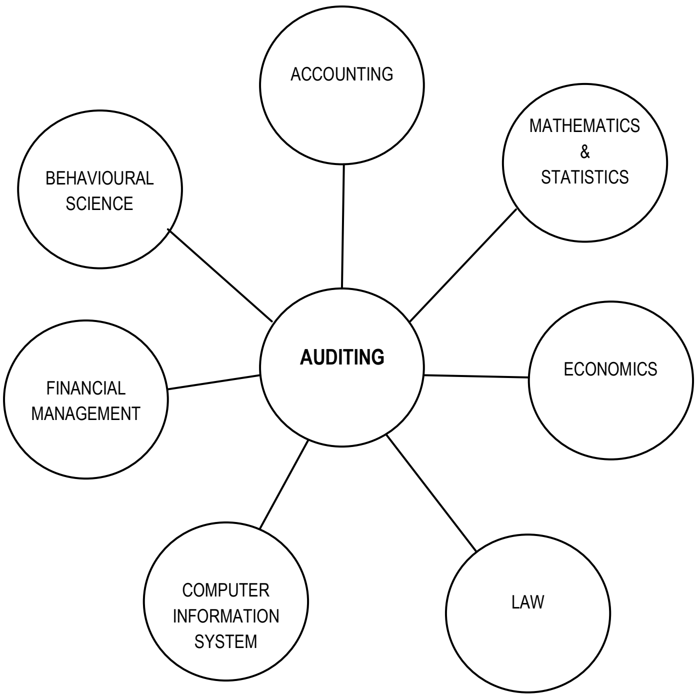
1.2.5 Relationship of Audit with other disciplines:

As business works in its environment, the accountant and auditor should take into account all areas in business environment. Auditing is nothing but examination of all books, accounts and financial statements in respect of true and fair view of financial condition. Here, we can see the relationship of audit with other disciplines such as accounting, economics, law, mathematics and statistics, financial management, computer information system and behavioural science.

1. Accounting:

Auditor has to examine all books, accounts and vouchers so he must know about accounting rules, accounting principles and accounting standards also. He should be aware of the accounting them to evaluate financial statements with considering their compliances.

Figure-1.1 Relationship of Audit with other disciplines



2. Economics:

While examining books of accounts, auditor requires knowledge regarding business and economic environment which has impact on their clients. Auditor should take into account the issues which affect on the process of auditing.

3. Mathematics and Statistics:

Auditor handles always financial data and examines and verifies the amount that is shown in financial statements. The measurement is one of the important functions of accounting; hence, it requires knowledge of calculation procedure involved in computing various items. Auditor should have knowledge of statistical sampling for making meaningful conclusion.

4. Law

Legal environment always influences accounting and auditing framework. Audit of a business concern should in compliance with provisions of a law. Therefore, an auditor should have sound knowledge of laws to understand how the respective client affects. How the client is benefited or loosing

5. Computer Information System

Now accounting is maintained with computer softwares, hence, the record is in the form of information system. Auditor should be able to conduct audit in an effective way by computer systems. The digitization of accounting significantly leads to the digitization of auditing also.

6. Financial Management

Financial management is important area of management. Auditor should have knowledge of financial tools and techniques for understanding and evaluating the financial statements in a better way.

7. Behavioural Science

Auditor has to deal with many people for conducting the audit efficiently. He has to understand and study the behaviour of the people and then he can handle the situations.

1.2.6 Basic Principles of Governing Audit (AAS-1):

This Auditing and Assurance Standard was the first standard on auditing issued by the Institute. This Standard describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out. An audit is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. Other Auditing and Assurance Standards to be issued by the Institute (taken in other unit) will elaborate on the principles set out herein to give guidance on auditing procedures and reporting practices. Compliance with the basic principles requires the application of auditing procedures and reporting practices appropriate to the particular circumstances.

These principles are, namely, integrity, objectivity and independence, confidentiality, skills and competence, work performed by others, documentation, planning, audit evidence, accounting system and internal control, and, finally, audit conclusions and reporting.

1. ***Integrity, Objectivity and Independence:***

The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

2. ***Confidentiality:***

The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

3. ***Skills and Competence:***

The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing. The auditor requires specialized skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognized for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

4. ***Work Performed by Others:***

When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956, the auditor's report should expressly state the fact of such reliance. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

5. ***Documentation:***

The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

6. ***Planning***:

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business. Plans should be made to cover, among other things:

(a) acquiring knowledge of the client's accounting system, policies and internal control procedures;

(b) establishing the expected degree of reliance to be placed on internal control;

(c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and

(d) coordinating the work to be performed.

Plans should be further developed and revised as necessary during the course of the audit.

7. ***Audit Evidence:***

The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. They are of two types:

a) tests of details of transactions and balances;

b) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

8. ***Accounting System and Internal Control:***

Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

9. ***Audit Conclusions and Reporting***

The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

(b) the financial information complies with relevant regulations and statutory requirements;

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

The audit report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down in or prescribed under any agreement or statute or regulation, the audit report should comply with such requirements. An unqualified opinion indicates the auditor’s satisfaction in all material respects with the matters dealt with in paragraph 21 or as may be laid down or prescribed under the relevant agreement or statute or regulation, as the case may be.

When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons therefor.

(Effective Date: This Auditing and Assurance Standard becomes operative for all audits relating to accounting periods beginning on or after April 1, 1985).

Check Your Progress-1

(A) Choose the appropriate alternative from given alternatives below the statement:

1) Principle of Independence is the elementary principle of auditing which refers to the following ....

   (a) The work of auditing should be based on the related evidences and should be done in an unbiased manner.

   (b) Auditor should examine material transactions as well as probable frauds and errors in much greater depth.

   (c) The work of auditing should be separate and independent from work of accounting. Accounts should be examined in an independent and unbiased manner, in the audit.

   (d) Client should provide the auditor with all available records, evidences and explanations. The auditor should also declare the result of his examination in clear and unambiguous manner.

2) The scope of audit is determined by the auditor having no regard to which following point?:

   (a) Relation with client

   (b) Terms of the Audit Engagement,

   (c) Requirement of Relevant Statute and

   (d) Pronouncements of the ICAI.

(B) State whether the following statement is true or false:

1) Audit is not an intelligent and a critical scrutiny of the books of account, it is simple verification of transactions.

2) Audit should cover the examination of all aspects of an entity relevant to financial statements being audited.

3) The auditor should determine whether relevant information is disclosed in financial statements.

1.2.7 Difference between Audit and Investigation:

Sometime students have impression that auditing and investigation are one and the same. There is lot of difference between them. Now we will try to understand what is the difference between audit an investigation.

Sr. No.	Audit	Investigation
1	Audit is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose.	Investigation is a process of searching enquiry into the profit-earning capacity or the financial position of a concern or to find out the extent of the fraud if there is any suspicion about it and so on.
2	Audit is conducted on behalf of owners i.e. shareholders or proprietor etc.	Investigation is carried out on behalf of outsiders. Such outsiders may be potential buyer of the business or banker or money lenders to know the earning capacity or the financial position of the firm. Sometime on behalf of owner also it can be carried out when they suspect any fraud. Sometime it is carried out by the Government in the interest of shareholders or at the instance of the court.
3	According to Companies law, audit is compulsory.	Investigation is not compulsory.
4.	It once audit is done, accounts are not again audited. The exception is only of special audit.	Investigation may be conducted even though accounts are already audited.
5.	The audit of accounts is done for a	Investigation may cover a period of

	year or six months.	over three to seven years.
6.	The accounts are audited with a view to ascertaining whether or not the Profit and Loss Account and Balance sheet are drawn up as per law and they exhibit a true and fair view of the state of affairs of a business.	Investigation is conducted with a particular object in view for e.g.- to know the financial position of the concern or its earning capacity etc.
7.	Audit is a kind of test checking.	Investigation is a thorough examination of the books of accounts for a particular year or a number of years.
8.	Audit includes an examination of the books of accounts of a business.	Investigation is not only an examination of accounts but it is also an inquiry into other factors affecting the business such as the extent of fraud, who committed it or the causes of the fall in the profits.
9.	The report of auditor is sent to the managing director/chairman of the company who put it before the shareholders.	The report of the investigator is sent to the party which has appointed him.
10.	The report of the auditor is stereotyped except when he mentions the points on which he is not satisfied with regard to the accounts of the client.	The report of the investigator is in detail and refers to (a) the instructions given to him, (b) the method of approach, (c) the work carried out, (d) the documents relied upon, and (e) his findings and often his recommendations to the client.
11.	The auditor is concerned with accounting policies adopted by the concern and he states the fact about it.	The investigator is not concerned with accounting policies followed by the firm.

1.2.8 Statutory Audit:

When the audit is conducted under the statute, it is called statutory audit. The internal audit is helpful to the statutory audit. Both the internal auditor and the statutory auditor are interested to check an authenticity of the accounts. The internal auditor reviews the operations and performs such functions as evaluation, compliance, verification and ensures that policies, procedures, rules and other type of controls of the business are carried out efficiently. The statutory auditor accepts some of the detailed checking made by the internal auditor. However, the area of cooperation between internal auditor and statutory auditor is somewhat limited as the statutory auditor has a responsibility under law to various authorities, while the internal auditor is responsible only to the management.

The statutory auditor has to carry out his duties in accordance with standard accounting and auditing practices and provisions of law which govern the organization. Before accepting the assignment of checking of accounts and other documents carried out by internal auditor, the statutory auditor must undertake such test checks necessary to find out the effectiveness of internal audit. Statutory audit is an independent audit made by an auditor as per the provisions of statute or laws. It is compulsory by law. The statutory auditor is appointed by shareholders. Statutory auditor should have specific qualification like Chartered Accountant as stipulated by various laws. He has to report whether the balance sheet and the profit and loss account of a company have been drawn up in conformity with law and whether they show true and fair view of the state of affairs of the company. The statutory auditor has identical duty of detecting errors and frauds, if any. He conducts audit on applying test checks, however, internal auditor has to check all the transactions. Statutory audit is carried out for the satisfaction of shareholders. Statutory auditor has right to attend a meeting of shareholders. He is periodic, usually for a year.

Elements of Statutory Audit:

1. Statutory audit is obligatory in case of business houses incorporated under the Companies Act and other acts.
2. Statutory audit can be carried out only by those who are qualified for appointment as per the provision of the Companies Act and other acts.

3. The rights, duties, responsibilities and liabilities of auditors are governed by the provisions of law.
4. The auditor is independent of management.
5. The statutory auditor is concerned with the legality and validity of the transactions of business. His audit work is based on the financial statement prepared by the business.

1.2.9 Internal Audit:

Internal audit is a critical examination of functioning of various operations of the firm including its internal check. By internal audit process, the firm wants to test accuracy, completeness, reliability and timeliness of accounting information and to report for remedial actions.

It is defined that "Internal audit is the independent appraisal of activity within an organization for the review of accounting, financial and other business practices as a protective and constructive arm of management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control."

According to Howard F. Stettler, "Internal auditing is an independent appraisal activity within an organisation for the review of operations as a service to management."

Walter B. Meigs says "... internal auditing consists of continuous, critical review of financial and operating activities by a staff of auditors functioning as full-time salaried employees."

1.2.10 Cost Audit:

Cost audit is not popular in India. For time being a few selected industries follow cost audit.

R. W. Dobson defines "Cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accountancy plan'. CIMA has defined cost audit as "the verification of the correctness of cost accounts had of the adherence to the cost accounting plan." Cost auditor plays a role of an advisor in this respect. Cost auditor has to form a judgment as to whether the size and channels of expenditure are fit to yield best results and optimum returns from expenditure are expected. Section 233 B of the companies Act deals with cost audit. This section empowers central Government to order the audit of cost accounts in respect of such companies.

The following are the purposes of cost audit:

1. To verify the arithmetical accuracy of cost accountancy entries in the books of accounts
2. To find out whether the cost accounts have been properly maintained according to the principles of costing employed in the industry concerned
3. To verify the cost statements are properly drawn up as per the records and that they represent a true and fair view of the cost of production and marketing.
4. To assist the organization and government in fixation of proper prices.
5. To ensure that information presents to the management is reliable.
6. To assist the government in calculating taxes and taking decision regarding grant of tariff protection to a specific industry.
7. To help in defecting inefficiencies that a rise in the utilisation of scarce resources.
8. To make sure that cost accounting records are correct and cost accounting principles have been property followed.

Cost auditor prepare the programme of cost audit in the light of requirements such as (a) disclosure requirements under cost audit (report) rules, (b) manufacturing process, (c) product/ range specifications, (d) cost accounting system, (e) marketing/ distribution channels, (f) internal control system, and (g) knowledge about company/ organizational structure.

A details cost audit programme also includes (a) review of entire cost accounting system, (b) arithmetical accuracy of cost records, and (c) evaluation of operational efficiency etc.

1.2.11 Tax Audit:

Tax audit means the audit applicable under Section 44AB of Income Tax Act. Tax audit is applicable to the concerns whose turnover during the financial year crosses Rs. 1 crore (in case of trading/ manufacturing) or Rs. 60 Lakh (in case of professional). The tax audit report is to be given by an accountant as defined in the Income Tax Act. Accountant means Chartered Accountant within the meaning of the Chartered Accountants Act. The tax auditor has to submit (a) tax audit report and (b) statement of particulars. These forms are given in Rule 6G of Income Tax Rules such as Form No. 3CA, 3CB, 3CC, 3CD.

1.2.12 Management Audit:

The statutory auditor does not go into detail to see whether the policies laid down by the management are properly carried out or not: whether any improvement for maximizing profit or to eliminate waste is done; and whether decentralization or centralization has been done. Internal audit is different than statutory audit. The management audit is nothing but expansion of internal audit. Management is an independent appraisal for taking the review of control of managerial functions in order to ensure compliance with the organizational goals, policies and procedures.

According to William P. Leonard, Management Audit is “a comprehensive and constructive examination of an organizational structure of a company, institution or branch of government, or of any component thereof, such as a division or department, and its plans and objectives, it means of operations, and its use of human and physical facilities.”

Leslie R. Howard defines Management Audit as “Management audit is an investigation of a business from the higher level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with the outside world and the most efficient organization and smooth running of internal organization.”

Taylor and Perry defines it as “Management Auditing is a method to evaluate the efficiency of management at all levels throughout the organization, or more specifically, it comprises the investigation of a business by an independent body from the highest executive level downwards, in order to ascertain whether sound management prevails throughout, and to report as to its efficiency or otherwise, with recommendations to ensure its effectiveness where such is not the case”.

With considering all above definitions, we can say management audit is an examination, review and appraisal of the various policies and actions of the management. The statutory auditor examines the historical records of the past performance while the management auditor appraises and reviews of the past as well as looks to the future. Management auditor reports the performance of the management during the particular period and suggests ways and means to achieve the objectives in future, if they have not already been reached.

The various areas (Prasad, 1981) covered by management audit are as given below:

“1. Marketing Function

   (a) Market survey, sales forecast, and sales and distribution policy.

   (b) Sales planning, based on market research or survey, keeping in view production policy and capacity.

   (c) Policy for sales promotion or advertising.

   (d) Product pricing policy, discount and credit policy.

   (e) Organization of various channels of sales and distribution.

2. Production Management

   (a) Production planning and its co-ordination with production.

   (b) Utilization of capacity, best use for idle or surplus capacity.

   (c) Organization for tools, maintenance, and repairs.

   (d) Specifications and standards for materials and operative time, machine as well as manual. Improvement of production methods and development, designing and testing of new products and production methods.

   (e) Research.

   (f) Value analysis.

   (g) Job evaluation.

   (h) Cost reduction.

3. Inventory control

   (a) Purchase organization and procedure, operating of provisioning drill, e.g. determination of order levels, safely balance and optimum order size.

   (b) Storage procedure, cost of inventory carrying and inventory turnover.

   (c) Issue routine.

   (d) Slow moving and obsolete items, inventory turnover.

   (e) Valuation of stock and work-in-progress.

4. Personnel administration (now Human resource management)

   (a) Procedure for recruitment, promotion, transfer, and training, time and costs-personnel shortages, oversupplies, layoffs, overtime etc.

   (b) Absenteeism and sickness, recruitment times and costs, action taken to reduce them.

   (c) Methods for wage payment and incentives, wage and salary administration.

   (d) Labour turnover: methods adopted to analyze and action taken to reduce rate of labour turnover.

   (e) Accidents: preventive measures for safety.

   (f) Welfare measures.

   (g) Productivity of labour, performance norms

   (h) Discipline and morale, union-management co-operation, collective bargaining, participative involvement etc.

5. Financial Control

   (a) Setting and operation of budgetary system of control: report of variances.

   (b) Internal audit including cost audit.

   (c) Financial reports and financial ratios: rendering analysis and interpretation.

   (d) Scrutiny of financial proposals: investment plans and project decisions

   (e) Delegation of financial powers.

6. General

   (a) Delegation of authority.

   (b) Flow of information and

   (c) Levels of decision making."

Check your progress-2:

(A) Choose the appropriate alternative from given alternatives below the statement:

   1) As compared to audit, investigation is carried out ....

      (a) on behalf of owners

      (b) on behalf of outsiders

(c) to send report to the chairman

(d) to examination of accounts, books etc.

2) ....is a comprehensive and constructive examination of an organizational structure of a company, institution or branch of government, or of any component thereof, such as a division or department, and its plans and objectives, it means of operations, and its use of human and physical facilities.

(a) Internal audit

(b) Statutory audit

(c) Management audit

(d) Cost audit

(B) State whether the following statement is true or false:

1) Investigation is compulsory.

2) Audit is a kind of test checking.

3) The audit which is done by employees continuously is called statutory audit.

1.2.12 Vouching:

A voucher is documentary evidence in support of a transaction recorded in the books of accounts. The process of establishing the accuracy and authenticity of entries in the books of accounts is called vouching.

Ronald A. Irish defines vouching as "a technical term, which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction."

According to Taylor and Perry, "vouching is an examination of the evidence offered in substantiation of the entries in the books, including such examination the proof, so far as possible, that no entries have been omitted from the books."

F. R. M. de Paula opined that "vouching does not mean merely the inspection of receipts with the cash book, but includes the examination of receipts with the transactions of the business, together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in the books."

On the basis of above definitions we can say that following are the primary objects of vouching:

(a) Vouching authenticates the correctness of transactions

(b) It examines the entries in the books with receipts, invoices, bills, agreements and copies of correspondence, true extracts of minute books, opinion of experts.

(c) It authenticates the transactions.

In addition to the above objects, some other objects of vouching are there which can be seen as follows:

1) Vouching confirms the transaction represented by the voucher pertains to the accounting period.

2) Confirmation of purchases and sales disclosed by the vouchers with client's actual normal business.

3) Testing arithmetical accuracy of all vouchers and records accordingly.

4) Proper distinction between capital and revenue items.

Vouching is main part of auditing. It is nothing but backbone of auditing. The auditor has to do vouching with proper care and intelligence. Following should be the protocol for vouching for any auditor:

1) Deciding in advance what is to be proved.

2) Concluding that the fact to be proved is material.

3) Collecting evidence within the prescribed time limit.

4) Deciding that evidence collected is valid or invalid.

5) Drafting audit report based on the facts.

1.2.13 Verification and Valuation:

In the process of audit, auditor should make verification and valuation of assets and liabilities. Verification means 'providing the truth' or 'confirmation'. First of all we will try to understand the meaning of verification by the following definitions.

Irish says "verification means the auditor must satisfy himself by physical inspection or by suitable documentary evidence that the asset exist, that they are owned by the client, that all assets are recorded, that they are properly valued according to accepted accounting principles, and that they are in the custody of a proper party."

According to Spicer and Pegler, "the verification of assets implies an inquiry into the value, ownership and title, existence and possessions, and the presence of any charge on the assets."

Alverstone C. J. said "It is the duty of the auditor to verify the existence of assets stated in the balance sheet and he will be liable for any damage suffered by the client if he fails in his duty..."

The verification of assets involves the issues such as (a) comparison of the ledger accounts with the balance sheet, (b) verifying existence of asset on the date of balance sheet, (c) satisfying that they are free from any charge or mortgage, (d) verifying their proper value and (e) assets are acquired for the business.

The true and fair view of financial statements depends upon the value of assets and liabilities shown in the balance sheet. The accuracy of the balance sheet and estimated profits of a firm depends upon the correct valuation of the assets and liabilities. Such valuation is made by mostly the proprietors or officials of the firm. The auditor generally rely upon the certificates given by competent persons such as valuers, surveyors etc. He should write so in his audit report. Off course, he cannot guarantee the correctness of the valuation of assets. The compliance of provisions in accounting standards should be taken into consideration by an auditor for the purpose of valuation of assets.

1.3 Summary:

Audit is a systematic and independent examination of data, statements, records, operations and performances of an enterprise for a stated purpose. The auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report. The elementary principles of auditing are: (a) Principle of Independence, (b) Principle of Objectivity, (c) Principle of full disclosure and (d) Principle of Materiality. There are some other principles of auditing such as Integrity, Confidentiality, Skill and Competence, reliance on work performed by others and documentation.

The objectives of auditing are (1) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement and (2) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. Independence implies acting without any fear or favour. Unless and until the independence of auditor is maintained properly, auditor cannot perform his duties rightly.

The scope of audit has been described in this unit. One of the important concepts used in accounting and auditing is 'true and fair view'. This unit has highlighted this concept in lucid manner. Auditing and Assurance Standard-1 is entitled as "Basic Principles of Governing Audit" which describes the basic principles which govern the auditor’s professional responsibilities and which should be complied with whenever an audit is carried out.

As far as the difference between audit and investigation is concerned, a lot of difference is there which we have observed in the last part of this unit. If simply we see meaning of these two concepts, we can refer the difference between them. Audit is a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. Investigation is a process of searching enquiry into the profit-earning capacity or the financial position of a concern or to find out the extent of the fraud if there is any suspicion about it and so on.

This unit covers concepts of statutory audit and internal audit on one hand and cost audit, management audit and tax audit on the other hand. Statutory audit is an independent audit made by an auditor as per the provisions of statute or laws. It is compulsory by law. Internal audit is done by the employees of the organization on continuous basis. An audit governed under section 44AB of Income Tax Act. Cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accountancy plan. Management audit is an investigation of a business from the higher level downward in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with the outside world and the most efficient organization and smooth running of internal organization.

Vouching is a backbone of auditing. It is an examination of the evidence offered in substantiation of the entries in the books, including such examination the proof, so far as possible, that no entries have been omitted from the books. In the process of audit, auditor should satisfied with the verification and valuation of assets and liabilities so as to confirm true and fair view of financial statements.

1.4 Terms to Remember

1. **Audit:** Audit is a systematic and independent examination of data, statements, records, operations and performances of an enterprise for a stated purpose. The auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.
2. **True and Fair View:** Accounts are true and fair when the financial performance shown by financial statements is true and fair. It is auditor's prime duty to verify whether financial statements represent true and fair view.
3. **Window dressing:** It is an act of showing accounts a much better than the actual condition.
4. **Independence of Auditor:** Independence implies acting without any fear or favour. Unless and until the independence of auditor is maintained properly, auditor cannot perform his duties rightly.
5. **Investigation:** It is a process of searching enquiry into the profit-earning capacity or the financial position of a concern or to find out the extent of the fraud if there is any suspicion about it and so on
6. **Statutory Audit**: When the audit is conducted under the statute, it is called statutory audit.
7. **Internal Audit:** Independent appraisal activity within an organisation for the review of operations as a service to management.
8. **Tax Audit:** An audit governed under section 44AB of Income Tax Act.
9. **Cost Audit:** Verification of the correctness of cost accounts and of the adherence to the cost accounting plan.
10. **Management Audit:** An audit implemented to identity problems or significant weaknesses in the organisation and to repair the problem area.
11. **Vouching:** Vouching is an examination of the evidence offered in substantiation of the entries in the books, including such examination the proof, so far as possible, that no entries have been omitted from the books.

12. **Verification**: the verification of assets implies an inquiry into the value, ownership and title, existence and possessions, and the presence of any charge on the assets.

13. **Valuation:** It is estimation of value of assets and liabilities. Valuation of assets is the process of determining a fair market value of assets.

1.5 Answers to Check your progress

Check Your Progress-1

(A) 1) - (c), 2) - (a)

(B) 1) False, 2) True, 3) True

Check Your Progress-2

(A) 1) - (b), 2) - (c)

(B) 1) False, 2) True, 3) False

1.6 Exercise:

1) What is audit? Describe the scope of audit.
2) Explain the basic principles governing an audit according to Auditing and Assurance Standard-1.
3) Distinguish between audit and investigation.
4) How do you relate audit with other disciplines?
5) What is the difference between internal audit and statutory audit?
6) Write short notes on:
   (a) True and Fair View.
   (b) Independence of auditor.
   (c) Investigation.
   (d) Management Audit
   (e) Cost Audit

1.7 Reference for further study:

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Unit-2

Audit of Specific Items in Financial Statements

Structure of Unit

2.0 Objectives

After studying this unit you will be able to:

1. Understand how to conduct practical audit of final accounts.
2. Explain audit of sale of products and services as well as various items of income and expenses.
3. Explain audit of assets and liabilities.
4. Find relationship between theory of audit and practical points to be considered while auditing.

2.1 Introduction

In the first unit we studied introductory part of the audit such as meaning, nature, principles, types of audit etc. In this unit we will study how to audit important items from financial statements.

As we know, the term ‘financial Statements’ mainly refers to Profit and Loss Account and Balance Sheet. Profit and Loss Account shows operational result and efficiency of an enterprise for a particular period of time, generally, a financial year and Balance Sheet shows financial strength or position of an enterprise on a particular day. These statements are prepared as per the provisions of applicable laws, taking into account the type of business organisation.

An Auditor needs to assess occurrence, authenticity, completeness, existence and appearance of items appearing in financial statements. The auditor has to gather necessary information regarding the postings made in the financial statements and verify all the records, so as to make his opinion on the financial statements, confirming to the truth and fairness of operational result and financial strength of an enterprise and to prepare audit report.

Before starting with audit of items in financial statements, it would be better to understand first the financial statements and the items appearing in these statements.

a) **Profit and Loss Statement -** As we know, profit and loss statement includes items of income and expenditure pertaining to a particular period i.e. the accounting period or a financial year. Income generated by way of sale of goods and services is the main operating source of income. In addition, an organisation may have other operating or other sources of income. On the other hand, purchases are the prime expenditure. In addition to this, an enterprise incurs several other expenses to perform its regular business operations. All items appearing in profit and loss statement are revenue items. Therefore, this statement is also termed as revenue statement.

b) **Balance Sheet -** The Balance Sheet is another prominent statement. It shows financial strength of an enterprise on a particular date. It includes capital and liabilities at one side and property and assets on the other.

Tests of Audit of items in Financial Statements- The auditor examine the items in the financial statements on the following viewpoints.

a) Occurrence: The items appearing in the financial statements should have occurred during the audit period.

b) Authenticity: The items recorded in the statements must be related to the enterprise and should be authentic.

c) Completeness: All items appearing in the financial statements were recorded and disclosed at right time. Also, the required notes to the items are accompanied to the financial statements.

d) Existence: The items appearing in the statements were existed on the date of the statement, possessed by and related to the enterprise.

e) Measurement or Valuation: The items in the statements are recorded accurately with their appropriate amounts.

f) Disclosure: The items in the financial statements have been classified and presented properly in the financial statements as per applicable accounting standards.

Check your progress - A

State whether the following statements are true or false.

1. Profit and loss statement includes items of income and expenditure pertaining to a financial year.
2. Balance Sheet shows financial strength of an enterprise on a particular date.
3. The items appearing in the financial statements should have occurred during the period of audit.
4. The items appearing in the financial statements must be related to the enterprise and should be authentic.
5. All items appearing in the financial statements should have recorded and disclosed during the period under audit with required notes.
6. The auditor should verify that items appearing in the statements were existed on the date of the statement, possessed by and related to the enterprise.
7. The auditor should verify that the items in the statements are recorded accurately with their appropriate amounts.
8. The auditor should check that the items in the financial statements have been presented as per applicable accounting standards.

2.2 Audit of Specific Items in Financial Statements

Before starting actual work of checking of records, an auditor should -

- Study the nature and size of the business.
- Study the concerned Acts and provisions applicable to the business.
- System of accounting and its computerisation and
- Examine the internal control system relating to the concerned item.

2.2.1. Audit of Specific Items in Profit & Loss Account

2.2.1.1. Audit of Items of Incomes

I. Sale of Products and Services-

Audit Procedure - In this respect an auditor,

a) needs to identify the control system of sales in order to determine how strong and reliable it is. If it finds strong enough, the auditor can apply test checking instead of routine checking to reduce his work.

b) should examine the related customer purchase orders, invoices and customer statements.

c) is to go for analysis of sales trends and category wise sales.

d) needs to know the sales prices of the products or services over the year, monthly average sales, price per product or service, discount policy, etc.

In addition to this, auditor has to confirm with the basic tests relating to sales transaction.

A) Occurrence - In order to check the occurrence of the transaction, auditor should perform the following procedure.

a. Check whether a single sales invoice is recorded twice or a cancelled sales invoice is recorded.

b. Check whether any bogus customer and sales have been recorded.

c. Check whether goods are delivered without consent and agreement of the customer.

d. Check whether unearned revenue is recorded as earned.

e. Check whether any doubt exists about collectability.

f. Review sequence of sales invoices and journal entries to ensure for unusual transactions.

g. Vouch all supporting documents.

h. Calculate the ratio of sales return to sales and compare it with previous year and note down the reason for increase / decrease.

i. Check the sales return with sales invoice, challan, credit note, stock register, reversal of tax, etc.

B) Completeness - In order to check the completeness of the transactions, auditor should perform the following procedure.

a. Auditor is to see whether all sales are recorded and there is no understatement or overstatement.

b. He is to see that revenues are recognised in the current accounting period and sales were not tampered at the end of the period.

c. The auditor is to see "credit notes" issued after the accounting period. Sometimes fictitious sales are recorded at the end of the year to show the achievement of target and it is cancelled during the beginning of the next year. In order to detect such transactions, auditor has to verify delivery challan received and credit notes issued during post year end period. He has to check documents such as delivery challan of the goods sold, entries in the sales journal, quantity of goods dispatched as per stock records and the tax effects of the same.

d. Trace a few transactions from commencement to its completion.

C) Measurement - Auditor has to see that all the sales are accurately measured as per applicable accounting standards and correctly recorded i.e. journalized, summarized and posted and the value of such transactions were reasonable.

D) Authenticity- The auditor has to see whether sales transactions were properly authorized.

E) Disclosure - Auditor has to ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made.

a. Whether the sales of each class of goods has been disclosed properly.

b. Whether revenue is disclosed separately in respect of sale of products and services and other operating revenues.

c. Whether brokerage and discount on sales, other than the usual trade discount has been disclosed.

d. Whether the transactions with related parties are disclosed properly.

In nutshell, an auditor needs to perform following tasks.

1. Checking of approved sales orders,
2. Checking amendment in the sales order and its approval,

3. Checking terms and conditions of sales orders,
4. Checking whether all invoices have been raised correctly;
5. Checking that quantity and rates in the sales order are matching with the invoice,
6. Checking whether tax rate and its application is correct,
7. Checking that the delivery challan are prepared as per invoices and are checked and signed by stores authority,
8. Checking whether all the materials are dispatched in good condition
9. Checking whether any damage is notified to the buyer or any rejections and returns,
10. Checking returns inward have been received properly in the stores and the credit has been raised for the same and
11. Checking GST charged, collected and its reverse credit are recorded properly
12. Checking whether sales register, stores register / stock book have been maintained correctly with all the sales entries.

II. Interest Income

The income earned by sources other than core business operations is generally classified as other income. Interest is one of them. The enterprise invests its excess funds in fixed deposits, loans, mutual funds, etc. Under Ind AS it is recognised on time basis at the predetermined rate. The amount of investment, period for which it is outstanding and the rate of interest are the basis of audit of interest income. The auditor has to follow the following process to verify interest income.

a. Obtain the list of investment- The investment may be in fixed deposits, loans given, shares, debentures or any other securities.
b. Study the terms of investment- date of investment, date of maturity, duration for which it is outstanding, rate of interest, method of calculation and charging of interest i.e. daily, fortnightly, monthly quarterly, half yearly or annually.
c. Verify the accuracy of calculation of interest – It can be traced out by multiplying the deposit amount with the applicable rate of interest and duration of outstanding during the audit period.

d. Confirm Existence – If the investments are still outstanding as at the date of statements, auditor is to obtain confirmation certificate from the respective bank or financial institution.

e. Confirm Interest Amount- Obtain a confirmation of interest income and verify the interest income with the calculation shared by the enterprise. The auditor can obtain a copy of TDS certificate pertaining to interest and reconcile it with the calculation shared by client.

f. Ensure Compliance of Disclosure- The auditor has to see whether the interest income is properly disclosed by complying with required accounting standards viz. AS-5, AS-9 (Ind AS 18), AS 22 (Ind AS 12).

III. Rental Income

Rent is earned on letting any asset. Generally, rent is recovered on monthly basis. There must be an agreement of letting the assets. Auditor is to assess the agreement in order to understand the conditions of agreement like the period of agreement, amount of rent, periodicity of payment, the responsibility of the parties regarding cost of repairs, maintenance of the asset, the escalation clause, the rate of escalation and its periodicity etc. Accordingly, the auditor has to verify and confirm the occurrence, authenticity, periodicity, compliance in relation to the accounting standards and other laws, completeness and disclosure of transactions relating to receipt of rent during the audit period.

In the audit of Rental Income, the auditor has to confirm-

A) Occurrence - The amount of rent is earned during the period of audit.

B) Completeness - The amount of rent earned was properly recorded and there is no understatement or overstatement.

C) Measurement - It has been measured as per the applicable accounting standards.

D) Authenticity- In order to confirm authenticity of rental income, the auditor can examine the agreement of rent and confirmation from the tenant.

IV. Dividend Income

Dividend is earned on the amount invested by the enterprise in the shares of other companies. It is recognised in the statement of profit and loss of an enterprise only when,

(i) the right is established to the enterprise to receive payment of the dividend,

(ii) the economic benefits associated with the dividend flow to the enterprise and

(iii) the amount of the dividend can be measured reliably.

Audit procedures- In the audit of dividend income, the auditor is to confirm-

A) Occurrence- the amount of dividend is earned during the audit period.

B) Completeness- the amount of dividend earned was properly recorded and there is no understatement or overstatement.

C) Measurement- It has been measured as per the applicable accounting standards.

D) Existence and Authenticity- The auditor is to confirm that the investment in shares was existed during the audit period. He is to calculate the amount of dividend considering the number of shares, amount of investment, the rate of dividend declared and confirm it with the amount received as dividend with the help of dividend warrants and other correspondence from the respective company.

V. Net Gain/Loss on Sale of Investments

Gain or loss on sale of investment is the difference between the redemption price and carrying value of the investments.

Audit procedures- In the audit of Gain/ Loss on Sale of Investments etc, the auditor is to confirm-

A) Occurrence- the investments are sold during the period of audit.

B) Completeness- the amount of gain / loss was properly recorded and there is no understatement or overstatement.

C) Measurement- It has been measured as per the applicable accounting standards.

D) Authenticity- The auditor is to obtain the statement and trace the gain or loss as recorded in the books of account with that reflected in the statement.

E) Presentation and Disclosure- the auditor is to see that the gain or loss is recorded in the statement of profit and loss properly and disclosures pertaining to income have been appropriately complied with.

Check your progress - B

State whether the following statements are true or false.

1. To check the completeness, an auditor needs not to trace transactions from commencement to its completion.
2. The auditor is to see whether all sales are recorded or not.
3. To check income from investment, it is not necessary to obtain complete list of investments.
4. While checking rental income an auditor should assess agreement with the tenant.
5. While checking income from dividend, an auditor should check the list of debentures purchased by the enterprise.
6. To verify net gain or loss from sale of investment, an auditor should make actual calculation.

2.2.1.2. Audit of Items of Expenses

I. Purchases

The process of purchases begins with issuing purchase order and ends with receipt of goods and its payment. The process of purchase involves following activities.

Pre-purchase activities-

a) Collection of requisitions and determination of goods to be purchased,

b) Formation of purchase committee and conducting its meetings,

c) Inviting quotations/ tenders,

d) Preparation of comparative statement and short listing the supplier/s,

e) Preparation and issue of purchase order to short listed supplier/s.

Post-purchase activities

f) Receipt and inspection of goods,

g) Verification of purchases with purchase order, purchase invoice and delivery challan,

h) Preparation of goods received note,

i) Rejection of (damaged/poor-quality) goods and issue of debit note pertaining to the price of goods rejected,

j) Passing order for payment and making payment for goods accepted.

Audit Procedure

1) Auditor is to check how the process of procurement of goods is performed at an enterprise. He is to identify the control point and internal control system in action for purchases. Generally, it is authorised to an officer to purchase goods up to certain limit. If the volume and amount of purchase order exceeds the limit, the quotations/tenders are invited and purchase committee deals with the further procedure of purchases.

2) Auditor is to check purchase procedure thoroughly in order to judge how internal control system is effective. If he finds internal control system effective, he can apply test-checking method of audit. He is to check purchase order, supplier's invoice, delivery challan, goods inward register, stock book, purchase register, inspection report, acceptance and rejection reports of goods, debit note issued for goods rejected.

3) The auditor is to go for analysis of trends of purchase. The auditor needs to know the price of goods purchased over the year, monthly average, discount policy of the suppliers, etc.

4) The purchase invoice received should be the "Original" copy and should be in the name of auditee. In addition to this, auditor is to confirm with the basic tests relating to purchases.

A) Occurrence:

a. Check whether the goods purchased are actually received during audit period.

b. Check whether a single purchase invoice is recorded twice or a cancelled purchase invoice is recorded.

c. Check in detail whether any bogus purchases have been recorded.

d. Review sequence of purchase invoices and journal entries to ensure for unusual transactions.

e. Compare purchases returns of the current year with that of last year and note down the reasons for increase / decrease.

B) Completeness:

a. See whether all purchases are recorded and there is no understatement or overstatement.

b. See that purchases were not tampered.

c. See Debit Notes issued to trace out fictitious purchases. He can see delivery challan, invoices, stock book entries and reverse GST effects of the same.

d. Trace a few transactions from commencement to its completion.

C) Measurement:

a) See that all the purchases are accurately measured as per applicable accounting standards and correctly recorded.

b) Ensure purchases are not understated/ overstated.

D) Authenticity:

a) See whether purchase transactions were properly authorized,

b) Check the values of such transactions were reasonable.

E) Disclosure: Auditor is to ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:

a. Whether special discount on purchases other than the usual trade discount has been disclosed.

b. Whether the transactions with related parties are disclosed properly.

II. Other Expenses

An enterprise incurs much expenditure like Interest expense, Rent, Repairs to Building and Machinery, Insurance, Taxes, Travelling Expenses, and Miscellaneous Expenses that are essential and incidental to running of business operations. The auditor while auditing such expenditures needs to confirm-

A) **Occurrence** – confirm recorded expenditure was actually incurred during the audit period.

B) **Completeness** - The expenditure pertaining to the period have been recorded appropriately and there in no understatement or overstatement.

C) **Measurement** - The expenditure has been measured appropriately.

D) **Authenticity** - The expenditure is in certain limit and if it is in excess, appropriate procedure has been followed. See that the expenditure incurred is authentic and it is spent by applying certain procedure laid down. Analyse the monthly trends for expenses. verify that -

   a. the expenditure pertained to audit period.

   b. the expenditure qualified as a revenue and not capital expenditure;

   c. the expenditure is supported with valid documents like travel tickets, insurance policy, third party invoice, etc;

   d. the expenditure has been classified under the correct head of expense;

   e. the expenditure was authorised as per the delegation of authority;

   f. the expenditure relates to business and it is not personal.

In addition to these, auditor needs to consider special facts attached to each of the expenses. Special points that are to be considered by the auditor are discussed below.

i. Interest Expenses - Auditor should confirm amount of debts, applicable interest rates, due dates, period, interest paid, interest outstanding etc.

ii. Rent - Auditor should check agreement of rent and confirm whether the agreement is in the name of the enterprise and whether the rent expense pertains to premises is used for running the business operations of the enterprise, monthly amount of rent, increase or decrease in rent etc.

iii. Insurance - Auditor should go through all insurance policies taken by the client in order to know their validity period, policy amount and premium on it, periodicity of payment of premium, due date, mode of payment, prepaid amount etc.

iv. Taxes -Auditor should know the taxes applicable to the client, basis of charging tax, provisions applicable etc. Verify the tax amount by actual calculation and vouch the payment.

v. Repair to Building and Plant and Machinery - Auditor should get details of repairs- causes of repairs, types of repairs, the system adopted to carry out repairs, tools and consumables used for repairs and authentication of the same and reasonableness of expenses.

vi. **Travelling Expenses** - Auditor should examine the need of travel, the person travelled, the place of designation, its authentication, mode (Road, Rail, Air, Sea) and class of seat (I, II or economy / corporate / AC etc.), time and distance of travel.

vii. **Miscellaneous Expenses** – The auditor should follow the common points discussed above.

III. Depreciation

As per the accrual concept of accounting, cost of an asset is proportionally charged to the period over which the asset is expected to be used. This proportionate amount is called as 'depreciation'. It is significant part of expenses and has direct impact on the profit / loss of the enterprise. Hence, auditor needs to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of laws and as per generally accepted accounting principles.

Auditor needs to consider the following traits while auditing depreciation

i. The accounting policy related to depreciation.

ii. The policy for charging depreciation is as per the provisions of Companies Act and applicable accounting standards.

iii. Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.

iv. Whether depreciation and amortisation charges are valid.

v. Whether depreciation and amortisation charges are accurately calculated.

vi. Whether all depreciation and amortisation charges are recorded in the appropriate period.

vii. Whether the parts (components) of each item of property, that are to be depreciated separately has been properly identified.

viii. Whether the most appropriate depreciation method has been used for each asset considering the nature of the asset.

The audit procedure -

A) **Completeness -** Depreciation expenses pertaining to the period have been recorded appropriately and there in no understatement/ overstatement.

B) **Measurement** - Depreciation expenses have been measured appropriately

C) **Occurrence-** Recorded depreciation expenses were actually incurred during the period

D) **Presentation and disclosure -** Required disclosures for depreciation have been appropriately made

Check your progress – C

State the following statements are true or false

1. Making payment for purchase of goods is the first step in the process of purchase.
2. It is not the duty of the auditor to check recorded expenditures are actually incurred during the period of audit.
3. The provisions of Companies Act 2013 and concerned standards are not applicable for the depreciation of fixed assets of public limited company.
4. While auditing expenses on interest, an auditor has no right to take confirmation from concerned parties.
5. While checking insurance premium, it is not necessary to check insurance policies.
6. While checking travelling expenses, it is not the business of the auditor to verify need and reason of travelling.

2.2.2. Audit of Specific Items in Balance Sheet

2.2.2.1. Items of Capital and Liabilities

I. Share Capital

Public limited companies raise its capital through issue of shares. Capital of a company is classified as-

a) Authorised Capital or Nominal capital : It is the sum stated in the memorandum as the capital of the company with which it is registered. It is the maximum amount of capital to be raise by issuing shares.

b) Issued Capital : Issued capital is that part of authorised capital which is offered by the company for subscription.

c) Subscribed Capital : It is that part of issued capital which is subscribed by the public. It also includes the shares allotted for consideration other than cash.

d) Called Capital : It is that part of subscribed capital which is called upon by the company for payment from the shareholders.

e) Paid up Capital : It is that part of called up capital which is actually received by the company

The shares can be issued at par or at premium. In case a company has issued shares at a premium, the auditor needs to verify whether the premium received on shares, has been transferred to a "securities premium account" and whether the application of any amount out of the said account is only for the purposes mentioned.

As per section 53 of the Companies Act, 2013, a company shall not issue shares at a discount, except in the case of an issue of sweat equity. The auditor needs to verify that the company has not issued any of its shares at a discount

Issue of Sweat Equity Shares - According to section 54 of the Companies Act, 2013, the "Sweat Equity Shares" means equity shares issued by the company to its employees or directors at a discount or for consideration other than cash for providing know-how, making available intellectual property rights, value additions, by whatever name called. The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with-

(a) the issue is authorised by a special resolution passed by the company;

(b) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(c) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

(d) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

The rights, limitations, restrictions and provisions applicable to equity shares shall be applicable to the sweat equity shares. The auditor also needs to verify whether the fresh issue of shares was a rights issue or a preferential issue and whether the relevant requirements for issue of share capital as per provisions of Companies Act, 2013 have been complied with.

In addition to this, the auditor is to assess-

i. balance at the beginning of the audit period, changes during the audit period and balance at the end of the audit period,

ii. Rights of shareholders, preferences and restrictions.

iii. Shares held by the holding company, subsidiaries of the holding company and associates of the holding company

iv. Shareholder holding more than 5% shares (Aggregate number and class of shares).

v. Shares allotted as fully paid up pursuant to contract(s) without payment being received in cash

vi. Shares allotted as fully paid up by way of bonus shares

vii. shares bought back

If there is no change in share capital, obtain a written confirmation form the Company Secretary in this regard. In case there is any change in share capital during audit period, obtain the certified copies of relevant resolutions passed at the meetings of board of directors and shareholders authorising the increase / decrease in authorised and paid up share capital. Also, obtain and verify copies of forms filed with Ministry of Corporate Affairs and with Reserve Bank of India (in case of Foreign Direct Investment by a Non- resident shareholder) and verify the number of securities issued along with the issue price.

In case there was increase in authorised share capital, verify whether the Company has accurately calculated the fee and stamp duty payable to Ministry of Corporate Affairs and obtain a copy of the receipt in support of the payment made.

Reduction of Capital - For verifying reduction of capital, the auditor needs to undertake following procedures:

a) Verify that the Articles of Association authorises reduction of capital,

b) Verify that the meeting of the shareholder held to pass the special resolution was convened and the proposal was circulated in advance among all the shareholders,

c) Examine the order of the Tribunal confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies,

d) Inspect the Registrar's Certificate as regards to reduction of capital,

e) Vouch the accounting entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I have been complied with,

f) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet,

g) Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid-up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old and the old ones have been cancelled;

h) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.

i) Verify that the Memorandum of Association of the company has been suitably amended.

II. Reserve and Surplus and Provisions

i. Reserves - Reserves are amounts appropriated out of free profits. Reserves are segregated as revenue or capital reserves. Revenue reserves represent profits that are available for distribution as dividend. If a company appropriates revenue profit for creation of 'Asset Replacement Reserve' with the objective to use it for a capital purpose, such a reserve shall also be a capital reserve. A capital reserve, generally, can be utilised for writing down fictitious assets, losses and issuing bonus shares. Capital Reserve is not utilised for distribution as dividend.

ii. Provisions- The provisions are amounts charged against revenue to provide for a renewal or diminution in the value of assets or liabilities or a disputed claim. Provisions are charged to the Profit and Loss Account.

The auditor is to undertake following procedure for auditing reserves and surplus.

a) Tally the opening balance of reserves and surplus to the previous year's audited financial statements.

b) Verify the addition or utilisation of reserve in current year.

c) Verify the resolution passed by the board of directors regarding declaration of dividend, adjustment related to dividend payment and the dividend distribution tax.

d) Confirm withdrawal from securities premium account is only for the following purposes.

   (i) issue of fully paid bonus shares,

   (ii) writing off of preliminary expenses,

   (iii) writing off of expenses / commission / brokerage on issue of shares or debentures,

   (iv) payment of premium payable on redemption of redeemable preference shares / debentures or purchase of own shares under section 68.

Ensure whether the disclosure required as per Ind AS have been complied with. See whether the company has disclosed the balance at the beginning, changes in accounting policy, transfer to retained earnings, any changes and balance at the end of reporting period

III. Borrowings

Borrowings are third party obligations of an enterprise. It may be short- term or long-term. The auditor is to verify all borrowings on the balance sheet date are valid claims by third parties. He should,

- Review board minutes for approval of new borrowings and significant debt commitments.
- See that details of loans recorded agree with the loan agreement.
- Verify that borrowing limits imposed by agreements are not exceeded.
- See that overdrafts and loans agree with confirmation certificates obtained.
- See that details of leases and hire purchase creditors recorded agree with underlying agreement.

- Examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants.
- When debt is retired, ensure that a discharge is received on assets securing the debt.
- see that all borrowings have been accounted for in the books of the company on a timely basis.
- Obtain a schedule of short-term and long-term borrowing showing beginning and ending balances and repayments during the year.
- Verify evidences of debts like minutes of the board, contracts, bank accounts, records of cash disbursements and other documents. Check totals and calculations.
- Review debt activity for a few days before and after end of the audit period to determine if there are unrecorded liabilities at year-end and the transaction is recorded in the correct period.
- Obtain a confirmation for the amounts owed to each or selected lenders
- Check that the liability is recorded at the correct amount.
- Confirm that the accounting policies and methods of recording debt are appropriate and applied consistently
- Check that borrowings have been presented, classified and disclosed in the financial statements in accordance with the requirements of Companies Act, 2013 and applicable Indian GAAP.
- Confirm whether the following items are properly recorded, classified, and/or disclosed.

    a. Debt owed to related parties.

    b. Debt callable by the creditor (e.g., due to loan covenant violations).

    c. Short-term obligations expected to be refinanced.

    d. Discounts or premiums and related amortization.

    e. Unconditional purchase obligations.
- If enforcement of the provisions has been waived by the lender, obtain confirmation of the waiver from the lender.

- Examine the relevant details of interest rates, due dates and terms of redemption or conversion to ensure completeness and accuracy.
- See that instalments of long-term loans falling due within the next twelve months have been disclosed in the financial statements and verify the correctness of the amount of such instalments.
- Review debt for related parties' transactions or borrowings from major shareholders.
- Examine the debt agreements for provisions relating to default and ensure disclosure thereof in the financial statements.
- Examine whether the requirements of the applicable statutes have been complied with including disclosure of the same to the extent mandated and considered necessary for proper understanding of the user of financial statements.
- Verify that the amount borrowed is within the borrowing powers of an enterprise.
- Verify that the company has not breached the restrictions laid down by Section 180 of the Companies Act 2013, on the borrowings of the company.
- Examine the purpose for which the amount is borrowed and the amount is not used against the interest of an enterprise.
- Where the enterprise has accepted deposits, examine whether the directives issued by the Reserve Bank of India or other appropriate authority have been complied with.
- Ensure whether the following disclosures as required under Ind AS are made regarding each amount disclosed as 'long term borrowings'.
    a. Sub-classification as secured and unsecured.
    b. For secured borrowings, nature of security separately in each case.
    c. Where loans are guaranteed by directors or others, whether the company has disclosed the aggregate amount of such loans under each head.
    d. Terms of repayment. It should include the period of maturity, number and amount of instalments due, applicable interest rate and other significant relevant terms (if any).

e. Default in repayment of borrowing and / or interest on the balance sheet date.

IV. Trade Payables (Creditors)

Trade payables are the short-term financial obligations created in the regular operations of the business of an enterprise such as e.g. amount payable to suppliers for credit purchases of goods and services.

To audit accounts payable, auditor must check –

1. The terms of payments.
2. The accounts payable turnover ratio
3. Is there any practice followed to increase net income by not recording payables?
4. The validity of transactions relating to accounts payable. Most commonly, an auditor can check the validity of a transaction by reaching out to vendors and suppliers to get a confirmation request.
5. Payable balance is properly disclosed in financial statements.
6. The enterprise is disclosed a mandatory letter from management attesting that all financial statements fully represent accounts payable and purchases.

V. Other Current Liabilities

Current liabilities mean all liabilities of an enterprise that are to be settled within a period of accounting year. It also includes the instalments due on the long-term loans in the current fiscal year.

The auditor shall obtain a certificate from the management that all current liabilities that had accrued till the close of the accounting year are carefully accounted for by complying with the required accounting procedure.

The auditor should ask for a list of all current liabilities from a responsible officer with classification as per the nature.

He should check the cash book to confirm that they have been paid off by the time of audit. He should compare current liabilities of the current year with that of the previous year to identify deviations, if any and ask for clarification.

He should obtain confirmation from all significant creditors regarding balance of the liability. Any deviation in the balance as per the statement and the confirmation letter obtained should be asked for clarification.

The auditor should confirm that the disclosures required in respect of current liabilities have been complied with.

Check your progress - D

State whether the following statements are true or false

1. According to Section 52 of the Companies Act 2013, if any company issued shares at premium, the amount of premium should be transferred to Securities Premium Account.
2. A limited company has a freedom of recording any amount as reserves to make the balance sheet tally.
3. An auditor should ensure that all borrowings are approved by the board of directors in their meetings.
4. To confirm the validity of trade payables it is not necessary to get confirmation from the suppliers.
5. The auditor should confirm that the disclosures required in respect of current liabilities have been compiled with.

2.2.2.2 Audit of Assets

I. Fixed Assets

Assets of a permanent or a semi-permanent nature, which are held not for resale but for use within the business with a view to earning profits and the benefits whereof is expected to last for more than one year and acquiring a benefit of continuing nature are called fixed assets. Fixed assets are long-term investments and are essential for performing the day-to-day operations of the business enterprise. They are divided as tangible and intangible assets.

a) Tangible Assets - The assets which have physical existence are called tangible assets, e.g. Land and Building, Plant and Machinery, Furniture and Fixtures, Office Equipments, Electric Installations, Vehicles etc.

The audit procedure for auditing tangible fixed assets is as under.

i. The auditor is to obtain proper information about controls and accounting system pertaining to fixed assets.

ii. The auditor is to review the internal control system relating to fixed assets

iii. The auditor should see that for each fixed asset, the records are maintained properly.

iv. The auditor should verify physically the assets and check disposal of fixed assets and treatment of low value assets.

v. The auditor should see that fixed assets have been properly used for meeting the objectives of the enterprise.

vi. The auditor should verify the calculation and allocation of depreciation, disposals, repairs and maintenance charges, etc.

vii. The auditor is to verify that all the assets appear in the balance sheet.

viii. Check opening balances of the fixed assets from schedule of fixed assets, ledger or register balances.

ix. Verify acquisition of new fixed assets and improvements in the existing ones with reference to supporting documents.

x. Check self-constructed fixed assets, improvements and capital work-in-progress with reference to the supporting documents

xi. Examine expenses on Repairs and maintenance have not been included therein.

xii. Examine whether low value fixed assets have been written off or fully depreciated in the year of acquisition / construction in accordance with applicable regulatory requirements.

xiii. If fixed assets are destroyed, scrapped or sold, examine that-

   a. the appropriate procedures have been properly followed;

   b. appropriation of consideration amongst various assets sold is proper where several assets have been sold for a consolidated consideration.

   c. the profit or loss on sale of assets have been properly disclosed in the profit and loss account.

   d. obtain a certificate from the management that all assets scrapped, destroyed or sold have been properly recorded in the books.

xiv. verify the ownership of assets by examining title deeds.

xv. verify that the assets are held in the name of the client and it is properly documented there for.

xvi. Ensure that the valuation of assets and disclosure in the financial statements are consistently followed and they are in accordance with the generally accepted accounting principles.

xvii. Verify that the enterprise has charged depreciation on all its fixed assets. Also check the calculations of depreciation and the total depreciation arrived at should be compared with that of the preceding years to identify reasons for variations.

xviii. Examine whether the depreciation charge is adequate keeping in view the generally accepted accounting principles for depreciation or Income Tax Rules.

xix. For assets revalued, examine scientific/technical appraisals and consider acceptance.

xx. see that all expenses of capital expenditure such as expenses incurred to bring assts to the place of erection, erection charges, octroi / GST on the value of assets, wages paid on construction of building, etc. are added to the concerned assets

xxi. See that spare parts, stand-by equipments and servicing equipments are recognised as property, when they meet the definition of capital expenditure. Otherwise, such items are classified as inventory.

xxii. See that Items of property, plant and equipments acquired for environmental safety, although not directly increasing the future economic benefits to an enterprise are to be consider as the assets of the enterprise.

xxiii. Where several assets have been purchased for a consolidated price, examine the method by which the consideration has been apportioned to various assets.

xxiv. If valuation has been done on the basis of an expert valuation, examine whether the same appears reasonable.

xxv. If an enterprise owns assets jointly with others (otherwise than as a partner in a firm) examine the relevant documents such as title deeds, agreements etc., in order to ascertain the extent of the enterprise share in such assets.

xxvi. Examine whether any of the tangible asset has been impaired. If so, examine whether the provisions of AS 28 has been applied.

