UNIT 1: INCOME TAX LAW: AN INTRODUCTION

Learning Objectives
After studying this unit, you would be able to -
♦ understand the meaning of tax
♦ recognize the types of taxes
♦ comprehend the reason for levy of taxes
♦ know the components of income-tax law
♦ grasp the concept of income
♦ understand the procedure for computation of total income for the purpose of levy of income-tax
♦ know that there is a requirement of paying advance tax and deduction of tax at source
♦ appreciate what a “Return of income” means

1.1 What is a Tax?

Let us begin by understanding the meaning of tax. Tax is a fee charged by a government on a product, income or activity. There are two types of taxes – direct taxes and indirect taxes (See Chart below this paragraph). If tax is levied directly on the income or wealth of a person, then it is a direct tax e.g. income-tax. If tax is levied on the price of a good or service, then it is called an indirect tax e.g. excise duty. In the case of indirect taxes, the person paying the tax passes on the incidence to another person.
1.2 Why are Taxes Levied?

The reason for levy of taxes is that they constitute the basic source of revenue to the government. Revenue so raised is utilized for meeting the expenses of government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc.

1.3 Overview of Income-Tax Law in India

Income-tax is the most significant direct tax. In this material, we would be introducing the students to the Income-tax law in India. The income-tax law in India consists of the following components–

The various instruments of law containing the law relating to income-tax are explained below:

**Income-tax Act, 1961**: The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act. This Act came into force on 1st April, 1962. The Act contains 298 sections and XIV schedules. These undergo change every year with additions and deletions brought about by the annual Finance Act passed by Parliament. In pursuance of the power given by the Income-tax Act, 1961 rules have been framed to facilitate proper administration of the Income-tax Act, 1961.

**The Finance Act**: Every year, the Finance Minister of the Government of India presents the Budget to the Parliament. Part A of the budget speech contains the proposed policies of the Government in fiscal areas. Part B of the budget speech contains the detailed tax proposals. In order to implement the above proposals, the Finance Bill is introduced in the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.

**Income-tax Rules**: The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income-tax Act, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962. It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

**Circulars and Notifications**: Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assessees. The department is bound by the circulars. While such circulars are not binding the assessees they can take advantage of beneficial circulars.
Case Laws: The study of case laws is an important and unavoidable part of the study of income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assessees and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

1.4 Levy of Income-Tax

Income-tax is a tax levied on the total income of the previous year of every person. A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company etc.

1.5 Concept of Income

The definition of income as per the Income-tax Act, 1961 begins with the words “Income includes”. Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. Certain important principles relating to income are enumerated below -

➤ Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, 1961, even certain income which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.

➤ Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income-tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g. Capital gains i.e. gains on sale of a capital asset like land.

➤ Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head [For knowing about heads of income, see step 2 of para 1.6 below] is prescribed under the Income-tax Act.

➤ Income is taxable either on due basis or receipt basis. For computing income under the heads “Profits and gains of business or profession” and “Income from other sources”, the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.

➤ Income earned in a previous year is chargeable to tax in the assessment year. Previous year is the financial year, ending on 31st March, in which income has accrued/ received. Assessment year is the financial year (ending on 31st March) following the previous year. The income of the previous year is assessed during the assessment year following the previous year. For instance, income of previous year 2012-13 is assessed during 2013-14. Therefore, 2013-14 is the assessment year for assessment of income of the previous year 2012-13.
1.4 Income-tax

1.6 Total Income and Tax Payable

Income-tax is levied on an assessee’s total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Let us go step by step to understand the procedure of computation of total income for the purpose of levy of income-tax –

**Step 1 – Determination of residential status:** The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.

The residential statuses as per the Income-tax Act are shown below –

<table>
<thead>
<tr>
<th>RESIDENTIAL STATUSES UNDER THE INCOME TAX ACT, 1961</th>
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<tbody>
<tr>
<td>RESIDENT</td>
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<tr>
<td>RESIDENT AND ORDINARILY RESIDENT</td>
</tr>
<tr>
<td>NON-RESIDENT</td>
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<tr>
<td>RESIDENT BUT NOT ORDINARILY RESIDENT</td>
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</tbody>
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In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

The residential status of a person determines the taxability of the income. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

**Step 2 – Classification of income under different heads:** The Act prescribes five heads of income. These are shown below –

