



# BASIC CONCEPTS

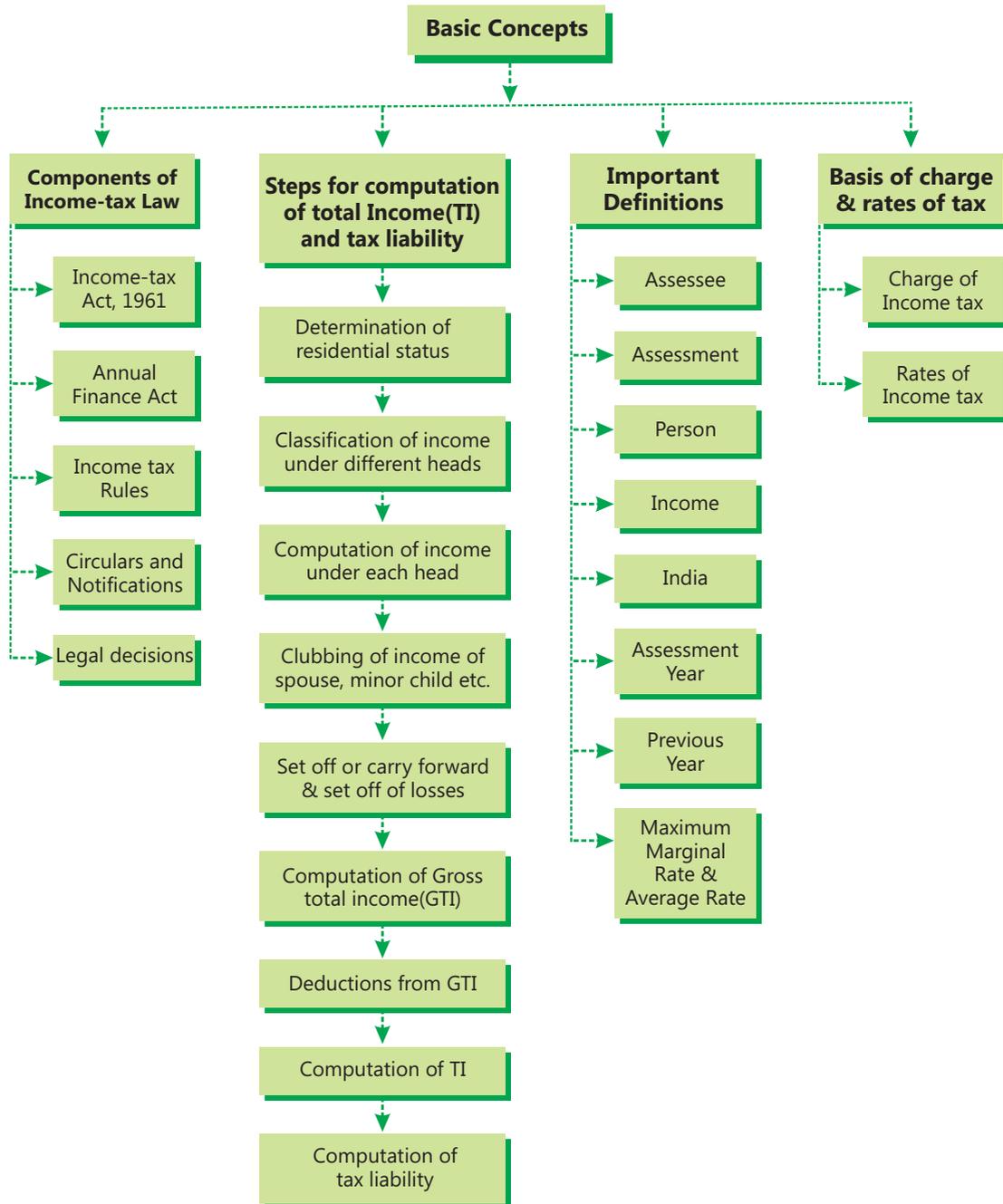


## LEARNING OUTCOMES

After studying this chapter, you would be able to-

- comprehend the meaning of tax and types of taxes.
- discern the difference between direct and indirect taxes.
- appreciate the components of income-tax law.
- comprehend the procedure for computation of total income for the purpose of levy of income-tax.
- comprehend and appreciate the meaning of the important terms used in the Income-tax Act, 1961.
- recognise the previous year and assessment year for the purpose of computing income chargeable to tax under the Income-tax Act, 1961.
- explain the circumstances when income of the previous year would be assessed to tax in the previous year itself.
- apply the rates of tax applicable on different components of total income of a person for the purpose of determining the tax liability of such person.

## CHAPTER OVERVIEW



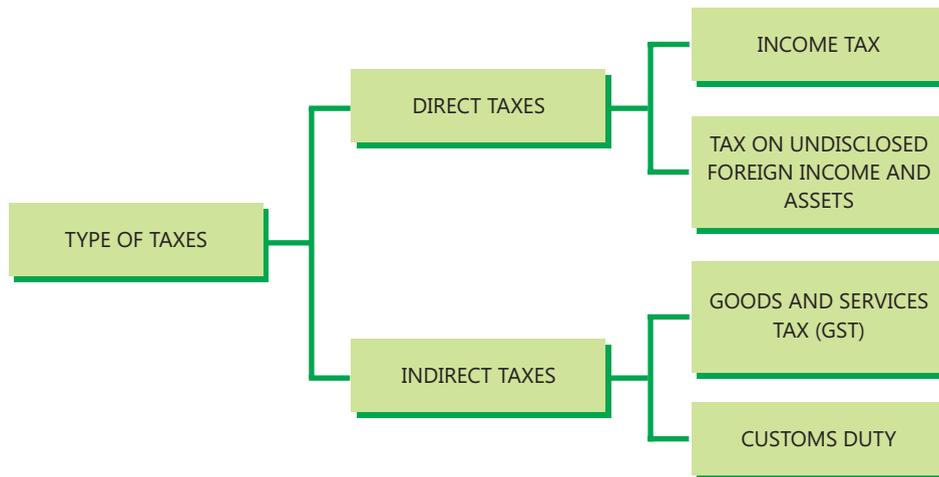
## 1. INTRODUCTION

### 1.1 What is 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.

**Direct Taxes:** If tax is levied directly on the income or wealth of a person, then, it is a direct tax e.g. income-tax.

**Indirect Taxes:** If tax is levied on the price of a good or service, then, it is an indirect tax e.g. Goods and Services Tax(GST) or Custom 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 Power to levy taxes

Constitution of India gives the power to levy and collect taxes, whether direct or indirect, to the Central and State Government. The Union and State Government are empowered to levy taxes by virtue of Article 246 of the Constitution of India.

**Seventh Schedule to Article 246** contains three lists which enumerate the matters under which the Union and the State Governments have the authority to make laws for the purpose of levy of taxes.

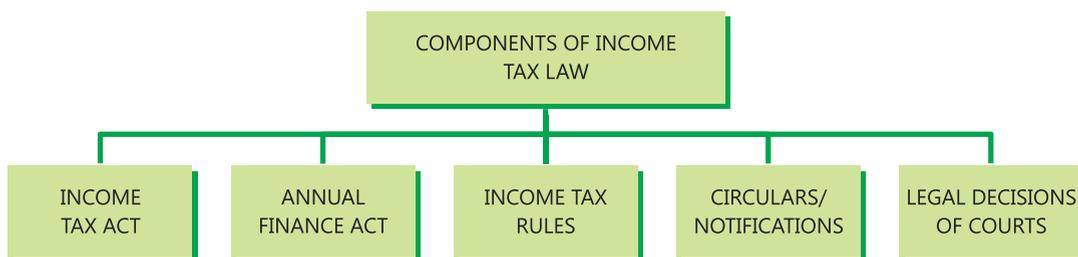
The following are the lists:

- (i) **Union List:** Central Government has the exclusive power to make laws on the matters contained in Union List.
- (ii) **State List:** State Government has the exclusive power to make laws on the matters contained in the State List.
- (iii) **Concurrent List:** Both Central and State Governments have the power to make laws on the matters contained in the Concurrent list.