Rights and Obligations - The auditor is to see that the enterprise has valid legal ownership rights over the fixed assets claimed to be held by the enterprise and recorded in the financial statements. If the enterprise has created any charge on its assets, the auditor is to see whether such charge was created in the interest of an enterprise. If the enterprise has given fixed asset as security for any borrowings and the original title deeds are not available with the enterprise, the auditor should request the enterprise's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. In addition, the auditor should also verify the register of charges, available with the enterprise to assess the PPE that has been given as security to any third parties.

Presentation and Disclosure - Required disclosures for tangible fixed assets have been appropriately made. Auditor is to see whether all items of fixed assets have been classified appropriately. For each fixed asset, whether the enterprise has disclosed a reconciliation of the gross and net carrying amounts at the beginning and end of the reporting period showing separately:

- Opening balance
- Additions
- Acquisitions through business combinations
- Disposals
- Disposals through demergers
- Other adjustments
- Closing balance of gross carrying amount

For each fixed asset, whether the enterprise has disclosed:

- Opening accumulated depreciation
- Depreciation for the year
- Deduction / other adjustments for depreciation
- Closing accumulated depreciation

b) Intangible Assets

An Intangible Asset is an identifiable without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Enterprises frequently expend resources or incur liabilities on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items covered by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

If an item covered does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the date of the amalgamation. The physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable.

In determining whether such an asset should be treated under AS 10 / Ind AS-16- Accounting for Fixed Assets, or as an intangible asset, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset. As per AS-26 and Ind AS- 38, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

Existence- the auditor should verify that, such intangible asset is in active use in the operations of the enterprise. If any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the enterprise’s management and amortization charge should have ceased to be charged beyond the date of deletion.

Completeness- the auditor should verify that,

- additions to Intangible assets during the period under audit have been recorded appropriately in the financial statements.

- the movement in the Intangible assets schedule i.e. Opening +Additions - Deletions= Closing Balance and tally the closing balance to the books of account the enterprise.
- the arithmetical accuracy of the movement in intangible asset schedule, tally the opening balances to the audited financial statements of the previous year. For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures.

- Verify if the additions have been approved by appropriate personnel of the enterprise and is in pursuant to approval by the board of directors.
- Verify if proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets.
- For all material additions, verify if such expenditure meets the criterion for recognition of an intangible asset. An intangible asset shall be recognised if, and only if:
- the said asset is identifiable;
- the enterprise controls the asset i.e. the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
- it is probable that future economic benefits associated with the asset will flow to the enterprise;
- the cost of the item can be measured reliably.

To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into a research phase and a development phase.

Research phase - No intangible asset arising from research shall be recognised.

Development phase- An intangible asset arising from development shall be recognised if, and only if, an enterprise can demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;

- its ability to use or sell the intangible asset;

In relation to deletions to intangible assets,

- understand from the management the reason and rationale for deletion
- obtain discard note authorising discard of the asset from its active use.
- verify the process followed for sale of discarded asset – inviting competitive quotes, tenders and the basis of calculation of sales proceeds.
- verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on discard in the enterprise's books of account.

Valuation- Intangible assets have been valued appropriately as per generally accepted accounting policies and practices. The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents an item of cost to the enterprise for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should,

- verify that the enterprise has charged amortization on all intangible assets,
- verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the enterprise.
- The auditor should also verify if the management has undertaken an impairment assessment to determine whether an intangible asset is impaired. For the purpose, the auditor needs to verify if the enterprise has applied Ind AS 36, Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

Rights and Obligations- The enterprise has valid legal ownership rights over the intangible assets claimed to be held by the enterprise and recorded in the financial statements. The auditor should also verify that all invoices/ purchase contracts are in the name of the enterprise that entitles legal title of ownership to the respective enterprise.

Presentation and Disclosures- Required disclosures for intangible assets have been appropriately made. Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made.

- For Goodwill, whether the enterprise has disclosed a reconciliation of the gross and net carrying amounts at the beginning and end of the reporting period showing separately, Opening balance, Additions, Disposals, Impairments and Other adjustments.

Whether all items of intangible assets have been classified as,

- Brands/trademarks
- Computer software
- Mastheads and publishing titles
- Mining rights
- Copyrights, and patents and other intellectual property rights, services and operating rights
- Recipes, formulae, models, designs and prototypes
- Licenses and franchise
- Others (specifying nature)

For each class of Intangible assets, whether the enterprise has disclosed a reconciliation of the gross and net carrying amounts at the beginning and end of the reporting period showing separately,

- Opening balance of gross carrying amount
- Additions
- Acquisitions through business combinations
- Disposals
- Disposals through demergers
- Other adjustments
- Borrowing costs capitalized
- Closing balance of gross carrying amount

For each class of intangible assets, whether the enterprise has disclosed,

- Opening accumulated amortization
- Charge for the year

- Deduction / other adjustments for amortization
- Closing accumulated amortization

For each class of intangible assets, whether the enterprise has disclosed,

- Opening accumulated impairment losses
- Impairment losses
- Impairment reversals
- Closing accumulated impairment losses

II. Loans and Advances

Loans and advances are current assets similar to trade receivables. While loans could be understood to mean money advanced to other parties whereas, advances include amounts recoverable either in cash or in kind or for value to be received, e.g., rates, taxes and insurance paid in advance/ prepaid. Other current assets primarily include accrued interest on loans/ fixed deposits held, balances with statutory/ government authorities etc. outstanding incomes such as rent receivable, unclaimed dividend, etc.

The audit procedures to be undertaken while auditing loans and advances and other current assets-

Existence- Establish the existence of loans and advances and other current assets as at the end of period of audit. In case of loans and advances, direct confirmation procedures, similar to those performed for ''Accounts receivable'' are undertaken with the only difference that of direct confirmations, in addition to the principal amount, interest received / receivable, if any, as per the agreed terms between the parties, may also be included as part of the balance to be confirmed.

Completeness- Loans and advances and other current assets have been recognized in the financial statements properly.

- Obtain a list of all advances and other current assets and compare them with balances in the ledger.
- Inspect loan agreements and acknowledgements of parties in respect of outstanding loans.
- A loan or an advance, if material, can be granted only if authorised by the Memorandum and Articles of Association in the case of Company.

- It should confirm that the loans advanced were within the capacity of persons who had advanced the same, directors in the case of a company, partners in the case of a firm and trustees in the case of a trust.
- Inspect the minutes of meeting of board of directors to confirm if all material loans and advances were approved by the board of directors.
- Verify that the loan has been acknowledged by the party and, in addition, inspect if any security has been deposited against due repayment of the loan.
- Ascertain if loans are being recovered regularly as per agreed instalments.
- Related party loans and advances- If there are any related party loans and advances, review whether they were properly authorized and the value of such transactions were reasonable and recoverable.
- In relation to balances with statutory authorities like service tax / VAT/ excise input credit, verify the balances by applying applicable rate to sales and purchases. If found any variance with, reasons for variance should be requested from client for clarification. Further, the auditor should obtain copies of returns filed like excise returns / GST returns etc. and verify whether the amount recorded as per books of account tallies with the claim made with the authorities.

Valuation- Loans and advances and other current asset balances should be valued appropriately.

- Auditor should review the process followed by the enterprise to derive an allowance for doubtful accounts. Also consider the consistency of the method used in the last year, and determine whether the method is appropriate.
- Obtain the ageing report of loans and advances. It is to split as not currently due, 30 days old, 30-60 days old, 60-180 days old, 180-365 days old and more than 365 days old. Also, obtain the list of loans and advances under litigation and compare with previous year.
- Scrutinize the analysis and identify those loans and advances that appear doubtful. Discuss with management their reasons, if any of these loans and advances is not included in the provision for bad recoverable. Perform further testing where any disputes exist. Reach a final conclusion regarding the adequacy of the bad and doubtful loans/ advances provision.

- Assess bad loans written-off. Prepare schedule of movements on Bad loans and written offs. See that the transaction shave been approved by an appropriate authority.
- Check that the restatement of foreign currency loans and advances / other current assets has been done properly.

Presentation and Disclosure- Required disclosures for loans and advances and other current assets have been appropriately made. Ensure whether the following disclosures as required under Ind AS have been made.

Whether loans have been classified as security deposits, loans to related parties and other loans with nature,

Whether all the above loans have been further sub-classified as,

Secured and considered good

Unsecured but considered good and

Doubtful

Whether bad debts written and doubtful loans have been disclosed separately under the relevant heads i.e. loans due from-

Director of the company

Director of the company jointly with other persons

Officer of the company

Officer of the company jointly with other persons

Firm in which director is a partner

Private Company in which director is a director or a member

III. Trade Receivables

Trade receivables are often referred to as debtors or account receivables. These are monies which are owed to an enterprise by a customer. The account receivable is a sale made on credit to a customer. It is important to carry out compliance procedures in the sales audit as part of the debtors' audit. It is to ensure that the system for receivables has the following features.

- Only bonafide sales lead to receivables.
- All such sales are made to approve customers.

- All such sales are recorded.
- Once recorded, the debts can only be eliminated by receipt of cash or on the authority of a responsible official.
- Debts are collected promptly.
- Balances are regularly reviewed.
- A proper system of follow up exists and if necessary, adequate provision for bad debts is made.

The audit procedures to be undertaken while auditing trade receivables is as under

Existence-To assess the existence of trade receivables as at the end of the year,

- Check whether there are controls in place to ensure that sales invoices cannot be recorded more than once and are automatically recorded in the general ledger from the original invoice.
- Ensure that trade receivables ledger reconciles to general ledger.
- Calculate the receivable report, aging report to verify that the total traced to the general ledger is correct.
- See whether realization is recorded invoicewise or not. If not, check that money received from debtors is adjusted chronologically invoicewise and on FIFO basis i.e. previous bill is adjusted first. If realization is made on account, verify if the Company has obtained confirmations from debtors.

Confirmation with the Customers - The auditor, with the consent of the enterprise under audit, is to contact customers directly and ask them to confirm the unpaid amounts at the end of the audit period. There may be situations where the management of the enterprise requests the auditor not to seek confirmation from certain trade receivables. In such cases, the auditor should consider whether there are valid grounds for such a request. The form of requesting confirmation may be either 'positive' or 'negative'.

In case of positive form, the customers are asked to confirm whether the outstanding balance is correct or not, whereas, in case of negative form, the customers are requested to respond only if they disagree with the balance shown. The use of the positive form is preferable if individual account balances are relatively large, the internal controls are weak, there found substantial number of accounts in dispute, or inaccuracies or irregularities. The negative form is useful when internal controls are effective, a large number of small balances are involved and when the auditor has no reason to believe that the trade receivables are unlikely to respond.

The method of selection of the trade receivables to be circularised should not be revealed to the enterprise until the trial balance of the trade receivables' ledger is handed over to the auditor. A list of trade receivables selected for confirmation should be given to the enterprise for preparing request letters for confirmation. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters or the auditor may request the enterprise to provide duly authorised confirmation letters and s/he may fill in the names, addresses and the amounts relating to trade receivables selected by him and mail the letters directly. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client. Any discrepancies revealed by the confirmations received, the enterprise should be asked to investigate and reconcile the discrepancies. In addition, the auditor should also consider what further tests he can carry out in order to satisfy himself as to the correctness of the amount of trade receivables taken as a whole.

If no reply is received, the auditor should perform additional testing regarding the balances. This may include-

Agreeing the balance to cash received,

Agreeing the detail of the respective balance to the customer's remittance advice,

Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions were actually occurred,

If there are any related party receivables, review them for recovery, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

Check that receivables for other than sales or services are not included in the list. Review a trend line of sales and accounts receivable to see if there are any unusual trends. Also, measure the average collection period. Make inquiries about reasons for changes in trends from the management and document the same in audit work papers.

Completeness- Trade receivable balances are supposed to be recorded correctly in the financial statements. The auditor needs to satisfy himself of correct and proper cut-offs. Without a correct cut-off, sales could be understated or overstated, hence, the need to perform the following cut off tests.

- For the invoices issued during the last week closer to the cut-off date, the goods should have been dispatched and not lying with the enterprise and included in closing stock;
- All good dispatched prior to the year-end have been invoiced and included in debtors;
- No goods dispatched after the year- end have been invoiced and included in debtors for the period under audit.

Test invoices listed in receivable report- Select few invoices from the accounts receivable ageing report and compare them with supporting documents to see if they were billed with the correct amounts, to the correct customers and on the correct dates.

Match invoices to dispatch log- Match invoice dates to the shipment dates for those items in the dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they should have been included in the period under audit.

Assess bill and hold sales- It is known as “bill and hold” procedure. If there is a situation where the enterprise is billing customers for sales despite still retaining the goods on-site, examine supporting documentation to determine whether a sale has actually taken place.

Review receiving log- Review the receiving log to see if the enterprise has recorded a very large amount of customer returns after the audit period, which would suggest that the enterprise may have shipped more goods near the end of the audit period, than the customers had authorized. Study the system of giving discounts and check-

- Whether the same is being given as per the policy,
- Whether cash discount is given on the basis of date of realization of cheque or on the basis of date of receipt of cheque. If it is on the basis of date of receipt of cheques, verify that the cheque has been realized within a reasonable time.

Review credit memos- Review the credit memos issued during the audit period to see if they were properly authorized, whether they were issued in the correct period and whether they indicate other problems. Also, review credit memos issued after the period being audited, to see if they relate to transactions from within the audit period. Where any deduction has been made against a bill, check the reason and correspondence for the same.

Valuation- Trade receivable balances have been valued appropriately. The auditor is to assess the allowance for doubtful accounts. Review the process followed by the enterprise to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.

Obtain the ageing report of accounts receivable and split as not currently due, 30 days old, 30-60 days old, 60- 180 days old, 180- 365 days old and more than 365 days old. Also, obtain the list of debtors under litigation and compare them with that in previous year.

Scrutinize and identify the debts which appear doubtful, discuss with management about their reasons, if any of these debts are not included in the provision for bad debts, perform further testing where any disputes exist, find the adequacy of the bad debts provision.

Assess bad debt write offs- Prepare schedule of movements on Bad Debts – Provision Accounts and Debts written off and compare the proportion of bad debt to sales for the current year in comparison to prior years, to see if the current expense appears reasonable. Also check that write-offs have been approved by an appropriate authority.

Presentation and Disclosure- Required disclosures for trade receivables have been appropriately made. Check that the confirmation of foreign currency trade receivables has been done properly. Determine that the accounting policies and procedures related to accounts receivables are appropriate and are applied consistently according to GAAPs. Validate that the enterprise presents and discloses its accounts receivable balances in the balance sheet and its accompanying notes properly.

Verify that the split between more than 6 months and less than 6 months has been done from the due date instead of sales invoice date. Check classification of amount due is properly disclosed as,

- Secured, considered good
- Unsecured, considered good
- Doubtful

Verify that proper disclosure of amounts due from the following parties has been made:

- By directors
- By other officers of the company
- By any of them either severally
- By jointly with any other person
- By firms
- By private companies respectively in which any director is a partner or director or member.

Note down the transactions with parties under section 189 of Companies Act, 2013 and ensure that the same is reported properly in CARO.

IV. Inventories

Inventories are a form of current asset held for sale in the ordinary course of business or for consumption in the production of goods / service for sale. As per AS 2- 'Valuation of Inventories' and IND AS 2- 'Inventories'', inventory is valued at lower of cost and net realisable value. This general principle applies to valuation of all inventories except inventories of the following to which special considerations apply.

(a) Work-in-progress arising under construction contracts, including directly related service contracts (refer Accounting Standard (AS) 7, "Construction Contracts"),

(b) Shares, debentures and other financial instruments held as inventory (refer AS 2- 'Valuation of Inventories' and IND AS 2- 'Inventories') and

(c) Inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well-established practices in those industries (refer AS 2- 'Valuation of Inventories') and biological assets as defined under IND AS 41- ''Agriculture'' and part of exclusions under IND AS 2- 'Inventories''.

The inventories referred to in (c) above are measured at net realisable value at different stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores and gases have been extracted and sale is assured under a forward contract or a Government guarantee, or when a homogenous market exists and there is a negligible risk/ uncertainty of failure to sell. Such inventories are accordingly, excluded from the scope.

Work in Progress- Ascertain how the various stages of production/ value add are measured and estimates are made, understand the basis for such estimates. Ascertain what elements of cost are included and the basis of inclusion. Ensure that the overheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the draft financial statements.

Consistency-There should be consistency in the basis of valuation of inventory and that of work-in-progress. If it is changed during the period under audit, it should be disclosed how it has affected the financial statements of the enterprise.

The audit procedures required to be undertaken while auditing 'inventories' and work-in-progress-

Existence-To establish the existence of inventories and work-in-progress as on the date of year ending -

- Review client's plan for performing inventory and work-in-progress count.
- Ensure that consigned goods have been segregated.
- Evidence of appropriate supervision for those performing count should be examined.
- Personally perform test counts to verify that,

• the employees are adhering to the agreed plan.
• all items are properly tagged.
• proper amounts are shown on tags.
• tags and summary sheets are controlled and reconciled.
• reconciliation of test counts with tags and summary sheets and discrepancies noted, if any are summarized and agreed with client personnel.

- Stay alert and cautious about empty boxes, etc. and obsolete items.

- Establish cut off by documenting last receiving reports and shipping documents for the period.
- Ensure exclusion of third party stock and damaged or obsolete stock.
- Ensure the accounting of all stock sheets.
- Investigating any significant difference between the physical stock and the stock records.

Further, the auditor should ask the client personnel to sign all stock count sheets and also agree the variances observed, if any to avoid any conflicts of opinion at the time of reporting. When control risk is high and/or client uses periodic system, inventory count should be undertaken at end of the period. If client uses perpetual system, inventory may be counted at interim dates. Confirm or investigate public warehouse inventory of client and also, any inventory of client lying with a third party.

Completeness- Only the inventories held by enterprise have been recorded in the financial statements and do not include any inventories that belong to third parties but does include inventories owned by the enterprise and lying with a third party. Perform analytical procedures-

— Compute inventory turnover ratio

— Perform vertical analysis

— Compare budgetary expectations vis-à-vis actual

Examine weights and measures.

Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end. Perform tests for omitted transactions and tests for invalid transactions with respect to tagged inventory.

- Verify the clerical and arithmetical accuracy of inventory listings.
- Reconcile physical inventory amounts with perpetual records.
- Reconcile physical counts with general ledger control totals.

Rights and Obligations- The enterprise has valid legal ownership rights over the inventories claimed to be held by the enterprise and recorded in the financial statements

Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice, and cancelled check or payment file).

Evaluate the consigned goods- Examine client correspondence, sales and receivables records, purchase documents.

- Determine existence of collateral agreements
- Review consignment agreements
- Review material purchase commitment agreements
- Examine invoices for evidence of ownership
- In case of inventory held by third party, the auditor should insist on obtaining declaration from the third party confirming that the items of inventory belong to the enterprise and are being held by such third party on behalf of and for the benefit of the enterprise under audit.

Valuation- Inventories have been valued appropriately and as per generally accepted accounting policies and practises. Inventory may be value by using "first in first out (FIFO)" "last in first out (LIFO)," or a weighted average system.

Presentation and Disclosure- Required disclosures for inventories have been appropriately made. Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made.

- Whether mode of valuation has been stated separately for each class of inventory
- Whether inventory has been classified as,

— Raw materials

— Work-in-progress

— Finished goods

— Stock-in-trade (goods acquired for trading)

— Stores and spares

— Loose tools

— Others (specifying nature)

- Whether goods-in-transit have been disclosed separately under each sub-head of inventory

V. Cash and Cash Equivalents

Cash and cash equivalent in the form of cash in hand, stamps in hand, balances with bank in various accounts, cheques in hand, etc. represent the most liquid assets of an enterprise. Utmost professional scepticism needs to be exercised while auditing such balances.

Existence- Establish the existence of cash and cash equivalent balances as at the end of the period.

Completeness- Cash and cash equivalent balances have been recorded in the financial statements as required to record.

Verification of cash balances are to be checked by surprise without giving notice of the auditor's visit either to the client or to his staff. If there are more than one cash balances, all of them should be checked simultaneously, as far as practicable. It is desirable for the cashier to be present while cash is being counted and he should be made to sign the statement of the cash balance counted. If the auditor is unable to check the cash balance on the date of the Balance Sheet, he should arrange with his client for all the cash balance to be banked and where this cannot conveniently be done on the evening of the close of the financial year.

The practice should also be adopted in the case of balance at the factory, depot or branch where cash cannot be checked at the close of the year. In case this is not possible, the auditor should verify the receipts and payments of cash up to the date he counts the cash. This should be done soon after the cash balances have been counted. The Cash Book of the day on which the balance is verified should be signed by the auditor to indicate the stage at which the cash balance was checked. If any cheques or drafts are included in cash balance, the total thereof should be disclosed.

If there is any rough Cash Book or details of daily balance are separately kept, the auditor should test entries from the rough Cash Book with those in the Cash Book to prove that entries in the Cash Book are correct. If the auditor finds any slip, chit or (I owe you) I.O.U.s in respect of temporary advances paid to the employees included as part of the cash balance he should have them initialled by a responsible official and debited to Appropriate Accounts.

The auditor should also perform a cash sensitivity analysis by compiling a summary of total cash receipts and payments each month and analyse the trends to see if there is variations in any specific month and request explanations from the management. The auditor needs to obtain bank reconciliation statements for all bank accounts maintained. The auditor should request the client to provide Bank Reconciliation Statement signed by the accountant and approved by the authorised official so that he is able to assign responsibility in case of any errors.

Verification of Bank Reconciliation Statement shall perform the following-

- Tally the balance as per books to the trial balance
- Tally the balance as per bank to the bank statement
- Checking of all material reconciling items and should verify if the cheques issued have subsequently been cleared by bank. For all cases where cheques have become stale i.e. 3 months or more has lapsed since the issue date, the same should not appear in the BRS and should have instead been clubbed under liabilities.
- Cheques deposited but not credited by bank, verify if the balances were credited by bank subsequently.
- For any instances related to cheques not cleared beyond reasonable time, the auditor should seek explanations from the management and in case such explanations are found to be unsatisfactory, the auditor should verify of the revenue recognition related to such parties was in order and as per the normal revenue recognition accounting policy.
- For Amounts / Charges debited / credited by bank but not accounted for; auditor should request for bank statements and tally the same. If the amounts are found to be material, the auditor should insist the management to record adjustments for the same in its books of account or else, the auditor should qualify his opinion with respect to cash and cash equivalents

For confirmation of cash and cash equivalents, following procedure is to be followed.

- Ask for confirmation certificate from bank to confirm the balances held in all bank accounts.

- Ask the client to investigate and reconcile the discrepancies, if any and have written explanations from the banks on any unresolved queries.
- In remote situations were no reply is received, the auditor should perform additional testing regarding the balances.

Valuation- Cash and cash equivalent balances have been valued appropriately. In addition to the procedures performed above, the auditor should ensure that all bank accounts holding foreign currency have been restated at the closing exchange rates.

Presentation and Disclosure- Required disclosures for cash and cash equivalents have been appropriately made. Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:

- Cash and cash equivalents shall be classified as-
  - (a) Balances with banks;
  - (b) Cheques, drafts on hand;
  - (c) Cash on hand;
  - (d) Others (specifying nature)
- Earmarked balances with banks shall be separately stated.
- Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- Bank deposits with more than 12 months' maturity shall be disclosed separately.

VI. Provisions and Contingent Liabilities

Provisions are amounts charged against revenue to provide for a -

(i) known liability, the amount whereof cannot be determined with substantial accuracy or

(ii) claim which is disputed.

A provision is recognised when-

(i) an enterprise has a current legal obligation as a result of a past event;

(ii) it is probable that an outflow of resources will be required to settle the obligation; and

(iii) a reliable estimate can be made of the amount of the obligation. If the above conditions are not met, no provision is recognised.

Contingent Liability -The contingent liability is the probable liability which may or may not occur depending upon happening or non-happening of an event in future. It is not wholly within the control of the enterprise. These liabilities do not meet the recognition criteria.

a) It is a present obligation but is not recognized because it is not likely that will be required to settle,

b) The amount of the obligation cannot be measured with sufficient reliability.

c) In a general sense, all provisions are contingent because they are uncertain. The term 'contingent' is used for liabilities and assets that are not recognized because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events.

The audit procedures required to be undertaken while auditing provisions and contingent liabilities:

Existence - Establish the existence of provisions as at the end period under audit.

Completeness- Provisions that were supposed to be recorded have been recognized in the financial statements.

Valuation- Provision balances have been valued appropriately.

Audit Procedure to be followed-

- Obtain a list of all provisions and compare them with balances in the ledger.
- Inspect the appointment agreement with employees to understand the enterprise's commitment towards defined benefits,
- Inspect agreement with customers to assess warranty commitments, any legal and other claims on the enterprise.
- Obtain from the management the original working and the basis for each of the provisions made and verify whether the same is complete and accurate.

Presentation and Disclosure- Required disclosures for provisions have been appropriately made. Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made.

- Whether current and non- current portions have been split for provision for employee benefits and others (specifying nature)
- Whether for each class of provision, disclosure has been made for-
- The carrying amount at the beginning and end of the period,
- Additional provisions made in the period, including increases to existing provisions,
- Amounts used during the period,
- Unused amounts reversed during the period and
- A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

If the possibility of settlement of contingent liabilities is less, see whether disclosure has been made for each class of contingent liability at the end of the reporting period. It should disclose-

- an estimate of its financial effect,
- an indication of the uncertainties relating to the amount or timing of any outflow and
- the possibility of any reimbursement.

Whether Contingent liabilities have been classified as-

- Claims against the company not acknowledged as debts;
- Guarantees;
- Other money for which the enterprise is contingently liable.
- Whether the amount of any guarantees given by the enterprise on behalf of directors or other officers of the enterprise has been stated and where practicable, the general nature of each such contingent liability, if material has also been specified.

Check your progress - E

State whether the following statements are true or false.

1. In respect of fixed assets, auditor should check self constructed assets, improvements and capital work-in-progress.

2. An auditor should verify that intangible assets are in active use in the operations of the enterprise.
3. It is the duty of the auditor to inspect loan agreements and acknowledgements of parties while auditing loans and advances.
4. While checking trade receivables, auditor can rely fully on the amounts mentioned in the balance sheet without confirming its authenticity and accuracy.
5. In general, there should be consistency in the basis of valuation of inventories and work-in-progress.
6. Bank Reconciliation Statement is prepared to confirm cash balance and bank balance as per cash book and bank pass book.
7. As the contingent liabilities not affect the total of the balance sheets, it is not the duty of the auditor to verify the contingent liabilities.

2.3 Summary

In this unit we studied how to audit important items from financial statements. Auditor needs to assess occurrence, authenticity, completeness, existence and appearance of items appearing in financial statements which are called as Tests of Audit.

Before starting actual work of checking of records, an auditor should study the nature and size of the business, the concerned Acts, system of accounting and its computerisation and the internal control system.

While conducting audit of Specific Items in Profit & Loss Account, an auditor should verify carefully the Sale of Products and Services**,** Interest Income, Rental Income, Dividend Income and Net gain/loss on sale of Investments from income side and Purchases, Depreciation, Interest expense, Rent, Repair to building, Repair to Machinery, Insurance, Taxes, Travelling Expenses, Miscellaneous Expenses from expenses side.

It is the duty of the auditor to audit each and every item of balance sheet. The auditor should audit Share Capital, Reserve & Surplus, Long Term Borrowings, Trade Payables (creditors), Provisions, Short Term Borrowings and Other Current Liabilities considering every aspect.

The auditor should also examine the assets, Land and Buildings, Plant and Equipment, Furniture and Fixtures, Goodwill, Brand, Trademarks, Computer

Software, Loans and Advances, Trade Receivables, Inventories, Cash and Cash Equivalents, Other Current Assets and Contingent Liabilities carefully with all supportive evidences.

2.4 Terms to Remember

1. Financial Statements - Financial Statements refers to Profit and Loss Account and Balance Sheet.
2. Test of Audit of items in Financial Statements –
   a) Occurrence – This test verifies the items appearing in the financial statements have actually occurred during the period of audit and are related with the enterprise.
   b) Authenticity: This test examines the items recorded in the statements are related to the enterprise and authentic.
   c) Completeness: This test assesses all items appearing in the financial statements were recorded and disclosed at right time. Also, the required notes to the items are accompanied to the financial statements.
   d) Existence: This test verifies the items appearing in the statements were existed on the date of the statement, possessed by and related to the enterprise.
   e) Measurement or Valuation: This test checks the items in the statements are recorded accurately with their appropriate amounts.
   f) Disclosure: This test reveals the items in the financial statements have been classified and presented properly in the financial statements as per applicable accounting standards.

2.5 Answers to check your progress

Check your progress – A –

Answers – All the statements are true.

Check your progress – B

Answers-1. false 2. true 3. false 4. true

5. false 6. true

Check your progress – C

Answers – All the statements are false.

Check your progress – D

Answers- 1.True 2. False 3.True 4. False 5.True

Check your progress – E

Answers – 1. true 2. true 3. true 4. false

5. true 6. true 7. false

2.6 Exercise

A) Broad answer type questions

1. How will you audit Sales of Products or Services?
2. How will you audit Purchases?
3. How will you audit Share Capital?
4. How will you audit Borrowings?
5. How will you audit Tangible Fixed Assets?
6. How will you audit Intangible Fixed Assets?
7. How will you audit Trade Receivables?

B) Short answer type questions

1. How will you audit Other Expenses?
2. How will you audit Reserves and Surplus and Provisions?
3. How will you audit Trade Payables?
4. How will you audit Other Current Liabilities?
5. How will you audit Loans and Advances?
6. How will you audit Inventories?
7. How will you audit Cash and Cash Equivalents?

C) Write short notes

1. Tests of Audit items in Financial Statements
2. Audit of Interest Income
3. Audit of Rental Income

4. Audit of dividend
5. Audit of Net Gain or Loss on sale of Investments
6. Audit of Depreciation
7. Audit of Contingent Liabilities.

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Unit-3

Company Audit

Structure of Unit

3.0 Objectives:

After studying this unit, students shall be able to-

- Understand the provisions of the companies act relating to audit
- Understand the reporting requirement under the companies act

3.1 Introduction :

Companies Act 2013 has given various provisions regarding audit of companies. Sections 139 to 148 of the Companies Act deal with audit of companies. Therefore, it is important to understand these provisions in order to know the details about company audit. Section 128 to 138 give the details about 'Accounts' of the companies while the sections 139 to 148 give the details of 'Audit' of companies. Eligibility, qualification, disqualification, powers and duties of auditor are mentioned in these sections. Similarly provisions relating to appointment, remuneration and removal of company auditor are also given in these sections.

3.2 Presentation of Subject Matter

3.2.1 Auditor's Eligibility, Qualifications and Disqualifications of Auditor

Eligibility and Qualification : Section 141 (1) & (2) of the Act prescribed the following eligibility and qualifications of auditor :-

i. Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.

ii. Where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm

Disqualifications of Auditor

Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of the company:

- A body corporate, except LLP;
- An officer or employee of the company;
- Any partner/employee of officer or employee of company;
- A person who himself or his relative/partner is holding any security or interest in the company, or any company which is its holding, subsidiary, associate;
- A person whose relative is holding security or interest not exceeding Rs. one Lac face value in companies as mentioned above. Provided that this condition be also applicable in the case of a company not having share capital or other securities, wherever relevant. Provided further that in the event of acquiring any security or interest by a relative, above the threshold limit i.e. Rs. one lac, the corrective action to maintain the limits (Rs. one lac) shall be taken by the auditor within 60 days of such acquisition or interest;

- A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment;
- A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment;
- A person or a firm who, whether directly or indirectly, has "business relationship" with the company, or its subsidiary, or its holding or associate company; The term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except – (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts; (ii) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
- A person whose relative is a director or is in the employment of the company as a director or key managerial personnel; 6 Audit and Auditors
- A person who is in full time employment elsewhere;
- Person who is auditor of more than 20 companies;
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

According to section 141 (4) where a person appointed as an auditor of a company incurs any of the disqualifications mentioned as above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor

3.2.2 Appointment of Auditor

Appointment of Auditor of Companies in General : In terms of section 139(1) of the Companies Act, 2013 read with rule 3 of Companies (Audit and Auditors) Rules, 2014 every company shall at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting (AGM) and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as prescribed under

Before considering the appointment of auditor, the Audit Committee or the Board, as the case may be, shall consider any pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court. Further they may call for such other information from the proposed auditor as it may deem fit. Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment. If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of auditor to the members in the AGM otherwise, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement. Thereafter if the Audit Committee decides not to reconsider its original recommendation, then Board shall record reasons for its disagreement with the Audit committee and send its own recommendation for consideration of the members in the AGM and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.

The auditor appointed in the AGM meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting. Such appointment shall be subject to ratification in every AGM till the sixth AGM by way of passing of an ordinary resolution. If the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act. Section 139(6) of the Act stipulated that first Auditor of the Company other than Government Company, shall be appointed by the Board within 30 days of its date of registration and in case of failure to do so by Board of Directors, the members shall be informed and they shall appoint the same within 90 days form incorporation, who shall hold office till conclusion of first annual general meeting.

As per second proviso of section 139(1) read with rule 4 stipulated that written consent of the auditor must be taken before appointment. The auditor appointed shall submit a certificate that: (a) the individual/firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(b) the proposed appointment is as per the term provided under the Act;

(c) the proposed appointment is within the limits laid down by or under the authority of the Act;

(d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct. Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Act

Appointment of Auditor in Companies in case of Government Companies :The appointment of auditor in Government company or government controlled (directly/indirectly) company shall be held in accordance with the following provisions:

The First auditor shall be appointed by the Comptroller and Auditor General within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing government companies, the Comptroller & Auditor General shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within thirty days. In case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days. The Act also provides that in case the Company has an Audit Committee, then all appointments of Auditor including filling of casual vacancy, shall be made after taking into account the recommendations of the Committee.

3.2.3 Removal and Resignation of Auditor

Removal of Auditor : The auditor appointed under section 139 may be removed from his office before the expiry of the term only by

(i) Obtaining the prior approval of the Central Government by filling an application in form ADT-2 within 30 days of resolution passed by the Board

(ii) Holding the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

(iii) Giving a reasonable opportunity of being heard.

Resignation of Auditor : The auditor who has resigned from the company shall file a statement in Form ADT-3 indicating the reasons and other facts as may be relevant with regard to his resignation as follows:

(i) In case of other than Government Company, the auditor shall within 30 days from the date of resignation, file such statement to the company and the registrar.

(ii) In case of Government Company or government controlled company, auditor shall within 30 days from the resignation, file such statement to the company and the Registrar and also file the statement with the Comptroller and Auditor General of India (CAG). The onus to file such statement containing relevant facts and reasons for resignation is on the resigning auditor and any contravention of sub clause (2) is punishable with monetary fine which could be minimum Rs. 50,000 and maximum Rs. 5 lakh.

3.2.4 Remuneration of Auditor

Section 142 of the Act prescribed that the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. Board may fix remuneration of the first auditor appointed by it. The remuneration will be in addition to the out of pocket expensed incurred by the auditor in connection with the audit of the company and any remuneration paid to him for any other service rendered by him at the request of the company

3.2.5 Powers and Duties of Auditor

3.2.5.1 Powers of an Auditor:

Section 143(1) provided that Every auditor can access at all times to the books of accounts, vouchers and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f). It is the duty of every auditor to make proper enquiry regarding these matters, besides other matters and if he is satisfied, it is not necessary to disclose this fact in his report. However, on enquiry, if he finds some adverse features, it is his duty to report the same. Specific enquiries to be made by the auditor under this sub-Section are as under:

a) Loans and Advances made by the Company Auditor shall inquire into "whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its members." It is applicable to all loans and advances made on the basis of security. The auditor should verify that the security held against the loans and advances made by the company are legally enforceable and also ascertain the valuation of securities to see whether the loan is fully secured or partly secured.

b) Transactions represented by book entries Auditor is required to inquire "whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company". He should verify the all book entry transactions and determine whether such transactions have actually taken place and are not prejudicial to the interest of the company.

c) Sale of investments Auditor should inquire, "whether so much of the assets of the company (except an investment company or a banking company) as consists of shares, debentures and other securities, have been sold at a price less than that at which they were purchased by the company". Auditor must verify the cases where securities are sold at a price less than their cost of acquisition and if he finds that such sale is bona fide Audit and Auditors 11 and the price realised is considered to be reasonable, having regards to the circumstances of each case, no further reporting is required.

d) Loans and Advances shown as deposits Auditor must verify "whether loans and advances made by the company have been shown as deposits". The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.

e) Charging of Personal expenses to revenue account Auditor should inquire as to "whether personal expenses have been charged to revenue account". Auditor must ensure that no personal expenses of directors and officers of the company have been charged to revenue account.

f) Allotment of shares for cash Auditor should inquire as to "whether cash has actually been received in respect of shares stated to have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading". In this connection, auditor must ensure in respect of shares allotted in cash by the company that cash has actually been received in respect of such allotment by the company. He should verify and report the cases where cash was not received and that the position, as stated in books of accounts and balance sheet, is correct, regular and not misleading. Auditor will have access to books of accounts and vouchers, not only to those kept at registered office of the company but also to those kept at any other place. Such access shall be available at all times. Also, auditor of a holding company shall have access to the books of all of its subsidiary companies for the purpose of consolidation of financial statements of holding company and its subsidiaries.

3.2.5.2 Duties of an Auditor:

The duties of an auditor have been laid down by the Companies Act, 2013, provided in Section 143. The Act explains the duties in a simplified manner, although the list given is not exhaustive.

Prepare Audit Report

- An audit report, in simple terms, is an appraisal of a business's financial position. The auditor is responsible for preparing an audit report based on the financial statements of the company. The books of accounts so examined by him should be maintained in accordance with the relevant laws.

- He must ensure that the financial statements comply with the relevant provisions of the Companies Act 2013, relevant Accounting Standards etc.
- In addition to this, it is imperative that he ensures that the entity's financial statements depict a true and fair view of the company's financial position.

Form an Opinion : Positive of Negative:

The auditor's report has a high degree of assurance and reliability because it contains the auditor's opinion on the financial statements. Where the auditor feels that the statements do not depict a true and fair view of the financial position of the business, he is also entitled to form an adverse opinion on the same. Additionally, where he finds that he is dissatisfied with the information provided and finds that he cannot express a proper opinion on the statements, he will issue a disclaimer of opinion. A disclaimer of opinion basically indicates that due to the lack of information available, the financial status of the entity cannot be determined. However, it is to be noted that the reasons for such negative opinion is also to be specified in the report.

Make Inquiries

One of the auditor's important duties is to make inquiries, as and when he finds it necessary. A few of the inquiries include:-

- Whether loans and advances made on the basis of security are properly secured and the terms relating to the same are fair
- Whether any personal expenses (expenses not associated with the business) are charged to the Revenue Account
- Where loans and advances are made, they are shown as deposits. d. Whether the financial statements comply with the relevant accounting standards

Assist in Branch Audit:

Where the auditor is the branch auditor and not the auditor of the company, he will lend assistance in the completion of the branch audit. He shall prepare a report based on the accounts of the branch as examined by him and then send it across to the company auditor. The company auditor will then incorporate this report into the main audit report of the company. In addition to this, on request, if he wishes to, he may provide excerpts of his working papers to the company auditor to aid in the audit.

Comply All Auditing Standards:

The Auditing Standards are issued by the Central Government in consultation with the National Financial Reporting Authority. These standards aid the auditor in performing his audit duties with relevant ease and accuracy. It is the duty of the auditor to comply with the standards while performing his duties as this increases his efficiency comparatively.

Report Fraud, if any:

Generally, in the course of performing his duties, the auditor may have certain suspicions with regard to fraud that's taking place within the company, certain situations where the financial statements and the figures contained therein don't quite add up. When he finds himself to be in such situations, he will have to report the matter to the Central Government immediately and in the manner prescribed by the Act.

Professional Ethics and Code of Conduct :

The auditor, being a professional, must adhere to the Code of Ethics and the Code of Professional Conduct. Part of this involves confidentiality and due care in the performance of his duties. Another important requisite is professional scepticism. In simple words, the auditor must have a questioning mind, must be alert to possible mishaps, errors and frauds in the financial statements.

Assistance in Investigation:

In the case where the company is under the scope of an investigation, it is the duty of the auditor to provide assistance to the officers as required for the same. Hence, it can be seen that the duties of the auditor are pretty diverse, it has an all-round and far-reaching impact. The level of assurance provided by a set of audited financial statements is comparatively far higher as compared to regular unaudited financial statements.

3.2.6 Branch Audit and Joint Audit

Branch Audit : Accounts of branch office can be audited by :

1. The company's auditor; or

2. Any other person, qualified to be and appointed as an auditor as per the provisions of the Act as branch auditor; or
3. In case of foreign branch, by the company's auditor or by an accountant or a competent person appointed in accordance with the prevailing laws of the foreign country.

The branch auditor shall prepare a report on the accounts of the branch examined by him and the company's auditor shall deal with such report in his audit report in a manner as he considers necessary.

Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.:

1. The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143 i.e. right of access to books of accounts, ensure about the mandatory books of accounts maintained, prepare auditors' report and state the reasons of qualification in report, if any etc .
2. The branch auditor shall submit his report to the company's auditor.
3. The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Joint Audit : A joint audit is an audit of financial statements of an entity by two or more auditors appointed with the objective of issuing the audit report. Such auditors are described as joint auditors. The engagement partner and other key members of the engagement team from each of the joint auditors shall be involved in planning the audit. The joint auditors shall jointly establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Prior to the commencement of the audit, the joint auditors shall discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors shall:

a. Identify division of audit areas and common audit areas amongst the joint auditors that define the scope of the work of each joint auditor;
b. Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

c. Consider and communicate among all joint auditors the factors that, in their professional judgment, are significant in directing the engagement team's efforts;

d. Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other or similar engagements performed earlier by the respective engagement partner(s) for the entity is relevant.

e. Ascertain the nature, timing and extent of resources necessary to perform the engagement.

At this stage, risks of material misstatement need to be considered and assessed by each of the joint auditors and shall be communicated to other joint auditors, and documented, whether pertaining to the overall financial statements level or to the area of allocation among the other joint auditors. The joint auditors shall discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. The joint auditors shall obtain common engagement letter and common management representation letter. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Responsibility and Co-ordination among Joint Auditors : In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures. All the joint auditors shall be jointly and severally responsible for:

a. the audit work which is not divided among the joint auditors and is carried out by all joint auditors;

b. decisions taken by all the joint auditors under audit planning in respect of common audit areas concerning the nature, timing and extent of the audit procedures to be performed by each of the joint auditors.

c. matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

d. examining that the financial statements of the entity comply with the requirements of the relevant statutes;

e. presentation and disclosure of the financial statements as required by the applicable financial reporting framework;

f. ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI.

Where, in the course of the audit, a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

Standard on Auditing (SA) 299 (Revised) : It shall be the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the areas of work allocated to said joint auditor. It is the individual responsibility of each joint auditor to study and evaluate the prevailing system of internal control and assessment of risk relating to the areas of work allocated to said joint auditor.

3.2.7 Reporting Requirements under the Companies Act, 2013 including CARO

Section 143 (2) prescribed that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company. The Audit report should take into consideration the provisions of this Act, the Accounting and Auditing standards and matters which are required under this Act or rules made there under or under any order made u/s 143(11). The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company's affair as at the end of the financial year and the profit or loss and the cash flow for the year and such other matters as may be prescribed. Section 143 (3) laid down that auditor's report shall also state other details which are as under:

(a) whether he has sought and obtained all the information and explanations which were necessary and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the branch audit report prepared by a person other than the company's auditor has been sent to him;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as director under section 164 (2);

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) Rule 11 prescribed that Auditor's Report shall also include their views and comments on the following matters, namely:- (i) whether the company has disclosed the impact, if any, Audit and Auditors 13 of pending litigations on its financial position in its financial statement; (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts; (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company. The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. {Section 143 (4)}

An auditor conducts an independent examination of the accounting information presented by the business and issues a report there on. An auditor's report is the formal statement of the auditor's opinion of the financial statements after conducting an audit. Audit opinions are classified as follows:

1. **Unqualified opinion :** This opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity, in conformity with generally accepted accounting principles.
2. **Qualified opinion :** A qualified opinion states that, except for the effects of the matter(s) to which the qualification relates, the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity, in conformity with generally accepted accounting principles.
3. **Adverse opinion :** This opinion states that the financial statements do not present fairly the financial position, results of operations, and cash flows of the entity, in conformity with generally accepted accounting principles.
4. **Disclaimer of opinion :** A disclaimer of opinion states that the auditor does not express opinion on the financial statements. A disclaimer of opinion is rendered when the auditor has not performed an audit sufficient in scope to form an opinion.

The typical unqualified (or clean) opinion has three paragraphs. The first paragraph indicates the financial statements that have been audited and states that these statements are the responsibility of the company's management. This paragraph indicates that the auditors have the responsibility to express an opinion on these statements based on the audit or to disclaim an opinion.

The second paragraph indicates that the audit has been conducted in accordance with generally accepted auditing standards. Auditing standards define the required level of audit quality. These standards are classified as to "general standards," "field work standards," and "reporting standards." The paragraph goes on to state that these standards require the audit or to plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. The second paragraph also includes a brief description of what is included in an audit. Further, following description should be given as per the sequence.

Heading	Brief of contents
Title	Title should mention that it is an 'Auditor's Report'.
Addressee	Should mention clearly as to whom the report is being given to.

	For example 'Members' / Shareholders of …..Ltd.
Management's Responsibility for Financial Statements	It should be clearly mentioned that it is the Management's responsibility to Prepare the Financial Statements of the company and auditors duty is to give his opinion on these statement.
Auditor's Responsibility	Mention that responsibility of the Auditor is to express an unbiased opinion on the financial statements and issue an audit report.
Opinion	Should mention the overall impression obtained from the audit of financial statements of the organisation where audit is conducted.
Basis of the Opinion	State the basis on which the opinion as reported has been achieved. Facts of the basis should be mentioned.
Other Reporting Responsibility	If any other reporting responsibility exists, the same should be mentioned. For example Report on Legal or Regulatory requirements
Signature of the Auditor	The auditor shall sign the audit report. In case of firm of auditors, working partner has to sing the report. The seal and membership number shall also be part of the report just below the signature.
Place of Signature	The city in which audit report is signed.
Date of Audit Report	Date on which the audit report is signed.

The third paragraph gives an opinion on the statements - that they are in conformity with GAAP. In certain circumstances, an unqualified opinion on the financial statements may require that the auditor add an explanatory paragraph after the opinion paragraph. In this paragraph, the auditor may express agreement with a departure from a designated principle, describe a material uncertainty, describe a change in accounting principle, or express doubt as to the ability of the entity to continue as a going concern. An explanatory paragraph may also be added to emphasize a matter.

Audit Report is a document used by the Auditors to express their opinion on the financial statements they have audited. Auditors' opinion is that financial statements give (or not give) true and fair view at a specific date

For any enterprise, the audit report is a key deliverable which shows the end results of the entire audit process. The users of financial statements like Investors, Lenders, Customers, and others base their decisions and plans on audit reports of any enterprise. An audit report is always critical to influencing the perceived value of any financial statement's audit.

The auditor should be careful in issuing the audit report as there is are a large number of people placing reliance on such report and taking decisions accordingly. The report should be issued by being unbiased and objective in discharging the functions.

Reporting Requirements under the Companies Audit Report Order (CARO)

Ministry of Corporate Affairs (MCA) notifies Companies (Auditor's Report) Order, 2020 (CARO 2020) which is applicable for audit of financial statements of eligible companies for the financial years commencing on or after the 1st April, 2020. The auditor is required to report under this order for all class or classes of companies, except for exempted companies, on the matters specified in the CARO 2016.

Companies (Auditor's Report) Order, 2020 shall be made applicable from the financial year 2020- 2021 instead of from 2019-2020 notified earlier. CARO, 2020 shall be applicable to all those companies on which CARO, 2016 was applicable. These companies are as follows:

Every Public Company and Foreign Company as defined in Section 2(42) of the Companies Act,2013 except Banking company , Insurance company, Company licensed to operate under section 8 of the Companies Act,2013, One Person Company, Small company (Companies with Paid up capital less than or equal to Rs. 50 Lakhs and Last reported turnover less than or equal to Rs. 2 Crores), Private limited company, not being a subsidiary or holding company of a public company.

Following 21 clauses have to be reported under CARO, 2020.

i) Reporting requirements on:

Property, Plant, Equipment and intangible assets only.

Revaluation of Property, Plant, Equipment including rights of use assets or intangible assets.

ii) Proceedings under the Benami Transactions (Prohibition) Act, 1988 and disclosure in financial statements.

iii) Physical verification of inventory at reasonable interval by management and the Opinion of the auditor on the coverage and procedure of such verification.

iv) The material discrepancies of 10% or more noticed if any.

v) Compliances if company was sanctioned working capital limits in excess of five crore rupees or more from banks or financial institutions.

vi) Reporting requirements of investments in or providing of any guarantee or security or granting any loans or advances to companies, firms, Limited Liability Partnerships or any other parties.

vii) Reporting requirement on the compliances of provisions of section 185 and 186 of the companies Act, 2013 in respect of loans, investments, guarantees and security.

viii) Reporting of compliances with RBI directives and the provisions the Companies Act with respect to deposits or deemed deposits.

ix) Reporting requirements of Maintenance of Cost Record.

x) Reporting requirement on statutory dues.

xi) Reporting requirements with respect to transactions not recorded in the books of account surrendered or disclosed as income in the income tax proceedings.

xii) Reporting requirements on Default in repayment of loans or other borrowing or interest thereon, Declared as will defaulter by bank / financial institution / other lender, Utilization of term loan for the purposes for which term loan has been raised, Fund raised on short term basis have been used for loan term purposes, Funds taken by the company to meet obligation if its subsidiaries, associates or joint ventures, Loans raised on the pledge of securities held in its subsidiaries, associates, joint ventures.

xiii) Reporting requirement on Utilization of money raised by way of IPO or further public offer for the purposes for which money has been raised, Preferential allotment or private equity placement of shares or fully or partly convertible debentures and compliance of section 42 of Companies Act, 2013.

xiv) Reporting requirement on Notice of fraud by / on the company, Report u/s 143(12) filed by the auditors in Form ADT-4, Treatment by auditor of whistle-blower complaints received during the year by the company

xv) Reporting requirements on Net Owned Funds to Deposits of Nidhi Company in the ratio of 1:20 and maintaining of 10% unencumbered terms deposits as per Nidhi Rules 2014 and for default in the payment of interest on deposits or repayments thereof for any period.

xvi) Reporting requirements on transaction with related parties

xvii) Reporting requirements on non-cash transaction with director or person connected with him

xviii) Reporting requirement of Registration u/s 45IA of the Reserve Bank of India Act, 1934, NBFC activities without valid certificate of registration, Fulfilling the criteria of Core Investment Company (CIC), Number of CICs which are part of group

xix) Reporting on cash losses and reporting on resignation of the statutory auditors

xx) Reporting on uncertainty of company capable of meeting its liabilities

xxi) Reporting requirements on transfer of unspent CSR amount to Fund specified in Schedule VII Reporting requirements on qualifications or adverse remarks by the auditors in the CARO reports of companies included in the consolidated financial statements

CARO 2020 comes with more details and disclosures and obviously, more compliance would be called for at the end of the company. The Chief Financial Officer being an internal person in the company, has the responsibility towards presenting the financial statements truly and fairly which are subsequently audited by the statutory auditors of the Company. Obviously, the financial statements need to comply with adhering the mandated accounting standards and also ensuring the disclosure which are called for including disclosure of significant accounting policies of the company in the financial statements. Therefore the Chief Financial Officer has a greater responsibility to ensure the required increased disclosure as per CARO 2020 along with required compliance.

3.3 Summary

This unit describes some of the important aspects in audit of companies. It describes about eligibility, qualifications and disqualifications of auditor. The provisions of the Companies Act, 2013 relating to appointment of auditor have also been discussed in the act. The appointment is closely associated with the aspects like remuneration and removal and as such these provisions are also mentioned. Powers and duties are the two sides of a coin which auditor has to consider in the course of audit. These are discussed at length in this unit. The provisions regarding reporting requirement and particularly the recent announcement in Company's Audit Report Order, 2020 (CARO) are also important to be known before an auditis started. Thus, this unit focusses on the important aspect about company audit. An auditor as well as a company must have knowledge of these provisions as auditor and management of the company have to report on the various aspects associated with these provisions.

3.4 Key words :

Audit, Appointment, Removal, Eligibility, Qualification, Disqualification, Remuneration, Reporting, Financial Statements

3.5 Check your progress

A) Choose the correct alternative from the alternatives given below

i) An auditor of a company is appointed in ……………

a) Board Meeting c) Annual General Meeting

b) Creditors Meeting d) All of the above

ii) Auditor of a company is disqualified if he/she is……………………

a) Indebted to the company c) is aofficer of employee

b) Is a partner of any director of company d) all of the above

iii) Powers and duties of auditor are mentioned in …………of companies act.

a) Section 143 c) Section 142

b) Section 149 d) Section 226

iv) Companies Audit Report Order (CARO), 2020 replaces……………

a) CARO, 2016 b) CARO, 1956

c) CARO, 2013 d) CARO, 1991

v) Audit report of a company is addressed to …………..

a) The shareholders b) the Board of Director

c) the Chairman d) the Company Secretary

B) State whether the following statements are true or false

i) Audit is done only for detection of frauds and errors in accounts and financial statements.

ii) Remuneration of auditor is decided by the board of directors of the company.

iii) Once appointed, the auditor can not be removed from his office.

iv) Companies Audit Report Order (CARO) is mostly applicable to the manufacturing companies.

v) The scope of branch audit is restricted to the branch only.

vi) Liability of joint auditors is limited to the work done by respective auditor.

3.6 Questions for Self-Study

1. Explain the provisions of appointment of an auditor of a company.
2. Explain the qualifications, disqualifications and eligibility of company auditor.
3. Discuss the provisions about remuneration and removal of auditor.
4. What are the duties and powers of a company auditor?
5. Explain the applicability of Companies Audit Report Order (CARO), 2020.
6. What are the points to be reported under CARO, 2020?
7. Explain the scope of joint audit and branch audit.
8. Explain the contents and features of an audit report.
9. Explain the types of audit report. What are contents of audit report?

