

Problems on residential status and tax incidence

34-PI X and Mrs. X are foreign citizens. They come to India on October 15, 2024 for a visit of 270 days. In the previous years, they are in India as follows :

	X	Mrs. X
2023-24	265 days	310 days
2022-23	26 days	240 days
2021-22	25 days	4 days
2020-21	120 days	208 days
2019-20	30 days	75 days
2018-19	20 days	360 days
2017-18	100 days	240 days
2016-17	5 days	195 days
2015-16	6 days	176 days
2014-15	130 days	146 days

During the previous year 2024-25, X and Mrs. X have the following incomes :

	X Rs.	Mrs. X Rs.
Interest on company deposit in India	1,40,000	2,40,000
Income deemed to be earned in India	62,000	1,55,000
Income from business situated in Nepal and controlled from India (40 per cent is received in India and 60 per cent is received outside India)	84,000	98,000
Salary (after standard deduction) received in India for service rendered outside India	92,000	86,000
Interest received from the Government of India (received outside India)	1,58,000	46,000
Interest received from a foreign company outside India (on capital which is utilised outside India)	80,000	25,000
Interest received from a foreign company outside India (on loan which is utilised for doing business in India)	68,000	92,000
Royalty received in India from the Government of India	9,10,000	6,05,000
Royalty received in India from a non-resident in respect of technology used by such person outside India	48,000	37,000

The following information is also available :

	Place of birth	Year of birth
X	Delhi	1951
Mrs. X	Bombay	1952
Father of X	Muscat	1922
Mother of X	Kathmandu	1925

	Place of birth	Year of birth
Grandfathers of X	Mexico and Dubai	1893
Grandmothers of X	Taipei and Lagos	1895
Father of Mrs. X	Dubai	1926
Mother of Mrs. X	Belfast	1927
Grandfathers of Mrs. X	Chicago and Muscat	1901
Grandmothers of Mrs. X	Karachi and Dubai	1902

Find out the residential status and gross total income of X and Mrs. X for the assessment year 2025-26.

SOLUTION : X and Mrs. X are foreign citizens. While Mrs. X is a person of Indian origin [her grandmother was born in undivided India (Karachi)], X is not a person of Indian origin (X or his parents or grandparents was not born in undivided India).

X and Mrs. X can become resident in India only if they satisfy any of the following basic conditions :

	X		Mrs. X	
	Presence of X in India during 2024-25	Presence of X in India during April 1, 2020 and March 31, 2024	Presence of Mrs. X in India during 2024-25	Presence of Mrs. X in India during April 1, 2020 and March 31, 2024
Condition 1	182 days	—	182 days	—
Condition 2	60 days	365 days	Non-functional	

As X satisfies basic condition 2, he is a resident in India. However, he is unable to satisfy one of the additional conditions (he is not resident in at least two out of preceding 10 years). X is, therefore, resident but not ordinarily resident in India for the assessment year 2025-26. Mrs. X is a non-resident in India, as she is not in India for at least 182 days during the previous year 2024-25.

Net income of X and Mrs. X shall be determined as follows :

	X (Resident but not ordinarily resident) Rs.	Mrs. X (Non-resident) Rs.
Interest on company deposits in India	1,40,000	2,40,000
Income deemed to be earned in India	62,000	1,55,000
Income from business in Nepal		
- 40% received in India	33,600	39,200
- 60% received outside India (as business is controlled in India)	50,400	—
Salary from outside India	92,000	86,000
Interest from Government of India	1,58,000	46,000
Interest from foreign company (borrowed money is utilised outside India)	—	—
Interest from a foreign company (borrowed money is utilised in India)	68,000	92,000
Royalty from the Government	9,10,000	6,05,000
Royalty received in India	48,000	37,000
Gross total income	<u>15,62,000</u>	<u>13,00,200</u>

34-P2 X furnishes the following particulars of his income earned during the previous year relevant to the assessment year 2025-26 :

