

BASIC CONCEPTS OF INCOME TAX LAW AND TAX RATES

Income Tax Law:

Income-tax is a tax levied on the total income of an assessee, being a person charged under the provisions of this Act, for the relevant previous year.

For understanding Income tax law in India, the following components need to be studied carefully:

- (1) Income-tax Act, 1961
- (2) Annual Finance Acts
- (3) Income-tax Rules, 1962
- (4) Notification and Circulars, issued from time to time
- (5) Judicial Decisions

(1) Income-tax Act, 1961: The levy of income-tax in India is governed by the Income-tax Act, 1961 which extends to whole of India and came into force on 1st April, 1962. The Act contains 298 sections and XIV schedules. It contains provisions for determination of taxable income, tax liability, assessment procedures, appeals, penalties and prosecutions. These undergo changes every year with additions and deletions brought by the Annual Finance Act passed by the Parliament.

(2) Annual Finance Acts: Every year, Finance Bill is introduced by the Finance Minister of the Government of India 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.

(3) Income-tax Rules: Central Board of Direct Taxes (CBDT) looks after the administration of direct taxes and is empowered u/s 295 of the Income Tax Act to make rules for carrying out the purposes of the Act. Thereby it frames various rules from time to time for the proper administration of the Income-tax Act, 1961. These rules were first framed in 1962 and are thereby collectively called Income-tax Rules, 1962.

(4) 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 assesseees**. These circulars are **binding on the department and not on the assessee** and therefore the assessee can take advantage of beneficial circulars.

Notifications are issued by the Central Government to give effect to the provisions of the Act. For example, u/s 10(15)(iv)(h), interest on bonds and debentures are exempt by the Central Government subject to such conditions through Notifications. The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications. For example, u/s 35CCD, the CBDT is empowered to prescribe guidelines for notification of skill development project.

(5) Judicial Decisions: Judicial decisions are an important and unavoidable part of the study of income-tax law. For the Parliament, it is not possible to provide for all possible issues that may arise in the implementation of any Act and hence the **judiciary will have to consider various cases between the assesseees 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**. In case, where

the apparently contradictory decisions are given by benches having similar number of judges, the principle of the later decision would be applicable. The **decisions given by various High Courts will apply in the respective states** in which such High Courts have jurisdiction.

Charge of Income Tax: [Sec. 4]

Tax cannot be levied or collected in India except under the authority of Law. Section 4 of the Income-tax Act, 1961 gives authority to the Central Government for charging income tax. This is the charging section in the Income-tax Act, 1961 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 insofar as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

Assessment Year: [Sec. 2(9)]

Assessment year means a period of 12 months commencing on 1st April every year. The total income earned by the assessee during the previous year shall be chargeable to tax in the next year; which is termed as the assessment year. For example, for the previous year 2022-23, the relevant assessment year shall be 2023-24 (1.4.2022 to 31.3.2023).

Previous Year: [Sec. 3]

The year in which income is earned, i.e. the financial year immediately preceding the assessment year, is called the previous year and the tax shall be paid on such income in the next year which is called the assessment year. This means that the tax is **levied** on the income in the year in which it is earned; referred as previous year and the tax on such income will be **paid** in the assessment year. All assesseees are required to follow a uniform previous year i.e. the financial year starting from 1st April and ending on 31st March.

Person: [Sec. 2(31)]

As the income tax is levied on the total income of the previous year of every 'person', it becomes important to understand the term 'Person'. The term 'person' includes the following seven categories:

- (i) an individual,
- (ii) a Hindu Undivided Family (HUF),
- (iii) a company,
- (iv) a firm,
- (v) an Association of persons (AoP) or a Body of Individuals (BoI), whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person not falling within any of the preceding sub-clauses. *e.g.*, a university or deity.

As per Explanation to Sec. 2(31), an AoP/ BoI/ Local authority or any artificial juridical person shall be deemed to be a person, irrespective of whether they were formed or established with the purpose of earning or deriving profits or not.