<table>
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<tr>
<th>HEADS OF INCOME</th>
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<tr>
<td>SALARIES</td>
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<tr>
<td>INCOME FROM HOUSE PROPERTY</td>
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<tr>
<td>PROFITS AND GAINS OF BUSINESS OR PROFESSION</td>
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<tr>
<td>CAPITAL GAINS</td>
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<tr>
<td>INCOME FROM OTHER SOURCES</td>
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These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Salary, pension earned is taxable under the head “Salaries”. Rental income is taxable under the head “Income from house property”. Income derived from carrying on any business or profession is taxable under the head “Profits and gains from business or profession”. Profit from sale of a capital asset (like land) is taxable under the head “Capital Gains”. The fifth head of income is the residiary head under which income taxable under the Act, but not falling under the first four heads, will be taxed. The tax payer has to classify the income earned under the relevant head of income.
Step 3 – Exclusion of income not chargeable to tax: There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These income have to be excluded and will not form part of Gross Total Income. Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 – Computation of income under each head: Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a charging section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head.

Step 5 – Clubbing of income of spouse, minor child etc.: In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

Step 6 – Set-off or carry forward and set-off of losses: An assessee may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head “Profits and gains of business or profession”.

Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, profits and gains of business or profession. There are provisions in the Income-tax Act, 1961 for allowing inter-head adjustment in certain cases. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.

Step 7 – Computation of Gross Total Income: The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.
1.6 Income-tax

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from Gross Total Income. These deductions are of three types –

**DEDUCTIONS FROM GROSS TOTAL INCOME**

**DEDUCTIONS IN RESPECT OF CERTAIN PAYMENTS**
- Examples:
  1. Life Insurance Premium paid
  2. Contribution to Provident Fund/ Pension Fund
  3. Medical Insurance premium paid
  4. Payment of interest on loan taken for higher education
  5. Rent paid
  6. Donation to certain funds, charitable institutions, etc.
  7. Contributions to political parties

**DEDUCTIONS IN RESPECT OF CERTAIN INCOMES**
- Examples:
  1. Profits and gains from Industrial undertakings or enterprises engaged in infrastructure development
  2. Profits and gains by an undertaking/ enterprise engaged in development of special economic zone.
  3. Certain income of co-operative societies
  4. Royalty income etc. of authors of certain books other than text-books.
  5. Royalty on patents.

**OTHER DEDUCTIONS**
- Example: Deduction in case of a person with disability

Step 9 – Total income: The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It is also called the Taxable Income. It should be rounded off to the nearest multiple of ₹ 10.

The process of computation of total income is shown hereunder –

**COMPUTATION OF TOTAL INCOME**

- Determination of residential status.
- Classification of Income under 5 heads

- Salaries
- Income from house property
- Profits and gains of business or profession
- Capital gains
- Income from other sources

- Aggregation of Income
- Application of clubbing provisions
- Set-off/carry forward and set-off of losses

- Gross Total Income
- Deductions from Gross Total Income

- Total Income
Step 10 – Application of the rates of tax on the total income: The rates of tax for the different classes of assesses are prescribed by the Annual Finance Act.

For individuals, HUFs etc., there is a slab rate and basic exemption limit. At present, the basic exemption limit is ₹2,00,000 for individuals. This means that no tax is payable by individuals with total income of up to ₹2,00,000. Those individuals whose total income is more than ₹2,00,000 but less than ₹5,00,000 have to pay tax on their total income in excess of ₹2,00,000 @ 10% and so on. The highest rate is 30%, which is attracted in respect of income in excess of ₹10,00,000.

For firms and companies, a flat rate of tax is prescribed. At present, the rate is 30% on the whole of their total income.

The tax rates have to be applied on the total income to arrive at the income-tax liability.

Step 11 – Surcharge: Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. Surcharge is applicable only in the case of companies. The rate of surcharge for domestic companies is 5% and for foreign companies is 2%, if their total income exceeds ₹1 crore.

Step 12 – Education cess and secondary and higher education cess on income-tax: The income-tax, as increased by the surcharge, if applicable, is to be further increased by an additional surcharge called education cess @2%. The education cess on income-tax is for the purpose of providing universalized quality basic education. This is payable by all assesses who are liable to pay income-tax irrespective of their level of total income. Further, “secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

Step 13 - Advance tax and tax deducted at source: Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in certain installments on the basis of estimated income. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act. For example, in the case of salary income, the obligation of the employer to deduct tax at source arises only at the time of payment of salary to the employees. Such tax deducted at source has to be remitted to the credit of the Central Government through any branch of the RBI, SBI or any authorized bank. If any tax is still due on the basis of return of income, after adjusting advance tax and tax deducted at source, the assessee has to pay such tax (called self-assessment tax) at the time of filing of the return.

