TAXATION LAW

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Unit I: Understanding Tax Law

What is Tax?

Tax is a mandatory financial charge that is levied on individuals, groups or businesses by the government on their income and profits, or included to the cost of goods, services and transactions.

The major taxes in India are imposed by the Central government and the State governments and some minor ones by local authorities like the Municipalities. Article 265 of the Constitution of India specifies that *"No tax shall be levied or collected except by the authority of law"*. Thus, every tax levied must be supported by a legislation, "*no taxation without representation"*.

Why is Tax levied?

1) Taxes are the main source of revenue for the government which is utilized in its smooth running, further in various services like health, education, security, infrastructure, etc., which are important for overall development of the country.
2) Furthermore, the revenue generated is put to use in social and welfare schemes hence, ensuring improved living standards of its citizens.
3) Another purpose of levying tax is to safeguard its citizens from harmful products being dumped in the country by international manufacturers.
4) Import duties being imposed on certain products serves double purpose- to protect the local industries and in turn encourage local employment.
5) Taxation is a primary fiscal policy tool for the government as it controls the balance of payment.

Types of Taxes-

In India, taxes are broadly classified as Direct Tax and Indirect Tax; evidently the former is levied directly on the income or wealth, whereas the later one is added to the price of goods and services.

Different types of Direct Taxes-

A Direct Tax is imposed on person's income or wealth and is paid directly to the government. These taxes are progressive in nature and are levied in proportion with the income of the individual, i.e. goes up or down with increase or decrease in one's income or wealth.

The different types of Direct Taxes and these are regulated by Central Board of Direct Taxes (CBDT), under the Finance Ministry of Government of India.

a) **Income Tax**
b) **Wealth Tax**
c) **Corporate Tax**
d) **Property Tax**
e) **Import and Export Duties**

Different types of Indirect Taxes-

Indirect Taxes are imposed on goods and services and indirectly paid by the consumers when they purchase or use them. These are considered to be regressive and is levied equally on all irrespective of their economic condition.

There are various types of Indirect Taxes and they are collected by either the Central government or the State government.

a) **GST**
b) **Service Tax**
c) **Sales Tax**
d) **Central Excise Duty**
e) **Customs Duty**
f) **Value Added Tax**

Differences Between Direct And Indirect Tax

CONTEXT	DIRECT TAX	INDIRECT TAX
Imposed On	Incomes & Profits	Goods & services
Taxpayer	Individuals, Companies, Firms & HUFs	Consumers of goods & services
Applicability	Only to the taxpayer	Every stage of the production-distribution

Tax Burden	Falls directly on the individual	Indirect as the burden is shifted on the consumer
Coverage	Restricted to an individual/entity	Wide coverage as everyone is taxed
Transferability	Cannot be transferred	Can be transferred
Tax Evasion	Possible	Not possible
Mode of Progress	Progressive- reduces inequality	Regressive- promotes inequality

Similarities Between Direct Tax and Indirect Tax

1. Both are payable to the government
2. Both carry penalty for non-payment
3. Both attract interest on delayed payment
4. Improper administration in both can lead to tax evasion or tax avoidance

INCOME TAX

Income Tax is the most prominent of all the Direct Taxes, and is governed by Income Tax Act, 1961. It is hugely extensive and complex covering over 300 Sections comprising of several subsections. Every year a Finance Act is passed by the Parliament and certain additions and deletions take place in the Act.

Previous Year and Assessment Year

Assessment Year: Section 2(9) of the Income Tax Act, 1961, defines the assessment year as the year in which the assessee's previous years taxable income shall be assessed. For example:

PREVIOUS YEAR	ASSESSMENT YEAR
2019-20	2020-21
2018-19	2019-20
2017-18	2018-19

2016-17	2017-18

The calculation of income shall be done for the duration of what is called as the financial year, i.e. from April 1 to March 31 of the specific year.

Previous Year: The year that is just preceding the assessment year is termed as the previous year. Income tax is calculated based on the previous year's taxable income/profit.

Definition of Some Common Terms as in Income Tax Act, 1961:

Section 2 of the Act gives definitions of various terms and expressions used therein like Persons, Assessee, Income, Application of Income and Diversion of Income by overriding Titles, etc.

#1. Person: As per Section 2(31) the term 'person' includes the following-

i. an individual,
ii. a Hindu Undivided Family,
iii. a company,
iv. a firm,
v. an association of persons or a body of individuals, whether incorporated or not,
vi. a local authority, and
vii. every artificial juridical person, not falling in any of the categories mentioned above.

Note: For the purposes of this clause, v, vi and vii shall be deemed to be person, whether or not incorporated with the intention of deriving income, profits or gains.

i. Individual: Individual refers to a human being, both male and female. It also comprises a minor, a person of unsound mind.

ii. HUF: According to Act, a Hindu Undivided Family is treated as an independent identity and therefore, liable to pay income tax. A Hindu is born into a HUF and the male members continue to enjoy being a member till the partition does not occur. The spouses of the male members and unmarried daughters are also members of a HUF.

iii. Company: The term 'Company' has a very wide connotation and it includes-

- Any Indian company under Section 2(26); or
- Any corporate body incorporated outside India or any foreign company; or
-

- Any institution or association which is or was assessable or assessed for assessment on or before 01.04.1970 under the present act; or
- Any institution or association Indian or foreign, incorporated or not, which is declared by the order of CBDT, for assessments as specified by a general or special order.

iv. Firm: A firm has the same definition as in Indian Partnership Act, 1932 and also includes the terms as defined in Limited Liability Partnership (LLP) Act, 2008. However, a minor shall also be liable to income tax as a partner if he is admitted to the benefits of partnership. 'Partners' refers to individuals who enter into partnership with each other, and collectively they are referred to 'Firm'.

v. (a) Association of Persons (AOP)**:** When persons do not in law constitute a partnership but combine together for promotion of joint enterprise, then they shall be assessable as an AOP. Hence, co-donees, co-legatees and co-heirs coming together for a common cause shall be chargeable as an AOP.