*Income-tax is the most significant direct tax. **Entry 82 of the Union List** i.e., List I of Seventh Schedule to Article 246 of the Constitution of India has given the power to Central Government to levy taxes on income other than agricultural income.*

### 1.4 Overview of Income-tax law in India

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.

- It came into force on 1st April, 1962.
  - It contains 298 sections and XIV schedules.
    - ❖ A section may have **sub-sections, clauses and sub-clauses**. For example,
      - The clauses of section 2 define the meaning of terms used in the Income-tax Act, 1961. Clause (1A) defines "agricultural income", clause (1B) defines "amalgamation" and so on.
- Likewise, the clauses of section 10 contain the exemptions in respect of certain income, like clause (1) provides for exemption of agricultural income and clause (2) provides for exemption of share income of a member of a hindu undivided family and so on.

- Section 5 defining the scope of total income has two sub-sections (1) and (2). Sub-section (1) defines the scope of total income of a resident and sub-section (2) defines the scope of total income of a non-resident.
- ❖ A section may also have **Provisos and Explanations**.
  - The Proviso(s) to a section/sub-section/clause spells out the exception(s) to the provision contained in the respective section/sub-section/clause.
  - The *Explanation* to a section/sub-section/clause gives a clarification relating to the provision contained in the respective section/sub-section/clause.
  - For example,
    - Sections 80GGB and 80GGC provides for deduction from gross total income in respect of contributions made by companies and other persons, respectively, to political parties or an electoral trust.
    - The proviso to sections 80GGB and 80GGC provide that no deduction shall be allowed under those sections in respect of any sum contributed by cash to political parties or an electoral trust. Thus, the proviso to these sections spell out the circumstance when deduction would not be available thereunder in respect of contributions made.
    - The *Explanation* below section 80GGC provides that for the purposes of sections 80GGB and 80GGC, “political party” means a political party registered under section 29A of the Representation of the People Act, 1951. Thus, the *Explanation* clarifies that the political party has to be a registered political party.
- The Income-tax Act, 1961 undergoes change every year with additions and deletions brought out by the annual Finance Act passed by Parliament.

### The Finance Act

Every year, the Finance Minister of the Government of India introduces the Finance Bill in the Parliament’s Budget Session. When the Finance Bill is passed by both the houses of the Parliament and gets the assent of the President, it becomes the Finance Act. Amendments are made every year to the Income-tax Act, 1961 and other tax laws by the Finance Act.

The First Schedule to the Finance Act contains four parts which specify the rates of tax -

- **Part I** of the First Schedule to the Finance Act specifies the rates of tax applicable for the current Assessment Year.
- **Part II** specifies the rates at which tax is deductible at source for the current Financial Year.
- **Part III** gives the rates for calculating income-tax for deducting tax from income chargeable under the head "Salaries" and computation of advance tax.
- **Part IV** gives the rules for computing net agricultural income.

### **Income-tax Rules, 1962**

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, 1961, the CBDT frames rules from time to time. These rules are collectively called **Income-tax Rules, 1962**.
- Rules also have sub-rules, provisos and Explanations. The proviso to a Rule/Sub-rule spells out the exception to the limits, conditions, guidelines, basis of valuation, as the case may be, spelt out in the Rule/Sub-rule. The Explanation gives clarification for the purposes of the Rule.
- 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***

- 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 certain provisions of the Act.
- 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 on the assessees, they can take advantage of beneficial circulars.

#### ***Notifications***

Notifications are issued by the Central Government to give effect to the provisions of the Act. The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications.

## 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 assessee 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.

**Note – Case laws are dealt with at the Final level.**

## 1.5 Levy of Income-tax

Income-tax is a tax levied on the total income of the previous year of every person (Section 4).

A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company etc.

### (1) Total Income and Tax Payable

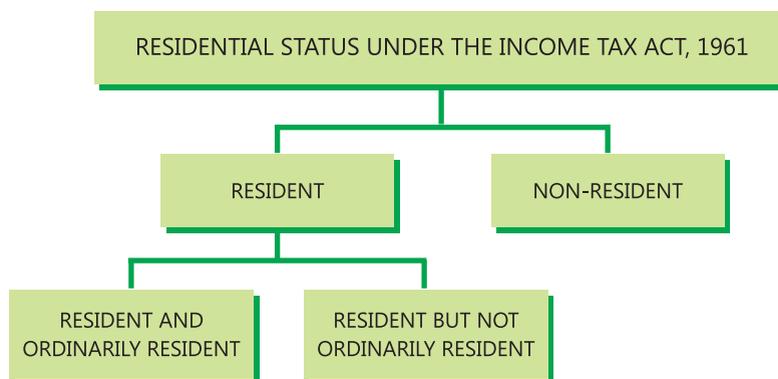
Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961.

Let us go step by step to understand the procedure for computation of total income of an individual 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 status as per the Income-tax Act, 1961 can be classified as under –

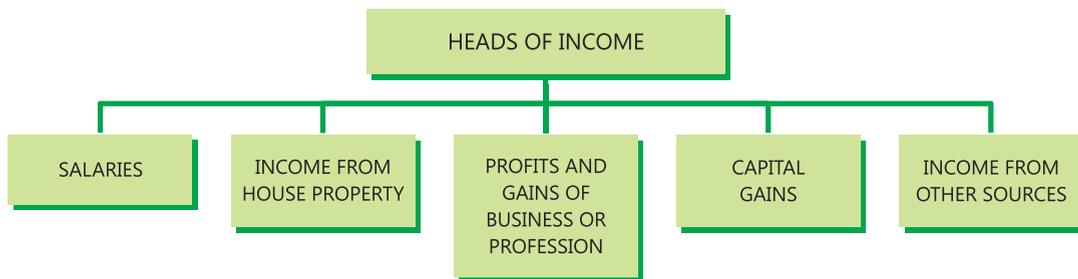


In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

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 –



There is a charging section under each head of income which defines the scope of income chargeable under that head. These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Accordingly, the income is classified as follows:

1. Salary, pension earned is taxable under the head **“Salaries”**.
2. Rental income is taxable under the head **“Income from house property”**.
3. Income derived from carrying on any business or profession is taxable under the head **“Profits and gains from business or profession”**.
4. Profit from sale of a capital asset (like land) is taxable under the head **“Capital Gains”**.
5. The fifth head of income is the residuary head. The income which is not taxable under the first four heads will be taxed under the head **“Income from other sources”**.

The tax payer has to classify the income earned under the relevant head of income.

### **Step 3– Computation of income under each head**

Income is to be computed in accordance with the provisions governing a particular head of income.

**Exemptions:** There are certain incomes which are wholly exempt from income-tax e.g. agricultural income. These incomes 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.

**Deductions:** 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 4 – 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 5 – 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.

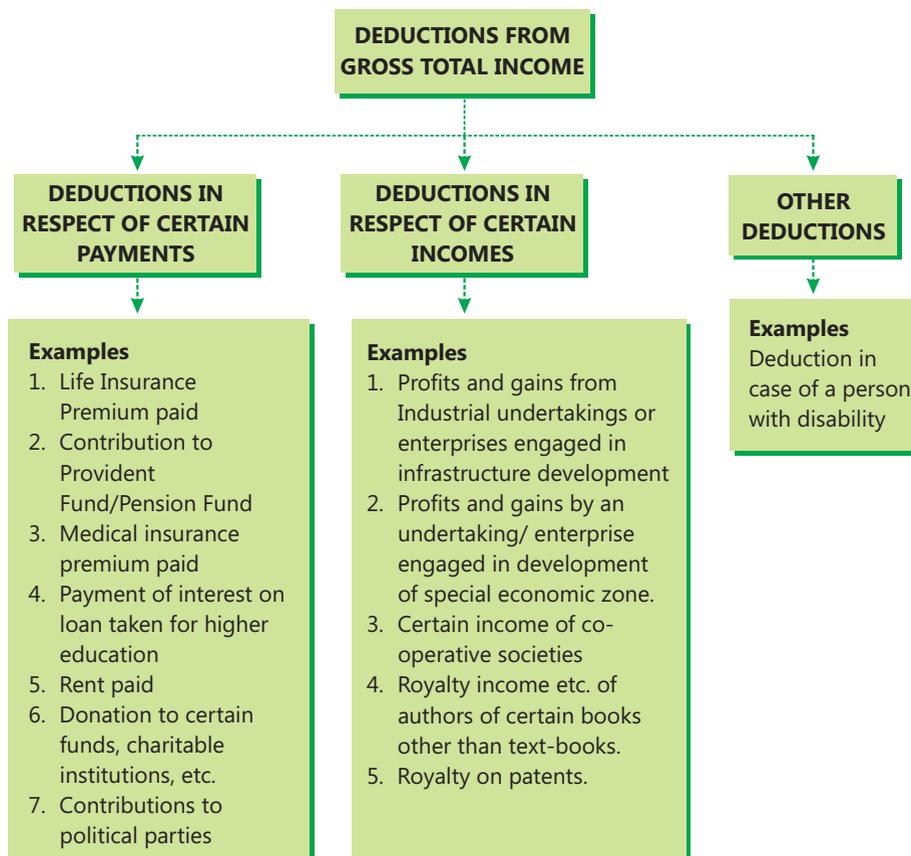
However, there are also restrictions in certain cases, like business loss is not allowed to be set-off against salary income. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.