1.7 Return of Income

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assesses is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

The Act has prescribed due dates for filing return of income in case of different assesses. All companies and firms have to mandatorily file their return of income before the due date. Other persons have to file a return of income if their total income exceeds the basic exemption limit.
UNIT – 2: IMPORTANT DEFINITIONS IN THE INCOME TAX ACT, 1961

Learning Objectives

After studying this unit, you would be able to understand and appreciate –

- the meaning of the important terms used in the Income-tax Act, 1961
- the scope of definition of those terms for the purposes of this Act.

Section 2 gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like ‘person’, ‘assessee’, ‘income’, etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like “dividend”, “transfer”, etc. have been given a wider meaning in the Income-tax Act than they are commonly understood.

Some of the important terms defined under section 2 are given below:

2.1 Assessee [Section 2(7)]

Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. Sometimes, a person becomes assessable in respect of the income of some other persons. In such a case also, he may be considered as an assessee. This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

2.2 Assessment [Section 2(8)]

This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

2.3 Person [Section 2(31)]

The definition of ‘assessee’ leads us to the definition of ‘person’ as the former is closely connected with the latter. The term ‘person’ is important from another point of view also viz., the charge of income-tax is on every ‘person’.

The definition is inclusive i.e. a person includes,

(i) an individual,
(ii) a Hindu Undivided Family (HUF),
(iii) a company,
(iv) a firm,
(v) an AOP or a BOI, whether incorporated or not,
(vi) a local authority, and
(vii) every artificial juridical person e.g., an idol or deity.

We may briefly consider some of the above seven categories of assesses each of which constitutes a separate unit of assessment.

(i) **Individual** - The term 'individual' means only a natural person, i.e., a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

(ii) **HUF** - Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term “person” under section 2(31). The levy of income-tax is on “every person”. Therefore, income-tax is payable by a HUF. “Hindu undivided family” has not been defined under the Income-tax Act. The expression is however defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.

The relation of a HUF does not arise from a contract but arises from status. A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (kartha) are called co-parceners. A hindu co-parcenary includes those persons who acquire by birth an interest in the joint coparcenary property. Only the coparceners have a right to partition.

A Jain undivided family would also be assessed as a HUF, as Jains are also governed by the laws as Hindus.

**Schools of Hindu Law**

There are two schools of Hindu law. They are –

(1) Mithakshara school of Hindu law
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(2) Dayabhaga school of Hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus every child born in the family acquires a right/share in the family property.

Dayabagha law prevails in West Bengal and Assam. In Dayabagha law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF

(iii) Company [Section 2(17)] - For all purposes of the Act the term ‘Company’, has a much wider connotation than that under the Companies Act. Under the Act, the expression ‘Company’ means:

(1) any Indian company as defined in section 2(26); or
(2) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
(3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
(4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT’s order.

Classes of Companies

(1) Domestic company [Section 2(22A)] - means an Indian company or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, payable out of such income.

Indian company [Section 2(26)] - Two conditions should be satisfied so that a company can be regarded as an Indian company -

(a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and
(b) the registered office or the principal office of the company should be in India.

The expression ‘Indian Company’ also includes:

(i) A corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation),
(ii) An institution or association or body which is declared by the Board to be a company under section 2(17)(iv) provided its registered or principal office is in India.

(iii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State.

(iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

**Company in which public are substantially interested [Section 2(18)]** - The following companies are said to be companies in which the public are substantially interested:

(i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.

(ii) A company which is registered under section 25 of the Companies Act, 1956 (formed for promoting commerce, arts, science, religion, charity or any other useful object).

(iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.

(iv) A company which is not a private company as defined in the Companies Act, 1956 and which fulfills any of the following conditions:

- its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India; or
- its equity shares carrying at least 50% (40% in case of industrial companies) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by (a) Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or (d) any wholly owned subsidiary of company mentioned in (c).

(v) A company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act to be Nidhi or a Mutual Benefit Society.

(vi) A company whose equity shares carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

**Person having substantial interest in the company [Section 2(32)]** – is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with or without a right to participate in profits, carrying at least 20% of the total voting power.

**Note:** The main criterion is the ‘beneficial’ ownership and not ‘legal’ ownership. Therefore, the registered holder of even the majority of equity shares, would not fall within this definition if he
has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to at least 20% of the equity share capital of a company would fall within this definition even if he is not the registered holder of any shares.