(b) Body of Individuals (BOI): Persons like trustees or executors who just receive income jointly and may be assessable in like manner. Thus, as co-trustees and co-executors they are assessable as a BOI as their title and interests are indivisible.

vi. Local Authority: This term refers to a municipal committee or district board or other such authorities legally entrusted by the govt for managing a municipal or local fund.

vii. Artificial Juridical Person: This category shall cover all artificial juridical person not falling under other heads such as an idol or a deity.

Thus, from the above given definition of 'person' as in the Act, it refers to an individual or any sort of artificial entity, and it says that Income Tax shall be paid by every such 'person'.

#2. Income: defined under Section 2(24) 'income' includes-

i. Profits and gains;
ii. Dividend;
iii. Voluntary contributions received by an institution or a trust, formed for charitable or religious purposes, or by an association or institution referred to in Section 10(21) or Section (23C) (3ad) (3ae) or (iv) (v) (vi) (via) or an electoral trust.

iv. The value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17.

v. Any other special allowance or benefit that is particularly accorded exclusively to the assessee to meet expenses of office or office of profit.

vi. Any allowance granted to meet his personal expenses in office or place of residence or to compensate for inflation.

vii. The value of any benefit received from a company, irrespective if it can be converted into money or not, in lieu of an obligation.

viii. The value of any benefit or perquisite received from any representative assessee stated under Section 160 (1), (iii) and (iv), imperative of whether convertible into money or not, which ordinarily the beneficiary would have required to pay.

ix. Deemed amount chargeable to Income Tax under clauses (ii) and (iii) of Section 28 or 41 or 59.

x. Profits and gains of profession and business chargeable to Income Tax under Section 28.

xi. Any capital gains chargeable under Section 45.

xii. The profits and gains of any insurance business carried on by a cooperative society or a Mutual Insurance Company, computed in accordance with Section 44.

xiii. The profits and gains of any co-operative society and its members, which carries on business of banking (including giving credit facilities).

xiv. Any winnings from lotteries, races (including horse racing), crossword puzzle, card games and any form of gambling or betting.

xv. Any contributions from employer to his provident fund, superannuation fund or any other welfare scheme.

xvi. Any sum received under Keyman insurance policy, including bonus, shall constitute income.

xvii. Any amount referred to under clause (va) of Section 28 shall be chargeable to Income Tax under the head “profits and gains of business or profession’.

xviii. Any sum of money or value of property referred to under Section 56 (2)(vii) or (viia).

xix. Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in clause (viib) of sub-section (2) of section 56;

#3. Application of Income: The Application of Income refers to the spending of earned income after it reaches the assessee. The applied income shall not be excluded from the total income of the assessee and hence, shall be taxable.

#4. Diversion of Income by overriding Titles: Diversion of Income is in opposition to Application of Income. The income is diverted in a particular way before it reaches the assessee, thus is not considered as the income of the assessee. There is an overriding charge or title for such a diversion the obligation lies on the source and not on the receiver. This can take place-

- by a decree of a Court of Law
- under a statutory provision
- right to maintenance of coparceners on partition or of dependents

Assessee and Assessment

#1. Assessee: As per Section 2(7) an "assessee" means a person by whom [any tax] or any other sum of money is payable under this Act, and includes—

(a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income [or assessment of fringe benefits] or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;

(b) every person who is deemed to be an assessee under any provision of this Act;

(c) every person who is deemed to be an assessee in default under any provision of this Act;

The Act has classified assessees into different categories- a Normal Assessee, a Representative Assessee, a Deemed Assessee or an Assessee in Default.

1) Normal Assessee- refers to an individual who is legally accountable to pay taxes based on the income earned during a particular financial year. Anyone who is liable to pay to the government interest or penalty, or entitled to tax refund under the Act, all are grouped as a Normal Assessee.

2) Representative Assessee- refers to payment made by an individual on behalf of a third party. Generally, the agents or guardians of non-residents, minors or lunatics are deemed to be representative assessees.
3) Deemed Assessee- refers to an individual who is legally authorized to pay taxes on behalf of someone.
    - The executors of the will of a dead person
    - Eldest son or other legal heirs of a person who dies intestate
    - The guardian of a minor, lunatic or idiot, having taxable income under the Act
    - Anyone acting on behalf of a non-resident having income in India
4) Assessee-in-Default- refers to an individual who has failed to perform his statutory obligations. For example, if an employer fails to deduct tax at source or does not deposit in govt treasury, he shall be deemed to be an Assessee in Default.

Understanding an 'assessee' through practical examples:

a) Income of Mr. A is Rs 2,30,000 for the assessment year 2018-19. He does not file a return because his income is within the exempted slab. Mr. A is not an assessee as no tax is due from him.
b) Income of Mr. B is Rs 2,60,000 for the assessment year 2018-19. He does not file a return but because his income is more than the exempted slab, he is supposed to file returns and hence, Mr. B is an assessee.
c) Income of Mr. X is Rs 1,90,000 for the assessment year 2018-19. He files a return although his income is within the exempted slab. An assessment order is passed by the Assessing Office without any adjustment. Mr. X is an assessee.
d) Income of Mr. Y is Rs 2,40,00 for the assessment year 2018-19. To claim his refund of tax deducted by ABC Ltd. on the interest paid to him, he files his return. Here, ABC Ltd. is an assessee.
e) Income of Mr. Z is Rs 1,70,000 and he does not file return. During the assessment year 2018-19 he paid Rs 2,30,000 to an employee. He was supposed to deduct TDS but due to ignorance, he did not. Here, Mr. Z is an assessee even though his income is in the exempted slab.