Answers to check you progress:

A) i.c, ii.d, iii.a, iv.a, v.a

B) i.False, ii. False, iii.False, iv. True, v. True, vi. False

3.7 References for Further Reading

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Unit-4

Special Audit & Audit Report

Structure of Unit

4. SPECIAL AUDIT

Objectives :-

Understand the concept of Special Audit & Audit Report

Explain the different entities audit which are covered under Special Audit. Explain elements of Audit Report & types of Audit Report.

4.2.1 An audit other than the annual audit of accounts of the company required to be carried at under of the Companies Act 2013 special circumstances, is known as Special Audit. Section 233 A empowers the Central Government in certain cases, to call for a 'special audit' of a company. It can be seen that this type of audit is mainly initiated by a third party, like a Government agency or the tax authority. Special audit is mostly needed when some abnormal behavior is suspected within the organization.

★ **The Need For Special Audit:-**

Special audit is mostly needed when some abnormal behavior is suspected within the organization. Mostly, they are called when it is suspected that the laws and regulations have been overlooked pertaining to finance, or financial management within the organization. However, they are not only restricted to cases pertaining to fraud.

It can also be conducted when there is other institutional violation are observed include pertaining to duties, authorization, internal controls procedures or responsibilities of the senior management etc. In the same manner special audit can also be related to corporate governance or bankruptcy.

4.2.2 Scope of Special audit:-

As mentioned earlier it can be seen that a special audit is conducted out of routine, with a specific or a routine purpose. However, these special purposes are quite varied in nature, and the overall outcomes based out of those special audits.

★ **Compliance Audit :-**

This is mainly conducted when there is a need to examine whether depend upon the purpose for which it is carried out. The policies and procedure to be followed are in respect with internal and regulatory standard.

★ **Construction Audit :-**

This analyzes the costs that occur for a given construction project. In the same manner, this also tracks down actual amount that is paid to the contractor, suppliers and other reimbursements that take place in this regard.

★ **Information System Audit :-**

Information system audit is mainly conducted when there is a need to review the overall control present in software development. Additionally, it also involves a review of control regarding software development, data processing and the overall access to the computer system.

★ **Investigative Audit :-**

Investigative audit takes places when there is need to find details of a specific event or an incident within the company that was suspicious.

★ **Tax Audit :-**

This audit is mainly initiated to analyze the overall tax returns that are submitted by an individual or a business entity. The main rationale is to see if the paid tax is actually valid and correct as per the prevailing tax regulations.

4.2.3 Special Auditor :-

★ **Powers and Duties of Special Auditor :-**

The auditor so appointed shall have the same powers and duties in the of the Companies Act 2013 of special audits as the statutory auditor of a company has under section 227, except for the fact that he must report to the Central Government in place of the members of the company.

The Audit may be conducted either by the company auditor or a Chartered Accountant who may or may not be engaged in practice, appointed by the Central Government section u/s 233(1) and (2) of the Companies Act 2013.

★ **Report :-**

On receipt of the report, the Central Government may take necessary action under companies Act 2013 or any other laws.

If no action is taken within four months from the receipt of the report the Central Government must send a complete copy of the report or the relevant extract from it and direct the copy or extract among the members or to led it in the general meeting (section 233A (6) of the Companies Act 2013)

★ **Remuneration and its Recovery:-**

The expenses incidental to a special audit, including the remuneration of the special auditor are fixed by the Central Government.

If the company default in making the payment the amount can be recovered from the company as arrears of a land revenue (section 233A (6) of the Companies Act 2013)

4.2.4 AUDIT OF BANK:-

A bank audit is a routine procedure designed to review the services of financial institutions to ensure that they are in compliance with the laws and industry standards. Its purpose is to discover if the institution's financial activities are accurate, legitimate, and complete. It's primary goal is to provide an independent evaluation of the systems, findings are generated, and auditors recommend corrective actions that the bank needs to take. Auditor will begin his work by carrying out a thorough verification of the assets and liabilities of the banking company. Points to which he must pay his special attention in the performance of this work with regard to each individual asset and liability are discussed below: -

1. Cash in hand / with other banks :-

Auditor will verify cash in hand or bullion by actually the cash & the bullion counting or weighing. He will compare and tally the balance with the Cash Book, the Day Book. Balances with the State Bank or other bank shall be verified & reconciliation statement's for explaining the discrepancies.

2. Investments :-

Auditor shall obtain a list of the investments of the bank. He shall verify these investments at the close of the year by carrying out an actual inspection of the scripts or other documentary evidences available with the bank. He must take utmost care to see that the same investments are not shown to him twice and also that they are valued as per regulations.

3. Advances, Overdrafts, Loans and Cash Credits :-

Auditor shall obtain a schedule of all loans, advances, cash credits and overdrafts etc from the bank and then proceed to verify them with the balances of respective ledger's. The totals will be compared and checked up with the respective total accounts maintained in the general ledger.

The responsibilities of the auditor with regards to the verification of loans and advances etc are very heavy. He will have to pay special attention with regard to the different kinds of advances such as: a) Advances against government securities; b) Advances against stock in trade; c) Advances against properties; d) Advances against Life insurance policies; e) Advances against fixed deposits; f) Advances against bullion.

4. Bills Discounted and Purchased :-

Auditor will verify bills discounted and purchased as recorded in the books with those which are in the actual possession of the bank. He must see that the limits fixed by the Board of Directors have not been exceeded and that the total of the Bills Discounted Ledger agrees with the balance of the control account in the General Ledger. He will examine the date of maturity of each bill in order to verify the amount of overdue bills.

5. Contra Accounts :-

Usually, they relate to the following types of accounts (a) Bills for collection (b) acceptances, guarantees, and letters of credit etc, opened on behalf of the customers. These items appear on both sides of the balance sheet as they constitute both the assets and liabilities of the bank.

6. Branch adjustments :-

This item discloses the combined effect of the differences in the inter-branch balances. Auditor shall verify this item from the certificates of balances received from branches preparing reconciliation statement.

7. Other Assets :-

Other assets of the bank shall include premises, furniture and fixtures, stock of stationary, interest accrued on investments etc. Auditor shall examine the title deeds or any other type of documentary evidence in order to ascertain that the assets of the bank, on the date of the Balance Sheet, do exist in the name of the bank and that they have been properly valued.

8. Other Liabilities:-

Important items which usually appear on the liabilities side of the Balance Sheet of a bank are the customer's deposits, borrowings from other banks or agents etc, bills payable, branch adjustments, liabilities for outstanding expenses and contingent liabilities etc. Auditor will try to check-up the understatement or overstatement of liabilities.

4.2.5 AUDIT OF INSURANCE COMPANY:-

The Insurance auditors shall examine policy and liability procedures, risk valuation, tax documents, and various other financial record of insurance. It is to ensure that proper insurance rates and premiums are implemented and regulators laws are being followed by insurance companies. Claims and commission are also the core areas to verify during the course of insurance audits. In Addition to these responsibilities, insurance auditors might be expected to maintain quality control between insurance companies and policyholders.

1. Vouch the premiums received with the copies of insurance policies, cover notes or premium receipts.
2. Interest and dividends are to be checked.
3. The Claims paid or payable by the company to be checked.
4. Commission payments should be vouched.
5. Management Expenses should be examined.
6. All the reinsurance in detail should be checked.
7. Scrutinize carefully the outstanding branch and agency balances to determine that they are recoverable.
8. All the investments made and cash balanced should be verified.
9. She that the sufficient amount has been set aside as reserve for unexpired risks.
10. Make sure that all the contingent liabilities are ascertained and provided for.
11. Make sure that the code of conduct has been duly observed as it is required to be observed by the insurance companies in India.

12. She that the annual accounts of insurer have been prepared in accordance with the prescribed forms and regulaions.

4.2.6 AUDIT OF CHARITABLE TRUST :-

A charitable society is performing its operation for rendering social services. Its main sources of revenue are donations and legacies. The objective of audit of this type of society is to ensure that its revenue is being utilized for the purpose for which the society has been established and it is being operated in conformity with its rules and regulations.

The auditor should pay attention to the following points, while auditing the accounts of a charitable institution:

1. Study of the constitution:-

Studying the constitution under which the charitable institution has been set up. It may be registered as a society under the Societies Registration Act, 1860, as a company limited by guarantee or as a trust. It the charitable Institution is a public trust, then the provision of the state legislation, if any, affecting its accounts and audit should be taken into account.

2. Examination of activities:-

Verifying whether the institution is being managed in the manner completed by the law under which it has been set up.

3. Review of internal control system:-

The internal control system regarding the cash receipts and cash disbursement should be reviewed.

4. Inspection of the minute book:-

The auditor should inspect the minute book of the meetings of the Managing Committee and identify the resolutions having bearing on accounts and audit.

5. Interest and dividend:-

Interest and dividend from the deposits and investment should be checked with the relevant vouchers. In addition to that, the interest on such deposits and dividend, either ex-dividend or cum- dividend should be checked to see whether these are recorded properly in the books of accounts.

6. Rent and other income from house property:-

Rent and other income from house properties of the institution should be checked with the help of counterfoils of receipts and other relevant documents.

7. Receipts from charity show etc.:-

Receipts from charity shows or other special function should be checked with the counterpart of the tickets sold, statement of cash collection and entries in the cash book.

8. Distinction between capital and revenue expenditure:-

The auditor should see that proper distinction has been made in the accounts between capital expenditure and revenue expenditure.

9. Grants made by the institution:-

Grants made by the institution constitute the major expenses of the institution. So, the auditor should pay special attention to check these payments. The auditor should ensure himself that all grants have been made for admissible purpose and they are properly authorized.

10. Purchase and sale of assets and investments:-

Purchase and sale of movable as well as immovable properties and investments should be verified with the help of relevant documents. The auditor should assure himself about their existence through physical verification at a particular point of time.

11. Verification of assets and liabilities:-

The auditor should verify all assets and liabilities with the help of relevant documents. He would confirm about their physical existence either through physical verification or through confirmation from the concerned parties.

12. Utilization of fund:-

In this type of organization, different types of funds are created for certain specific purposes. The auditor should ensure the proper utilization of these funds for the purpose specified is being done.

13. Taxability of income:-

The auditor should see whether the income of the institution is exempt from income tax according to the provisions of section 11 of the Income Tax Act, 1961, and if so, whether refund of income tax deducted at source (TDS) from interest income, if any, has been claimed from the tax authority.

14. True and fair view:-

The auditor should examine the financial statement and see whether they give a true and fair view of the surplus or deficit and of the state of affair of the institution.

4.2.7 AUDIT OF HOTEL:-

The business of running a hotel is very much dissimilar to running of any other organizations. It is a service-oriented business and may have some element of production of foodstuff and sales thereof. However, this business is characterized by handling of liquid cash, stocking and providing a large variety of items, keeping watch on customers to ensure that satisfactory services being provided to them, etc.

In view of these, following matters should be considered by the auditor in auditing hotel businesses:

1. Internal control:-

The internal control system of the hotel should be reviewed first. The auditor should ensure himself that effective internal control is in operation and for this purpose, he should evaluate the following:

a. Effectiveness of arrangement regarding receipts and disbursement of cash.

b. Purchase procedure and stocking of various commodities and provisions.

c. Billing procedure for the customers.

2. Cash collection :-

Control of cash assumes great importance in any hotel. The auditor should reconcile the total sales reported with the total bills issued. Billing may be done room – wise as well as customer wise. The auditor should see that there exists numerical control over the bills which are included in the total.

3. Stocks:-

The stock in any hotel is both portable and saleable particularly the food and beverage stock. It is, therefore, extremely important that all movements and transfer of such stocks should be properly documented. Control over stocks can be imposed from the point of two directions-

a. Control over movements: The area where stocks are kept should be locked under the supervision of the departmental manager. The auditor should see that the movements of goods in or out of the store take place only after proper authorization and recording.

b. Control over valuation: Although valuation of stocks is made by the experts appointed by the management, it is important that the auditor satisfies himself that the amount included for such stocks are reasonable. The auditor can also attend at the physical stocktaking and check certain pricing calculations.

4. Fixed assets :-

The accounting of fixed assets is likely to differ from hotel to hotel. Certain hotels may consider its utensils as a stock item while others may treat it as fixed assets. A comprehensive definition of the stock should be there and the auditor should see whether the same has been clearly followed or not. Regarding auditing of fixed assets, the auditor should ensure that –

a. All the fixed assets are physically verified and properly valued at the end of the accounting period, and

b. Adequate provisions have been made for depreciation on all fixed assets for the accounting year.

5. Compliance with statutory provisions:-

A number of statutory provisions are required to be complied with in running a hotel business. All types of hotels are governed by various rules and regulations by different authorities, which include the following:

a. Foreign exchange regulatory authority: In Large hotels, it is very common to have facility of exchanging foreign currency into Indian Rupees. There are provisions for foreign exchange transactions.

b. Department of tourism: The Department of Tourism also prescribes various conditions to be fulfilled by the hotels.

c. Local authority: Approval of the local authority and license are required for running hotel business. The auditor should see that various applicable regulation and conditions are duly complied with by the hotel.

6. Dealings with travelling agents :-

It is very common that the hotels get their booking through travel agents or other booking agencies. The auditor should ensure that money is recovered from travel agents as per the terms of credit allowed. Commission, if any, paid to travel agents should be checked by reference to the agreement on that behalf.

7. Vouching the receipts and expenses :-

The auditor should vouch all receipts and expenses with reference to the entries in the cash book with the help of documentary evidence. He should pay special attention to the following points:

a. Consumption shown in various physical stock accounts may be traced to customer's bill on a sampling basis, whether practicable to ensure that all issues have been billed or accounted for.

b. All Payments made to foreign collaborator, if any, are in accordance with the terms of agreement.

c. Expenses and receipts may be compared with the figures of the previous year having regard to the average occupancy of visitors and changes in the rates.

d. Special receipts on account of letting out of the auditorium space and other spaces for shops and for special exhibitions, etc. should be verified with reference to the respective agreements.

e. Customer's ledger should be examined on a sample basis but in depth to check that all charges that should be made to the customers are in fact made.

f. Proper reserves are required to be maintained for redecoration and renovation of building and other structural facilities.

8. Other Points :-

In addition to the above important points regarding the working of the hotel, the auditor should also take into consideration the following points:

a. Taxability of Income: The auditor should check the assessment of tax aspect of the hotel in order to verify whether the tax return is submitted by the hotel on a regular basis along with the amount of tax.

b. Deposit of sales and entertainment tax: The auditor should examine whether the sales and entertainment tax collected by the hotel is duly deposited to the proper authorities within the prescribed time limit.

c. True and fair view: The auditor should also see whether the financial statements give a true and fair view of the profit or loss and of the balance sheet of the hotel for the accounting period.

4.2.8 AUDIT OF HOSPITALS :-

The hospital are usually established with the fund provided by the government, local authorities, municipalities and similar other type of funds. On the basis of ownership, hospitals can be government hospital or private hospital or a joint venture of public – private partnership. As the nature of activities of a hospital is totally different from that of other organization or institutions, the audit programmed to be followed for conducting audit of these types of organization will also differ.

1. Legal Status:-

The auditor should see relevant documents to ascertain the legal status of the hospital. He should examine the constitution of the management and provisions affecting annual accounts for consideration of auditing technique to be used.

2. Inspection of the minute book:-

If there is a managing committee or a governing body, the auditor should go through the minutes of their meetings in order to note the decision concerning financial matters, especially, engagement of staff, acquisition and sale of fixed assets and investments, delegation of authority regarding expenditure, etc. and to see that the resolutions affecting accounts have been duly complied with.

3. Internal check system:-

The auditor should examine the internal check as regards to the issue and receipts of stores, linen, apparatus, clothing, instruments, etc. so as to ensure that purchase has been properly recorded in the stock register and that issues have been made only against proper authorization.

4. Examination of activities:-

The activities of the hospital should be identified and the auditor should ensure himself that all the activities as decided to be undertaken are being actually performed by the hospital.

5. Cash Collection:-

The auditor should check the cash collections as entered in the cash book, with the receipt counterfoils and other evidence. He should also check the bill registers of patients to see that the bills have been correctly prepared.

6. Free bed facility: -

He should see that bills have been issued to all patients from whom any amount was recoverable according to the rules of the hospital. He should also ensure that free bed facilities were extended to the patients only in terms of hospital regulation.

7. Income from property and investments:-

The auditor should refer to the properties and investment registers to see that all income that should have been recovered by way of rent from properties, dividend and interest on securities, etc. have been collected.

8. Legacies and donations :-

He should also ascertain that legacies and donations received for a specific purpose have been so utilized.

9. Grants received:-

The auditor should verify that the grants received, if any, have been duly accounted for. He should also ensure that the refund in respect of taxes deducted has been claimed.

10. Income from other sources:-

The auditor should verify the income of the hospital from any other sources, with reference to the source of income, e.g., X- rays lab, blood testing lab, etc.

11. Distinction between capital and revenue expenditure:-

The auditor should see that proper distinction has been made in the accounts between capital expenditure and revenue expenditure.

12. Purchase and sale of assets:-

Purchase and sale of movable as well as immovable properties Should be verified with the help of relevant documents.

The auditor should assure himself about their existence through physical verification at a particular point of time.

13. Vouching of expenses:-

The auditor should vouch all the expenses including the capital expenditure. He should verify that the capital expenditure has been incurred only with the prior sanction of the Managing Committee.

14. Depreciation on fixed assets:-

He should see that depreciation at appropriate rates has been written off against all the fixed assets.

15. Verification of assets and liabilities:-

The auditor should see that all fixed assets have been acquired under proper authority and that proper registers are maintained to record their particulars. He should also confirm about their physical existence either through physical verification or through confirmation from the concerned parties.

16. Stock-in-trade:-

The auditor should obtain inventories of stocks and stores at the end of the year and check a percentage of them physically. He should also verify stock register in respect of stock and stores such as medicines, test tubes, cleaning materials, etc. and see that the management has carried out a periodical inspection of all such store items.

17. Taxability of income:-

The auditor should see whether the income of the hospital is exempt from income tax according to the provision of the Income Tax Act, 1961, and if so, whether refund of TDS, if any, has been claimed from the tax authority.

18. True and Fair view:-

The auditor should examine the financial statement and see whether they give a true and fair view of the financial results as well as of the financial position of the hospital.

★ **Multiple Choice Questions:-**

1. Which of the following item does not form a part of liability side of balance sheet of bank:

   a. Customer's deposits

   b. Borrowing from another bank

c. Advances against properties

d. Bills payable

2. Auditor should pay attention towards different kinds of advances:

   a. Advances against Government Securities

   b. Advances against Stock – in- trade

   c. Advances against Life Policies

   d. All of the above

3. Contra account relates to following type of account:

   a. Bill for collection

   b. Acceptance, guarantees and letter of credit

   c. Only b

   d. Both a and b

4. Main source of revenue of Charitable Trust are

   a. Donations

   b. Legacies

   c. Both a and b

   d. Only a

5. On the basis of ownership, types of hospital can be:

   a. Government hospital

   b. Joint venture of public or private partnership

   c. Private hospital

   d. All of the above

4.3 AUDIT REPORT :-

The audit report is the report that contains the auditor's opinion which is issued by independent auditor after their examination on the entity's financial statement, and related reports. Those including financial statement, management account, management report or other report like compliant report.

4.3.1 Elements of Audit Report:-

As prescribed in Standard on Auditing -700, the auditor's report includes the following basic elements, ordinary in the following layouts:

1. **Title :-** The auditor's report should have an appropriate title.
2. **Addressee :-** Generally, the auditor's report is addressed to the authority appointing the auditor.
3. **Opening or introductory paragraph :-** The report should include a statement that the financial statement is the responsibility of the management of the entity and a statement that the responsibility of the auditor is to express an opinion on the financial statement based on the audit. In short, the opening paragraph shall include-
   - **a.** Identification of the financial statements audited, and
   - **b.** a statement of the responsibility of the entity's management and responsibility of the auditor.
4. **Scope paragraph**:- The auditor's report should describe the scope of the audit by stating that the audit was conducted in accordance with auditing standards accepted in India. The report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the financial statement is free from material misstatement. In short, the scoping paragraph shall include:
   - **a.** a reference of the auditing standards generally accepted in India, and
   - **b.** a description of the work performed by the auditor.
5. **Opinion paragraph:-** The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statement give a true and fair view in accordance with that financial reporting framework. In addition to an opinion on true and fair view, the auditor's report may need to include an opinion as to whether the financial statement comply with other requirement specified by relevant statutes or law. In short, the opinion paragraph shall include-
   - **a.** a reference to the financial reporting framework used to prepare the financial statement, and

b. An expression of opinion on the financial statements.

6. **Date of the report:-** The date of report informs the reader that the auditor has considered the effect on the financial statements and on the report of the events and transactions of which the auditor became aware and that occurred up to that date.

7. **Place of signature:-** The report should name specific location, which is ordinarily the city where the audit report is signed.

8. **Auditor's signature:-** The report should be signed by the auditor in his personal name along with the membership number assigned by the Institute. Where the firm is appointed as the auditor, the report should be signed also in the personal name of the auditor and in the name of the audit firm.

4.3.2 Auditors Opinion :-

4.3.2.1 Clean Opinion:-

An unqualified opinion is considered a clean report. This is type of report that auditors give most often. This is also the type of report that most companies expect to receive. An unqualified opinion doesn't include any disclaimer about any clauses or the audit process. This type of a report indicates that the auditors are satisfied with the company's financial reporting. The auditor believes that the company's operations are in good compliances with governance principle and applicable laws. The company, the auditors, the investors and public perceive such report to be free from material misstatement.

4.3.2.2 Qualified opinion: -

When an auditor isn't confident about any specific process or transaction that prevents them from issuing an unqualified or clean report .The auditor may choose to issue a qualified opinion. Investors don't find qualified opinion acceptable, as they project a negative opinion about a company's financial status.

The auditor shall express a qualified opinion when:

I. The auditor having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statement; or

II. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statement of undetected misstatements, if any, could be material but not pervasive.

4.3.2.3 Adverse opinion :-

Auditors who discover a high level of material misstatement or irregularities know that this creates a situation in which investors and government will mistrust the company's financial reports.

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statement.

Auditors adverse opinion is a big red flag. An adverse audit report usually indicates that financial report contains gross misstatement and have potential for fraud.

Auditors use all type of qualified report to alert the public as to the transparency, reliability and accountability of companies.

4.3.2.4 Disclaimer of opinion :-

When an auditor issues a disclaimer of opinion report , it means that they are distancing themselves from providing any opinion at all related to the financial statement, one of the reasons that auditor may issue a disclaimer of opinion is because they felt that the company limited their ability to conduct a thorough auditor they couldn't get satisfactory explanation for their questions.

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, not withstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties it is not possible to form an opinion on the financial statement due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statement.

★ **<u>Multiple choice question</u>**:-

6. Which Standard of Auditing prescribes element of audit report:

   a. 700

   b. 701

   c. 375

   d. 301

7. Clean opinion may also known as:

   a. Adverse opinion

   b. Unqualified opinion

   c. Qualified opinion

   d. Disclaimer of opinion

8. Auditors report is addressed to whom:

   a. Management

   b. Authority appointing the auditor

   c. Third parties

   d. Board of Directors

9. There are how many types of auditor's opinion:

   a. 3

   b. 4

   c. 5

   d. 6

10. Which audit opinion indicates big red flag:

    a. Qualified opinion

    b. Clean opinion

    c. Adverse opinion

    d. Disclaimer of opinion

4.4 Summary :-

Therefore, it can be seen that special audits are mainly conducted in order to investigate a special cause or to justify something that is not normal within the organization.

The main reasoning behind such an audit is to ensure that the overall functioning within the organization is normal, and there are no productivity losses involved.

This greatly helps them to be able to identify relevant area of improvement, where they are able to trace weak link and ensure that they are able to trace weak links and ensure that they are corrected for optimal performance within the organization.

The Purpose of an audit is to enhance the degree of confidence of intended users of the financial statement. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor.

The objectives of the auditor is to form an opinion on the financial statement based on an evaluation of the conclusion drawn from the audit evidence obtained and to express clearly the opinion through a written report. The auditor shall modify the opinion in the auditor’s report when the auditor concludes that, based on the audit evidence obtained, the financial statement as whole are not free from material misstatement; or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

4.5 Terms to Remember :-

- Legacies – Gift that someone leaves to charitable organization in their/his will.
- Constitution- The basic principle and laws
- Legitimate – Confirming to the law or to rules
- Admissible- Acceptable or valid
- Delegation of authority- Process of transferring responsibility for a task to another
- Bankruptcy – unable to repay their outstanding debts

4.6 Answers of Multiple-choice question :-

1. c
2. d
3. d
4. c
5. d
6. a
7. b
8. b
9. b
10. c

4.7 Exercise :-

1. Draft an audit programme for examining the accounts of either a hotel or a hospital.
2. Prepare an audit programme of any one of the following two organizations-
   a. Bank
   b. Insurance Company
3. What are the special points the auditor has to consider in conducting audit in the following institutions?
   a. Charitable Trust
4. What are the elements of the audit report?
5. What is meant by auditor's report?
6. What is a qualified report?
7. How many types of audit report may be submitted by a company auditor and in what circumstances? – Discuss briefly.

4.8 Reference for Further Study :-

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- Advanced Auditing : Study material issued by the ICAI.
- www.icai.org

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Unit-1

Basic Concepts

Structure of Unit

1.0 Objectives

After reading this unit you should be able;

1. To understand the basic introduction of income tax.
2. To know the basic concepts of income tax.
3. To understand Residential status and taxability of an individual and HUF.
4. To determine Residential status of firms and companies

1.1 Introduction

Most of the people while discussing about income; they talk on various issues related to tax. It raises the question in the mind about what is tax? Let we understand the meaning of word "Tax". Many people are unaware about the structure of Tax. Tax is levied as a financial charge by the Government on income, commodity or activity. Generally there are two types of tax which is levied by the Government i.e. Direct tax and Indirect tax.

Direct tax is paid by an assessee to the government directly. The tax is levied on the income of an assessee as per rules of Income Tax Act 1961. Direct tax is a progressive form of tax. In case of Direct tax, taxpayer should bear the burden of tax. Direct Taxes are broadly classified as: Income Tax and Corporate Tax.

Income tax is paid by an individual or HUF or a person or taxpayer other than companies on their income at the prescribed rate as per the tax law. While Corporate tax is paid by the companies or businesses on their profit as per income tax law of India.

Whereas, **Indirect tax** is paid by the person other than the one who utilizes the product or service. Indirect tax includes Custom duty, Goods & Services Tax (GST) etc. The burden of tax is shifted or shouldered to another person. In simple sense, the whole society is the indirect tax payer to the government e.g. service tax on restaurant bills, and movie tickets, GST on purchase or sale of goods and services etc.

1.2 Presentation of Subject Matter

This unit is related to the important basic concepts of Income tax. It is essential to know the terminologies like previous year, assessment year, person, assessee, income, residential status etc. This is the base to compute taxable income from salary, business, profession etc as per Income Tax Act 1961.

1.2.1 Income Tax in India

Income tax was introduced in India for the first time by Sir James Wilson in 1860 in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. After that there were several amendments were made in it from time to time in the year 1886, 1918 and in the year 1922 onwards also as per the requirement of tax policy. The Government of India appointed the Direct Taxes Administration Enquiry Committee who submitted its report in 1956. In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India including Jammu and Kashmir.

Income-tax law in India:

The following important components are included in income tax law in India:

1. Income tax Act
2. Income tax rules
3. Annual Finance Act
4. Circulars, notifications etc
5. Legal decision of courts.

1. Income tax Act:

Income Tax Act was passed in 1961 and brought into force on 1st April, 1962 in India. This Act includes 1 to 298 sections and XIV Schedules. The sections may include sub sections with clauses and /or sub clauses.

2. Income-tax Rules:

The Central Board of Direct Taxes (CBDT) is the authority who looks after the administration of direct taxes. The CBDT frames rules on time to time for smooth functioning of Income Tax Act. These rules are collectively called Income-tax Rules, 1962. Rules may include sub rules, provisions and explanations.

3. Annual Finance Act:

Every year the budget is presented by the Finance Minister of the Government of Indiato the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President of India, it becomes the Finance Act. It contains four parts which specifies:

Part I : the rates of tax applicable for current assessment year.

Part II : rates at which tax is deductibles at source for the current financial year.

Part III : Rates for computation of income tax

Part IV: rules for computing net agriculture income

4. Circulars and Notifications:

The CBDT issues circulars and notifications to sort out the specific problems and to clears the doubts regarding the scope and meaning of the provisions. These circulars are mainly issued for the guidance of the officers and /or assessee.

5. Legal Decisions of Court:

The legal decisions laid by the Supreme Court and High court, are compulsory to all and strictly implemented in the various states of the country.

1.2.1.1 Meaning of Income Tax

Income tax is the basic and major source of revenue to the government. Such revenue is generated by the government from individuals and companies from their income and profits as per the prescribed rate of tax. The collected tax revenue reutilizes and spend on providing amenities to the society by incurring expenses on the government projects like infrastructure, education, health-care, roads, defense etc.

Income tax is compulsory to the person who lies under the categories of income rates under Income Tax Act, 1961. It is mandatory to the taxpayer to pay tax annually by filing the specific income tax returns (ITRs). As per Article 265 in the Constitution of India, the Central and state government levy and collect direct or indirect tax from the society.

1.2.1.2 Basis of Charge(Section 4)

Income-tax Act, 1961 section 4 provides following basis of charge:

i) AS per Annual Finance Act, Tax shall be charged at the prescribed rates for the year.

ii) The charge is on every person specified under section 2(31);

iii) Tax is chargeable on the total earnings during the previous year and not the assessment year.(The sections 172, 174, 174A, 175 and176 have certain exceptions.);

iv) Tax shall be levied as per the provisions included in Income Tax Act.

1.2.1.3 Rates of Tax

The Income Tax Act, 1961 lays down the following rates of tax in case of an individual, Hindu Undivided Family, Association of Persons, Body of individuals, Artificial Judicial Person, Senior citizen, Firm, LLP, Local authority, Co-operative society, Company etc.

1. Individual/ Hindu Undivided Family (HUF)/ Association of Persons (AOP)/ Body of Individuals (BOI)/ Artificial Juridical Person

(i)	Income upto Rs. 2,50,000	NIL
(ii)	Rs. 2,50,000 -Rs. 5,00,000	5%
(iii)	Rs.5,00,000 ---Rs 10,00,000	20%
(iv)	More than Rs.10,00,000	30%

2. For senior citizens (being resident individuals of the age of 60 years or more but less than 80 years)

(i)	Income upto Rs. 3,00,000	NIL
(ii)	Rs. 3,00,000 ------Rs.5,00,000	5%
(iii)	Rs.5,00,000------Rs.10,00,000	20%
(iv)	Income more than Rs.10,00,000	30%

3. For resident individuals of the age of 80 years or more at any time during the previous year

(i)	Income Upto Rs. 5,00,000	NIL
(ii)	Rs. 5,00,000--------Rs. 10,00,000	20%
(iv)	More than Rs. 10,00,000	30%

4. For Firm/LLP/Local Authority

1	**Firm/LLP**	On the whole of the total income30%
2	**Local authority**	On the whole of the total income30%

5. Co-operative society

(i)	Income upto Rs. 10,000	10% of the total income
(ii)	Rs.10,000-----Rs. 20,000	20%
(iii)	Income More than Rs. 20,000	30%

6. Company

i)	Domestic Company (Total Turnover / Gross Receipts in the P.Y. 2017-18 is less than /equal to Rs.400 Crores	25% of the total income
i)	Other Domestic Company	30%
iii)	Foreign Company(Other than domestic company)	40%

Specific Tax Rates for certain Income as per Income Tax Act, 1961 Finance (No. 2) Act, 2019.

S.No.	Section	Income	Rate of Tax
(a)	112	Long term capital gains (other than LTCG taxable as per section 112A)	20%
(b)	112A	Long term capital gains on transfer of – • Equity share in a company • Unit of an equity oriented fund • Unit of business trust Condition for availing the benefit of this concessional rate is Securities Transaction tax should have been paid–	@10% On more than Rs.1 lakh Long Term Capital Gain
		In case of Capital Asset | **Time of payment of STT**	

		Equity shares in a company — both at the time Unit of equity oriented fund or unit of business trust — at the time of transfer **Note:** i) LTCG upto Rs 1 lakh is exempt. ii) LTCG exceeding Rs. 1 lakh is taxable @10%.	
(c)	111A	Short-term capital gains on transfer of – • Equity shares in a company • Unit of an equity oriented fund • Unit of business trust The conditions for availing the benefit of this concessional rate are – (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004; and (ii) such transaction should be chargeable to securities transaction tax.	15%
(d)	115BB	Winnings from • Lotteries; • Cross word puzzles; • Races including horse races; • Card games and other games of any sort; • Gambling or betting of any form or nature	30%
(e)	115BBDA	Income by way of dividend exceeding Rs. 10 lakhs in aggregate other than a person in domestic company, a fund or institution or trust or any university or other educational institution or any hospital or other medical institution or a trust or institutions who is	10%

		resident in India @10% The taxation of dividend income in excess Rs.10 lakh shall be on gross basis it means no deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of dividends.	
(f)	115BBE	Unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section (i) 69D *plus* surcharge @25% of tax. Thus, the effective rate of tax (including surcharge @25% of tax and cess @4% of tax and surcharge) is 78%. (ii) exemption or allowance or expenditure shall be allowed (iii) no set off of any loss shall be allowable against income brought to tax under Section 68 or 69 or 69A or 69B or 69C or 69D.	60%

(Source: Finance Act, 2019)

1.2.1.4 Surcharge on Income Tax:

An assessee or a taxpayer has to pay surcharge levied on the amount of income tax in the prescribed rate of income tax. It is an additional charge payable on income tax. It is an excessive burden of tax on the taxpayers, if he is having his total income in the following range as stated below in the table during the financial year. As a result, there are different rates of surcharge applicable to different taxpayers under the Income Tax Act, 1961 under section 111A or section 112 or section 112A

Rate of Surcharge for the Assessment Year 2020-21

i) Individual/HUF/AOP/BOI/Artificial juridical person

Range of Income	Rs. 50 Lakhs to Rs. 1 Crore	Rs. 1 Crore to Rs. 2 Crores	Rs. 2 Crores to Rs. 5 Crores	Rs. 5 crores to Rs. 10 Crores	Exceeding Rs. 10 Crores
Surcharge	10%	15%	25%	37%	37%

Note: The enhanced surcharge of 25% & 37%, as the case may be, is not levied, from income chargeable to tax under sections 111A, 112A and 115AD. Hence, the maximum rate of surcharge on tax payable on such incomes shall be 15%.

Sr.No.	**Assessee**	**Income**	**Surcharge**
ii)	Firm/Limited Liability Partnership/Local Authorities/Co-operative societies	Total income exceeds over Rs.1 Crore	12%
iii)	a) Domestic Company	Exceeds Rs. 1 Crore and less than or equal to Rs.10 Crores	7%
		Total income exceeds over Rs.10 Crores	12%
	b) Foreign Company	Exceeds Rs. 1 Crore and less than or equal to Rs.10 Crores	2 %
		Total income exceeds over Rs.10 Crores	5 %

a) Rebate (Section 87A) :

It is tax relief to the tax payer in 5% tax slab u/s.87A. If an individual is having his total income not exceed over Rs. 5 lakhs, he will get rebate of Rs. 12500 or tax payable on total income whichever is less. It is not applicable whose income exceed over Rs.5 lakhs to 5 Crores.

b) Health & Education Cess on Income Tax: It is additional surcharge as health and education cess4% of income tax plus surcharge, if applicable.

c) Marginal Relief:

A marginal relief will be provided to such tax payers having a total income more than the amount exceed, the income tax is payable (including surcharge)

	Total income	Surcharge payable at %age of income tax	Excess Tax Payable and Marginal Relief
Individual/ HUF/AOP/ BOI/Artificial juridical person	i) Exceeds Rs.50 lakhs but below or equal to Rs.1 Crore	10%	**Excess tax payable** = Tax payable including surcharge 10% on total income tax payable -(less)Tax payable on total income Rs.50 lakhs **Marginal Relief** = Excess tax payable -(less) excess income over Rs. 50 lakhs
	ii) Exceeds Rs.1 Crore but less than or equal to Rs.2 Crore	15%	**Excess tax payable** = Tax payable including surcharge 15% on total income tax payable -(less)Tax payable on total income Rs.1 Crore +(add)10% surcharge **Marginal Relief** = Excess tax payable -(less) excess income over Rs. 1 Crore.
	iii) Exceed Rs. 2 Crores and less than or equal to	25%	**Excess tax payable** = Tax payable including

	Rs.5 Crore		surcharge 25% on total income tax payable -(less)Tax payable on total income Rs. 2 Crore + (add)15% surcharge **Marginal Relief** = Excess tax payable -(less) excess income over Rs. 2 Crore.
	iv) Exceeds Rs. 5 Crores	37%	**Excess tax payable** = Tax payable including surcharge 37% on total income tax payable -(less)Tax payable on total income Rs.5 Crore + (add) 25% surcharge **Marginal Relief** = Excess tax payable -(less) excess income over Rs. 5 Crore
Firm/Limited Liability Partnership/ Local Authority/Co-operative society	exceeds Rs. 1 crore	12%	**Marginal Relief** = Excess tax payable -(less) excess income over Rs. 1 Crore
Domestic Company	i) exceeds Rs. 1 crore but does not exceed Rs. 10 crore,	7%	**Marginal Relief** = Excess tax payable -(less) excess income over Rs. 1 Crore.
	ii)Exceeds Rs.10 Crore	12%	**Marginal Relief** = Excess tax payable -(less) excess income over Rs. 10 Crore.
Foreign	i) exceed over Rs.1 Crore butis lower or equal to Rs.	2 %	**Marginal Relief** = Excess tax payable -(less) excess

company	10 Crore		income over Rs. 1 Crore.
	ii) exceeds Rs. 10 crore	5 %	**Marginal Relief** = Excess tax payable -(less) excess income over Rs. 10 Crore.

1.2.1.5 Practical Illustrations

Illustration 1

Mr. Sharma has a total income of Rs.14,00,000 from his salary for the financial year 2019-20.

Solution: Tax liability for Rs 14,00,000

For First	Income Upto Rs. 2,50,000	- Nil	
For Next	Rs. 2,50,000 to Rs. 5,00,000	@ 5% of Rs. 2,50,000	Rs. 12,500
For Next	Rs. 5,00,000 to Rs. 10,00,000	@ 20% of Rs. 5,00,000	Rs. 1,00,000
Balance excess over Rs.10,00,000	Rs. 14,00,000 – Rs. 10,0000 = Rs. 4,00,000	@30 % of Rs. 4,00,000	Rs. 1,20,000
		Total Tax	**Rs. 2,32,500**

Mr. Sharma has tax liability for the A.Y. 2020-21 of Rs. 2,32,500

Illustration 2

Mr. Sachin is of 44 years. In the assessment year 2020-21 he has income from his salary and other sources of Rs. 50,75,000. He also has fixed deposit in bank and got interest as income. There is no any cess in this case.

Compute his tax liability of Mr. Sachin for the A.Y.

Solution:

Computation of tax liability of Mr. Sachin for the A.Y.2020-21

Tax payable including surcharge on total income		Rs. 50,75,000
Rs. 2,50,000 - Rs.5,00,000 @ 5%	12,500	
Rs.5,00,000 - Rs.10,00,000 @20%	1,00,000	

Rs.10,00,000 - Rs.50,75,000 @30%	12,22,500	
Total Add: Surcharge @ 10%	13,35,000 1,33,500	14,68,500
Tax payable on total income of Rs. 50 lakhs (12,500 + 1,00,000 + 12,00,000)		13,12,500
Excess tax payable (14,68,500 -13,12,500)		1,56,000
Marginal Relief (Rs.1,56,000 – 75,000) Excess amt. of income over 50 lakhs		81,000
Tax payable (14,68,500 – 81,000)		13,87,500

Illustration 3

Mr. Sunil, age 53, has total income of Rs. 1,00,50,000 from his salary and other bank interest on investments in fixed assets. Compute the tax liability of Mr. Sunil for the Assessment Year 2020-21. Ignore cess.

Solution : Computation of tax liability of Mr. Sunil for the A.Y. 2020-21

Tax payable including surcharge on total income		Rs. 1,00,50,000
Rs. 2,50,000 - Rs.5,00,000 @ 5%	12,500	
Rs.5,00,000 - Rs.10,00,000@20%	1,00,000	
Rs.10,00,000 - Rs.1,00,50,000 @30%	27,15,000	
Total Add: Surcharge @ 15% x 2827500	28,27,500 4,24,125	32,51,625
Tax payable on total income of Rs. 01 crore (12,500 + 1,00,000 + 27,00,000 +2,81,250 i.e. surcharge 10% upto 1 crore)		30,93,750
Excess tax payable (32,51,625 – 30,93,750)		1,57,875
Marginal Relief (Rs. 1,57,875 – 50,000) Excess amt. of income over 1 crore		1,07,875
Tax payable (32,51,625 – 1,07,875)		31,43,750

Illustration:4

Mrs. Neha, age 57, is having her total income of Rs. 2,00,50,000 including her salary, interest on Fixed deposits and House property during 2019-20. Compute the tax liability of Mrs. Neha by ignoring cess for the Assessment Year 2020-21.

Computation of tax liability of Mr. Sunil for the A.Y.2020-21

Tax payable including surcharge on total income		Rs. 2,00,50,000
Rs. 2,50,000 - Rs.5,00,000 @ 5%	12,500	
Rs.5,00,000 - Rs.10,00,000@20%	1,00,000	
Rs.10,00,000 - Rs.2,00,50,000 @30%	57,15,000	
Total Add: Surcharge @ 25% x 58,27,500	58,27,500 14,56,875	72,84,375
Tax payable on total income of Rs. 02 crore (12,500 + 1,00,000 + 57,00,000 + 8,71,875 i.e. surcharge 15% upto 2 crore)		6,68,475
Excess tax payable (72,84,375 – 6,68,475)		6,61,519
Marginal Relief (Rs. 6,61,519 – 50,000) Excess amt. of income over 1 crore		6,11,519
Tax payable (72,84,375 **– 6,11,519)**		66,72,856

Illustration 5

Compute the tax liability by ignoring cess of Mrs. Shahane, age 44, having total income of Rs. 5,00,75,000 from his salary, interest on fixed deposit and other source like house property for the Assessment Year 2020-21.

Solution:

Computation of tax liability of Mrs. Shahane for the A.Y. 2020-21

Tax payable including surcharge on total income		Rs. 5,00,75,000
Rs. 2,50,000 -Rs.5,00,000 @ 5%	12,500	
Rs.5,00,000 -Rs.10,00,000@20%	1,00,000	
Rs.10,00,000 -Rs.50,07,5000 @30%	1,47,22,500	
Total Add: Surcharge @ 37% x **1,48,35,000**	1,48,35,000 54,88,950	2,03,23,950
Tax payable on total income of Rs. 05 crore (12,500 + 1,00,000 + 1,47,00,000 + 37,03,125 i.e. surcharge 25% upto 5 crore)		18,51,625
Excess tax payable (2,03,23,950 – 18,51,625)		1,84,72,325
Marginal Relief (Rs. **1,84,72,325** – 75,000) Excess amt. of income over 1 crore		1,83,97,325
Tax payable (2,03,23,950 **– 1,83,97,325)**		19,26,625

1.2.2 Basic Concepts

It is necessary to understand the basic concepts of income tax to know the scope of income tax. The following are the main basic concepts used in Income Tax:

1.2.2.1 Previous year[Section 2 (34) and 3]

"Previous Year" means the **Financial Year** immediately preceding the Assessment Year. The income earned by the assessee is taxable in the next year. Hence, the year in which income earned by an assessee is known as Previous year. and the tax on which the income is assessed is called as Assessment year. The present Previous Year 2019-20 and its Assessment Year is 2020-2021.

From the assessment year 1989-90 onwards, all assessees are required to follow financial year (i.e. April 1st of one year to March 31st of next year) as previous year. The uniform previous year has to be followed for all sources of income.

In case of the Previous Year for newly established business from the date of setting up of the business to the end of the Financial Year in which business was set up. e.g. X Ltd. started business on 1.11.2015 So for X Ltd. Previous Year will be considered as 1.11.2015 to 31.3.2016.

1.2.2.2 Assessment year [Section 2 (9)]

"Assessment year" means the period of twelve months commencing on 1st April every year. Thus it is normally period beginning from 1st April of every year and ending on 31st March of the next year. Income of previous year of an assessee is taxed during the following assessment year at the rates prescribed by the relevant Finance Act. The present Assessment Year is 2020-2021 relating to Previous Year 2019-2020.

1.2.2.3 Person [Section 2(31)]

Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important to know the definition 'person'. As per section 2(31). Person includes:

i) An individual

A natural human being, i.e. male, female, minor or a person of sound or unsound mind.

ii) A Hindu undivided family

It consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters.

iii) A Company

Section 2(17) defines the term 'company' to mean:

(a) any Indian company, or

(b) any body corporate incorporated by or under the laws of a country outside India i.e. a foreign company, or

(c) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or

(d) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a company only for such assessment year or assessment years (whether commencing before the first day of April, 1971 or, on or after that date), as may be specified in the declaration.

iv) A Firm

A firm includes a partnership firm whether registered or not and shall include a Limited Liability Partnership as defined under Partnership Act, 1932.

v) An Association of Person (AOP) or a body of individuals whether incorporated or not

The difference between Association of persons and body of individuals is that whereas an association implies a voluntary getting together for a definite purpose, a body of individuals would be just a body without an intention to get-together. Moreover, the members of body of individuals can be individuals only whereas the members of an association of persons can be individual or non-individuals (i.e. artificial persons).

vi) A local authority

It means a municipal committee, district board, body of port commissioners, or other authority legally entitled to or entrusted by the Government with the control and management of a Municipal or local fund.

vii) Every artificial, juridical person, not falling within any of the above categories

This is a residuary clause. If the assessee does not fall in any of the first six categories, he is assessed under this clause. Generally, a statutory corporation, deity or charitable institution or an endowment for charitable or religious purposes falls under artificial juridical person.

1.2.2.4 Income [section 2(24)]

Every person is always in search of monetary return in the regular form. This is received in the form of cash or kind, receipt or accrual basis, legal or illegal, temporary or permanent, lump sum or installments, gifts etc. As per the Income Tax Act 1961, a person who do not earns or receive income on regular basis is not considered as income for tax. The casual income as Winnings from lotteries, crossword puzzles etc are not Income. The Income Tax Act does not have a positive definition of the term, 'Income':

Income [Section 2(24)] includes:

1. Profits or gains of business or profession.
2. Dividend.

3. Voluntary Contribution received by a Charitable / Religious Trust or University / Education Institution or Hospital.
4. Value of perquisite or profit in lieu of salary taxable u/s 17 and special allowance or benefit. Specifically granted either to meet personal expenses or for performance of duties of an office or an employment of profit.
5. Export incentives, like Duty Drawback, Cash Compensatory Support, Sale of licenses etc.
6. Interest, salary, bonus, commission or remuneration earned by a partner of a Firm from such Firm.
7. Capital Gains chargeable u/s 45.
8. Profits and gains from the business of banking carried on by a cooperative society with its members.
9. Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
10. Deemed income u/s 41 or 59.
11. Sums received by an assessee from his employers towards welfare fund contributions such as Provident Fund, Superannuation Fund etc.
12. Amount received under Key man Insurance Policy including bonus thereon.
13. Amount received under agreement for (a) not carrying out activity in relation to any business, or (b) not sharing any knowhow, patent, copyright etc.
14. City Compensatory Allowance/ Dearness allowance
15. Benefit or Perquisite to a Director:
16. Any Benefit or perquisite to a Representative Assessee;
17. Any sum chargeable under section 28, 41 and 59 :
18. Gift received for an amount exceeding ₹ 50,000 in clause (vii) or clause (vii a) of sub-section (2) of Section 56.

1.3.2 Agriculture Income: Sec. 2(1A)

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. As per section 10(1), agricultural income earned by the taxpayer in India is exempt from tax.

Most of the following incomes are not considered as agriculture incomes:

Incomes from-

i) Mining royalties, stone quarries.

ii) Sale of earth or brick making

iii) Poultry & Dairy

iv) Forest trees, bamboo etc.

v) Fisheries etc,

vi) Managerial remuneration from agriculture farm

vii) Dividend from agriculture business or company

viii) Irrigation water supply

1.2.2.5 Assessee [Section 2(7)]

1. In simple language, every tax payer is an assessee. However, the word assessee has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act and includes:

2. 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 to determine the loss sustained by him or by such other person or to determine the amount of refund due to him or to such other person.

3. Every person who is deemed to be an assessee under any provision of this Act.
4. Every person who is deemed to be an assessee in default under any provision of this Act. Accordingly, assessee is a person by whom tax or any other sum is payable under the Act.
5. The expression “other sum of money” includes fine, interest, penalty and tax or person to whom any refund of tax etc. is due under the Act or if any proceeding under the Act has been taken against any person, he is also an assessee.

CHECK YOUR PROGRESS-I

Q.1. A) Fill in the blanks:

1. Income tax was introduced in India for the first time by ---------------in 1860 in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857.
2. The Income Tax Act 1961 has been brought into force with effect from--------------.
3. Every year the budget is presented by the ------------------of the Government of India to the Parliament.
4. ----------- is the basic and major source of revenue to the government.
5. “Previous Year” means the ----------------immediately preceding the Assessment Year.
6. The year in which income earned by an assessee is known as--------------.
7. The year on which the income is assessed is called as --------------.
8. Income-tax is charged in respect of the ------------ of the previous year of every person.

Q.1 B) State whether True or False:

1. Income Tax Act includes 1 to 298 sections and XIV Schedules.
2. Rules may not include sub rules, provisions and explanations.
3. Section 2(7) defines the term ‘company’.

4. The charge is on every person specified under section 2(31).

5. "Previous Year" means the Financial Year immediately preceding the next Assessment Year.

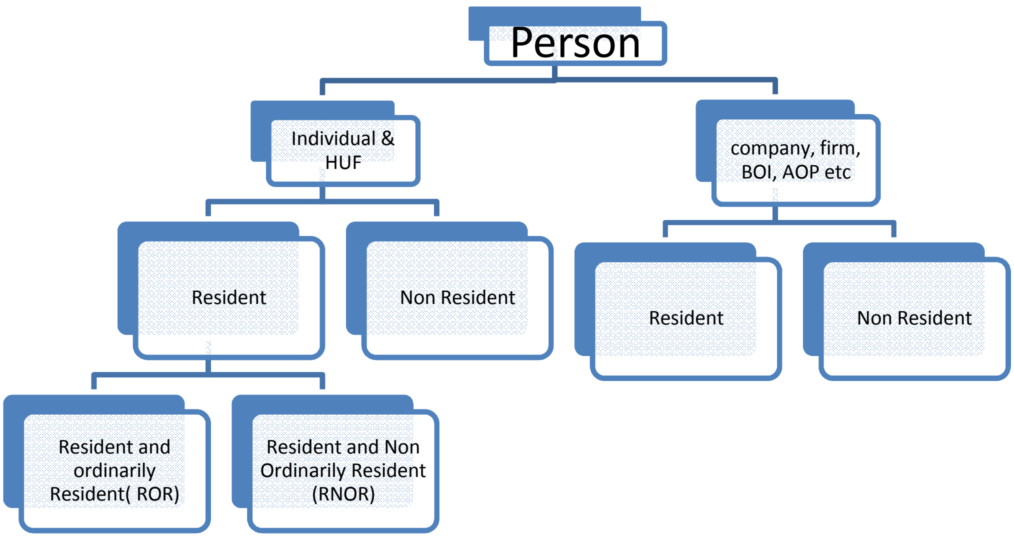
6. It is mandatory to the taxpayer to pay tax annually by filing the specific income tax returns.

7. The year on which the income is assessed is called as Previous year.

1.2.3 Residential Status and taxability

The income tax liability of any assessee depends upon their residential status. The income earned in outside India by an assessee is also considered for determination of taxability. Therefore, the resident of an assessee is the basis for understanding the taxability of an assessee.

The residential status is classified as under: On the basis of residence, all the assesses are classified into two classes :



(a) **Resident of India (ROI)**. – [For individuals and HUFs]

This is also sub classified into two i.e –

i) Resident and Ordinary Resident (ROR)

ii) Resident and Non Ordinary Resident(RNOR)

(b) Non-Resident of India (NRI).

There are separate rules are followed for determining the residential status of an individual, HUF, Firms, Association of Persons (AOP), Local authorities and Artificial persons

1.2.3.1 Residential Status of an Individual [Section. 6 (1)]

A) Resident:

An individual is resident in India if he satisfies any one of the following two basic conditions and not satisfies the additional conditions:

I) Basic Conditions:

i. He has been in India for 182 days or more in the relevant previous year or

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

Condition number (ii) has following exceptions:

Condition (ii) above is not applicable in following cases (means in following cases a person shall be resident of India only when he is in India for 182 days or more in the previous year):

a. If Indian Citizen leaves in India during the previous year for employment outside India or as a member of crew of an Indian Ship

b. If Indian citizen or person of Indian origin visits India during previous year

II) Additional Conditions:

a) Resident and Ordinary Resident Section 6(6):

An individual is to become Resident and Ordinary Resident if he satisfies both the conditions given below: -

1. He should have been resident in India at least 2 out of 10 previous years, immediately preceding to the previous year.
2. He should have been in India for a period amounting to 729 days or more in 7 years proceeding to the previous year.

b) Resident but Non-Ordinary Resident:

If an individual or assessee does not satisfy any one of the above mentioned conditions or both his Residential Status will be Resident but Not Ordinary Resident.

B) Non resident [Section 2 (3)]:

If the basic condition under section 6(1) is not fulfilled by an individual or assessee, he is to be a Non resident of India during the previous year.

Other points:

- Residential status is determined for every year separately
- India includes territorial waters of India.
- Employment includes self-employment
- In computing the period of 180 days, the day of entry into India and the day of exit from India shall be included.
- Person of Indian origin is a person who himself or any of his parents or any of his grandparents was born in undivided India before 15th August 1947.

Easy Rules for determining residence of an individual

- **Resident (R):** who satisfies at least 1 basic condition
- **Resident and Ordinary Resident (ROR)**: Who satisfies at least 1 basic + both the additional conditions
- **Resident but Not Ordinary Resident (RNOR)**: Who satisfies at least 1 basic + Either none (or one) of the additional
- **Not Resident (NR)**: who does not satisfy any of the basic

1.2.3.2 Determination of Residential Status of Hindu Undivided Family (HUF) – Sec 6(2)

A) Resident:

A HUF is said to be resident in India-

i) when during that year control and management is situated wholly or partly in India.

ii) Control and management lies at the place where decision regarding the affairs of the HUF taken.

a) Resident and Ordinarily Resident:

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

i) He has been resident in India for at least 2 out of 10 previous years immediately preceding the relevant previous year

And

ii) He has been in India for 730 days or more during 7 previous years immediately preceding the relevant previous year.

b) Resident but Not Ordinary Resident:

If the karta of HUF does not satisfy any or both of the above conditions number (i) & (ii), then HUF shall be resident but not ordinarily resident in India.

B) Non-Resident [Section 2(30)]

It will be non-resident in India if no part of the control and management of affairs is situated in India.

Easy rules for determination of residential status of a HUF

Resident: Control and management of the affairs is located wholly in India or partly in India and partly outside India.

ROR: Karta satisfies both the additional conditions, HUF is as ROR

RNOR: Karta satisfies both or one of the additional conditions, HUF as RNOR.

Non-Resident: Control and management of the affairs of a HUF is located outside India.