(2) **Foreign company [Section 2(23A)]** - Foreign company means a company which is not a domestic company.

(iv) **Firm** - The terms ‘firm’, ‘partner’ and ‘partnership’ have the same meanings as assigned to them in the Indian Partnership Act. In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually ‘partners’ and collectively a ‘firm’.

**Note:**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Consequently, the following definitions in section 2(23) have been amended -

1. The definition of ‘partner’ to include within its meaning, a partner of a limited liability partnership;

2. The definition of ‘firm’ to include within its meaning, a limited liability partnership; and

3. The definition of ‘partnership’ to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a ‘partner’ as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(v) **Association of Persons (AOP)** - When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the
income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.

**Body of Individuals (BOI)** – It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

**(vi) Local Authority** - The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

**Note** : A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority’s own jurisdictional areas is exempt from tax.

**(vii) Artificial Persons** - This category could cover every artificial juridical person not falling under other heads. An idol, or deity would be assessable in the status of an artificial juridical person.

**2.4 Income [Section 2(24)]**

Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:—

1. Profits and gains.
2. Dividends.
3. Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section 23C(iiiad)/(iiiiae) or section 10(23C)(iv)(v)(vi) or an electoral trust —

| Research association approved under section 35(1)(ii) | 10(21) |
| Universities and other educational institutions | 10(23C)(iiiad)/(vi) |
| Hospitals and other medical institutions | 10(23C)(iiiae) / (via) |
| Notified funds or institutions established for charitable purposes | 10(23C)(iv) |
| Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes | 10(23C)(v) |
| Electoral trust | 13B |

4. The value of any perquisite or profit in lieu of salary taxable under section 17.
(5) Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

(6) Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

(7) The value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.

(8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.

(9) Deemed profits chargeable to tax under section 41 or section 59.

(10) Profits and gains of business or profession chargeable to tax under section 28.

(11) Any capital gains chargeable under section 45.

(12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act.

(13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

(14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose,

(i) “Lottery” includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) “Card game and other game of any sort” includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

(15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.
(16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.

“Keyman insurance policy” means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former’s business.

(17) Any sum referred to clause (va) of section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copyright, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head “profits and gains of business or profession”.

(18) Any sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viia).

(19) Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in section 56(2)(viib).

Students should carefully study the various items of receipts included in the above definition. Some of them like capital gains are not revenue receipts. However, since they have been included in the definition, they are chargeable as income under the Act. The concept of revenue and capital receipts is discussed hereunder –

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. The distinction between capital and revenue receipts is somewhat blurred. Even then, capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction remains real and most material for tax purposes.

Certain capital receipts which have been specifically included in the definition of income are Compensation for modification or termination of services, income by way of capital gains etc.

It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

**Distinction between capital and revenue receipts:** The following are some of the important criteria which may be applied to distinguish between capital and revenue receipts.

1. A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is exempt from tax while the latter is taxable. In cases where a capital asset is transmuted into income and the price realized on its sale takes the form of periodic payments (e.g., annuities and annual installment of capital), the receipt would be taxable even though it is referable to a capital asset.
(2) Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessee’s business or the transaction constitutes an adventure in the nature of trade.

(3) Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax. For example, a banker’s or financier’s dealings in foreign exchange or sale of shares and securities, a shipbroker’s purchases of ship in his own name, a share broker’s purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. If transactions are partly in the course of and partly outside the regular trading activity of the assessee, the income arising therefrom must be segregated and allocated between the two parts and treated accordingly for tax purposes.

(4) In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would be a taxable receipt. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

(5) Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee’s business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising therefrom would be taxable. Purchase of any article with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

(6) In the case of annuities which are payable in specified sums at periodic intervals of time the receipt would be of a revenue nature even though it involves the conversion of capital into income for an annuity means the purchase of an income. An annuity received from an employer is taxable as “Income from salaries” whereas all other annuities are chargeable under the head “Income from other sources”.

Annual payments, as distinguished from annuities, are in fact annual installments of capital. The purchase price of a business or property may be agreed to be paid in installments
annually or otherwise. In such cases, the amount of installment received would be of capital nature not liable to tax. Thus, on the sale of property or business in consideration of annual payment:

(i) if the sale is for a price which is to be paid in installments, the installments would be capital receipts;

(ii) if the property is sold for an annuity payable regularly, the property disappears and the annuity which takes its place would be chargeable to tax;

(iii) if the property is sold for what looks like an annuity but actually there is no transmutation of the principal sum into income and the annual payments are merely installments of the principal sum with interest only so much of the amount of installments as representing the interest payable would be income chargeable to tax, the balance being capital receipt; and

(iv) if the property is sold for a consideration which is share of the profits or gross receipt of a business, the receipt of the share of profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However, if the circumstances of the case show that the receipts were only installments of a capital nature, though fluctuating in amount and measurable with reference to profits, they would not be taxable.