### **Step 6 – 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.

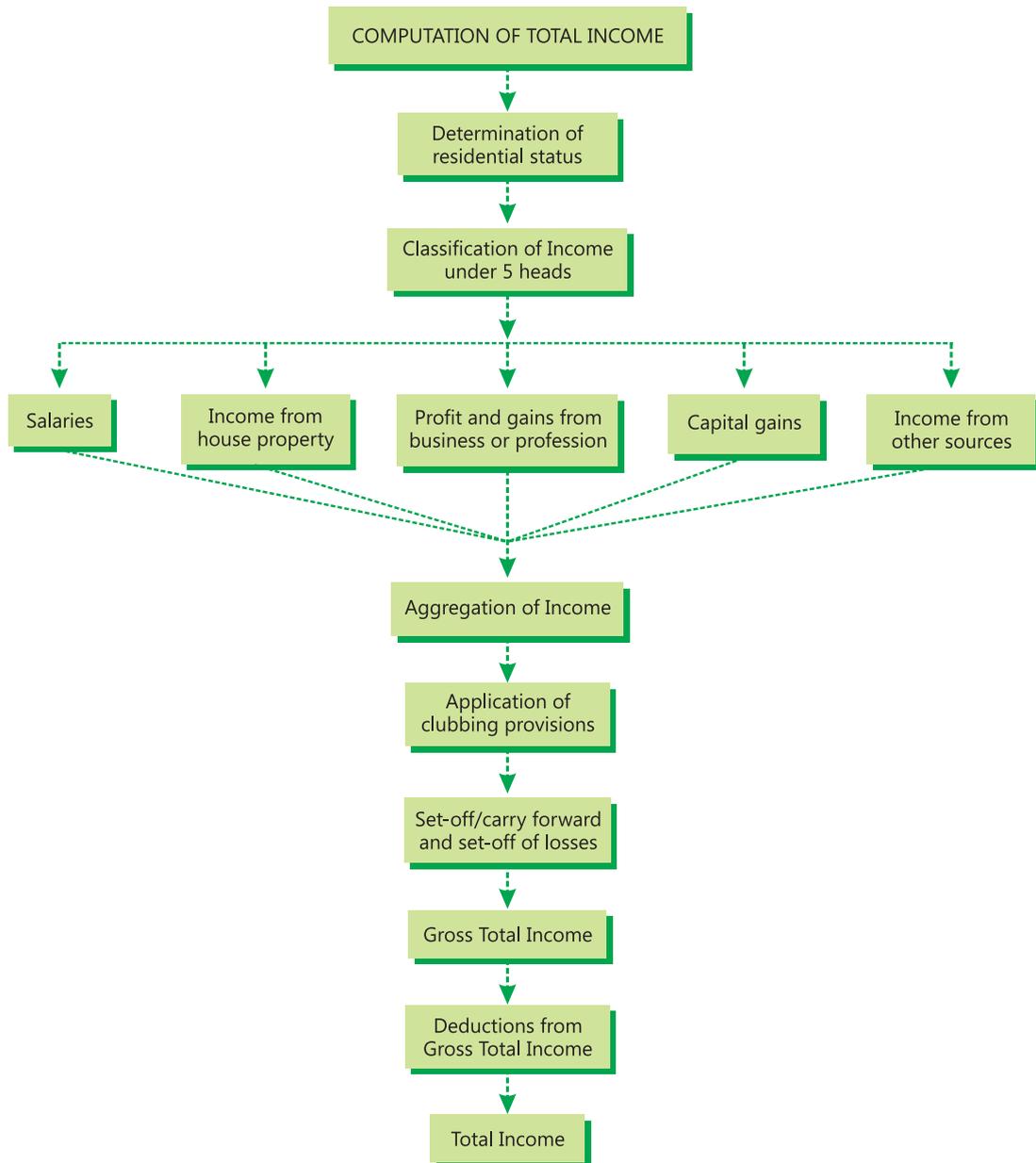
### **Step 7 – Deductions from Gross Total Income**

There are deductions prescribed from Gross Total Income. These deductions are of three types–



**Step 8 – Total income**

The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It should be rounded off to the nearest multiple of ₹ 10. The process of computation of total income is shown hereunder –



**Step 9 – Application of the rates of tax on the total income**

The rates of tax for the different classes of assessee 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 ₹ 2,50,000 for individuals. This means that no tax is payable by individuals with total income of up to ₹ 2,50,000.

Those individuals whose total income is more than ₹ 2,50,000 but less than ₹ 5,00,000 have to pay tax on their total income in excess of ₹ 2,50,000 @ 5% and so on.

The highest rate is 30%, which is attracted in respect of income in excess of ₹ 10,00,000.

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

**Step 10 - Surcharge / Rebate under section 87A**

**Surcharge:** Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. In case where the total income of an **individual/HUF/AOP/BOI** exceeds ₹ 50 lakhs but does not exceed ₹ 1 crore, surcharge is payable at the rate of **10%** of income-tax and in case total income exceeds ₹ 1 crore, surcharge is payable at the rate of 15% of income-tax.

**Rebate under section 87A:** In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 3,50,000. The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ **2,500**, whichever is less.

Level of Total Income	Surcharge	Rebate u/s 87A
≤ ₹ 3,50,000	Not applicable	Income-tax on total income or ₹ <b>2,500</b> , whichever is less
> ₹ 3,50,000 ≤ ₹ 50,00,000	Not applicable	Not applicable
> ₹ 50,00,000 ≤ ₹ 1,00,00,000	<b>10%</b> of income-tax	Not applicable
> ₹ 1,00,00,000	<b>15%</b> of income-tax	Not applicable

**Step 11 – Education cess and secondary and higher education cess on income-tax**

The income-tax, as increased by the surcharge or as reduced by the rebate under section 87A, if applicable, is to be further increased by an additional surcharge called education cess@2% and secondary and higher education cess on income-tax @1% of income-tax plus surcharge, if applicable.

**Step 12 – 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 four installments on the basis of estimated income i.e., on or before 15<sup>th</sup> June, 15<sup>th</sup> September, 15<sup>th</sup> December and 15<sup>th</sup> March. However, residents opting for presumptive taxation scheme can pay advance tax in one installment on or before 15<sup>th</sup> March instead of four installments. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Income-tax Act, 1961 or the Annual Finance 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. However, in respect of other payments like, fees for professional services, fees for technical services, interest made to residents, the person responsible for paying is liable to deduct tax at source at the time of credit of such income to the accounts of the payee or at the time of payment, whichever is earlier. 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.

**Step 13: Tax Payable/Tax Refundable**

After adjusting the advance tax and tax deducted at source, the assessee would arrive at the amount of net tax payable or refundable. Such amount should be rounded off to the nearest multiple of ₹ 10.

The assessee has to pay the amount of tax payable (called self-assessment tax) on or before the due date of filing of the return. Similarly, if any refund is due, assessee will get the same after filing the return of income.

**(2) 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 assessees 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 assessees. All companies and firms have to mandatorily file their return of income before the due date. Individuals and HUFs have to file a return of income if their total income, without giving effect to the deductions under Chapter VIA and exemption under section 10(38), exceeds the basic exemption limit.

