CHAPTER 2

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME



LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** whether a particular income would constitute agricultural income or non-agricultural income;
- **compute** the tax on non-agricultural income by applying the concept of partial integration of agricultural income with non-agricultural income;
- **examine** the provisions of different schedules referred to in section 11;
- **analyse and apply** such provisions to determine whether a particular income would form/ would not form part of total income;
- **analyse and apply** the provisions of section 14 to determine the expenditure incurred in relation to income not includible in total income.

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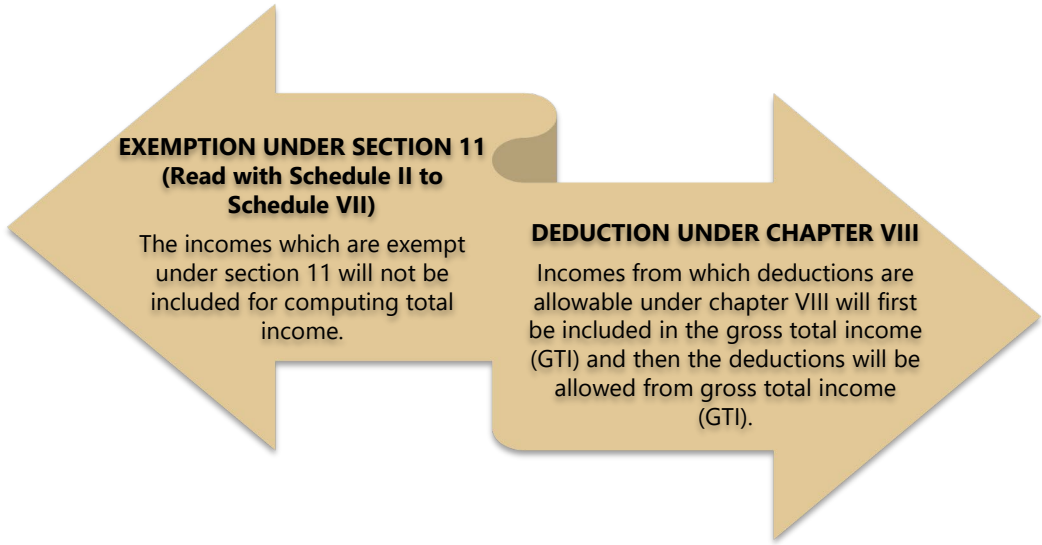
2.1 INTRODUCTION

Exemption under section 11 and the schedules thereunder *vis-a-vis* Deduction under Chapter VIII

The various items of income referred to in the Schedules mentioned under section 11 are excluded from the total income of an assessee, subject to the fulfilment of prescribed conditions. Such incomes are regarded as exempt incomes. Consequently, these incomes do not enter into the computation of taxable income.

Further, there are certain other incomes which are included in the Gross Total Income but are wholly or partly allowed as deductions under Chapter VIII of the Income-tax Act, 2025 while computing the Total Income.

Students should note an important distinction between **exemption under section 11 (read with Schedule II to Schedule VII)** and **deductions under Chapter VIII**, which is explained below.



Structure of Exemptions referred to in Section 11

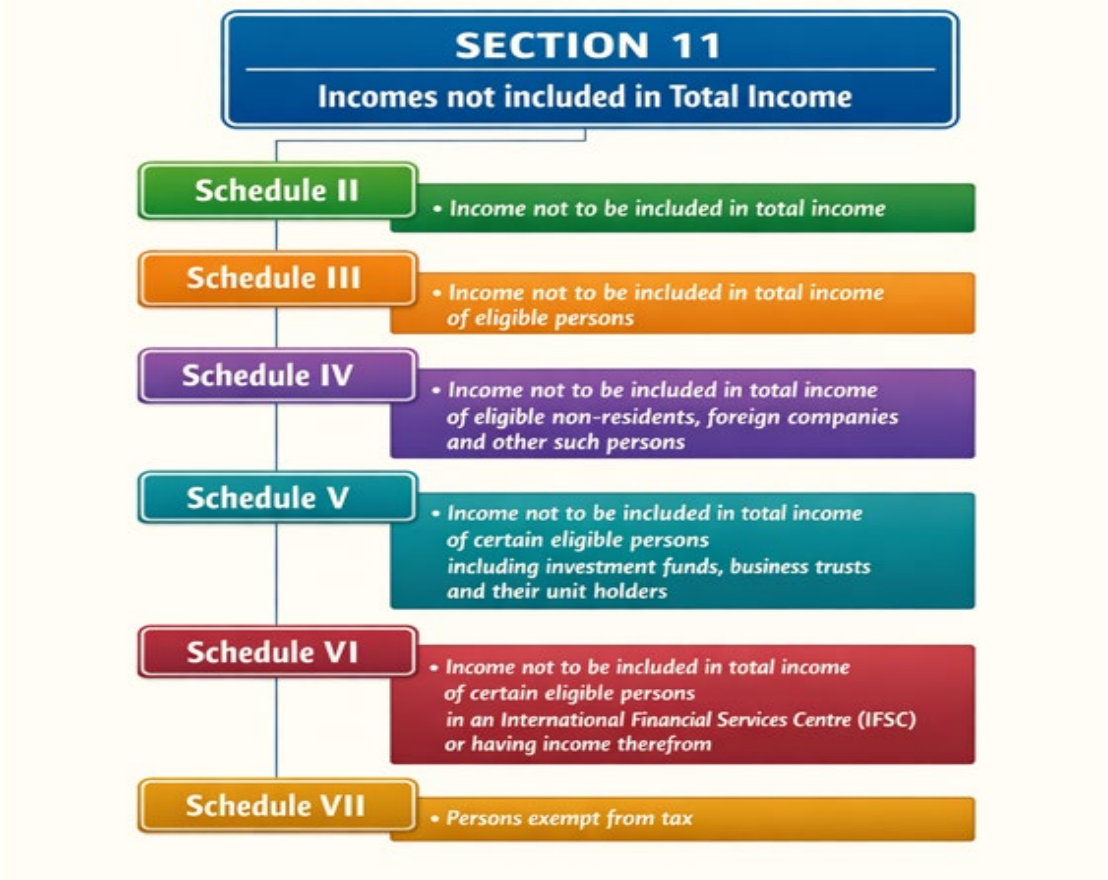
Section 11 provides a **framework of exemptions**, which are organised through **Schedules II to VII**.