#2. Assessment: Persons and entities having taxable income have to furnish the details of their income to the Income Tax Dept. at the end of each financial year. (A financial year refers to twelve-month period from April 1 to March 31). These details are given in return of income that is filed by the taxpayers. The process of scrutinizing the return of income by the Income Tax Dept. is termed 'Assessment'. It is a process that occurs subsequent to filing of return and it is done to gather as well as review information provided by an assessee.

Different Types of Assessment:

1. **Self-Assessment (Section 140A):** The procedure of self-calculating the income and finding out if one is liable to pay tax or not, is called self-assessment. Section 140A deals with the details of self-assessment of income tax.

   Self-assessment calculation to be done as:

	Particulars	**Amount**
	Compute Total Income	XX
	Calculate Tax	XX
Add	Edu. Cess + surcharge	XX
Less	Relief under Section 89, 90, 91 & 90A	XX
Less	MAT credit under 115 JAA or 115JD	XX
Less	TDS/TCS	XX
Less	Advance Tax Paid (if any)	XX
Add	Interest u/s 234A, 234B, 234C	XX

Amount payable as self-assessment u/s 140A	**XX**

Self-assessment tax can be filed by challan ITNS 280 or online too. It shall be paid 31st July of every year.

2. **Scrutiny Assessment (Section 143(3):** An income tax officer may be assigned to examine the returns randomly based on certain criteria. If one is selected for scrutiny assessment, an Income tax notice shall be issued u/s 143(2). The concerned taxpayer may be asked to share certain documents, information's, Books of account for this purpose. The officer in charge shall compute the income and the tax payable. If there is a mismatch, the taxpayer shall agree to pay according to the order passed, or in case of a clerical error, may apply for rectification u/s 154. In addition, one can also approach the Commissioner of Income Tax by making a revision application u/s 263 or 264. If still dissatisfied by the order, the taxpayer can appeal to CIT (A), further to ITAT, thereafter to High Court and finally move to the Supreme Court.
3. **Best Judgement Assessment (Section 144):** Best Judgement Assessment refers to assessing the income and tax is done by the officer who is undertaking the scrutiny. The need to do so arises when a taxpayer:

- does not file return,
- does not comply with an income tax notice,
- does not cooperate in the way of imparting information,
- does not maintain Books of Account, or
- the tax officer is not convinced by the information provided.

Note: The income tax officer must give an opportunity to the taxpayer to be heard, before passing an order.

4. **Income Escaping Assessment (Section 147):** If a tax officer suspects that assessee has escaped assessment, he has the power to re-open such assessment up to 6 years. To begin this scrutiny the officer must issue a notice to the taxpayer u/s 148.

Capital Receipt and Revenue Receipt

During the course of business, two types of receipts occur- Capital receipt and Revenue receipt.

 # Capital receipt: This refers to the money brought in to business from non-operating sources like proceeds from the sale of assets, capital brought by the proprietor, sum received from loan or from the debenture holders, etc.

 # Revenue receipt: These receipts are the most important source of income for all businesses as they occur from day to day activities like sale of inventory and scrap, income generated from services, discount received from suppliers, interest received and rent received.

Difference between Capital Receipts and Revenue Receipts

Comparison	Capital Receipts	Revenue Receipts
Nature	Non-recurring	Recurring
Term	Long term	Short term
Depicted in	Balance sheet	Income statement
Received in exchange for	Source of income	Income
Value as asset or liability	Decreases the value of asset or increases the value of liability	Does not increase or decrease the value of asset or liability

Rates of Income Tax: Proportional and Progressive Rate of Taxation

Principle of Proportional Tax:

Advocated by the classical economists, the proportional system of taxation lays stress on a flat rate of tax. Adam smith emphasized the need to achieve principle of equality in levying tax by taxing everyone at an equal rate.

For example, if the tax rate is fixed at 10%, then 'A' who earns Rs 1000 shall pay Rs 100 as tax, whereas, 'B' whose income is Rs 10,000 shall pay Rs 1000 as tax. In this manner the higher one earns, the more he pays.

The classical economists champion this uniform rate of levying tax which they believe secures equality of sacrifice.

Principle of Progressive Tax:

However, levying tax at the same rate on the poor and the rich brings about a sense of unfairness and therefore, the modern economists discard the theory of proportional tax as regressive. They instead propagate the principle of progressive tax. According to them a person's taxable capacity increases more than the proportion of the increase in income. Therefore, the principle of progression mandates different tax rate for different incomes.

For example, if the tax rate is fixed at 10%, then 'A' who earns Rs 1000 shall pay Rs 100 as tax, whereas, for the higher earner the rate is fixed at 15%, then 'B' whose income is Rs 10,000 shall pay Rs 1500 as tax. This is based on principle of progression which has been generally accepted.

Income Tax in India: Proportional or Progressive?

The Income Tax system of India is based on the principle of progressive system, where the richer are charged more than the less fortunate ones. It has a slab system in which the higher the income, the higher the tax rate goes, thus impacting the lowest slab the least.