## 2. IMPORTANT DEFINITIONS

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.

**Terms defined in the Act:** Section 2 gives definitions of the various terms and expressions used therein. If a particular definition is given in the Act itself, we have to be guided by that definition.

**Terms not defined under the Act:** 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, 1961 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. In addition, it includes –

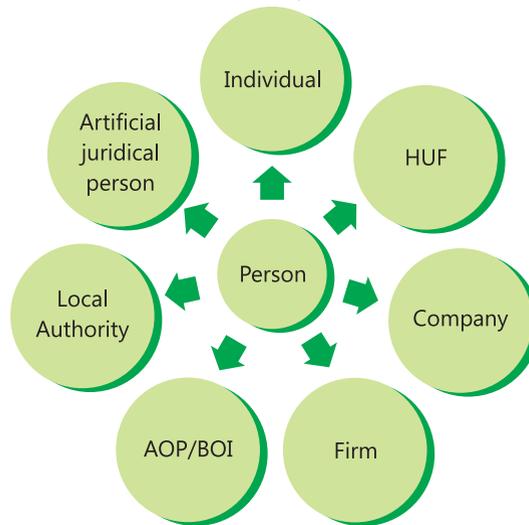
- Every person in respect of whom any proceeding under this Act has been taken for the assessment of
  - his income; or
  - assessment of fringe benefits; or
  - the income of any other person in respect of which he is assessable; or
  - the loss sustained by him or by such other person; or
  - the amount of refund due to him or by such other person.
- Every person who is deemed to be an assessee under any provision of this Act;
- Every person who is deemed to be 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'.



We may briefly consider some of the above seven categories of assessee each of which constitute 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<sup>1</sup> 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.

<sup>1</sup> under section 161(1)

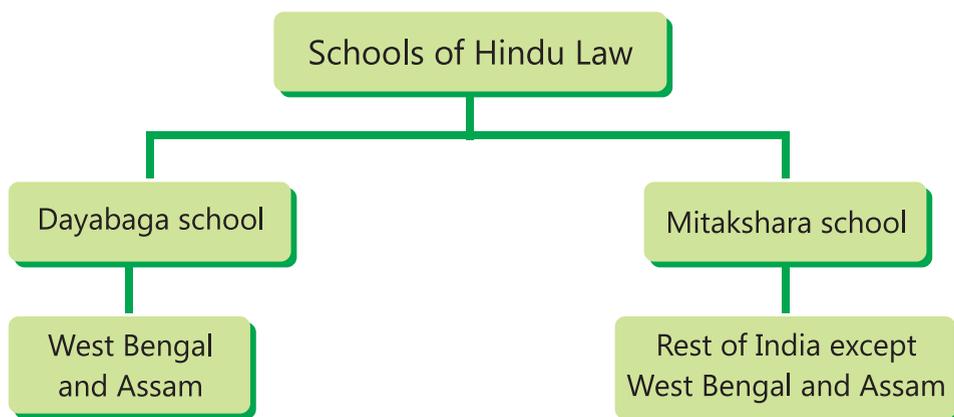
“Hindu undivided family” has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

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 (karta) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendents were considered as coparceners. With effect from 6<sup>th</sup> September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to partition.

A daughter of coparcener by birth shall become a coparcener in her own right in the same manner as the son. Being a coparcener, she can claim partition of assets of the family. The rights of a daughter in coparcenary property are equal to that of a son. However, other female members of the family, for example, wife or daughter-in-law of a coparcener are not eligible for such coparcenary rights.

The relation of a HUF does not arise from a contract but arises from status. There need not be more than one male member or one female coparcener w.e.f. 6<sup>th</sup> September, 2005 to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of atleast two male members or two coparceners.

Under the Income-tax Act, 1961, Jain undivided families and Sikh undivided families would also be assessed as a HUF.



The basic difference between the two schools of Hindu law with regard to succession is as follows:

Dayabaga school of Hindu law	Mitakshara school of Hindu law
Prevalent in West Bengal and Assam	Prevalent in rest of India
Nobody acquires the right, share in the property by birth as long as the head of family is living. Thus, 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. Hence, the father and his brothers would be the coparceners of the HUF.	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.

### **(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) anybody 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 -

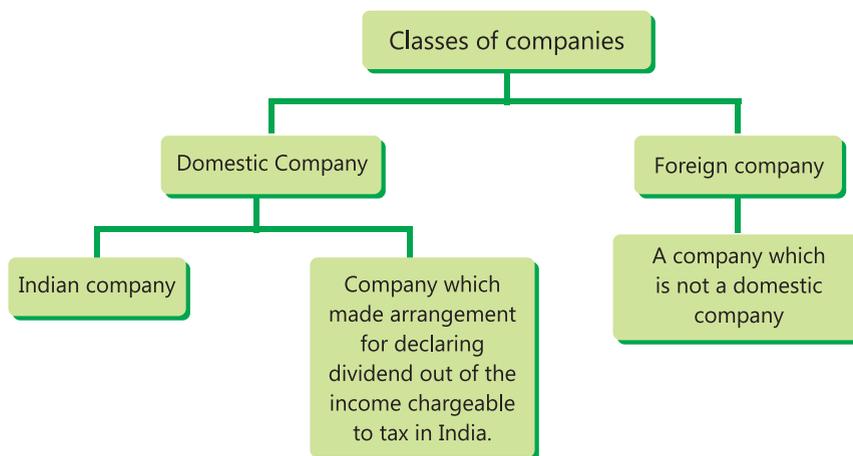
- (a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and

- (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.

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

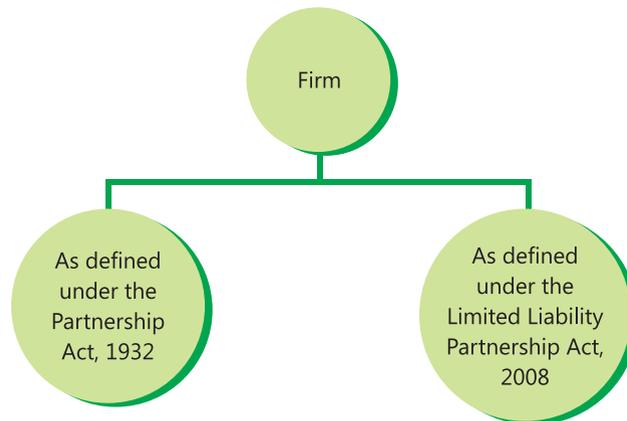


**(iv) Firm [Section 2(23)]**

The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act, 1932. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership 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.

*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'.*



#### **(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 for a **common purpose or 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.

#### **(vi) 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.

#### **(vii) 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.

### **(viii) 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)]**

### **(1) Definition 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.

Section 2(24) of the Act gives a statutory definition of income. At present, the following items of receipts are specifically 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 certain research association or universities and other educational institutions or hospitals and other medical institutions or an electoral trust.
- (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 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 profession; or not sharing any know-how, patent, copy right, trade-mark, 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 consideration received for issue of shares as exceeds the fair market value of the shares [Section 56(2)(viib)].
- (19) Any sum of money received as advance, if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset [Section 56(2)(ix)].
- (20) Any sum of money or value of property received without consideration or for inadequate consideration by any person [Section 56(2)(x)].

*[For details, refer to Unit 5 of Chapter 4 "Income from Other Sources"]*

- (21) Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee is included in the definition of income.

However, subsidy or grant or reimbursement which has been taken into account for determination of the actual cost of the depreciable asset in accordance with *Explanation 10* to section 43(1) shall not be included in the definition of income.

## **(2) Concept of Income under the Income-tax Act, 1961**

- **Regular receipt vis-a-vis casual receipt:** 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.
- **Revenue receipt vis-a-vis Capital receipt:** Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income in general parlance. 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 assets like land.
- **Net receipt vis-a-vis Gross receipt:** 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 is prescribed under the Income-tax Act, 1961. Income from certain eligible businesses/professions is also determined on presumptive basis i.e. as a certain percentage of gross receipts. *[We will discuss in detail in Unit 3 of Chapter 4 of "Profit and gains from business and profession".]*
- **Due basis vis-a-vis receipt basis:** 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. Some receipts are taxable only on receipt basis, like, income by way of interest received on compensation or enhanced compensation.