(7) A receipt in substitution of a source of income is capital receipt not chargeable to tax. Thus compensation received for restraint of trade or profession is a capital receipt. Where an assessee receives compensation of termination of the agency business being the only source of income the receipt is a capital nature but taxable under section 28(ii). But where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the service contract is a revenue receipt taxable under section 15. In case where the compensation received is partly of a capital and partly of a revenue nature, the two will have to be segregated and treated accordingly for tax purposes.

Awards in the case of a sportsman, who is not a professional, will not be liable to tax in his hands as it would not be in the nature of income.

A lump sum payment made gratuitously (i.e. gratuity, leave encashment) or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Act.

(8) A lumpsum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads. Amount received under a policy of insurance would be a capital or revenue receipt depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally of a revenue nature since they would
be to supplement the income from business. But where a grant is received for specific purpose but not as a supplementary trading receipt (e.g., to enable the company to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax. Premium or discount received by a debenture holder, being a capital receipt, would not be chargeable to tax.

Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lump sum or by way of a fixed annual sum or a tonnage royalty or the minimum royalty. Similarly, royalties paid for use of whether paid in lump sum or in installments of fixed or varying amounts would be taxable as income whereas the payment received in lieu of total or partial assignment of patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt.

Premium on issue of shares or debentures, profit on forfeiture of shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax. The amount received by a shareholder on the winding up is a capital receipt (except where the receipt is a dividend under section 2(22)). But in case of a partnership, the amount receivable by an outgoing partner in respect of his share of the firm's profit whether, before or after its dissolution would be a revenue receipt chargeable to tax. Compensation received by a partner for relinquishing all his interests in the firm and amounts received in settlement of claim to an interest in the capital of a firm are capital receipts.

It is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the particular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact.

(9) Normally, gifts constitute capital receipts in the hands of the recipient. However, it is possible that gifts may partake the character of income under certain circumstances.

**Example:**

(i) Gifts received by doctors from their patients is taxable under the head Profits and Gains from Business or Profession.

(ii) Any sum of money or value of property received without consideration or for inadequate consideration by an individual or a HUF from any person, other than a relative, is chargeable under the head “Income from Other Sources” [For details, refer to Unit – 5 of Chapter 4 on “Income from Other Sources”].

### 2.5 Dividend [Section 2(22)]

The term ‘dividend’ as used in the Act has a wider scope and meaning than under the general law. According to section 2(22), the following receipts are deemed to be dividend:

**a)** **Distribution of accumulated profits, entailing the release of company's assets** - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets. For example, if
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accumulated profits are distributed in cash it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company’s assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder.

(b) Distribution of debentures, deposit certificates and bonus shares to preference shareholders - Any distribution to its shareholders by a company of debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is taxable in the hands of the preference shareholder. In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

Note: Bonus shares given to equity shareholders are not treated as dividend.

(c) Distribution on liquidation - Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not, is deemed to be dividend income.

Note: Any distribution made out of the profits of the company after the date of the liquidation cannot amount to dividend. It is a repayment towards capital.

Accumulated profits include all profits of the company up to the date of liquidation whether capitalised or not. But where liquidation is consequent to the compulsory acquisition of an undertaking by the Government or by any corporation owned or controlled by the Government, the accumulated profits do not include any profits of the company prior to the 3 successive previous years immediately preceding the previous year in which such acquisition took place subject to certain exceptions.

(d) Distribution on reduction of capital - Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.

Exception - The same exceptions as given in case (c) above shall also apply in this case.

(e) Advance or loan by a closely held company to its shareholder - Any payment by a company in which the public are not substantially interested of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

There are two exceptions to this rule:

(i) If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company’s business, the loan or advance to a shareholder is not deemed to be dividend.
(ii) Where a loan had been treated as dividend and subsequently the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again be treated as a dividend.

**Advance or loan by a closely held company to a specified concern** - Any payment by a company in which the public are not substantially interested to any concern (i.e. HUF / Firm / AOP / BOI / Company) in which a shareholder, having the beneficial ownership of at least 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. at least 20% share of the income of the concern). The dividend income shall be taxable in the hands of the concern. Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also be deemed to be dividend. However, in both cases the ceiling limit of dividend is the extent of accumulated profits.

