P.R.GOVT. COLLEGE (AUTONOMOUS) KAKINADA

B.COM – III YEAR – (CECS)

SYLLABUS: V SEMESTER EXAMINATIONS

COURSE 5302: INCOME TAX AND PRACTICAL AUDITING

W.e.f. 2014 -15 ACADEMIC YEAR

Hours: 5 Hrs. (3 Lecture + 2 Tutorial) **Max. Marks: 100 (70+30)**

CREDITS: (Theory 2)

OBJECTIVES:

- To impart knowledge pertaining to the concepts of Income Tax.
- To acquaint oneself with auditing procedure.

LEARNING OUTCOME:

- By the end of this course students can identify the types of taxes and computation of the tax liability of an assessee.
- By the end of this course students can have the better understanding about the Concepts of Auditing.
- By the end of this course students can have the skill of audit planning and Preparation of Audit Programme and vouching.
- By the end of this course students can have the ability of Audit Control.

MODULE - I: Introduction – Basic concepts – Definitions – Agricultural Income – Income -Residential Status – Exempted Incomes – Incidence of Tax – Income from Salary.

Self Study:
Need for and Rationale of taxes
An Overview of Taxation System in India.
Progressive v/s Regressive Taxes. 2
Return Filing and Assessment thereof

ASSIGNMENT: **Filing Relevant Forms for Individual Assesses.**
Format and filling of Form:16
Format and filling & filing of ITR-1 & ITR-2

MODULE – II : INCOME FROM HOUSE PROPERTY 2

Income from House Property – Depreciation.

ODULE - III: INCOME FROM BUSINESS - PROFESSION ✓

Profit and Gains from Business or Profession.

ODULE - IV: Meaning – Definition and Objectives of Auditing – Types of Audit – Audit process and Procedure – Audit Planning and Programming – Preliminaries in Commencing a new audit – Internal Check – Internal Audit and Internal Control – Vouching. ✓

Self Study: Differences between Internal and External Audit

Differences between Interim and Final Audit.

Audit of Contents of Balance Sheet

Study of model Vouchers of an organisation.

Assignment: Procedure of Internal Audit

Audit of Companies

Types of Audits

Vouching of cash book of a local business unit.

Differences between vouching, investigation, verification and valuation.

Assignment: Preparation of Audit programme for an organization

Audit of Companies

Types of Audits

* * *

P.R.GOVT.COLLEGE (A), KAKINADA

DEPARTMENT OF COMMERCE
III B.COM (CECS)

SUBJECT: INCOME TAX AND PRACTICAL AUDITING
Vth SEMESTER QUESTION BANK

1. Define previous years and its exemptions?
   గత సం అనగా నేమి? దాని మినహాయింపులు వివరించండి
2. Define Agricultural and Non Agricultural Incomes?
   వ్యవసాయ ఆధాయము మరియు వ్యవసాయేతర ఆదాయము వివరించండి?
3. Define Residential of an Individual?
   నివాస ప్రతిపత్తి అనగా నేమి? విడి వ్యక్తి యొక్క నివాస ప్రతిపత్తిని నిర్ణయించండి?
4. Incidence of Tax?
   నివాస ప్రతిపత్తి యొక్క పన్ను భాధ్యత వివరించండి?
5. Define Income and features of Income?
   ఆదాయం అనగా నేమి ? దాని లక్షణాలు వ్రాయండి?
6. Define Direct tax and Indirect tax? Difference between both?
   ప్రత్యక్ష మరియు పరోక్ష పన్నులు అనగా నేమి? వాటి మధ్య గల తేడాలు వ్రాయండి?
7. Briefly explain the history and Origin of Income tax in India?
   ఆదాయపు పన్ను అనగా నేమి? దాని యొక్క చరిత్ర ను వివరించండి?
8. Basic concepts :
   a. Persons విడి వ్యక్తి
   b. Assessee అసెస్సీ
   c. PAN శాస్వత ఖాతా స్థిర సంఖ్య
   d. Cess సెస్
   e. Surcharge సర్ చార్జ్
   f. Assessment Year అస్సెస్మెంట్ ఇయర్
   g. Section 24 deductions (House property) సెక్షన్ 24 మినహాయింపులు
   h. Section 16 deductions (salaries) సెక్షన్ 16 మినహాయింపులు
9. How to compute Total Income? మొత్తం ఆదాయాన్ని ఏ విధంగా లెక్కిస్తారు?

10.Fully and partly exempted incomes under section 10.
పూర్తిగా మరియు పాక్షికంగా పన్ను మినహాయింపు ఆదాయాలును వివరించండి?

11. How to compute income from salaries?
జీతాలు నుండి ఆదాయాన్ని ఏవిధంగా లెక్కిస్తారు ?

12.Briefly explain difference types of provident funds?
వివిధ రకాల భవిష్యనిధులను వివరించండి?

13.Briefly explain difference types of Allowances?
వివిధ రకాల అలవెన్సులను వివరించండి?

14.Briefly explain difference types of Perquisites?
వివిధ రకాల పరిలబ్దులను వివరించండి

15.How to compute income from house property?
గృహస్తి నుండి ఆదాయాన్ని ఏ విధంగా లెక్కిస్తారు ?

16.How to compute income from business and profession?
వృత్తి మరియు వ్యాపారం నుండి ఆదాయాన్ని ఏ విధంగా లెక్కిస్తారు ?