	Rs.
1. Interest on German Development Bonds (one-sixth is received in India)	36,000
2. Income from agriculture in Pakistan, received there but later on Rs. 86,000 is remitted to India	3,41,000
3. Interest from property in USA received outside India [Rs. 92,000 is used in Canada for meeting the education expenses of X's son in Canada and Rs. 2,48,000 is later on remitted to India]	3,40,000

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| 4. Income earned from business in Iran which is controlled from New Delhi (Rs. 70,000 is received in India) | 4,00,000 |
| 5. Dividend paid by an Indian company on May 10, 2024 but received outside India | 1,95,800 |
| 6. Past untaxed profit of 2021-22 brought to India in May 2024 | 2,10,000 |
| 7. Profits from a business in New Delhi and managed from outside India (50 per cent of the profit is received outside India) | 92,000 |
| 8. Profits on sale of a building in India but received in Nepal | 18,74,000 |
| 9. Pension from a former employer in India, received in Iran (amount net of standard deduction) | 2,15,000 |
| 10. Gift in foreign currency from a friend received in India on September 6, 2024 | 80,000 |

Find out the gross total income of X : (i) if he is resident and ordinarily resident in India, (ii) if he is resident but not ordinarily resident in India, and (iii) if he is non-resident for the assessment year 2025-26.

SOLUTION :

	Resident and ordinarily resident Rs.	Resident but not ordinarily resident Rs.	Non-resident Rs.
(1)	(2)	(3)	(4)
1. Interest on German Development Bonds :			
<input type="checkbox"/> One-sixth is taxable on receipt basis	6,000	6,000	6,000
<input type="checkbox"/> Five-sixths is taxable in the case of resident and ordinarily resident on accrual basis	30,000	—	—
2. Income from agriculture in Pakistan :			
<input type="checkbox"/> Income accrued and received outside India	3,41,000	—	—
3. Income from property in USA received outside India :			
<input type="checkbox"/> Income received outside India	3,40,000	—	—
4. Income earned from a business in Iran controlled from New Delhi :			
<input type="checkbox"/> Rs. 70,000 is taxable on receipt basis	70,000	70,000	70,000
<input type="checkbox"/> Balance is not taxable in the case of non-resident	3,35,000	3,35,000	—
5. Dividend paid by an Indian company			
<input type="checkbox"/> Income deemed to accrue or arise in India	1,95,800	1,95,800	1,95,800
6. Past untaxed profit brought to India :			
<input type="checkbox"/> Not income of the previous year 2024-25, hence, not taxable	—	—	—
7. Profit from a business in New Delhi and managed from outside India :			
<input type="checkbox"/> Income accrued in India	92,000	92,000	92,000
8. Profit on sale of a building in India but received in Nepal :			
<input type="checkbox"/> Income deemed to accrue or arise in India	18,74,000	18,74,000	18,74,000
9. Pension from an Indian former employer received in Iran :			
<input type="checkbox"/> Income deemed to accrue or arise in India	2,15,000	2,15,000	2,15,000
10. Gift in foreign currency			
<input type="checkbox"/> Now taken as income	80,000	80,000	80,000
Gross total income	35,78,800	28,67,800	25,32,800

Problems on computation of capital gains

188-P1 On March 31, 2025, X sells the following :

15,61,200

	Date of sale	Sale proceeds	Cost of acquisition	Year of purchase	Fair market value on April 1, 2001
		Rs.	Rs.		Rs.
Preference shares	August 10, 2024	4,90,000	4,61,063	2003-04	1,80,000
Agricultural land in rural area (outside the municipal limits)	May 25, 2024	30,00,000	2,30,000	1983-84	3,40,000
Agricultural land in urban area	June 10, 2024	51,00,000	14,11,476	2006-07	2,00,000
Debentures (listed)	April 10, 2024	5,17,900	2,30,615	2003-04	1,80,000
Personal car	July 1, 2024	1,25,000	70,000	2007-08	NA

On July 31, 2025 (being the due date of furnishing return of income), X deposits Rs. 30,00,000 under section 54B in claiming exemption in future by purchasing agricultural land. By withdrawing from the deposit account, he purchases agricultural land for Rs. 27,00,000 till June 9, 2026. Assuming that the income of X from other sources for the previous years 2024-25 and 2026-27 is Rs. 86,000 and Rs. 1,92,000, respectively, find out taxable income for the assessment years 2025-26 and 2027-28.