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- Schedules II to VI specify types of income which are not included in total income, subject to fulfilment of prescribed conditions.
- Schedule VII, on the other hand, lists persons whose total income itself is exempt from tax, again subject to fulfilment of conditions.

Thus, the exemption framework under the Act operates in two ways:

1. Exemption of specific incomes (Schedules II to VI)
2. Exemption of specified persons (Schedule VII)



Exemptions which are discussed under the relevant chapters:

In this chapter, we are going to study the provisions of section 11 and schedules referred thereunder, which enumerate the various categories of income that are exempt from tax.

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Students may note that, in this chapter, only some of the exemptions are discussed. The remaining exemptions are being discussed in the respective chapters as shown hereunder[1]:

LIST OF EXEMPTIONS BEING DISCUSSED IN RESPECTIVE CHAPTERS

Capital Gains

- Receipts from LIP including ULIP [Schedule II, Table: Sl. No. 2]
- Capital gain on transfer of a unit of Unit Scheme [Schedule II, Table: Sl. No. 14]
- Capital gain on compulsory acquisition of agricultural land within specified urban limits [Schedule III, Table: Sl. No. 18)]
- Income received in transaction of reverse mortgage [Schedule III, Table: Sl. No. 35]
- Income on account of compulsory acquisition [Schedule III, Table: Sl. No. 38C]
- Capital gains from transfer of specified capital asset [[Schedule III, Table: Sl. No. 38D]

Income from Other Sources

- Receipts from LIC including ULIP [Schedule II, Table: Sl. No. 2]
- Interest income arising to certain persons [Schedule II Table Sl. No. 11,12,13 & 17]
- Educational scholarships [Schedule II, Table: Sl. No. 9]
- Family pension received by widow/ children/ nominated heirs of armed forces members [Schedule III, Table: Sl. No. 16]
- Gratuity to widow, children, or dependants on death of an employee [Schedule III, Table: Sl. No. 38]
- Interest on compensation awarded by Motor Accidents Claims Tribunal [Schedule III, Table: Sl. No. 38B]

Income of other Persons Included in Total Income of Assessee

- Exemption in respect of minor's income included in the hands of parent [Schedule III, Table: Sl. No. 17]

Deductions from Gross Total Income

- Payment from Sukanya Samriddhi Account [Schedule II, Table: Sl. No. 5]
- Payment from NPS Trust [Schedule II, Table: Sl. No. 6, 15 and 16]
- Payment from NPS Trust to an employee or an assessee, being the parent or guardian of a minor on partial withdrawal [Schedule III, Table: Sl. No. 4]
- Payment from Agnipath Corpus Fund to a person enrolled under the Agnipath Scheme or to his nominee [Schedule II, Table: Sl. No. 7]

Assessment of Registered Non-profit Organisations, Political Parties and other special entities

- Income of Securitisation trusts [Schedule III, Table: Sl. No. 26]
- Income of Investment Fund [Schedule V, Table: Sl. No. 1]
- Income of Unit holders of Investment Fund [Schedule V, Table: Sl. No. 2]
- Income of business trusts [Schedule V, Table: Sl. No. 3,4,5)]

[1] *The exemptions under schedule III in relation to Salaries have been dealt with in detail at the Intermediate level itself. The remaining exemptions are discussed in other chapters of this Study Material.*

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Non-resident Taxation

- Allowances or perquiste paid to an Indian citizen by the Government outside India [Schedule III, Table: Sl. No. 9]
- Interest on moneys standing to the credit of individual in his NRE account [Schedule IV, Table: Sl. No. 1]
- Remuneration received by individuals, who are not citizens of India [Schedule IV, Table: Sl. No. 2,3,4,5]
- Income arising to foreign companies from projects connected with the security of India [Schedule IV, Table: Sl. No. 6]
- Royalty income or fees for technical services arising to non-resident from National Technical Research Organisation (NTRO) [Schedule IV, Table: Sl. No. 7]
- Interest income arising to NR or RNOR [Schedule IV Table: Sl. No. 8]
- Income of a foreign company from lease rentals of cruise ships [Schedule IV, Table: Sl. No. 9]
- Income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Schedule IV, Table: Sl. No. 11]
- Income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India [Schedule IV, Table: Sl. No. 12]
- Income accruing or arising to a foreign company on account of sale of leftover stock of crude oil, if any, from the facility in India after the expiry of the agreement or the arrangement [Schedule IV, Table: Sl. No. 13]
- Certain specified income not to be included in total income [Schedule IV, Table: Sl. No. 13A, 13B & 13C]
- Interest income falling under section 10(15)(iiia)/(15)(iv)(fa)[Schedule IV, Table: Sl. No. 14]
- Income of a non-resident as a result of transfer of non-deliverable forward contracts/ offshore derivative instruments/ over the counter derivatives entered into with an offshore banking unit of an IFSC [Schedule VI, Table: Sl. No. 5]
- Income of a non-resident by way of royalty or interest, on account of lease of an aircraft or a ship in a tax year, paid by a unit of an IFSC [Schedule VI, Table: Sl. No. 6]
- Income of a non-resident from portfolio of securities etc. in an account maintained with an offshore banking unit in any IFSC [Schedule VI, Table: Sl. No. 7]
- Income received by a non-resident or a Unit of an IFSC [Schedule VI, Table: Sl. No. 8]
- Income accruing or arisiing to or received by a unit holder from a specified fund or on transfer of units in a specified fund [Schedule VI, Table: Sl. No. 9]
- Any income of a unit of IFSC primarily engaged in the business of leasing of an aircraft or a ship, by way of dividends from a company being a unit of any IFSC primarily engaged in the business of leasing of an aircraft or a ship [Schedule VI, Table: Sl. No. 11]
- Interest income to a NR from a unit in IFSC [Schedule VI, Table: Sl. No. 12]

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2.2 INCOMES NOT INCLUDED IN TOTAL INCOME [SECTION 11]

Let us now look at the various incomes that are exempt from tax and the conditions that must be met to be eligible for exemption.

(1) Agricultural Income [Schedule II, Table: Sl. No. 1]

Schedule II, Table: Sl. No. 1 provides that agricultural income is not to be included in the total income of the assessee. The reason for the total exemption of agricultural income from the scope of central income-tax is that under the Constitution, the Central Government has no power to levy a tax on agricultural income.