To understand it thoroughly, go through the different slabs-

For Male and Female individuals below 60 years and HUF-

Income Tax Slabs	Income Tax Rates
Total income does not exceed Rs 2,50,000	NIL
Total income exceeds Rs 2,50,000 but does not exceed Rs 5,00,000	5% of the amount by which it exceeds 2,50,000
Total income exceeds Rs 5,00,000 but does not exceed Rs 10,00,000	20% of the amount by which it exceeds 5,00,000
Total income exceeds Rs 10,00,000	30% of the amount by which it exceeds 10,00,000

For Senior Citizens above 60 years of age-

Income Tax Slabs	Income Tax Rates
Total income does not exceed Rs 3,00,000	NIL
Total income exceeds Rs 3,00,000 but does not exceed Rs 5,00,000	5% of the amount by which it exceeds 3,00,000
Total income exceeds Rs 5,00,000 but does not exceed Rs 10,00,000	20% of the amount by which it exceeds 5,00,000
Total income exceeds Rs 10,00,000	30% of the amount by which it exceeds 10,00,000

For all Senior Citizens above 80 years of age-

Income Tax Slabs	Income Tax Rates
Total income does not exceed Rs 5,00,000	NIL
Total income exceeds Rs 5,00,000 but does not exceed Rs 10,00,000	20% of the amount by which it exceeds 5,00,000
Total income exceeds Rs 10,00,000	30% of the amount by which it exceeds 10,00,000

Thus, it is quite evident that the progressive rule is applicable in income tax.

Agricultural Income

Section 2(A0 of the Income Tax act, 1961, gives the definition of agricultural income. It not only includes agricultural produce but various other factors.

a) Any rent or revenue earned from land which is used for agricultural purposes and is situated in India.
b) Any income generated through the commercial sale of produce gained from an agricultural land.
c) Any revenue generated through renting or leasing in and around the agricultural land subject to certain factors.

While assessing agricultural income it is imperative to keep in mind that it can also be from a land that is not under the ownership of an assessee.

Income Tax on Agricultural Income: Section 10(1) of the Act specifies agricultural income shall not be taxed. Hence, the income generated by agriculture is exempted from taxation and if an individual has only agricultural income then he need not file income tax return. In case the assessee has other incomes like salary, business income etc. then he is liable to file returns.

The calculation of tax in such cases shall be as-

- Agricultural income is added to other incomes
- Tax calculated as per relevant slab
- Agricultural income is added to the basic exemption limit of the assessee and tax is recalculated
- Difference derived between both the calculations shall be the actual tax liability of the taxpayer. The surcharge and cess shall be added to this amount.

The doctrine behind keeping agricultural income tax free is that India is an agrarian economy and 95% of the farmers hold small agricultural plots. Besides, agriculture is also the spine of the economy and by keeping it out of taxation the government ensures boosting of farm and agricultural produce.

UNIT II: RESIDENTIAL STATUS AND CHARGEABILITY

Meaning and Rules for determining The Residential Status of an Assessee

The charging of income tax and calculation of tax liability under the Income Tax (IT) Act, 1961, is based on the residential status of the assessee.

Section 6 of the Act prescribes the tests used to determine the residential status of all taxpayers. The residential status of assessee in the previous year is considered, not his residential status in the current or assessment year.

- All assessees under the Income Tax Act can be divided into Residents and Non-Residents.
- Out of all assessees, individual persons and Hindu United Families (HUFs) that are resident in India, are further divided into Resident and Ordinarily Resident in India (ROR) and Resident but not Ordinarily Resident in India (RNOR)

A. <u>In case of Individuals</u>

1. Under Section 6 (1), an individual is ruled to be a resident in India in any previous year if:
    a) The individual was in India in the previous year for a period of 182 days (minimum) or more. The 182 period may be spent in India at a stretch or in parts which must cumulatively amount to 182 days or more.

    or,

    b) The individual should have been in India for 60 days (minimum) during the previous year, and also, he should have been in India for 365 days (minimum) during the 4 years immediately preceding the previous year.
2. If an individual does not satisfy either one of the two tests of residency, he is treated as a Non-Resident. The conditions for testing the residency are alternate tests and not cumulative test. Only one condition (either (a) or (b)) is to be fulfilled.
3. Resident and Ordinarily Resident (ROR)

    For an individual to be an ROR, in addition to fulfilling one condition for residency, he must also fulfil both the conditions detailed below:
    a) He must be a resident in at least 2 (minimum) out of the 10 previous years immediately preceding the relevant previous year,

    and,

    b) He must have been in India for 730 days (minimum) or more during the 7 previous years immediately preceding the relevant previous year.
4. Resident but Not Ordinarily Resident (RNOR)

    A person becomes an RNOR if:
    a) He has been a non-resident in India in 9 out of the 10 previous years immediately preceding the relevant previous year,

    or,

    b) In the 7 previous years immediately preceding the relevant previous year, has been in India for a period of 729 days (maximum) or less.

B. <u>In case of HUFs</u>

1. As per section 6 (2), a HUF is resident in India if the control and management of the affairs of the HUF is wholly or partly situated in India.

2. A HUF is ruled to be Non-Resident in India if the control and management of the affairs of the HUF is situated wholly outside India.

   The expression "control and management" refers to the functions of decision-making and issuing directions. It bears little connection to the places from where the business is carried on. The control and management is situated at that place where policy decisions are taken. Policy decisions are decisions concerning finance, marketing, production, advertising, etc, and do not refer to day to day operations of the concern.
3. A HUF is ruled to be a ROR if the Karta of the HUF, as an individual, satisfies the conditions of a ROR.
4. A HUF is ruled to be a RNOR if the Karta of the HUF, as an individual, satisfies the conditions of a RNOR.

C. <u>In case of Companies</u>

All Indian Companies, as defined under section 2 (26) of IT Act are deemed to be resident in India irrespective of the place of control and management of its affairs.

In case of a foreign company, the place of control and management of its affairs is the basis on which the company's residential status is determined.

D. <u>In case of Firms and Associations of Persons (AoP)</u>

A firm or AoP would be resident in India if the control and management of its affairs is situated wholly or partly in India.