### **(3) Concept of revenue and capital receipts**

Students should carefully study the various items of receipts included in the definition of income. 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. Capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction between capital and revenue receipts is 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.

**Fixed capital or Circulating capital:** 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 not taxable while the latter is taxable. Tangible and intangible assets which the owner keeps in his possession for making profits are in the nature of fixed capital. The circulating capital is one which is turned over and yields income or loss in the process.

**Income from transfer of capital asset or trading asset:** 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.

#### ***Capital Receipts vis-a-vis Revenue Receipts: Tests to be applied***

**(1) Transaction entered into the course of business:** 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. Whereas building and land would constitute capital assets in the hands of a trader in shares, the same would constitute stock-in-trade in the hands of a property dealer.

- (2) **Profit arising from sale of shares and securities:** 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 constitute his stock-in-trade. 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.

**Note:** *However, securities held by Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992 would be treated as a capital asset. Even if the nature of such security in the hands of the Foreign Portfolio Investor is stock-in-trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.*

- (3) **A single transaction - Can it constitute business? :** 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.
- (4) **Liquidated damages:** Receipt of liquidated damages directly and intimately linked with the procurement of a capital asset, which lead to delay in coming into existence of the profit-making apparatus, is a capital receipt. The amount

received by the assessee towards compensation for sterilization of the profit earning source is not in the ordinary course of business. Hence, it is a capital receipt in the hands of the assessee.

**(5) Compensation on termination of agency:** Where an assessee receives compensation on termination of the agency business being the only source of income, the receipt is a capital nature, but taxable under section 28(ii)(c). However, 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 capital receipt, but is taxable as profit in lieu of salary under section 17(3).

**(6) Gifts:** Normally, gifts constitute capital receipts in the hands of the recipient. However, certain gifts are brought within the purview of income-tax, for example, receipt of property without consideration is brought to tax under section 56(2).

For example, any sum of money or value of property received without consideration or for inadequate consideration by 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 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.

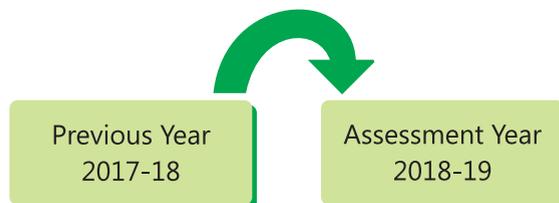
## 2.6 Maximum marginal rate and Average Rate of tax

As per section 2(10), "Average Rate of tax" means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Section 2(29C) defines "Maximum marginal rate" to mean the rate of income-tax (including surcharge on the income-tax, if any) applicable in relation to the highest

slab of income in the case of an individual, AOP or BOI, as the case may be, as specified in Finance Act of the relevant year.

## 3. PREVIOUS YEAR AND ASSESSMENT YEAR



### 3.1 Assessment year

The term has been defined under section 2(9). This means a period of 12 months commencing on 1<sup>st</sup> April every year. The year in which income is earned is the previous year and such income is taxable in the immediately following year which is the assessment year. Income earned in the previous year 2017-18 is taxable in the assessment year 2018-19.

### 3.2 Previous year

The term has been defined under section 3. It means the financial year immediately preceding the assessment year. As mentioned earlier, the income earned during the previous year is taxable 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 31<sup>st</sup> 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 31<sup>st</sup> March of the financial year.

#### Examples:

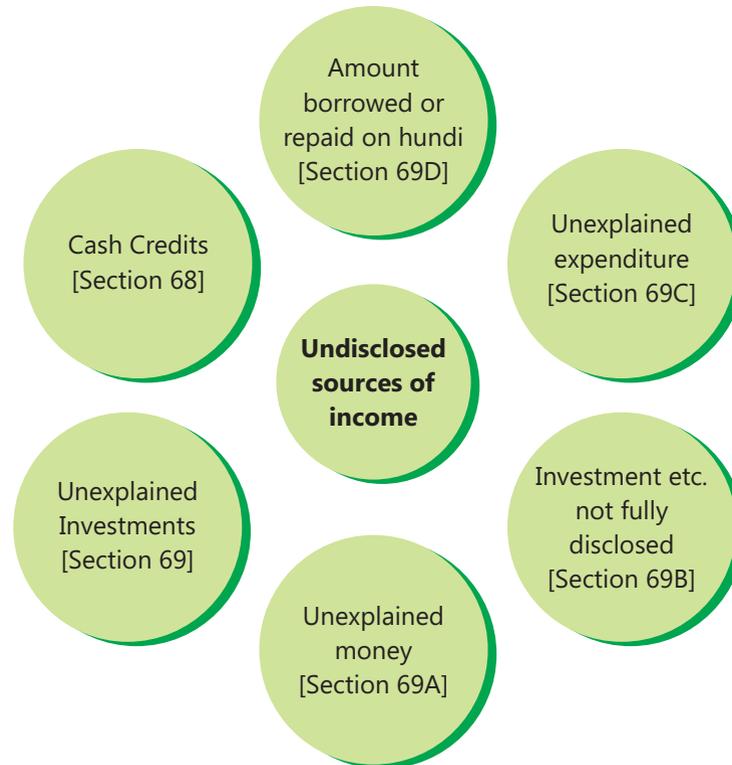
1. A is running a business from 1993 onwards. Determine the previous year for the assessment year 2018-19.

**Ans.** The previous year will be 1.4.2017 to 31.3.2018.

2. A chartered accountant sets up his profession on 1st July, 2017. Determine the previous year for the assessment year 2018-19.

**Ans.** The previous year will be from 1.7.2017 to 31.3.2018.

### 3.3 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.

**(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.

**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 31.3.2018 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 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.

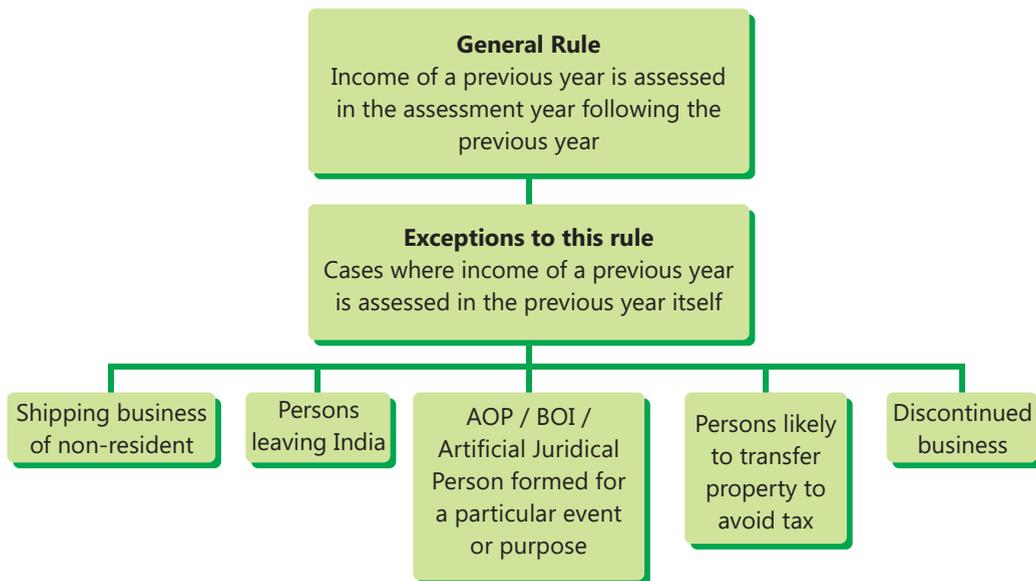
***(vi) Amount borrowed or repaid on hundi [Section 69D]***

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.

*Section 115BBE provides the rate at which such cash credits, undisclosed income, undisclosed expenditure, deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be subject to tax. See Special rates of tax in para 4.1 of this Chapter*

### 3.4 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. For instance, income of previous year 2017-18 is assessed during 2018-19. Therefore, 2018-19 is the assessment year for assessment of income of the previous year 2017-18.