Definition of agricultural income [Section 2(5)]

This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

The term **"agricultural income"** means the following:

(i) Rent or Revenue from Agricultural Land [Section 2(5)(a)]

Any **rent or revenue derived from land** which—

- is **situated in India**, and
- is **used for agricultural purposes**.

(ii) Income Derived from Agricultural Land [Section 2(5)(b)]

Any income derived from such land by:

(a) **Agricultural Operations** - Income derived from **agriculture carried out on such land**.

(b) **Agricultural Processing** -Income derived from the **performance of any process ordinarily employed by a cultivator or receiver of rent-in-kind** to render the produce raised or received **fit to be taken to market**.

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(c) Sale of Agricultural Produce - Income from **sale of agricultural produce raised or received**, where no process other than the process mentioned above has been carried out.

(iii) Income from Farm Buildings [Section 2(5)(c)]

Income derived from a **building owned and occupied by the receiver of rent or revenue of such land**, or by the **cultivator or receiver of rent-in-kind**, provided the following conditions are satisfied:

Conditions:

- The building is **on or in the immediate vicinity of such agricultural land**, and
- The land is either:
  - assessed to land revenue in India, or
  - subject to a local rate collected by Government authorities, or
  - where not so assessed, not situated in urban areas specified under section 2(22)(iii)(A) or (B)); **and**
- The building is **required as a dwelling house, storehouse, or other out-building** by the receiver of rent or revenue of such land, or by the cultivator or receiver of rent-in-kind because of his connection with the land.

(iv) Income from Nursery [Section 2(5)(d)]

Any income derived from saplings or seedlings grown in a nursery.

Incomes Not Treated as Agricultural Income

The term **"agricultural income" does not include**:

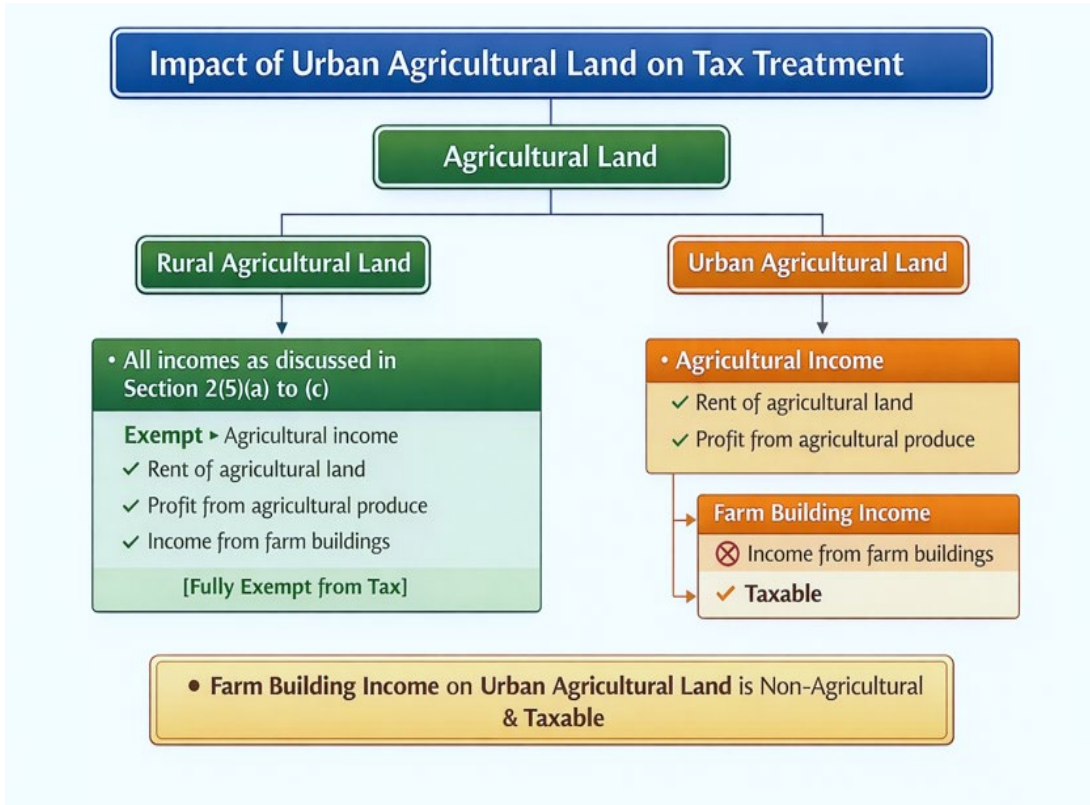
1. Income from buildings or land used for non-agricultural purposes, such as letting for residential use or for business or profession.
2. Income arising from transfer of urban agricultural land referred to in section 2(22)(iii)(A) or (B).

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Limits defined under section 2(22)(iii)(A)/B are discussed in detail later in the chapter – Income from a building used in agricultural operations will qualify as agricultural income only if the land is not situated in urban areas referred to in Section 2(22)(iii)(A)/(B).

Therefore:

Situation	Treatment
Building on rural agricultural land	Agricultural income
Building on urban agricultural land	Not agricultural income



Now let us take a critical look at the following aspects:

(A) Rent or revenue derived from land situated in India and used for agricultural purposes: The following three conditions have to be satisfied for income to be treated as agricultural income:

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(a) Rent or revenue should be derived from land;

(b) Land has to be situated in India (If agricultural land is situated in a foreign country, the entire income would be taxable); and

(c) land should be used for agricultural purposes.

The amount received in money or in kind, by one person from another for right to use land is termed as **Rent.** The rent can either be received by the owner of the land or by the original tenant from the sub-tenant. It implies that ownership of land is not necessary. Thus, the rent received by the original tenant from sub-tenant would also be agricultural income subject to the other conditions mentioned above.

The scope of the term "**Revenue"** is much broader than rent. It includes income other than rent. For example, fees received for renewal for grant of land on lease would be revenue derived from land.

(B) Income derived from such land by

(i) Agriculture: The term "Agriculture" has not been defined in the Act. However, cultivation of a field involving human skill and labour on the land can be broadly termed as **agriculture**.

"Agriculture" means tilling of the land, sowing of the seeds and similar operations. It involves basic operations and subsequent operations.

Basic Operations

- Those operations by agriculturists which are absolutely necessary for the purpose of effectively raising produce from the land are the basic operations.