17. Exempted incomes under section 30 to 36? Income from business and profession?
వృత్తి మరియు వ్యాపారం నుండి మినహాయింపులు సెక్షన్ 30 తో 36 క్రింద?

UNIT - 1

Introduction to Income Tax

Introduction

The word "tax" was derived from the Latin word "taxore", which means to estimate, to appreciate or value. Tax is the amount paid by the person staying within a territorial limit of a country. It is levied on individuals, property, business, service etc. It is an important and significant source of revenue of the government.

The taxation system in the Republic of India is quite well structured. The importance of revenue of the Finance Ministry of the Government of India is responsible for the computation levy as well as collection of most the taxes in the country. However, some of the taxes are even levied solely by local state bodies or respective government of the different states in the nation.

A good taxation system is helpful to achieve various Socio-economic objectives. Such as:

i) Generation of revenue to Government.

ii) Welfare maintenance of the state.

iii) Development in the economy.

iv) Encourage to savings and eveats investment.

v) Creates employment opportunities.

vi) Of wealth for benefit of the Society.

vii) Prevent concentration of wealth in a few hands.

viii) Stimulating Industrial growth.

ix) Promotion of exports.

x) Regulating Imports.

xi) Nurturing domestic trade and commerce.

Over a period of 10 years to 15 years. The tax system in India has under gone some significant changes. The entire system has been tremendously reformed. The slabs for the imposition of taxes have been modified. Besides that, the rate of which any particular tax is being levied have been restructured as well as various laws that govern the levying of taxes were being simplihed. All of these reformation have resulted in the following:

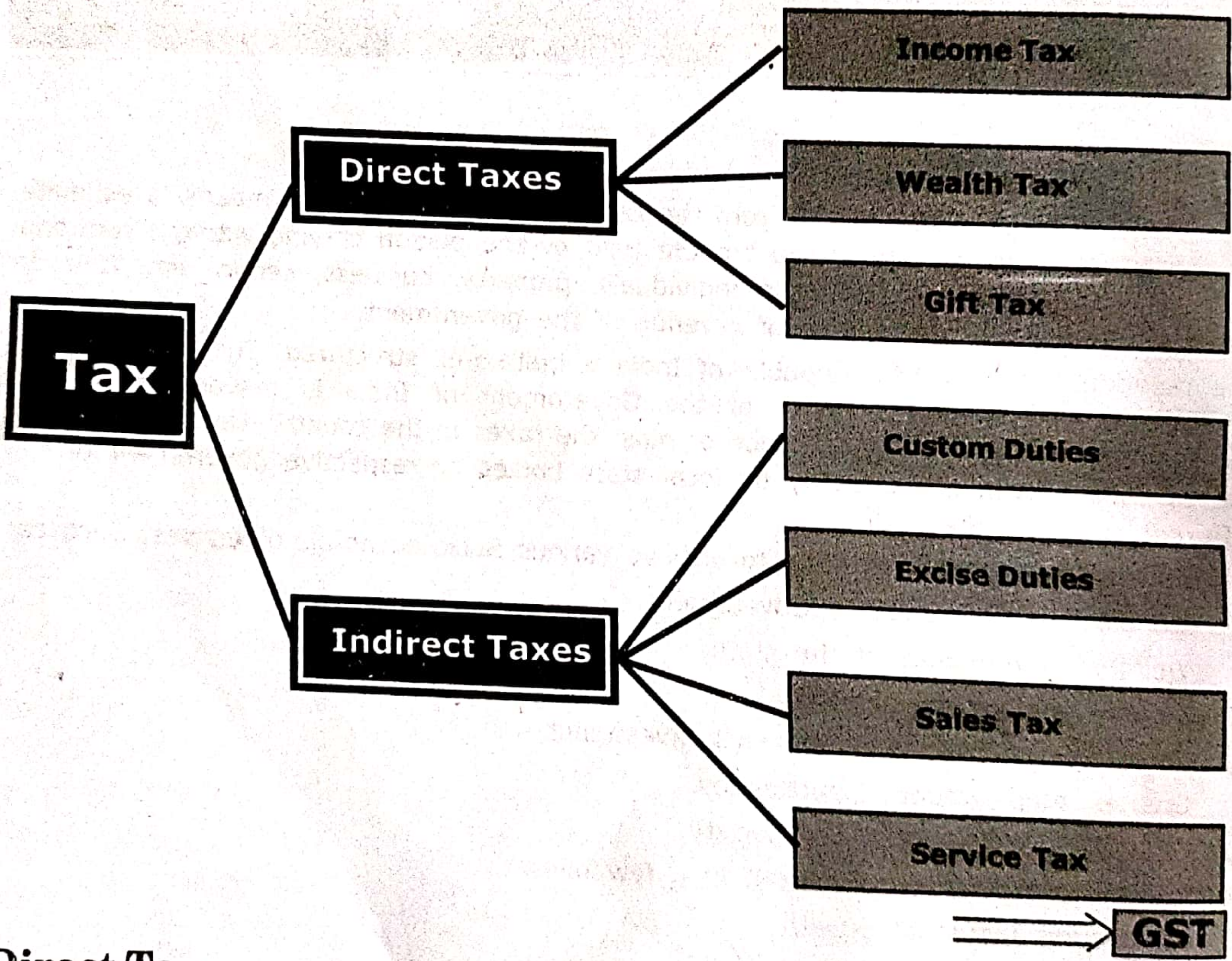
i) Better compliance.

ii) Better enforcement.

iii) Easy payment levied taxes.