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 10.6.2017 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. 2017-18 as well as the total income earned during the period 1.4.2017 to 10.06.2017.*

**(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.

**4. CHARGE OF INCOME-TAX**

Section 4 of the Income-tax Act, 1961 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 back bone 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.

#### 4.1 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, 2017 read with Part I of the First Schedule to the Finance Act, 2017, seeks to specify the rates at which income-tax is to be levied on income chargeable to tax for the assessment year 2017-18.

Part II lays down the rate at which tax is to be deducted at source during the financial year 2017-18 from income subject to such deduction under the Income-tax Act, 1961; 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 2017-18.

Part III of the First Schedule to the Finance Act, 2017 will become Part I of the First Schedule to the Finance Act, 2018 and so on.

**The slab rates applicable for A.Y.2018-19 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 ₹ 2,50,000	NIL
(ii)	where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 2,50,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 12,500 <i>plus</i> 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,12,500 <i>plus</i> 30% of the amount by which the total income exceeds ₹ 10,00,000

**ILLUSTRATION 1**

Mr. X has a total income of ₹ 12,00,000 comprising of his salary income and interest on fixed deposit. Compute his tax liability.

**SOLUTION****Computation of Tax liability**

Tax liability = ₹ 1,12,500 + 30% of ₹ 2,00,000 = ₹ 1,72,500

Alternatively:

Tax liability :

First ₹ 2,50,000	- Nil		
Next ₹ 2,50,000 – ₹ 5,00,000	- @ 5% of ₹ 2,50,000	=	₹ 12,500
Next ₹ 5,00,000 – ₹ 10,00,000	- @ 20% of ₹ 5,00,000	=	₹ 1,00,000
Balance i.e. ₹ 12,00,000 minus ₹ 10,00,000	- @ 30% of ₹ 2,00,000	=	₹ 60,000
		=	<b>₹ 1,72,500</b>

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 ₹ 3,00,000. 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 assesseees 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 ₹ 3,00,000	NIL
(ii)	where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 3,00,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 10,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,10,000 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 ₹ 10,00,00	₹ 1,00,000 <i>plus</i> 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 <i>plus</i> 20% of the amount by which the total income exceeds ₹ 10,000
(iii)	Where the total income exceeds ₹ 20,000	₹ 3,000 <i>plus</i> 30% of the amount by which the total income exceeds ₹ 20,000

**(5) Company**

(i)	In the case of a domestic company <ul style="list-style-type: none"> <li>• If the total turnover or gross receipt in the P.Y.2015-16 <math>\leq</math> ₹ 50 crore: 25% of the total income.</li> <li>• In other case: 30% of the total income</li> </ul>	
(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 Finance Act, 2017. However, in respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates—

S. No.	Section	Income	Rate of Tax
(a)	112	Long term capital gains (For details, refer Unit 4 of Chapter 4 on "Capital gains")	20%
(b)	111A	Short-term capital gains on transfer of – Equity shares in a company Unit of an equity oriented fund Unit of business trust The conditions for availing the benefit of this concessional rate are – (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and (ii) such transaction should be chargeable to securities transaction tax.	15%
(c)	115BB	Winning from Lotteries Crossword puzzles Race including horse races Card game and other game of any sort Gambling or betting of any form	30%
(d)	115BBDA (See Note 1 Below)	Income by way of dividend exceeding ₹ 10 lakhs in aggregate	10%
(e)	115BBE (See Note 2 below)	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	60%

#### Notes:

##### (1) Taxability of dividend under section 115BBDA

Section 115BBDA provides that any income by way of aggregate dividend in excess of ₹ 10 lakh shall be chargeable to tax in the hands of a person other than

- a domestic company or

- a fund or institution or trust or any university or other educational institution or any hospital or other medical institution<sup>2</sup> or
- a trust or institution<sup>3</sup>

who is resident in India, at the rate of 10%.

Further, the taxation of dividend income in excess ₹ 10 lakh shall be on gross basis i.e., no deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of dividends.

**(2) Unexplained money, investments etc. to attract tax @60% [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 rate of **60% plus surcharge @25% of tax**. Thus, the effective rate of tax (including surcharge@25% of tax and cess@3% of tax and surcharge) is 77.25%.
- (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.
- (iii) Further, no set off of any loss shall be allowable against income brought to tax under sections 68 or section 69 or section 69A or section 69B or section 69C or section 69D.

## 4.2 Surcharge

The rates of surcharge applicable for A.Y.2018-19 are as follows:

**(i) Individual/HUF/AOP/BOI/Artificial juridical person**

**(a) Where the total income > ₹ 50 lakh but is ≤ ₹ 1 crore**

Where the total income exceeds ₹ 50 lakh but does not exceed ₹ 1 crore, surcharge is payable at the rate of **10%** of income-tax computed in accordance with the provisions of sub-para (1) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such persons having a total income exceeding ₹ 50 lakh i.e., the total amount of income-tax payable (together with surcharge) on such income should not exceed the amount of income-tax payable on ₹ 50 lakh by more than the amount of income that exceeds ₹ 50 lakh.

<sup>2</sup> referred to section 10(23C)(iv)/(v)/(vi)/(via)

<sup>3</sup> registered under section 12AA

**ILLUSTRATION 2**

Compute the tax liability of Mr. A (aged 42), having total income of ₹ 51 lakhs for the Assessment Year 2018-19. Assume that his total income comprises of "Salary income", "Income under the head house property" and "Interest from Saving Bank Account".

**SOLUTION****Computation of tax liability of Mr. A for the A.Y. 2018-19**

<b>(A)</b> Tax payable including surcharge on total income of ₹ 51,00,000		
₹ 2,50,000 – ₹ 5,00,000 @ 5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000 @ 20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 51,00,000 @30%	<u>₹ 12,30,000</u>	
Total	₹ 13,42,500	
Add: Surcharge @ 10%	<u>₹ 1,34,250</u>	₹ 14,76,750
<b>(B)</b> Tax Payable on total income of ₹ 50 lakhs (₹ 12,500 plus ₹1,00,000 plus ₹ 12,00,000)		<u>₹ 13,12,500</u>
<b>(C)</b> Excess tax payable (A)-(B)		₹ 1,64,250
<b>(D)</b> Marginal Relief (₹ 1,64,250 – ₹ 1,00,000, being the amount of income in excess of ₹ 50,00,000)		<u>₹ 64,250</u>
<b>(E)</b> Tax payable (A)-(D)		₹ 14,12,500
Add: Education cess @1% and SHEC@2%		<u>₹ 42,375</u>
<b>Tax Liability</b>		<u>₹ 14,54,875</u>
<b>Tax Liability (Rounded off)</b>		<b>₹ 14,54,880</b>

**(b) Where the total income > ₹ 1 crore**

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of **15%** of income-tax computed in accordance with the provisions of sub-para (1) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such persons having a total income exceeding ₹ 1 crore i.e., the total amount of income-tax payable (together with surcharge) should not exceed the amount of income-tax and surcharge payable on total income of ₹ 1 crore by more than the amount of income that exceeds ₹ 1 crore.

**ILLUSTRATION 3**

Compute the tax liability of Mr. A (aged 42), having total income of ₹ 1,01,00,000 for the Assessment Year 2018-19. Assume that his total income comprises of "Salary income", "Income under the head house property" and "Interest from fixed deposit Account".

**SOLUTION****Computation of tax liability of Mr. A for the A.Y. 2018-19**

<b>(A)</b> Tax payable including surcharge on total income of ₹ 1,01,00,000		
₹ 2,50,000 – ₹ 5,00,000 @ 5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000 @ 20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 1,01,00,000@30%	<u>₹ 27,30,000</u>	
Total	₹ 28,42,500	
Add: Surcharge @ 15%	<u>₹ 4,26,375</u>	₹ 32,68,875
<b>(B)</b> Tax Payable on total income of ₹ 1 crore [(₹ 12,500 plus ₹ 1,00,000 plus ₹ 27,00,000) plus surcharge@10%]		<u>₹ 30,93,750</u>
<b>(C)</b> Excess tax payable (A)-(B)		₹ 1,75,125
<b>(D)</b> Marginal Relief (₹ 1,75,125 – ₹ 1,00,000, being the amount of income in excess of ₹ 1,00,00,000)		<b>₹ 75,125</b>
<b>(E)</b> Tax payable (A)-(D)		₹ 31,93,750
Add: Education Cess @1% and SHEC @2%		<u>₹ 95,813</u>
<b>Tax Liability</b>		<b><u>₹ 32,89,563</u></b>
<b>Tax Liability (Rounded off)</b>		<b>₹ 32,89,560</b>

**(ii) Firm/Limited Liability Partnership/Local Authorities/Co-operative societies**

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of 12% of income-tax computed in accordance with the provisions of sub-para (2)/(3)/(4) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such persons 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.