SOLUTION: Previous year 2024-25 (assessment year 2025-26)

Capital gain

Rural agricultural land Rs.	Urban agricultural land Rs.	Shares Rs.	Debentures Rs.	Personal car Rs.
30,00,000	51,00,000	4,90,000	5,17,900	1,25,000
N.A.	14,11,476	4,61,063	2,30,615	NA
—*	36,88,524	28,937	2,87,285	—*
—	30,00,000	—	—	—
—	6,88,524	28,937	2,87,285	—

Sale proceeds
Less: Cost of acquisition
Capital gain (*agricultural land in rural area and personal car are not capital assets, amounts arising on sale of these is not taxable at all)
Less: Exemption under section 54B

Balance	
Income under the head "Capital gains"	10,04,746
Income from other sources	86,000
Gross total income	10,90,746
Less: Deduction under sections 80C to 80U	Nil
Net income	10,90,750
Previous year 2026-27 (assessment year 2027-28)	
Amount deposited in bank account on July 31, 2025	30,00,000
Less: Amount utilised for purchase of agricultural land within 2 years from sale of agricultural land (i.e. up to June 9, 2026)	27,00,000
Long-term capital gain	3,00,000
Income from other sources	1,92,000
Net income	4,92,000

188-P2 Discuss the following :

- X acquired a plot of land on June 30, 2001 for Rs. 1,10,000. The funds invested were borrowed at the rate of 9 per cent per annum (the amount was repaid by X on March 31, 2005). X sells the plot of land on September 30, 2024 for Rs. 25,00,000. What will be the amount of capital gains for the assessment year 2025-26? Can X claim deduction of ground rent paid by him?
- XY & Co., a partnership firm, owns a house property which is utilised by partners for their residence. On June 30, 2024, the firm sells the property at a long-term capital gains of Rs. 1,20,000. Can the firm or partners claim exemption under section 54?

SOLUTION: 1. Capital gains is computed after deducting cost of acquisition from the amount of sale consideration. The cost of acquisition may include an expenditure incurred after the date of acquisition, e.g., interest on funds borrowed for payment of purchase consideration—CIT v. Mithilesh Kumari [1973] 92 ITR 9 (Delhi).

In this case, land was purchased during 2001-02. The date of payment of interest is not given. Most probably interest will be payable on the last day of the previous year. Interest liability for the previous year 2001-02 will be Rs. 7,425 (payable on March 31, 2002). Similarly, interest payable on March 31, 2003, March 31, 2004, March 31, 2005 will be Rs. 9,900 every year. Present value for these payments on March 31, 2002 will be added to the cost of acquisition of Rs. 1,10,000. There is no prescribed factor for calculating present value. It may be calculated on the basis of cost inflation index which is notified for calculating long-term capital gains as follows –

	Present value on March 31, 2002 for interest payable in future Rs.
Interest payable on March 31, 2002 (Rs. 7,425 × 100 ÷ 100)	7,425
Interest payable on March 31, 2003 (Rs. 9,900 × 100 ÷ 105)	9,429

	Present value on March 31, 2004 for interest payable in future Rs.
Interest payable on March 31, 2004 (Rs. 9,900 × 100 ÷ 109)	9,063
Interest payable on March 31, 2005 (Rs. 9,900 × 100 ÷ 113)	8,761
Total	34,698

Computation of capital gain -

Full value of consideration

Less: Cost of acquisition (cost of acquisition : Rs. 1,10,000 + Rs. 34,698)

Long term capital gain

23,56,000
3,44,698
23,53,302

X cannot claim deduction of ground rent from long-term capital gains as ground rent constitutes an expenditure incurred for the purpose of the maintenance of capital asset and not for the purpose of its acquisition—*CIT v. Maheshwari* [1973] 92 ITR 9 (Delhi).