Tax

Tax is the important sources of revenue of the government. It is compulsory contribution from a person to the expenses incurred by the state in common interest of all without reference to specific benefits on any individuals.



Direct Tax

Direct Taxes are taxes which are levied on person for the income earned or activities conducted, the incidence of which is to be borne by the person himself on whom it is levied. It means tax payer and tax bearer is same person. And the first and final burden is on the same person. Here the tax payer pays directly from his income or wealth or estate etc. The direct taxes are paid after the income reached in the hards of taxpayer. It consists of:

i) Income Tax: It is a tax on the income of an individual or an entity. It is on the income of Individuals, HUF, Unregistered firms and other association of people. In this Tax system income from all the source are added, certain rebates deductions, Expenditure etc. are allowed on account of life insurance, medical insurance, saving in provident fund etc.

Since 1960-61 Income Tax is levied on the income of registered company and corporations as independent entities. Corporations are taxed at a flat rate but certain rebates examinations are also provided. Tax rates are different for Indian company and foreign company.

ii) Wealth Tax: The Wealth Tax Act was enacted in 1951 and is responsible for the taxation related to the net wealth of an individual, a company or a Hindu Unified Family. The simplest calculation of wealth tax was that if the net wealth exceeded ₹ 30 lakhs, then 1% of the amount that exceeded ₹ 30 lakhs was payable as tax.

[It was abolished in the budget announced in 2015. It has since been replaced with a surcharge of 12% on individuals that earn more than ₹ 1 crore per annum. It is also applicable to companies that have a revenue of over ₹ 10 crores per annum. The new guidelines drastically increased the amount the government would collect in taxes as opposed the amount they would collect through the wealth tax.]

iii) Gift Tax: The Gift Tax Act came into existence in 1958 and stated that if an individual received gifts, monetary or valuables, as gifts, a tax was to be to be paid on such gifts. The tax on such gifts was maintained at 30% but it was abolished in 1998. Initially if a gift was given and it was something like property, jewellery, shares etc. it was taxable. According to the new rules gifts given by family members like brothers, sister, parents, spouse, aunts and uncles are not taxable. Even gifts given to you by the local authorities is exempt from this tax. How the tax works now is that if someone, other than the exempt entities, gifts you anything that exceeds a value of ₹ 50,000 then the entire gift amount is taxable.

Indirect Tax

It is a tax where the impact is one person and the incidence in on another. *For example,* sales Tax is paid to Government by the seller but it is to be collected same amount from the buyer. Here, the impact or sales Tax is on seller while the incidence or sales tax is on the buyer. The impact and incidence are on two different persons, it is an indirect tax. Indirect taxes are those which taxes payer pays indirectly which purchasing goods and commodities or paying for services. It is paid before the goods/services reach the tax payer.

(I) Central Excise: Excise duty is a tax on manufacture or production of goods in India. Excise duty on alcohol, alcoholic preparations and narcotic substances is collected by the state Government and is called state Excise duty.

The Excise Duty on the rest of the goods is called central Excise duty and is collected in terms of section 3 of the central Excise Act" 1944 the central Government.

(II) Customs Duty: Customs duty is levied on impacts into Indian from a place outside

Agricultural Income

Agricultural Income

Agricultural Income Means -

(i) Any Rent or Revenue derived from a land situated in India and used for agricultural purposes. (i.e., basic operations like tilling of land, sowing of seeds, planting, harvesting, irrigation should be carried out on the land).

(ii) Any rent or revenue received from a house property situated in the immediate vicinity of agricultural land and used for residences of the owner or tenant or for storing agricultural equipments or produces.

Farm Building

- Applicable only for receiver of rent in kind/cultivator
- Such farm building should be used as dwelling house or store house or out house
- Such farm building should be in agriculture land or in immediate vicinity to such land.

Such Land

- Is subject to local rates of tax
- OR
- Situated in Non Urban Area

Urban Area Means

a) The area situated within the local limits of municipality or cantonment board having population not less than ₹ 10,000 OR

b) Situated within 8 kms from the local limits of such municipality or cantonment

Note: *Capital Gain arising on the transfer of agriculture land is not considered as agriculture Income.*

(iii) Income drived from an ordinary manufacturing activity concerned with agriculture and carried out by the agriculturist himself.

Example of Agriculture Income

(i) Income from growing and selling paddy, wheat, flowers, trees.

(ii) Insurance money received for destruction of agricultural produce.

(iii) Income from sale of dried Tobacco leaves.

(iv) Income from sale of straw.

(v) Income from growing and maintaining nursery, tea leaves.

Examples of Non-agricultural Income

(i) Income from sales of trees, grass of spontaneous growth.

(ii) Income of salt produced by flooding the land with sea water.

(iii) Interest received by money-lender in the from of agricultural produce.

(iv) Income from butter and cheese making.

(v) Income from poultry farming.

(vi) Income from fishing

(vii) Income derived from land let-out for storing crops.

(viii) Income from dairy farming.

(ix) Interest on loan given to a farmer.

(x) Dividend received from a company engaged in agricultural operations.