It is a non-resident if the control and management of its affairs is situated wholly outside India.

<u>Charge of Income Tax and Scope of Total Income</u>

Taxation in India finds its springhead in Article 265 of the Indian Constitution. The Article states explicitly that no tax is to be levied or collected except by the authority of Law. This provision lays down two requirements to be fulfilled by State when it decides to levy and collect taxes.

1. Tax should be levied by law. The body enacting the law (either Parliament or State Legislative Assembly) must have the authority to do so.
2. The law levying the tax must be not violate the Constitution, especially, the Fundamental Rights Chapter.

The charging section creates the levy of tax and hence must qualify as a valid for the taxation statute to be valid.

A. <u>Section 4 of the IT Act, 1961: The Charging Section</u>

The section lays down the basis on which income tax is imposed. It clarifies four major components of income tax, which are:

#1. What is taxable?

The levy of tax on the assessee is on his total or taxable income (Section 5) computed in accordance with and subject to the appropriate provisions of the IT Act, including the provisions for the levy of additional income tax.

#2. For what period is tax calculated (frequency with which tax is collected)?

The income sought to be taxed is that of the previous year and not on the assessment year.

#3. Who is to pay the tax?

The charge of tax is on various persons specified under Section 2 (31) of the IT Act.

#4. At what rates is tax being calculated?

The section states that income tax will be charged at the rates prescribed in the finance act for the relevant previous year.

The section also states that, wherever provided in the IT Act, tax may also be charged on income of a period other than the previous year.

B. <u>Section 5 of the IT Act: Meaning and Scope of Total Income</u>

Since the charging section imposes tax on the total or taxable income of the assessee, it is important to determine the total income of the assessee.

The scope of total income and thereafter, the liability to pay income tax depends upon the following facts:

- Whether the income accrues or is received in India or outside
- The exact time at which accrual or receipt of income takes place
- The residential status of the assessee during the previous year

The section categorizes the scope of total income on the basis of Residential status.

1. **Resident and Ordinarily Resident Assessee**

   Section 5 (1) states that the total income of a resident and ordinarily resident assessee consists of:

i) Income received or deemed to be received in India during the accounting year by or on behalf of the assessee

ii) Income that accrues or arises or is deemed to accrue or arise to the assessee in India during the accounting year

iii) Income that accrues or arises to the assessee outside India during the accounting year. The concept of deemed accrual or arising is not applicable to foreign income

2. **Resident but Not Ordinarily Resident in India**

   The proviso to section 5 (1) provides scope of total income of a person resident but not ordinarily resident in India.

   i) Income received or deemed to be received in India during the accounting year by or on behalf of the assessee

   ii) Income that accrues or arises or is deemed to accrue or arise to the assessee in India during the accounting year

   iii) Income that accrues or arises to the assessee outside India during the previous year if it is derived from a business controlled in or a profession set up in India

3. **Non-Resident**

   Section 5 (2) provides for the composition of total income of a non-resident.

   i) Income received or deemed to be received in India during the accounting year by or on behalf of the assessee

   ii) Income that accrues or arises or is deemed to accrue or arise to the assessee in India during the previous year

Income accrued in India: Income is said to accrue when it comes into existence for the first time or at the point of time when the right to receive the income arises and becomes vested in the assessee. The right may be exercised or exercisable at a future date. The income is received when it reaches the assessee.

Income deemed to accrue or arise in India: Certain types of income are deemed to accrue or arise in India even though they actually accrue or arise outside India. Some categories of such income are:

a. Income accruing or arising to an assessee in places outside India, whether directly or indirectly:

i) Through or from any business connection in India

ii) Through or from any property in India

iii) Through or from any asset or source of income in India

iv) Through the transfer of a capital asset situated in India

b. Income that qualifies as "salary" when earned in India, even if it is paid outside.

Income deemed to be received in India: Incomes that are not actually received by the assessee and/or not received during the relevant previous year are also included in his total income for taxing purposes. Such incomes are known as income deemed to be received. Examples of such income are:

a. All sums deducted as taxes at source (Section 198)
b. Incomes of other persons which are included in the income of the assessee under sections 60 to 64
c. The amount of unexplained or unrecorded investments (Section 69)
d. The amount of unexplained or unrecorded moneys, etc. (Section 69A)
e. Any dividend declared by a company or distributed or paid by it within the meaning of section 2 (22)

Income Exempted from Tax and Deductions Under Income Tax Law

The IT Act provides for three types of reliefs that can be availed by the taxpayer. These reliefs are:

A. Exemptions

Exemption are claimed on the basis of source of income. Exempted income is not included in the computation of Gross Total Income of the assessee. Section 10 of the IT Act lays down various exemptions. A few important exemptions are detailed below:

1. Agriculture Income (Section 10(1))- Agricultural income earned by the assessee in India is exempt from tax. Agricultural income is defined under section 2(1A) of the IT Act. It generally means:
    a. Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.
    b. Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

c. Any income attributable to a farm house subject to satisfaction of certain conditions specified in this regard in section 2(1A). Income derived from saplings or seedlings grown in a nursery is deemed to be agricultural income.