**(iii) Domestic company****(a) In case of a domestic company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore**

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 7% of income-tax computed in accordance with the provisions of sub-para (5)(i) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such companies 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.

**(b) In case of a domestic company, whose total income is > ₹ 10 crore**

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 12% of income-tax computed in accordance with the provisions of sub-para (5)(i) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 10 crore should not be more than the amount of income exceeding ₹ 10 crore.

**(iv) Foreign company****(a) In case of a foreign company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore**

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 2% of income-tax computed in accordance with the provisions of sub-para (5)(ii) of para 4.1 above or section 111A or section 112.

**Marginal relief**

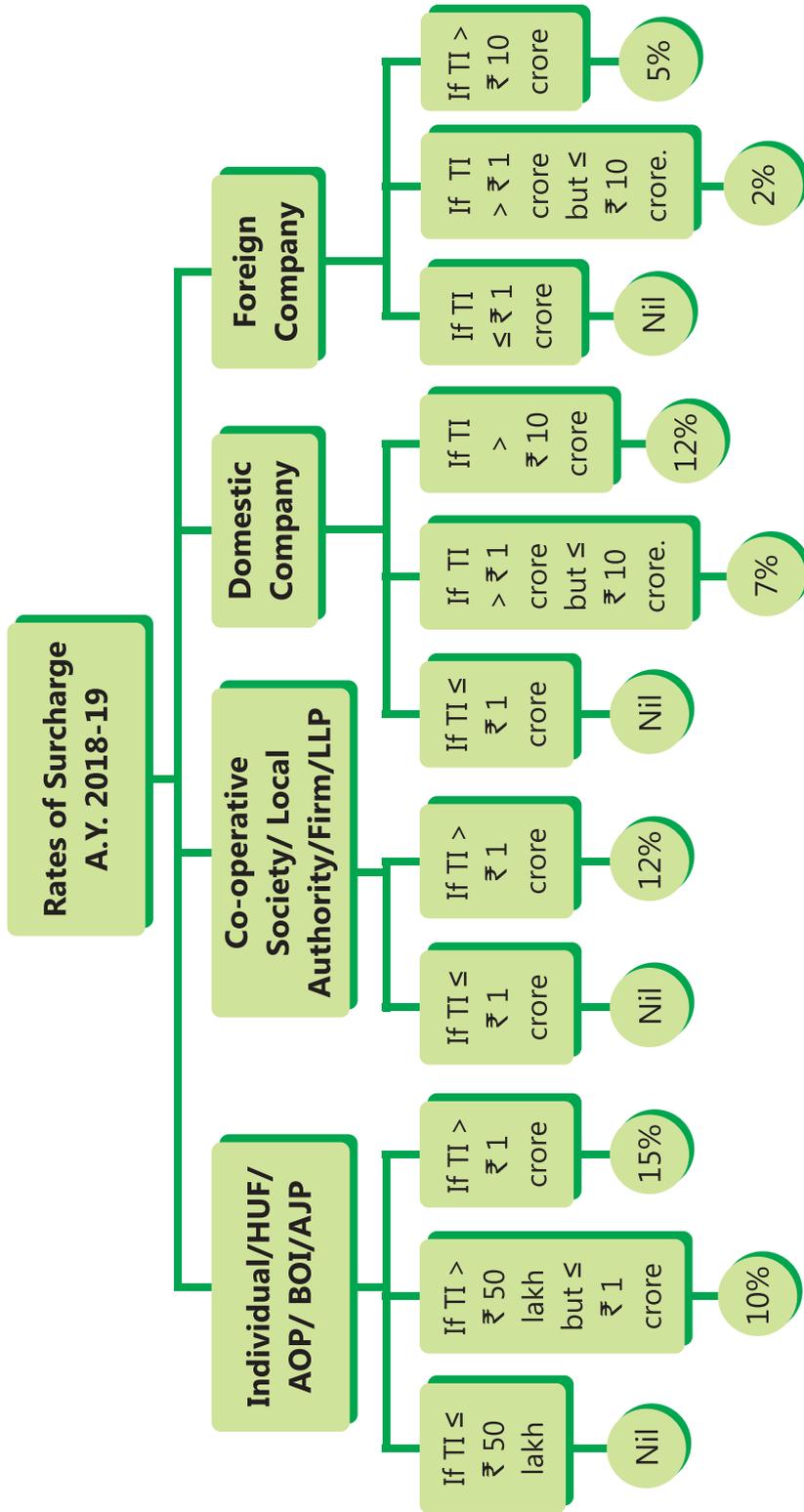
Marginal relief is available in case of such companies i.e., the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

**(b) In case of a foreign company, whose total income is > ₹ 10 crore**

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with the provisions of sub-para (5)(ii) of para 4.1 above or section 111A or section 112.

**Marginal relief**

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 10 crore should not be more than the amount of income exceeding ₹ 10 crore.



### 4.3 Rebate of up to ₹ 2,500 for resident individuals having total income of up to ₹ 3.5 lakh [Section 87A]

In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 3,50,000.

- (i) The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 2,500, whichever is less.
- (ii) Consequently, any individual having total income up to ₹ 3,00,000 will not be required to pay any tax. Further, every individual having total income of above ₹ 3,00,000 but not exceeding ₹ 3,50,000 shall get a tax relief of ₹ 2,500. In effect, the rebate would be the tax payable or ₹ 2,500, whichever is less.
- (iii) Further, the aggregate amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

#### “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.

#### ILLUSTRATION 4

*Mr. Raghav aged 26 years, has a total income of ₹ 3,40,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y. 2018-19.*

#### SOLUTION

##### Computation of tax liability of Mr. Raghav for A.Y. 2018-19

Particulars	₹
Tax on total income of ₹ 3,40,000	
Tax@5% of ₹ 90,000 (₹ 3,40,000 – ₹ 2,50,000)	4,500
Less: Rebate u/s 87A (Since total income ≤ ₹ 3,50,000)	2,500
	2,000
Add: Education cess@2% and SHEC@1%	60
<b>Total tax liability</b>	<b>2,060</b>

**EXERCISE****Question 1**

*Describe average rate of tax and maximum marginal rate under section 2(10) and 2(29C) of the Income-tax Act, 1961.*

**Answer**

As per section 2(10), "**Average Rate of tax**" means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Section 2(29C) defines "**Maximum marginal rate**" to mean the rate of income-tax (including surcharge on the income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, AOP or BOI, as the case may be, as specified in Finance Act of the relevant year.

**Question 2**

*Who is an "Assessee"?*

**Answer**

As per section 2(7), assessee means a person by whom tax or any other sum of money is payable under the Income-tax Act, 1961.

In addition, the term includes –

- Every person in respect of whom any proceeding under the Act has been taken for the assessment of –
  - his income; or
  - the income of any other person in respect of which he is assessable; or
  - the loss sustained by him or by such other person; or
  - the amount of refund due to him or to such other person.
- Every person who is deemed to be an assessee under any provision of this Act;
- Every person who is deemed to be an assessee in default under any provision of this Act.

**Question 3**

*State any four instances where the income of the previous year is assessable in the previous year itself instead of the assessment year.*

**Answer**

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, 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) 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) 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.
- (iii) 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) 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) 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.

### LET US RECAPITULATE

Income-tax is the most significant direct tax. **Entry 82 of the Union List** i.e., List I of Seventh Schedule to Article 246 of the Constitution of India has given the power to Central Government to levy taxes on income other than agricultural income.