Taxation of Agricultural Income

It is totally exempted from tax U/S 10(1). But, in case of agricultural income from land situated outside India, it will be fully taxable under the head other sources.

Partial Integration

The concept of partial integration has been introduced to ensure that non agricultural Income is taxed at higher slab rate.

Conditions for Partial Integration

1. Agricultural Income should exceed ₹ 5,000 and
2. Non agricultural Income should exceed the taxable limit. i.e. ₹ 3,00,000 in case of Resident Senior Citizen, in case of other individuals ₹ 2,50,000 and ₹ 5,00,000 in case of super Senior Citizen.
3. Partial Integration is applicable for Individual, HUF, AOP, Artificial Juridical Person. In other words this concept is not applicable for

   a) Companies
   b) Co-operative Societies
   c) Local Authorities
   d) Partnership Firms

Steps in Partial Integration

1. *Add:* Agricultural Income to Non agricultural Income and compute tax.
2. *Add:* Agricultural Income to maximum income exempted from Income tax and compute the tax.
3. Gross Tax liability = Step 1 - Step 2

Illustration – 9

Compute agricultural income from cultivation of land:

	₹
Sale proceeds of agricultural produce	1,60,000
Depreciation of equipments	6,000
Labour charges	24,000
Cost of seeds	6,000
Cost of fertilizers	3,000
Electricity charges	12,000

Solution:

Computation of Agricultural Income

Particulars	₹	₹
Sale Proceeds		1,60,000
Less: Expenses:		
Depreciation	6,000	
Labour charges	24,000	
Cost of seeds	6,000	

Income from Salary
(Sec. 15 to 17)

An Income can be taxed under the head "income from salaries", if the following conditions are satisfied:

1. The relationship between the payer and Payee should be that of master-servant relationship or employer-employee relationship.

Examples:

- Remuneration received by a lecturer from his/her college is taxable under the head "income from salaries", as there is employer- "employee relationship between payer and payee. On the other hand, remuneration received by a lecturer from the university is taxable under the head "Income from other sources" as there is no employer-employee relationship between them.
- Salary received by the member of parliament is taxable under the head "income from other sources" because he/she is the elected representative of the people but not an employee of the government.
- Salary, fee, commission received by a partner from the firm, is taxable under the head "income from business", because there is no employer-employee relationship between the partner and firm.

2. The amount received by the assessee from the payer must be for the services rendered by him as an employee and such payments should be shown in the service agreement register.

Definition of Salaries

Section 17(1) defines salaries includes:

1. wages
2. any annuity or pension
3. any advance of salary
4. any gratuity
5. any fees, commission, perquisites or profits in lieu of or any addition to salary or wages.
6. any leave encashment received.
7. the annual accretion to the credit balance of employees recognised provident fund to the extent it is taxable.
8. transferred balance of unrecognised provident fund to the balance of recognised provident fund to the extent it is taxable.
9. the contribution made by the Central government to the account of an employee under a pension scheme referred to in section 80CCD.

Meaning of Salary for various purposes

1) In case of Entertainment Allowance

Salary = Basic pay only.

2) In case of Gratuity under payment of Gratuity Act

Salary = Basic Pay + Full DA

3) In case of Rent Free House

Salary = Basic + A (taxable allowances) + B (Bonus) + C (Commission of all types) + D (Dearness allowances, Which enters into retirement benefits) + F (Fees) + L (Leave salary received during service period)

4) In case of Others

Salary = Basic + Dearness pay + Dearness allowances (which enters into retirement benefits) + Commission (if employee is given commission at fixed percentage on sales achieved by him)

Mrs. Kalpana Chawla (resident) an employee of Central Govt. in Bangalore submits the following information. Compute her net salary for the A.Y. 2017-18.

Basic Salary ₹ 40,000 per month

DA 30% of Basic (60% enters into all retirement benefits)

HRA ₹ 3,500 per month

Annual bonus ₹ 15,000

Entertainment allowance ₹ 15,000

Rent paid by the Kalpana is ₹ 72,000 p.a.

Solution:

Computation of Gross Salary

Assessee : Mrs. Kalpana Chawla — **Previous Year :** 2016-17

Status & Category: Resident & Non Govt. employee — **Assessment Year :** 2017-18

	₹
Salary	
Basic Salary (40,000 × 12)	4,80,000
Bonus (annual)	15,000
Entertainment allowance	15,000
Allowances:	
Dearness Allowance (30% of 4,80,000) (Working Note-1)	1,44,000
House Rent Allowance (Working Note-2)	26,640
Gross Salary	**6,80,640**

Less: Deduction U/S 16 (2) Least of the following is deductable: (i) Maximum limit ₹ 5,000 (ii) 20% of basic pay (₹ 4,80,000 x 20%) = ₹ 96,000 (iii) Actual EA received ₹ 15,000	5,00
Net Salary	**6,75,64**

Working Note-1:

Calculation of Dearness Allowance

(i)	Enters into retirement benefits	= 86,400
(ii)	Does not enter into retirement benefits	= 57,600
		1,44,000

Working Note-2:

(a) Calculation of salary for ascertaining taxable HRA

"Salary" Basic Salary	4,80,000
Dearness Allowance (enters) (1,44,000 x 60%)	86,400
Commission	-
"Salary"	**5,66,400**

(b) Calculation of exempted amount of HRA

1.	40% × 5,66,400 = 2,26,560	2,26,560
2.	Rent paid - 10% "Salary" [72,000 - (10% × 5,66,400)]	15,360
3.	Actual HRA Received (3,500 × 12)	42,000
	Exemption HRA =	**15,360**

(c) Calculation of Taxable HRA = Actual HRA - Exemption

42,000 - 15,360 = ₹ **26,640**

Income from House Property (Sec. 22 to 27)

Conditions

An income can be taxed under the head "income from house property", if the following conditions are satisfied:

1. There must be building and land appurtenant there to.
2. The assessee must be the owner of the property.
3. The property must not be used by the assessee for his/her own business or profession.