Subsequent Operations

- Operations to be performed after the produce of sprouts from the land (e.g., weeding, digging etc.) are subsequent operations. These subsequent operations would be agricultural operations only when taken in conjunction with and as a continuation of the basic operations.

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"Agriculture" comprises within its scope the basic as well as the subsidiary operations regardless of the nature of the produce raised on the land.

These produce may be grain, fruits or vegetables necessary for *sustenance* of human beings, including plantation and groves or grass or pasture for the consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco or commercial crops like cotton flax, jute hemp and indigo.

The term comprises of products of land having some utility either for consumption or for trade and commerce, and would include forest products such as sal, tendu leaves etc.

Note: The term 'agriculture' cannot be extended to all activities which have some distant relation to land like dairy farming, breeding and rearing of live stock, butter and cheese making and poultry farming.

(ii) Process ordinarily employed to render the produce fit to be taken to the market: Sometimes, to make the agricultural produce a saleable commodity, it becomes necessary to perform some kind of process on the produce. The income from the process employed to render the produce fit to be taken to the market would be agricultural income. However, it must be a process ordinarily employed by the cultivator or receiver of rent in kind and the process must be applied to make the produce fit to be taken to the market.

The ordinary process employed to render the produce fit to be taken to the market includes thrashing, winnowing, cleaning, drying, crushing, etc.



Process ordinarily employed by the cultivator to obtain the rice from paddy is to first remove the hay from the basic grain, and thereafter to remove the chaff from the grain. The grain has to be properly filtered to remove stones etc. and finally the rice has to be packed in gunny bags for sale in the market.

After such a process, the rice can be taken to the market for sale. This process of making the rice ready for the market may involve manual

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operations or mechanical operations. All these operations constitute the process ordinarily employed to make the product fit for the market. The produce must retain its original character in spite of the processing unless there is no market for selling it in that condition.

However, if marketing process is performed on a produce which can be sold in its raw form, income derived therefrom is partly agricultural income and partly business income.

(iii) Sale of such agricultural produce in the market: Any income from the sale of any produce to the cultivator or receiver of rent-in kind is agricultural income provided it is from the land situated in India and used for agricultural purposes.

However, if the produce is subjected to any process other than process ordinarily employed to make the produce fit for market, the income arising on the sale of such produce would be partly agricultural and partly non-agricultural income.

Similarly, if other agricultural produce like tea, cotton, tobacco, sugarcane, etc. are subjected to manufacturing process and the manufactured product is sold, the profit on such sale will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be exempted.

Apportionment of Income between business income and agricultural income

Rules 270 and 271 of Income-tax Rules, 2026 provide the basis of apportionment of income between agricultural income and business income.

Rule 270 - Determination of income, being partly from agricultural and partly from business

Where income is partially agricultural income and partially business income, the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind would be allowed as deduction, if

- such agricultural produce has been utilised as raw material in such business or

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- sale receipts of such agricultural produce are included in the accounts of the business.

  No further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

Determination of market value - There are two possibilities here:

(i) **Where agricultural produce is ordinarily sold in the market in its raw stage -** The agricultural produce is capable of being sold in the market either in its raw stage or after application of any ordinary process to make it fit to be taken to the market.

In such a case, the value calculated at the average price at which it has been so sold during the relevant tax year will be the market value.

(ii) **Where produce is not ordinarily sold in the market -** It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following -

- The expenses of cultivation;
- The land revenue or rent paid for the area in which it was grown; and
- Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

ILLUSTRATION 1

Mr. Amar grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 40% of sugarcane produce is sold for ₹ 12 lakhs, and the cost of cultivation of such sugarcane is ₹ 6 lakhs. The cost of cultivation of the balance sugarcane (60%) is ₹ 15 lakhs and the market value of the same is ₹ 25 lakhs. After incurring ₹ 1.5 lakhs in the manufacturing process on the balance sugarcane, the sugar was sold for ₹ 30 lakhs. Compute Amar's business income and agricultural income.

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SOLUTION

Computation of Business Income and Agriculture Income of Mr. Amar

Particulars	Business Income	Agricultural Income	
	(₹)	(₹)	(₹)
Sale of Sugar			
Business income			
Sale Proceeds of sugar	30,00,000		
Less: Market value of sugar (60%)	25,00,000		
Less: Manufacturing exp.	1,50,000		
	3,50,000		
Agricultural income			
Market value of sugarcane (60%)		25,00,000	
Less: Cost of cultivation		15,00,000	
			10,00,000
Sale of sugarcane			
Agricultural Income			
Sale proceeds of sugarcane (40%)		12,00,000	
Less: Cost of cultivation		6,00,000	
			6,00,000
			16,00,000

Rule 271 – Income from Manufacture of Rubber, Coffee and Tea

Certain activities involving the cultivation and production of agricultural produce of rubber, coffee and tea mostly result in composite income (i.e., partly agricultural and partly business).

In such cases, the **entire income is first computed as business income**, and thereafter **only a prescribed percentage is treated as taxable business income**, while the remaining portion is treated as **agricultural income**. Accordingly, income from manufacturing of rubber, coffee and tea shall be apportioned as agricultural income and business income in the following manner:

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Sl. No.	Nature of Income	Agricultural Income	Business Income
1.	Income from sale of rubber products derived from rubber plant grown by the seller in India*	65%	35%
2.	Income from sale of coffee		
	- grown and cured by the seller in India	75%	25%
	- grown, cured, roasted and grounded by the seller in India with or without mixing chicory or other flavoring ingredients	60%	40%
3.	Income from sale of tea grown and manufactured by the seller in India	60%	40%

* Income from sale of centrifuged latex, cenex, latex-based crepes (e.g., pale latex crepe), brown crepes (estate brown crepe, remilled crepe, smoked blanket crepe, flat bark crepe), or technically specified block rubbers, manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India

ILLUSTRATION 2

Mr. Nilesh manufactures latex from the rubber plants grown by him in India. These are then sold in the market for ₹ 36 lakhs. The cost of growing rubber plants is ₹ 16 lakhs and that of manufacturing latex is ₹ 12 lakhs. Compute his total income.

SOLUTION

The total income of Mr. Nilesh comprises of agricultural income and business income.

Total profits from the sale of latex = ₹ 36 lakhs – ₹ 16 lakhs – ₹ 12 lakhs = ₹ 8 lakhs.