1.2.3.3 **Determination of Residential Status of Firms, AOP, BOI etc – Sec 6(2), 6(4)**

i) A Firm, AOP, BOI etc is said to be resident in India when during that year control and management is situated wholly or partly in India. In other words it will be non-resident in India if no part of the control and management of affairs is situated in India.

ii) Control and management lies at the place where decision regarding the affairs of the firms etc are taken.

1.2.3.4 Determination of Residential Status of Companies – Sec 6(3)

1) Indian Company:

A company is said to be resident in India in any previous year-

i) It should be an Indian Company (always resident in India)

ii) control and management of its affairs wholly in India.

2) Foreign Company

When Foreign Company is resident in India-

Residential status of a foreign company depends upon place of effective management "POEM".

It is cleared that a person is (1) a Resident whose POEM of the business is situated wholly in India.

It means if control and management of its affairs is situated wholly in India during relevant previous year i.e. if all the board meetings of the foreign company is held in India, then it shall be resident.

Non Resident [Section 2(30)]:

Above conditions are not fulfill by any company, it is treated as non-resident. or whose control and management of affairs is partly located outside India, is treated as Non Resident Company.

It means a Person is **Non-Resident if** POEM of the business is situated wholly or partly outside India.

1.3.2.5 Scope of Total Income/ Incidence of Tax/ Tax Libility [Sec 5)

The Scope of total income is according to residential status of assessee.

1. Resident in India/ ordinarily resident in India [Section 5 (1)]

A person is assessable to tax in respect of income which-

i. is received or deemed to be received in India, even in outside India by him or on his behalf or

ii. accrues or arises or deemed to accrue or arise to him in India, even in outside India or

iii. accrues or arises to him outside India

2. Resident but not ordinarily resident in India [Section 5 (1)]

A person is assessable to tax in respect of income which-

i. is received or deemed to be received in India, even in outside India by him or on his behalf or

ii. accrues or arises or deemed to accrue or arise to him in India, even in outside India or

iii. accrues or arises to him outside India from a business controlled in or profession set up in India.

3. Non-resident in India [Section 5(2)]

A person is assessable to tax in respect of income which-

i. is received or deemed to be received in India, even in outside India by him or on his behalf or

ii. accrues or arises or deemed to accrue or arise to him in India, even in outside India

Other points:

- Received in India means first receipt in India. If an income is received first outside India and then subsequently remitted to India, it shall be treated as received outside India.
- **Past untaxed profits** shall not be considered to be income of the current year in any case.

Illustration 6

Mr. J. Willam comes to India for 100 days every year. Determine his residential status for the assessment year 2020-21.

Solution:

Mr. J. Willams residential status can be determined as:

Step 1: He resides in India 100 days in F.Y. 2019-2020. It means in the last 4 preceding year his total stay in India =100 days x 4 years= 400 days.

As he satisfies 2nd condition of the basic conditions, he is a resident in India.

Step 2: His total stay in India in last 7 years preceding F.Y. 2019-20 = 100 x 7 = 700 days., he satisfies the 2^{nd} condition of the additional conditions, It means, he is Not-Ordinarily Resident (NOR) in India.

Therefore Mr. J. Willam is the resident but Not Ordinarily Resident (NOR)for A.Y. 2020-21,

Illustration 7

Mahesh, an Indian citizen, leaves India on 25^{nd} September 2019 for the first time, to work as an employee of a company in Australia. Determine his residential status for A.Y. 2020-21.

Solution: Mahesh's stay in India during the F.Y. 2019-20,

= 30 (April) + 31 (May) + 30 (June) + 31 (July) + 31 (August) + 25 (September) =178 days and is leaving India for joining his company in Australia.

Here, 2^{nd} condition of basic condition is not applicable to Mahesh.

Even though, He never fulfils the 1^{st} condition of basic conditions also.

As a result, he is the Non-Resident in India for the A.Y. 2020-21

Illustration 8:

Mr. Suraj came to India for the first time on 15th July 2019 and he left India on 03rd March 2020.

Determine his residential status for the AY 2020-21.

Solution: Mr. Suraj stays in India during the financial year i.e. P.Y 2019-20 (From 15^{th} July to 03^{rd} March) =17+31+30+31+30+31+31+29+03 =233 days.

He satisfies the condition of stay in India 182 days or more.

Thus, Mr. Suraj is a resident in India for the AY 2020-21.

Illustration 9

Mrs. James, a US citizen but of Indian origin, comes to India for the first time during the previous year 2015-16. Since then she is coming every year on a visit to India for some days as shown below:

Years	2015-16	2016-17	2017-18	2018-19	2019-20
Stay in India (days)	70	65	84	187	67

Determine her residential status for the assessment year 2020-21.

Solution: As She is an Indian Origin the basic condition 2 is not applied.

She came India in the previous including 2019-20.

The 1st basic condition is that she has to stay 182 days or more in the P.Y.2019-20.

The other additional conditions are applicable who has become resident in the relevant previous year. Mrs. James stays only 67 days and never 182 days or more in the P.Y. 2019-20 as condition.

Hence, She is Non Resident for the assessment year 2020-21.

Tax liability on the basis of Residential Status

Where tax incidence arises in case of	**Resident or Resident & Ordinarily Resident(ROR)**	**Resident but not Ordinarily Resident (only Individual or HUF)(RNOR)**	**Non-Resident (NR)**
Income received in India (Whether accrued in or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income deemed to be received in India (Whether accrued in or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income accruing or arising in India (Whether received in India or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income deemed to accrue or arise in India (Whether received in India or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income received and accrued outside India from a business controlled or a profession set up in India	**TAXABLE**	**TAXABLE**	**NOT TAXABLE**
Income received and accrued outside India from a business controlled from outside India or a profession set up	**TAXABLE**	**NOT TAXABLE**	**NOT TAXABLE**

outside India			
Income earned and received outside India but later on remitted to India (whether tax incidence arises at the time of remittance)	**NOT TAXABLE**	**NOT TAXABLE**	**NOT TAXABLE**

(ROR- Resident/Ordinary Resident of India**, RNOR-** Resident but not Ordinarily Resident, **NR-** Non Resident **)**

Explanation:

1. Income received or deemed to be received in India [Sec 7)

a) Income received in India:

Any income which is received in India is liable to tax in India, whether the person receiving income is resident or non- resident. 'Received in India' means first receipt.

Income deemed to be received in India: Following incomes shall be deemed to be received in India even in the absence of actual receipt:

i. Contribution by employer to recognized provident fund in excess of 12% of salary of employee

ii. Interest credited to RPF in excess of 9.5%

iii. Transferred balance from unrecognized PF to RPF

iv. Contribution by Government/Employer to notified pension scheme

Dividend Income (Sec 8)

Dividends from Indian company shall always be deemed to accrue or arise in India. However, as per Sec 10(34), such dividend is exempt in the hands of shareholder.

Income deemed to accrue or arise in India (Sec 9)

Following income shall be deemed to accrue or arise in India:

i. Income from any property, asset or source of income in India

ii. Income from the transfer of any capital asset situated in India

iii. Any income from salary if it is payable for services rendered in India

iv. Salary (not allowances) payable by the government of India to an Indian citizen for services rendered outside India

v. Interest payable by-

   a. Government or

   b. Resident in India if money is used by the borrower for the purpose of business or profession or earning any income from any source in India or

   c. Non-resident in India if money is used by the borrower for the purpose of business or profession in India

vi. Royalty payable by

   a. Government or

   b. Resident in India if services are utilized for the purpose of business or profession or earning any income from any source in India or

   c. Non-resident in India if services are utilized for the purpose of business or profession or earning any income from any source in India

vii. Fees for technical services payable by

   a. Government or

   b. Resident in India it services are utilized for the purpose of business or profession or earning any income from any source in India or

   c. Non-resident in India it services are utilized for the purpose of business or profession or earning any income from any source in India

viii. Income from a business connection in India

Any income which arises, directly or indirectly, from any activity or a business connection in India is deemed to be earned in India. If all business activities are not carried out in India, then only such part of income, as is reasonably attributable to the operations carried out in India, is taxable. E.g business connection includes-

i. branch office in India,

ii. agent of non-resident entering into contracts,

iii. Subsidiary in India

iv. maintaining stocks etc

However in case of non-resident, following shall not be treated as business connection in India:

i. Purchase of goods in India for purpose of exports

ii. Collection of news and views for transmission outside India by non-resident who is engaged in the business of running news agency or of publishing newspapers, magazines or journals

iii. Shooting of films in India if

    a. In case of individual – he is not a citizen of India

    b. In case of Firm – none of the partner is citizen or resident of India

    c. In case of company – none of the shareholder is citizen or resident of India

Illustration 10:

Following are the summary of the incomes of Mr. Raju for the previous year 2019-2020.

a) Income earned in India but received in London Rs. 15,000

b) Income earned in London in the earlier years but brought during the year of Rs. 40,000

c) Income from Bank of Maharashtra as interest on deposits Rs. 10,000

d) He earned income from his business at US which is controlled from Canada Rs. 25,500.

e) Income from House property in Japan received in India Rs. 9,000

Compute his taxable income for the A.Y. 2020-2021 by determining Mr. Raju is -a) Resident (ii) Not Ordinarily Resident (iii) Non-Resident

Solution:

Computational Taxable Income of Mr. Raju for the A.Y. 2020-21

Income	Resident (R)	Not Ordinarily Resident (ROR)	Non Resident (NR)
a) Income earned in India but received in London			

(Earned in India)	15,000	15,000	15,000
b)Income earned in London in the earlier years but brought during the year of Rs. 40,000 (No earning this year)	Nil	Nil	Nil
c)Income from Bank of Maharashtra as interest on deposits (Accrued in India)	10,000	10,000	10,000
d)He earned income from his business at US which is controlled from Canada (Foreign Income)	25,500	Nil	Nil
e)Income from House property in Japan received in India (Received in India)	9,000	9,000	9,000
Total	59,500	34,000	34,000

CHECK YOUR PROGRESS-II

Q.1.A) Fill in the Blanks:

1. The income tax liability of any assessee depends upon their -------------
2. The residential status is classified into ----------- classes.
3. -------------- lies at the place where decision regarding the affairs of the HUF taken.
4. AOP Stands for…………………
5. ---------------is determined for every year separately.

Q.1B) Match the following:

	Resident	Section
a)	Resident and Ordinary Resident Section	i) Sec 6 (2)
b)	Non-resident	ii) [Section 2(30)]
c)	HUF	iii) Sec 6 (3)
d)	Non-Resident	iv) [Section 2 (3)]
e)	Residential Status of Companies	v) 6 (6)

1.2.3.6 Terms to Remember

1. **Income** Every person is always in search of monetary return in the regular form.
2. **Person** Income-tax is charged in respect of the total income of the previous year of every person.
3. **Assessee :** every tax payer is an assessee.
4. **Assessment year :** "Assessment year" means the period of twelve months commencing on 1st April every year.
5. **Previous year:** Previous year means the financial year immediately preceding the assessment year.
6. **Residential Status:**

The income tax liability of any assessee depends upon their residential status.

1.3 Summary

Tax is revenue to the government, generally used for public utility. In India, Income tax was introduced for the first time in 1860 by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. The Income Tax Act 1961 has been brought into force with 1 April 1962. Tax is the financial charge levied by the Government on income, commodity or activity of a person under certain conditions prescribed by Finance Act every year. Every person has to pay income tax on the basis of tax rates given under Income Tax Act, 1961. Generally, there are two types of tax which is levied by the Government i.e. Direct tax and Indirect tax. The income tax law in India consists of the components as Income tax Acts, Income tax rules, Finance Act, Circulars, notifications, and Legal decision of courts. Income Tax is levied on the total income of the previous year of every person. **The main basic concepts used in Income Tax are** Income, Agriculture Income, Person, Assessee, Assessment year, Previous year.

The income tax liability of any assessee depends upon their residential status. The residential status is classified as under: On the basis of residence, all the assesses are classified into two classes as Resident of India(ROI). This is also sub classified into two i.e- i) Resident and Ordinary Resident ii) Resident and not Ordinary Resident, Non-Resident of India (NRI).

1.4 Answer to check your progress

CHECK YOUR PROGRESS-I

Q.1. A) 1. Sir James Wilson, 2. 1st April 1962,

3. Finance Minister, 4. Income tax,

5. Financial Year, 6. Previous year,

7. Assessment year, 8. total income.

B) 1. True, 2. False, 3. False, 4. True, 5. False, 6. True, 7. False

CHECK YOUR PROGRESS-II

Q.1.A) 1. residential status, 2. two,

3. Control and management 4. Association of Person,

5. Residential status

Q.1.B) a) –v, b) –iv, c)- i, d) –ii e)- iii

1.5 Exercise

Short Questions:.

1. Explain the following basic concepts:

a) Income,

b) Agriculture Income,

c) Person,

d) Assessee,

e) Assessment year,

f) Previous year,

2. Explain the types of residential status with conditions and exceptions.

3. Explain the scope of total income or incident of tax.

4. Write note on : Residential status

5. Ms. Shambhavi has a total income of Rs. 13, 00,000 from his salary for the financial year 2019-20. Compute tax liability of Ms. Shambhavi for the A.Y. 2020-21.

6. Mr. Ram is of 43 years. In the assessment year 2020-21 he has income from his salary and other sources of Rs. 51,00,000. He also has fixed deposit in bank and got interest as income. There is no any cess in this case.

Compute his tax liability of Mr. Sachin for the A.Y.

7. Mr. Sunil, age 50, has total income of Rs. 1,01,00,000 from his salary and other bank interest on investments in fixed assets. Compute the tax liability of Mr. Sunil for the Assessment Year 2020-21. Ignore cess.

8. Mrs. Neha, age 40, is having her total income of Rs. 2,01,00,000 including her salary, interest on Fixed deposits and House property during 2019-20. Compute the tax liability of Mrs. Neha by ignoring cess for the Assessment Year 2020-21.

9. Compute the tax liability by ignoring cess of Mrs. Sheetal, age 34, having total income of Rs. 5,01,00,000 from his salary, interest on fixed deposit and other source like house property for the Assessment Year 2020-21.

10. Mr. Willy comes to India for 96 days every year. Determine his residential status for the assessment year 2020-21.

11. Mahesh, an Indian citizen, leaves India on 20th October 2019 for the first time, to work as an employee of a company in Australia. Determine his residential status for A.Y. 2020-21.

12. Mr. Suraj came to India for the first time on 15th July 2019 and he left India on 03rd March 2020. Determine his residential status for the AY 2020-21.

13. Mrs. Jadhav, a US citizen but of Indian origin, comes to India for the first time during the previous year 2015-16. Since then she is coming every year on a visit to India for some days as shown below:

Years	2015-16	2016-17	2017-18	2018-19	2019-20
Stay in India (days)	70	65	84	187	67

Determine her residential status for the assessment year 2020-21.

14. Following are the summary of the incomes of Mr. Raje for the previous year 2019-2020.

    a) Income earned in India but received in London Rs. 10,000

    b) Income earned in London in the earlier years but brought during the year of Rs. 30,000

    c) Income from Bank of Maharashtra as interest on deposits Rs. 20,000

    d) He earned income from his business at US which is controlled from Canada Rs. 28,500.

    e) Income from House property in Japan received in India Rs.7,000

    Compute his taxable income for the A.Y. 2020-2021 by determining Mr. Raje is -a) Resident (ii) Not Ordinarily Resident (iii) Non-Resident

1.6 Further readings and References

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❑❑❑

Unit-2

Exemptions and Deductions from Total Income

Structure of Unit

2.0 Objectives

After going through this unit, you should be able to -

- know the meaning of exempted incomes
- understand the various types of exempted incomes U/s 10
- know the meaning of deductions
- understand the deductions of chapter VI 'A' applicable to individual

2.1 Introduction

The income Tax is a tax on the income of a person, the meaning of the term income is very important. But the income Tax Act, 1961 does not define the term income Sec. 2 & 3 of the Act, however defines the terms & expressions of the word ‘income’ these are of two types – (i) Inclusive and (ii) Exhaustive the exhaustive definition tries to explain the meaning of the term, where as the inclusive divination gives the contents included in such term.

Generally speaking, the word Income covers receipts in the shape of money or money’s worth which arise with certain source. However all receipts do not from the basis of taxation under the act. For levy of Income Tax first of all the taxable income of a person should be determined as per the provisions of the Act & Rules. The Taxable income should be computed under the five heads. The total of such net amount is called Gross total Income. There are other permissible deductions under the act which are to be deducted from Gross Total Income. But there are some Incomes are not included in the above income.

Exemptions available U/s 10, 10A, 10 B, 13 A & deductions under 80C to 80U are of special nature of are allowed to certain limits.

These exemptions and deductions available under the act may be broadly be grouped as " –

(a) tax free Income (sec. 10,10 A,10 B &13 A)

(b) Deductions from Gross Total Incomes (Sec. 80C to 80U)

In this chapter, we are going to study exempted incomes and deductions of chapter VI 'A' applicable to Individual.

2.2 Incomes Exempted from tax U/s 10

In the following cases, income is exempt from tax.

1. Agricultural Income [sec.10(1)]

Agricultural Income is fully exempted. However, the net agriculture income is taken into account in income liable to tax. (for details refer pervious chapter).

2. Any sum/receipts received from Hindu Undivided family (HUF) [sec10 (2)]

Any sum/receipts received by an Individual as a member of Hindu undivided family or out of income of estate belonging to the family is exempt from tax. Such receipts are not chargeable to tax in the hands of an Individual member ever if tax is not paid or payable by the receipts from a HUF are, however taxable vide sec. 64 (2).

3. Share of profit from a partnership firm [sec.10(2A)] –

Share of profit received by partners from a firm (which is assessed as firm) is not taxable in the hands of partners. However, such share of a partner should be computed by dividing the taxable profit of the firm in the same proportions as per the profit sharing ratio mentioned in the partnership deed.

4. Interest received by a Non Resident – [sec. 10 (4) (4B)]

The following interest incomes are exempt from tax -

(a) any income of a non resident by way of interest on notified Government Securities (including premium on redemption of such bonds) – sec. 10 (4) (i)

(b) Income from interest standing to credit in a Non Resident (external) Account in India, in accordance with the FEMA or a person who has been Permitted by the RBI to maintain the a foreside account – sec. 10 4 (ii) and

(c) In the case of an, Indian citizen or a person of Indian origin who is a non resident, National saving certificates VI & VII Issues if such certificates are subscribed from outside thorough official channels – sec 10 4 (B)

5. Leave Travel concession to an Indian citizen – [sec 10(5)]

The exemption in respect of value of leave travel concession is available to an Indian citizen. The value of any travel concession received by or due to an individual from his employer for himself and his family while proceeding on leave to any place in India is exempt. Such concession received from his present or former employer after retirement or after termination of his service is also exempt.

The amount to be exempted should not exceed the amount of expenses actually incurred for the purpose of such travel.

The cremation is available to an employee in respect of two journeys performed in a black of 4 calendar years commencing from 1986. if such concession is not availed of by him during a black of 4 calendar years, the amount received by him in the first calendar year in the previous block of 4 years is eligible for exemption. Here. “family” means the spouse, children, parents, brothers and sisters mainly dependent on the Individual.

6. Death – cum retirement gratuity [sec. 10 (10)]

(a) Any gratuity received by the employees of Government or semi Government department including the employees of a local authority, is FULLY EXEMPT.

(b) Any gratuity received by employees Covered by the payment of Gratuity Act 1972, is exempt to the extent that it is payable as per the provisions of that Act being the least of the following (i) Actual Gratuity received (ii) Rs. 7,00,000 (iii) 15 days salary (7 days in the case of employees of seasonal establishment) based on salary last drawn for each completed year of service or part there of exceeding 6 months

(c) Any other gravity received by on employee from the employer of private sector /corporations on his retirement or becoming in capacitated, or on termination is exempt being the least of the following : -

(i) half month's average salary for each year of Completed Service.

(ii) maximum limit Rs. 7,00,000.

(iii) Actual gratuity received.

The average salary is calculated on the basis of 10 months preceding the month in which the gravity is paid. For this purpose salary means "Basic pay +Dearness allowance (if the terms of employment provides) +Commission (if it is based on percentage of turnover)

7. Retrenchment Compensation [sec.10(10B)]

Any compensation on received by a workman under the Industrial Despots Act 1947 or other Act Rules or orders or Awards at the time of his retrenchment, is exempt to the extent of the amount calculated as per the provisions of the Industrial Disputes act 1947 or an amount not being less than Rs. 5,00,000 as notified by the Government whichever is less.

8. Compensation Under Bhopal Gas Leak Disaster Act [sec. 10 (10BB)]

Compensation received by an assessee under the provisions of Bhopal Gas Leak Disaster (processions of claims) Act 1985 and any scheme framed there under, is exempt from tax. However, any payment or Compensation received by an assessee in connection with Bhopal Gas Leaks Disaster, to the extent he has been allowed as deduction from his taxable income on account of any loss or damage caused to him, will not be exempt from tax.

9. Compensation on Voluntary Retirement [sec. 10 (10C)]

Any compensation received by an employees of a public sector company or of any other company or local authority or an authority set up under government Act or co-operative society or university or India institute of technology or specified institute of management on his retirement, is exempt subject to a maximum limit of Rs. 5,00,000 in accordance with the scheme formed there under [Rule 2 BA]. In the case of Companies the scheme should be approved by the chief Commissioner or Director General as the case may be. Further if such exemption has been allowed for any employee for any assessment year, no exemption will be allowed again for any other assessment year.

10. Payment from Provident Fund [sec. 10 (11)]

Provident fund scheme is a retirement benefit scheme. Any payment from a provident fund to which provident fund Act 1925 (statutory provident fund) or any other provident fund set up by central government and notified in the official gazette is totally exempt from tax.

11. Sum received from life Insurance Policy [sec. 10 (12)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, shall not be included in the total income of a persons. The exemption is however not available in respect of such polices which is in sec. 8- DDA (3) or under key man insurance policy.

12. Payment from an approved superannuation fund [sec. 10(13)]

The payment form this fund is exempt it is paid :-

(i) on the death of a beneficiary or

(ii) to an employee in lieu of or in Commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated before such retirement or

(iii) by way of refund of Contributions on the death of beneficiary or

(iv) by way of refund of contributions to an employee on his leaving the service with which the fund is established and where the retirement and other conditions are not applications and the interest there on.

13. House Rent Allowance : [sec. 10 (13A)] –

The house rent allowance actually received by an employee specially granted to him by his employer to meet the expenditure incurred on rent, is exempt to the extent of the least of the following –

(i) HRA actually received

(ii) The excess of rent paid over 10% of salary

(iii) (a) 50% of salary if the house is situated in Mumbai, Kolkata, Chennai & Delhi (b) 40% of salary if the house is situated at any other place. “salary for this propose" is equal to Basic salary +D.A. (if terms of employment provides) + Commission (if based on Fixed percentage).

The period of occupation of the house by the assesses during the previous year is to be taken into account for the above calculation.

14. Interest on Certain Government Securities: [sec. 10 (15)] –

The interest received from any of following securities is exempt :

(1) interest on notified Securities, bonds or certificates (2) Interest on 10% Relief Bonds (for Individual / HUF only) (3) Interest on notified bonds / debentures of a public sector Company (4) 12 years National saving annuity Certificates (5) National defence Gold Bonds (6) Post office cash certificates (5 years) (7) Post office National Saving certificates (12 years / 7 years) (8) Post office Saving Bank Account (9) Post office Cumulative Time Deposit Rules 1981 (10) Scheme of fixed deposits governed by Government Saving Certificates Rules (11) National defence Gold Bonds (12) special Bearer Bonds 1991 (13) Treasury Saving Deposit Certificates (10 years) (14) Special deposit Scheme 1987 (15) Resurgent India Bonds (16) 7% Saving Bonds 2002.

15. Educational Scholarships: [sec. 10 (16)]

Scholarship granted to meet the cost of education is exempt from tax. In order to avail the exemption it is not necessary that the government should finance scholarship.

16. Daily allowance of Members of Parliament

Sec. 10 (17) Clause (17) of section 10 provides exemption to Members of parliament of state Legislature in respect of the following allowances :

(a) Daily allowance Entire amount is exempt. (b) any other allowance received by a Member of parliament under the Members of Parliament (Constituency allowance) Rules 1986 and (c) all other allowances (not exceeding Rs.2000 P.M.) received by any person by reason of his Membership of any state legislature or any Committee there of, which the Central Government may notify.

17. Awards &Rewards : [sec. 10 (17A)]

The following payment received either in cash or in kind are exempt – (a) Any award Instituted in the public interest by the government or any other approved public body (b) any reward received from the government for such purpose that are approved in the public interest.

18. Annual Value of palace of a Ruler [sec.10(19A)]

The annual value of any one palace in the occupation of a Ruler during the pervious year, is exempt provided such exemption was given be before the commencement of the Constitution Act 1971.

19. Dividend of Domestic Companies [sec. (34)]

Any income by way of dividends of Indian Companies referred to in sec.115 is exempt from tax, in the hands of recipient.

20. Income from units of Mutual Fund [sec. 10 (35)]

Any income received in respect of the units of Mutual fund specified under clause 10 (23D) & units of UTI or specified Company are exempt from tax, in the hands of recipients.

Other important exemptions are as under –

(i) Income of employees stats Insurance Fund [sec.10(25A)]

(ii) Income of National Minorities Development and finance corporation [sec10(26B B)]

(iii) Subsidy form Tea Board [sec.(10 (30)]

(iv) Subsidy received by planters [sec10(31)]

(v) Capital Gains on transfer of U/s 64 [sec.10 (33)]

(vi) Capital Gains on transfer of listed equity shares [sec.10 (36)]

(vii) Income of an International sporting event [sec.10 (39)]

(viii) Grant received by subsidiary Company from holding Company sec.10 (40)

(ix) Income of Insurance Regulatory Authority [sec. 10 (23BBC)

(x) Pension or family pension of gallantry award winners sec. 10 (18).

2.3 Deductions under Chapter VI 'A' applicable to Individual

The Chapter VI 'A' of the Income tax act provides for the deductions an assessee can claim in Computing the total Income. It includes sec. 80C to 80U these are explained as :-

1. Deductions U/s 80 C –

The following are the main provisions of sec. 80C.

(i) It is available from Gross total Income.

(ii) It is available to Individual or HUF.

(iii) It is available on the basis of specified qualifying investments/contributions etc. can be made out of taxable income

(iv) Maximum amount of deduction is Rs.1.5 Lakhs.

- **Computation of deductions u/s 80c –**

  Following are the 2 steps,

  Step I – Gross Qualifying amt.

  Step II – Amt. of deduction.

Step I – Gross qualifying amt. It is the aggregate of the following –

(1) Life Insurance premium.

(2) Contribution towards statutory PF and Recognized PF.

(3) Contribution towards PPF.

(4) Contribution towards approved super annuation fund.

5) Subscription to NSS VIII issue.

6) Contribution to ULIP scheme by UIT, LIC mutual fund.

7) Payment for notified annuity plan of LIC. (e.g. New Jeevan Dhara, New Jeevan akshay.)

8) Payment in respect of non-commutable deferred annuity.

9) Subscription towards notified units of mutual Fund.

10) Contribution to notified pension fund. (set up by mutual fund or UIT)

11) Any sum deducted from salary payable to Govt. Employee for the purpose of serving him a deferred annuity (subject to a maximum of 20% of salary)

12) Any sum paid (including accrued interest) as subscription to home loan account scheme of National housing bank.

13) Any sum paid as tuition fees to any university/college /educational institution.

14) Any payment towards the cost of purchase or construction of residential property (including repayment of loan taken from Govt. bank LIC,NHB etc.)

15) Amount invested in approved debenture /equity shares (in a public co. engaged in infrastructure, power sector, etc.)

16) Amount deposited as a term deposit for a period of 5 years or more.

17) Subscription to any notified bonds of NABARD.

Step II : Amount of deduction

- **The amount of deduction is calculated as,**

  (a) Gross qualifying amount. (step I amount.)

  (b) Rs. 1,50,000 whichever is lower.

2. Deduction under Sec. 80 D – Medical Insurance Premia

(i) Taxpayer is an individual

(ii) Insurance scheme is framed by central insurance company & approved by central government

(iii) It is essential to issue cheque of insurance premium by an assessee

(iv) Premium is paid out of income chargeable to tax.

(v) Mediclaim policy is taken on the health of Individual, this spouse, dependent parents, dependent children.

(vi) Mediclaim policy is taken on the health of any member of the family, in case of HUF.

Amount of deduction –

It above conditions are satisfied then the insurance premium paid or 15000 whichever is lower, is deductible (maximum amt. of Rs. 15000 increased to Rs. 20000 if the family Member consist a senior citizen).

3. Sec. 80 DD- Deduction in respect of maintenance including medical treatment of handicapped dependent –

The assesses should be either an individual or a HUF. He may have incurred some amount for medical treatment or training or rehabilitation of handicapped dependent or may have deposited some amount in an approved scheme by LIC or UIT for such handicapped dependent.

The subscriber should have made nomination of either handicapped dependent or any other person, trust to receive the payment and use it for the benefit of handicapped dependent. The assesses can claim deduction under this section of Rs50000 (A higher deduction of Rs 1,00,000 shall be allowed it dependent is a person having disability ever 80%)

4. Sec. 80 DDB – Deduction in respect of medical Treatment –

The deduction is available to individual and a HUF. The assessee should have actually incurred some expenditure on medical treatment for specified ailments. In case of an individual the expenditure might be for himself or any dependent relative. for HUF it can be for any Member of is Rs. 40,000 and if the patient is a senior citizen the amount of deduction shall be Rs. 60,000 or the expenditure actually incurred whichever is lower.

5. Sec. 80 E – Deduction in respect of Interest of loan taken for higher educations.

The assessee should be an individual. It is available to student & not to parent. Loan is taken from any financial institution or banking company. The deduction is available for maximum 7 years & it is available only for amount paid by way of interest & not for repayment of principal Loan amount.

6. Sec. 80G – Deductions in respect of Donations –

Only donations in cash qualify for the deduction. Generally the Qualifying Amount of donations should not exceed 10% of Gross total Income after deductions allowed under chapter VI 'A'.

Dontations to following funds / Institutions are100% deductible.

(i) National Defence fund by Central Govt.

(ii) Prime Minister National Relief fund

(iii) National foundation for communal harmony.

(iv) Any State Government Fund for providing medical relief to tried poor.

(v) Chief Minister's Earthquake Fund, Maharashtra.

(vi) Zilla Saksharta Samiti.

(vii) Central welfare fund of army &air force.

(viii) Andra Pradesh chief minister cyclone relief fund.

(ix) National Illness Assistant fund.

(x) National sports fund or National cultural fund.

Donations to following are 50% deductible-

(1) Any notified temple, mosque, gurudwar church or other place of workshop.

(2) Any corporation specified in sec. 10 (26BB) for promoting interest of minority community.

(3) Any other fund or institution which satisfies conditions in 80F(5)

(4) Jawaharlal National Memorial fund

(5) Prime Minister's Drought Relief fund.

(6) Indira Gandhi Memorial Trust.

(7) Rajiv Gandhi foundation

The above deductions are available only to Individual.

2.4 Summary

Sec. 10 of Income Tax Act. 1961 enumerates income which are tax free. They are called exempted incomes. These incomes are not included in computing the total income of on assessee. Any income falling within only of the clauses in sec. 10 shall be exempted. The burden of proving that of particulars item of income falls within this section is on the assessee. Some of the important exempted are agriculture income, receipts from HUF, share of income/ profits from firm, Gratuity etc.

In computing the total income of an assessee, certain deductions, are available from gross total Income. Such deductions are contained in chapter VI 'A' of the Act. And they have been specified in sec. 80C to 80U. The aggregate amount of deductions u/s 80C to 80U cannot exceed Gross Total Income. The main purpose of these deductions is to encourage saving of the people. Every sections in this chapter VI A explains basis of calculations of these deductions.

2.5 Key terms

1. **Exempted Incomes :** Sec. 10 of Income tax Act 1961 contains Incomes which are tax free. These incomes are called exempted Incomes. These incomes are not to be included in computing the total income of an assessee.

2. **Deductions of Chapter VI 'A' :** Chapter VI 'A' of Income Tax Act. 1961 contains certain deductions which are available to assessees. These deductions can be claim by assesses while Computing his total Income. Chapter VI 'A' covers sec. 80C to 80U.

3. **Exemption and Deductions :** Exemption covers Incomes which are not taxable where as deductions covers incomes which are allowed to be deducted from Gross total Income.

2.6 Self-Assessment Questions

(A) Objective Type Questions

I. Choose the correct alternative:

1. Maximum limit of exemption u/s 10(10)in respect of gratuity is …………..

   (a) Rs. 2,50,000 (b) Rs. 3,50,000 (c) Rs. 5,00,000 (d) Rs. 7,00,000

2. Agriculture income is ………..

   (a) fully exempted (b) fully taxable

   (c) Partially taxable (d) None of the above

3. Sec. 80 DD in respect of maintenance of handicapped dependent available to …………

   (a) Individual (b) Individual & HUF only

   (c) HUF (d) HUF, firm & company.

4. Medical Insurance Premium u/s 80 D available only when it is paid by –

   (a) cash (b) cheques (c) DD (d) all of the above.

5. Donation to National Defence fund is ………. % deductible.

   (a) 50% (b) 60 (c) 70 (d) 100

Ans. : [1. d 2. a 3. b 4. b 5. d]

II. State True or False.

1. Section 10 of income tax Act Contains all exemption income
2. Deduction U/s 80E is in relation to donations.
3. Any Grauity received by Govt., semi Govt. employee is taxable.
4. Donations given to Prime Minister's Draught relief fund is deductible at 100% from total Income.
5. Maximum limit of deduction U/s 80C is Rs. 1,50,000.

Ans. : [1. T 2. F 3. F 4. F 5. T]

(B) Short answer questions -

1. Explain House Rent Allowance u/s 10 (13A).
2. Explain Interest on Certain Govt. Securities [sec 10 (15)]
3. Explain Medical Insurance Premium u/s 80 D.
4. Explain Deduction in respect of donations u/s 80 G.
5. Explain any 8 incomes exempted from income tax.

(c) Essay Type Questions –

1. Enumerate incomes which are totally exempt.
2. Explain briefly the provisions of the Income tax Act 1961, regarding deductions allowable in computing the total income of the Individual.
3. Explain briefly the provisions of sec. 80C and 80 D.

2.7 Further Readings

1.	Students Guide to Income Tax	:	Dr. Vinod singhania Dr. Monica Singhania.
2.	Income Tax Rules 1961	:	Taxman publication
3.	Direct Tax Laws	:	Dinkar Pagare Sultanchand & sons publication
4.	Income Tax Laws & Practice	:	Dr. Mehotra H.C.
5.	Direct Tax	:	T. N. Manoharan

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Unit-3

Heads of Income, Computation of total income and tax liability

Structure of Unit

3.0 Objectives:

After studying this Unit you will able to understand the:

- To comprehend the meaning of salary, allowances, perquisites and various retirement benefits and admissible deductions from salary income and calculation of Income from salary
- Determine annual value of different kinds of house property and computation from income from house property
- To comprehend the meaning of meaning of business and profession, identify allowable and disallowed expenditure, maintenance of books and computation of Income from business and profession

- Identify the assets classified as a capital assets for the purpose of chargeability under capital gain, determining short term and long term capital assets, meaning of transfer, different exemptions available for investments of capital gain, compute the capital gains chargeable to tax .
- Indentify the income which are chargeable to tax under the head income from other source, admissible deductions and computation of income from other source
- Computation of total taxable income and tax liability of an individual as per income tax provisions.

3.1 Introduction:

In the previous chapter you have learnt different exemptions and deductions from total Income of Individual. Person earns income from different sources. Income tax is imposed on assessee's total income. Section 14 of Income Tax Act 1961, classified and taxable under particular groups or heads. These known as 'Heads of Income'. These heads of income grouped under five heads which are as under :

1) Income from salaries
2) Income from house property
3) Income from Business and profession
4) Capital gains
5) Income from other sources

Assessee's income is computed under each head separately by applying charging and Deeming provisions of the act, Income tax act providing different permissible deductions and exemptions from gross total income.. after claiming the deduction under chapter VI A if any, from the gross total income, we get the taxable income of assessee.

Lets understand in detail five different heads of income and income tax provisions for Computation of income. Person earn income different sources but all this income are Classifies under five heads of income.

3.2 Presentation of Subject Matter

3.2.1 Income from salaries :

The provisions relating to income under the head salaries are mentioned in section 15, 16 and 17 in income tax act. The condition for compute income under the head Salaries is that the relation between payer and payee of such payment should be of An employer and employee. Salary consist of Allowances, perquisites, retirement Benefits.

- **Concept of Salary:**

Meaning of salary for income tax purposes is much wider. Salary means every Payment monetary or non -monetary made by employer to employee for Service rendered by employee.

1) The amount received by an individual shall be treated as salary only if the relationship between payer and payee of such payment should be of an employer and employee .
2) Conceptually salary and wages are same there is no difference.
3) It does not matter whether the employment is full time or part time. Once the relationship between employer and employee exists the income is to be charged under the head 'salaries'. If an individual receives salary from more than one employer during previous year is taxable under the head salary
4) Salary received from former employer, present employers or prospective employer should be clubbed and bought to charges under the head salary for relevant previous year
5) Once salary has accrued to an employee it subsequent waiver by the employee does not absolve him from liability to income tax.
6) If an employee surrenders his salary to the central government, the surrender salary would be exempt while computing his taxable income.
7) If employer pay the tax which is due on salary the amount of tax paid by the employer and salary received from employer both are taxable as salary income.
8) Voluntary payments by employer in the form of gift or perquisite are taxable under head salary.

- Definition of salary:

Section 17(1) of the income tax act gives an inclusive definition of salary which includes:

a) Wages

b) Any annuity and pension

c) Gratuity

d) Fees, commission, allowances , perquisites or profit in lieu of salary

e) Any advance of salary

f) Leave Encashment

g) Any advance of salary

h) Contribution of employer to Recognized Provident Fund to the extent it is taxable

i) The contribution made by central government or any other employer to the to the account of an employee under notified pension scheme

j) Transferred balance in a recognized provident fund to the extent it is taxable

- **Basis of Charge: U/s .15**

1) As per section 15 of the Act the income from salary is chargeable to tax on 'due' or 'receipt' basis whichever is earlier.

2) where any salary, paid in advance, is chargeable in the year of payment, it cannot be subsequently chargeable to tax in the year in which it becomes due.

3) Any arrears of salary paid or allowed to employee in the previous year by or on behalf of employer or former employer, if not assessed to tax in any earlier previous year then only taxable.

- **Profits in lieu salary :[sec.17(3)]:**

These payments are received by employee in addition to salary and wages. It includes the following:

a) Any compensation received by an Individual from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions of employment. The termination may be due to retirement, premature termination, and resignation or otherwise.

b) The payment due to or received by an assessee from an unrecognised provident fund or an unrecognised superannuation fund to the extent to which such it does not consist of employees contributions or interest on such contribution.

c) Any sum received under key man insurance policy including the sum allocated by way of bonus on such policy, will also be considered as profit in lieu of salary.

d) Any amount received in lump sum or otherwise prior to employment or employment or after cessation of employment.

e) All other payments received by an employee from his employer or former employer except the following.

Payment of gratuity exempted under section 10(10)

Payment of House Rent Allowance exempted under section 10(13A)

Payment of commuted pension exempted under section 10(10A)

Payment of retrenchment compensation exempted under section 10(10B)

Payment from an approved superannuation fund under section 10(13)

Payment from statutory provident fund or public provident fund

Payment from recognized provident fund to the extent it is exempt under section 10(12).

- **Pension:**

Pension is a periodical payment made by the employer to the employee after the retirement or death of employee as a reward for past service.

Pension is of two types: commuted and un-commuted.

Un-commuted or periodical pension: Un- commuted pension received periodically. It is fully taxable in the hands of both government and non-government employees.

Commuted pension: Commuted pension means lump sum amount taken by commuting the whole or part of the pension.

Exemption in respect of commuted pension [Sec.10 (10A)]:

a) For the employee of government organization, local authorities, statutory corporations-It is fully exempt from tax hence not included in gross salary.

b) For other employees:- any commuted pension received is exempt from tax to the following extent .

Gratuity received / Not received	Exemption
Gratuity **received**	Commuted value of **one third** of the pension is exempted from tax.
Gratuity **not received**	Commuted value of **one half** of the pension is exempted from tax.

c) Any commuted pension received by an individual out of annuity plan of the fund set up by LIC will be exempt.

Illustrations 1

Mr. Suresh retired on 1.10.2020 is receiving Rs. 5,000/- per month as pension. On 1.02.2021, he commuted 60 % of his pension and received Rs. 3,00,000/- you are require to compute his taxable pension assuming :

a) Suresh is a Government employee

b) He is a private sector employee and received gratuity also at the time of retirement.

c) He is a private sector employee and he did not receive gratuity at the time of retirement.

Solution:

a) Suresh is a government employee :

Uncommuted pension received (October to March) (5000 x 4 months) + (40% of 5000 x 2 months)	24,000
Commuted pension received Rs. 3,00,000 Less: Exempt u/s 10(10A) - Rs. 3,00,000	Nil
Taxable pension	**24,000**

b) Suresh is private sector employee and received gratuity –

Particular	Amount
Uncommuted pension received (October to March) (5000 x 4 months) +(40% of 5000 x 2 months)	24,000
Commuted pension received Rs. 3,00,000 Less: Exempt u/s 10(10A) Rs. 1,66,667 $(\frac{1}{3} \text{ x } \frac{3,00,000 \, x \, 100\%}{60\%})$	1,33,333
Taxable pension	**1,57,333**

c) Suresh is private sector employee and did not receive gratuity:

Particular	Amount
Uncommuted pension received (October to March) (5000 x 4 months) + (40% of 5000 x 2months)	24,000
Commuted pension received Rs. 3,00,000 Less: Exempt u/s 10(10A) Rs. 2,50,000 $(\frac{1}{2} \text{ x } \frac{3,00,000 \, x \, 100\%}{60\%})$	50,000
Taxable pension	**74,000**

Gratuity:

Gratuity is the payment made by the employer to the employee in appreciation of past services rendered by employee. In short gratuity is the retirement benefit.

Exemption in respect of Gratuity [sec 10(10)]: Tax treatment of gratuity is given below :

i) **Government employees** and employees of local authority: The entire amount of gratuity received received by them is exempted from tax**.**

ii) **Employees covered under payment of Gratuity Act, 1972-** Any death-cum-retirement gratuity is exempt from tax to the extent of least of the following;

1	Gratuity actually received
2	Rs. 20,00,000
3	15 days of salary for every completed year of service or part thereof in excess of six months

Note : 1) Salary for the purpose means basic pay and dearness allowance

2) Number of days in a month for this purpose, shall be taken as 26

iii) Other employees:

In case of employees not covered in the above two categories, gratuity received from the employers is exempt to the extent of minimum of following.

1	Gratuity actually received
2	Rs. 20,00,000
3	Half month of average salary for every completed year of service (fraction to be ignored) (Based on last 10 months average salary preceeding the month of retirement)

Note: : 1) Salary for the purpose means basic pay , dearness allowance (if terms of employment so provide),commission (if it is based on fixed percentage of turnover)

2) Gratuity received during period of service is fully taxable

Illustrations 2

Mr. Shankar retired on 15/06/2020 after completion of 26 years 8 months service and received gratuity of Rs. 16,00,000. His monthly basic salary at the time of retirement was Rs. 70,000 p.m., Dearness allowance Rs. 14,000 p.m. (60% of which for retirement benefits), Commission 1% of turnover (Turnover in last 12 months was Rs. 1,50,00,000), Bonus Rs. 30,000 p.a.

Compute his taxable gratuity assuming –

a) He is private sector employee and covered by payment of Gratuity Act, 1972

b) He is private sector employee and not covered by payment of Gratuity Act, 1972

c) He is a Government employee

Solution :

a) He is covered by payment of Gratuity Act,1972:-

Particular	Amount Rs.	Amount Rs.
Gratuity received at the time of retirement		16,00,000
Less: Exemption u/s 10(10) Least of the following		13,08,461
a) Statutory limit b) Gratuity received c) 15 days salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months $\frac{15}{26}$ x (70,000 + 14000) x 27 15/26 x 84000 x 27	20,00,000 16,00,000 13,08,461	
Taxable Gratuity		**2,91,538**

b) He is covered by payment of Gratuity Act ,1972:-

Particular	Amount Rs.	Amount Rs.
Gratuity received at the time of retirement		16,00,000
Less: Exemption u/s 10(10) Least of the following		11,81,700

a) Statutory limit b) Gratuity received c) Half month's of salary based on average salary of last 10 months preceding the month of retirement For each completed year of service (Note)	20,00,000 16,00,000 11,81,700	
Taxable Gratuity		**4,18,300**

Note: $\frac{1}{2}$ × Average salary × year of service

$$\text{Average Salary} = \frac{(70{,}000x10)+(14{,}000x60\%x10)+[1{,}50{,}00{,}000x1\%\ x\frac{10}{12}}{10}$$

$$= \frac{7{,}00{,}000+84{,}000+1{,}25{,}000}{10} = 9{,}09{,}000/10 = 90{,}900$$

1/2**x** 90,900 x26 = 11,81,700

C) He is Government employee:

Particular	Amount Rs.	Amount Rs
Gratuity received at the time of retirement		16,00,000
Less: Exemption u/s 10 (10)		16,00,000
Taxable Gratuity		**Nil**

- **Leave salary or Leave Encashment :-**

Employees are allowed to take various kinds of leave during the period of service some of these leaves is not availed by employee are allowed to be encashed every year or accumulated for future and encashed after retirement or death as per the rules of the organization. The payment received on account of encashment of leave would form part of salary. Tax treatment for leave salary under section 10(10AA) are as under :

Nature of leave encashment	Status of employee	Tax treatment
Received during service	Government and non government employee	Fully taxable, However relief can be taken u/s 89
Received at the time of retirement /leaving job	Government employee	Fully exempt u/s 10(10AA)(i)
Received at the time of retirement /leaving job	Non- Government employee	Least of following is exempt: a) Rs. 3,00,000 b) Leave salary actually received c) Cash equivalent of leave standing at the credit of employee (Based on average salary of last 10 months) (Maximum 30 days for every year of service) d) 10 month's salary (based on average salary of last 10 months preceding retirement)

- **Voluntary Retirement compensation (Sec.10(10c):**

Any amount of received or receivable on voluntary retirement would be taxable as profit in lieu of salary. However it would be exempt subject to following :

Status of employee	Tax treatment
Central and state government employee, public sector company, any other company, local authority, cooperative society, IIT etc	Least of following is exempt : a) compensation actually received b) Rs. 5,00,000 c) 3 month's salary × completed year of service d) last drawn salary × remaining months of service left

- **Retrenchment Compensation: [Sec10(10B)]:**

Least of following is exempt :

a) Compensation actually received

b) Rs. 5,00,00

c) 15 days average pay × completed year of service and part thereof in excess of 6 months .

- **Leave Travel Concession (LTC): [Sec.10(5)]:**

Exemption is available for 2 trips in a block of 4 calendar year :

Journey performed by	Exemption
Air	Amount of economy class air fare by the shortest route or amount spent whichever is less
Any other mode:-	
i) Journey performed by rail	Amount of air –conditioned first class rail fare by the shortest route or amount spent, whichever is lower.
ii) Rail service is not available	
a) And public transport does not exist	An amount equal to air –conditioned first class rail fare by the shortest route, as if the journey had been performed by rail,
b) But public transport exists	Amount not exceeding first class or deluxe class fare by shortest route to the place of destination.

- **National pension scheme (NPS):**

Contribution made by employer to NPS account of employee is first included under the salary, but at the time computation of total income of employee a deduction u/s 80CCD is available to employee for employees and employers contribution.

- **Provident funds:**

Provident fund is a retirement benefit scheme. Under this scheme a certain amount is deducted by the employer from the employee's salary as his contribution towards the fund. The employer also generally makes matching contribution to the provident fund. The employees and employers contribution are invested outside in securities. The interest earned on it is also credited to the Provident Fund Account. At the time of retirement, the accumulated balance is given to the employee.

Following of the different types of provident funds:

1) Statutory Provident Fund (S. P. F):

These provident fund set up under Provident Fund Act, 1925. This is maintained by the government and the semi government organizations, local authorities, universities and recognized educational institutions.

2) Recognised Provident Fund (R.P.F.):

This is set up under the Employee's Provident Fund Act, 1952 and is maintained by private sector employees. These provident fund are recognized by the commissioner of Income Tax

3) Unrecognized Provident Fund: (U. R.P.F.)

If a provident fund is not recognized by the Commissioner of Income Tax. These fund approved by commissioner of Provident fund.

4) Public Provident Fund (P. P. F.):

The central government has established these fund under Public Provident Fund Act, 1968. The membership of the open to every individual. Minimum contribution to the fund Rs. 500.

Income tax Provisions for Provident Fund :

Particular	**R. P. F.**	**U. R. P. F**	**S. P. F.**	**P. P. F.**
Employees contribution Or assesses	Eligible for deduction u/s 80 C	Not eligible for deductions	Eligible for deduction u/s 80 C	Eligible for deduction u/s 80 C

contribution				
Employer's contribution	Amount in Excess of 12 % of salary is taxable	Not taxable yearly	Exempt from tax	Employer does not contribute
Interest credited	Amount in excess of 9.5 % p.a. is taxable	Not taxable yearly	Exempt from tax	Exempt from tax
Amount received on retirement	Exempt if, continuing service over five years, entire balance transferred to his NPS account , on cessation of employment and get new employment to the extent of accumulated balance in RPF account transferred to his RPF account maintained by the new employer.	Employers contribution and interest there on is taxable as salary Employees contribution is not taxable. Interest on employees contribution taxable as income from other source.	Fully exempt from tax	Fully exempt from tax

Note: Salary for R. P. F. Basic salary, dearness allowance (if enters retirement benefit), Fixed percentage commission on sales.

- **Allowances:**

Allowance is the fixed monetary amount paid by employer to employee for the meeting particular requirements like house rent, expenses of uniform, conveyance etc.

Various types of allowances are as under

A) Fully Taxable Allowances :

Dearness Allowance	Entertainment Allowance
Overtime Allowance	Fixed Medical Allowance
City Compensatory Allowance	Interim Allowance
Servant Allowance	Project Allowance
Tiffin/Lunch/Dinner Allowance	Any other Cash Allowance
Warden Allowance	Non-Practicing Allowance
Transport Allowance for to employee other than handicapped/blind, deaf and dumb	Washing Allowance
Conveyance Allowance for personal use	Conveyance Allowance (Unspent allowance)

B) Fully Exempted Allowances :

Allowance to high court judge	Allowance paid by united nations organization
Compensatory allowance received by Judge	Allowance granted to government employee outside India.
Sumptuary Allowance to high court or supreme court judge	

C) Allowances which are Partly exempted :

i) House Rent Allowance [Sec. 10(13A)]:

HRA is given by employer to employee towards payment of rent for residence is taxable under the head of salaries. It is exempt u/s 10(13A) to the extent of the **leas**t of the following:

Metro cities (Mumbai, Delhi, Kolkata, Chennai)	Other places in India
a) Actual amount of HRA received	a) Actual amount of HRA received
b) Rent paid (-) 10% of salary for the relevant period	b) Rent paid (-) 10% of salary for the relevant period
c) 50% of Salary	c) 40% of Salary

Note: 1) Salary for this purpose include: Basic pay, Dearness Allowance (if enters for retirement benefit), Commission (if it is based on fixed percentage of turnover achieved by employer)

2) If the employee is not paying any rent or the rent paid by he is less than 10% of salary then exemption is not available.

ii) Notified Special Allowances [Sec.10 (14)]:

Notified special allowances which are exempt either in full or up to certain limit provided they are not in the nature of Perquisites. These allowances are of two types.

I. **Allowance exempt to the extent of actual expenditure or actual amount received whichever least. They are following. [sec.10 (14)(i)]**

a) Travelling Allowance: Any allowance granted to meet the cost of travel or tour on transfer of duty.

b) Daily Allowance: The allowance granted for the period of Journey on tour or transfer to meet the ordinary daily charges.

c) Conveyance Allowance: Any allowance granted to meet the expenditure incurred on conveyance in the performance of duties of an office.

d) Helper Allowance: Any allowance granted to meet the expenditure incurred on a helper where such helper is engaged in the performance of the duties of an office or employment of profit.

e) Research Allowance: The allowance granted for encouraging the academic research and training in educational institutions.

f) Uniform Allowance: Any allowance granted to meet the expenditure on purchase and maintenance of uniform.

Note: An employee being an assessed that chooses the provision of section 115BAC (alternate tax regime) would be entitled for exemption only in respect of travelling allowance, daily allowance, conveyance allowance in above.

II. Allowances which of exempt to the extent amount received or the Limit specified whichever is least.

Sr. No	**Allowance**	**Exemption limit**
1	Special compensatory Allowance (Hilly Areas) or Snow bound area, Uncongenial allowance (Areas in Manipur, Arunachal pradesh, Sikkim, U.P. , H.P.	Rs. 800 or Rs.300 per month depending on specified location Rs. 7,000 per month in Siachen area of Jammu and Kashmir
2	Border area, Remote Locality or Disturbed Area or Difficult Area Allowance (Subject to certain conditions and locations)	Amount exempt from tax varies from Rs. 200 to Rs. 1,300 per month.
3	Tribal / Schedule /Agency area allowance in (a) Madhya Pradesh (b) Tamil Nadu (c) Uttar Pradesh (d) Karnataka (e) Tripura (f) Assam (g) West Bengal (h) Bihar (i) Orissa	Rs. 200 per month
4	Allowance to a employee of the transport business to meet his personal expenditure during his duty performed in the course of running of such transport from	Amount of exemption shall be lower of following: a) 70% of such allowance; or b) Rs. 10,000 per month

	one place to another place provided employee is not in receipt of daily allowance	
5	Children Education Allowance	Up to Rs. 100 per month per child up to a maximum of 2 children is exempt
6	Hostel Expenditure Allowance	Up to Rs. 300 per month per child up to a maximum of 2 children is exempt
7	Compensatory Field Area Allowance. If this exemption is taken, employee cannot claim any exemption in respect of border area allowance (Specified areas in specified states.)	Rs. 2,600 per month
8	Compensatory Modified Area Allowance. If this exemption is taken, employee cannot claim any exemption in respect of border area allowance(Subject to certain conditions and locations)	Rs. 1,000 per month
9	Counter Insurgency Allowance granted to members of Armed Forces operating in areas away from their permanent locations. If this exemption is taken, employee cannot claim any exemption in respect of border area allowance	Rs. 3,900 per month
10	Transport Allowance granted to an employee who is deaf and dumb, blind or handicapped to meet expenditure on commuting	Rs. 3,200 per month

	between place of residence and place of duty	
11	Underground Allowance to employees working in uncongenial, unnatural climate in underground mines	Rs. 800 per month
12	High Altitude Allowance granted to armed forces	Rs. 1,060 per month - for altitude of 9,000 to 15,000 feet Rs. 1,600 per month - for altitude above 15,000 feet
13	Highly active field area allowance granted to members of armed forces	Rs. 4,200 per month
14	Island Duty Allowance granted to members of armed forces in Andaman and Nicobar and Lakshadweep group of Island	Rs. 3,250 per month

Note: An employee being an assessee who opts for provision of section 115BAC would be entitled for exemption only in respect of Transport Allowance granted to an employee who is blind, or deaf and dumb or Orthopedically handicapped with disability of the lower extremities of the body to the extent of Rs. 3,200 per month.