2. Benefit under section 54 can be availed only if the house property is owned by an individual or Hindu undivided family. Therefore, the firm cannot claim deduction under section 54. Moreover, the partners of the firm also cannot claim the benefit of section 54 as the transferor of the asset is the firm and not the partners.

188-P3 X owns 1,000 partly paid shares in a company. These shares have been forfeited by the company for non-payment of call money. X wants to claim Rs. 8,000 (i.e., amount paid at the time of application and allotment) as short-term capital loss. Is the claim of X tenable?

SOLUTION : The forfeiture of partly paid shares because of non-payment of call money is in accordance with clauses 29 to 35 in Table A of Schedule I of the Companies Act, 1956. Under rule 7 of Table A, a person becomes member of a company as soon as the shares have been allotted to him. The holder of such shares is also entitled to receive within 3 months of allotment, relevant share certificate. Therefore, it can be said that X was legal owner of shares at the time of forfeiture. The point for consideration is whether forfeiture of shares amounts to a "transfer" under section 2(47). Transfer in relation to capital asset includes "the extinguishment of any rights therein". The Gujarat High Court in *CIT v. Vania Silk Mills (P.) Ltd.* [1977] 107 ITR 300 has held that the expression "the extinguishment of any rights therein" in section 2(47) covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the bundle of rights—qualitative or quantitative—which the assessee has in a capital asset, whether such asset is corporeal or incorporeal. In the given problem, X's rights in the shares are undoubtedly extinguished. There is, therefore, transfer of capital under section 2(47) and, accordingly X is entitled to claim short-term capital loss of Rs. 8,000.

188-P4 X is a partner in a firm, A Co., along with three other persons. On December 31, 2024, the firm is dissolved and X takes over the following assets :

	Plant and machinery (depreciation is claimed by the firm) Rs.	Residential house premises (no depreciation is claimed) Rs.
Fair market value of assets on December 31, 2024	6,50,000	48,00,000
Agreed value of assets taken over by X as per dissolution deed	4,60,000	18,50,000
Cost of acquisition (*as per section 50)	3,10,000*	6,00,000
Year of acquisition	1990	1990
Fair market value on April 1, 2001	—	15,31,200

Discuss whether A Co. is liable for tax on any capital gains. Will X be able to claim depreciation in respect of plant and machinery on Rs. 6,50,000?

SOLUTION : Section 9B charges tax on surplus arising from the transfer of capital asset by a firm to partners on dissolution of the firm or otherwise. It is taxable in the previous year in which the transfer takes place. For this purpose, fair market value of the asset on the date of such transfer is deemed to be the value of consideration received or accruing as a result of transfer.

Taxable capital gains of the firm will be determined as under:

Fair market value of assets on the date of transfer (agreed value is not relevant)
 Less: Cost of acquisition (*as per section 50, **fair market value on April 1, 2001)
 Capital gain (*surplus arising on sale/transfer of depreciable asset is short-term capital gain, as per section 50)

Plant	Residential House
Rs	Rs
6,50,000	48,00,000
3,10,000	15,37,200**
3,40,000	32,62,800

An assessee is entitled for depreciation on actual cost in the first year and on the written down value in the subsequent years. In the given problem X is entitled to claim depreciation in respect of plant and machinery on its actual cost, i.e., Rs. 4,60,000, being the cost incurred by it on the acquisition of asset following the dissolution of the firm. Unless it is established by the Income-tax Department that the purchase price is determined amongst the partners by resorting to fraud, collusion and inflation and deflation of values for ulterior purposes, cost of the asset to a partner must necessarily be its cost to him at the time of dissolution whether mentioned in the dissolution deed or ascertainable otherwise—*Kalooram Govindram v. CIT* [1965] 57 ITR 335 (SC). On the strength of this judgment, the Delhi High Court in *Raj Narain Agarwala v. CIT* [1970] 75 ITR 1 has held that on the dissolution of firm, if assets are divided amongst partners at a genuine valuation, the cost to the partner who utilises the assets in his business, is the valuation at which he took them over. Therefore, X is entitled for depreciation on Rs. 4,60,000.