Points to be noted with regard to income from house property can be enumerated as follows:

i) This income is limited to the income from building or land appurtenant i.e., attached to building only. Buildings includes residential houses, warehouses, any block of bricks or stone work covered by a roof etc.

ii) Annual value is defined under section 23(1). According to this section, the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to be let-out from year to year subject to deduction of municipal taxes.

iii) The assessee should be the owner or deemed owner of the house property.

iv) In case of a dispute about ownership, the person who receives rent shall be liable to pay the tax till the courts order is obtained.

period of lease is not less than 12 years, Y becomes deemed owner of the property)

Exempted Incomes from House Property

Under Section 10 of the Income Tax Act 1961, following incomes from house property are exempted from tax. These incomes are not to be included in the total income of assessee. Hence no tax is payable on such incomes. They are:

i) Agricultural House Property under Section 2(1)(C). or Section 2(1A).

ii) House property held for charitable purposes Section 11.

iii) Self-occupied but vacant house Section 23(3).

iv) House used for own business or profession.

v) Property held by registered trade union under Section 10(24).

vi) Annual value of one palace in the occupation of a ex-ruler section 10(19A).

vii) Income from house property in the hands of a political party Section 13A.

viii) Income from house property belonging to scientific research association Section 10(21).

ix) Income from letting of godowns by certain authorities U/S 10(29).

x) Property income of an educational institutional and hospital U/S 10 (23C).

Types of House Properties

On the basis of nature of occupation, house property can be classified into the following categories:

I Let out property for residence or commercial.

II Self occupied property for residence.

III Deemed to be let-out property.

IV Partly let-out and partly self-occupied property.

I. Let out Property

Format for Computing Taxable Income from Let Out Property

Particulars		₹
Gross annual value (GAV)		xxx
Municipal taxes paid by the assessee during the P. Y.		xx
Net annual value (NAV)		xxx
Deductions U/S 24		
(a) Standard deduction - 30% of NAV	xx	
(b) Interest on borrowed capital		
(i) Previous year interest	xx	
(ii) Pre-completion interest	xx	xx
		xxx
Add: Unrealised rent recovered		xx
Add: Arrears of rent received		xx
Taxable Income from House Property		xxx

Gross Annual Value (GAV)

For calculating the GAV, the following factors should be considered:

1. Fair Rental Value (FRV)

Fair rent refers to the rent of a similar type of house in the same locality. It is an important consideration in the determination of gross annual value of house property.

2. Actual Rent (AR)

Actual rent is the rent which is actually received from the house property. In case tenant pays composite rent that is rent of building, plant and machinery etc., the rent of house property should be separated from rent of plant and machinery, furniture etc. i.e. actual rent is reduced by the amount of rent of plant and machinery, furniture etc. and balance should be treated as actual rent of house property.

Further, if cost of common facilities like -

a) Swimming pool maintenance charges,

b) Lift and pump maintenance charges,

c) Lighting of stairs and corridors,

d) Salary of gardener and watchman,

e) Water and electricity charges etc.

If such expenses are borne by the owner and is provided by the owner and it is included in the rent. Such cost is reduced out of actual rent received and balance should be treated as Real Rental value.

3. Municipal Rental Value (MRV)

The municipal corporation or committee conducts a periodical survey of the house properties in their local limits for the purpose of levying local taxes. On the basis of the survey conducted the rental value are fixed which serves as the basis for levying tax. The rental value so fixed is called municipal rental value.

4. Standard Rent (SR)

The rent fixed under Rent Control Act is called a standard rent.

5. Expected Rental Value (ERV)

The municipal rental value or the fair rental value whichever is higher is considered and then such higher value is compared with standard rent and whichever is less is treated as expected rental value.

6. Unrealised Rent (UR)

It refers to the rent that could not be realised by the owner from his/her tenant. Unrealised rent can be deducted from annual rental value, if the following conditions are satisfied:

(i) The tenancy is bonafide.

(ii) The defaulting tenant has vacated the property.

(iii) The defaulting tenant is not in occupation of any other property belonging to the owner.

(iv) The assessee has undertaken all necessary steps to institute legal proceedings.

7. Vacancy Period Rent

It refers to the rent for the period during which let out property has remained vacant in the previous year.

Gross Annual Value	**75,000**

Illustration - 2

Calculate ARV of Mr. Ram (resident) from the particulars given below:

MRV - ₹ 90,000

FRV - ₹ 88,000

Standard Rent - ₹ 70,000

Annual Rent - ₹ 96,000

During the previous year 2016-17 the assessee could not realise rent for three months.