**Illustration** : Suppose Mr. X is a shareholder in a Company A as well as Company B. He has 10% shareholding in Company A and 20% shareholding in Company B. The accumulated profits of Company A = ₹ 10 lakh. A loan of ₹ 12 lakh is given by Company A to Company B. This loan up to the extent of accumulated profits of ₹ 10 lakh is treated as dividend and is taxable in the hands of Company B.

**Other exceptions**

Apart from the exceptions cited above, the following also do not constitute “dividend” -

(i) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;

(ii) any distribution of shares on demerger by the resulting companies to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

**Basis of charge of dividend** : Any income by way of dividends, referred to under section 115-O, is excluded from the total income of the shareholder [Section 10(34)]. Under section 115-O, any dividend declared, distributed or paid by a domestic company, whether out of current or accumulated profits, shall be charged to additional income-tax at a flat rate of 15% in addition to normal income-tax chargeable on the income of the company. This is known as corporate dividend tax. Corporate dividend tax is not leviable on deemed dividend under section 2(22)(e). Hence, the same will be taxed in the hands of the shareholder.

Dividends received from a company, other than a domestic company, are still liable to tax in the hands of the shareholder. For example, dividend received from a foreign company is liable to tax in the hands of the shareholder.

**Year of accrual of dividend** : Section 8 provides that deemed dividend under section 2(22) declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is declared, distributed or paid, as the case may be. Any interim dividend shall be deemed to be the income of the previous year in which the amount is unconditionally made available to the member who is entitled to it.
2.6 India [Section 2(25A)]

The term 'India' means –

(i) the territory of India as per article 1 of the Constitution,
(ii) its territorial waters, seabed and subsoil underlying such waters,
(iii) continental shelf,
(iv) exclusive economic zone or
(v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

2.7 Infrastructure Capital Company [Section 2(26A)]

"Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

(1) any enterprise or undertaking wholly engaged -
   (a) in the business referred to in section 80-IA(4) i.e. business of
      (i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
      (ii) providing telecom services, whether basic or cellular
      (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government
      (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.
   (b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.

(2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.

(3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or

(4) a project for constructing a hospital with at least 100 beds for patients.
2.8 Infrastructure Capital Fund [Section 2(26B)]

Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

(1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or

(2) an undertaking developing and building a housing project referred to in section 80-IB(10); or

(3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or

(4) a project for constructing a hospital with at least 100 beds for patients.

2.9 Manufacture [Section 2(29BA)]

'Manufacture', with its grammatical variations, shall mean a change in a non-living physical object or article or thing,—

(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.
UNIT – 3: BASIS OF CHARGE AND RATES OF TAXES

Learning Objectives
After studying this unit, you would be able to –
♦ understand the basis of charge of income-tax
♦ know the rates of taxes applicable for different classes of assesses
♦ know whether surcharge is applicable to a particular class of assessee and if so, the rate of surcharge and the level of income above which the same is applicable
♦ understand the concept of marginal relief
♦ know about the levy of education cess and secondary and higher education cess.

3.1 Charge of Income-Tax
Section 4 of the Income-tax Act is the charging section which provides that:
(i) Tax shall be charged at the rates prescribed for the year by the annual Finance Act.
(ii) The charge is on every person specified under section 2(31);
(iii) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);
(iv) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the backbone of the law of income-tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

3.2 Rates of Tax
Income-tax is to be charged at the rates fixed for the year by the annual Finance Act. Section 2 of the Finance Act, 2012 read with Part I of the First Schedule to the Finance Act, 2012 specifies the rates at which income-tax is to be levied on income chargeable to tax for the A.Y. 2012-13. Part II lays down the rate at which tax is to be deducted at source during the financial year 2012-13 i.e. A.Y. 2013-14 from income subject to such deduction under the Act; Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "salaries" and the rates for computing advance tax for the financial year 2012-13 i.e. A.Y. 2013-14. Part III of the First Schedule to the Finance Act, 2012 will become Part I of the First Schedule to the Finance Act, 2013 and so on.
1.24 Income-tax

The slab rates applicable for A.Y.2013-14 are as follows:

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

   (i) where the total income does not exceed ₹ 2,00,000 Nil;
   (ii) where the total income exceeds ₹ 2,00,000 but does not exceed ₹ 5,00,000 10% of the amount by which the total income exceeds ₹ 2,00,000
   (iii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 ₹ 30,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000;
   (iv) where the total income exceeds ₹ 10,00,000 ₹ 1,30,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