2. Any sum received by a Coparcener from HUF (Section 10(2))- Amount received out of family income, or amount received out of income of family estate (in case of impartible estate) by any member of a HUF is exempt from tax.
3. Share of Income from the Firm (Section 10(2A))- Share of profit received by a partner from his firm and LLP is exempt from tax in the hands of the partner. This exemption is limited only to share of profit and does not apply to interest on capital and salaries received by the partner from the firm/LLP.
4. Interest paid to Non-Residents (Section 10(4)(i))- In the case of a non-resident, any income by way of interest on certain notified securities or bonds (including income by way of premium on the redemption of such bonds) is exempt from tax.
5. Leave Travel Concession or Assistance (LTC/LTA) to an Employee who is an Indian Citizen (Section 10(5))- The employee is entitled to exemption in respect of the value of travel concession or assistance received by or due to him from his employer or former employer for himself and his family. The exemption is subject to certain limitations depending on the mode of transportation used, etc. LTC that is received without making the journey is completely taxable.
6. Perquisites and Allowances paid by Government to its Employees serving outside India (Section 10(7))- Any allowances or perquisites paid or allowed, as such, outside India by the Government to a citizen of India, for rendering services outside India, are exempt.

B. <u>Deductions</u>

Deductions are allowed on the basis of the payments and investments made by the assessee out of the income earned by him. They are listed under Chapter VI-A. They are first included in the Gross Total Income of the assessee, after which they are subtracted. The deductions are allowed under different heads of income as well as from total income. Deductions are further explained in later sections.

C. <u>Rebate</u>

Rebate is a percentage amount reduced from the total income tax payable. It is a reduction on the total amount of tax that is calculated.

Heads Of Income and It's Justification

Section 14 of the IT Act recognizes that persons may acquire income from various sources and through various modes. The tax is computed on the total income of a person.

For convenient computation, income from various sources has been classified under five distinct heads under the IT Act. The Act prescribes separate rules for computation of income under each head. The income from that head is determined after applying the specific set of rules.

The total income is calculated by adding the income under each applicable category. The tax on the total taxable income, that is, income arrived at after deductions, is then calculated subject to the income tax slab rates.

The five main heads of income according to section 14 are:

1. **Income from Salary**

   The term salary is defined as any kind of remuneration that is generated through professional services and from different jobs. Any income derived as a result of a relationship of employer and employee is taxable under the head of Salary. Wherever the relationship does not exist or cannot be proved, then the income cannot be deemed to be income from salary.

2. **Income from House Property**

   The second head of income is Income from House Property. Section 22 to 27 of the IT Act lays down the provisions for computing total standard income earned by a person from the house property or land that he owns.

   The rental income earned from the house property is taxable under this head. Where the property is not rented out, the income tax is calculated on the expected rent. Expected rent is the rent that would have been received from the property.

   Income from House Property is the only income that is taxed on a notional basis. Various deductions such as tax deduction on a home loan are allowed under this income head.

   Income from House property is calculated on the basis of Annual Value. The annual value (for a let out property) is based on the following:

- HRA received
- Municipal Valuation
- Fair Rent (as determined by the Income Tax department)

3. **Income from Profits and Gains of Business or Profession**

Income that is earned from a profession, trade, manufacturing activity or commerce is taxable under this income head. The components usually include:

- Profits or gains of a business
- Any compensation or such payment due or received by any person in connection with modification or termination of his management; etc
- Income derived by a trade, professional association from specific services for its members
- Export incentives
- Any interest, salary, bonus, commission or remuneration due / received by a partner from the firm in which he is partner
- Any sum received under Keyman Insurance Policy
- Income from speculation business, etc.

4. **Income from Capital Gains**

Any profit or gain earned from transfer of a capital asset or securities, which is held as an investment, in the effective financial year is chargeable under the head of Income from Capital Gains and shall be deemed to be the income of the financial year in which the transfer took place.

However, certain capital gains are exempted from taxation under Section 54, 54B, 54D, 54EC, 54ED, 54F, 54G or 54GA. Tax exemptions are afforded to long term capital gains earned from the sale of residential house or other capital asset or even agriculture land.

The capital gains are divided into short term capital gains and long term capital gains. Moreover, the IT Act also provides a special rate of tax for taxing capital gains on shares and mutual funds.

5. **Income from Other Sources**

Income that does not fit under the above 4 heads of income is chargeable under this head. This is a head under which all residuary incomes are charged, like:

- Interest on bank deposits and securities

- Dividend
- Income from sub-letting a house property by a tenant
- Insurance commission
- Income from royalty and more

 # Justification for categorising income under five heads

The categorisation and fixing of various items of income under different heads bears great significance. Below mentioned cases highlight the importance of heads of income and their effect on tax computation.

1. ***Commissioner of Income Tax* v. *Justice R.M. Datta***[1]

   The case: Justice R.M. Datta was a retired judge of Calcutta High Court and was the assessee in this case. He received sums of Rs. 14,000 and Rs. 10,000 in the accounting years relevant to the assessment years 1968-69 and 1969-70, respectively, as arrears of professional fees from solicitors and clients for services rendered by him as a lawyer before he became a judge in the year 1967.

   The Tax Officer identified that the assessee had maintained his accounts on receipt basis, that is, on cash basis, and not on accrual basis. He, however, held the view that the said amount would be chargeable to income-tax under Section 176(4) of the IT Act.

   Date of Verdict: 4 July, 1989

   Judges: Two judge bench of Calcutta High Court

   The verdict: The Court held that assessee could not be charged tax under section 176 (4) since he maintained his account on receipt basis. The Court held that if there is an income which cannot be brought to tax under any of the five heads of income under the IT Act, such income could not be included to compute the total taxable income of the assessee.

2. ***United Commercial Bank* v. *Commissioner of Income Tax***[2]

   The Case: For the assessment year (1945-46) the taxable income of the bank was computed by the IT Officer by splitting up its income into two heads "interest on securities" and "business income", and deducting the business loss from interest on securities. In the previous year the assessment showed a loss which was computed by setting off the

[1] (1989) 180 ITR 86 (Cal).
[2] (1957) 32 ITR 688 (SC).