#### Components of income-tax law

- Income-tax Act, 1961
- Income-tax Rules, 1962
- Annual Finance Act
- Circulars/Notifications
- Case law decisions

Income-tax is a **TAX** levied on the **TOTAL INCOME** of the **PREVIOUS YEAR** of every **PERSON**.

**(1) Person:** A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals(BOI), a firm, a company etc.

**(2) Concept of Previous year(P.Y.) and Assessment Year (A.Y.):** Previous year is the financial year immediately preceding the assessment year i.e., it is the financial year ending on 31<sup>st</sup> March, in which the income has accrued/received.

In case of a newly set-up business, the previous year would be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly came into existence, and ending on 31<sup>st</sup> March.

**Assessment year (A.Y.):** Assessment year means the period of twelve months commencing on the 1st April every year.

#### Exception to the rule that income is charged to income-tax in the Assessment Year following the previous year:

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in the following cases, this rule does not apply and the income is taxed in the previous year in which it is earned.

- (i) Shipping business of non-resident [Section 172]
- (ii) Persons leaving India [Section 174]
- (iii) AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A]
- (iv) Persons likely to transfer property to avoid tax [Section 175]
- (v) Discontinued business [Section 176]

**Previous Year for Undisclosed Sources of Income:** The following undisclosed source of income are charged to tax in the previous year in which they assessed by the Assessing Officer:

- (i) Cash Credits [Section 68]
- (ii) Unexplained Investments [Section 69]
- (iii) Unexplained money etc. [Section 69A]
- (iv) Amount of investments etc., not fully disclosed in the books of account [Section 69B]
- (v) Unexplained expenditure [Section 69C]
- (vi) Amount borrowed or repaid on hundi [Section 69D]

The above undisclosed income are chargeable to tax @60% plus surcharge @25% as specified under section 115BBE.

**(3) Total Income:** Total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The following steps has to be followed for computing the total income of an assessee:

- Step 1 – Determination of residential status
- Step 2 – Classification of income under different heads
- Step 3– Computation of income under each head
- Step 4 – Clubbing of income of spouse, minor child etc.
- Step 5 – Set-off or carry forward and set-off of losses
- Step 6 – Computation of Gross Total Income
- Step 7 – Deductions from Gross Total Income
- Step 8 – Computation of Total income

**(4) Tax liability:** Tax has to computed by applying the rates of tax mentioned in the Annual Finance Act and the rate specified under the Income-tax Act, 1961, as the case may be.

Persons	Rate of taxes	
<b>Individual</b>	<b>Total income (in ₹)</b>	<b>Rate of Tax</b>
	Upto ₹ 2,50,000 (below 60 years)	Nil
	Upto ₹ 3,00,000 (60 years or above but less than 80 years and resident in India)	Nil
	Upto ₹ 5,00,000 (above 80 years and resident in India)	Nil
	₹ 2,50,001/3,00,001, as the case may be, to ₹ 5,00,000	5%
	₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%	

<b>Hindu Undivided Family (HUF) / Association of Persons (AOP) / Body of Individuals (BOI) / Artificial Juridical Person</b>	<b>Total income (in Rs.)</b>		<b>Rate of Tax</b>
	Upto ₹ 2,50,000		Nil
	₹ 2,50,001 to ₹ 5,00,000		5%
	₹ 5,00,001 to ₹ 10,00,000		20%
	Above ₹ 10,00,000		30%
<b>Firm/LLP/local authority</b>	<b>30%</b>		
<b>Co-operative Society</b>	<b>Total income (in ₹)</b>		<b>Rate of Tax</b>
	Upto ₹ 10,000		10%
	₹ 10,001 to ₹ 20,000		20%
	Above ₹ 20,000		30%
<b>Company</b>	<b>Domestic Company</b>		<b>Foreign Company</b>
	Total turnover or gross receipt in the P.Y.2015-16 ≤ ₹ 50 crore	Other domestic companies	
	25%	30%	40%
<b>Surcharge</b>			
<b>Individual/HUF/AOP/BOI/Artificial juridical person</b>			
Where the total income > ₹ 50 lakh but is ≤ ₹ 1 crore			10%
Where the total income > ₹ 1 crore			15%
<b>Firm/Limited Liability Partnership/Local Authorities/Co-operative societies</b>			
Where the total income > ₹ 1 crore			12%
<b>Domestic company</b>			
Total income > ₹ 1 crore but is ≤ ₹ 10 crore			7%
total income is > ₹ 10 crore			12%

<b>Foreign company</b>	
Total income > ₹ 1 crore but is ≤ ₹ 10 crore	2%
Total income is > ₹ 10 crore	5%
<b>Rebate under section 87A:</b> Rebate of up to ₹ 2,500 for resident individuals having total income of up to ₹ 3.5 lakh.	
<b>“Education Cess” and “Secondary and Higher Education Cess” on Income-tax:</b>	
Education cess	2% of income-tax and surcharge, if applicable
Secondary and Higher Education Cess	1% of income-tax and surcharge, if applicable

 **TEST YOUR KNOWLEDGE**

1. *The basic source of income-tax law is -*
  - (a) *Income-tax Act, 1961*
  - (b) *Circulars/Notifications issued by CBDT*
  - (c) *Judgments of Courts*
  - (d) *None of the above*
  
2. *A domestic company means -*
  - (a) *Only an Indian company*
  - (b) *Only a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India*
  - (c) *Indian company and a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India*
  - (d) *Both Indian company and foreign company which has or has not made the prescribed arrangement for declaration and payment of dividends in India*
  
3. *The rates of income tax are mentioned in -*
  - (a) *The Income-tax Act, 1961 only*
  - (b) *The Annual Finance Act*
  - (c) *Both in the Income-tax Act, 1961 and the Annual Finance Act*
  - (d) *Income-tax Rules, 1962.*
  
4. *The surcharge applicable in the case of an individual is -*
  - (a) *10% of tax payable if total income exceeds ₹ 50 lakhs but does not exceed ₹ 1 crore*
  - (b) *10% of tax payable if total income exceeds ₹ 1 crore*
  - (c) *15% of tax payable if total income exceeds ₹ 1 crore*
  - (d) *Both a) and c), as the case may be.*
  
5. *In respect of a non-resident assessee, who is of the age of 60 years or more but less than 80 years at any time during the previous year 2017-18, -*
  - (a) *Basic exemption of ₹ 2,50,000 is available*
  - (b) *Basic exemption of ₹ 3,00,000 is available*
  - (c) *Basic exemption of ₹ 3,50,000 is available*
  - (d) *Basic exemption of ₹5,00,000 is available.*
  
6. *The rate of tax applicable to a domestic company for A.Y. 2018-19, where turnover/ gross receipts do not exceed ₹ 50 crore during the P.Y. 2015-16, is -*

- (a) 29%
- (b) 25%
- (c) 30%
- (d) None of the above
7. The surcharge applicable to a domestic company for A.Y. 2018-19 is -
- (a) 5%, if total income exceeds ₹ 1 crore.
- (b) 10%, if the total income exceeds ₹ 1 crore
- (c) 7%, if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 15%, if the total income exceeds ₹ 10 crore.
- (d) 7%, if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 12%, if the total income exceeds ₹ 10 crore.
8. The surcharge applicable to a foreign company for A.Y. 2018-19 is -
- (a) 5%, if the total income exceeds ₹ 1 crore.
- (b) 10%, if the total income exceeds ₹ 1 crore.
- (c) 2%, if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore and 5% if the total income exceeds ₹ 10 crore.
- (d) 2%, if the total income exceeds ₹ 10 crore.
9. The rate of tax applicable to a firm for A.Y. 2018-19 is -
- (a) 25%
- (b) 30%
- (c) 35%
- (d) 40%
10. Where the total income of an artificial juridical person is ₹ 3,10,000, the income-tax payable is ₹ ..... and surcharge payable is ₹ .....
- (a) ₹ 3,000; surcharge – nil.
- (b) ₹ 6,000; surcharge – nil.
- (c) ₹ 11,000; surcharge – ₹ 1100
- (d) ₹ 93,000; surcharge – ₹ 4650.
11. "Income of a previous year will be charged to tax in the assessment year following the previous year"- Discuss the exceptions to this general rule.
12. Explain the concept of "Marginal Relief" under the Income-tax Act, 1961.

### Answers

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