**Illustration:** Mr. X has a total income of ₹ 12,00,000. Compute his gross tax liability.

**Tax liability =** ₹ 1,30,000 + 30% of ₹ 2,00,000 = ₹ 1,90,000

Alternatively:

**Tax liability :**

First ₹ 2,00,000 - Nil

Next ₹ 2,00,000 – ₹ 5,00,000 - @ 10% of ₹ 3,00,000 = ₹ 30,000

Next ₹ 5,00,000 – ₹ 10,00,000 - @ 20% of ₹ 5,00,000 = ₹ 1,00,000

Balance i.e. ₹ 12,00,000 – ₹ 10,00,000 - @ 30% of ₹ 2,00,000 = ₹ 60,000

**Total tax =** ₹ 1,90,000

It is to be noted that for a senior citizen (being a resident individual who is of the age of 60 years but not more than 80 years at any time during the previous year), the basic exemption limit is ₹ 2,50,000. Further, resident individuals of the age of 80 years or more at any time during the previous year, being very senior citizens, would be eligible for a higher basic exemption limit of ₹ 5,00,000.

Therefore, the tax slabs for these assessees would be as follows –

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

(i) where the total income does not exceed ₹ 2,50,000 Nil;

(ii) where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000 10% of the amount by which the total income exceeds ₹ 2,50,000;
(iii) where the total income exceeds \( ₹ 25,000 \) plus 20% of the amount by which the total income exceeds \( ₹ 10,00,000 \);

(iv) where the total income exceeds \( ₹ 1,25,000 \) plus 30% of the amount by which the total income exceeds \( ₹ 10,00,000 \).

For resident individuals of the age of 80 years or more at any time during the previous year

(i) where the total income does not exceed ₹ 5,00,000 Nil;

(ii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 20% of the amount by which the total income exceeds ₹ 5,00,000;

(iv) where the total income exceeds ₹ 10,00,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

(2) Firm/LLP

On the whole of the total income 30%

(3) Local authority

On the whole of the total income 30%

(4) Co-operative Society

(i) Where the total income does not exceed ₹ 10,000 10% of the total income

(ii) Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000 ₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000

(iii) Where the total income exceeds ₹ 20,000 ₹ 3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000

(5) Company

(i) In the case of a domestic company 30% of the total income

(ii) In the case of a company other than a domestic company 40% on the total income

However, specified royalties and fees for rendering technical services (FTS) received from Government or an Indian concern in pursuance of an approved agreement made by the company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS) would be chargeable to tax @50%.
The above rates are prescribed by the annual Finance Acts. However, in respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates—

1. **Section 112** has prescribed the rate of tax @20% in respect of long term capital gains. In case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of unlisted securities would be subject to tax@10% without giving effect to indexation provision and currency fluctuation (For details, refer Unit 4 of Chapter 4 on “Capital gains”)

2. **Section 111A** provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -
   (i) an equity share in a company or
   (ii) a unit of an equity oriented fund.
   The conditions for availing the benefit of this concessional rate are –
   (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and
   (ii) such transaction should be chargeable to securities transaction tax.

3. **Section 115BB** prescribes the rate of tax @30% for winnings from-
   (i) any lottery; or
   (ii) crossword puzzle; or
   (iii) race including horse race; or
   (iv) card game and other game of any sort; or
   (v) gambling or betting of any form.

**Surcharge**

1. In the case of domestic companies, the rate of surcharge is 5%, where the total income exceeds ₹ 1 crore.

2. In the case of foreign companies, the rate of surcharge is 2%, where the total income exceeds ₹ 1 crore.

3. No surcharge is leviable for assesses, other than companies.

**Marginal Relief:** The concept of marginal relief is applicable only in the case of companies. Marginal relief is available in case of companies having a total income exceeding ₹ 1 crore i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.
Example

Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹1,01,00,000 and the total income does not include any income in the nature of capital gains.

The tax payable on total income of ₹1,01,00,000 of X Ltd. computed@ 31.5% (including surcharge) is ₹31,81,500. However, the tax cannot exceed the tax of ₹30,00,000 payable on total income of ₹1 crore by more than the ₹1,00,000, being the amount of total income exceeding ₹1 crore. Therefore, the tax payable on ₹1,01,00,000 would be ₹31,00,000 (30,00,000+1,00,000). The marginal relief is ₹81,500 (i.e., ₹31,81,500 - ₹31,00,000).