- **Perquisites :-**

The term perquisite indicates some extra benefits in addition to the amount that may be legally due by way contract for service rendered**.** It may in cash or kind. In modern times salary packages of employees include monetary salary and perquisites.

The term perquisite defined in under section 17(2) of Income Tax Act. Include the following items.

a) The value of rent free accommodation

b) The value of concession rent

c) The value of any benefit or amenity granted or provided free of cost or concessional rate if any.

On the basis of definition perquisites can be classified in following three ways.

I) Perquisites taxable in the case of all employees

II) Tax free Perquisites in case of all employees

III) Perquisites taxable only in the hands of all specified employees

- **Perquisites taxable in the case of all employees:-**

  Perquisites taxable in the case of all employees and their valuation is as Under:

- **Rent free or concessional Rent Accommodation:**

i) If the accommodation is ' UNFURNISHED :-

For Government employees : The value of accommodation shall be equal to the LICENCE FEE charged for such accommodation.

For Non- Government or other employees:-

Valuation is as under as per prescribed rate:

Population of City as per 2001 census	**Where the accommodation is owned by employer**	**Where the accommodation is not owned by employer.**
In cities having population above 25 lakhs	15% of salary in respect of period during which the accommodation is occupied by employee as reduced the rent if any, actually paid by employee.	Actual rent paid or payable by the employer or 15% of salary whichever is lower.
In cities having population above 10 lakhs but does not exceeding 25 lakhs	10% of salary in respect of period during which the accommodation is occupied by employee. as reduced the rent if any ,actually paid by employee.	Actual rent paid or payable by the employer or 15% of salary whichever is lower.
In cities having population up to 10 lakhs.	7.5% of salary in respect of period during which the accommodation is	Actual rent paid or payable by the employer or 15% of salary

	occupied by employee. as reduced the rent if any, actually paid by employee.	whichever is lower.
Accommodation in hotel	----	24% of salary or actual charges paid whichever is less

Note: - Salary for the purpose of Valuation of rent free accommodation includes the following:

1) Basic Salary
2) Dearness Allowance to the extent applicable for retirement benefit
3) Bonus fees and commission
4) Taxable allowances
5) Leave encashment of salary pertaining to the current year.

Following should not be included in salary.

1) Employer's contributions to P.F. and Interest P.F.
2) Dearness Allowance not applicable for retirement benefit
3) Exempted Allowances
4) Value of Perquisites
5) Advance Salary

II. If the accommodation is 'FURNISHED':

Value of Rent free unfurnished accommodation (as per above rule)	xx
Add :- Value of furniture	xx
Taxable value of Rent free furnished accommodation	**xx**
Less :- Rent amount received from employee if any	xx
Taxable value of Rented furnished accommodation	**xx**

Note:

1) Value of Furniture: it includes Radio sets, T.V., Refrigerator, Air conditioners and other household appliances.

If furniture is owned by employer	10% p.a. of the cost of furniture
If furniture is not owned by the employer	Rent /lease of furniture paid by employer

2) If an accommodation is provided in a hotel is not chargeable to tax if the following two conditions are satisfied.

i) Total period not exceeding in aggregate 15 days in previous year.

ii) Such accommodation is provided to an employee's transfer from one place to another.

A) Monetary obligations of the employee discharged by the employer :-

- **Valuation of Free domestic Servants :**

If domestic servants are engaged by the employee and the employer paid or reimbursed to the employee for the wages of such servants the actual cost to the employer shall be taxable in the hands of all employee.

- **Valuation of perquisite in respect of gas, electric energy or water supply :**

If the gas, electric energy or water connections are taken by the employee and employer paid or reimbursed such expenses then actual expenditure of the employer as reduced by any amount recovered from employee, is a taxable in the hand of all employee.

- **Valuation of perquisite in respect of education facility :**

Children's education fee paid or reimbursed. (Bills issued in the Name of employee**)**

- Holiday home facility
- Hotel bill or club bill of employee discharged by the employer
- Income tax or Professional tax of employee paid by the Employer.

C) Life Insurance premium or Deferred Annuity Premium of Employee paid by employer.

D) Specified security or sweat equity shares allotted or transferred by employer.

E) The amount or aggregate of amounts of any contribution made –

In Recognized Provident Fund,

In NPS referred to in section 80CCD (1)

In an approved superannuation fund

By the employer to the account of employee, to the extent is Exceeds Rs. 7, 50,000. [section17 (2) (vii)}

F) Annual accretion by way of interest, dividend, or any other amount

Similar nature during the previous year to the balance at the credit of RPF/NPS/Approved superannuation fund to the extent its relate to employer contribution to the included in total income on account of the same having exceeded Rs. 7,50,000.

G) Any other Fringe Benefits –

Any other amenity includes following:-

i) Interest free or concessional rate loan :

Interest free or concessional rate loan given by an employer to employee or his family member chargeable to tax in the hand of all employees are taxable on following basis.

1) Find out the maximum outstanding balance for each loan as on the last day of each month.
2) Find out rate of Interest charged by State Bank of India (SBI) on the first day of relevant previous year in respect of loan for the same purpose advanced by it.
3) Calculate interest for each month of the previous year on the outstanding amount (mentioned in point 1) at the rate of interest (given in point 2)
4) Find Interest actually recovered if any
5) The balance amount is taxable value of perquisite (point 3-point 4)

No value would be charges as perquisite if

a) Loan in aggregate does not exceed Rs 20,000

b) Loan is provided for treatment of specified diseases (Rule 3A) like neurological diseases, Cancer, AIDS, Chronic renal failure, Hemophilia (specified diseases)

ii) Use of movable assets of the employer by the employee is a Taxable perquisite as under: 17(2)(viii) read with Rule 3(7)(vii)

Use of Laptops and Computers	Nil
Movable asset other than Laptops, computers and Motor Car	10% of original cost of the asset (if asset is owned by the employer) or actual higher charges incurred by the employer (if asset is taken on rent) less amount recovered from employee.

ii) Transfer of movable assets by an employer to its employee:-

17(2)(viii) read with Rule 3(7)(viii)

The value of benefit arising to the employee from the transfer of any movable asset owned by the employer is to be determined as under :

Asset transferred	**Value of perquisite**
Computers, Laptop and Electronics items	Original cost of asset less depreciation at 50% (using reducing balance method) for each completed year of usage by employer less amount recovered from the employee
Motor Car	Original cost of asset less depreciation at 20% (using reducing balance method) for each completed year of usage by employer less amount recovered from the employee
Any other asset	Actual cost of asset less depreciation at 10% (on SLM basis) for each completed year of usage by employer less amount recovered from the employee.

iv) Travelling, touring and accommodation: 17(2)(viii) read with Rule 3(7)(ii)

a) Facility of travelling, touring and accommodation availed of by the Employee or any member of his household for any holiday.

b) Perquisite value taxable in the hands of employee shall be expenditure incurred by the employer less amount recovered from employee

c) Where such facility is maintained by the employer, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public less amounts recovered from employee.

v) Free food and non-alcoholic beverages: 17(2)(viii) read with Rule 3(7)(iii) :

a) Fully Taxable: Free meals in excess of Rs. 50 per meal less amount paid by the employee shall be a taxable perquisite

b) Exempt from tax: Following free meals shall be exempt from tax

- Food and non-alcoholic beverages provided during working hours at office or
- Through non-transferable paid vouchers usable only at eating joints (exemption would not be available in case of employee being an assessee, who opts for the provisions of section115BAC) provided by an employer is not taxable, if cost to the employer is Rs. 50or less per meal.
- Tea, Coffee or Non-Alcoholic beverages and Snacks during working hours are tax free perquisites;
- Food in office premises during working hours in remote area or an off-shore installation.

vi) Gift or Voucher or Coupon:- 17(2)(viii) read with Rule 3(7)(iv):

- Gifts in cash or convertible into money (like gift cheque) are fully taxable.
- Gift in kind up to Rs.5,000 in aggregate per annum would be exempt, beyond which it full amount would be taxable It may be given an ceremonial occasion or otherwise. The gift may be given to the employee or any his family member by the employer.

vii) Credit cards: 17(2)(viii) read with Rule 3(7)(v):-

An employer gives credit card to employee or his family Member, credit card which can be used for personal purpose also. In Such as case the membership fee annual fees paid by the employer Will be taxed as perquisite as under

- Personal expenditure incurred by the employer in respect of credit card used by the employee or any member of his household less amount recovered from the employee is a taxable perquisite
- Expenses incurred for official purposes shall not be a taxable perquisite provided complete details in respect of such expenditure are maintained by the employer

viii) Free Recreation/ Club Facilities: 17(2)(viii) read with Rule 3(7)(vi):

- Expenditure incurred by the employer towards annual or periodical fee etc. less amount recovered from the employee is a taxable perquisite.
- Expenses incurred on club facilities for the official purposes are exempt from tax.
- Use of health club, sports and similar facilities provided uniformly to all employees shall be exempt from tax.
- In case corporate membership of club fee to acquire corporate membership is not treated as perquisite
- **Tax- free Perquisites in all cases:-**

A) Medical facilities: [Proviso to section 17(2)]:

Expense incurred or reimbursed by the employer for the medical treatment of the employee or his family (spouse and children, dependent - parents, brothers and sisters) in any of the following hospital is not chargeable to tax in the hands of the employee:

- Hospital maintained by the employer.
- Hospital maintained by the Government or Local Authority or any other hospital approved by Central Government
- Hospital approved by the Chief Commissioner having regard to the prescribed guidelines for treatment of the prescribed diseases.

- Payment or reimbursement of Health Insurance premium of employee by employer.
- Amount paid or reimbursed for medical treatment of employee or any family member in outside India is tax free to the extent permitted by Reserve Bank of India.

B) **Refreshment**: Any refreshment provided by employer to employees during office hours at a place of work are tax free.

C) **Subsidized lunch** or dinner provided by employer at office in office hour is tax free if cost of per meal is less than Rs. 50.

D) **Training facility**: Amount spent on training of employee is Tax free.

E) **Free telephone including mobile phone**: Telephone provided to an Employer to an employee at his residence. Telephone or Mobile bill paid by employer is tax free

F) **Transport facilities**: Transport facilities provided by an employer Engaged in the business of carrying of passenger or goods to his employees either free of charge or at concessional rate.

G) Employer contribution to staff group insurance scheme is fully exempt.

- **Perquisites taxable on in case of 'specified employees':**

[Section 17(2)(iii)]:

Meaning of Specified employees:

The following employees are called specified employees.

a) A director employee of a company.

b) An employee who has substantial interest in a company.

A person has a substantial interest in a company if he is a beneficial owner of equity shares carrying 20% or more voting power in a company.

c) Employee drawing salary in excess of Rs. 50,000.

Salary for this purpose shall include all taxable monetary payments but shall not include the value of any nonmonetary perquisite. From salary deduct entertainment allowance if applicable and tax on employment.

Following are the taxable perquisites in case of specified Employees only.

A) Car facility :

The valuation of a car facility is done as under :

i) Car is owned or hired by the employer and used only for the office duties employee :NIL

ii) **If car is owned or hired by the employer and provided to the employee used exclusively for private purpose** of employee The amount spent by employer on running and maintenance of the car during the previous including the chauffeur's salary ,if any shall be taken as value of perquisite. If the car is owned by the employer, even the amount of no wear and tear of the car calculated at 10% of the cost of the car should further added to such value.

iii) If car is owned or hired by the employer & provided to employee to be party for private purpose and partly for office :

Exp. Of the car By…	Small car 1600 cc or Less engine capacity	Large car of more than 1600 cc engine capacity
A EMPLOYEE	Rs.600 p.m.	Rs.900 p.m.
B EMPLOYER	Rs.1800 p.m.	Rs.2400 p.m.

If the chauffeur's is also provided by the employer to run the car, the value perquisite increased by the Rs.900 p.m.

iv) **If employee owns any automotive conveyance (other than car) and running and maintenance charges are met or reimbursed by employer :** The value will be NIL if it is used wholly for official purposes. If 'Specified conditions' are satisfied. But if the conveyance is used partly for official are partly for private purpose, the actual expenditure incurred employee as reduced by Rs. 600 p.m. (or as reduced by a higher amount specified conditions) given below are satisfied is taxable.

v) **If any other conveyance** like scooter/ motor cycle is provided by the employer. The value of perquisite is the amount actually spent by the employee on the running and maintenance of conveyance attributable to the private use being reasonable in the opinion of the Assessing officer.

vi) **If car owned by the employee, expenses incurred by employer and used for partly official and partly personal purposes** Actual expenditure incurred by employer minus expenses pertaining to official use minus anything recovered from employee, is taxable in the hands of employee. Expenditure pertaining to official use can be calculated as per logbook of the car. Alternatively, expenditure pertaining to official use can be calculated at the rate of Rs. 1800 per month (1600 cc or less) / Rs. 2,400 per month (above 1600 cc) for car and Rs. 900 per month for driver.

vii) The use of vehicle by an employee for traveling from his residence to place of work and back shall not be perquisite at all.

B) **Free Education Facilities** : The value of benefit to the employee resulting from provision of free or concessional education facilities member of his household (i.e. spouse, children & their spouses, servants and dependents) shall be as under.

i) **Where educational institution is owned by employer**: The value benefit will be treated NIL, if the cost of education does not exceed Rs, p.m., per child. But if the cost of education exceeds Rs.1, 000 p.m. shall be treated as the value of perquisite.

ii) **Where educational institution is not owned by the employer**: The perquisite shall be taxable for all employees on the basis of school fees reimbursed by the employer in respect of education provided to the me of his household (i.e. spouse, children & their spouses, parents, servant dependents) Tuition fee chargeable to tax **Scholarship** given by employees children of its employee is not assessable perquisite in the hands of employer.

C) Valuation of provision for domestic servants :

If domestic servant engaged by employer and facility of such servants provided to the employee, it will be taxable in the hands of only specified employee**.** If any amount paid by employee for such services the amount so paid shall be deducted from the value of perquisite.

D) Free supply of Gas electricity and water :

If the gas, electric energy or water connections are taken in the name of employer and facility of such supplies provided to employee it will be perquisite in the hand of only specified employee. Value of such benefit determined as under

Circumstances	Value of benefit
If purchased from outside & supplied to	Amount paid to the supplier

employee	
If supplied from own source	Manufacturing cost per unit incurred by the employer

If any amount paid by employee for such services the amount so paid shall be deducted from the value of perquisite.

- **Deductions from salaries: (Section 16)**

  From salary income only following deductions are allowed:

- **Standard Deduction: u/s .16(i)**

  The standard deduction of Rs. 50,000 or the amount of salary, whichever is Lower is to be deducted from gross salary of employee.

- **Entertainment Allowance: u/s. 16(ii)**

  Entertainment Allowance received by an employee is first added in salary Income and there after deduction is to be made from gross salary.

However this **deduction is available only to the Government Employee.** The Amount of deduction will be lower of following:-

i) 20% of basic salary

ii) Actual Entertainment Allowance received

iii) Rs. 5,000

Actual amount spent by employee towards entertainment out of the allowance received by him is not a relevant consideration.

- **Professional Tax on employment : u/s 16(iii) –**

  Professional Tax or Tax on Employment, levied by a State under article 276 of The Constitution, is Allowed as Deduction.

The following points should be kept in view —

1) Deduction is available only in the year in which professional tax is paid.
2) If the professional tax is paid by the employer on behalf of an employee, it is first Included as salary income and then the same amount is allowed as deduction on

   Account of "professional tax" from gross salary.

3) There is no monetary ceiling under the Income-tax Act. Under article 276 of the Constitution, a State Government cannot impose more than Rs. 2,500 per annum as professional tax. Under the Income-tax Act, whatever professional tax is paid during the previous year is deductible.

- **Computation of Income From Salary :**

Computation of Taxable income from salary of Mr./ Mrs.….. for the Assessment year 2021-2022 Financial year : 2020-2021. PAN:

Particulars	Rs.
1) Basic Salary (* 12)))	XXX
2) Dearness Allowance (* 12)	XXX
3) City Compensatory Allowance (* 12)	XXX
4) Entertainment Allowance, Tiffin allowance (* 12)	XXX
5) Medical Allow,/ Servant Allow/ Other Special allowances (* 12)	XXX
6) Bonus, Commission, Fees	XXX
7) Advance of Salary/Arrears of Salary / Ex. Gratia payment	XXX
8) Pension or annuity, leave encashment while in service	XXX
9) H.R.A.(Exempt a. H.R.A. received b. rent paid less 10% of salary c. 50% of salary In Mumbai, Delhi, Kolkata & Chennai or 40% in other place whichever is less)	XXX XXX XXX
10) Children Education Allowance (Exempt Rs. 100 P.m. per child up to 2 children)	XXX
11) Children Hostel Allowance (Exempt Rs. 300 P.m. per child up to 2 children)	XXX XXX
12) Assesses in Transport system: Transport Allow, (exem. 70% of allow. Or Rs. 10,000 p.m. whichever is less)	XXX XXX
13) Employer's contribution to Recognized Provident fund in excess of 12% of salary	XXX
14) Interest on Provident Fund exceeding 9.5% p.a.	XXX
15) Gratuity (Less : Exempt u/s 10 (10)	XXX

16) Commuted value of pension (Less : Exempt u/s 10 (10A)	XXX
17) Leave salary (less : exempted u/s 10 (10AA)	XXX
18) Rent-free Accommodation (As per rules)	XXX
19) Domestic Servants (As per rules)	
20) Personal payments of employee paid by employer and Other perquisites.	**XXX**
GROSS SALARY	XXX
Less Deductions :	
1.Standard Deduction u/s 16(i)	
2. Entertainment Allowance u/s 16 (ii) [20% on Basic pay] (If assesses is of Govt. Servant)	
3. Professional / Employment Tax u/s 16 (iii)	
TAXABLE AMOUNT OF SALARY	$\boxed{\textbf{XXX}}$

- **Illustrations :**

Illustration 1

Mr. Anup an employee of Infosys ltd. Pune, gives you details of his salary for the year ended 31/03/2021 as under :

i) Basic salary Rs. 25,000 p.m.

ii) D.A. Rs. 15,000 p.m. (considered for retirement benefit)

iii) Transport Allowance Rs. 1,500 p.m.

iv) Children Hostel Allowance Rs. 1,500 p.m. for 3 children.

v) Children Education Allowance Rs. 1,500 p.m. for 3 children.

vi) The company contributes Rs. 5,000 p m. towards his R.P.F.

vii) Rs. 14,500 was credited to his RPF as interest @14.50% p.a.

vii) He paid professional tax Rs. 2,500 during the year.

You are asked to compute the income from salary for the A. Y. 2021-2022 assuming Mr. Anup has not opted for the provisions of section 115BAC.

Answer:

Computation of Income from Salary of Mr. Anup For A. Y. 2021-2022

Particular	**Rs.**	**Rs.**
1) Basic Salary (Rs. 25,000 x12)		3,00,000
2) D. A. (Rs. 15,000x12)		1,80,000
3) Transport Allowance (Rs. 1,500x12)		18,000
4) Children Hostel Allowance :-		46,800
Amount Received (Rs.1,500x12x3)	54,000	
Less : Exemption (u/s.10(14)) (Rs. 300x12x2)	-7,200	
5) Children Education Allowance :-		51,600
Amount Received (Rs,1,500x12x3)	54,000	
Less: Exemption (u/s.10(11)) (Rs. 100x12x2)	- 2,400	
6) Employer contribution to R.P.F. (Rs.5,000x12)	60,000	2,400
Less: Exemption (see Note 1)	-57,600	
7) Interest on RPF 14.5%	14,500	725
Less: Exempt (u/s.10(11)) [14500x9.5%]	13,775	
Gross Salary		**5,99,525**
Less: Deduction u/s 16		52,500
i) Standard deduction 16(i)	50,000	
ii) Professional tax 16(iii)	2,500	
Taxable Income From Salary		**5,47,025**

Note:1) Employer Contribution to Recognized Provident Fund (RPF):

Salary for RPF	**Rs.**
Basic Salary	3,00,000

D. A. (Applicable)	1,80,000
Salary for RPF	4,80,000

Employer's contribution exempted up to : 12% of salary i.e Rs. 4,80,000 x 12% = Rs. 57,600.

Illustration 2

Mr. Arjun, a GST officer from Kolhapur submits the following details for computation of his salary income for the assessment year 2021-2022.

Particular	Rs. P.a.
Basic pay	2,52,000
Dearness Allowance (forming part of salary)	54,000
House Rent Allowance	24,000
Children's Hostel Allowance (for three children)	3,000
Entertainment Allowance	2,400
Employer's contribution to Statutory Provident Fund @14% of Basic salary and D. A.	42,840
Interest credited to above PF account @12% p. a.	51,120
Transport Allowance	14,400
Rent paid by Mr. Arjun for residence	36,000
Mr. Arjun has been granted a soft loan of Rs. 2,00,000. On 01-10-2020 repayable after 5 years. The state Bank of India interest rate is 14% p.a. The interest rate on this soft loan charged is 2% p.a.	
Mr. Arjun was admitted in a Government hospital for treatment against heart trouble. The re-imbursement received by arjun for this medical treatment was Rs.45,000.	
Professional tax paid Rs. 2,500 during the year	

Compute the income from salary for the A. Y. 2021-2022 assuming Mr. Arjun has not opted for the provisions of section 115BAC.

Answer: Computation of Income From Salary of Mr. Arjun for A. Y. 2021-2022

Particular	**Rs.**	**Rs.**
1) Basic pay		2,52,000
2) Dearness Allowance (forming part of salary)		54,000
3) House Rent Allowance :		18,600
Amount Actual Received	24,000	
Less: Exemption u/s 10 (13A) (Note 1)	5,400	
4) Children's Hostel Allowance :		Nil
Amount Actual Received	3000	
Less: Exemption us u/s 10(14) (300x12x2)	7200	
5) Entertainment Allowance		2,400
6) Employer's contribution to Statutory Provident Fund (Exempt)		Nil
7) Interest credited to above PF account @12% p. a. (Exempt)		Nil
8) Transport Allowance		14,400
9) Concessional Rate loan (2,00,000 X 12%X6/12)		12,000
10) Reimbursement of medical expenditure at government hospital (Exempt)		Nil
Gross Salary		**3,53,400**
Less: Deductions u/s 16		54,900
i) Standard deduction u/s 16(i)	50,0000	
ii) Entertainment Allowance u/s 16(ii) (note 2)	2,400	
iii) Professional Tax u/s. 16(iii)	2,500	
Taxable Income From Salary		**2,98,500**

Note: **1) House Rent Allowance :**

Salary for HRA	**Rs.**
Basic Salary D. A. (Applicable)	2,52,000 54,000
Salary for HRA	3,06,000

Exempt least of the following	Rs.
1) H. R. A. received	24,000
2) Rent Paid (-) 10% of salary	5,400
[(36,000-(3,06,000 x 10%)] 36,000-30,600=5,400	
3) 40% of Salary (3,06,000 x 40%)	1,22,400

Exempted House Rent Allowance Rs. 5,400.

2) Entertainment Allowance :

Exempt least of the following	**Rs.**
1) Actual Allowance Received	2,400
2) 20% of basic pay (2, 52,000X20%)	50,400
3) Maximum Rs. 5000	5,000

Deduction available Rs.2,400.

Illustration 3

Mr. Ravi, a Managing director of LKP ltd. Delhi, receives the following salary and perquisite from his employer during the previous year 2020-2021.

1) Basic salary Rs. 66,000 p.a.
2) Bonus Rs. 18,000
3) D. A. Rs. 2,000 p.m. (enters into retirement benefit)
4) Commission on sales at 4 % turnover of Rs. 18,50,000
5) Advance salary of Rs. 22,000
6) Employer contribution towards recognized provident fund Rs. 18,000.
7) Interest credited in RPF Account at. 13% Rs. 13,000.

8) A rent free furnished house in Delhi. (Rent of furnished house paid by employer Rs. 84,000 rent of furniture Rs. 18,000.)

9) He has provided free services of a Gardner salary Rs. 4,000 p.a. free services of cook salary is Rs. 3,600 p.a. of watch man salary Rs. 900 p.a.

10) Mr. Ravi's 2 children are studying in the school run by the employer. The cost of education in similar institution per student is Rs. 1,000 p.a.

11) Electricity bill paid by employer Rs. 3,000 p.a.

12) He has been provided 1800 cc car for both official and private purpose. The Running and maintenance expenses paid by employer.

13) Company is provided free lunch during working days (in all 250 lunches Rs. 70 each)

14) He received Rs. 17,000 by way of reimbursement of the private hospital bill by the Employer.

15) He paid life insurance premium Rs. 15,000 p.a.

16) He paid professional tax Rs. 2,500 p.a.

Compute the income from salary for the A. Y. 2021-2022 assuming he has not opted for the provisions of section 115BAC.

Answer : Computation of Income from Salary of Mr. Raj For A. Y. 2021-2022

Particular	**Rs.**	**Rs.**
Basic salary		66,000
Bonus		18,000
D. A. (2,000X12)		24,000
4% commission on sales (Rs. 18,50,000X4%)		74,000
Advance salary		22,000
Employer contribution to RPF	18,000	Nil
Less: Exempt u/s 10(11)(12) (Note -1)	-19,680	
Interest on R.P, F. @13%	13,000	3,500
Less: Exempt u/s10 (11)(12) 9.5%	-9,500	
Value of rent free furnished accommodation (Note-2)		45,300
Grander salary		4,000

Cook salary		3,600
Watchmen salary		900
Education facility (1,000 x 12X2)	24,000	Nil
Less : Exempt up to (1,000 x 12X2)	24,000	
Electricity bill paid by employer		3,000
Value of motor car facility (Note -3)		28,800
Lunch facility (Rs. 50 x 250 days)	17,500	
Less: Exempt up to (Rs. 20 x 250 days)	-12,500	5,000
Reimbursement of Hospital bill		17,000
Gross Salary		3,15,100
Less: Deduction u/s 16		52,500
i) Standard deduction u/s 16(i)	50,000	
ii) Professional Tax u/s 16(iii)	2,500	
Taxable Income From Salary		**2,62,600**

Note:**1) Employer Contribution to Recognized Provident Fund (RPF):**

Salary for RPF	**Rs.**
Basic Salary	66,000
D. A. (Applicable)	24,000
4% commission	74,000
Salary for RPF	**1,64,000**

Employer's contribution exempted up to: 12% of salary i.e Rs.1,64,000 x 12% = Rs. 19,680

2) Value of Rent Free Furnished accommodation –

Accommodation is not owned by employer.

Salary for Accommodation	**Rs.**
Basic Salary	66,000
D. A. (Applicable)	24,000
4% commission	74,000

Bonus	18,000
Salary for accommodation	**1,82,000**

Particular	Rs.	Rs.
Value of furnished accommodation is **lowe**r of following		
a) Rent paid by employer	84,000	
b) He is at Delhi So 15 % of salary (1, 82,000 x 15%)	27,300	
Value of unfurnished accommodation		27,300
Add: value of furniture		+18,000
Value of rent free furnished accommodation		45,300

3) Value of Motor car facility:

Situation: Car owned by employer and expenses paid by employer

Purpose: Official and private

Engine capacity (C.C.): 1,800 C.C. Above 1,600 CC

Value of Motor car: Rs. 2,400 x12 = **Rs. 28,800**

Illustration 4) Mr. Sachin is General Manager of a Raftar Ltd. Delhi. He has submitted the following particulars of his income for the financial year 2020-2021.

1) Basic salary Rs. 1,10,000 p.a.
2) D. A. Rs. 2,000 p. m. (Rs. 500 p.m enters in to retirement benefit
3) Medical Allowance Rs. 500 p.m.
4) Commission on sales Rs. 20,000
5) Entertainment allowance Rs. 800 p.m.
6) Travelling Allowance for his official tour Rs. 40,000 actual expenditure on tour Rs. 27,000
7) He was given cloth worth Rs. 2,000 by his employer free of cost.
8) He resides in the Bungalow of the company. Its fair rent is Rs. 2,000 p.m. He pays Rs. 11,000. p.a. as a rent for the house. Furniture of Rs.60.000 is also provided by company.

9) A watchmen and a cook have been provided by the company who were paid Rs. 400 p.m. each

10) He had been provided with motor car of 1.8 liter engine capacity power for his official as well as personal use. Running and maintenance expenses are born by the company

11) Professional tax paid Rs. 2,500 p.a.

Compute his income from salary for the A. Y. 2021-2022 assuming he has not opted for the provisions of section 115BAC

Answer: Computation of Income from Salary of Mr. Sachin For A. Y. 2021-2022

Particular	**Rs.**	**Rs.**
Basic Salary		1,10,000
Dearness Allowance (Rs. 2,000 x 12)		24,000
Medical Allowance (Rs. 5,00 x 12)		6,000
Commission		20,000
Entertainment allowance (Rs. 800 x 12)		9,600
Travelling Allowance for official use	40,000	13,000
Less: Actual expenditure exempt [u/s 10(14)]	-27,000	
Free cloth given by employer (exempted)		Nil
Value of rented furnished accommodation (Note .1)		19,690
Watchmen Salary (Rs. 400 x 12)		4,800
Cook salary (Rs. 400 x12)		4,800
Value of motor car facility (Note.2)		28,800
Gross Salary		2,40,690
Less: Deduction u/s 16		52,500
i) Standard deduction u/s 16(i)	50,000	
ii) Professional Tax u/s 16(iii)	-2,500	
Taxable income from salary		**1,88,190**

Note: 1) Value of concessional rent furnished accommodation –

Accommodation is owned by employer.

Salary for Accommodation	**Rs.**
Basic Salary	1,10,000
D. A. (500X12)	6,000
Commission	20,000
Medical Allowance	6,000
Entertainment allowance	9,600
Travelling Allowance	13,000
Salary for accommodation	**1,64,600**

Particular	Rs.
Value of furnished concessional rate accommodation :	
He is at Delhi So 15% of salary (1,64,600 x15%)	24,690
Add: value of furniture (Rs.60,000 x10%)	6,000
Value of rent free furnished accommodation	30,690
Less: Amount collect from employee	-11,000
Value of furnished concessional rate accommodation	**19,690**

2) Value of Motor car facility:

Situation: Car owned by employer and expenses paid by employer

Purpose: Official and private

Engine capacity (C.C.): 1,800 C.C. Above 1,600 CC

Value of Motor car : Rs. 2,400 x12 = **Rs. 28,800**

Illustration : 5) Mrs. Radhika employed as lecturer in private Institute at Pune, gives you, her earnings during the year 2020-2021.

1) Basic pays Rs. 30,000 p. m.
2) D.A. 5,000 p. m. (enter for retirement benefit)

3) H.R.A. 2,500 p.m.

4) Gratuity received Rs. 30,000 p.a.

5) She gets education allowance Rs.1500 p.m. per child for 2 children

6) She paid professional tax Rs. 2,500 pa

7) Employer‘s expenditure on free supply of gas, electricity and water Rs. 3000

8) She get conveyance allowance Rs. 3,400 p.a. spent Rs. 2,400.

Compute her income from salary for the A. Y. 2021-2022 assuming she has opted for the provisions of section 115BAC.

Answer : Computation of Income from Salary of Mrs Radhika For A. Y. 2021-2022

Particular	**Rs.**
Basic salary (30,000x12)	3,60,000
D.A. (5,000x12)	60,000
H.R. A .(2500x12)	30,000
Gratuity received (Gratuity received in employment is taxable)	30,000
Education allowance (Rs.1500 x 2 x 12)	36,000
Free supply of gas, electricity and water	3,000
Conveyance allowance (3400-2400)	1,000
Gross Salary	5,20,000
Less: Deduction u/s 16	
i) Standard deduction u/s 16(i)	Nil
ii) Professional Tax u/s 16(iii)	Nil
Taxable income from salary	**5,20,000**

Note : The following are the deductions and exemptions cannot claim by Radhika as she opt opted for the provisions of section 115BAC.

1. The standard deduction, professional tax.
2. House Rent Allowance (HRA)
3. Children education allowance

- **Check your progress: I**

A) Choose correct alternative from the given alternatives .

i) Advance salary of an employee is taxed in the year _________.

a) of receipt b) To which is becomes due

c) As decided by the employee d) As decided by the employer

ii) Any payment received by an employee from his former employer shall be charged to tax under the head ______.

a) Salary income b) Income from other sources

c) Capital gains d) Profits and gains from Business or Profession

iii) Gratuity received by a government employee is ____________

a) Fully exempt b) Fully taxable

c) Exempt up to certain limit d) None of the above

iv) The concession available while valuing perquisites in respect of meal provided to an employee is Rs. ________ per meal.

a) 200 b) 100 c) 25 d) 50

v) While computing perquisite in respect of interest free loan, small loans upto Rs. ______/- in the aggregate shall be ignored. (i.e. exempt).

a) 20,000 b) 25,000 c) 2,00,000 d) 2,50,000

B) Fill in the blanks.

i) Value of rent free unfurnished accommodation in the hands of private sector employee (where accommodation is owned by the employer) is _______% of salary where population of city is 8 lakhs.

ii) Meaning of term "Salary" is defined under section _____ of the Act.

iii) In case of Government employee the maximum deduction for entertainment allowance Rs.

iv) Employer does not contribute to ------- provident fund

v) Un commuted pension is ________ whether received by the Government employee or non-government employee

3.2.2 Income from House Property :

- **Introduction** An Owning a house is everybody dream for this, every one saves towards this and hopes to achieve this one day. A house property could be home, an office, a shop, a building or some land attached to the building like a parking lot. The Income Tax Act does not differentiate between a commercial and residential property. All types of properties are taxed under the head 'income from house property' The Income from house property is computed on the annual value basis.
- **Basis of Charges (Section 22):**

  For computation of Annual value require to fulfill following conditions:

  a) The property should consist of buildings or lands appurtenant or (connected) thereto.

  b) Assesses should be owner of property owner means legal owner and deemed owner.

  c) Property should not be occupied by the owner for his own business or profession.

  d) Property held as stock in trade etc. Annual value of house property will be charged under the head Income from house property where it is held by assesses as a stock in trade of a business also.
- **Annual Value : (Section 23)**

Annual value is the amount arrived after deducting the municipal taxes Actually paid by the owner during the previous year from the gross Annual Value. The Gross Annual Value of let out house property is determined by taking in to consideration following four factors.

a) Actual Rental Value :

Actual rental value is the sum for which the property is let out. The rent receivable of received us reduced by the amount spent by the owner on meeting the obligations of tenant if the obligations of owner met by the tenant the rent received or receivable is increased by the value of obligation.

b) Municipal Value :

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

c) Fair Rent :

Fair rent means rent which similar property in the same locality would fetch.

d) Standard Rent :

Standard rent is rent fixed by Rent Control Act. The land lord cannot reasonably accept from tenant anything more than standard rent.

- **Determination of Annual Value:**

For computation of the annual value, house properties can be classified in to the following types.

1) Let out property
2) Self- occupied house property
3) House property let out for part of the year and self occupied for part of the year
4) House partly self occupied for residence and partly let out
5) More than one house self occupied (Deemed let out)
6) House reserved for self occupation

Detrmination of annual value for different types of house properties as under :

- **Let out property : [Section 23(1)]:**

Where the property is let out for the whole year computation of Annual value calcualte infollwing step;

Step:1. Ascertain Gross Annual Value :(GAV)

a) Findout expected rent or reasonable lettable value :

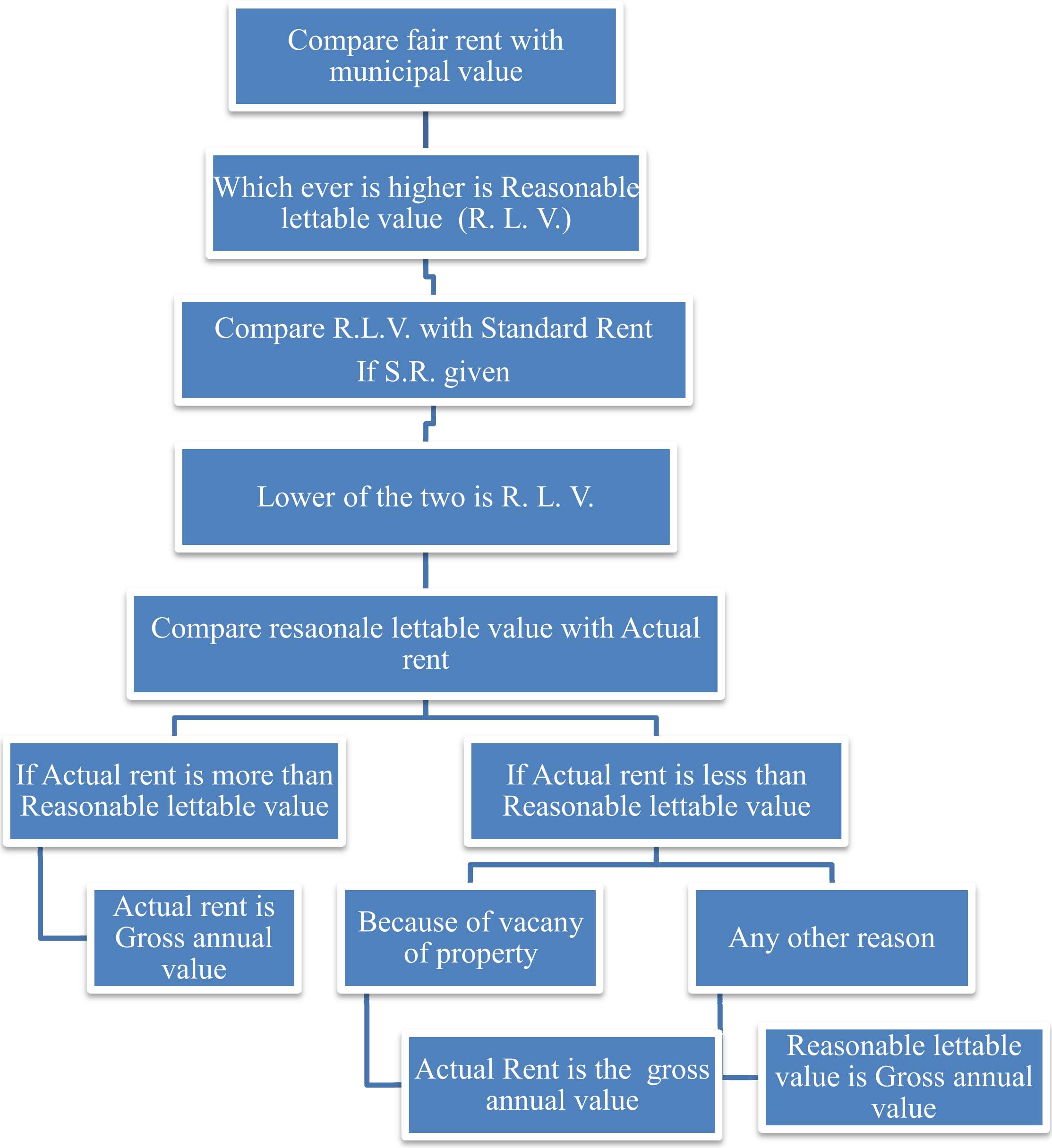
If the Rent Control Act is not applicable where hosue proprty is let out then expected rent or reaonable lettable value is fair rent or munucipal value whichever is more. If the Rent Control Act is applicable for the palce where hosue proprty Is let out, then expected rent or reaonable lettable value should not exceed the Standard Rent given under Rent Control Act.

b) Gross Annual Value :

Where the property is let out and the actual rent recevied and receivble by the owner is in excess of the Reasonable lettable value as above the amount so received shall be the Gross Annual Value. Where the let out property was vacant during the whole year or part of year and owing to this vacancy the acutal rent received or receivable by the owner in respect of there is less than the reasonable lettable value the amount so received or receivable shall be the Gross Annual Value .

c) The unrealsied rent if any may be decuted from the rent received/receivable only if the tenancy is bonafide.

Computation of Annual Value at glance :



Step II. Deduct Municipal Taxes:

Property taxes are allowable as deduction from gross annual value if it should be actual **paid by owner of property during previous year**. If the local taxes born by the tenant no deduction is to be made.

Step III. Allow deductions u/s. 24:

There are two deductions from Annual value :-

i) **Standard deduction under section 24 (a)** :

This is a flat deduction at the rate 30% of the net annual value of the let out property is allowed in respect of the actual expenditure incurred for the repairs and other incidental expenditure. This deduction allowed can be claimed irrespective of fact whether the actual expenditure on house property is more or less than **30% of annual value**. In case of self occupied property standard deduction is not allowed as its annual value is Nil.

ii) **Interest on borrowed capital under section 24(b):**

Interest payable on funds borrowed for the purpose of purchase, construction, repairs or renewal of house property is allowed as a deduction. However, the interest on loan taken on security of house property for any other purpose such as marriage or medical expenses etc. is not available as deduction. Interest payable on fresh loan taken for repay the original loan taken earlier for the house construction, purchase or renovation is also admissible as deduction.

a) Interest for preconstruction period: Preconstruction period is the period prior to the previous year in which property is acquired or construction is completed**.**

Interest for Preconstruction period is accumulated and can be claimed as deduction over a period of 5 continuous year in equal installments, from the year of completion of construction.

b) Interest on post construction period: Post construction period starts from the beginning from the financial year in which construction is completed.

Illustrations : 1) From the following particulars of three let out house properties, ascertain the annual value of each house.

Properties	I	II	III	IV
a) Municipal value	1,50,000	2,00,000	2,50,000	5,50,000
b) Fair rent	2,00,000	1,50,000	2,00,000	6,00,000
c) Standard Rent	N.A.	N.A.	N.A.	7,50,000
d) Annual rent	1,00,000	1,20,000	3,60,000	7,20,000
e) Municipal taxes paid:				
By Owner	15,000	10,000	-	--
By Tenant	--	--	25,000	50,000
f) Months vacant	---	3months	---	---
g) Unrealized rent	---	---	20,000	----

Answer: Computation of Annual Value

Properties	I	II	III	IV
Gross Annual Value :				
a) Municipal value	1,50,000	2,00,000	2,50,000	5,50,000
b) Fair rent	2,00,000	1,50,000	2,00,000	6,00,000
c) Higher of (a) and (b)	2,00,000	2,00,000	2,50,000	6,00,000
d) Standard Rent	N.A.	N.A	N.A	7,50,000
e) Reasonable Lettable Value (lower of (c) and (d) above	2,00,000	2,00,000	2,50,000	6,00,000
f) Actual rent received or receivable (excluding unrealized rent)	1,00,000	1,20,000	3,40,000	7,20,000
Gross Annual Value (Higher of (e) and (f) above	**2,00,000**	**2,00,000**	**3,40,000**	**7,20,000**
Less : Vacancy period rent if any	**----**	**Nil**	**----**	**----**
(As short fall is not due to vacancy alone)				
	2,00,000	**2,00,000**	**3,40,000**	**7,20,000**
Less: Municipal taxes paid by owner	15,000	10,000	----	----
Annual value	**1,85000**	**1,90,000**	**3,40,000**	**7,20,000**

- **Self –occupied for Residence (SOR) : Sec. 23(2)(a)(i):**

Where proprty is self occupeid for own redidecne during the whole previous year .

Annual value of such property will be **Nil if the following two condtions are fullfilled**

1) No other benefit is derived by the owner from scuch property.

2) The propety is not let out catually during any part of the year .

The benefit of Nil annual value is availabel only for up to two self occupied or unoccupied house proprties

Dedcucions u/s 24 : Interest on loan taken for SOR property will be allowed as a deduction as are under : (Interest include $1/5^{th}$ of accumulated interest of preconstrucion period.)

Sr. No	Condition	Deduction Amount
1	**Loan borrowed before 1-4-1999:** Where property has been purchased, constructed, reapired or rennovate with borrowed capital before 1-4-1999	Actual interest payable in aggregagate for one or two self occupied properties, subject to maximum of Rs. 30,000.
2.	**Loan borrowed on or after 1-4-1999:** a) Where property is acquired or constructed with fudns borrowed on or after 1-4-1999 and such aquition or construction is completed within 5 years from the end of the financial year in wich the fund was borrowed . b) Where property is repaired, renewed with fudns borrowed on or after 1-4-1999	Actual interest payable in aggregagate for one or two self occupied properties, subject to maximum of Rs. 2,00,000. Actual interest payable in aggregagate for one or two self occupied properties, subject to maximum of Rs.30,000

However the total interest deduction udner (1) and (2) can not excceed Rs. 2,00,000.

Example : Manas is the owner of a hosue occupied by him throught the previos year for his own residence Municipal valie of the property is Rs. 2,15,000, where as fair rental value Rs. 2,25,000. The following expenses are incurred by Manas municpal tax Rs. 21,500, insurance Rs. 2,000, interest on borrowed capital to construct the property Rs. 1,66,000, interest on capital borrowed by mortgaging the property for daughter's marriage Rs. 20,000. Compute the income from house property if the housing loan was borrowed on -

a) 01/01/1999

b) capital borrowed on 01/06/1999

Computation of income of Self occupied house property

Particualr	If loan taken 01/01/1999	If loan taken 01/05/1999
Gross Annual Value	Nil	Nil
Less :Municipal tax	Nil	Nil
Net Annual value	Nil	Nil
Less: Interest on borrowed capital	-30,000	-1,66,000
House property Income	**-30,000**	**-1,66,000**

- **Partly Self –occupied and partly Let out :**

If part of house is let out and the other part is self occupeid for residance during the year, the annula value of self occupeid part is taken to be the NIL and the annual value of let out portion is detremined as let out house property .

- **Where hosue self occupeid for a part of the previosu year ans let out for the part :[Section23 (3)] :**

a) If a singal unit of property is sellf occupied for part of the year and let out for the ramaning part of the year, then the fair rent of the property for the whole year shall be taken in to account for detrminig gross annual value.

b) The fair rent of the whole year shall be comapred with the actual rent for the let out period and which ever is higher shall be adopted as the Gross Annual Value.

c) Municipal tax paid by the owner for the whole year shall be allowed as deduction.

d) Interest for loan taken for the whole year shall be allowed as deduction.

- **In case of deemed to be let out property : [Section 23(4)]:**

a) In case the assesse occupies **more than two** properties for self occupation then the income from **any two properties**, at the option of the assessee ,is treateds as self occupied and its annual value is considered to be NIL .

b) Other self occcupied properties will be treated as “Deemed to be let out properties".

c) In case deemed let out property ,the Municipal value or fair rent ,whichever is higher but subject to maximum of standard rent.

d) Question of actual rent received /receivable does not areise.

e) Municipal taxes actually paid by the owner during the previosu year can be claimed as dedcution.

f) Standard deduction and Interest on borrowed capital can be claimed as dedcution.

- **In case of Hosue property held as stock in trade (Section23(5):**

    a) In case property held as stock in trade and whole or any part of property may not be let out during the whole or part of the previous year .

    b) The annual value of such property shall be NIL.

    c) This benefit would be available for the period up to two years from the end of the financial year in which certificte of complition of constrcution oF property is obtained.

- **Compiosit Rent:**

    i) Property owner may sometimes receive rent inrespect of building as well as other assets and for different services provided in building like furniture, machinery, lift etc. The amount so received as known as composite rent.

    ii) Tax treatment :

        a) Letting out of building and letting out of other assets are inseparable (i.e., both the lettings are composite and not separable) In this situation, entire rent is taxed under the head "Profits and gains of business or profession" or "Income from other sources". This rule is applicable even if rent of both lettings is fixed separately.

(b) Letting out of building and letting out of other assets are separable (i.e., both the lettings are separable) (e.g., letting out of bike along with building). In this situation rent of building is taxed under the head "Income from house property" and rent of other asset is taxed under the head "Profits and gains of business or profession" or "Income from other sources" (as the case many be). This rule is applicable even if the assessee receives composite rent for the two lettings.

- **Amount not Deductible (Section 25):**

a) Interest on borrowings payable outside India is not deductible from annual value if no tax has been deducted at source and person receiving such interest is not assessed in India nor any of his representative is taxed in India.

b) i) In case the unrealsied rent already as allowed deuction ia realised subsequenltly from the teanant shall be demmed to income from house property in the financial year in which such rent is reeived .

ii) Section 25A(2) provides a dedcution of 30% of arrears of rent subsequently realsied .

- **Property owned by co-owners (Section 26):**

i) Where property consisting of building or buildings and lands appurtenant there to is owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not in respect of such property be assessed as an association of persons but the share of each such person in the income from the property as computed in accordance with sections 22 to 25 and included in his indiviaul total income of the previous year.

ii) Where such property is in the joint occupation of the owners, the annual value of property of each co owner will be Nil and each cowner shall be entitled to dedcution for Interest on borrowing of Rs. 30,000/2,00,000 as the case may be. however, if the co ownres another self occupied proprty, the aggregate interest from the co owned property and other self occupied property can not exceed Rs. 30,000 and 2,00,000 as the case may be.

iii) In case, the share of each co owner is not definite and un certainable, the income from such house property will be assessed udner the status of Association of persons .

- **Computation of Income from house property at Glance :**

1) If property is let out

Particular	Rs	Rs.
Gross Annual Value :		
a) Municipal value	xx	
b) Fair rent	xx	
c) Higher of (a) and (b)	xx	
d) Standard Rent	xx	
e) Reasonable Lettable Value	xx	
(lower of (c) and (d) above		
f) Actual rent received or receivable (excluding unrealized rent)	Xx	
Gross Annual Value (Higher of (e) and (f) above	Xx	
Less : Vacancy period rent if any	Xx	
(As short fall is not due to vacancy alone)		
Less: Municipal taxes paid by owner	Xx	
Net Annual Value (NAV)		xx
Less: Deductions under section 24		xx
i) Standard deduction (30% of NAV)	Xx	
ii) Interest on housing loans	Xx	
Add: Arrears of rent received		xx
Unrealized rent realized	Xx	
Less: Standard deduction 30%	-xx	
Add: Unrealised rent past collected		xx
Income from let out house property		**xxx**

ii) If property is self occupied :

<table>
<tr><td>Particualr</td><td>Rs.</td></tr>
<tr><td>Gross Annual Value
Less :Municipal tax
Net Annual value
Less: Interest on borrowed capital</td><td>Nil
Xxx
Nil
Xxx</td></tr>
<tr><td><table>
<tr><td>If property acquired or consructed with capital borrowed</td><td>Maximum limit</td></tr>
<tr><td>Up to 31/03/1999</td><td>30,000</td></tr>
<tr><td>On or after 01/04/1999</td><td>2,00,000</td></tr>
</table></td><td></td></tr>
<tr><td>Loss from self occupied House property</td><td>Xxx</td></tr>
</table>

- **Illustrations:**

Illustration 1) Mr. Sangram has two houses in Pune. The constrcution of both these houses got completed on 1 st July 2018. The particualrs of these houese for the year ending 31/03/2021 are as udner :

Particualr	House I	House II
Municipal valuation	1,50,000	1,00,000
Fair rent	1,80,000	1,20,000
Standard rent as per Rent Control Act	1,35,000	96,000
Actual rent received	1,75,000	----
Municipal taxes paid	10% of MV	10% of MV
Fire insuracne	15,000	17,000
Ground rent	4,000	6,000
Land revenue	3,000	2,000
Interest on loan for construction :		
a) Pertaning to period prior to 1-7-2018	60,000	50,000
b) for the year ending 31/03/2021	50,000	45,000
Nature of occupation	Let out for residence	Self occupied

Solution :Computation of Income from Hosue property of Mr.Sangram for F.Y. 2020-2021

Particular	Rs	Rs.
I. Property let out for residence :		
Gross Annual Value :		
a) Municipal value	1,50,000	
b) Fair rent	1,80,000	
c) Higher of (a) and (b)	1,80,000	
d) Standard Rent	1,35,000	
e) Reasonable Lettable Value (lower of (c) and (d) above	1,35,000	
f) Actual rent received or receivable (excluding unrealized rent)	1,75,000	
Gross Annual Value (Higher of (e) and (f) above	**1,75,000**	
Less: Municipal taxes paid by owner	15,000	
Net Annual Value (NAV)	**1,60,000**	**1,60,000**
Less: Deductions under section 24		**1,10,000**
i) Standard deduction (30% of NAV)	48,000	
ii) Interest on housing loans		
for preconstruction period (60000x1/5)	12,000	
for previous year	50,000	
Income from let out house property		**50,000**
II. Self occupied house property :		
Annual value		**Nil**
Less: **Deductions under section 24**		
i) Interest on housing loans		55,000
For preconstruction period (50,000x1/5)	10,000	
For previous year	45,000	
Loss from self occupied house property		**-55,000**

Total taxable income from house property

Particualrs	Amount
House I	50,000
House II	-55,000
Total Income from house property	-5,000

Illustration 2) Mr. Vijay owns one residential hosue at Mumbai. The hosue is having two identical units . first unit of the house is self occupied by Mr. Vijay and another unit is rented for Rs. 8,000 p.m. the rented unit was vacant for 2 monhts during the year. The particualrs of the hosue for the previous year 2020-2021 are as under:

1) Standard Rent Rs. 1,62,000 p.a
2) Municiapl valuation Rs. 1,90,000 p.a .
3) Fair Rent Rs. 1,85,000 p.a.
4) Municipal taxes paid by the Mr. Vijay 15% of municipal value
5) Light and warer charges Rs. 500 p.m.
6) Insurance charges Rs. 3,000 p.a.
7) Interest on borrowed capital Rs. 1,500 p.m.

Compute income from hosue property of Mr. Vijay for the A. Y. 2021-2022

Computation of Income from House property of Mr. Vijay for A.Y.2021-2022

Particular	**Rs**	**Rs.**
I. Property let out for residence (50% of total area)		
Gross Annual Value :		
a) Municipal value (1,90,000/2)	95,000	
b) Fair rent (1,85,000/2)	92,500	
c) Higher of (a) and (b)	95,000	
d) Standard Rent (1,62,000/2)	81,000	
e) Reasonable Lettable Value	81,000	
(lower of (c) and (d) above		
f) Actual rent received or receivable (8,000x12)	96,000	
Gross Annual Value (Higher of (e) and (f) above	**96,000**	

Less Vacancy period rent (8000x2)	16,000	
Less: Municipal taxes paid by owner (95000x15%)	14,250	
Net Annual Value (NAV)	**65,750**	**65,750**
Less: Deductions under section 24		
i) Standard deduction (30% of NAV)	19,725	
ii) Interest on housing loans (750x12)	9,000	**28,725**
Income from let out house property		37,025
II. Self occupied house property (50% of total area)		
Annual value	**Nil**	**Nil**
Less: **Deductions under section 24**		
i) Interest on housing loans (750x12)	**9,000**	9,000
Loss from self occupied house property		**-9000**

Total taxable income from house property :

Particualrs	Amount
House I	37,025
House II	-9,000
Total Income from house property	28,025

Illustration 3) Dilip and Suresh are co owners of a house property with equal share. The property was constructed during the financial year 1998-1999. The propety consists of eight identicle units and it situated at Kolhapur.

During the financial year 2020-2021, each co owner occupies one unit for residence and the balacne of six units were let out at a rent of Rs. 12,000 per month per unit. The municipal value of the house property is Rs. 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows

1) Repairs Rs. 40,000 2) Insurance Rs. 15,000

3) Interest on loan taken for construcion of house Rs. 3,00,000

One of the let out units remained vacant for four months during the year.

Dilip could not occupy his unit for six months as he was transferred to Mumbai. He does not own any other hosue .

Computer the 'Income from Hosue Property' of two brothers for the assessment year 2020-2021.