Agricultural income = 65% of ₹ 8 lakhs = ₹ 5.2 lakhs

Business income = 35% of ₹ 8 lakhs = ₹ 2.8 lakhs

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(C) Income from farm building – As we now know that the income from a building used in agricultural operations subject to other conditions discussed above will qualify as agricultural income if the building:



- is on or near (immediate vicinity of) the agricultural land, and
- the land must:
  - either be assessed to land revenue in India, or be subject to local tax collected by Government officers, or
  - if not so assessed, it should be in a rural area (i.e., not in areas specified in section 2(22)(iii)(A) or (B) or can be referred as urban area).

When is Agricultural Land treated as Situated in Urban Areas?

Agricultural land is considered as **urban** if it satisfies **any one** of the following conditions:

1. Land situated within Municipality / Cantonment [Section 2(22)(iii)(A)]

- The land is located **within the limits** of:
  - a municipality (municipal corporation, town committee, etc.), or
  - a cantonment board,
- AND the population of that area is **10,000 or more.**

2. Land near Municipality (Aerial Distance Rule) [Section 2(22)(iii)(B)]

Even if the land is outside municipal limits, it is still **urban** if it lies within the following distance:

Population of Municipality or cantonment board	Within distance, measured aerially, from local limits of any municipality or cantonment board not being more than
>10,000 and upto 1,00,000	2 km
>1,00,000 and upto 10,00,000	6 km
> 10,00,000	8 km

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Example:

	Area	Aerial Distance, from local limits of any municipality or cantonment board referred to in item a.	Population of Municipality or cantonment board	Whether Urban land or not?	Would income derived from farm building situated in this area be treated as agricultural income?
(i)	A	1 km	9,000	No	Yes
(ii)	B	1.5 kms	12,000	Yes	No
(iii)	C	2 kms	11,00,000	Yes	No
(iv)	D	3 kms	80,000	No	Yes
(v)	E	4 kms	3,00,000	Yes	No
(v)	F	5 kms	12,00,000	Yes	No
(vi)	G	6 kms	8,000	No	Yes
(vii)	H	7 kms	4,00,000	No	Yes
(viii)	I	8 kms	10,50,000	Yes	No
(ix)	J	9 kms	15,00,000	No	Yes

Would income arising from transfer of agricultural land situated in urban area be agricultural income?

No, as per section 2(5), the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under Schedule II, Table: Sl. No. 1 but will be taxable under section 67.



Suppose Bittoo sells agricultural land situated in New Delhi for ₹ 10 lakhs and makes a surplus of ₹ 8 lakhs over its cost of acquisition. This surplus will not constitute agricultural income exempt under Schedule II, Table: Sl. No. 1 *and will be taxable under section 67.*

Indirect connection with land

We have seen above that agricultural income is exempt, whether it is received by the tiller or the landlord. However, non-agricultural income does not become

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agricultural merely on account of its indirect connection with the land. The following examples will illustrate the above point.



A rural society has as its principal business the selling on behalf of its member societies, butter made by these societies from cream sold to them by farmers. The making of butter was a factory process separated from the farm.

The butter resulting from the factory operations separated from the farm was not an agricultural product and the society was, therefore, not entitled to exemption under Schedule II, Table: Sl. No. 1 in respect of such income.



X was the managing agent of a company. He was entitled for a commission at the rate of 10% p.a. on the annual net profits of the company. A part of the company's income was agricultural income. X claimed that since his remuneration was calculated with reference to the income of the company, part of which was agricultural income, such part of the commission as was proportionate to the agricultural income was exempt from income tax.

Since, X received remuneration under a contract for agency service calculated on the amount of profits earned by the company, such remuneration does not constitute agricultural income.



Y owned 100 acres of agricultural land, a part of which was used as pasture for cows. The lands were purely maintained for manuring and other purposes connected with agriculture and only the surplus milk after satisfying the assessee's needs was sold. The question arose whether income from such sale of milk was agricultural income.

The regularity with which the sales of milk were effected and quantity of milk sold showed that the assessee carried on regular business of producing milk and selling it as a commercial proposition. Hence, it was not agricultural income.



In regard to forest trees of spontaneous growth which grow on the soil unaided by any human skill and labour there is no cultivation of the soil at all. Even though operations in the nature of forestry operations performed by the assessee may have the effect of nursing and fostering the growth of such forest trees, it cannot constitute agricultural operations.

Income from the sale of such forest trees of spontaneous growth does not, therefore, constitute agricultural income.

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Examples of Agricultural income and non-agricultural income

For better understanding of the concept, certain examples of agricultural income and non-agricultural income are given below:

Agricultural income

- *Income derived from saplings or seedlings grown in a nursery.*
- *Income from growing of flowers and creepers.*
- *Rent received from land used for grazing of cattle required for agricultural activities.*
- *Income from growing of bamboo.*

Non-agricultural income

- *Income from breeding of livestock.*
- *Income from poultry farming.*
- *Income from fisheries.*
- *Income from dairy farming.*

ILLUSTRATION 3

Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, ₹ 5 lakhs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under Schedule II, Table: Sl. No. 1. He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income.

SOLUTION

The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations on the land. The amount paid was only for shooting of a film on such land.

To claim exemption in respect of agricultural income under Schedule II, Table: Sl. No.1, the conditions contained in section 2(5)(a) to (d) have to be first complied

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with/ fulfilled by the assessee. The Madras High Court in the case of *B. Nagi Reddi v. CIT (2002) 258 ITR 719,* following the judgment of Apex Court in the case of *CIT v Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466,* has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

Partial integration of agricultural income with non-agricultural income

As in the above discussion, we have seen that agricultural income is exempt subject to conditions mentioned in the definition clause of section 2(5). However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as **partial integration of agricultural income with non-agricultural income.** It is applicable to individuals, HUF, AOPs, BOIs and artificial juridical persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed ₹ 5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax

Tax Regime	Basic Exemption Limit
Default Tax Regime u/s 202(1)	₹ 4,00,000
Optional Tax Regime	
- for resident individuals of the age of 80 years or more at any time during the tax year	₹ 5,00,000
- for resident individuals of the age of 60 years or more (but less than 80 years) at any time during the tax year	₹ 3,00,000
- for all others	₹ 2,50,000

It may be noted that aggregation provisions do not apply to company, LLP, firm, co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

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Tax calculation in such cases is as follows:

Zn = Xn – Yn	
Zn	Income-tax chargeable
Xn	Amount of income-tax determined in respect of the Aggregate Income (AIn) as if such AIn were the total income [**Note -** Tax shall be computed as per the rates specified under default tax regime u/s 202(1) or optional tax regime, as the case may be]
Yn	Amount of income-tax determined in respect of the net agricultural income increased by applicable basic exemption limit, as if the net agricultural income as so increased were the total income
Aggregate Income (AIn)	Total income + Net agricultural income.
The sum **(Zn)** so arrived at shall be – ✓ increased by surcharge, if applicable, ✓ reduced by the rebate, if any, available u/s 156.	
Thereafter, it would be increased by health and education cess @4%.	