Solution:

Computation of Gross Annual Value

Assessee : Mr. Ram — **Previous Year :** 2016-17

Status : Resident — **Assessment Year :** 2017-18

Particulars		₹
MRV	which ever is higher	90,000
or		
FRV		88,000
Notional Rent		90,000
Notional Rent	which ever is less	90,000
or		
Standard Rent		70,000
Expected Rent		70,000
Expected Rent	which ever is higher	70,000
or		
Actual Rent		72,000
Gross Annual Value		**72,000**

Working Note:

Annual Rent	= 8,000 x 12 =	96,000
Less: Unrealised Rent	= 8,000 x 3 =	24,000
Actual Rent		72,000

Illustration - 10

Mr. X is the owner of property. It is given on rent of ₹ 11,000 p.m. Municipal value of the property is ₹ 1,35,000. Fair rent is ₹ 1,43,000 and standard rent is ₹ 1,30,000. Municipal tax paid by Mr. X is ₹ 26,000 on 1.4.2016 rent is increased from ₹ 11,000 p.m to ₹ 14,000 p.m. with retrospective effect from 1.4.15. Arrears of rent is paid on 1.4.16. Find out taxable income from house property for the A.Y. 2017-18.

Solution:

Computation of Taxable Income from House Property

Assessee : Mr. X

Status : Assumed to be Resident

Previous Year : 2016-17

Assessment Year : 2017-18

Particulars			
Municipal Value or Fair rent	which ever is higher	1,35,000 1,43,000	1,35,000 1,43,000
Notional Rent		1,43,000	1,43,000
Notional rent or Standard rent	which ever is less	1,43,000 1,30,000	1,43,000 1,30,000
Expected Rent		1,30,000	1,30,000
Expected rent or Actual rent	which ever is higher	1,30,000 1,32,000 (11,000 x 12)	1,30,000 1,68,000 (14,000 x 12)
Gross Annual Value		**1,32,000**	1,68,000
Less: Municipal taxes paid by the owner			26,000
Net Annual Value			1,42,000
Less: Deductions u/s 24 Standard deduction - 30% of NAV			42,600
Total			99,400
Add: Arrears of rent received during the P.Y. 2015-16 (Note-1)			25,200
Taxable Income from House Property			**1,24,600**

Working Note-1:

Gross annual value of the P.Y. 2016-17	1,68,000
(-) Gross annual value of the P.Y. 2015-16	1,32,000
Arrears of rent	36,000
(-) 30% of 36,000	10,800
Taxable value of arrears of rent	= 25,200

Illustration - 11

From the following particulars, compute the taxable income from House Property of Mr. X:

Municipal value ₹ 1,20,000
Annual rent received ₹ 1,50,000
Date of borrowing the loan 1-7-2010.
Date of completion of construction 31-5-2014
Amount of loan borrowed ₹ 50,000
Rate of Interest on loan 15% p.a.

Solution:

Computation of Taxable Income from House Property

Assessee : Mr. X — Previous Year : 2016-17
Status : Assumed to be Resident — Assessment Year : 2017-18

Particulars			₹
Municipal value	1,20,000		
or w.e.h			
Annual rent received	1,50,000		
Gross annual value			1,50,000
Less: Municipal taxes			Nil
Net annual value (NAV)			1,50,000
Less: Deductions U/s 24			
1. Standard deduction at 30% of NAV		45,000	
2. Interest on loan $\left(50{,}000 \times \frac{15}{100}\right)$		7,500	
3. Pre-construction interest $\left(50{,}000 \times \frac{15}{100} \times \frac{45mth}{12} \times \frac{1}{5}\right)$		5,625	
			58,125
Taxable income from let out property			**91,875**

Business or Profession

(Sec.28 to 44)

Introduction

The profits/gains from business or professions carried on by the assessee at any time during the P.Y. are assessed to tax under the head Income from business or profession. Further, the profits or gains shall be computed according to the method of accounting regularly employed by the assessee. If the Profit & loss account prepared by the assessee is not computed from income tax point of view, such account has to be adjusted from income tax point of view, in order to ascertain the correct taxable profits or gains from business or profession.

Before knowing the tax provisions of Sections 28 to 44, it is important to understand the meaning of the terms Business, Profession, Vocation and format for computing taxable income from business or profession.

Business [Section 2(13)]

According to section 2(13) of the Income tax Act, the term Business means any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Profession [Section 2(36)]

According to Section 2(36) Profession refers to an occupation, where intellectual skill and technical expertise in a specified field is acquired for earning a livelihood. Lawyer, Doctor, Auditor are the some of the examples of Profession. Further, Profession includes Vocation.

Vocation means an activity upon which a person spends the major portion of his time and out of which he makes his living. Music, Dancing, Writing books and contribution of articles to Journals constitute the vocation of an assessee.