Assessee: [Sec. 2(7)]

Assessee means a person by whom **any tax or any other sum of money is payable** under this Act. It **also includes the following**:

- (i) Every person in respect of whom **any proceeding under this Act has been taken** for the assessment of his income;
- (ii) Every person who is **deemed to be an assessee** under any provisions of this Act. Sometimes, a person becomes assessable in respect of the income of some other persons. In such case also, he is considered as an assessee; For example, legal representative of a deceased person;
- (iii) Every person who is deemed to be an **assessee in default** under any provision of this Act. For example, where a person making any payment to other person is liable to deduct tax at source, and if he has not deducted tax at source or has deducted but not deposited the tax with the government; he shall be deemed to be an assessee in default.

Certain Principles relating to Income under Income-tax Act:

The following are the important principles relating to income:

- Income generally refers to **revenue receipts**, but however under the Income-tax Act, 1961, certain capital receipts have also been specifically included within the definition of income for example capital gains i.e. gains on sale of a capital assets like land.
- The income to be considered for tax purpose shall be **net receipts** and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts.
- Income is taxable either on due basis or receipt basis, as provided under the respective head of income. For the purpose of computing income under the heads 'Profits and gains of business or profession' and 'Income from other sources', the **method of accounting** which is regularly followed by the assessee should be considered, which can be either cash system or mercantile system.
- Income earned during the year i.e. the previous year shall be **chargeable to tax in the next year i.e. the assessment year**. e.g. the income of the P.Y. 2022-23 shall be chargeable in the A.Y. 2023-24 But, there are **certain exceptions** to this principle (i.e. **Accelerated assessment u/s 172, 174, 174A and 175**) which are discussed in the Chapter 'Liability in Special Cases'.

Definition of Income: [Sec. 2(24)]

The definition of 'Income' given under section 2(24) is inclusive and not exhaustive and therefore it may be possible that certain items may be considered as income under this Act according to its general and natural meaning, even if it is not included under section 2(24). The term 'Income' includes the following:

- Profits and gains;
- Dividend;
- Voluntary contributions received by a trust which is created wholly or partly for charitable or religious purposes; or by educational institutions, hospitals or electoral trust;
- The value of any perquisite or profit in lieu of salary taxable u/s 17;
- Any special allowance granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of office or employment duties;

- The value of any benefit or perquisite, whether converted into money or not, obtained from a company either by a director or by a person who has 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, otherwise, would have been payable by the director or other person aforesaid;
- The value of benefit or perquisite to a representative assessee like a trustee appointed under a trust;
- Any sum chargeable to income-tax under clauses (ii) and (iii) of sec. 28 or sec. 41 or sec. 59;
- Any sum chargeable to income-tax under clauses (iiia), (iiib), (iiic), (iv), (v), (va) and (via) of sec. 28;
- Any capital gains chargeable u/s 45;
- The profits and gains of any insurance business carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profit and gains by virtue of provisions contained in the First Schedule;
- The profits and gains of any of banking business (including providing credit facilities) carried on by a co-operative society with its members;
- Winnings from lottery, crossword puzzles, races (including horse races), card games or other games of any sort or from gambling or betting;
- Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under Employees' State Insurance Act, 1948 or any fund for the welfare of such employee; [Sec. 2(24)(x)]
- Any amount received under the Keyman insurance policy including the sum allocated by way of bonus; [Sec. 2(24)(xi)]
- Any sum chargeable to income-tax u/s 56(2)(v), (vi);
- Any sum of money or specified movable or immovable properties received without consideration or inadequate consideration as provided u/s 56(2)(vii), (viia);
- Any consideration received for issue of shares as exceeds the FMV of shares referred to in section 56(2)(viib);
- Any sum of money received as advance in the course of negotiation for transfer of a capital asset, if such sum is forfeited as the negotiation do not resulted in transfer of the asset 56(2)(ix);
- Any sum chargeable to income-tax u/s 56(2)(x);
- Any compensation or other payment referred to in Sec. 56(2)(xi)
- Income shall include assistance received in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) from the Central Government or a State Government or any other authority or body or agency in cash or kind to the assessee ***other than:***
 - (a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43,
 - (b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or the State Government, as the case may be.

Heads of Income: [Sec. 14]

For the purpose of computation of total income under the Income tax Act, 1961, all the incomes shall be classified under the **following 5 heads of income:**

- (i) Salaries [Secs. 15 to 17]
- (ii) Income from House Property [Secs. 22 to 27]
- (iii) Profits and Gains of Business or Profession [Secs. 28 to 44DB]
- (iv) Capital Gains [Secs. 45 to 55A]
- (v) Income from Other Sources [Secs. 56 to 59]

Gross Total Income means aggregate of income computed under the above five heads, after making clubbing provisions and adjustments of set off and carry forward of losses.