Computation of Income from House property for A. Y. 2020-2021

Particular	**Dilip Rs.**	**Suresh Rs.**
i)Self Occupied portion (25%)		
Annual Value	Nil	Nil
Less: Deduction u/s 24(b)		
Interest on loan taken for house construction (Note1)	-30,000	-30,000
Loss from self occupied hosue property	-30,000	-30,000
ii) Let out Hosue property (75%) (Note 2)	1,25,850	1,25,850
Total income from house property	**95,850**	**95,850**

Note 1. 300000/8 = 37,500 but restricted to maximum of Rs. 30,000 for each co owner since the property was constructed before 01-04-1999 hence it is assumed that loan was taken for before 1.4.1999

Note 2. Comutation of let out house property income

Particular	**Rs**	**Rs.**
I. Property let out for residence (75% of total area)		
Gross Annual Value :		
a) Municipal value (9, 00,000 x 75%)	6,75,000	
b) Fair rent	-	
c) Higher of (a) and (b)	6,75,000	
d) Actual rent received or receivable (12,000 x 12 x 6)	8,64,000	
Gross Annual Value (Higher of (c) and (d) above	8,64,000	
Less Vacancy period rent (12,000 x 4)	48,000	
Less: Municipal taxes paid by owner (6,75,000 x 20%)	1,35,000	
Net Annual Value (NAV)	**6,81,000**	6,81,000
Less: Deductions under section 24		4,29,300
i) Standard deduction (30% of NAV)	2,04,300	

ii) Interest on housing loans (3,00,000 x75%)	2,25,000	
Income from let out house property		**2,51,700**
Share of each co owner (50%)		**1,25,850**

Illustration 4) Mrs. Poonam has three houses , all of which are self occupied. The particualrs of the houses for the previosu year 2020-2021 are as udner :

Particular	Hosue I	Hosue II	Hosue III
Municipal valuation p.a.	3,00,000	3,60,000	3,30,000
Fair rent p.a .	3,50,000	3,40,000	3,75,000
Date of completion /purchase	31.03.1999	31.03.2001	1.4.2014
Municipal taxes paid during the year	12%	8%	6%
Interest on money borrowed for repair	--	55,000	--
Interest on loan for purcahse of property	---	----	1,75,000

Compute Poonam's income from Hosue property for A.Y. 2021-2022

Solutions: Let us first calcualte the income from each hosue property assuming that they are deemed to be let out .

Computation of Income from Hosue property of Mrs. Poonam for the A.Y. 2021-2022

Particular	**House I Rs**	**House II Rs**	**House III Rs**
Gross Annual Value :			
a) Municipal value	3,00,000	3,60,000	3,30,000
b) Fair rent	3,50,000	3,40,000	3,75,000
Gross Annual Value (Higher of (a) and (b) above	3,50,000	**3,60,000**	**3,75,000**
Less: Municipal taxes paid by owner	36,000	28,800	19,800
Net Annual Value (NAV)	**3,14,000**	**3,31,200**	**3,55,200**

Less: Deductions under section 24			
i) Standard deduction (30% of NAV)	94,200	99,360	1,06,560
ii) Interest on housing loans	----	55,000	1,75,000
Income from let out house property	**2,19,800**	**1,76,840**	**73,640**

Poonam can option to traeat any two of the above hosue properties are self occupied.

Option I . Hosue I and II - Self occupied and house III –deemed to be let out.

Particualr	**Amount Rs.**
House I self occupied	Nil
House II self occupied (Interest deduciton restricted to Rs. 30,000)	-30,000
House III deemed to be let out	73,640
Income from house property	**43,640**

Option II . House I and III - Self occupied and house II –deemed to be let out.

Particualr	**Amount Rs.**
House I Self occupied	Nil
House II deemed to be let out	1,76,840
House III Self occupied	-1,75,000
Income from house property	**1,840**

Option III . House II and III - Self occupied and house I –deemed to be let out.

Particualr	**Amount Rs.**	**Amount Rs.**
House I deemed to be let out		2,19,800
House II Self occupied (Interest deduciton restricted to Rs. 30,000)	30,000	
House III Self occupied	1,75,000	
Total interest deduction restricted to Rs. 2,00,000		-2,00,000
Income from house property		**19,800**

Option II is most benificial, poonam should pot to treat hosue I and III as self occupied and Hosue II as deemed to be let out.her income from house property would be Rs.1,840 for the A.Y. 2021-2022.

Illustration 5) Mr. Milind is the owner of three houses at Aurangabad. He has furnished the following details .

Partiuclar	**House A**	**House B**	**House C**
Hosue used by tenants	Residential	Offcie	Residential
Construction completed	1-4-1999	1-6-2006	31-03-1996
Municipal valuation	1,60,000	1,80,000	1,00,000
Annual fair rent	1,80,000	1,50,000	1,20,000
Rent per month	20,000	12,000	11,000
Repairs expenses	1,000	----	4,000
Renr collection charges	4,000	5,000	--
Ground rent	2000	3000	----
Interest on loan:			
1) For constrcution	1,00,000	---	----
2) For marriage of daughter	----	60,000	----
3) for repaires	-----	-----	10,000
Municiapl Tax 20 % of municipal valuation.	Paid by Onwer	Not paid up to year end	Paid by tentant

The house C remained vacant for 4 months. Ground rent of house B . Arrears of rent for past years colleted during previous year Rs. 1,00,000.

Compute income from house property for assessment year 2021-2022.

Solution :**Statement showing income from hosue property for assessment year 2020-2021**

Particular	**House A**	**House B**	**House C**
	Let out for residence	**Let out Office**	**Let out for residence**
Gross Annual Value : a) Municipal value	1,60,000	1,80,000	1,00,000

b) Fair rent	1,80,000	1,50,000	1,20,000
c) Higher of (a) and (b)	1,80,000	1,80,000	1,20,000
d) Actual rent receivable	2,40,000	1,44,000	1,32,000
Gross Annual Value (Higher of (c) and (d) above	2,40,000	1,80,000	1,32,000
Less Vacancy period rent (11000x4) house C	-----	-----	44,000
Less: Municipal taxes paid by owner @20% paid by owner	32,000		
Net Annual Value (NAV)	2,08,000	1,80,000	88,000
Less: Deductions under section 24			
i) Standard deduction (30% of NAV)	62,400	54,000	26,400
ii) Interest on housing loans		----	-----
- For constructions	1,00,000	------	----
For repairs	-----	-------	10,000
Income from let out house property	**45,600**	**1,26,000**	**51,600**

Total taxable income from house property:

Particualrs		Amount
House A		45,600
House B		1,26,000
House C		51,600
Income from house property		2,23,200
Add: arrears of rent received	1,00,000	
Less: Standard deduction 30%	- (30,000)	70,000
Total Income from house property		**2,93,200**

- **Check your progress II:**

1) Fill in the blanks .

i) The Annual value of self occupied house is -------------

ii) ------------ is the value determined by the municipal authorities for levying municipal taxes on hosue property .

iii) The benefit of Nil value in respecct of upto ----- self occupied houe property is avilable only to an indiviual and HUF for F.Y. 2020-2021.

iv) Standard deduction for let out hosue is ---------- of annual value.

v) If the municipal taxes paid by the tenant ----- is to be made.

3.2.3 Income from Business / Profession

Introduction :

In case asseesee carreid on any buinness or profession by him or his behlaf then inocme from such activityes are taxable under the head Incoem from buiness and profession.

Maximum number if assessees are assessed for tax under this head.

Buisenss : The term business defined in section 2(13) to "includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

Thus business is any activity carried out with the intention to earn profit, whether such an activity is continuous or temporary is immaterial.

Profession : The term profession has been not defined in the Act. It means an occupation requiring to some degree of learning **.** Profession requires intellectual skill or manual skil or both. The examples are doctor , advocate, chatered acountanat, engineers etc The term profeesion include vocations as well.[Section 2(36)]

- **Method of computing taxable income :**

A) Gross Sales or Gross fees as the case may be are to be taken as the base if Receipt and Payment A/c or cash Book is given. From this Gross income expenses which are Specifically allowed by the income tax act are deducted to arrive at taxable income.

B) If profit & loss a/c or income & expenditure a/c is given Net Profit or (Surplus) is Taken as the base and then following adjustments are made:

i) Expenses, which are debited, to profit & loss a/c, but disallowed by the income tax Act and either fully or partially are added back

ii) Expenses, which are not debited, to profit & loss a/c but which are allowed by the Income Tax Act are deducted.

iii) Income that is credited to profit & loss a/c but not taxable at all or taxable under Some different head is to be deducted.

iv) Income that is not credited to profit & loss a/c, but which is chargeable to tax as business income is to be added.

- **Basis of charge: Section 28:**

  Following are the income chargeable to tax under the head Profits or Gains from Business or profession: -

1) **Profit and Gains of any business or profession** that is carried on by the assessee at any time during the previous year.
2) Any **compensation or other paymen**t due to or received by an assessee for loss of agency due to termination or modification of terms.
3) **Income derived by a trade, professional** or a similar association for specific services performed for its members.
4) **Any profit on sale of a license** granted under Imports (controls) Order 1955 made under Imports & Exports (control) Act of 1947.
5) **Any cash assistance** (by whatever name called) received or receivable against exports under any scheme of Government of India.
6) **Any duty of customs or excise** repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duty's Drawback Rules 1971.
7) **Any profit on the transfer of** the Duty entitlement pass book scheme under export import policy.
8) Any profit on the transfer of the **Duty free replenishment certificate** under export import policy.

9) The value of any **benefit or perquisite** whether convertible into money or not arising from business or exercise of a profession e.g. A gift received by the lawyer from his client.

10) Any **interest, salary, bonus, commission or remuneration** due to or received by partner of a firm from such firm.

11) Sum received or receivable in **cash or in kind under an agreement for not carrying** out any activity in relation to any business or not sharing any know how, patent, copyright, trade mark, license franchise or any other business or commercial right of similar nature or information or technique likely to assist the manufacture or processing of goods or provision of services.

12) Any sum received including bonus under Key man Insurance Policy.

13) Any sum received (or receivable) in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, Discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

14) Income from a speculative business.

- **Deductions for expenses specifically allowed under section 30 to 43:-**

Following deductions are expressly allowed as deductions while computing income from business and profession.

1. Rent, rates, taxes, repairs and insurance of building (Section 30):

a) If premises has occupied as a tenant, rent of the premises and if he has agreed to bear cost of repairs, such cost is allowed as deduction, provided it is not in capital nature

b) If the business premise is self owned then the repairs, land revenue, local taxes, insurance premium etc. are allowed as deduction. However, no expenditure in form of capital expenditure is allowed.

2. Repairs & Insurance of machinery, Plant & Furniture (Sec.31):

Amount paid on account of repairs and insurance premium against risk of damage in respect of machinery, plant & furniture are allowed as deduction provided they are not of capital nature.

3. Depreciation u/s 32:

Under Section 32 depreciation on assets is allowed as deduction while computing income from business or profession. To claim this deduction following Conditions should be satisfied:

1) Assessee should be owner of the asset.

2) Asset must be used for the business.

3) Such use must be in the previous year.

Depreciation is allowed not on individual asset items, but on block of assets. The block of assets mean a group of assets within a class of assets in respect of which the same percentage of depreciation is prescribed. The block of assets are as under :

1) Building

2) Plant and Machinery

3) Furniture

4) Intangible Assets acquired after March 31, 1998 such as know-how, Patents, Trademarks, licenses, franchises or any other business or commercial rights of similar nature.

The term plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the business but exclude tea bushes or live stock. If any asset falling in block of assets is acquired during the year and **put to use** during the previous year for **less than 180 days** depreciation on such asset shall be restricted to **50% of the normal depreciation**.

Additional depreciation:

It can be claimed on new plant & machinery acquired after 31st March 2005 by an assessee. In the previous year in which it begins manufacturing or producing or power generation and distribution.

Rate of additional depreciation: 20% of actual cost

Where an assessee, sets up an undertaking or enterprise for manufacture or production of any article or thing, on or after the 1st day of April, 2015 in any backward area notified by the Central Government in this behalf, in the State of

Andhra Pradesh or in the State of Bihar or in the State of Telangana or in the State of West Bengal, and acquires and installs any new asset for the purposes of the said undertaking or enterprise during the period beginning on the 1st day of April, 2015 and ending before the 31/03/2020 in the said backward area, then, there shall be allowed a deduction of 15% and higher depreciation @35% (instated of 20 %) of the actual cost of such new asset for the assessment year relevant to the previous year in which such new asset is installed.

Therefore, if new plant and machinery acquired and installed in notified backward areas on or After 1-4-2020, deduction under section 32 AD is not allowable. Further additional depreciation is not allowable at higher rate of 35%. Additional depreciation allowable at 20%, .

Unabsorbed Depreciation:

If profit for the year is not sufficient to absorb depreciation either fully or partially, unabsorbed depreciation can be deducted from any other head of income. If it still remains unabsorbed it can be carried forward to subsequent assessment years to be adjusted Against future taxable income. It can be carried forward for unlimited period.

Rate of Depreciation :

All assets are divided into four main categoreis and rate of depreciation as prescribed by rule 5(1) are as under :

A. TANGIBLE ASSETS		
I	**Buildings**	Rate of dep,
Block 1.	Residential buildings other than hotels and boarding houses	5%
Block 2.	Office, factory, godown or building which not mainly used for residential purpose (cover hotels & boarding houses & not covered in block1 & 3	10%
Block 3.	Buildings acquired on or after the 1st day of September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infra- structure facilities	40%

Block 4.	Purely temporary erections such as wooden structures	40%
2	**Furniture & Fittings**	
Block 1.	Furniture and fittings including electrical fittings	10%
3.	**Plant & Machinery**	
Block 1	i) Motor car other than those used in the business of running them on hire , purchased on or after 23.08. 2019 but before the 1 April 2020 and is put to use before 1.4. 2020 ii) Motor car other than those used in a business of running them on hire, aquired or put to use on or after 1.4.1990 (other than motor cars mentioned in (i) above .	30% 15%
Block 2.	i) Motor Taxis, Moto Lorries, Motor Buses used in a business of running them on hire, purchased on or after 23.08. 2019 but before the 31.03.2020 and is put to use before 31.03. 2020 ii) Buses, lorries and taxies used in the business of running them on hire (other than mentioned in (i) above).	45% 30%
Block 3.	Moulds used in rubber and plastic goods factoreis	30%
Block 4	Aeroplanes , Aeroegines	40%
Block 5.	Specified air Pollution control equipment, Water pollution control equipments, solid waste control equipment and solid wate recycling and resocue recovery system .	40%
Block 6.	Plant and machienry used in semi- consuter industry covering all integrated circuiys.	30%
Block 7	Life saving medical equipments	40%
Block 8	Machinery and plants purchased and installed on or after the 01.09.2002 in a water supply project or a water treatment system and which is put to use for the purpsoe of buiness of providng infrastructure facility .	40%
Block 9	Oil wells	15%

Block 10	Renewable Energey Saving Devices (as specified)	40%
	i) Windmills and any specially designed devices which run on wind-mills installed on or before 31.03.2014. And any special devices including electric generators and pumps running on wind energy installed on or before 31.03.2014. ii) Windmills and any specially designed devices which run on wind-mills installed on or after 1.04.2014.	
Block 11	Computers including computer software	40%
Block 12	Books (annual publications or other than annual publications) owned by assessees carrying on a profession	40%
Block 13	Books owned by assessees carrying on business running lending libraries	40%
Block 14	Plants & Machinery (General rate)	15%
4	**Ships**	
Block 1	Ocean –going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by block 3 below.	20%
Block 3	Speed boats operating on inland water	20%
	PART B. INTANGIBLE ASSETS	
	Know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature	25%

4) Expenditure on Scientific Research [U/S 35]:

Scientific Research means any activities for the expansion of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. The following expenditure on scientific research is allowed as deduction:

a) Revenue expenditure incurred for scientific research related to assessee's business. Will be fully allowed. This may be the payment of any salary to the persons engaged in scientific research or purchase of materials for use in such scientific research.

b) Capital expenditure incurred on scientific research related to assessee's business, will be allowed in full, however purchase of land is not allowed. No depreciation is allowed u/s 32 in respect of such asset during the previous year and subsequent year.

c) Contribution made to approve scientific research association or college or university or other approved institutions for scientific research and to approve university, college or institution for the use of scientific research is allowed. Above may or may not be related to assessee's business & a sum equal to amounts paid is allowed as a deduction.

d) Contribution made to approved university, college or institution for research in social science or statistical research is allowed. Above may or may not be related to assessee's business & a sum equal to amounts paid is allowed as a deduction.

e) Any sum paid to a "National laboratory" or I.I.T. or a university or a specified person approved by prescribed authority, to be used for scientific research under an approved program, will be allowed deduction of the amount so paid [Sec. 35(2AA)]

f) Company engaged in business of bio-technology or manufacturing of article or things. Not being an article or thing specified in the list of the eleventh schedule. A deduction of a sum equal to the expenditure will be allowed. Such expenditure should not be in the nature of cost of any land or building. For entitle to take deduction company require to enters into agreement with prescribed authority for co operation in such research and development.

5) Investment linked tax incentives for specified business: (Section 35AD] :

This section provides for investment linked tax deduction in respect of following specified business:

a) Setting of and operating cold storage, transport facility for agriculture produce, meat and meal, poultry, marine and dairy products.

b) Setting up or operating warehousing facility for agricultural produce.

c) Laying and operating a cross country natural gas pipeline.

d) Building or operating a hotel of two star or above category, anywhere in India.

e) Building and operating a hospital anywhere in India, at least 100 beds for patients.

f) Developing and building a housing project under a notified scheme for affordable housing farmed by the central government or state government.

g) Production of fertilizers in India.

Amount of deductions; 100% of capital expenditure excluding land, goodwill and financial instruments.

6) Amortization of certain preliminary expenses under section 35 D:

Amortizations of preliminary expenses section 35D an Indian company or a resident non-corporate taxpayer can claim deduction under section 35D in respect of preliminary expenses. Such expenditure may be incurred before commencement of the business or after commencement of the business in connection with extension of an undertaking or in connection with setting up a new unit.

Amount of deduction: **1/5th** of the total eligible preliminary expense is allowed in **5 equal annual** installments starting from the year in which the business commences or unit expanded or the new unit commences production or operation.

Maximum amount eligible for deduction: In case non corporate resident assessee at a 5% of the cost of project. In case of Indian company 5 % of the cost of the project or capital employed whichever is higher.

7) Other deductions : [Section36]:

i) Insurance: Section 36(1) (i)- Premium paid to cover the risk of damage or destruction of stocks, stores, cattle and on health of employees under the approved scheme.

ii) Insurance Premium paid by Federal milk co-op. society on the lives of cattle owned by the members of a Primary Milk Co-op, Society affiliated to it. Section 36(1) (ia)

iii) Premium for insurance on health of employees in accordance with scheme framed by GIC& approved by Central Government or any other insurer & approved by the Insurance Regulatory & Development Authority (only if paid by cheque) Section 36(1) (ib).

iv) Bonus or commission paid to Employees: Section 36(1) (ii): It is allowed as deduction So far as they are mo paid as profit or dividend.

v) Interest on borrowed capital: Section 36(1) (iii): - It is allowed as deduction.

However, interest paid by firm to its partners is allowed subject to provisions of Sections 40(b).

vi) Discount on zero coupon bonds is deductible by issuing Company on pro rata Basis Sec.36(1)(iiia)

vii) Contribution to recognized Provident fund or an approved super annuation fund:

Section 36(1)(iv).Any sum paid by the assessee as an employer by way of contribution Towards pension scheme.

viii) Contribution to Pension Scheme: Section 36(1)(iv a) Any contribution by an employer By way of contribution towards pension scheme referred to a section 80CCD for an employee up to 10% of salary shall be allowed as deduction.

ix) Contribution to approved Gratuity Fund Section 36(1)(v): - Amount contributed to the fund which is for the exclusive benefit of the employees will be allowed as deduction.

x) Contributions received from employees (when deposited) Section 36(1)(va): - Any contribution received from employees towards any funds for the welfare of the employees e.g. P.F. will be allowed as deduction when such contribution is credited to employees a/c on or before the due date. It is allowed as deduction not because it is an expenditure of the assessee. In fact, it is not at all an expenditure of the assessee. But when this amount is deducted from salary of employees, it is treated as an income under section 2(24)(x). Therefore, deduction is allowed when payment is made by the due date.

xi) Animals used for the business: Section 36 (1) (vi): - Deduction is allowed when animals have died or have become permanently useless. Amount of deduction will be difference between actual cost of the animals and amount realised if any in respect of carcasses of the animals Deduction is allowed only if animals are used for the purpose of business but not as stock in trade.

xii) Bad debts: Section 36(1)(vii) and Section 36(2): - Deduction is allowed on this account of debts have arisen out of business transaction. It is the responsibility of the assessee to prove to the satisfaction of income tax officer that such debts are irrecoverable.

xiii) Expenditure for promoting family planning: Section 36(1)(ix): - Only a company can claim this deduction. Any expenditure incurred by a company to promote family planning among its employees is allowed as deduction fully, provided it is revenue expenditure. Any capital expenditure on this account is allowed as deduction in 5 equal installments. If profit is not sufficient to absorb this expenditure it can be carried forward to be set off in future. No depreciation can be claimed under section 32 on capital assets used for promoting family planning and allowed as deduction under section 36(1)(ix).

xiv) Any amount of security transaction tax paid during the year. 36(1)(xv

8) Residuary Expenses : [Section 37]:

Any other expenditure not covered by section 30 to 36 which is of revenue nature will be allowed as deduction provided it is incurred exclusively for the purpose of business or profession. e. g.

1. Embezzlement of cash.
2. Expenses on local festival such as Diwali, Muhurta etc.
3. Cash shortage found in the business at the end of the day.
4. Entertainment Expenses
5. Advertisement Expenses
6. Travelling Expenses
7. Guest House Expenses.
8. Lawful expenses related to illegal business.
9. Premium on redemption of debentures
10. Discount on issue of debentures (on pro rata basis)

Expenses Not Deductible Under Section 37

1. Donations
2. Charities
3. Gifts to relatives
4. Income tax

5. Wealth tax
6. Advance income tax
7. Fines and penalties for breach of any laws.
8. Personal Drawings
9. Salary to owner
10. Interest on proprietor's capital
11. Capital expenditure
12. Purchase of an assets
13. Extension of building
14. Personal expenditure
15. Household expenses.
16. Drawings
17. Education expenses of children
18. Residential telephone bill
19. Residential electricity bill
20. Residential maintenance
21. Amount transferred to reserve
22. Personal Hotel expenses
23. R.D.D. But deduction is allowed for actual bad debts
24. Personal motor expenses
25. L.I.C. on own life.
26. Any Investments
27. Any expenses related to let out house property.
28. Expenditure on Advertisement (Section 37(2B): It is allowed as deduction. However, as per Section 37 (2B), any expenditure incurred by an assessee on the advertisement in any souvenir, brochure, pamphlet etc. published by a political party will not be allowed as deduction.
29. In case of all assessee Section 40(a): Interest, royalty, fees for technical services or any other sum chargeable to tax payable outside India without deducting tax at source & where there is no person to be treated as an agent of person receiving this amount.
30. Salary paid outside India without deducting tax at source
31. Any contribution to PF or any other Fund, if there is no arrangement for TDS from any payment to be made from such Fund if it is taxable under the head Salaries.

- **Expenditure ExpresslyDisallowed : [Section 40]:**

The following amounts are not deductable from business or profession income :

In case of any assessee u/s 40(a):

i) Interest, royalties, fees for technical services or any other other expenses chargeable to tax payable outside India, or in India to a non-resident on which no tax has been paid or deducted at source. Interest, commission, brokerage, professional fee, payments to contractors payable to resident also will not be allowed as a deduction if income tax has not been deducted and paid before the due date of filling of return.

ii) Income tax : Any tax levied on profits and gains on business or profession.

iii) Tax on perquisites paid by employer u/s 10 (10cc) is not deductable

iv) Section 40 (a) (iib): (a) royalty, license fee, service fee, privilege fee, service charge or any other name whatever called if such royalty etc., is exclusively levied on a State Government undertaking by the State Government; or

(b) any amount which is appropriated directly or indirectly from a State Government undertaking by the state government.

v) Section 40 (a) (iii): Salaries paid outside India or to a non-resident are not allowed unless income tax has been paid or deducted at source.

vi) Section 40 (a) (iv) : Any contribution to a provident fund, if no arrangment is being made for deduction of tax at source .

In case of firm u/s 40 (b): Payment of salary, bonus, commission or remuneration to working partner of the firm, by the firm is allowed as deduction only to the following extent: -

1. Loss or profit up to Rs. 3,00,000	-	1,50,000 or 90% of book profit whichever is more
2. On the balance of book profit	-	60% of book profit

Book profit means the net profit as shown in profit and loss account computed in the manner laid down in chapter (IV –D) without considering the deduction for remmuneartion as calcualte above.

Interest to any partner in excess of 12 % p.a. : Interest on capital of partners is allowed as deduction provided it is authorized by the partnership deed & rate of interest does not exceed 12% p.a.

- **Expenses or payments not deductible in certain circumstances (Section 40A):**

i) Payment to relatives and associates: Section 40A(2)

Payments made by assessee to following persons :-

(a) Who is relative of assessee, if assessee is an individual i.e. spouse, brother, sister or an lineal ascendant & descendant

(b) Who is director, partner, member or their relatives, if assessee is a company or a firm or AOP or HUF

(c) Any person who is having substantial interest in business or profession of the assessee. i.e. a person who is beneficial owner of at least 20% of equity capital or entitled to 20% profit. If any payment is made by assessee on any account to above mentioned persons & if in the opinion of assessing officer such payment is excessive or unreasonable then to the extent it is unreasonable will be disallowed.

ii) Payments exceeding Rs. 1**0,000 made otherwise than by a crossed cheque or a draft** Section 40A(3) & 40A (4):-

If assesses incurs any expenditure exceeding Rs. 10,000 otherwise than by a crossed cheque or a draft or electronic mode it shall be disallowed to the extent of 100% where the assessee incurs any expenditure in respect of which a payment or

Aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds ten thousand rupees, no deduction shall be allowed in respect of such expenditure.

The monetary limit of Rs. 35,000 in the case of payment made transport operator.

iii) Provision made for payment of gratuity under section 40 A (7):

No deduction shall be allowed in respect of any provision for payment of gratuity to employees, by whatever name called.

However, the deduction shall be allowed in respect of following:

Provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year.

iv) **Contributions made by employer to non-statutory funds 40A(9):**

No deduction shall be allowed to an assess for contribution made as an employer to any fund other than recognized provident fund, approved superannuation fund or approved gratuity fund.

- **Deemed Income from Business or profession: Section 41**

i) Recovery against any Allowance or Deduction Allowed earlier:

The amount received by the assessee in respect of a loss or expenditure allowed as deduction in the earlier years, is deemed to be profit of the previous year in which it is received by the assessee, whether the business or profession in respect of which the deduction has been made is in existence in the year or not.

ii) Remission or censure of liability: The amount of liability which was allowed as deduction in the earlier years if waived or ceased is deemed to be profit of previous years during which it is waived by the creditor.

iii) Profit on sale of asset used for scientific research :

Where any capital asset used in scientific research is sold without having been used for other purposes and the sale proceeds, together with the amount of deduction allowed under section 35, exceed the amount of the capital expenditure incurred on purchase of such asset, such surplus (i.e., sale price) or the amount of deduction allowed, whichever is less, is chargeable to tax as business income in the year in which the sale took place.

iv) Bad debts recovered :

Where any bad debt has been allowed as deduction under section 36(1)(vii) and the amount subsequently recovered on such debt is greater than the difference between the debt and the deduction so allowed, the excess realization is chargeable to tax as business income of the year in which the debt is recovered.

12) Disallowance of unpaid statutory liability (Section 43B): - This section is applicable only if books are maintained on accrual basis. In the following cases, deduction otherwise allowable under the Income-tax Act will not be allowed unless the amounts are actually paid by the due date for filing return of income. If these liabilities are disallowed under section 43B in the year of provision, they will be allowed in succeeding year or year when actually paid: -

1) Tax, duty, cess or fees, under any law (e.g. Sales-tax, Excise duty, etc.)
2) Employer's contribution to provident fund or super annuation fund or gratuity fund or any other fund for the welfare of the employees.
3) Bonus or commission for services rendered payable to employees referred to in section (1) (ii) & sum due in lieu of leave balance.
4) Interest on any loan or borrowing from any public financial institutions or a State Financial Corporation or a State Industrial Investment Corporation, in accordance with the terms and conditions of loan/borrowing agreement.
5) Interest on any term loan from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan. It should be noted that these payments will not be allowed as deduction on accrual basis if not paid by the due date of filing return of income even if books are kept on mercantile basis

- **Other Important provision :**

1. Maintenance of accounts by certain Assessees under section 44AA(1):

a) Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.

   (i) If their gross receipts in the profession exceed Rs. 1,50,000 in all the 3 years immediately preceding the previous year; or

ii) If profession newly set up in the previous year, his gross receipts are likely to exceed Rs. 1,50,000 in that year.

b) Every person carrying on business or profession [not being a profession referred to in sub-section (1) above: section 44AA(2):

i) In case Individual or HUF:

Existing business or profession: In case where the income from the existing business or profession exceeds Rs. 2,50,000 or the total sales or gross receipts exceeds Rs. 25,00,000 any one of three year immediately preceding the accounting year.

For Newly set up business: If his income from business or profession is likely to exceed Rs. 2,50,000 or his total sales or receipts are likely to exceeds Rs. 25,00,000.

ii) Person other than individual and HUF:

Existing business or profession: In case where the income from the existing business or profession exceeds Rs. 1,20,000 or the total sales or gross receipts exceeds Rs. 10,00,000 any one of three year immediately preceding the accounting year.

For Newly set up business : If his income from business or profession is likely to exceed Rs. 1,20,000 or his total sales or receipts are likely to exceeds Rs. 10,00,000.

c) Where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AE or section 44BB or section 44BBB, as the case may be, and the assessee has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, during such previous year; or

- **Audit of accounts of certain persons carrying on business or profession (Section 44AB):**

The Finance Act 2020 has made amendment in the threshold limit of tax audit under section 44AB. The tax audit limit under section 44AB is as under:

- Where the person is carrying on business shall and his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds Rs. 1 crore in any previous year is liable for ax audit.

- As per amendment made by Finance Act 2020, where the person is carrying on business and fulfills below conditions then threshold limit for tax audit shall be increased to Rs. 5 Crores:

(i) aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and

(ii) Aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment.

(c) In case the person is carrying on profession then he shall be liable for tax audit if his gross receipts in profession exceed Rs. 50 lakh in any previous year.

- **Estimated income scheme of assessment :**

Where the person is carrying on the business shall and is opting for presumptive taxation scheme under the following provisions:

i) Section 44AD: Presumptive taxation in case of business:

Under Section 44AD of presumptive taxation, small taxpayers with less than Rs. 2 crore of turnover can opt for presumptive tax scheme to declare profit of 8% of their turnover. For availing benefit under this scheme, profits where income is credited digitally or through the bank will be considered as 6% as against 8% for cash receipts. If a taxpayer opts for presumptive taxation, he will not be allowed deduction for expenses u/s 30 to 38

(ii) Section 44ADA: Presumptive taxation in case of Profession:

Presumptive income of profession shall be 50% of gross receipt (if gross receipt of assessee does not exceed Rs. 50 lakh).

(iii) Section 44AE: Presumptive taxation in case of business of plying, hiring or leasing goods carriages. For Heavy Goods Vehicle:

Rs. 1,000 per ton of gross vehicle weight for every month or part of a month during which the heavy goods vehicle is owned by assessee

For Other Goods Vehicle:

Rs. 7,500 for every month or part of a month during which the goods carriage is owned by assessee

- **Computation of the profit and gains of business and profession :**

a) When profit and loss account or Income and expenditure is given :

Computation of Income from business or profession :

Legal Status : **Previous year :**

Residential Status: **Assessment year :**

Particular	**Rs.**	**Rs.**
Net profit/ loss as per P& L A/c. or I/E. A/c.		**Xxx**
Add: Disallowed expenses :		
Household Expenses, Personal Expenses, Capital expenses	xx	
Expenditure on L I. C., Donation, Provisions &Reserve	xx	
Provisions for various funds & reserve	xx	
Proprietor Salary, Interest on capital, Drawing	xx	
Losses of earlier years	xx	
Expenses related with other heads	xx	
Preliminary expenses in excess of provision u/s 35D	xx	
100% payments in excess of Rs. 10,000 not made by crossed cheque or draft	xx	
Income tax, wealth tax, STT	xx	
Depreciation debited to P& L not as per the income tax rule	xx	
		Xxx
		Xxx
Less: Income credited to P& L A/c. or I/E A/c		
Not taxable under this head or exempt		
Income from house property	xx	
Income from other source like Interest, dividend	xx	
Salary	xx	
Income tax refund	xx	
Capital gain	xx	
Bad debts recovered (previously disallowed as deduction)	xx	
Income exempt u/s 10	xx	
		Xxx

		Xxx
Less: Depreciation as per IT rule		Xxx
Income from Business or profession		**Xxx**

B) When Receipts and payment account is given :

Computation of Income from business or profession :

Legal Status : **Previous year :**

Residential Status: **Assessment year :**

Particular	**Rs.**	**Rs.**
Professional Receipts (Income)		
Consultation fees	xx	
Professional fees	xx	
Visiting fees	xx	
Sale proceeds of medicines etc (doctor)	xx	
Gifts from patients or client	xx	
Other professional receipts	xx	
Examiner's fee	xx	**xx**
Less: Allowable professional expenses		
Production expenses	xx	
Office & administrative expenses	xx	
Postage, telegram, stipend	xx	
Finance charges	xx	
Subscription or membership fees for profession	xx	
Car expenses relating to business or profession	xx	
Medicines, printing and stationery	xx	
Depreciation as per IT rule	xx	
Books and journal annual publication	xx	
Staff salary	xx	**xxx**
Income from business or profession		**xxx**

- **Illustratons :**

Illustration 1) Mr. Shaha has prepared following profit and loss account :

Profit and Loss Account for the year ended 31/03/2021

Particular	**Amount**	**Particular**	**Amount**
Salaries	80,000	Gross profit b/d	5,03,000
Advertisement	40,000	Winning from TV show	18,500
Sundry Expenses	45,000	Interest on securities	2,000
Interest on own capital	20,000	Dividend from co-operative society	4,000
Fire Insurance	3,000		
Income Tax	7,000		
Household Expenses	25,000		
Bad Debts	10,000		
Provision for Doubtful Debts	5,000		
Repairs	4,600		
Life Insurance Premium own life	6,000		
Donations	4,000		
Depreciation	37,000		
Net profit	2,40,900		
Total Rs	**5,27,500**	**Total Rs.**	**5,27,500**

Additional information :

a) Salary includes Rs. 16,000 paid to proprietor's son, studying in 8^{th} standard.

b) Sundry expenses include Rs. 150 towards charity and Rs. 2,500 towards school fees of the son.

c) Repairs include Rs. 1,500 for repairs carried out at the residence of Mr. Shaha

d) Depreciation as per income tax rule Rs. 35,000.

Compute his income from business for the year ending 31^{st} March 2021.

Answer : Computation of income from business of Mr. Shaha for A.Y. 2021-2022

Particular	**Amount**	**Amount**
Profit as per profit and loss account		**2,40,900**
Add: Expenses disallowed :		
Salary to proprietors son studying in 8th standard	16,000	
Sundry expenses for charity	150	
Sundry expenses for school fee of the son	2,500	
Interest on own capital	20,000	
Income tax	7,000	
Household expenses	25,000	
Provisions for doubtful debts	5,000	
Repairs	1,500	
Life insurance premium	6,000	
Donation	4,000	
Depreciation	37,000	
		1,24,150
		3,65,050
Less :Income chargeable under other head		
Winning from TV show	18,500	
Interest on securities	2,000	
Dividend from co-op. Society	4,000	24,500
		3,40,550
Less: Depreciation as per income tax rule		35,000
Income from business		**3,05,550**

Illustrations : 2) From the following Income expenditure account of a Dr. Pallavi Kulkarni, Kolhapur, compute the taxable income for the assessment year 2021-2022

Income & Expenditure Account for the year ended 31/03/2021

Particular	**Rs.**	**Particular**	**Rs.**
To Salaries to Staff	3,00,000	By consultation Fees	9,50,000
To Office Expenses	1,00,000	By Visiting Fees	4,50,000

To OPD Rent	2,40,000	By Salary as a Visiting lecturer	9,00,000
To Subscription	30,000	Examiner's Fees	20,000
To Books for Profession (Annual Publication)	60,000	Dividend from co operative society	30,000
To Car Expenses	1,00,000	By Rent from let out house property	3,60,000
To Purchase Of Computers (10-12-2020)	4,50,000	By Presents from Patients	1,40,000
To Advance Tax	2,50,000	By Prize received from lion club as best member of the year	1,00,000
To Donations	1,00,000	By Received a share from H.U.F. income	2,50,000
To Personal Drawings	8,00,000		
To Expenses of let out house	65,000		
To Life Insurance Premium	1,00,000		
To Depreciation	50,000		
To Surplus	5,55,000		
	32,00,000		**32,00,000**

Following further information is given :

1. Half of the car expenses were related to private purpose.
2. Depreciation allowable as per Income Tax rules amounted to Rs. 1, 20,000 excluding cost of computer but including depreciation on car Rs. 48,000.

3) Donation are given to Prime Minister's Earthquake Relief Fund.

Answer: Computation of Income From Profession of Dr. Pallavi Kulakarni For A. Y.2021-2022

Particular	Amount	Amount
Surplus as per Income & Expenditure Account		**5,55,000**
Add: Expenses disallowed :		
Car expenses (Personal expenses 1,00,000x1/2)	50,000	
Purchase of computers	4,50,000	
Advance Income Tax	2,50,000	
Donations	1,00,000	
Personal Drawings	8,00,000	
Let out house expenses	65,000	
Life Insurance Premium	1,00,000	
Books	60,000	
Depreciation	50,000	
		19,25,000
		24,80,000
Less: Income not taxable under profession head and tax free incomes		
Salary	9,00,000	
Dividend from co operative society	30,000	
Examiner's fees	20,000	
Prize received from lions club	1,00,000	
Received a share from H. U. F.	2,50,000	
Rent from let out house	3,60,000	16,60,000
		8,20,000
Less: Depreciation as per I. T. Rules:		
Car (48,000/2)	24,000	

Computer (4,50,000 x 40% x 1/2)	90,000	
Other Assets (1,20,000-48,000)	72,000	1,86,000
Income from Profession		**6,34 ,000**

Notes: 1) Purchase of computers is capital expenditure and hence not allowable.

2) Depreciation on computer @40 % p.a. charge for half year as computer used for less than 180 days in year.

Illustration 3): Profit and Loss Account of Mr. Ravi , Mumbai for the Financial year ended 31^{st} March 2021.

Profit and Loss Account

Particular	**Rs.**	**Particular**	**Rs.**
To Salary	2,00,000	By Gross Profit	16,00,000
To Advertise	40,000	By Interest on Securities	40,000
To General Expenses	80,000	By Rent From House Property	60,000
To Entertainment Expense	30,000	By Bad Debts Recovered (Previously allowed)	10,000
To Bad Debts	5,000	By Commission	60,000
To Travelling Exp.	45,000		
To G.S.T.	10,000		
To Interest on Capital	20,000		
To Repairs	5,000		
To Depreciation	30,000		
To Car Purchased	3,00,000		
To Car Expenses	30,000		
To Donations	20,000		
To Provisions For Bad Debts	20,000		
To Municipal Tax on House	10,000		
To Wealth Tax	15,000		

To Income Tax	25,000		
To Net Profit	8,85,000		
	17,70,000		**17,70,000**

Adjustments:

1) Half of the repairs were on house property let out.
2) Depreciation as per Income Tax Rule Rs. 40,000
3) Advertisement includes Rs. 10, 000 were spent on Permanent signboard fixed on the premises.
4) Donations paid to Prime Minister's National Relief Fund.

Compute his Income from Business for the year ending 31/03/2021.

Solution : Computation of Income from Business of Mr. Ravi for A. Y. 2021-2022

Particular	**Amount**	**Amount**
Profit as per profit and loss account		**8,85,000**
Add: Expenses disallowed :		
Advertisement	10,000	
Interest on capital	20,000	
Repairs	2,500	
Car purchased	3,00,000	
Donation	20,000	
Provision for bad debts	20,000	
Municipal Taxes of house	10,000	
Wealth Tax	15,000	
Income Tax	25,000	
Depreciation	30,000	**4,52,500**
		13,37,500
Less : Income chargeable under other head		
Interest on Securities	40,000	

Rent From House Property	60,000	**1,00,000**
		12,37,500
Less: Depreciation as per I.T. Rule		**40,000**
Income from Business		**11,97,500**

Illustration 4) Mr. Ramesh is a leading advocate at Pune. Following is the summary of cash book for the year ended 31/03/2021. Compute his income from profession.

Receipts	**Amt Rs.**	**Payments**	**Amt. Rs.**
Opening Balance	50,000	Salary to Assistance	2,50,000
Professional Fees	15,00,000	Rent of Chamber	1,80,000
Arbitration Fees	3,00,000	House Hold Expenses	8,00,000
Gifts	2,00,000	Membership Fees	60,000
Policy amount received on maturity of policy	20,00,000	Books For Profession (Annual Publication)	1,00,000
Interest on Bank Deposit	1,50,000	Fixed Deposits in Banks	20,00,000
		Car Expenses	2,00,000
		Advance Income Tax	50,000
		Bonus and Gifts to Staff	2,00,000
		Computer Purchase	1,00,000
		Telephone Expenses	1,30,000
		Closing Balance	1,30,000
	42,00,000		**42,00,000**

Additional Information :

1) Gifts included Rs. 70,000 received from friends & relatives on family function and balance from clients.
2) Depreciation allowable on assets as per rules amounted to Rs. 1,60,000 including Rs. 50,000 on car but excluding books purchased.
3) One fifth of car expenses are related to personal use.
4) Membership fees included Rs. 20,000 to bar council and balance to private club.

Solution : Computation of Income from Profession of Mr. Ramesh for A.Y. 2021-2022.

Particular	Amount Rs.	Amount Rs.
Allowed Income :		
Professional Fees	15,00,000	
Arbitration Fees	3,00,000	
Gifts	1,30,000	
		19,30,000
Less: Allowed Expenses :		
Salary to Assistance	2,50,000	
Rent of Chamber	1,80,000	
Membership Fees	20,000	
Car Expenses (2,00,00x4/5)	1,60,000	
Telephone Expenses	1,30,000	
Depreciation :		
On other assets (1,60,000-50000)	1,10,000	
On Car (50,000x4/5)	40,000	
Books Annual Publication (1, 00,000 x 40%)	40 ,000	**9,30,000**
Income from Profession		**10,00,000**

Illustrations 5) Dr. Suresh is a renowned medical practitioner who maintains books of account on cash basis, furnishes his Receipts and Payments Account for the financial year 2020.2021.

Receipts	Amt Rs.	Payments	Amt. Rs.
Balance b/d	2,80,000	Rent of Clinic	1,20,000
Consultation Fees	4,00,000	Electricity and Water	40,000
Visiting Fees	6,00,000	Purchase of Professional Books	80,000
Loan from Bank (For	5,00,000	Household Expenses	1,58,000

Profession)			
Pathological Tests	2,00,000	Motor Car Purchased	6,00,000
Receipts from Indoor Patient	10,00,000	Surgical Equipments	96,000
Gifts and Presents	1,00,000	Income Tax	2,00,000
Interest on Bank Deposits	4,60,000	Salary to Staff	3,00,000
		Life Insurance Premium	4,00,000
		Interest on Loan	40,000
		Car Expenses	3,00,000
		Purchase of Medicines	8,00,000
		Balance c/d.	4,06,000
	35,40,000		**35,40,000**

Additional Information:

1) 1/3rd of the car related to his personal use.
2) Depreciation on motor car allowable is 15%, on books 40%, and on surgical equipments 40%.
3) Gifts and present include Rs. 60,000 from patients and Rs. 40,000 received on birthday.
4) Closing stock of medicines amounted Rs. 1,10,000.
5) All fixed assets are purchased before 30/09/2020

Compute taxable income from profession for A.Y. 2021-2022.

Solution: Computation of Income from Profession of Mr. Suresh for A.Y. 2021-2022.

Particular	Amount Rs.	Amount Rs.
Allowed Income :		
Consultation Fees	4,00,000	
Visiting Fees	6,00,000	
Pathological Tests	2,00,000	
Receipts from Indoor Patient	10,00,000	
Gifts and Presents (1,00,000-40,000)	60,000	**22,60,000**
Less: Allowed Expenses :		
Rent of Clinic	1,20,000	
Electricity and Water	40,000	
Salary to Staff	3,00,000	
Interest on Loan	40,000	
Purchase of Medicines (8,00,000-1,10,000)	6,90,000	
Car Expenses (3,00,000x2/3) Professional purpose	2,00,000	
Depreciation :-		
On Car (6,00,000 x15%)=90000x2/3	60,000	
On Surgical equipments (96,000x40%)	38,400	
On Books (80,000x40%)	32,000	**15,20,400**
		7,39,600

- **Check your progress III :**

1) Fill in the blanks .

i) In case of a person adopting the provisions of section 44ADA, income will be computed on Presumptive basis, i.e., @ _________of gross receipts of the specified profession.

ii) Section ________ deals with the provisions relating to depreciation allowance while computing income chargeable to tax under the head "Profits and Gains of business or profession".

iii) Any interest, salary, bonus, commission or remuneration due to or received by partner of a firm are taxable under the head -------

iv) If the asset is acquired during the previous year by the taxpayer and the same is put to business use for less than _____ days during that year, then taxpayer can claim depreciation at 50% of normal depreciation

v) Section _______ deals with the deductibility of expenditure incurred by the assessee in respect of rent, rates, taxes, repairs and insurance for building under the head "Profits and Gains of business or profession".

3.2.4 Income from Capital Gain :

- **Introduction:**

Any profit or gain arising from the sale or transfer of a capital asset is chargeable to tax under the head Capital Gains under section 45. Capital gain can be short term or long term.

Capital gain arises when the selling price of asset is greater than purchase price of asset.

Followings are the different concepts and provisions applicable for calculation of capital gain.

- **Capital Assets : [Section 2(14)]:**

Capital asset means –

i) Any kind of property held by an assessee, whether or not in connection with his business or profession;

ii) Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 but does not include the following:

(1) Stock in trade

Stock in trade, consumable stores or raw materials held for business or profession.

(2) Personal effect

Personal effect means any movable property held for personal use of the assessee or for any dependent member of his family but excludes. Jewellery, paintings, drawings, archaeological collections, sculptures, or any other art work.

(3) Agricultural land in rural area

Agricultural land in **India** is not a capital asset **except** the following –

a. land which is situated within the jurisdiction of any Municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or Cantonment Board having population of 10,000 or more; or

b. in any area within the distance, measured aerially,—

Population of the municipality or cantonment board	**Area within the aerial distance from the local limits of such municipality or cantonment board is non-rural area**
More than 10,000 but not exceeding 1,00,000	Upto 2 kilometres
More than 1,00,000 but not exceeding 10,00,000	Upto 6 kilometres
More than 10,00,000	Upto 8 kilometres

(4) Gold Bonds

Following gold bonds issued by the Central Government are not capital asset:

(i) 6.5% Gold Bond, 1977 (ii) 7% Gold Bonds, 1980; and (iii) National Defence Gold Bond, 1980

(5) Special Bearer Bond

Special Bearer Bond, 1991 issued by the Central Government are not capital asset.

Note: It is not necessary that the assessee should be the initial subscriber.

(6) Gold Deposit Bonds

Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015 notified by the Central Government are capital asset.

- **Types of Capital Assets :**

Short Term Capital Asset [Sec. 2(42A]: It means capital assets held by an assessee for not more than 36 months immediately before the date of transfer.

Long Term Capital Asset [Sec. 2(29A]: A capital asset, which is not a short-term capital asset, is a long it is held for not -term capital asset

Exceptions: In the following cases, an asset shall be termed as a short-term capital asset (STCA) if more than following period before the date of transfer:

12 Months	24 months
Equity or preference share in a company (listed in India)	Equity or preference share in an unlisted company
Any security e.g. debenture, Government securities etc. (listed in India)	Immovable property being land or building or both
A unit of an equity oriented fund	
Zero-Coupon Bonds (whether quoted or not)	
Units of UTI (whether quoted or not)	

Short-term capital gain (STCG) arises on transfer of short-term capital assets (STCA) and long-term capital gain (LTCG) arises on transfer of long-term capital assets (LTCA).

However, any gain on transfer of an asset on which depreciation is allowed as per WDV method u/s 32(1)(ii) shall be taxable as short-term capital gain (irrespective of their period of holding) [Sec. 50]

- **Transfer: [Section 2 (47)]:**

Transfer in relation to a capital asset includes:

(a) Sale, Exchange & Relinquishment of the asset;

(b) Extinguishment of any right in an asset;

(c) Compulsory acquisition of an asset under any law;

(d) Conversion of asset into stock-in-trade by the owner;

(e) Any transaction of immovable property u/s 53A of the Transfer of Property Act, 1882;

(f) Any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.

(g) Maturity or redemption of a zero coupon bond

- **Transactions not regarded as transfer :**

  Following transactions are not regarded as transfer-

1. Distribution of asset in kind by a company to its shareholders at the time of liquidation.
2. Distribution of capital asset on total or partial partition of Hindu Undivided Family (HUF).
3. Transfer of capital asset under a gift or will or an irrecoverable trust.
4. Transfer of capital asset by a company to its wholly owned subsidiary.
5. Transfer of capital asset by a wholly owned subsidiary to its holding company.
6. Transfer of capital asset in the scheme of amalgamation.
7. Transfer of shares in an Indian company held by a foreign company under the scheme of amalgamation of two foreign companies.
8. Transfer of capital asset in the scheme of amalgamation of banking company with a Banking Institution.
9. Transfer a capital asset by a demerged company to resulting company.
10. Transfer of shares held in an Indian company by a demerged foreign company to resulting foreign company.
11. Any transfer of capital asset in a business reorganization, by the predecessor co-operative bank to the successor co-operative bank.
12. Any transfer by a shareholder, in a business reorganization, of a capital asset being shares held by him in the predecessor co-operative bank, if the transfer is made in consideration of allotment to him of any shares in the successor co-operative bank.
13. Transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of demerged company.

14. Allotment of shares in amalgamated company in lieu of shares of amalgamating company.
15. Transfer of a capital asset (being foreign currency convertible bond or Global Depository Receipts (GDR)) by a non-resident to another non-resident.
16. Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident.
17. Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident.
18. Transfer of capital asset made by a non-resident on a recognized stock exchange located in international financial services centre and where the consideration is paid/ payable in foreign currency.
19. Transfer by an individual of Sovereign Gold Bond (Issued by RBI under the sovereign Gold Bond Scheme, 2015) by way of redemption.
20. Transfer of agriculture and in India before 01/03/1970.
21. Transfer of capital asset (being work of art, manuscript, painting etc) to the Government/University/ national museum, etc.
22. Transfer by way on conversion of bonds or debentures into shares.
23. Transfer by way of conversion of bonds into shares or debentures of any company.
24. Transfer by way of preference shares of a company into equity shares of that company.
25. Transfer by way of exchange of capital asset being membership of a recognized stock exchange for shares of a company.
26. Transfer of land by a sick industrial unit which is managed by its workers' co-operative.
27. Transfer of capital asset by a firm to a company in case of conversion of firm into a company.
28. Transfer of capital asset, being a membership right held by a member of a recognized stock exchange in India.

29. Transfer of share by a private company/unlisted public company to a Limited Liability Partnership (LLP), or any transfer of shares held in the company by a shareholder, in case of conversion of company into LLP.
30. Transfer of capital asset to a company in the case of conversion of proprietary concern into company.
31. Transfer involved in the scheme of lending of securities.
32. Transfer of capital asset in a transaction of reverse mortgage made under the scheme notified by the Government.

- **Computation of Capital gain:**

Short-term Capital Gain means the gain arising on transfer of short-term capital asset

Long-term Capital Gain means the gain arising on transfer of long-term capital asset

Computation of Short Term Capital Gain (STCG)

Computation of capital gain of _____ for the Assessment Year ……..

Particulars	**Amount**	**Amount**
Sale consideration (Full value of consideration)		xx
Less: Expenses on transfer		xx
Net sale consideration		xx
Less: i) Cost of acquisition	xx	
ii) Cost of improvement	xx	xx
Short Term Capital Gain		xx
Less: Exemption u/s 54B, 54D, 54G, etc.		(xx)
Taxable Short Term Capital Gain		**xx**

Computation of Long Term Capital Gain (LTCG):

Computation of capital gain of _____ for the Assessment Year ……..

Particulars	**Amount**	**Amount**
Sale consideration (Full value of consideration)		xx

Less: Expenses on transfer		xx
Net sale consideration		xx
Less: i) Indexed cost of acquisition	xx	
ii) Indexed Cost of improvement	xx	xx
Short Term Capital Gain		xx
Less: Exemption u/s 54, 54B, 54D, 54EC, 54F, etc.		(xx)
Taxable Long Term Capital Gain		**xx**

The meaning of terms used in the computation:

(i) Sale consideration (full value of consideration)

It refers to sale value of the asset (in form of money or money's worth). **Consideration in installments** In case, consideration is receivable in installment in different years, the entire value of the consideration shall be taxable in the year of transfer.

(ii) Expenses on transfer

It means any expenditure incurred wholly and exclusively in connection with such transfer such as, brokerage or commission incurred for securing buyer, cost of stamp and registration fee by the vendor, traveling expenses, etc. It is reduced from sale consideration to get net sale consideration.

(iii) Cost of Acquisition [Sec. 55(2)]

Cost of acquisition includes expenditure incurred for acquiring the asset or completing the title of the asset. For instance–

i) Sum paid for discharge of mortgage debt to clear charge over the property (created by previous owner) is a part of cost of acquisition.

ii) Litigation expenditure incurred by a shareholder to get the shares registered in his name will form part of cost of acquisition of shares.

(iv) Cost of Improvement [Sec. 55(1)(b)]

Cost of improvement means an expenditure incurred to increase the productive quality of the asset. It includes all expenditures of a capital nature incurred in making any additions or alterations to the capital asset.

(v) Indexed Cost of acquisition:

"Indexed cost of acquisition" means the 'cost of acquisition' (as discussed in case of short term capital gain) adjusted according to the price level of the year of sale. As per explanation to sec.48, "Indexed cost of acquisition" is an amount which bears to the 'cost of acquisition' the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on 1/4/2001, whichever is later.

Taxpoint:

Indexed cost of acquisition = $\frac{Cost\ of\ acquisition\ x\ Index\ of\ the\ year\ of\ sale}{Index\ of\ the\ year\ of\ acquisition\ or\ for\ 2001{-}02\ Whichevere\ is\ latter}$

vi) Indexed cost of improvement

"Indexed cost of improvement" means the 'cost of improvement' is cost adjusted according to the price level of year of sale. As per explanation to sec. 48, indexed cost of any improvement" is an amount, which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place.