Format for Computation taxable Income from Business

Assessee: Status: *Particulars*	Previous Year: 2016-17 Assessment Year: 2017-18 *Amt. (₹)*	*Amt. (₹)*
Net Profit or Loss as per P & L A/c		xxx
Add: 1. Inadmissible expenses debited to P & L A/c	xxx	
2. Business/Professional income not credited to P & L A/c	xxx	
3. Overvaluation of opening stock	xxx	
4. Undervaluation of closing stock	xxx	
5. Notional loss*	xxx	xxx
		xxx
Less: 1. Admissible expenses not debited to P & L A/c	xxx	
2. Tax-free incomes credited to P/L account	xxx	
3. Non-Business Income credited to P & L A/c	xxx	
4. Under valuation of opening stock	xxx	
5. Overvaluation of closing stock	xxx	
6. Notional profit*	xxx	xxx
Taxable Income from Business		xxx

Rate of additional depreciation: Additional depreciation shall be available at 20%, 35% in case of Andhra Pradesh, Bihar and West Bengal of the actual cost of new plant and machinery acquired and installed after March, 2005. If the assets is put to use for less than 180 days in the year in which it is acquired, the rate of additional depreciation will be 10% and 17.5% in case Andhra Pradesh, Bihar and West Bengal and Telengana.

1. Format for computation of Income from Profession

In case of Doctor or Medical Practitioner

Particulars	₹	₹
Professional Receipts:		
1. Fees for conducting operation	xx	
2. Consultation fees	xx	
3. Visiting fees	xx	
4. Sale of medicines	xx	
5. Gifts received from patients for professional services rendered	xx	
6. Examiner's fees	xx	
7. Nursing home receipts	xx	
8. Any other professional receipts	xx	
Total Professional Receipts		xxx
***Less:* Professional Expenses:**		
1. Rent, Light, Water charges salary to staff, telephone expenses of clinic or hospital	xx	
2. Cost of medicines are determined in two ways		
a. If accounts are maintained on cash basis:		
Cost of actual medicines purchased during the previous year	xx	
or		
b. If accounts are maintained on mercantile basis:		
Opening stock + New purchases - Closing stock		
3. Depreciation on surgical equipment and X-ray M/C etc., at prescribed rates	xx	
4. Depreciation of books at prescribed rates.	xx	
5. Motor car expenses: Depreciation relating to profession work.	xx	
6. Expenditure incurred to increase professional knowledge.	xx	
7. Hospital or clinic expenses.	xx	
8. Any other expenditure incurred during the year pertaining to profession.	xx	xxx
Income from profession		xxx

In case of Chartered Accountant

Particulars	₹	₹
Professional Receipts:		
1. Audit fees	xx	
2. Gain from accountancy work	xx	
3. Institute fees	xx	
4. Examiners fees	xx	
5. Gifts from clients	xx	
6. Consultancy services	xx	
7. Any other professional receipt	xx	
Total Professional Receipts		xxx
***Less:* Professional Expenses:**		
1. Audit office expenditure	xx	
2. Institute Expenses	xx	
3. Depreciation on book at prescribed rates.	xx	
4. Motor car expenses relating to professional work	xx	
5. Membership fees	xx	
6. Depreciation on office equipment or vehicles	xx	
7. Any other expenditure incurred to increase professional knowledge	xx	
8. Stipend to trainees	xx	
9. Subscriptions	xx	
10. Depreciation on office furniture	xx	xxx
Income from Profession		xxx

In case of Lawyer or an Advocate

Particulars	₹	₹
Professional Receipts:		
1. Practicing fees	xx	
2. Legal fees	xx	
3. Special Commission	xx	
4. Presents from clients	xx	
5. Examiners fees	xx	
6. Any other Professional Receipts	xx	
Total Professional Receipts		xxx
***Less:* Professional Expenses:**		
1. Office Expenses		
2. Salary of staff, if any	xx	
3. Depreciation on professional books at prescribed rates	xx	
4. Depreciation of office equipment	xx	
5. Expenditure incurred to increase professional knowledge	xx	

Scanned with CamScanner

Taxable Business Income

Illustration - 10 ***(Taxable Income from Business)***

The following is the P/L A/c of Mr. Ranjith for the year ending 31st March 2017.

Particulars	₹	Particulars	₹
To Salaries	1,65,000	By Gross Profit	2,50,000
To Office expenses	18,000	By Bad debts recovered	10,000
To Depreciation	14,000	By Dividend	3,000
To Sales Tax	9,000	By Commission	10,000
To Legal expenses	8,000	By Rent of house property	9,000
To Income Tax	7,000	By Brokerage	10,000
To Patents purchased (1/8th)	12,000	By Sundry receipts	5,000
To Repairs	6,000	By Share of income from HUF	3,000
To Donation	2,000		
To Provision for bad debts	3,000		
To General expenses	12,000		
To Net Profit	44,000		
	3,00,000		**3,00,000**

Additional Information:

a) Salary includes ₹ 6,000 paid to workers employed at home. b) Legal expenses includes ₹ 1,000 paid to the advocate in connection with personal case. c) General expenses includes ₹ 4,000 as contribution to staff welfare fund. d) Out of the bad debts recovered only ₹ 4,000 were allowed as deduction earlier. Compute his income from bisiness for the assessment year 2017-18.