Total Income and Computation of Tax Liability:

Total income of an assessee means the Gross Total Income (GTI) as reduced by the amount of deduction available under sections 80C to 80U.

1. Income from Salaries		
Income from salary	.....
Add: Taxable allowances	.....
Add: Taxable perquisites	.....
Gross Salary	.....
Less: Deductions u/s 16		
– Standard deduction	.....
– Entertainment allowance	.....
– Professional tax	.....
Taxable Income under the head ‘Salaries’		.....
2. Income from House Property		
Net Annual Value	.....
Less: Deductions u/s 24	.....
Taxable Income under the head ‘Income from House Property’		.....
3. Profits and Gains of Business and Profession		
Net profit as per Profit and Loss Account	.....
Add: Amounts debited to P & L A/c but are not allowable as deduction under the Act	.....
Add: Amounts not credited to P & L A/c but are taxable under the head PGBP	.....
Less: Amounts credited to P & L A/c but are exempt u/s 10 or are taxable under other heads of income	.....
Less: Amounts not debited to P & L A/c but are allowable as deduction under the Act	.....
Taxable Income under the head ‘Profits and Gains of Business and Profession’		.....
4. Capital Gains		
Amount of Capital gains u/s 48	.....
Less: Exemption u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB, 54H	.....
Taxable Income under the head ‘Capital gains’		.....

5. Income from other sources		
Gross income	.....
Less: Deductions u/s 57	.....
Taxable Income under the head 'Income from other sources'		.....
Total [1 + 2 + 3 + 4 + 5]		.....
Less: Adjustment of set off and carry forward of losses		.....
Gross Total Income		.....
Less: Deductions under sections 80C to 80U [Chapter VI-A]		.....
Net Taxable Income		.....
<u>Computation of Tax Liability:</u>		
Tax on Net income		.....
Less: Rebate u/s 87A (Available if resident individual is having net taxable income of ` 5,00,000 or less)		.....
Income Tax after rebate		.....
Add: Surcharge, if applicable		.....
Tax and surcharge		.....
Add: Health and Education cess		.....
Less: Rebate u/s 86, 89, 90, 90A and 91		.....
Less: Prepaid taxes, if paid		
Self assessment tax paid (SAT)		.....
Tax Deducted or Collected at Source (TDS and TCS)		.....
Advance tax		.....
Total Net Tax liability		.....

Rounding off of Income: [Sec. 288A]

The total income computed in accordance with the provisions of this Act shall be rounded off to the nearest multiple of ` 10.

If the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is multiple of 10 and if the last figure is less than five, the amount shall be reduced to the next lower amount which is multiple of 10.

Rounding off of Tax: [Sec. 288B]

The total amount of income tax payable and the amount of refund due, computed in accordance with the provisions of this Act shall be rounded off to the nearest multiple of ` 10.

If the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is multiple of 10 and if the last figure is less than five, the amount shall be reduced to the next lower amount which is multiple of 10.

Certain Definitions under the Income Tax Act, 1961:

Definition of Company: [Sec. 2(17)]

Company means:

- (i) any Indian company, or
- (ii) any body corporate incorporated under the laws of any country outside India, or
- (iii) any institution, association or body which was assessed as a company for any assessment year under the Income-tax Act, 1922 or was assessed under this Act as a company for any assessment year commencing on or before 1-4-1970, or
- (iv) 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 CBDT to be a company.

Definition of Company in which public are substantially interested [Sec. 2(18)]

Section 2(18) defines 'A company in which the public are substantially interested' to include as under:

- (i) A company owned by Government or Reserve Bank of India.
- (ii) A company in which not less than 40% of the shares are held by Government or RBI or a corporation owned by the RBI.
- (iii) Companies registered u/s 25 of the Companies Act, 1956 or Sec. 8 of Companies Act, 2013. However, if at any time these companies declare dividend they would lose the status of a company in which the public are substantially interested.
- (iv) A company, declared by the CBDT.
- (v) Mutual benefit finance company, where principal business of the company is acceptance of deposits from its members and which has been declared by C.G. to be a Nidhi or a Mutual Benefit Society.
- (vi) A company in which at least 50% or more equity shares have been held by one or more co-operative societies.
- (vii) A Public Ltd. Company: A Company is deemed to be a public limited company if it is not a private company as defined by Companies Act, 2013 and is fulfilling either of the following two conditions:
 - (a) Its equity shares were listed on a recognized stock exchange, as on the last day of the relevant previous year; or
 - (b) Its equity shares carrying at least 50% of the Voting power (in the case of an industrial company, the limit is 40%) were beneficially held throughout the relevant previous year by Government or a statutory corporation or a company in which the public are substantially interested or a wholly owned subsidiary of such a company.