The above concept can be clearly understood with the help of the following illustration:

ILLUSTRATION 4

Mr. X, a resident, has provided the following particulars of his income for the tax year 2026-27.

i. Income from salary (computed) - ₹ 11,50,000

ii. Income from house property (computed) - ₹ 3,80,000

iii. Agricultural income from a land in Assam - ₹ 4,50,000

iv. Expenses incurred for earning agricultural income - ₹ 1,60,000

Compute his tax liability for tax year 2026-27, assuming his age is -

(a) 40 years

(b) 75 years

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SOLUTION

(a) Computation of tax liability (age 40 years)

Computation of the total income of Mr. X for the T.Y. 2026-27 under the default tax regime under section 202(1)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit under default regime i.e. ₹ 4,00,000.

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		11,50,000
Income from house property		3,80,000
Net agricultural income [₹ 4,50,000 (-) ₹ 1,60,000]	2,90,000	
Less: Exempt under Schedule II, Table: Sl. No.1	(2,90,000)	-
Gross Total Income		15,30,000
Less: Deductions under Chapter VIII		-
Total Income		15,30,000
Income-tax [Refer Note Below]		1,49,500
Add: Health and Education Cess @4%		5,980
Tax Liability		1,55,480

Note -

Income tax	**Zn = Xn – Yn** ₹ 1,49,500 = ₹ 1,64,000 – ₹ 14,500
Xn	Tax on Aggregate Income (AIn) i.e., Total Income + Net agricultural income (Ain) = ₹ 18,20,000 (₹ 15,30,000 + ₹ 2,90,000) Tax on ₹ 18,20,000 = ₹ 1,64,000 (i.e., 5% of ₹ 4,00,000 *plus* 10% of ₹ 4,00,000 *plus* 15% of ₹ 4,00,000 *plus* 20% of ₹ 2,20,000)

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Yn	Tax on (net agricultural income + basic exemption limit) = ₹ 6,90,000 (₹ 2,90,000, net agriculture income + ₹ 4,00,000, Basic Exemption Limit) Tax on ₹ 6,90,000 = ₹ 14,500 (i.e. 5% of ₹ 2,90,000)

Computation of total income of Mr. X for the T.Y. 2026-27 under normal provisions of the Act

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions, i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit under normal provisions i.e., ₹ 2,50,000.

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		11,50,000
Income from house property		3,80,000
Net agricultural income [₹ 4,50,000 (-) ₹ 1,60,000]	2,90,000	
Less: Exempt under Schedule II, Table: Sl. No.1	(2,90,000)	-
Gross Total Income		15,30,000
Less: Deductions under Chapter VIII		-
Total Income		15,30,000
Income-tax [Refer Note Below]		3,38,000
Add: Health and Education Cess @4%		13,520
Tax Liability		3,51,520

Note -

Income tax	**Zn = Xn – Yn** ₹ 3,38,000 = ₹ 3,58,500 – ₹ 20,500
Xn	Tax on Aggregate Income (AIn) i.e., Total Income + Net agricultural income AIn = ₹ 18,20,000 (₹ 15,30,000 + ₹ 2,90,000) Tax on ₹ 18,20,000 = ₹ 3,58,500 (i.e., 5% of ₹ 2,50,000 *plus* 20% of ₹ 5,00,000 plus 30% of ₹ 8,20,000)

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Yn	Tax on (net agricultural income + basic exemption limit) = ₹ 5,40,000 (₹ 2,90,000, net agriculture income + ₹ 2,50,000, Basic Exemption Limit) Tax on ₹ 5,40,000 = ₹ 20,500 (i.e. 5% of ₹ 2,50,000 *plus* 20% of ₹ 40,000)

(b) Computation of tax liability (age 75 years)

Computation of total income of Mr. X for the T.Y. 2026-27

under the default tax regime under section 202

Tax liability of Mr. X would be the same under the default tax regime, whether he is of age of 40 years of 75 years i.e., ₹ 1,55,480.

Computation of total income of Mr. X for the T.Y. 2026-27
under normal provisions of the Act

His tax liability is computed in the following manner:

Particulars	Amount (₹)
Income-tax [Refer Note Below]	3,28,000
Add: Health and Education Cess @4%	13,120
Tax Liability	**3,41,120**

Note -

Income tax	**Zn = Xn – Yn** ₹ 3,28,000 = ₹ 3,56,000 – ₹ 28,000
Xn	Tax on Aggregate Income (AIn) i.e., Total Income + Net agricultural income = ₹ 18,20,000 (₹ 15,30,000 + ₹ 2,90,000) Tax on ₹ 18,20,000 = ₹ 3,56,000 (i.e. 5% of ₹ 2,00,000 plus 20% of 5,00,000 plus 30% of 8,20,000)
Yn	Tax on (net agricultural income + basic exemption limit) = ₹ 5,90,000 (₹ 2,90,000, net agriculture income + ₹ 3,00,000, Basic Exemption Limit) Tax on ₹ 5,90,000 = ₹ 28,000 (i.e. 5% of ₹ 2,00,000 plus 20% of ₹ 90,000)

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(2) Awards in cash or in kind by the Government [Schedule II, Table: Sl. No. 10]

Any payment, whether in cash or in kind for any award or reward -

- in pursuance of any award instituted in the public interest by the Central/ State Government or any body and approved by the Central Government or
- as a reward by Central/ State Government for such purposes as may be approved by the Central Government in public interest,

would be exempt.

(3) Amounts received by a member from the income of the HUF [Schedule III, Table: Sl. No. 1]

(i) As explained in Chapter 1, a HUF is a 'person' and hence, a unit of assessment under the Act. Income earned by the HUF is assessable in its own hands.