"business loss against" interest on securities. The appellant claimed that in the computation of its profits for the assessment year in question it was entitled to set off the carried over loss of the previous year under section 24(2) Of the IT Act, 1922.

The Income-Tax Officer rejected the claim on the ground that the loss was under the head " business " and so could not be set off against income from securities under S. 24(2) of the Act.

Date of Verdict: 23 May, 1957

Judges: Four judge bench of the Supreme Court

The Verdict: The Supreme Court held that the five heads of income are mutually exclusive of each other. Therefore, when an item of income falls specifically under one head, it has to be charged under that head only and not under any other head.

Tax Treatment to Salary, Pre-requisites, Etc.

"Salaries" is one of the heads under which income tax is charged. Section 15 of the IT Act charges tax on a "due" or "paid" basis, whichever is earlier. Once it is taxed an a due basis, it cannot be taxed again when paid. Similarly, if salary is paid in advance and is taxed, it cannot be taxed again when it becomes due.

Section 17 (1) states that salary would include wages, allowances, annuity, pension, gratuity, fees, commission, advance, leave encashment and also perquisites and profits in lieu of salary, etc. The various components of salaries are discussed below:

A. Allowances

An allowance is a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on a due/accrual basis. Allowance may be paid in addition to the salary or in lieu thereof.

1. Fully Taxable Allowances- These include Dearness Allowance, Tiffin Allowance, Fixed Medical Allowance, Servant Allowance, Deputation Allowance, etc.

2. Allowances not fully taxable- These include House Rent Allowance under section 10 (13A) and Special Allowances under section 10 (14).
3. Fully exempt Allowances- These include allowances granted to High Court and Supreme Court Judges and to Government Employees outside India.

B. <u>Profits in Lieu of Salary</u>

These include:

1. Annuity and Pension- Annuity is a yearly payment to an employee post his retirement on account of the funds that were saved by him by way of subscription to the annuity fund from his salary when he was in employment. Annuity received from present employer is charged to tax as salary and annuity received from past employer is charged as Profit in lieu of Salary.

   Pension is generally paid by government or company to the employee for his past service. This too is payable post retirement. Pension may be commuted or uncommuted:

   - Commuted pension- This is received in lumpsum. There is no future right to receive payments. Where the employee is part of Central Government, Local Authorities, Defense Services, etc., the pension amount is fully exempted. For non-government employees, the pension is exempt from tax only to a certain extent. Where the employee is also receiving gratuity, ⅓ amount of pension is exempted. In the absence of gratuity, ½ the pension is exempted from tax.
   - Uncommuted pension- This is received periodically and is fully taxable for all employees.
2. Gratuity- It is paid for long-term service of an employee. An employee becomes eligible for gratuity only after completing 5 years of service with same employer. However, gratuity is paid voluntarily by employer in appreciation for long service. Gratuity is exempt as follows:

   - For Central/State Government employees and Defense Services, amount received as gratuity at the time of retirement or death is fully exempt.

- For employees in the private sector gratuity is exempt to certain extents depending on whether the employee is covered under the Payment of Gratuity Act, 1972.

3. Leave Encashment- This is the salary equivalent to the number of leaves which were entitled to an employee but not availed. Leave encashment taken during employment is fully taxable for all employees. But leave encashment taken at the time of retirement is exempted as follows:
    - Leave encashment received by employees of the Government is fully exempt from tax
    - For non-government employees, leave encashment is exempt from tax to a certain extent

C. <u>Pre-requisites</u>

Any facility or benefit granted by the employer, the use of which is enjoyed by the employee or any other member of the employee's household, is construed as a perquisite under the IT Act. It therefore, attracts tax.

1. Taxable Perquisites- These include rent free residential accommodation, interest free or concessional loan, transfer of movable assets, provision of gas, electricity, water, use of movable assets by employee or his family, club expenses, credit card expenses, etc.
2. Tax free Perquisites- Medical facilities, refreshment, subsidized lunch, dinner, recreational facilities, telephone facility, personal accident insurance, computer or laptops, transport, etc.

D. <u>Provident Funds</u>

Provident funds are grouped under three heads:

1. Statutory Provident Fund

   All funds set up under the Provident Funds Act, 1925, are called Statutory Provident Funds. Funds set up by institutions such as universities, colleges, RBI, SBI, State Government and Central Government are all statutory funds. The entire amount of contribution made by employer to the fund is not included in the income of the employee. It is exempted under section 10 (11) of the IT Act.

2. Recognized Provident Fund

   The provident funds recognized by the Commissioner of Income Tax under Rule 3 of Part A of Fourth Schedule of IT Act and provident funds established under schemes framed under the Employees Provident Funds Act, 1952, are called Recognized Provident Funds. An employer's contribution limited to 12% of the employee's salary is not considered as employee's income. Any excess contribution is treated as taxable income. The employee's contribution to the fund qualifies for tax deduction under section 80C of the IT Act.

3. Unrecognized Provident Fund

   Funds that are neither statutory nor recognized are termed as Unrecognized Provident Fund. Employees contribution to the fund do not qualify as a Deduction under IT Act. The employer's contribution and interest thereon are exempted from taxation whenever such contributions are made. But once the employee receives the money back as a lumpsum, the contribution of the employer is taxable as salary in the hands of the employee. The employees contribution is not taxable as it is not "income". However, the interest earned by him is taxed under "income from other sources."

E. <u>Deductions from Salaries</u>

Entertainment Allowance and Profession Tax are deductible from salaries to certain extents.

<u>Unit III. HEADS OF INCOME AND RULES OF TAX</u>

An individual can have varied sources of income, and therefore, it is very important to know how the computation of income is to be done.

<u>Tax Treatment To Income From House Property</u>

One of the heads of income is 'Income from House Property' and it is vital to understand all key provisions under the Act to make accurate calculation of the income.