Note:

'Company in which the public are substantially interested' is also referred to as **widely held company**.

The company in which the public are not substantially interested is also referred to as **closely held company**.

Definition of Indian Company: [Sec. 2(26)]

'Indian Company' means a company formed and registered under the Companies Act and includes –

- (i) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the Union Territories);
- (ia) a corporation established by or under a Central, State or Provincial Act;
- (ib) any institution, association or body which is declared by the Board to be a company;
- (ii) 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;
- (iii) 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.

Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body, in all cases is **in India**.

Definition of Domestic company [Sec. 2(22A)]

A domestic company means an Indian company or any other company which, in respect of its income is liable to tax under the Income Tax Act, has made arrangements for declaration and payment of the dividends (including dividends on preference shares) within India.

Definition of Foreign company [Sec. 2(23A)]

Foreign company means a company which is not a domestic company.

Definition of Amalgamation: [Sec. 2(1B)]

‘Amalgamation’ in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which is so merge being referred to as the amalgamating company or companies and company with which they merge or which is formed as a result of merger, as the amalgamated company) in such a manner that:

- (i) **all the property or liabilities** of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of amalgamation;
- (ii) shareholders holding **not less than 75% in value of the shares** in the amalgamating company or companies *other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary* **become shareholders** of the amalgamated company by virtue of amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

Definition of Demerger: [Sec. 2(19AA)]

‘Demerger’ in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that:

- (i) **all the property and liabilities** of the undertaking being transferred by the demerged company, immediately before the demerger, becomes the property and liabilities of resulting company by virtue of demerger;
- (ii) the property and liabilities are **transferred** by the demerged company **at values appearing in its books** of accounts immediately before the demerger;
Provided that this sub-clause shall not be applicable where the resulting company records the value of the property and liabilities at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger, in compliance to the IndAS specified in Annexure to the Companies (IndAS) Rules, 2015.
[Inserted by Finance (No. 2) Act, 2019, w.e.f. A.Y. 2020-21]
- (iii) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis *except where the resulting company itself is a shareholder of the demerged company*;
- (iv) the shareholders holding **not less than 75% in value of shares** in the demerged company *other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary* **become the shareholders of the resulting company** or companies by virtue of demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (v) the transfer of the undertaking is **on a going concern basis**;
- (vi) the demerger is in accordance with the **conditions, if any, notified u/s 72A(5)** by the Central Government in this behalf.

Definition of Maximum Marginal Rate: [Sec. 2(29C)]

For the purpose of Income Tax Act, 'Maximum Marginal Rate' means the rate of income tax (including surcharge, 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 the Finance Act of the relevant year.

Exemption and Deduction in respect of income:

- Exemption in respect of any income means that such income shall not form part of any head of income and therefore not to be included in computation of total income. Whereas, deduction in respect of any income means that such income shall be first included under the respective head of income for the computation of gross total income and thereafter deduction can be claimed on such income under the respective head or from the gross total income. Deduction may also be allowed for making certain specified payments or contributions.
- In other words, in case of exemption, the income is not taxable at all. Whereas in case of deduction the income is taxable but due to certain provisions, the taxability has been reduced or decreased.
- **For e.g. Section 10** provides **exemption** in respect of certain incomes; sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA, 54GB, 54H provides exemption in respect of capital gains of the assessee. Section 16 [i.e. standard deduction, entertainment allowance and professional tax] provides deduction from gross salary, section 24 provides standard deduction and deduction for interest of loan borrowed under the head 'Income from House Property'. Further, **Chapter VI-A** [i.e. sections 80C to 80U] provides **deduction** from gross total income of the assessee.
- Exemption cannot exceed the taxable income; but deduction can exceed taxable income.