(ii) In order to prevent double taxation of one and the same income, once in the hands of the HUF which earns it and again in the hands of a member when it is paid out to him, Schedule III, Table: Sl. No. 1 provides that members of a HUF do not have to pay tax in respect of any amounts received by them from the family.

(iii) The exemption applies only in respect of a payment made by the HUF to its member

(a) out of the income of the family or

(b) out of the income of the impartible estate belonging to the family.

(4) Share income of a partner [Schedule III, Table: Sl. No. 2]

Schedule III, Table: Sl. No. 2 exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

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Taxability of partner's share, where the income of the firm is exempt under Chapter III/ deductible under Chapter VIII [Circular No. 8/2014 dated 31.03.2014]

Schedule III, Table: Sl. No. 2 provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.

An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VIII

The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.

(5) Compensation received on account of disaster [Schedule III, Table: Sl. No. 3]

(i) Schedule III, Table: Sl. No. 3 exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster.

(ii) Such compensation should be granted by the Central Government or a State Government or a local authority.

(iii) However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.

(iv) "Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing -

(a) substantial loss of life or human suffering; or

(b) damage to, and destruction of, property; or

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(c) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

ILLUSTRATION 5

An amount of ₹ 5 lakhs was paid on 17.3.2027 to the parents of Amit by the Government of Chattisgarh as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Examine with reasons, whether the amount of compensation received is chargeable to tax in T.Y. 2026-27.

SOLUTION

As per Note 1 to Schedule III, the meaning of "disaster" shall be derived from Disaster Management Act, 2005 which defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment. It should be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.

If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then, the same will be exempt from tax. Accordingly, the amount of ₹ 5 lakhs received by the parents of deceased Amit from the Government of Chattisgarh for the disaster because of Dantewada bus bomb blast is exempt under Schedule III, Table: Sl. No. 3.

(6) Payments to MPs & MLAs [Schedule III, Table: Sl. No. 5,6,7]

The following incomes of Members of Parliament or State Legislatures will be exempt:

(i) **Daily Allowance -** Daily allowance received by any Member of Parliament or of State Legislatures or any Committee thereof. [Schedule III, Table: Sl. No. 5]

(ii) **Any Allowance of MPs -** In the case of a Member of Parliament, any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986 [Schedule III, Table: Sl. No. 6] and

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(iii) **Constituency allowance of MLAs -** Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature. [Schedule III, Table: Sl. No. 7]

(7) Pension received by recipient of gallantry awards [Schedule III, Table: Sl. No. 14, 15 & 38A]

(i) **Exemption of Pension [Sl. No. 14] -** Any income by way of pension received by an individual is exempt from income-tax if -

(a) such individual was an employee of Central or State Government and

(b) has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award notified by the Central Government in this behalf.

(ii) **Exemption of Family Pension [Sl. No. 15.] -** In case of the death of such individual referred in Sl. No. 14 above, any income by way of family pension received by any member of the family of the individual shall also be exempt under this clause.

(iii) **Exemption of Disability Pension [Sl. No. 38A] –** Disability pension received (including service element and disability element) by an individual who has been a member of the armed forces (including paramilitary forces) of the Union would be exempt if **-**

- the individual has been invalided out of such service in the armed forces on account of bodily disability attributable to or aggravated by such service and
- the individual has not retired on superannuation or otherwise

Meaning of Family

Family, in relation to an individual, means –

- the spouse and children of the individual; and
- the parents, brothers and sisters of the individuals or any of them wholly or mainly dependent on the individual.

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(8) Income of member of a scheduled tribe [Schedule III, Table: Sl. No. 19]

Any income which accrues or arises -

(a) from any source in the areas or States mentioned below or

(b) by way of dividend or interest on securities

in the hands of a member of a Scheduled Tribe residing in -

(i) any area specified in Part I or II of the Table appended to paragraph 20 of the Sixth Schedule to the Constitution or

(ii) the States of Arunachal Pradesh, Manipur, Mizoram, Nagaland and Tripura or

(iii) areas covered by notification No. TAD/R/35/50/109, dated the 23rd February, 1951, issued by the Governor of Assam under the proviso to the said paragraph 20(3) [as it stood immediately before the commencement the North-Eastern Areas (Reorganisation) Act, 1971] or

(iv) in the Union territory of Ladakh

is exempt from tax.

(9) Specified income of a Sikkimese Individual [Schedule III, Table: Sl. No. 20]

The following income, which accrues or arises to a Sikkimese individual, would be exempt from income-tax –

(a) income from any source in the State of Sikkim; or

(b) income by way of dividend or interest on securities.

(10) Tea board subsidy [Schedule III, Table: Sl. No. 21]

The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea, rubber, coffee, cardamom or such other commodity in India as may be notified by the Central Government through or from the Concerned Board under a scheme will be wholly exempt from tax.

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Conditions:

(i) The subsidy is received under a scheme for replantation or replacement of—

- tea bushes,
- rubber plants,
- coffee plants,
- cardamom plants, or
- plants for growing any other notified commodity;

or for rejuvenation or consolidation of areas used for cultivation of such commodities

(ii) The scheme is notified by the Central Government.

The assessee furnishes a certificate from the concerned Board to the Assessing Officer stating the amount of subsidy paid during the tax year, along with the return of income, or within such further time as the Assessing Officer may allow.

(11) Income of local authorities [Schedule III, Table: Sl. No. 22]

(i) **Exempt income -** Following income arising to a local authority would be exempt

- Income under the head house property; or
- Income from Capital gains; or
- Income from Other Sources; or
- Income from trade or business carried on by it which accrues or arises from the supply of
  - ✓ commodity or service under its jurisdictional area
  - ✓ water or electricity within or outside its own jurisdictional area.