Indexed cost of improvement = $\frac{Cost\ of\ improvement\ x\ Index\ of\ the\ year\ of\ sale}{Index\ of\ the\ year\ of\ improvement}$

vii) Cost of inflation index:

Cost inflation index, in relation to a previous year, means such Index as the Central Government may, having regard to 75% of average rise in the Consumer Price Index (urban) for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf. Cost Inflation Index for different financial years is as follows:

	Index	**Financial Year**	**Index**
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254

2006-07	122	2016-17	264
2007-08	129	2017-18	272
2008-09	137	2018-19	280
2009-10	148	2019-2020	289
2010-11	167	2020-2021	301

Notional cost of acquisition:[Section 49 (1)]

In the following certain cases the cost of acquisition is taken at notional figure.

(a) Assets received on total or partial partition of HUF

(b) Assets received under a gift or will

(c) Assets received by succession, inheritance or devolution

(d) Assets received on dissolution of a firm, BOI or AOP

(e) Assets received on liquidation of a company

(f) Assets received under a trust (whether revocable or irrevocable)

(g) On any transfer, by wholly owned Indian subsidiary company from its holding company

(j) on any transfer, by an Indian company from its wholly owned subsidiary. Or

(k) On any transfer in the scheme of amalgamation.

(h) Asset (being a self-acquired property of a member) received by an HUF from its member

- **When the capital asset become the property of the assessee before 1-04-2001**:

Where capital asset is acquired by the assessee or the previous owner before 1st April 2001, the cost of acquisition will be taken as the actual cost or fair market value on 1st April, 2001, whichever is beneficial to the assessee.

However, in case of capital asset, being land or building or both, the fair market value of such asset on 1-4-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 01-04-2001.

- Where a capital asset became the property of the assessee by any of the modes specified in sec. 49(1), cost of improvement includes improvement expenditure incurred by the previous owner.

- **Exemptions in respect of Capital Gain:**

Sections 54, 54B, 54D, 54EC, 54F, and of the act grant total or partial exemptions of capital gain so computed, the Provisions of these sections are discussed as under:

- **Capital Gain on Transfer of residential house property under section 54:**

Eligible Asseesee ; Individual and HUF

Conditions for claim exemption:

1) Assessee should transfer residential house property
2) It must be a long term capital asset.
3) Income from such house property is chargeable under the head income from house property.
4) Where the amount of capital gain exceeds Rs. 2 crore: One residential house in India Should be purchased within 1 year before or 2 years after the date of sale/transfer. Or constructed within a period of 3 years within a period of 3 years transfer.

Where the amount of capital gain less than Rs. 2 crore the assessee at his option purchase 2 residential house in India within one year before or 2 years after the date of transfer. construct 2 residential house in India within a period of 3 years after the date of transfer.

This exemption once claimed cannot be claimed in again in any other year. For all other years, Investment should be made in construction/ purchase of 1 residential house only.

5) If such investment is not made before the date of filling of return of income, then the capital gain has to be deposited under the capital gain deposit account scheme.

Amount of exemption: Minimum of Investment in new house or amount of capital gain.

Revocation of benefits: If the newly acquired residential house is transferred within 3 Years from the date of acquisition of new assets, then the benefit availed earlier shall be revoked. Such revoked income shall be reduced from cost of acquisition of new asset.

If the amount held in Capital Gains Deposit Account Scheme (1988) is unutilized, then such amount shall be taxable as long-term capital gain in the previous year in which the period of 3 years from the date of transfer expires.

- **Capital gains on transfer of agricultural land [Section 54B] :**

Eligible Assessee; Individual and HUF

Conditions for claim exemption:

1) Assessee must have transferred a capital asset being an urban agricultural land .
2) Such agricultural land must have been used by the individual or his parents or by such HUF for agricultural purposes for at least 2 years, prior to its transfer.
3) Assessee must purchase a new land for agricultural purpose. The new land may be in urban area or rural area.
4) If such investment is not made before the date of filling of return of income, then the capital gain has to be deposited under the capital gain deposit account scheme.

Amount of exemption: Minimum of Investment in new asset or amount of capital gain

Revocation of benefits: If the newly acquired asset is transferred within 3 years from the date of acquisition of new assets, then the benefit availed earlier shall be revoked. Such revoked income shall be reduced from cost of acquisition of new asset.

If the amount held in Capital Gains Deposit Account Scheme (1988) is unutilized, then Such amount shall be taxable as long-term capital gain in the previous year in which the period of 3 years from the date of transfer expires.

- **Capital Gains on Compulsory acquisition of land and building of industrial undertaking (Sec. 54D):**

Eligible Assessee; Any assessee

Conditions for claim exemption:

Assessee must have transferred a capital asset being a land or building or any right therein, forming part of an industrial undertaking. Tax point: Asset may be a short term or long-term capital asset.

Such capital asset has been compulsorily acquired under any law for the time being in force.

Such capital asset was used for industrial purpose by the assessee for at least 2 years prior to its transfer.

Assessee must purchase any other land or building or construct a building, for the purpose of shifting or reestablishing the said undertaking or setting up another industrial undertaking within 3 years from the date of transfer.

If such investment is not made before the date of filling of return of income, then the Capital gain has to be deposited under the capital gain deposit account scheme.

Amount of exemption: Minimum of Investment in new asset or amount of capital gain

Revocation of benefits: If the newly acquired asset is transferred within 3 years from the Date of acquisition of new assets, then the benefit availed earlier shall be revoked. Such revoked income shall be reduced from cost of acquisition of new asset.

If the amount held in Capital Gains Deposit Account Scheme (1988) is unutilized, then such amount shall be taxable as long-term capital gain in the previous year in which the period of 3 years from the date of transfer expires.

- **Capital gains not chargeable on investment in certain bonds [Section 54EC]-**

Eligible Asseesee; Any assessee

Conditions for claim exemption:

Assessee must have transferred any long-term capital asset being land or building or both.

Such asset can also be depreciable asset

The Capital gains arising from such transfer should be invested in long term specified assets within 6 months from the date of transfer.

Long-term specified asset means specified bond redeemable after 5 years, issued after 01-04-2018 by a) the National Highways Authority of India (NHAI);

b) The Rural Electrification Corporation Ltd.;

c) Any other bond being notified by the Central Government

Amount of exemption: Minimum of Investment in new asset or amount of capital gain. The total limit of exemption u/s 54EC for a capital gains relating to one financial year cannot exceed Rs. 50 lakhs.

Revocation of benefits: Earlier benefit shall be revoked if such bond is transferred or converted into money within 5 years of its acquisition or a loan is taken on security of the new asset within the period.

- **Capital gains in case of investment in residential house [Section 54F]:**

Eligible Assessee; Individual and HUF

Conditions for claim exemption: Long-term capital asset (other than residential house property) provided on the date of transfer, taxpayer does not own more than one residential house property (except the new asset stated below).

The taxpayer should purchase one residential house in India within a period of one year before or two years after the date of transfer or construct the one residential house in India within three years from the date of transfer.

If such investment is not made before the date of filling of return of income, then the

Capital gain has to be deposited under the capital gain deposit account scheme.

The taxpayer should not purchase any other residential house within a period of two years or construct any other house within a period of three years.

Amount of exemption: Minimum of the following:

$\frac{Investment\ in\ the\ \ new\ asset}{Net\ Sale\ consideration} \times$ Capital gain

Net sale consideration = Sale consideration – Expenditure on transfer

Revocation of benefit and its treatment :

1. If the newly acquired residential house is transferred within 3 years after the date of its acquisition, benefit availed earlier shall be revoked.
2. If another residential house is purchased (apart from newly acquired residential house property) by the assessee within 2 years or constructed within 3 years after the date of transfer of original asset, benefit availed earlier shall be revoked.

Such revoked income (exemption) in above two points shall be taxable as long-term capital gain in the year of revocation of condition.

3. If the amount, held in Capital Gains Deposit Account Scheme (1988), is unutilized, benefit availed earlier shall be revoked.

Chargeable amount shall be =

$$\frac{Unutilized\ amount\ for\ which\ benefit \frac{u}{s} 54F\ is\ availed}{Net\ sale\ consideration} \times \text{Original capital gain}$$

- **Capital Gains Accounts Scheme, 1988:**

If the new asset is not acquired till the due date of submission of return of income, then the taxpayer will have to deposit the money in 'Capital Gains Deposit Account' with a nationalized bank. The proof of deposit should be submitted along with the re-turn of income. On the basis of actual investment and the amount deposited in the de-posit account, exemption will be given to the taxpayer.

The taxpayer is to acquire a new asset by withdrawing from the deposit account. New asset must be acquired within specified time, provided in the relevant section.

The unutilized amount will become chargeable to tax in the previous year in which the specified time limit expires.

- **Tax on Capital Gain**s:
  1) Short-term capital gains: are taxable at normal rates but Short term capital gain on transfer of equity shares or units sold through Stock Exchange and Securities transaction tax paid, it will be taxable at concessional rate 15%.
  2) Long-term capital gains are taxable at special rates for each type of assessee –
     a. on sale of equity shares and units of equity oriented fun 10% over and above Rs. 1,00,000.

b. 20% on other long term capital gains.

- **Illustrations** :

Illustration 1) Mr. Paresh purchased a capital asset for Rs. 5,00,000 in the year 2005.06, spent Rs. 2,00,000 on its improvement during 2010-11. He sold the same for Rs. 50,00,000 in the previous year 2020-2021. The cost of inflation index for the financial years 2005-06, 2010-11 and 2020-2021 were 117,167 and 301 respectively. Compute the taxable capital gains for A. Y. 2021-2022.

Answer : Computation of taxable long term Capital Gain of Mr. Paresh for A.Y. 2021-2022

Particular	Amount
Sale proceeds of capital assets	50,00,000
Less: Indexed cost of acquisition	
(5,00,000/117x301)	-12,86,325
Less: Indexed cost of Improvement	
(2,00,000/167x301)	-3,60,479
Long term capital gains	**33,53,196**

Illustration 2) The written down value of a block of assets consisting of plants M, N, O as on 01/04/2020 was Rs. 4,40,000. During the year the new plant P was purchased for Rs. 1,60,000.

Compute the capital gains for A. Y. 2021-2022 if :

a) Plant M was sold for Rs. 8,00,000, the expenses on transfer being Rs. 80,000.

b) All the plants M, N, O, P were sold for Rs. 8,00,000 the expenses on sale being Rs. 80,000.

Answer: Computation of Short –term Capital Gains for F.Y. 2020-2021

Particular	Amount	Amount
a) If Plant M is sold		
Sale proceeds of plant M		8,00,000
Less: Cost of acquisition :		
1. Written down value of entire block of plants on	4,40,000	

01-04-2020		
2. Cost of new plant	1,60,000	
3. Expenses on transfer	80,000	6,80,000
Short term capital gains		**1,20,000**
b)If all the plants in block are Sold :		
Sale proceeds of all the plants in block are sold		8,00,000
Less: Cost of acquisition :		
1. Written down value of entire block of plants on 01-04-2020	4,40,000	
2. Cost of new plant	1,60,000	6,00,000
Short term capital gains		**2,00,000**

Illustration 3) Mr. Ganesh purchased 100 equity shares of Infosys Ltd. On 01-04-2005 at the rate of Rs. 1,000 per share in public issue of the company by paying security transaction tax he has sold all the shares on 01-10-2020 at the rate of Rs. 4,000 per share through a recognized stock exchange and paid brokerage Rs. 4,000 and securities transaction tax 0.02% compute his capital gain during the previous year 2020-2021. Fair market value of shares of Infosys Ltd. On 31/01/2018 is Rs. 2,000.

Answer : Computation of taxable capital gains of Mr. Ganesh for F. Y. 2020-2021

Particular	**Amount**
Sale proceeds of Share (100 X Rs.4,000)	4,00,000
Less: Brokerage	-4,000
Net sale consideration	3,96,000
Less: Cost of acquisition (100 X Rs. 2,000)	-2,00,000
Long term Capital Gain	**1,96,000**

Note: 1) Long term capital gains exceeding Rs. 1 lakh on sale of original shares through a recognized stock exchange and STT paid at the time of purchase and sale is taxable under section 112A at a concessional rate of 10%, without indexation benefit.

2) Cost of acquisition of equity shares acquired before 31/01/2018 is higher of :

   i) Actual cost of acquisition of shares i.e. Rs. 1,000 per share

   ii) Lower of –a) Fair market value of such asset Rs. 2,000 per share

      b) Full value consideration Rs. 4,000 per share i.e. Rs. 2, 000

   So the cost of acquisition of original share is Rs. 2,000 per share

Illustration 4) From the following information compute the taxable capital gains of Mr. Vishal for the A. Y. 2021-2022.

Particular	**Amount**
Capital Asset	Jewellery
Acquisition in 1996-97	------
Cost of acquisition	3,00,000
Cost of improvement in 1999-2000	30,000
Cost of improvement in 2011-2012	35,000
Fair market value on 01-04-2001	4,50,000
Sale proceeds on 01-12-2020	16,00,000
Selling expenses	40,000

Mr. Vishal has purchased a residential house costing Rs. 10,00,000 within the specified period the cost of inflation indices for the financial years 2001-02,2011-2012 and 2020-21 were 100,184,301 respectively. He was not owning any other residential house on the date of sale.

Answer: Computation of taxable capital gains of Mr. Vishal for A. Y. 2021-22

Particular	**Amount**	**Amount**
Sale proceeds of Jewellery		16,00,000
Less: 1. Indexed cost of acquisition (4,50,000\100*301)	13,54,500	

2. Indexed cost of improvement in 2011-12 (35,000/184*301)	57,255	
3. Selling Expenses	40,000	14,51,755
Long- term Capital Gains		1,48,245
Less: Exempt u/s 54F (1,48,245X10,00,000/16,00,000-40,000)		95,029
Taxable Long-term Capital Gain		**53,216**

Notes: i) As the fair market value of Jewellery as on 01-04-2001 is adopted as cost of acquisition, the cost of improvement before 01-04-2001 is ignored

ii) As cost of new residential house acquired is less than the net sale proceeds the long term capital gains arising is exempt u/s 54 proportionately .

- **Check your progress IV :**

1) Fill in the blanks .

i) Exemption under section 54 will be _______of the amount of capital gains arising on transfer of eligible asset or amount invested in purchase/construction of new residential house property

ii) The upper limit for claiming exemption under section 54 EC in a financial year is_______

iii) The holding period for an Immovable property to consider it as a Long Term Capital Asset is _______

iv) The holding period for Listed Equity shares and Equity Mutual Fund Units, to consider them as Long Term Capital Asset is _______

v) The Cost Inflation Index for the year 2001 is _______

3.2.5 Income from Other Source :

- **Introduction:** Income from other sources is a residuary head of income under the Income Tax in which we can consider all the different sources of income which does not fall under other heads as Income from salary or House property or Capital Gains or Business / profession. As per Section 56(1), any income which is not specifically exempted & not chargeable to tax under any other heads of income, shall be chargeable under the head Income from Other Sources.

- **Types of Incomes Chargeable under the head Income from other Sources** [Section 56(2)]

  Section 56(2) lays down an inclusive list of incomes taxable under this head.

  These are – 1. Dividend

  2. Winning from lotteries, crossword puzzles, horse races, card games, other games of any sort of gambling, betting of any form or nature.
  3. Interest on Securities
  4. Income by way of letting on hire of machinery, Plant or Furniture.
  5. Any sum received from employee as contribution towards staff welfare scheme.
  6. Any sum received under Keyman Insurance Policy.
  7. Any sum of Money or Value of Property received without consideration or for inadequate consideration to be subject to tax in the hands of the recipient [i.e. Taxability of Gift , section 56(2)(X)]
  8. Interest on loan /Debenture
  9. Director's sitting Fees
  10. Agricultural Income outside India.
  11. Remuneration received by the Members of Parliament.
  12. Insurance Commission
  13. Remuneration received by a teacher for acting as an examiner.
  14. Compensation or Other Payment.
  15. Interest on Bank deposits.
  16. Interest on undisclosed sources.
  17. Gratuity received by a director.
  18. Family Pension.

- **Taxability of Gift , section 56(2)(X)]:**

    i) For prevent the practice of receiving sum of money or the property without consideration or for inadequate consideration, sec 56(2)(x) brings to tax any sum of money or the value of any property received by any person without consideration or the value of any property received for inadequate consideration

Sr No	Nature of asset	Particular	Taxable value
1	Money	without consideration	The whole amount if the same exceeds Rs. 50,000
2	Movable property	without consideration	The aggregate fair market value of the property if it exceeds Rs. 50,000
3	Movable property	Inadequate consideration	The difference between the aggregate fair market value of and the consideration, such difference exceeds Rs. 50,000
4	Immovable property	without consideration	The stamp Duty value of such property if it exceeds Rs. 50,000.
5	Immovable property	Inadequate consideration	The difference between the stamp duty value and the consideration, if such difference exceeds the higher of Rs. 50,000 and 10% of consideration.

Receipts exempted from the applicability of section 56(2)(x):

1) From any relative on the occasion of the marriage of the individual
2) Under a will or by way of inheritance,

3) In contemplation of death of the payer or donor as the case may be,

4) From any local authority

5) From such class of persons

6) subject to such conditions as may be prescribed.

- **Admissible deduction [Sec 57]**: For computation of Taxable income under this head, the following deduction are to be made.

1. In case of Dividend (other than u/s 115 – O) or interest on securities - Any reasonable sum paid by way of commission or remuneration to a banker or any other person.

2. Income consists of recovery from employees as contribution to any PF. Superannuation fund etc. Amount of contribution remitted before the due date under the respective Acts, in accordance with the provision of section 36(1)(va)

3. Income from letting on hire of machinery, Plant & furniture - Current Repairs to the machinery, Plant & furniture - Insurance Premium - Depreciation / Unabsorbed Depreciation.

4. Family Pension- - 1/3 rd of such income or Rs. 15,000 whichever is less.

5. Interest on Compensation / enhanced Compensation received – - 50% of such interest

6. Any other expenditure not in the nature of capital expenditure incurred wholly & exclusively for earning such income.

- **Illustration:**

Illustration 1) From the following particulars of Mr. Dipak, compute the income from other source for AY 2021-22.

1) Income from Units of UTI Rs. 25,000.

2) Composite rent from letting on hire of building & Machinery Rs. 80,000

3) Ground rent received Rs. 40,000

4) Winning form lotteries (Gross) Rs. 50,000.

5) Interest on Government securities Rs. 4,000.

6) Dividend from Shares of Axis bank Ltd. Rs. 9.450.

7) Dividend from co-operative Society Rs. 8,000.

8) Royalty received on text book written by him Rs. 15,000

Solution: Computation of Income from Other source of Mr. Dipak for A.Y. 2021-2022

Particulars	**Amount**
Income from UTI	25,000
Composite rent from letting on hire of building & Machinery	80,000
Ground rent received	40,000
Winning form lotteries	50.000
Interest on Government securities	4,000
Dividend from Shares of Axis bank Ltd	9,450
Dividend from co-operative Society	8,000
Royalty received on text book	15,000
Income From other source	**2,31,450**

Illustration 2) From the following particulars of Mrs. Kirti Joshi, compute the income from other source for AY 2021-2022**.**

1) Directors fees Received Rs. 80,000.

2) Prize won in crossword puzzles Rs. 5,000.

3) Remuneration as a working as a examiner in the university exam. Rs. 10000

4) Dividend from listed Indian company Rs. 15,000

5) Interest on government securities Rs. 4,000 (Net)

6) Interest on Fixed deposits with Bank Rs. 15,000

7) Dividend from co-operative Society Rs. 5,000.

8) Gift from Mother Rs. 20,000.

Solution : Computation of Income from other source of Mrs. Kirti Joshi for AY. 2021-2022

Particulars	**Amount**
Directors fees received	80,000
Casual Income (Prize won in crossword puzzles	5,000
Remuneration as examiner	10,000
Dividend from listed Indian company	15,000
Interest on government securities	4,000
Interest on Fixed deposit	15,000
Dividend on shares of Co-operative society	5,000
Gifts from mother	Nil
Income From other source	**1,34,000**

- **Check your progress V :**

I) Fill in the blanks

1) Mrs. Aruna receives a family pension of Rs. 5000 per month. She entitled to a standard deduction of Rs. -----------

2) The stamp duty value of immovable property received by a person without consideration shall be charged to tax if the same will exceed ________

3) Dividend received from a foreign company is charged to tax under the head______.

4) Mrs. Patil won a lottery. At what rate such winnings would be chargeable to tax?

5) Income from sub-letting is taxable under the head _________

3.2.6 Computation of Gross Total Income and Tax Liability in Respect of Individuals only

- **Introduction**: Individual means an human being. Income tax is levied on assesses total income. The total income of individual is computed after making deductions from gross total income. Gross total income is aggregate of the income computed under different five heads.

- **2.6.2**. **Steps for calculate total taxable income:**

Following steps are considered for computing total income of individual and charge tax there

Step 1	Determination of residential status – Resident, Resident But Not Ordinary resident , Non- resident	
Step 2	Classifications of income under different heads	
Step 3	Exclusion of Income not chargeable to tax	
Step 4	Computation of income under each head – Salary, House Property, Business, Capital gain, Income from other source	
Step 5	Apply the clubbing provision if any	
Step 6	Set- off or carry forward and set- off of losses	
Step 7	Compute Gross total Income	
Step 8	Deductions from Gross Total Income	
Step 9	Compute Total Income	
Step 10	Application of the rates of tax on the total income	
	Total Income	Rate of Tax
	Up to Rs. 2,50,000 (below 60 years)	Nil
	Up to Rs. 3,00,000 (60 years and above but less than 80 year)	
	Up to Rs. 5,00,000 (above 80 years and resident in India)	
	Rs. 2,50,001\Rs. 3,00,001, as the case may be to Rs. 5,00,000	5%
	Rs.5,00,001 to 10,00,000	20%
	Above Rs. 10,00,000	30%
Step 11	Rebate under section 87A of maximum up to Rs. 12,500 if total income does not exceeds Rs. 5,00,000	
Step 12	Calculate surcharge if applicable	
	Total income (assuming that the	Surcharge

	same does not include dividend, LTCG u/s. 112A, and STCG u/s 111A)	
	More than Rs.50 lakhs and less than Rs. 1 crore	10% of income tax
	More than Rs. 1 crore and less than Rs. 2 crore	15% of income tax
	More than Rs. 2 crore and less than Rs. 5 crore	25% of income tax
	More than Rs. 5 crore	37% of income tax
Step 13	Health and education cess at 4% on income tax and surcharge if payable	
	Total Tax Liability=Tax on total income at applicable rate+ surcharge if applicable –Rebate u/s 87A if total income less than 5 lakh+ Education cess	
Step 14	Examine the applicability of Alternate Minimum Tax (AMT):-	
	a) If an individual is claiming deductions under section 10 AA or under section 35 AD or section 80JJAA, 80QQB, & 80RRB and his adjusted total income exceeds Rs. 20 lakhs, Minimum Alternate Tax provisions will apply b) Compute minimum Alternate Tax @18.50% of adjusted total income c) If AMT is more than tax computed as per normal provisions, adjusted total income will be deemed to be total income d) tax applicable 18.5% e) Tax credit to be carried forward =AMT less tax computed as per regular provision f) If Individual or HUF s opted for section 115BAC are not liable for MAT u/s. 115JC	
Step 15	Examine whether or not to exercise option u/s 115BAC for availing concessional tax slab :-	
	1) The Budget 2020 introduces a new regime under section 115BAC giving an option to individuals and HUF taxpayers to pay income tax at	

	lower rate other than income chargeable to tax at special rates Subject to following conditions A) Exemptions and deductions not claimable under the new tax regime The following are the deductions and exemptions you cannot claim under the new tax system: 1. The standard deduction, professional tax and entertainment allowance on salaries 2. Leave Travel Allowance (LTA) 3. House Rent Allowance (HRA) 4. Other special allowance [Section10(14)] 5. Interest on housing loan on the self-occupied property or vacant property (Section 24) 6. Chapter VI-A deduction (80C, 80D, 80E and so on) (Except Section 80CCD(2) and 80JJAA) 7. Deduction from family pension income 8. Daily allowance or constituency allowance of MPs and LMAs 9. Exemption in respect of income of minor child included in the income of parent 10. Tax holiday for units established in SEZ 11. Additional depreciation 12. Deduction in respect of contribution to notified approved research association, Approved Indian company for scientific research, an national laboratory , universities B) Total income of individual should be computed without set off any brought loss and depreciation. 2) Time limit for exercise the option : 1) If an individual having income from business or profession exercise the option to pay tax under section 115BAC in a previous year, then said provision would apply for all subsequent previous years. 2) A salaried taxpayer can opt-in and opt-out every year. That means you can choose the new tax regime in one year and choose the regular tax regime in another year.

	C) Concessional Tax Rate : Up to Rs. 2,50,000 — Nil From 2,50,001 to 5,00,000 — 5% From 5,00,001 to 7,50,000 — 10% From 7,50,001 to 10,00,000 — 15% From 10,00,001 to 12,50,000 — 20% From 12,50,001 to 15,00,000 — 25% Above Rs. 15,00,000 — 30% Compare the Normal tax liability with liability computed under section 115BAC and choose them one.
Step 16	Credit for Advance tax , TDS and TCS
Step 17	Tax payable / Tax refundable

The rate of income tax is specified in the Finance Act

- **Performa Showing Computation of Total Income of Individual**

Particular	**Rs.**	**Rs**
Income from salary		xx
Income from house property		xx
a) Self occupied	xx	
b) Let out	xx	
Income from business or profession		xx
Capital gains		xx
Income from other source		xx
Gross Total Income		xx
Less: Deductions under chapter VIA u/s 80C to 80 U		xx
Total Taxable Income		xxx
Tax payable	zxx	
Less: Relief u/s 87 A if applicable	-xxx	
Tax Payable after relief	xxx	

Add: Education cess	xxx	
Add: Surcharge if applicable	xxx	
Tax liability	xxx	
Add: Interest payable if any	xx	
Total Tax liability		xxxx
Less: Advance tax paid	xxx	
Less: TDS	xxx	-xxxx
Total tax payable/ Refund		**xxxx**

- **Illustrations:**

Illustration 1) Mrs. Priti, aged 35 years, is a chartered accountant in practice. Her Income

And Expenditure Account for the year ended 31/03/2021 are as follow.

Expenditure	**Rs.**	**Income**	**Rs.**
Salary to staff	15,50,000	Professional Fees	55,98,300
Stipend to article assistant	1,50,000	Dividend from Indian listed company	10,524
Office Rent	12,00,000	Income from UTI	7,600
Printing and stationery	12,46,000	Honorarium received from valuation of answer papers	15,800
Meeting seminar and conference	31,600	Rent received from residential flat let out	85,600
Purchase of car on 01/05/2020 for office use	80,000		
Repairs and maintenance	4,000		
Travelling expenses	5,25,000		
Municipal tax of house property	3,000		
Surplus	9,28,224		
	57,17,824		**57,17,824**

Other information :

1) Allowable rate of depreciation on motor car is 15%

2) Value of benefits received from clients during the course of profession is Rs. 10,500

3) Travelling expenses include Rs. 30,000 for private purpose

4) She invested an Amount of Rs. 10,000 in National Saving Certificate

5) Medical insurance premium paid in cash Rs. 10,000

6) She has paid Rs. 70,000 towards advance tax during the previous year 2020-2021

7) TDS on dividend made by UTI Rs. 1,052 and other Indian listed company Rs.760.

Compute the total income and tax payable of Mrs. Priti for A.Y. 2021-2022 under normal provision and provision as per section 115BAC. Which option is beneficial to her?

Answer: Computation of total income and tax payable of Mrs. Priti for the A.Y. 2021-2022

Particular	**Rs.**	**Rs**
Income from House Property (See working Note No. 1)		57,820
Profit and gains on business and profession (See working note No. 2)		9,20,200
Income from other source (See working note No. 3)		33,924
Gross Total Income		10,11,944
Less: Deduction under chapter VI A		10,000
Total Income		10,01,944
Total Income Rounded off		10,01,940
Tax on Total Income		
Up to Rs. 2,50,000	Nil	
Rs. 2,50,001 to Rs. 5,00,000 @5% (5,00,000-2,50,00 x 5%)	12,500	
Rs. 5,00,001 to Rs. 10,00,000 @20% (10,00,000-	1,00,000	

5,00,000x20%)		
Rs. 10,00,000 and above @30% (10,01,940 - Rs. 10,00,000 x30%)	582	1,13,082
Add : Health and education cess @4%		4,523
Total Tax liability		1,17,605
Less: Advance tax		70,000
Less: TDS (Rs. 1052, Rs.760)		1,812
Tax payable		45,793
Tax payable (Round off)		**45,790**

Computation of tax payable in accordance with provisions of section 115BAC

Particular	Rs.	Rs
Gross Total Income		10,11,944
Income under the head profession, house property, Income from other source would remain the same even if she opts for special provisions u/s 115BAC, because deductions claimed by her under these heads is allowable even u/s 115BAC)		
Less: Deductions under chapter VI-A (Not allowable if opts for section 115BAC)		Nil
Total Income		10,11,944
Total Income rounded off		10,11,940
Tax on total income		
Up to Rs. 2,50,000	Nil	
Rs. 2,50,00 to Rs. 5,00,000 @5% (5,00,000-2,50,000 x5%)	12,500	
Rs. 5,00,000 to Rs. 7,50,000 @10% (7,50,000-5,00,000)	25,000	
Rs. 7,50,000 to Rs. 10,00,000 @15% (10,00,000-7,50,000x15%)	37,500	
Rs 10,00,000 to Rs.12,50,000 @20% (10,11,944-10,00,000x 20%)	2,388	77,388

Add Health and education cess @4%		3,096
Total Tax liability		80,484
Less: Advance tax	70,000	
Less: TDS (Rs. 1052, Rs.760)	1,812	71,812
Tax payable		8,672
Tax payable (Round off)		**8,670**

Working Notes:

1) Income from house property:

Particular	Rs.
Gross Annual Value	85,600
Less: Municipal tax paid	-3,000
Net Annual Value (NAV)	82,600
Less: Standard deduction @30%of NAV	24,780
Income from house property	**57,820**

2) Income under the head profits and gains from Business and Profession :**2) 2Npre**

Particular	Rs.	Rs.
Net profit as per Income and Expenditure account		9,28,224
Add: Expenses debited but not allowable		
Personal Travelling expenses	30,000	
Amount paid for purchase of car	80,000	
Municipal tax of residential house	3,000	1,13,000
		10,41,224
Add: Gifts from client		10,500
		10,51,724
Less: Income credited but not taxable under this head		
Dividend from Indian listed companies	10,524	
Income from UTI	7,600	
Honorarium for valuation of answer paper	15,800	

Rent of flat	85,600	1,19,524
		9,32,200
Less: Depreciation on car		12,000
Income from profession		**9,20,200**

3) Computation of Income from Other Source

Particular	**Rs.**
Dividend from Indian listed company	10,524
Income from UTI	7,600
Honorarium received from valuation of answer papers	15,800
Total	**33,924**

4) Health insurance paid in cash is not eligible for deduction u/s 80D**F2**

5) Since tax payable as per provisions of section 115BAC is lower than the tax payable under regular provision, it would be beneficial to Priti to opts for section 115BAC

Illustration 2) From the following details, compute the total income and tax liability of Virat, aged 31 years, of Mumbai both as per regular provisions and as per section 115BAC of Income -tax Act, 1961 for assessment year 2021-2022

Particular	**Amount**
Salary including DA	3,00,000
Bonus	15,000
Salary of servant provided by the employer	15,000
Rent paid by Virat for his accommodation	60,000
Bills paid by the employer for gas, electricity and water	11,000
Interest received on Fixed deposit	9,500
He received cash gift of Rs. 30,000 each from four friends	1,20,000
Rent received Rs. 3,500 per month. He paid Interest on home loan Rs. 24,000 p.a. He paid Municipal tax paid by him for rented property Rs. 4,300 p.a.	
He contributed Rs. 50,000 to Public Provident Fund during the year.	

Answer : Computation of total income and tax payable of Mr. Virat for the A.Y. 2021-2022

Particular	Rs.	Rs
I. Income From Salary		**2,91,000**
Salary including DA	3,00,000	
Bonus	15,000	
Salary of servant provided by the employer	15,000	
Free gas, electricity and water	11,000	
	3,41,000	
Less: Standard deduction	50,000	
	2,91,000	
II. Income From House Property		**2,390**
Gross Annual Value (Rent receivable is taken as GAV in the absence of other information) (Rs.3,500 X 12)	42,000	
Less : Municipal taxes paid	4,300	
Net Annual Value (NAV)	37,700	
Less: Deductions under section 24		
i) 30% of NAV	11,310	
ii) Interest on loan	24,000	
	2,390	
III. Income From Other Source		**1,29,500**
Interest on Fixed Deposit	9,500	
Gifts received from friends (as the aggregate amount received during the year exceeds Rs. 50,000)	1,20,000	
	1,29,500	
Gross Total Income		**4,22,890**
Less: Deductions under section 80 C (PPF)		50,000
Taxable total Income		3,72,890
Tax on total income		
(3,72,890-250000)X5%		6,145
Less: Rebate under section 87A , since total income does not exceeds Rs. 5,00,000		6,145
Tax Liability		**Nil**

Computation of total income and tax payable of Mr. Virat in accordance with the provisions of section 115BAC for the A.Y. 2021-2022

Particular	Rs.	Rs
I. Income From Salary		**3,41,000**
Salary including DA	3,00,000	
Bonus	15,000	
Salary of servant provided by the employer	15,000	
Free gas, electricity and water	11,000	
	3,41,000	
Less: Standard deduction	Nil	
	3,41,000	
II. Income From House Property		**2,390**
Gross Annual Value (Rent receivable is taken as GAV in the absence of other information) (Rs.3,500 X 12)	42,000	
Less : Municipal taxes paid	4,300	
Net Annual Value (NAV)	37,700	
Less: Deductions under section 24		
i) 30% of NAV	11,310	
ii) Interest on loan	24,000	
	2,390	
III. Income From Other Source		**1,29,500**
Interest on Fixed Deposit	9,500	
Gifts received from friends (as the aggregate amount received during the year exceeds Rs. 50,000)	1,20,000	
	1,29,500	
Gross Total Income		**4,72,890**
Less: Deductions under section 80 C (PPF)		Nil
Taxable total Income		4,72,890
Tax on total income		
(4,72,890-2,50,000)X5%		11,145
Less: Rebate under section 87A, since total income does not exceeds Rs. 5,00,000		11,145
Tax Liability		**Nil**

Illustration 3) From the following information compute total income of Mr. Sagar for assessment year 2021-2022 as per regular provision of tax Act .

Particular	**Amount**	**Particular**	**Amount**
Salary to Staff	3,00,000	Gross Profits	10,00,000
Salary to Proprietor	60,000	Gross Salary	4,20,000
General Expenses	50,000	Life Insurance policy amount received	2,00,000
Interest on Capital	40,000	Commission and Brokerage	20,000
Drawings	2,10,000	Interest on Debentures	30,000
Income Tax	38,000	Interest on Saving Bank Accounts	25,000
Bad Debts	20,000	Interest on Fixed Deposits	35,000
Provision for Bad Debts	30,000	Rent Received	4,80,000
Fire Insurance	5,000		
Life Insurance Premium	2,04,000		
Law Charges	27,000		
Furniture purchased	25,000		
Donations	16,000		
Charity to students	17,000		
GST paid	80,000		
Repairs	8,000		
Municipal Tax Paid	5,000		
Depreciation	70,000		
Net Profit	10,05,000		
	22,10,000		**22,10,000**

Additional information:

1) General expenses included Rs. 10,000 being compensation paid to an employee on termination of his service in the interest of the business.

2) Donation were paid to Prime Minister Relief Fund

3) Insurance Premium on own life

4) Repairs included Rs. 2,000 for let out house property.

5) Depreciation as per Income Tax rule Rs. 90,000.

Answer: Computation of Total Income of Sagar for A.Y. 2021-2022

Particular	Amount	Amount	Amount
I. Income From Salary			3,70,000
Gross Salary	4,20,000		
Less: Standard Deduction	-50,000		
Net Income from Salary	3,70,000		
II. Income From House Property :			
Gross Annual Value (Rent Received)	4,80,000		
Less: Municipal Tax Paid	-5,000		
Annual Value	4,75,000		
Less: Deductions u/s 24			
Standard Deduction (4, 75,000X30%)	1,42,500		
	3,32,500		3,32,500
III. Income From Business :			
Net Profit as per Profit and Loss Account		10,05,000	
Add: Expenses debited but not allowed			
Salary to proprietor	60,000		
Interest on capital	40,000		
Drawing	2,10,000		
Income Tax	38,000		
Life Insurance premium	2,04,000		
Furniture	25,000		
Donations	16,000		
Charity to students	17,000		
Repairs	2,000		
Provision for bad debts	30,000		

Municipal Tax Paid	5,000		
Depreciation	70,000	7,17,000	
		17,22,000	
Less: Income Taxable under other head or exempt			
Gross Salary	4,20,000		
Life Insurance policy amount received	2,00,000		
Interest on Debentures	30,000		
Interest on Saving Bank Accounts	25,000		
Interest on Fixed Deposits	35,000		
Rent Received	4,80,000		
	11,90,000	11,90,000	
		5,32,000	
Less: Depreciation as per IT rule		90,000	
		4,42,000	4,42,000
IV. Income From Other Source			
Interest on Debentures	30,000		
Interest on Saving Bank Accounts	25,000		
Interest on Fixed Deposits	35,000		90,000
Gross Total Income			12,34,500
Less: Deductions u/s 80			
Life Insurance Premium u/s 80C	2,04,000	1,50,000	
Interest on Saving accounts u/s 80TTA	25,000	10,000	
Donations u/s 80G	16,000	16,000	
		1,76,000	1,76,000
Total Taxable Income			**10,58,500**
Tax on Total Income			
Up to Rs. 2,50,000			
Rs. 2,50,001 to Rs. 5,00,000 @5%	12,500		

(5,00,000-2,50,00x5%)		
Rs. 5,00,001 to Rs. 10,00,000 @20% (10,00,000-5,00,000x20%)	1,00,000	
Rs. 10,00,000 and above @30% (10,58,500 - Rs. 10,00,0000 x30%)	17,550	
Total	1,30,050	
Add Health and education cess @4%	5,202	
Total Tax liability	1,35,252	
Less: Advance tax	----	
Less: TDS	---	
Tax payable	1,35,253	
Tax payable (Round off)	**1,35,250**	

Note : 1) LIC amount received is exempt from tax u/s 10(10D)

2) Maximum allowable deduction us 80 c Rs. 1,50,000.

Illustration 4) Mr. Pranit is working in India Ltd. Pune. He has furnished the following details of his income for the financial year 2020-2021.

1) Basic Salary Rs. 50,000 p.m.
2) D.A. 40 % of salary (Considered for retirement benefit)
3) Bonus equal to 2 months of basic salary
4) He received House Rent Allowance of Rs. 20,000 per month from the employer. But he paid rent Rs. 25,000
5) Helper Allowance Rs. 1,000 p.m.
6) He contribute to Public provident Fund Rs. 50,000 per annum
7) Life Insurance Premium Paid Rs. 1,00,000
8) Income from business Rs. 3,50,000
9) Dividend received from listed Indian Company Rs. 15,000
10) He has self occupied at Kolhapur during the year he has paid Rs. 1,15,000 as interest and 50,000 as principle amount on housing loan
11) Interest on Fixed deposit Rs. 50,000

12) The company has deducted income tax Rs. 50,000

13) Tax paid on employment Rs. 2000

Compute income and tax liability of Mr. Pranit for A.Y. 2021.2022 under regular provision and provision u/s 115BAC. Which is beneficial to him?

Answer : Computation of total income of Mr. Pranit as per regular provisions for A.Y.2021-2022

Particular	**Amount**	**Amount**	**Amount**
I. Income From Salary			
Basic Salary (Rs. 50,000X12)		6,00,000	
D. A. (Rs. 6,00,000X40%)		2,40,000	
Bonus (Rs. 50,000X2)		1,00,000	
House Rent Allowance		24,000	
Allowance Received (Rs. 20,000X12)	2,40,000		
Less: Exempt (Working note .1)	2,16,000		
	24,000		
Helper Allowance (1,000X12)		12,000	
Gross Salary		9,76,000	
Less: Deductions u/s 16			
i)Standard Deduction	50,000		
ii) Professional Tax	2,000		
	52,000	52,000	
Income From Salary		9,24,000	9,24,000
II. Income From Business			3,50,000
III. Income From House Property			
Self occupied			
Annual Value	Nil		
Less: Interest paid on Housing Loan	-1,15,000		
Loss From House Property			(1,15,000)

IV) Income From Other Source			
Dividend From Listed Indian company	15,000		
Interest on Fixed Deposit	50,.000		
	65,000		65,000
v) Capital Gain			Nil
Gross Total Income			12,24,000
Less: Deductions under chapter VIA			
Life insurance premium (u/s 80C)	1,00,000		
Principal repayment of housing loan (u/s 80C)	50,000		
Public Provident Fund contribution (u/s 80C)	50,000		
(Maximum allowable under section 80C)	2,00,000		-1,50,000
Total Taxable Income			10,74,000
Tax on Total Income			
Up to Rs. 2,50,000			Nil
Rs. 2,50,001 to Rs. 5,00,000 @5% (5,00,000-2,50,00x5%)			12,500
Rs. 5,00,001 to Rs. 10,00,000 @20% (10,00,000-5,00,000x20%)			1,00,000
Rs. 10,00,000 and above @30% (10,74,000 - Rs. 10,00,0000 x30%)			22,200
Total			1,34,700
Add Health and education cess @4%			5,388
Total Tax liability			1,40,088
Less: Advance tax			---
Less: TDS			50,000
Tax payable			90,088
Tax payable (Round off)			90,090

Working Notes:

1) House Rent Allowance:

Salary For H.R. A.	**Amount**	**Exempt least of following**	**Amount**
Basic	6,00,000	a) H. R. A. Received	2,40,000
D.A.	2,40,000	b) Rent paid (-) 10% of salary	
Salary for H. R. A.	**8,40,000**	[(25,000X12)-(8,40,000X10%)]=300000-84000	2,16,000
		c) 40% of Salary (8,40,000X40%)	3,36,000
		Whichever is least is exempt i.e.	2,16,000

Computation of total income of Mr. Pranit in accordance with the provisions of section 115BAC for A. Y.2021-2022

Particular	**Amount**	**Amount**	**Amount**
I. Income From Salary			
Basic Salary (Rs. 50,000x12)		6,00,000	
D. A. (Rs. 6,00,000x40%)		2,40,000	
Bonus (Rs. 50,000x2)		1,00,000	
House Rent Allowance		2.40,000	
Helper Allowance (1,000x12)		12,000	
Gross Salary		11,92,000	
Less: Deductions u/s 16			
i) Standard Deduction	----		
ii) Professional Tax	----		
	----	---	
Income From Salary		11,92,000	11.92,000
II. Income From Business			3,50,000

III. Income From House Property			
Self occupied			
Annual Value	Nil		
Less: Interest paid on Housing Loan	----		
Loss From House Property			------
IV) Income From Other Source			
Dividend From Listed Indian company	15,000		
Interest on Fixed Deposit	50,.000		
	65,000		65,000
V) Capital Gain			Nil
Gross Total Income			16,07,000
Less: Deductions under chapter VIA			------
Total Taxable Income			**16,07,000**
Tax on total income			
Up to Rs. 2,50,000	Nil		
Rs. 2,50,00 to Rs. 5,00,000 @5% (5,00,000-2,50,000 x5%)	12,500		
Rs. 5,00,000 to Rs. 7,50,000 @10% (7,50,000-5,00,000)	25,000		
Rs. 7,50,000 to Rs. 10,00,000 @15% (10,00,000-7,50,000 x 15%)	37,500		
Rs 10,00,000 to Rs.12,50,000 @20% (12,50,000-10,00,000x 20%)	50,000		
Rs. 12,50,000 to Rs.15,00,000 @25% (15,00,000-12,50,000 x 25%)	62,500		
Rs. 15,00,000 and above (16,07,000-15,00,000x30%)	32,100	2,19,600	
Add Health and education cess @4%		8,784	
Total Tax liability		2,28,384	
Less: Advance tax	----		

Less: TDS	50,000	50,000	
Tax payable		1,78,384	
Tax payable (Round off)			**1,78,380**

Note: 1) If individual opts for section 115BAC he do not avail standard deduction, professional tax deduction, H.R.A. exemption, self occupied house interest exemption, deductions under chapter VIA .

2) As Mr. Pranit is require to pay lower tax as per the regular provisions of the Income Tax Act, it would be beneficial to him opt for regular provision.

Illustration 5) Following is the profit and loss account of Mrs. Tanuja for the previous year ending 31/03/2021

Particular	Amount	Particular	Amount
Travelling Expenses	1,50,000	Gross Profit	15,40,300
Salary to Staff	3,75,000	Long term Capital Gain on Equity shares	35,400
Telephone and Internet charges	10,500	Short term Capital Gain	15,000
Light Bill	60,000	Rent received	3,00,000
Provisions for Bad Debts	10,000	(Fair Rent 1,00,000, Municipal Value 2,00,00)	
Office Expenses	75,000	Dividend from listed company	5,000
Depreciation	50,000	Directors Fees	10,000
Printing and Stationery	47,000	Lottery Income (Net)	3,50,000
Insurance	15,000		
Collection Charges	5,000		
GST paid	80,000		
Municipal Taxes	4,500		
To Net Profit	13,73,700		
	22,55,700		**22,55,700**

Additional Information :

1) Municipal taxes are in connection with let out house.
2) Depreciation as per IT rules Rs. 55,600.
3) Collection charges Rs. 1,000 for dividend and Rs. 4,000 for house property.
4) Gross Lottery income Rs. 5,00,000. TDS made from this Rs. 1,50,000
5) LIC paid during the year Rs. 1,05,000

Compute her total income for the assessment year 2021-2022 as per regular provision of Income Tax Act.

Answer : Computation of total income of Mrs. Tanuja as per regular provisions for A. Y.2021-2022

Particular	Amount	Amount	Amount
I. Income From Salary			**Nil**
II. Income From Business			
Net Profit as per Profit and Loss Account		13,73,700	
Add: Expenses debited but not allowed			
Provisions for Bad Debts	10,000		
Collection Charges	5,000		
Depreciation	50,000		
Municipal Taxes	4,500		
	69,500	69,500	
		14,43,200	
Less: Income Taxable under other head or exempt			
Long term Capital Gain on Equity shares	35,400		
Short term Capital Gain	15,000		
Rent received	3,00,000		
Dividend from listed company	5,000		
Directors Fees	10,000		
Lottery Income (Net)	3,50,000		

	7,15,400	7,15,400	
		7,27,800	7,27,800
III. Income From House Property			
Gross Annual Value			
a) Municipal Value	2,00,000		
b) Fair Rent Value	1,00,000		
c) Annual Rent Value	3,00,000		
d) Annual Lettable Value	2,00,000		
(Higher of (a) or(b) above)			
e) Gross Annual Value	3,00,000		
(Higher of (c) or (d) above)			
Less: Municipal Tax Paid	4,500		
Annual Value	2,95,500		
Less : Deduction u/s 24			
Standard deduction (2,95,500X30%)	88,650		
Income From House Property	2,06,850		2,06,850
IV. Capital Gain			
Long term Capital Gain on share	35,400		
Exempt up to Rs. 1,00,000	-35,400	Nil	
Short Term Capital Gain		15000	
			15,000
V. Income From Other Source			
Dividend from listed company	5,000		
Directors Fees	10,000		
Lottery Income (Gross)	5,00,000		5,15,000
Gross Total Income			14,64,650
Less: Deductions under chapter VIA			
LIC premium paid			1,05,000
Total Taxable Income			**13,59,650**

3.3. Summary

Total income of assessee has to be computed as per the different provisions of contained in the Income – tax Act, 1961. For computation of total income first we require to calculate five different heads Income from salary, Income from business or profession, Income from house property, Capital gain and Income from other source sum total of these five heads of income is called gross total income. Some person has all heads of income but some has only few heads of income. After calculation of gross total income deduct there from deductions under chapter VIA and then calculate tax liability applicable rate determined in finance act.

3.4. Terms to Remember:

- **Income From Salary:**

Meaning of salary for income tax purposes is much wider. Salary means every Payment monetary or non -monetary made by employer to employee for Service rendered by employee.

Allowances : There are three types of allowances:

1. Allowances included in salary & full taxable.
2. Allowances totally exempt from tax and not included in salary.
3. Allowances partly included in salary and partly exempted.

PERQUISITES (Section 17 (2)

Perquisites mean "any casual emolument fee or profit" attached to an office or position in addition to salary or wages. It is a personal advantage – something that benefits a man by going "into his own pocket"

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1. Taxable for all Employees :

1. Rent free Accommodation 2. Accommodation at concessional rent

3. Monetary obligation of employee discharged by employers like:

a. Life insurance premium or deferred Annuity Premium.

b. Income – tax or Profession tax (c) Hotel or club bill.

d. children's education fee e Personal conveyance exp. Car or other

f. Wages of domestic servants engaged by employers.

g. Personal gas, water, electricity bills (connection in name employee) any other personal bills.

2. Other fringe Benefits: (a) Interest free loans or loans at concessional interest (loan exceeding Rs. 20,000) and not for medical for medical treatment of specified disease, excess or prescribed rate over actual interest rate taxable (b) Use of movable asset by an employee except computer & laptops (c) transfer of movable asset to an employee (d) Travelling & tour (e) free food (g) Gift vouchers exceeding Rs. 5,000 (h) Credit cards (i) Club expenditure.

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3. Tax-free Perquisites for all Employees : 1, Medical facility

2. Refreshment during working hours 3. Free meals 4. Recreation in group

5. Transport facilities to work place and back 6. Training facility

7. Goods at concession 8. Telephone bills for connection given at residence (including cellular) 9. Free ratio to armed force personal 10. Family planning expenses of employee 11. Conveyance facilities to Judges 12. Perquisites to Govt. Employees posted abroad 13. Computer, laptops given to employee for official or personal use. 14. Transfer of movable asset (like car, computer or electronic item) more than 10 years old without consideration 15. Accident insurance premium paid by employer for his own benefit 16. Value of shares or debentures given free of cost or at concession to employees. 17. Accommodation provided in hotel or transfer of employee for not exceeding 15 days

4. Taxable Perquisites only for Specified Employees

1. Supply of gas, electricity k & water 2. Education facility to children

3. Services of domestic servant provident by employer.

4. Free transport facility to employee by transport undertaking.

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Meaning of "salary" for different calculations :

(A) 1. House Rent Allowance, 2. Employer's Contribution to Recognized Provident Fund 3. Gratuity (not being gratuity under the payment of Gratuity Act). 4. Leave Encashment at the time of Retirement

Salary : 1 Basic salary + **2.** Dearness allowance /Pay it part of salary or Computing all retirement benefits and **3.** Commission if paid as percentage of turnover achieved by an employee)

(B) Value of Rent-Free Accommodation / Concessional House:

Salary – Basic salary + Dearness allowance / pay if part of alary OR computing all retirement benefits +bonus + commission+ Fees+ taxable allowance and any monetary benefit otherwise chargeable to tax.

DEDUCTIONS U/S 16 : The income chargeable under the head "salary" shall be computed after making deduction.

1. Standard Deduction: Rs. 50,000 or actual salary whichever less
2. Entertainment Allowance : It is to be added to salary income first and then a deduction is allowed LEAST of the following for Govt. Employees only. A Rs. 5,000 B.20% of Basic salary only. C. Entertainment allowance actually received during the year.
3. Professional Tax: Deduction is allowed in respect of any sum paid by the assesses on account of tax on employment.

- **Income From House Property**

  Basis of Charges (Section 22):

For computation of Annual value require the property should consist of buildings or lands appurtenant or (connected) thereto, Detrmination of annual value for different different types of house properties as under :

1) Let out property
2) Self- occupied house property
3) House property let out for part of the year and self occupied for part of the year
4) House partly self occupied for residence and partly let out
5) More than one house self occupied (Deemed let out)

6) House reserved for self occupation

Let Out property ::

Step:1. Ascertain Gross Annual Value :(GAV)

a) Actual Rental Value:

Actual rental value is the sum for which the property is let out

b) Municipal Value:

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

c) Fair Rent :

Fair rent means rent which similar property in the same locality would fetch.

d) Standard Rent :

Standard rent is rent fixed by Rent Control Act. The land lord cannot reasonably accept from tenant anything more than standard rent.

a) Findout expected rent or reasonable lettable value .:

If the Rent Control Act is not applicable : expected rent or reaonable lettable value is fair rent or munucipal value whichever is more .

If the Rent Control Act is applicable: Expected rent or reaonable lettable value should not exceed the Standard Rent given under Rent Control Act.

b) Gross Annual Value :

Where the property is let out and the actual rent recevied and receivble by the owner is in excess of the Reasonable lettable value as above the amount so received shall be the Gross Annual Value.

Where the let out property was vacant during the whole year or part of year and owing to this vacancy the acutal rent received or receivable by the owner in respect of there is less than the reasonable lettable value the amount so received or receivable shall be the Gross Annual Value .

c) The unrealsied rent if any may be decuted from the rent received/ receivable only if the tenancy is bonafide.

Step II. Deduct Municipal Taxes:

Actual Municipal tax **paid by owner of property during previous year**..

Step III. Allow deductions u/s. 24:

There are two deductions from Annual value :-

i) **standard deduction under section 24(a)** : This is a flat deduction at the rate 30% of the net annual value of the let out property .In case of self occupied property standard deduction is not allowed as its annual value is Nil.

ii) **Interest on borrowed capital under section 24(b):** Interest payable on funds borrowed for the purpose of purchase, construction, repairs or renewal of house property is allowed as a deduction

a) **Interest for preconstruction period:**

Interest for Preconstruction period is accumulated and can be claimed as deduction over a period of 5 continuous year in equal installments, from the year of completion of construction.

b) Interest on post construction period: Post construction period starts from the beginning from the financial year in which construction is completed

Self –occupied for Residence (SOR) : Sec. 23(2)(a)(i):

Annual value of such property will be **Nil**

Dedcucions u/s 24 : Interest on loan taken for SOR property will be allowed as a deduction as are under

Loan borrowed before 1-4-1999: Actual interest payable in aggregagate for one or two self occupied properties ,subject to maximum of Rs. 30,000.

Loan borrowed on or after 1-4-1999: subject to maximum of Rs. 2,00,000.

- **Income From Business or Profession:**

Buisenss : Includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Profession : It means an occupation requiring to some degree of learning**.** Profession requires intellectual skill or manual skil or both. The examples are doctor, advocate, chatered acountanat , engineers etc The term profeesion include vocation.

