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 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:** 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. 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 assesses. The department is bound by the circulars. While such circulars are not binding on the assesses, they can take advantage of beneficial circulars.

Notifications are issued by the Central Government to give effect to the provisions of the Act. For example, under section 10(15)(iv)(h), interest payable by any public sector company in respect of such bonds or debentures and subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in this behalf would be exempt. Therefore, the bonds and debentures, interest on which would qualify for exemption under this section are specified by the Central Government through Notifications.

The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications. For example, under section 35CCD, the CBDT is empowered to prescribe guidelines for notification of skill development project. Accordingly, the CBDT has, vide Notification No.54/2013 dated 15.7.2013, prescribed Rule 6AAF laying down the guidelines and conditions for approval of skill development project under section 35CCD.

**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 assesses 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.
1.4 Income-tax

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, 1961.

- 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 2016-17 is assessed during 2017-18. Therefore, 2017-18 is the assessment year for assessment of income of the previous year 2016-17.

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 –

RESIDENTIAL STATUS UNDER THE INCOME TAX ACT, 1961

- RESIDENT
- NON-RESIDENT
  - RESIDENT AND ORDINARILY RESIDENT
  - RESIDENT BUT NOT ORDINARILY RESIDENT

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 –

HEADS OF INCOME

- SALARIES
- INCOME FROM HOUSE PROPERTY
- PROFITS AND GAINS OF BUSINESS OR PROFESSION
- CAPITAL GAINS
- INCOME FROM OTHER SOURCES

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 residuary 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.

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from Gross
Total Income. These deductions are of three types –
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 should be rounded off to the nearest multiple of ₹ 10. The process of computation of total income is shown hereunder –
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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 ₹ 2,50,000 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 @ 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 domestic companies, a flat rate of tax is prescribed. At present, the rate is 30% on the whole of their total income. In case of domestic companies whose total turnover or gross receipts in the P.Y.2014-15 does not exceed ₹ 5 crore, the rate of tax is 29% of the total income for A.Y.2017-18.

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

Step 11 - 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 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 10% 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 ₹ 5,00,000. The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 5,000, whichever is less.

<table>
<thead>
<tr>
<th>Level of Total Income</th>
<th>Surcharge</th>
<th>Rebate u/s 87A</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ ₹ 5,00,000</td>
<td>Not applicable</td>
<td>Income-tax on total income or ₹ 5,000, whichever is less</td>
</tr>
<tr>
<td>≥ ₹ 5,00,000 ≤ ₹ 1,00,00,000</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>≥ ₹ 1,00,00,000</td>
<td>15% of income-tax</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

Step 12 – 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%. The education cess on income-tax is for the purpose of providing universalized quality basic education. This is payable by all assessees 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. 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.
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,
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(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 assessees 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 daughters.

The relation of a HUF does not arise from a contract but arises from status. There need not be more than one male member to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of at least two male members.

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 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 6th 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.

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

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) 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.

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.

(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
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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)/(iv)/(vi)/(via) 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) (iiiiae)/(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.
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(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, 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 sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viia) [Refer to Unit 5 of Chapter 4 “Income from Other Sources”].

(19) Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in section 56(2)(viiib) [Refer to Unit 5 of Chapter 4 “Income from Other Sources”].

(20) Any sum of money referred to in section 56(2)(ix) [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.

Subsidy or Grant which are not included in the definition of income u/s 2(24)

- Subsidy or grant or reimbursement taken into account for determination of actual cost of depreciable asset
- Subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by a Central Govt. or State Govt., as the case may be.

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. 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.

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 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.

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. 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.

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 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.

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.

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) 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.

(7) 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).

(8) 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 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 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.
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 assessees
- 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, 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 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, 2016 read with Part I of the First Schedule to the Finance Act, 2016, seeks to specify the rates at which income-tax is to be levied on income chargeable to tax for the assessment year 2016-17. Part II lays down the rate at which tax is to be deducted at source during the financial year 2016-17 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 2016-17. Part III of the First Schedule to the Finance Act, 2016 will become Part I of the First Schedule to the Finance Act, 2017 and so on.
The slab rates applicable for A.Y. 2017-18 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 10% 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 ₹ 25,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000;
(iv) where the total income exceeds ₹ 10,00,000 ₹ 1,25,000 plus 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. Compute his gross tax liability.

Tax liability = ₹ 1,25,000 + 30% of ₹ 2,00,000 = ₹ 1,85,000

Alternatively:

Tax liability : 
First ₹ 2,50,000 - Nil
Next ₹ 2,50,000 – ₹ 5,00,000 - @ 10% of ₹ 2,50,000 = ₹ 25,000
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 = ₹ 1,85,000

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 ₹ 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 assesses 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 10% 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 ₹ 20,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000;

(iv) where the total income exceeds ₹ 10,00,000 ₹ 1,20,000 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 ₹ 1,00,000 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 If the total turnover or gross receipt in the P.Y.2014-15 ≤ ₹ 5 crore, 29% of the total income. In case of other companies, 30% of the total income 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, 2016. 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. (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 or
   (iii) a unit of a 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.