188-P5 X purchased in 2002-03, 42,000 (non-listed) shares of a company at the rate of Rs. 100 per share with a view to acquiring controlling interest of the company. In 2024-25, he sells the entire lot of 42,000 shares at the market value of Rs. 45 per share. On account of this sale, X wants to claim capital loss of Rs. 1,23,10,000 in the assessment year 2025-26. The Assessing Officer finds that X had purchased the shares in 2002-03 at the rate of Rs. 100 per share when the market value of the shares was Rs. 76 per share. According to the Assessing Officer, the extra price of Rs. 24 per share was paid by X to acquire the controlling rights of the company. The Assessing Officer, therefore, determines the amount of loss at Rs. 13,02,000, excluding the extra price of Rs. 24 per share. Is the Assessing Officer legally correct?

SOLUTION : Controlling interest is an incidence arising from holding a particular number of shares in a company. It cannot be separately acquired or transferred. It flows from the fact that a number of shares are held by a person. If for acquiring that number of shares, a person is required to pay more than the market price and the transaction is genuine, then the cost of acquisition is that which has actually been paid. It is not right to conclude that controlling interest is a distinct capital asset which can be acquired or transferred independently of the shares. Therefore the view of the concerned Assessing Officer is not legally correct—*Maharani Ushadevi v. CIT* [1982] 8 Taxman 9 (MP).

188-P6 A car in personal use for about 6 years is sold at a profit of about Rs. 58,000. Will the gain be taxable?

SOLUTION : The point for consideration is whether a car used for personal purposes is a "capital asset" within the definition of the term in section 2(14). According to this definition, "capital asset" excludes "personal effects", that is to say, "movable property (including wearing apparel and furniture, but excluding jewellery) held for personal use by the assessee or any member of his family depending upon him". There is no court decision on the question whether a car is a "personal effect" with reference to this definition. According to *Black's Law Dictionary*, "personal effects" means "articles associated with person as property having more or less intimate relation to person of possessor". The *Random House Dictionary of the English Language* gives the meaning as "privately owned articles consisting chiefly of clothing, toilet items, etc., for intimate use by an individual". The *Cyclopaedic Law Dictionary* interprets the word as such tangible property as is carried out about the person. According to *Words and Phrases*, the term designates articles associated with the person or such tangible property as is worn or carried out by the person. In *H.H. Maharani Rana Hemant Singhji v. CIT* [1976] 103 ITR 61, the Supreme Court observed that "the Legislature intended only those articles to be included in the definition which are intimately and commonly used by the assessee". Since the expression "personal effects" is imprecise and it has not been exhaustively defined in the Act, it may be taken to include conveyance. According to this opinion, there can be no tax on the capital gain resulting from the sale of a conveyance which has been taken to cover a scooter, a car and even an aeroplane. There are at least four judgments of courts in other Commonwealth countries, which lend support to the construction of "personal" or "household" effects including motor cars :

Australia - "I feel no difficulty about the word 'effects' being sufficient to cover a motor car, even apart from the authorities," — *Re. Tormey, Tormey v. Tormey* [1935] VLR 300. "If a horse-drawn carriage is a household effect"

Cost of imp

A few case studies

44. The following case studies are given to have better understanding of the mechanism of converting cost of acquisition/improvement into indexed cost of acquisition/improvement -

■ Case study 1 - X purchases a house property for Rs. 80,000 on June 30, 1995. The following expenses are incurred by him for making addition/alteration to the house property:

- Cost of construction of first floor in 1996-97 : Rs. 40,000
- Cost of construction of the second floor in 2012-13 : Rs. 1,50,000

Fair market value of the property on April 1, 2001 is Rs. 3,00,000. The house property is transferred by X on June 15, 2024 for Rs. 80,00,000 (expenses incurred on transfer : Rs. 10,000).