Deductions for expenses specifically allowed under section 30 to 43

Rent, rates, taxes, repairs and insurance of building, repairs & Insurance of machinery,

Plant & Furniture, Depreciation u/s 32, **(**Expenditure on Scientific Research,) Investment linked tax incentives for specified business, Amortization of certain preliminary expenses under section 35 D:- Amount of deduction: **1/5th** of the total eligible preliminary expense is allowed in 5 equal annual installments,

Other deductions: Insurance Premium paid to cover the risk of damage or destruction of stocks, stores, cattle and on health of employees, Bonus or commission paid to Employees, Interest on borrowed capital, Discount on zero coupon bonds, Contribution to recognised Provident fund or an approved super annuation fund, Contribution to Pension Scheme, Bad debts

Residuary Expenses : Embezzlement of cash, Expenses on local festival such as Diwali, Muhurta etc., Cash shortage found in the business at the end of the day, Entertainment Expenses, Advertisement Expenses, Travelling Expenses, Guest House Expenses. Lawful expenses related to illegal business, Premium on redemption of Debentures Discount on issue of debentures (on pro rata basis)

Expenses Not Deductible Under Section 37

1. Donations, 2. Charities, 3. Gifts to relatives, 4. Income tax, 5. Wealth tax, 6. Advance income tax, 7. Fines and penalties for breach of any laws, 8. Personal Drawings, 9. Salary to owner, 10. Interest on proprietor's capital, 11. Capital expenditure, 12. Purchase of an assets, 13. Extension of building, 14. Personal expenditure, 15. Household expenses, 16. Drawings, 17. Education expenses of children, 18. Residential telephone bill, 19. Residential electricity bill, 20. Residential maintenance, 21. Amount transferred to reserve, 22. Personal Hotel expenses, 23. R.D.D. But deduction is allowed for actual bad debts, 24. Personal motor expenses, 25. L.I.C. on own life., 26. Any Investments, 27. Any expenses related to let out house property. 28. Expenditure on Advertisement (Section 37(2B): It is allowed as deduction. However, as per Section 37 (2B), any expenditure incurred by an assessee on the advertisement in any souvenir, brochure, pamphlet etc. published by a political party will not be allowed as deduction., 29. In case of all assessee Section 40(a): Interest, royalty, fees for technical services or any other sum chargeable to tax payable outside India without deducting tax at source. 30. Salary paid outside India without deducting tax at source, 31. Any contribution to PF or any other Fund, if there is no arrangement for TDS from any payment to be made from

such Fund if it is taxable. 32. Income Tax paid 33. Excess Payment of salary, bonus, commission or remuneration to working partner of the firm, Interest in excess of 12% on capital,

Deemed Income from Business or profession:

i) Recovery against any Allowance or Deduction Allowed earlier

ii) Remission or censure of liability :

iii) Profit on sale of asset used for scientific research

iv) Bad debts recovered

v) Disallowance of unpaid statutory liability

- **Capital Gain:**

  Types of Capital Assets :

  Short Term Capital Asset [Sec. 2(42A]: It means a capital assets held by an assessee for not more than 36 months immediately before the date of transfer

  Long Term Capital Asset [Sec. 2(29A]: A capital asset, which is not a short-term capital asset, is a long it is held for not -term capital asset

  Transfer: Transfer in relation to a capital asset includes: Sale, Exchange &

  Relinquishment of the asset; Extinguishment of any right in an asset; Compulsory acquisition of an asset under any law; Conversion of asset into stock-in-trade by the owner; Any transaction of immovable property u/s 53A of the Transfer of Property Act, 1882; Any transaction which has the effect of transferring or enabling the enjoyment of any immovable property, Maturity or redemption of a zero coupon bond

  Sales consideration: refers to sale value of the asset (in form of money or money's worth). ***Consideration in installments:*** In case, consideration is receivable in installment in different years, the entire value of the consideration shall be taxable in the year of transfer.

Expenses on transfer

It means any expenditure incurred wholly and exclusively in connection with such transfer

Cost of Acquisition

Cost of acquisition includes expenditure incurred for acquiring the asset or completing the title of the asset

Cost of Improvement:

Cost of improvement means an expenditure incurred to increase the productive quality of the asset.

Indexed cost of acquisition:, "Indexed cost of acquisition" is an amount which bears to the 'cost of acquisition' the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on 1/4/2001, whichever is later.

Taxpoint:

Indexed cost of acquisition = $\frac{Cost\ of\ acquisition\ x\ Index\ of\ the\ year\ of\ sale}{Index\ of\ the\ year\ of\ acquisition\ or\ for\ 2001-02\ Whichevere\ is\ latter}$

Indexed cost of improvement :

"Indexed cost of improvement" means the 'cost of improvement adjusted according to the price level of year of sale.

Indexed cost of improvement = $\frac{Cost\ of\ improvement\ x\ Index\ of\ the\ year\ of\ sale}{Index\ of\ the\ year\ of\ improvement}$

Cost of inflation index:

Cost inflation index, in relation to a previous year, means such Index as the Central Government may, having regard to 75% of average rise in the Consumer Price Index (urban) for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf.

Exemptions in respect of Capital Gain:

Section	Eligible Asseesee	Asset transferred	Asset held for a period more than	New asset eligible for exemption	Period limit for new asset purchase	Quantity of exemption
54	Individual	Residential	24	Residential	Within a one	Minimum of

	H.U.F.	House	Months	House	year before or 2 years after the transfer in case purchase or 3 years after transfer in case construction	Investment in new house or amount of capital gain.
54B	Individual	Agriculture land	24 Months	Agriculture land	Within 2 years after transfer	Same as above
54D	Any assessee	land and building of industrial undertaking acquired by Government	24 Months	Land and building for industrial undertaking	Within 3years after transfer	Same as above
54EC	Any assessee	Any long term capital asset	Long term	Specified long term asset	Within 6 months s	Same as above
54F	Individual H.U.F.	Any long term asset except residential house	Long term	Residential House	Within a one year before or 2 years after the transfer in case purchase or 3 years after transfer in case construction	Investment in the new asset Divided by Net Sale consideration into capital gain

- **Income from Other Source :**

Income from other sources is a residuary head of income under the Income Tax in which we can consider all the different sources of income which does not fall under other heads as Income from salary or House property or Capital Gains or Business / profession. As per Section 56(1), any income which is not specifically exempted & not chargeable to tax under any other heads of income, shall be chargeable under the head Income from Other Sources

- **Computation of Gross Total Income and Tax liability in respect of Individual:**

Individual means an human being. Income tax is levied on assesses total income. The total income of individual is computed after making deductions from gross total income. Gross total income is aggregate of the income computed under different five heads

3.5 Answers to Check your progress:

I) A) 1)- (a), 2) – (a), 3) - (a), 4) - (d), 5) - (a)

B) 1) – 7.5% 2)- 17(1), 3) 5000, 4) Public, 5) Taxable

II) 1) Nil 2) Municpal value 3) Two 4) 30% 5) No deduction

III) (1) - 50% (2) 32 (3) Income from business or profession (4) 180 (5)30

IV) 1) Lower 2) 50 lakhs 3) 24 months 4)12 months 5)100

V) 1) 15,000 2) 50,000 3) Income from other source 4) 30% 5) Income from other source

3.6 Exercise:

- **Write short notes**

i) Salary **ii)** Specified employee

iii) Perquisite **iv)** Types of provident fund

v) Annual Value of let out property **vi)** Self occupied property

vii) Standard deduction from Annual value **viii)** Fair rent

ix) Estimated income u/s 44AD **x)** Maintenance of books u/s 44AA

xi) Short term capital gain **xii**) Cost of inflation index

xiii) Exemptions from capital gains **xiv)** Income from other source

xv) Computation of total income of Individual

- **Illustrations :**

Illustration 1) Mrs. Vanita is an employee in a company at Aurangabad. She gives the Following information for the P. Y. 2020-2021

1) Basic salary Rs. 15,000 per month
2) Dearness allowance Rs. 9,000 per month (Rs. 3000 per month of this enters the retirement benefits
3) Project Allowance Rs. 600 p.m.
4) Education allowance for two children at Rs. 300 per month per child.
5) She is provided by employer a motor car of 1.8 liter engine capacity for both official and private purpose all expenses including driver salary are met by the company.
6) Employer's contribution to recognized provident fund is Rs. 2460 per month
7) Interest credited to the said fund at 13% p.a. Rs. 39,000
8) House Rent Allowance Rs. 3,000 per month
9) Entertainment Allowance Rs. 9000 per month
10) During the year she paid Rs. 2,500 as professional tax and Rs. 3,600 per month as rent for her residential house.

Compute her taxable Income from salary for A.Y. 2021-2022.

Illustration 2) Mr. Ajay is employed in Private company Parth ceramic Ltd. Mumbai. He is a member of unrecognized provident fund. The particulars of income for previous year 2020-2021 were as under;

i) Salary @Rs. 80,000 p.m.
ii) Dearness pay, forming part of salary for super-annuation benefits @ 20% of salary.
iii) House Rent Allowance @Rs. 15,000 p.m.
iv) Rent paid by him Rs. 25,000 p.m.

v) He contributed 10% of his salary for provident fund to which employer contributed 20% of salary

vi) He retired from service on 31st December. 2020 after 28 years and 8 months of service. He gets Rs. 9,00,000 as accumulated balance from provident fund . It consist of Rs. 2,00,000 as his own contribution and Rs. 1,50,000 as interest there on. The employers contribution Rs. 3,00,000 and interest thereon Rs. 2,50,000.

vii) He also get gratuity of Rs. 17,50,000 and pension of Rs. 30,000 p.m. on retirement. on 01-03-2021, he surrenders one half pension for a consolidate value of Rs. 12,00,000.

Compute his taxable income from salary for A.Y. 2021-2022

Illustration 3) Find out the income from house property of Mr. Shivam for the A.Y. 2021-2022

Particulars	**House I**	**House II**
Municipal Valuation	3,00,000	4,00,000
Fair Rent	3,50,000	4,80,000
Standard Rent	3,30,000	5,00,000
Annual Rent	3,60,000	---
Period of vacancy	2 months	---
Municipal Tax (Due)	30,000	30,000
Interest on Capital Housing Loan	70,000	2,05,000
Nature of occupation	Let out	Self – occupied

Housing loans for both houses are taken after 1st April, 1999 and constructions are completed by the end of March 2000.

Answer : House I Rs. 1,40,000. House II to (2,00,000)

Illustration 4) Mr. Jay owns three houses, particulars of which are as :

Particulars	**House I**	**House II**	**House III**
Municipal Valuation (M.V.)	3,60,000	4,80,000	6,00,000
Fair Rent	3,70,000	4,70,000	6,20,000
Standard Rent	3,80,000	4,65,000	6,30,000

Annual Rent (if the property let out throughout the year)	3,78,000	4,50,000	6,25,000
Unrealized rent for the year	15,700	----	----
Period of vacancy	1 month	---	----
Municipal Taxes	10% of M.V	10% of M.V	10% of M.V
Date of construction completed	10-04-2003	10-10-2002	10-05-2002
Date of loan taken for construction	16-11-1999	15-07-1998	02-11-1999
Interest paid on loan	1,70,000	1,53,000	1,55,000
Nature	Let out	Let out	Let out

Answer: House I. 41,750, House II .1,38,900, House III. 2, 40,500

Illustration 5) Profit and Loss Account of Mr. Naman for the year ended on 31st March, 2021

Particulars	**Amount**	**Particulars**	**Amount**
To Salary	1,25,000	By Gross Profit	3,00,000
To General Expenses	12,500	By Commission	33,000
To Travelling Expenses	1,250	By Gifts From Friends	12,000
To Telephone	125	By Interest on F. D.	23,075
To Depreciation	25,000	By Bad Debts recovered	10,000
To Printing and Stationery	2,500		
To Furniture Purchase	15,700		
To Donation to Education Institutions	10,500		
To GST paid	25,000		
To R. D. D.	2,500		
To Net Profit	1,58,000		
	3,78,075		**3,78,075**

Additional Information:

1) Salary includes Rs. 12,500 paid to Mr. Naman

2) General expenses include Rs. 5,850 as gift to a friend in his marriage ceremony.

3) Depreciation allowed as per income tax rule is amounted to Rs. 22,000

4) GST include Rs. 2,500 as penalty for evasion of GST

Compute taxable income from business of Mr. Naman for the A. Y. 2021-2022

Answer: Income from Business Rs. 1, 75,475.

Illustration 6) Advocate Pawar is a leading practitioner in Kolhapur. Following is a summery of his cash book for the year ended on 31/03/2021

Receipts	**Amount**	**Payments**	**Amount**
To Opening Cash Balance	1,10,000	By Salaries	60,000
Professional Fees	7,10,000	By Rent of Chamber	90,000
To Arbitration Fees	1,90,000	By Household expenses	1,50,000
To Gifts	1,00,000	By Membership Fees	20,000
To Agricultural Income	5,00,000	By Car Expenses	60,000
		By Fixed Deposit	6,00,000
		By Books	30,000
		By Income Tax	20,000
		By Donation PM Funds	10,000
		By Closing Cash Balance	5,70,000
	16,10,000		**16,10,000**

Additional Information :

1) Gifts include Rs. 25,000 received from relatives and balance from clients

2) Depreciation as per income tax rules amounted to Rs. 50,000 including that on books 100% and on car Rs. 20,000.

3) Half of the car is used for personal purpose.

4) Membership fees include Rs. 10,000 to bar council and balance to private club.

Compute taxable income from profession for A.Y. 2021-2022

Answer: Income from Profession Rs. 7,45,000

Illustration 7) Mr. Kamalakar Sells the following long –term capital assets on 11-01-2021

Particular	**Residential house**	**Gold**	**Silver**	**Diamonds**
Sales consideration	3,90,000	8,10,000	2,96,000	6,40,200
Indexed cost of acquisition	70,000	1,15,000	1,78,000	4,30,000
Expenses on transfer	10,000	81,000	6,000	32,000

The due date of filling return of income for the assessment year 2021-2022 is 31st July 2021 for claiming exemption under section 54 and 54EC, Kamalakar purchases the following assets –

Assets	Date of acquisition	Amount Rs.
Land for constructing residential house	02/04/2021	1,00,000
Bank deposit in saving account for constructing house	05/08/2021	50,000
Bonds of Rural Electrification Corporation (Long term)	05/07/2021	7,50,000
Bonds of National Highways Authority of India (Long Term)	10/07/2021	3,05,000

Find out the amount of capital gain chargeable to tax for the assessment year 2021-2022

Answer:

Particular	Residential house	Gold	Silver	Diamonds
Capital gain chargeable to tax	Nil	6,14,000	1,12,000	1,78,200

Illustration 8) Mr. Pradeep is senior residential individual submits the following information for A.Y.2021-2022

Particulars	**Amount**	**Particulars**	**Amount**
Staff Salary	6,30,000	Gross Profits	22,60,000
Drawing for household expenses	4,00,000	Rent from house property	4,80,000
Life Insurance Premium paid	65,000	Interest on fixed deposit with banks	70,000
Contribution to P.P.F.	10,000	Profit from firm	15,000
Depreciation on assets	90,000	Gold coin received from friend	46,000
Advertisement	25,000		
Printing and stationery	30,000		
Interest on loan	40,000		
Net Profit	15,81,000		
	28,71,000		**28,71,000**

Additional information:

1) Interest on loan related to personal loan
2) Depreciation as per income tax rule Rs. 1,10,000
3) Value of gold coin given in the profit and loss account is cost of gold coins purchased by friend in 1998. Fair market value of gold coin on the day of gift Rs. 1,40,000, Compute total taxable income for A.Y. 2021-2022

Answer : (Income from house property Rs. 3,36,000, Income from business Rs. 14,65,000, Income from Other source Rs. 2,10,000, Gross Total Income Rs. 20,11,000, Deductions under chapter VIA Rs. 1,25,000, , Net Income Rs. 18,86,000)

3.7. Reference for further study:

1) Dr .Singhania, V. K., & Dr. Singhania, M. (2020-2021). *Student's Guide to Income Tax Including GST.* Delhi: Taxmann Publications (P). Ltd.
2) (ICAI Knowledge portal)
3) Dr. Singhania & Dr. Singhania, 2019-2020.

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Unit-4

Basics of GST

Structure of Unit

4.0 Objectives:

After studying this unit the students should be able to:

- Understand the concept of Indirect-taxes
- Define and explain the important features of GST and its need
- Explain the framework, benefits and challenges in implementing GST

4.1 Introduction:

GST is the biggest reform for indirect taxes in India in the post independence period. It simplified indirect taxation, reduced tax complexities, removed the cascading effect and led to one nation and one tax regime in India. Experts believe that GST will have a huge positive impact on business and change the way the economy functions. In this chapter we shall have a brief introduction on new GST regime introduced in India since July, 2017. Before we are introduced to the system of GST in India let us know the concepts of Direct and Indirect taxes.

Concept of Direct and Indirect Taxes:

A tax may be defined as a fee charged by a government on a product, income or an activity. It is a pecuniary burden laid upon individuals or property owners to support the Government, a payment exacted by legislative authority. A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority".

Taxes are broadly classified into direct and indirect taxes.

i) Direct Taxes: If a tax is levied directly on an individual or an organization it is called direct tax. A direct tax is a kind of charge, which is imposed directly on the taxpayer and paid directly to the Government by the persons (juristic or natural) on whom it is imposed. An incidence of direct tax cannot be shifted by the taxpayer to someone else. The burden of such tax is borne by the payer of tax himself. An important direct tax imposed in India is *income tax*.

ii) Indirect Taxes: If tax is levied on the price of a good or service, then it is indirect tax. The person paying the indirect tax passes on the incidence of tax to some other person. He collects the tax from his customer on sale of goods and services and remits it to the government. The ultimate burden of such tax falls on the final consumer of such goods and services. *If the taxpayer (such as a manufacturer or provider of service or seller of goods) is just a conduit and at every stage the tax-incidence is passed on till it finally reaches the consumer, who really bears the brunt of it, such tax is indirect tax.* An indirect tax is one that can be shifted by the taxpayer to someone else.

Indirect taxes are also called consumption taxes, they are regressive in nature because they are not based on the principle of ability to pay. All the consumers, including the economically challenged bear the brunt of the indirect taxes equally.

Indirect taxes are levied on consumption, expenditure, privilege, or right but not on income or property. Hitherto, a number of indirect taxes were levied in India, namely, excise duty, customs duty, service tax, central sales tax (CST), value added tax (VAT), entry tax, purchase tax, entertainment tax, tax on lottery, betting and gambling, luxury tax, tax on advertisements, etc.

However, indirect taxation in India has witnessed a paradigm shift on July 01, 2017 with the introduction of a unified indirect tax regime wherein a large number of Central and State indirect taxes have been subsumed into a single tax – Goods and Services Tax (GST). The introduction of GST is a very significant step in the field of indirect tax reforms in India.

Distinction between Direct and Indirect Taxes:

Point of Distinction	Direct Taxes	Indirect Taxes
Incidence of tax	The person paying tax to the Government directly bears the incidence of tax	The person paying the tax to the Government collects the same from the ultimate consumer. Thus, incidence of the tax is shifted to the other person.
Nature	Progressive in nature – high rate of taxes for people having higher ability to pay.	Regressive in nature - All the consumers equally bear the burden, irrespective of their ability to pay.
Burden	Burden of tax borne by the payer of tax himself.	Burden of tax shifted by the payer to his customer in the distribution chain.

Features of Indirect-taxes:

i) A major source of revenue: Indirect taxes are an important source of tax revenues for Governments all over the world and continue to grow as more and more countries are moving to consumption oriented tax regimes. In India, indirect taxes contribute more than 50% of the total tax revenues of Central and State Governments.

ii) Tax on commodities and services: It is levied on commodities at the time of manufacture or purchase or sale or import/export thereof. Hence, it is also known as commodity taxation. It is also levied on provision of services.

iii) Shifting of burden: In the indirect taxes the tax burden is shifted by the tax payer to his customer. The tax is collected through the selling price of goods and services and remitted to the tax department of the government. Price of goods and services serves as vehicle for indirect taxes. For example, GST paid by the supplier of the goods is recovered from the buyer by including the tax in the cost of the commodity.

iv) No direct pinch to tax payers: Since, value of indirect taxes is generally inbuilt in the price of the commodity or service, most of the time the tax payer pays the tax without actually knowing that he is paying tax to the Government. Thus, tax payer does not perceive a direct pinch while paying indirect taxes. Through the purchase and consumption of various goods and services in our day to day life we are regularly paying several indirect taxes to the government treasury.

v) Inflationary: As indirect taxation directly affects the prices of commodities and services a rise in indirect taxes leads to inflationary trend.

vi) Wider tax base: Unlike direct taxes, the indirect taxes have a wide tax base. Majority of the products or services are subject to indirect taxes with low thresholds. Hence every person in a nation is indirect tax-payee. Therefore, it is rightly said that *there are two things certain in human life namely, death and taxes.*

vii) Promotes social welfare: High taxes are imposed on the consumption of harmful products (also known as 'sin goods') such as alcoholic products, tobacco products etc. This not only curtails their consumption but also enables the State to collect substantial revenue. Thus indirect taxes indirectly promote social welfare.

viii) Regressive in nature: Generally, the indirect taxes are regressive in nature. The rich and the poor have to pay the same rate of indirect taxes on certain commodities of mass consumption. This may lead to further increase the income disparities between the rich and the poor.

Evolution of GST in India:

France was the first country to implement GST in the year 1954. Within 62 years of its advent, about 160 countries across the world have adopted GST because this tax has the capacity to raise revenue in most transparent and natural manner.

i) Kelkar Task Force 2004 : The Finance Ministry of Government of India set up a Task Force under the chairmanship Mr.Vijay Kelkar in 2004 on the implementation of Fiscal Responsibility and Budget Management. It made recommendations to bring about a radical transformation of the Indian Tax System. It disagreed with the existing approach of the government to reduce government expenditure to achieve the fiscal consolidation. It has advised to go for a Revenue-led Approach which focuses on enhancing the revenues instead of compressing the expenditure. It went further to suggest that the Government should enhance capital expenditure in order to counterbalance the contraction effects of fiscal consolidation. The Goods and Service Tax is an outcome of the recommendations of the Task Force under the chairmanship of Mr. Vijay Kelkar. In India the draft of Goods and Service Tax (GST) was presented in the parliament in August, 2009.

ii) Initiative of NDA Government: Subsequently, the then Union Finance Minister, Shri P. Chidambaram announced that GST would be introduced from April 1, 2010. Since then, GST missed several deadlines and continued to be shrouded by the clouds of uncertainty. The talks of ushering in GST, however, gained momentum in the year 2014 when the NDA Government tabled the Constitution. (122nd Amendment) Bill, 2014 on GST in the Parliament on 19th December, 2014. The Lok Sabha passed the Bill on 6th May, 2015 and Rajya Sabha on 3rd August, 2016. Subsequent to ratification of the Bill by more than 50% of the States, Constitution. (122nd Amendment) Bill, 2014 received the assent of the President on 8th September, 2016 and became Constitution (101st Amendment) Act, 2016, which paved the way for introduction of GST in India. In the following year, on 27th March, 2017, the Central GST legislations - Central Goods and Services Tax Bill, 2017 integrates Goods and Service Tax Bill, 2017, Union Territory Goods and Services Tax Bill, 2017 and Goods and Services Tax (Compensation to States) Bill, 2017 were introduced in Lok Sabha. Lok Sabha passed these bills on 29th March, 2017 and with the receipt of the President's assent on 12th April, 2017, the Bills were enacted.

iii) State GST Laws: The enactment of the Central Acts was followed by the enactment of the State GST laws by various State Legislatures. Telangana, Rajasthan, Chhattisgarh, Punjab, Goa and Bihar were among the first ones to pass their respective State GST laws GST is a path breaking indirect tax reform which will create a common national market. GST has subsumed multiple indirect taxes like excise duty, service tax, VAT, CST, luxury tax, entertainment tax, entry tax, etc.

4.2 Presentation of Subject Matter

4.2.1 Meaning of GST

GST is a single value added tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

4.2.2 Features of GST:

i) Value Added Tax: GST is a single value added tax on the supply of goods and services levied by the government of India. Under GST, tax is levied only on the value added at each stage in the supply chain from producer to the ultimate consumer. For example, if a business house purchases the goods of Rs. 1,000 and sells it for Rs. 1500 by adding Rs. 500 to the initial cost (consisting of say business overheads Rs. 200 and Profits of Rs. 300) he will have to pay GST only on the value addition of Rs. 500 and not on the total cost of Rs. 1500.

ii) Comprehensive: GST subsumes all the prevailing indirect taxes. Moreover, by bringing in a unified taxation system across the country, it ensures that there is no more arbitrariness in tax rates.

iii) Multi-stage: GST is levied at each stage in the supply chain from manufacturer to the ultimate consumer where the transaction takes place. GST offers comprehensive and continuous chain of tax credits from the producer's point or service provider's point up to the retailer's level or consumer's level thereby taxing only the value added at each stage of supply chain.

iv) Credit of GST paid on Purchases: The supplier at each stage is permitted to avail credit of GST paid on purchase of goods and or services and can set-off this credit against the GST payable on supply of goods and services to be made by him. Thus only the final consumer bears the GST charged by the last supplier in the supply chain, with set-off benefits at all previous stages.

v) Destination based consumption: GST is collected at the point of consumption. The tax authority with appropriate jurisdiction in the place where the goods / services are finally consumed will collect the tax. For example let us say that the cotton garments are shipped from Gujarat to Maharashtra. Gujarat is producer state and Maharashtra is the consumer state. Tax revenue under GST shall be collected by GST authorities in Maharashtra.

vi) No Cascading Effect: Since only the value added at each stage is taxed under GST, there is no tax or cascading of taxes under GST system. GST does not differentiate between goods and services and thus the two are taxed at a single rate.

vii) Rates of GST: Currently there are four slabs of GST on the various categories of goods and services. They are 5%, 12%, 18% and 28%.

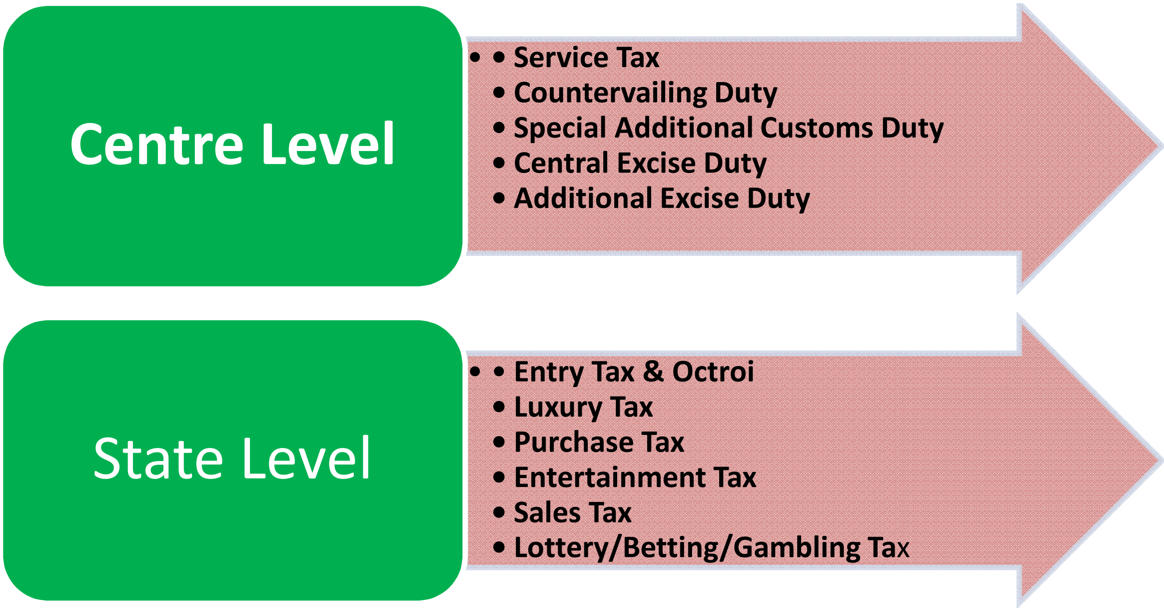
viii) Registration under GST: Every supplier who makes a taxable supply of goods and / or services liable to get himself registered in the state from where he supplies. Threshold limit (computed on all India basis) – Special category states – Rs.10 lakhs – Other states –Rs.20 lakh. Online application for registration has to be made within 30 days. PAN based Registration has to be done. Following persons have to obtain registration irrespective of their threshold limit: (a) Persons making inter-state taxable supply (b) Casual taxable persons and (c) Non-resident taxable persons

ix) GST for sale within the state: In case the buyer and seller of goods or service are from the same state transaction would be taxed simultaneously under Central GST (CGST) and State GST (SGST). The Central GST and the State GST would be levied simultaneously on every transaction of supply of goods and services except the exempted goods and services. Further, both would be levied on the same price or value. While the location of the supplier and the recipient within the country is immaterial for the purpose of CGST, however, SGST would be chargeable only when the supplier and the recipient are both located within the State.

x) GST for Inter-state Sale : Integrated Goods and Service Tax (IGST) would be levied and collected by the Centre on inter-State supply of goods and services. The GST on supplies in the course of Inter-State trade or commerce shall be levied and collected by the Government of India. Such tax shall be apportioned between the Union and the States in the manner as may be provided by the law.

Taxes Subsumed by GST:

GST incorporates the following taxes earlier levied at the center and state level.GST has replaced or subsumed the following taxes:



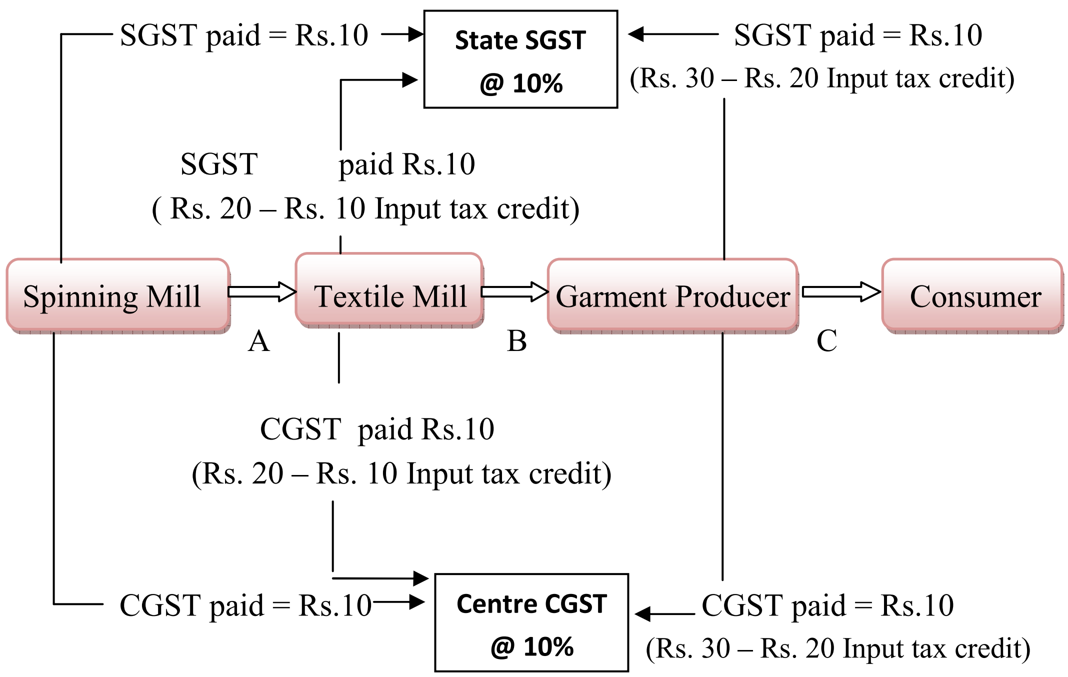
Taxes not to be subsumed by GST in India are:

● Basic Customs Duty ● Export Duty ● Toll Tax ● Road and Passenger Tax ● Electricity Duty ● Stamp Duty ● Property Tax

Note:

1. Alcoholic beverages for human consumption are proposed to be kept out of the purview of GST
2. GST on petroleum products would be levied from a notified date to be recommended by the GST Council

Illustrations explaining the working of GST:



	Tax Invoice A Rs.	Tax Invoice B Rs.	Tax Invoice C Rs.
Cost of Goods	100	200	300
SGST @ 10%	10	20	30
CGST @ 10%	10	20	30
Total	120	240	360

As shown in the above diagram when a spinning mill at Ichalkaranji sells yarn of Rs. 100 to a textile mill in Mumbai it collects GST of 20 % on sale of Rs. 100 i.e. Rs.20 from the textile mill of which CGST @ 10% (i.e. Rs. 10) is remitted to the central govt. and SGST @10% (i.e. Rs. 10) is remitted to the Maharashtra state govt. When the textile mill manufactures the cloth from the yarn and sells it to garment manufacturer in Kolhapur at Rs. 200 (i.e. Cost of yarn Rs. 100 plus value added Rs. 100 , consisting of its manufacturing expenses plus profit) it charges GST of 20% of sale of Rs. 200 i.e. Rs. 40 and from Garment Manufacturer of which it remits CGST @10% Rs. 20 to the central govt. and SGST @ 10% i.e. Rs. 20 to the Maharashtra State Govt. In the third stage of transaction when the Garment producer in Kolhapur manufactures dresses from the cloth and sell those to the final consumer in Kolhapur at Rs. 300 (i.e. Cost of cloth Rs. 200 plus value added Rs. 100, consisting of its manufacturing expenses plus profit) it charges GST of 20% of sale of Rs. 300 i.e. Rs.60 and from Garment Manufacturer of which it remits CGST @10% Rs. 30 to the central govt. and SGST @ 10% i.e. Rs.30 to the Maharashtra State Govt.

4.2.3 The benefits of GST: can be summarized as under:

A) For business and industry

i) Easy compliance: A robust and comprehensive IT system would be the foundation of the GST regime in India. Therefore, all tax payer services such as registrations, returns, payments, etc. would be available to the taxpayers online, which would make compliance easy and transparent.

ii) Uniformity of tax rates and structures: GST will ensure that indirect tax rates and structures are common across the country, thereby increasing certainty and 2 ease of doing business. In other words, GST would make doing business in the country tax neutral, irrespective of the choice of place of doing business.

iii) Removal of cascading: A system of seamless tax-credits throughout the value-chain, and across boundaries of States, would ensure that there is minimal cascading of taxes. This would reduce hidden costs of doing business.

iv) Improved competitiveness: Reduction in transaction costs of doing business would eventually lead to an improved competitiveness for the trade and industry.

v) Gain to manufacturers and exporters: The subsuming of major Central and State taxes in GST, complete and comprehensive set-off of input goods and services and phasing out of Central Sales Tax (CST) would reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

B) For Central and State Governments

i) Simple and easy to administer: Multiple indirect taxes at the Central and State levels are being replaced by GST. Backed with a robust end-to-end IT system, GST would be simpler and easier to administer than all other indirect taxes of the Centre and State levied so far.

ii) Better controls on leakage: GST will result in better tax compliance due to a robust IT infrastructure. Due to the seamless transfer of input tax credit from one stage to another in the chain of value addition, there is an inbuilt mechanism in the design of GST that would incentivize tax compliance by traders.

iii) Higher revenue efficiency: GST is expected to decrease the cost of collection of tax revenues of the 3 Government, and will therefore, lead to higher revenue efficiency.

C) For the consumer

i) Single and transparent tax proportionate to the value of goods and services: Due to multiple indirect taxes being levied by the Centre and State, with incomplete or no input tax credits available at progressive stages of value addition, the cost of most goods and services in the country today are laden with many hidden taxes. Under GST, there would be only one tax from the manufacturer to the consumer, leading to transparency of taxes paid to the final consumer.

ii) Relief in overall tax burden: Because of efficiency gains and prevention of leakages, the overall tax burden on most commodities will come down, which will benefit consumers.

4.2.4 Need of GST :

The prevailing value added tax system had several deficiencies which were cured by the GST. These deficiencies were as under:

i) Multi-tax Regime : In the earlier indirect tax regime, a manufacturer of excisable goods charged excise duty and value added tax (VAT) on intra-State sale of goods. However, the VAT dealer on his subsequent intra- State sale of goods charged VAT (as per prevalent VAT rate as applicable in the respective State) on value comprising of (basic value + excise duty charged by manufacturer + profit by dealer). Further, in respect of tax on services, service tax was payable on all 'services' other than the Negative list of services or otherwise exempted.

ii) Deficiencies and Diversities in Indirect taxes: The earlier indirect tax framework in India suffered from various shortcomings. Under the earlier indirect tax structure, the various indirect taxes being levied were not necessarily mutually exclusive.

To illustrate, when the goods were manufactured and sold, both central excise duty (CENVAT) and State- Level VAT were levied. Though CENVAT and State- Level VAT were essentially value added taxes, set off of one against the credit of another was not possible as CENVAT was a central levy and State-Level VAT was a State levy.

Moreover, CENVAT was applicable only at manufacturing level and not at distribution levels. The erstwhile sales tax regime in India was a combination of origin based (Central Sales Tax) and destination based multipoint system of taxation (State-Level VAT).

Service tax was also a value added tax and credit across the service tax and the central excise duty was integrated at the central level.

Despite the introduction of the principle of taxation of value added in India - at the Central level in the form of CENVAT and at the State level in the form of State VAT - its application remained piecemeal and fragmented on account of the several reasons:

4.2.5 Constitutional Provisions of GST:

The new regime for GST was given effect through the GST (101st Amendment) Act, 2016 . As the GST is a single tax that replaces multiple other indirect taxes, both the Centre and the States had to give up their exclusive powers to levy different indirect taxes. Through the GST Amendment, the Centre lost out on its power to levy taxes such as excise duty, while the States could no longer levy entry tax, VAT etc.

As the GST is a tax that is to be levied concurrently by the Centre and the States, a GST Council was established under Article 279A of the Constitution. The GST Council is headed by the Union Finance Minister. The other members of this body include the Union Minister of State for Finance, and the Finance Ministers of all the State Governments. The GST Council was envisaged to facilitate collective decision-making between the Centre and the States, for all matters concerning the GST, including the rate of GST applicable on different goods and services.

As the GST is implemented through a process of collective decision-making, both the Centre and the States have lost out on their autonomy to unilaterally determine their indirect tax policies. This is reflected in clause (9) of Article 279A, which lays down the voting pattern that shall be adhered to before any recommendation of the GST Council is ratified.

Under the voting pattern, the Centre's vote shall have a weightage of one-third of the total votes cast, which effectively gives it a veto over all decisions that may be put to vote before the Council. While the State Governments can also collectively exercise a veto, no individual State Government can exercise a veto over any decision of the Council. But the significant point here is that the Centre's veto power allows it to block any proposal moved before the GST Council, even if all the State Governments unanimously approve of the same. This veto power also has implications for the present crisis, which I shall address in the concluding sections of this piece.

Another significant aspect to note here is that the State Governments ceded their autonomy to independently frame their tax policies because they were assured of full compensation from the Centre, for revenue losses that may arise under the GST. This is reflected in Section 18 of the GST Amendment, which states that – "Parliament shall, by law, on the recommendation of the Goods and Services Tax Council, provide for compensation to the States for loss of revenue arising on account of implementation of the goods and services tax for a period of five years"

Interestingly, although Section 18 was part of the Constitutional Amendment Bill, it did not amend any provision of the Constitution. But it mandated Parliament to pass a law that would lay down a framework under which States would receive compensation for 5 years from the date of GST implementation (1st July 2017).

As Thomas Issac (Finance Minister of Kerala) points out, the assurance of compensation was one of the main foundations on which the States agreed to the GST in the first place, and ceded their autonomy to frame their tax policies independently. If this assurance of compensation was not mandated by law, States may not have agreed to the GST in the first place. In furtherance of the mandate given under Section 18 of the GST Amendment, Parliament enacted the GST (Compensation to States) Act, 2017 ('the Compensation Act'). This legislation forms the root of the present controversy, as the Centre's arguments to deny payment of compensation is based on its provisions which is discussed in the compensation act.

4.2.5.1 The Compensation Act

The Preamble of the Compensation Act clearly states that the statute aims to provide "compensation to the States for the loss of revenue arising on account of implementation of the goods and services tax in pursuance of the provisions of the Constitution (One Hundred and First Amendment) Act, 2016". The statute lays down the manner in which the compensation is to be paid for the first 5 years of the implementation of the GST (i.e. the transition period). Under Section 3 and Section 7 of the Compensation Act, the percentage of annual revenue growth of a State has been projected to be 14%. Under Section 7, if the annual revenue growth of a State is less than 14%, the State is entitled to receive compensation under the statute.

The compensation that is to be paid is the shortfall in the revenue growth. For instance, if the annual revenue growth of Maharashtra after GST implementation is 4%, it shall be compensated for the balance 10% – which is the shortfall. On the other hand, if the revenue growth of Tamil Nadu is 12%, it shall be compensated for the balance 2%. Under Section 9, the Centre has been granted the power to levy a GST Compensation Cess, which shall generate the funds required to compensate the States. The proceeds of this Cess have to be transferred to the GST Compensation Fund, from which the States shall be compensated for their revenue shortfall. Now, Section 10(2) of the Compensation Act states that "All amounts payable to the States under section 7 shall be paid out of the [GST Compensation] Fund".

4.2.5.2 The Centre's arguments and its discontents

As of today, the amount present in the GST Compensation Fund is insufficient to cover the revenue shortfall of the States. The Centre has been unable to collect the amount of Cess that is required to meet the revenue shortfall of the States. In this scenario, the Centre has taken benefit of Section 10(2) of the Compensation Act to argue that it has no further obligation to pay compensation to the States.

Through a Policy Paper issued by the Ministry of Finance (available here), the Centre has referred to Section 10(2) to contend that in case the amount present in the GST Compensation Fund is insufficient to fulfil the revenue shortfall of the States, it has no further obligation to compensate the States by tapping into other sources of funds. The Centre has argued that by virtue of Section 10(2), it has no obligation to compensate the States through the Consolidated Fund of India, or through any other source of finance.

But, at the same time, the Policy Paper also acknowledges that the Centre has an obligation to compensate the States for the entire shortfall of projected revenue, that arises by virtue of implementation of GST. Moreover, the Policy Paper accepts that this mandate cannot be evaded on account of an 'Act of God', such as the Covid-19 pandemic. The Policy Paper also refers to a legal opinion given to the Ministry of Finance by Attorney General K.K. Venugopal. In his legal opinion, K.K. Venugopal mentions that the Centre has an obligation to pay the full amount of compensation, even if there is a shortage in the amount available in the GST Compensation Fund.

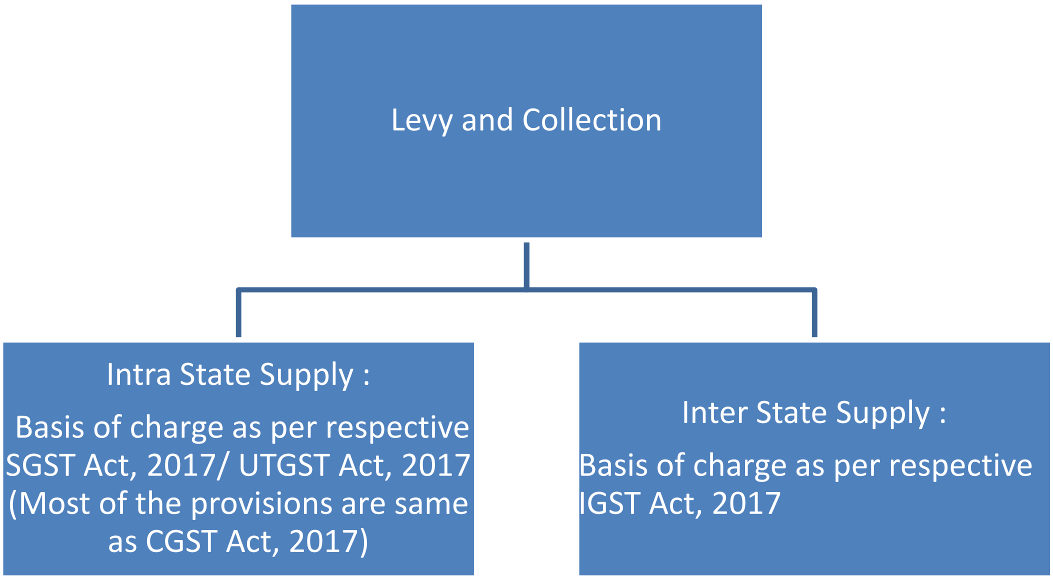
This highlights an inherent contradiction in the arguments of the Centre. On the one hand, the Centre states that it has no obligation to compensate the States by tapping funds from other sources if there is a shortfall in the amount present in the GST Compensation Fund. But, simultaneously, the Centre is also acknowledging that it has an obligation to pay the full amount of compensation to the States, even if there is a shortage in the GST Compensation Fund. The Policy Paper itself accepts that there is no provision in the GST Amendment or in the Compensation Act, which exempts the Centre from paying compensation, on account of an 'Act of God'. This is a mutually contradictory argument – as if the obligation to pay compensation is absolute, the Centre cannot then renege on its legal mandate.

Moreover, Section 10(2) of the Compensation Act does not bar the Centre from tapping into other sources of funds to compensate the States. Section 10(2) only states that all amounts payable to the States under Section 7 of the statute shall be out of the GST Compensation Fund, and does not in any way state that if there is a shortfall, the Centre can evade its primary obligation to the States. In this scenario, Section 10(2) should also be read in conjunction with Section 18 of the GST Amendment, and the Preamble of the Compensation Act. Both Section 18 and the Preamble unambiguously mention that States are entitled to compensation for the loss of revenue, which arises on account of GST implementation.

Also, as discussed above, the constitutional bargain which cements the GST is based on the Centre's obligation to compensate the States for the shortfall in revenue. If the Centre would not have assured compensation to the States, the States would never have consented to the GST Amendment, by limiting their taxation powers. Hence, if the true spirit behind Section 18 of the GST Amendment is taken into account, it can be argued that the Centre has an absolute obligation to compensate the States without exception – even if the amount present in the GST Compensation Fund is insufficient.

Another argument made by the Ministry of Finance in the Policy Paper is with reference to Section 10(1) of the Compensation Act. Under Section 10(1), the inflows to the GST Compensation Fund are to be made from the GST Compensation Cess, and any other sources as may be recommended by the GST Council. The GST Council can hence decide to tap the shortage and compensate the States through any other source of finance, such as the Consolidated Fund of India. But this is exactly where the design flaw in the GST Council's functioning begins to hurt the States

4.2.6 Levy and Collection of GST :



4.2.6.1 Levy and collection as per CGST Act, 2017

U/s 9(1) of CGST Act, 2017 there shall be levied a tax

- Called the Central Goods and Services Tax(CGST);
- On all the intra-state supplies of goods or services or both, except on supply of alcoholic liquor for human consumption;
- On the value determined u/s 15; and
- At such a rate (maximum 20%,) as notified by the Central Government on recommendation of GST Council; and z Collected in such a manner as may be prescribed; and
- Shall be paid by the taxable person.

(b) U/s 9(2) of CGST Act 2017, the CGST of following supply shall be levied with the effect from such date as notified by the Central Government on recommendation of GST Council

- Petroleum crude
- High speed diesel
- Motor spirit (commonly known as petrol)
- Natural gas
- Aviation turbine fuel

(c) U/s 9(3), CGST is to be paid on reverse charge basis by the recipient on notified goods/ services or both (liability to pay tax by the recipient of supply of goods / services rather than supplier of goods/ services under forward charge)

(d) U/s 9(4), CGST on taxable supply of goods/ services to registered supplier from unregistered supplier is to be paid on reverse charge basis by the recipient.

(e) U/s 9(5), E-Commerce operator is liable to pay CGST on notified intra-state supplies.

4.2.6.2 Levy and collection as per IGST Act, 2017

(a) U/s 5(1) of IGST Act, 2017 there shall be levied a tax

- Called the Integrated Goods and Services Tax (IGST);
- On all the inter-state supplies of goods or services or both, except on supply of alcoholic liquor for human consumption;
- On the value determined u/s 15 of CGST Act, 2017; and
- At such a rate (maximum 40%,) as notified by the Central Government on recommendation of GST Council; and
- Collected in such a manner as may be prescribed; and
- Shall be paid by the taxable person. Provided further that IGST will be imposed on goods/ services imported into India.

(b) U/s 5(2) of IGST Act, 2017, the CGST of following supply shall be levied with the effect from such date as notified by the Central Government on recommendation of GST Council

- Petroleum crude
- High speed diesel
- Motor spirit (commonly known as petrol)

- Natural gas
- Aviation turbine fuel

(c) U/s 5(3), IGST is to be paid on reverse charge basis by the recipient on notified goods/ services or both (liability to pay tax by the recipient of supply of goods / services rather than supplier of goods/ services under forward charge).

(d) U/s 5(4), IGST on taxable inter-state supply of goods/ services to registered supplier from unregistered supplier (agriculturist) is to be paid on reverse charge basis by the recipient.

(e) U/s 5(5), E-Commerce operator is liable to pay CGST on notified inter-state supplies

4.2.7 Introduction to CGST, SGST, IGST, UTGST

i) Dual GST

India has adopted a dual GST system, which was imposed concurrently by the Centre and States as CGST & SGST. Center has the power of tax intra-state sales and states are empowered to tax services. Now GST has extend to all over the India.

ii) CGST/SGST/UTGST/IGST;-

GST is a destination based tax applicable on all transactions involving supply of goods and services for a consideration subject to exceptions thereof. GST in India comprises of Central Goods and Service Tax (CGST) – levied and collected by Central Government, State Goods and Service Tax (SGST) – levied and collected by State Governments/Union Territories with State Legislatures and Union Territory Goods and Service Tax. (UTGST)-levied and collected by Union Territories without State Legislatures, on intra-State supplies of taxable goods and/or services. (IGST)-Inter-State supplies of taxable goods and/or services are subject to Integrated Goods and Service Tax. IGST is approximately the sum total of CGST and SGST/UTGST and is levied by Centre on all inter-State supplies.

iii) Legislative Framework:

There is single legislation – CGST Act, 2017 – for levying CGST. Similarly, Union Territories without State legislatures [Andaman and Nicobar Islands, Lakshadweep, Dadra and Nagar Haveli, Daman and Diu and Chandigarh] are governed by UTGST Act, 2017 for levying UTGST. States and Union territories with their own legislatures [Delhi and Puducherry] have their own GST legislation for levying SGST. Though there are multiple SGST legislations, the basic features of law, such as chargeability, definition of taxable event and taxable person, classification and valuation of goods and services, procedure for collection and levy of tax and the like are uniform in all the SGST legislations, as far as feasible. This is necessary to preserve the essence of dual GST.

Challenges in implementing GST:

While the desirability of the reform was undoubted, making a transition to GST involved not only considerable work but also formidable challenges.

i) Understanding between Center and States: Unlike in many other countries where GST is a centralized tax, in India it is to be executed by both central and state governments, according to the proposals. This implies that both the structure and administration of the levy had to emerge after detailed negotiations and bargaining between the centre, 29 states and the two Union Territories with legislatures. Given the sharp differences in the structure of the economy and sales tax revenue (as a ratio of gross state domestic product, or GSDP) across states, the interests of the states did not always coincide. Hence considerable effort was needed to persuade them to adopt a uniform or even a broadly harmonized structure and administrative system for the tax.

ii) Information Technology Platform: For ensuring seamless input tax credit, they had agreed on a mechanism wherein the tax levied at the stage of inter-state sale was to be collected and pooled separately and transferred to the destination state through a clearing house. They had also established the GST Network (GSTN), a special purpose vehicle with equity contributions from the technology partner (NSDL), and central and state governments to erect the information technology (IT) platform to administer GST.

iii) Issue of compensation for the loss of revenue: The 13th Finance Commission's recommendation that states should levy "flawless" GST to be eligible to receive compensation for any loss of revenue put the entire negotiation process on the back burner. The problem was compounded by the central government's refusal to pay compensation for the loss of revenue arising from the reduction in central sales tax (CST). CST is the sales tax levied on inter-state transactions. The tax which was levied at 4% by the exporting state was reduced to 2% in 2007 in preparation for the introduction of GST. The central government had agreed to pay compensation for the loss of revenue to the states until 2010, when the GST was to be implemented.

When the central government refused to compensate the states after 2010, a huge trust deficit was created and the entire negotiation process virtually broke down. The new finance minister has promised to clear the backlog of dues to the states and the states have resumed the negotiation process. The finance minister has also announced that the Constitution Amendment Bill will be placed in the winter session of Parliament. These developments bode well.

iv) Contentious issues and negotiation process: There are a number of issues on which negotiations are necessary to reach a consensus between the centre and the states and among the states themselves. The first issue relates to the inclusion of taxes within the ambit of GST. The bone of contention relates to inclusion of purchase taxes on foodgrain, taxes on motor spirit and high-speed diesel (GSD), and octroi or entry tax in lieu thereof. The foodgrain surplus states have been levying the purchase tax, the burden of which is exported to non-residents. The states were reluctant to bring motor spirit and high speed diesel within the ambit as presently the tax is levied at a floor rate of 20% and the states derive about 35% of their sales tax collections from these petroleum products.

v) Determination of Revenue Neutral Rate: Another issue to be decided is the rates of central and state GSTs to be levied. It was expected that the tax rates would be revenue neutral. This implies that in the short term, there would not be any revenue loss or gain, but over time the revenue productivity is expected to increase due to better compliance of the tax and increased productivity of the economy. However, estimation of revenue-neutral rate required consensus on the exemption list, number of tax rates to be levied and the list of goods and services to be included in different rate categories. Revenue-neutral rates had to be estimated for the centre and for each of the states. Furthermore, when there was a preference for two rates—one for essential goods and services consumed by common people and another general rate—the estimation of revenue-neutral rates becomes further complicated.

vi) Setting up of an administrative system: Another area where a lot of work is needed is the setting up of an administrative system for GST and working out the transitional arrangements. Ideally, from the viewpoint of reducing compliance cost, a unified administration would be desirable. However, that is not likely to happen as each state would like to control the administration of its GST. In this situation, harmonization of administrative processes with uniform systems, forms and procedures would be necessary. This would also require additional training of tax collectors in the administration and enforcement of the tax. Equally important is the dissemination of information about the tax to taxpayers.

Check Your Progress

A) Objective Type Questions:

Select the correct alternative:

1. Which of the following taxes have been subsumed in GST?
   (a) Central Sales Tax   (b) Central Excise Duty
   (c) VAT   (d) All of the above
2. Which of the following has not been subsumed in GST?
   (a) Central Sales Tax   (b) Central Excise Duty
   (c) VAT   (d) Income Tax
3. Inter-State supplies of taxable goods and/or services are subject to:
   (a) CGST   (b) SGST   (c) IGST   (d) UGST

B) Stat true or false:

1. GST is a direct-tax
2. Stamp duty is subsumed by GST.
3. GST is a value added tax.
4. The first draft of Goods and Service Tax (GST) was presented in the parliament in August, 2009
5. GST Bill were enacted on 12^{th} April, 2017.

4.3 Summary :

This unit introduces the concept of GST to the students. The basics of GST like meaning, definition, features, benefits and need of GST are elaborated in this unit. Importantly, this unit also covers the constitutional provisions of GST as well as levy and collection of GST. The terms like CGST, SGST, IGST and UTGST have been discussed in this unit. Interestingly, although Section 18 was part of the Constitutional Amendment Bill, it did not amend any provision of the Constitution. But it mandated Parliament to pass a law that would lay down a framework under which States would receive compensation for 5 years from the date of GST implementation (1st July 2017).

4.4 Terms to Remember :

GST : Goods and Services Tax

SGST : State Goods and Services Tax

CGST : Central Goods and Services Tax

IGST : Integrated Goods and Services Tax

UTGST : Union Territory Goods and Services Tax

Intra State Trade : Trade within the same state.

Inter State Trade : Trade between the two different states

4.5 Answers to Check Your Progress :

A) 1-d, 2- d, 3 -

B) 1- False, 2- False, 3- True, 4- True, 5- True

4.6 Exercises :

1. Differentiate between direct and indirect taxes.
2. Enumerate different types of direct and indirect taxes.
3. Explain the salient features of indirect taxes.
4. Explain the meaning and features of GST.
5. Which taxes have been subsumed by GST?
6. What are the benefits of GST to industry and business?
7. What are the benefits of GST to central and stage governments?
8. Explain in brief the framework of GST introduced in India.
9. Explain the evolution of GST in India.
10. What were the major challenges in the introduction of GST in India?

4.7 Reference for Further reading:

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