Solution:

Computation of Taxable Income from Business

Assessee: Mr. Ranjith | **Previous Year:** 2016-17
Status: Resident | **Assessment Year:** 2017-18

Particulars	*Amt. (₹)*	*Amt. (₹)*
Net profit as per P & L A/c		44,000
***Add:* Inadmissible expenses debited to P & L A/c**		
1. Salary paid to workers employed at home	6,000	
2. Legal expenses	1,000	
3. Income Tax	7,000	
4. Patents purchased	12,000	
5. Donation	2,000	
6. Provision for bad debts	3,000	
7. Contribution to staff welfare fund	4,000	35,000
		79,000
***Less:* Admissible expenses not debited to P & L A/c**		
Depriciation on patent rights (12,000 x 8/1 = 96,000 x 25%)	24,000	
***Less:* Non-Business income credited to P & L A/c**		
1. Bad debts recovered (10,000 - 4,000)	6,000	
2. Dividend	3,000	
3. Rent of house property	9,000	
4. Share of income from HUF	3,000	45,000
Taxable Income from Business		**34,000**

Scanned with CamScanner

Illustration - 12 *(Taxable Income form Business)*

A sole trading concern of Mr. Mehadi Hassan furnishes the following Trading and Profit and Loss A/c and other information for the year ending on 31st March 2017. Compute his taxable income from business for the relevant A.Y. 2017-18.

Dr. **Trading and Profit and Loss Account** Cr.

Particulars	₹	*Particulars*	₹
Opening Stock	46,000	Sales	5,05,000
Purchases	2,50,000	Closing Stock	86,000
Carriages	12,000	Rent from house property	24,000

Railway demerage	12,000	Refund of customs duty	10,000
Advertisements	12,000	Refund from income tax	15,000
Salary to Staff	18,000	Bad debts recovered	15,000
Repairs to house property	2,000	Capital Gains on Sale of	
Fire Insurance:		Short term capital investments	20,000
House property	1,800	Profits on sale of a car used	
Office and Godown	2,000	in the business	25,000
Goods	5,000		
Life insurance premium:			
On life of proprietor	3,000		
On employees life	2,000		
Depreciation:			
House property	6,000		
Business assets (excluding patents)	14,000		
Wealth tax	6,000		
Income tax	12,000		
Patents Rights purchased	35,000		
Interest on capital borrowed:			
For Business	7,000		
For reconstruction of H.P.	5,000		
Family planning expenses among employees	4,000		
Bad debts	9,000		
Provision for bad debts	3,000		
Provision for sales tax	22,000		
Net profit c/d	2,11,200		
Total	**7,00,000**	**Total**	**7,00,000**

Additional Information:

i) Opening Stock is valued at cost minus 12% however closing stock is valued at cost plus 8% basis.

ii) Bad debts recovered include ₹ 5,000 disallowed earlier.

iii) Income Tax includes ₹ 4,000 for preparation and filling of income tax returns and ₹ 1,000 income tax penalty on an earlier Assessment and ₹ 2,000 legal charges on income tax appeal.

vi) Rent from house property includes ₹ 6,000 rent received from the employees of the concern.

vii) 75% of house property expenses are personal use.

Solution:

Computation of Taxable Income from Business

Assessee: Mr. Mehadi Hassan
Status: Resident

Previous Year: 2016-17
Assessment Year: 2017-18

Particulars	**Amt. (₹)**	**Amt. (₹)**
Net profit as per P & L A/c		2,11,200
***Add:* Inadmissible expenses debited to P and L a/c**		
1. Repairs to house property (75%)	1,500	
2. Fire insurance on H.P (75%)	1,350	
3. Life insurance premium on proprietor	3,000	
4. Depreciation on H.P (75%)	4,500	
5. Wealth tax	6,000	
6. Income tax (12,000 - 4,000 - 2,000 = 6,000)	6,000	
7. Purchase of patents rights	35,000	
8. Interest on capital of house property $\left(5{,}000 \times \frac{75}{100}\right)$	3,750	
9. Provision for bad debts	3,000	
10. Provision for sales tax	22,000	
11. Family planning expenses	4,000	
		90,100
		3,01,300
***Less:* Admissible expenses not debited to P & L A/c**		
Depreciation on patent rights $\left(35{,}000 \times \frac{25}{100}\right)$	8,750	
Undervaluation of opening stock $\left(46{,}000 \times \frac{12}{88}\right)$	6,273	
Overvaluation of closing stock $\left(86{,}000 \times \frac{8}{108}\right)$	6,370	
***Less:* Non-Business & taxfree incomes credited to P & L A/c**		
1. Rent from house property (24,000 - 6,000)	18,000	
2. Refund of income tax (taxfree)	15,000	
3. Bad debts recovered [not allowed earlier] (taxfree)	5,000	
4. Capital Gain or Sale of investment	20,000	
5. Profit on sale of car in business	25,000	1,04,393
Taxable Income from Business		**1,96,907**

Note: 1. Expenses incurred towards filing of income tax return and legal charges of income tax appeal is a admissible expenses which is included in income tax. So, it is deducted. Income tax penalty is disallowed.

2. Refund of customs duty, if nothing is given it is assumed to be allowed earlier. Hence, it is a Business income.

Tax Treatment

Inadmissible Expenses

Inadmissible expenses are those expenses, which are not allowed under the Act. If such expenses are debited to Profit & Loss account by the assessee, they should be added back to the net profit. Following are some of the examples of inadmissible expenses:

1. Any business expense paid in cash exceeding ₹ 20,000, 100% of such payment shall be disallowed. (The monetary limit of ₹ 20,000 has been rasied to ₹ 35,000 in the case of payment made for plying, hiring or leasing goods carriages.)
2. Bad debts still recoverable.
3. Employer's contribution to the provident fund not paid on or before the due date of filing returns.
4. Betterment charges paid to corporation under Town Planning Act.
5. Capital losses like loss on sale machinery, loss on sale of car etc.
6. Charities and donations.