Computation of long-term capital gain -

Full value of consideration	80,00,000
Less:	
Indexed cost of acquisition [Note 1]	10,89,000
Indexed cost of improvement [Note 2]	2,27,250
Expenditure on transfer	10,500
Long-term capital gain [Note 3]	66,28,750

Notes -

1. Cost of acquisition or fair market value on April 1, 2001, whichever is higher : Rs. 3,00,000. Indexed cost of acquisition is Rs. 10,89,000 (i.e., Rs. 3,00,000 \times CII of 2024-25 : 363 \div CII of 2001-02 : 100).

2. Cost of construction of first floor is not taken into consideration (as the expenditure was incurred prior to April 1, 2001). Cost of construction of second floor of Rs. 1,50,000 shall be converted into indexed cost of improvement which comes to Rs. 2,27,250 (i.e., Rs. 1,50,000 \times CII of 2024-25 : 363 \div CII of 2012-13 : 200).

3. Long-term capital gain of Rs. 66,28,750 is chargeable to tax at the rate of 20% (+ SC + HEC) under section 112. Since the property is transferred before July 23, 2024, X does not satisfy conditions mentioned in para 186.1-3. He does not have any option to pay tax at the rate of 12.5% (without considering indexation benefit).

■ Case study 2 - X, a resident individual, purchases a house property on June 1, 1995 for Rs. 2,60,000. He dies in the year 2003-04 and property is inherited by Mrs. X. Mrs. X transfers the property on December 1, 2024 for Rs. 50,00,000. Fair market value of the property on April 1, 2001 is Rs. 6,00,000. Expenses on transfer incurred by Mrs. X is Rs. 1,00,000. Cost of improvement incurred by X during 2002-03 is Rs. 40,000. Likewise, improvement expenditure incurred by Mrs. X during 2017-18 is Rs. 1,40,000.

Computation of capital gain and tax liability - In the given case, capital asset is transferred after July 23, 2024. Generally, indexation benefit is not available if the transfer takes place on or after July 23, 2024. However, an exception is provided in section 112 [which is narrated in para 186.1-3] to pay tax at the rate of 20% (with indexation benefit) or 12.5% (without indexation). Tax liability of Mrs. X will be calculated as follows -

	Without indexation (tax rate 12.5%) Rs.	With indexation (tax rate 20%) Rs.
Full value of consideration	50,00,000	50,00,000
Less:		
Cost of acquisition (being cost to the previous owner or fair market value on April 1, 2001, whichever is higher)	6,00,000	-
Indexed cost of acquisition (Rs. 6,00,000 \times CII of 2024-25 : 363 \div CII of 2001-02 : 100)	-	21,78,000
Cost of improvement (Rs. 40,000 + Rs. 1,40,000)	1,80,000	-
Indexed cost of improvement (Rs. 40,000 \times CII of 2024-25 : 363 \div CII of 2002-03 when improvement took place : 105 + Rs. 1,40,000 \times CII of 2024-25 : 363 \div CII of 2017-18 : 272)	-	3,25,124
Expenses on transfer	1,00,000	1,00,000
Long-term capital gain	41,20,000	23,96,876
Tax on long-term capital gain at the rate of 12.5% of Rs. 41,20,000	5,15,000	-
Tax on long-term capital gain at the rate of 20% of Rs. 23,96,876	-	4,79,375

Tax liability is lower if indexation benefit is taken. Tax payable by Mrs. X is Rs. 4,79,375 (+ SC + HEC). As mentioned earlier, indexation benefit is not available if a capital asset is transferred on or after July 23, 2024 [except the case discussed in para 186.1-3].

■ *Case study 3 - In Case study 2, assume that X is a non-resident (or assume that X is a resident, but the capital asset is gold, not house property).*

Computation of capital gain and tax liability - Indexation benefit is not available if a capital asset is transferred on or after July 23, 2024 and the case does not fall within the parameters of exception discussed in para 186.1-3. If the transferor is a non-resident or if the capital asset which is transferred is not land/building, indexation benefit is not available. Consequently, capital gain and tax liability will be Rs. 41,20,000 and Rs. 5,15,000 (+ SC + HEC), respectively.

Computing indexed cost

Annex

Rs. 4,79,375 (+ SC + HEC). As transferred on or after July 23, 2024