(ii) **Meaning of Local Authority [Note 6 to Schedule III] -** Local authority means the following:

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(a) Panchayat

(b) Municipality

(c) Municipal Committee and District Board legally entitled to, or entrusted by the Government with the control or management of a Municipal or local Fund

(d) Cantonment Board

(12) Income of certain universities or hospitals or institutions [Schedule VII, Table: Sl. Nos. 17, 18 & 19]

The following persons shall **not be liable to pay income-tax on their total income for any tax year**, subject to fulfilment of the prescribed conditions-

Sl. No.	Eligible persons	Conditions
17	Any University or other educational institution **wholly or substantially financed by the Government.**	(a) It exists solely for educational purposes and not for purposes of profit; and (b) If the Government grant to such University or other educational institution exceeds such percentage of the total receipts including any donations, as may be prescribed, of such University or other educational institution, it shall be considered as being substantially financed by the Government during the relevant tax year.
18	Any hospital or other institution **wholly or substantially financed by the Government**.	(a) It is for the reception and treatment of persons suffering from illness or mental defectiveness, or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation. (b) it exists solely for philanthropic purposes and not for the purposes of profit; and (c) if the Government grant to such hospital or other institution exceeds such percentage of the total receipts including any donations, as may be prescribed, of such hospital or other

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		institution, it shall be considered as being substantially financed by the Government during the relevant tax year.
19	(a) Any University or other educational institution ; (b) any hospital or other institution.	(a) Such University or other educational institution exists solely for educational purposes and not for the purposes of profit; (b) such hospital or other institution is for the reception and treatment of persons suffering from illness or mental defectiveness, or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation; (c) such hospital or other institution exists solely for philanthropic purposes and not for the purposes of profit; and (d) the **aggregate** of annual receipts of such University or Universities or educational institution or institutions, and hospital or hospitals or institution or institutions, **does not exceed five crore rupees** (e) where such University or other educational institution or such hospital or other institution receives any anonymous donation defined under section 355(a), the provisions of section 337 (Table: Sl. No. 1) in respect of specified income shall apply ***mutatis mutandis*** as they apply in the case of a registered non-profit organisation and such anonymous donations shall be excluded from the income on which no tax is payable.

Students should carefully note that all the items under section 11 and its schedules listed above are either wholly or partially exempt from taxation and the exempt portion is not even includible in the total income of the person concerned.

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2.3 RESTRICTIONS ON ALLOWABILITY OF EXPENDITURE [SECTION 14 READ WITH RULE 14]

Section 14 provides that **expenditure incurred in relation to income which does not form part of total income shall not be allowed as a deduction** while computing the total income under the Act.

1. Basic Principle

As per section 14(1), irrespective of anything to the contrary contained in the Act, for the purpose of computing total income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income.

Thus, expenses attributable to exempt income **cannot be claimed as deduction against taxable income**.

2. Power of the Assessing Officer

Under section 14(2), the Assessing Officer may determine the amount of expenditure incurred in relation to such exempt income in accordance with the prescribed method, where he is not satisfied with -

- the correctness of the claim of expenditure incurred by the assessee, or
- the claim of the assessee that no expenditure has been incurred in relation to exempt income.

Such determination must be made having regard to the accounts of the assessee.

3. Applicability even if Exempt Income is not Earned

As per section 14(3), the disallowance shall apply even where expenditure has been incurred in relation to income which does not form part of total income, but -

- such income has not accrued or arisen, or
- has not been received during that tax year.

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Thus, disallowance may arise even if exempt income is not actually earned during the year.

Method for Determining Expenditure relating to Exempt Income [Rule 14]

Where the Assessing Officer applies section 14(2), the amount of expenditure in relation to exempt income shall be computed as the **aggregate of the following**:

(i) **Direct Expenditure** - the amount of expenditure directly relating to income which does not form part of total income;

(ii) **Indirect Expenditure** - an amount equal to 1% of the annual average of the monthly averages of the opening and closing balances of the value of investments, income from which does not form part of total income.

Maximum Limit of Disallowance -However, the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.

For example, if an assessee holds tax-free bonds, then interest incurred to earn such exempt income cannot be allowed as a deduction while computing taxable income.



CIT v. Kribhco (2012) 349 ITR 0618 (Delhi)

Issue: Is section 14 applicable in respect of deductions, which are permissible and allowed under Chapter VIII?

Analysis & Decision: Deductions under Chapter VIII are different from the exclusions/exemptions provided under Chapter III. Section 14 is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 2025. Therefore, **no disallowance can be made u/s 14 in respect of income included in total income in respect of which deduction is allowable under Chapter VIII.**

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TEST YOUR KNOWLEDGE

Questions

1. *Examine with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the tax year 2026-27:*

   (i) Rent of ₹ 60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes. The tenants, working in the nearby industrial area, occupy these houses for their own residential purposes.

   (ii) Income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.

   (iii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of ₹ 2,25,000 from the business located in Sikkim and interest of ₹ 55,000 on the securities/bonds issued by the Government of Rajasthan.

2. *Mr. Akash, a resident Indian, earns income of ₹ 22 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in India and ₹ 30 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia during the T.Y.2026-27. What would be his business income, assuming he has no other business?*

3. *Mr. Ram, a resident Indian, earns income of ₹ 15 lakhs from sale of coffee grown and cured in India during the T.Y.2026-27. His friend, Mr. Shyam, a resident Indian, earns income of ₹ 25 lakhs from sale of coffee grown, cured, roasted and grounded by him in India during the T.Y.2026-27. What would be the business income chargeable to tax in India of Mr. Ram and Mr. Shyam?*

Answers

1. **(i)** As per Schedule II, Table: Sl. No. 1, agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(5). According to section 2(5), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income.

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Therefore, the rent of ₹ 60,000 from letting out of houses constructed on agricultural land for residential purposes of industrial workers shall not be treated as agricultural income by virtue of section 2(5). Hence, such income would be chargeable to tax.

(ii) Section 2(5)(d) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income. Accordingly, the income of ₹ 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under Schedule II, Table: Sl. No. 1.

(iii) Schedule III, Table: Sl. No. 20 exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

2. Since Mr. Akash is a resident, his global income would be taxable in India. Income of ₹ 30 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia would be his business income since it is from rubber plants grown **outside India**. 35% income from sale of rubber manufactured from latex obtained from rubber plants grown by him in India would be taxable as business income and balance 65% would be exempt as agricultural income.

Business income = 35% of ₹ 22 lakhs + ₹ 30 lakhs = ₹ 37.70 lakhs

3. In case of income derived from the sale of coffee grown and cured by the seller in India, 25% income on such sale is taxable as business income. In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, 40% income on such sale is taxable as business income.

Business income of Mr. Ram = 25% of ₹ 15 lakhs = ₹ 3.75 lakhs

Business income of Mr. Shyam = 40% of ₹ 25 lakhs = ₹ 10 lakhs

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