“Education cess” and “Secondary and Higher education cess” on income-tax: The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the “Education cess on income-tax”, calculated at the rate of 2% of such income-tax and surcharge, if applicable. Education cess is leviable in the case of all assessees i.e. individuals, HUF, AOP / BOI, firms, local authorities, co-operative societies and companies. Further, “Secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.
UNIT – 4 : CONCEPT OF PREVIOUS YEAR AND ASSESSMENT YEAR

Learning Objectives
After studying this unit, you would be able to understand –
♦ the meaning and relevance of assessment year and previous year
♦ what is the previous year for undisclosed sources of income
♦ circumstances when income of the previous year would be assessed to tax in the previous year itself.

4.1 Meaning of Assessment Year And Previous Year

(i) **Assessment year** - The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. For example, for the assessment year 2013-14, the relevant previous year is 2012-13 (1.4.2012 to 31.3.2013).

(ii) **Previous year [Section 3]** – It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

*Business or profession newly set up during the financial year* - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

**Illustration:**


   **Ans.** The previous year will be 1.4.2012 to 31.3.2013.


   **Ans.** The previous year will be from 1.7.2012 to 31.3.2013.

4.2 Previous year for undisclosed sources of income

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(i) **Cash Credits [Section 68]** : Where any sum is found credited in the books of the
assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands. Otherwise, the explanation offered by the assessee-company shall be deemed as not satisfactory, consequent to which the sum shall be treated as income of the company. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

(ii) Unexplained Investments [Section 69]: Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the investments are taxed as income of the assessee of such financial year.

(iii) Unexplained money etc. [Section 69A]: Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(iv) Amount of investments etc., not fully disclosed in the books of account [Section 69B]: Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market value of which is ₹25,000) during the financial year ending 31.3.2013 but he has recorded to have spent ₹15,000 in acquiring it, the Assessing Officer can add ₹10,000 (i.e. the difference of the market value of such gold and ₹15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(v) Unexplained expenditure [Section 69C]: Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure
1.30 Income-tax

as the income of the assessee for such financial year. Such unexplained expenditure which is
deemed to be the income of the assessee shall not be allowed as deduction under any head
of income.

(vi) **Amount borrowed or repaid on hundi [Section 69D]**: Where any amount is borrowed
on a hundi or any amount due thereon is repaid other than through an account-payee cheque
drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the
person borrowing or repaying for the previous year in which the amount was borrowed or
repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any
person, he will not be again liable to be assessed in respect of such amount on repayment of
such amount. The amount repaid shall include interest paid on the amount borrowed.

**Unexplained money, investments etc. to attract maximum marginal rate of tax @30%
[New section 115BBE]**

(i) **In order to control laundering of unaccounted money by availing the benefit of
basic exemption limit, the unexplained money, investment, expenditure, etc.**
deemed as income under section 68 or section 69 or section 69A or section 69B or
section 69C or section 69D would be taxed at the maximum marginal rate of 30%
(plus surcharge and cesses) with effect from A.Y.2013-14.

(ii) **No basic exemption or allowance or expenditure shall be allowed to the assessee
under any provision of the Income-tax Act, 1961 in computing such deemed
income.**

4.3 Certain cases when income of a previous year will be assessed
in the previous year itself

The income of an assessee for a previous year is charged to income-tax in the assessment
year following the previous year. However, in a few cases, this rule does not apply and the
income is taxed in the previous year in which it is earned. These exceptions have been made
to protect the interests of revenue. The exceptions are as follows:

(i) **Shipping business of non-resident [Section 172]** - Where a ship, belonging to or chartered
by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship
is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been
made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to
any person on his behalf, whether in India or outside India on account of such carriage is deemed
to be his income which is charged to tax in the same year in which it is earned.

(ii) **Persons leaving India [Section 174]** - Where it appears to the Assessing Officer that
any individual may leave India during the current assessment year or shortly after its expiry
and he has no present intention of returning to India, the total income of such individual for the
period from the expiry of the respective previous year up to the probable date of his departure
from India is chargeable to tax in that assessment year.

**Example:** Suppose Mr. X is leaving India for USA on 10.6.2013 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X will be required to pay income tax on the income earned during the P.Y. 2012-13 as well as the total income earned during the period 1.4.2013 to 10.06.2013.

(iii) **AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A]** - If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(iv) **Persons likely to transfer property to avoid tax [Section 175]** - During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(v) **Discontinued business [Section 176]** - Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.