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.

4. Section 115BBDA provides that any income by way of aggregate dividend in excess of ₹ 10 lakh shall be chargeable to tax in the case of an individual, Hindu undivided family (HUF) or a firm 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.

**Surcharge**

The rates of surcharge applicable for A.Y. 2017-18 are as follows:

(i) **Individual / HUF / AOP / BOI / Artificial juridical person / Co-operative societies / Local Authorities / Firms / LLPs**

   Where the total income exceeds ₹ 1 crore, in case of individual, HUF, AOP/BOI and Artificial juridical person, surcharge is payable at the rate of 15% of income-tax computed in accordance with the provisions of para (1) above or section 111A or section 112.

   Where the total income exceeds ₹ 1 crore, in case of Firm/LLP, Local Authorities and Co-operative Societies, surcharge is payable at the rate of 12% of income-tax computed in accordance with the provisions of para (2)/(3)/(4) above or section 111A or section 112.
Marginal relief is available in case of such persons 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.

(ii) 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 para (5)(i) above or section 111A or section 112. 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.

Illustration 2
Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 1,01,00,000 for A.Y.2017-18 and the total income does not include any income in the nature of capital gains
[Note - The gross receipts of X Ltd. for the P.Y.2014-15 is ₹ 7,00,00,000]

Solution
The tax payable on total income of ₹ 1,01,00,000 of X Ltd. computed@ 32.1% (including surcharge@7%) is ₹ 32,42,100. However, the tax cannot exceed ₹ 31,00,000 (i.e., the tax of ₹ 30,00,000 payable on total income of ₹ 1 crore plus ₹ 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. The marginal relief is ₹ 1,42,100 (i.e., ₹ 32,42,100 - ₹ 31,00,000).

(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 para (5)(i) above or section 111A or section 112.

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.

Illustration 3
Compute the tax liability of Y Ltd., a domestic company, assuming that the total income of Y Ltd. for A.Y.2017-18 is ₹ 10,01,00,000 and the total income does not include any income in the nature of capital gains.
[Note - The gross receipts of Y Ltd. for the P.Y.2014-15 is ₹ 9,00,00,000]
Solution

The tax payable on total income of ₹ 10,01,00,000 of Y Ltd. computed @ 33.6% (including surcharge @ 12%) is ₹ 3,36,33,600. However, the tax cannot exceed ₹ 3,22,00,000 [i.e., the tax of ₹ 3,21,00,000 (32.1% of ₹ 10 crore) payable on total income of ₹ 10 crore plus ₹ 1,00,000, being the amount of total income exceeding ₹ 10 crore]. Therefore, the tax payable on ₹ 10,01,00,000 would be ₹ 3,22,00,000. The marginal relief is ₹ 14,33,600 (i.e., ₹ 3,36,33,600 - ₹ 3,22,00,000).

(iii) 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 paragraph (5)(ii) above or section 111A or section 112. 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 para (5)(ii) above or section 111A or section 112.

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.

Rebate of up to ₹ 5,000 for resident individuals having total income of up to ₹ 5 lakh [Section 87A]

In order to provide tax relief to the individual tax payers who are in the 10% 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 ₹ 5,00,000.

(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 ₹ 5,000, 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 ₹ 5,00,000 shall get a tax relief of ₹ 5,000. In effect, the rebate would be the tax payable or ₹ 5,000, 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.
### Rates of Surcharge
A.Y. 2017-18

**Individual/HUF, AOP, BOI, AJP**
- If TI ≤ ₹1 crore: Nil
- If TI > ₹1 crore: 15%

**Co-operative Society, Local Authority, Firm, LLP**
- If TI ≤ ₹1 crore: Nil
- If TI > ₹1 crore: 12%

**Domestic Company**
- If TI ≤ ₹1 crore: Nil
- If TI > ₹1 crores but ≤ ₹10 crores: 7%
- If TI > ₹10 crores: 12%

**Foreign Company**
- If TI ≤ ₹1 crore: Nil
- If TI > ₹1 crore but ≤ ₹10 crores: 2%
- If TI > ₹10 crores: 5%
“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 2017-18, the relevant previous year is 2016-17 (1.4.2016 to 31.3.2017).

(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:
1. A is running a business from 1993 onwards. Determine the previous year for the assessment year 2017-18.
   **Ans.** The previous year will be 1.4.2016 to 31.3.2017.

   **Ans.** The previous year will be from 1.7.2016 to 31.3.2017.

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 31.3.2017 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
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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.

**Unexplained money, investments etc. to attract tax @30% [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 30%.

(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.**

4.3 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
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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. 2016-17 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.