- **<u>Meaning of House Property:</u>** House Property refers to any building or land appurtenant thereto that the assessee is owner of. The related land can be in the form of courtyard or compound forming a part of the building. Such land is different from an open plot of land which is not covered under 'House Property'.

Apart from these, house property includes apartments, residential houses, shops, office space, godowns, factory sheds, cinema building, hotel building, etc.

- **Requisite conditions for taxing under this head:** Income from house property shall be taxable to the legal owner in whose name the property stands. It is not applicable to anyone who acts on 'behalf' of the owner. An individual who is entitled to accept income from a property shall be considered as its owner, irrespective whether the registered document carries his name or not.

  Following three conditions are laid down which need to be fulfilled before the income of the property can be taxed under the head 'Income from House Property'-

  1) The property must consist of buildings and land appurtenant thereto;
  2) The assessee must be the owner of such house property;
  3) The property may be used for any purpose but it shall not be used be used by the owner for his own business or profession. If used for self-purpose, tax shall not be chargeable on it.

Ownership includes both freehold and leasehold rights and also includes deemed ownership.

Deemed ownership has been defined under Section 27 as-

- Transfer of ownership to spouse or a minor child
- Holder of impartible estate. Impartible refers to those properties that cannot be legally divided.
- Property held by a member of a co-operative society.
- Any person who has acquired a property under Power of Attorney transaction.

Tax Chargeability: Section 22

Section 22 states that the annual value of property consisting of any building or lands appurtenant thereto, of which the assessee is the owner, shall be subject to Income-tax under the head "Income from House Property" after claiming deduction under Sec. 24, provided such property or any portion of such property is not used by the assessee for the purpose of any business or profession, carried on by him, the profits of which are chargeable to Income-tax.

Deductions from income from house property: Section 24

This section details the requirements of deductions to be made before the computation of income. It defines-

i. **Standard Deductions:** The assessee shall be allowed a standard deduction of a sum equal to 30% of the net annual value computed.

ii. **Interest on borrowed capital:** If a capital is borrowed to acquire, construct, repair, renew or reconstruct a property, then any interest payable on the capital amount is allowed as a deduction.

The amount of interest payable yearly shall be calculated separately and the deduction shall be claimed yearly; irrespective of the fact that the interest has actually been paid or not in the specified year.

Where the interest is paid or payable during the pre-construction phase, it shall be aggregated and be allowed for deduction in five successive financial years from the year in which construction or acquisition was completed.

Calculating the deductions provided under Section 24:

If a property has been let out then while calculating the income from it, various deduction can be availed that are enumerated under Section 24. The deductions that are included are-

- Standard deduction
- Deduction on the interest paid on loan amount
- Deduction of municipal taxes

Note: Commission or brokerage that may have been paid, shall not be eligible for deduction.

Understanding Gross Annual Value and Net Annual Value:

Gross Annual Value: The value at which a property might be expected to be let from year to year, is called Gross Annual Value. It is a speculative rent that the property might fetch if it was rented out. Even if the property is not let out then also the deemed rent is taxable.

Net Annual Value: four factors are taken into consideration to determine the annual value of a property. These are- (i) Actual rent (ii) Municipal value (iii) Fair rent (iv) Standard rent.

Net Annual Value is calculated as gross annual value less municipal taxes paid.

Profits and Gains of Business and Profession

'Profits and Gains of Business and Profession' is one of the heads of income under Income Tax Act 1961.

Meaning of Business: Section 2 (13)

- Trade
- Commerce
- Manufacture
- Any adventure or concern in the nature of trade, commerce or manufacture

Meaning of Profession: Section 2 (36)

- Profession includes vocation
- Profession requires intellectual or manual skill based on special learning or qualification attained through experience or training for example doctor, lawyer, architect, etc.
- Vocation implies natural talent of a person in distinct field like dancing, singing, etc. Vocation must be used as an earning means to qualify as a profession.

List of Incomes chargeable under 'Profits and Gains of Business and Profession':

- Profits and Gains from any business or profession carried on by the assessee any time during the previous year.
- Any compensation or other payments due or received by any person specified in Section 28 of the Act.
- Income obtained by a profession, trade or similar association from certain services executed for its members.
- Any profit derived from sale of import entitlement licenses or incentives by way of cash compensatory support including drawback of duty.
- The value of any fringe benefit or perk, whether converted into money or not, transpiring from business

- Any interest, salary, bonus, commission, or remuneration accepted by a partner of a firm, from such a firm
- Any sum, whether collected or to be received in cash or kind, under an agreement for not to share any know-how, patent, copyright, franchise, or any other business or commercial right of similar nature or technique likely to assist in the manufacture or processing of good.
- Any sum received under a keyman insurance policy.
- Income from notional or hypothetical deals.
- Suspension or termination of liability in respect of any loss, expenditure or trading liability suffered by the taxpayers.
- In case of any succession due to amalgamation or demerger or succession of a firm succeeded by another firm or company, etc., the recovery of trading liability shall be taxable to the successor.
- Any liability that is written off by the taxpayer from the books of accounts shall be considered as a closure of such liability and shall be chargeable to tax.
- In case of power generating units, if the depreciable asset is disposed, discarded, demolished or dismantled, the amount by which sale consideration and/or insurance compensation together with scrap value exceeds its WDV, shall be chargeable to tax.
- Any recovery of bad debts that have been allowed as deduction under Section 36(1)(vii) in earlier years, shall be chargeable to tax.
- Any amount that is withdrawn from special reserves created and maintained under Section 36(1)(viii) shall be chargeable as income in the previous year in which the amount is withdrawn.

<u>Deductions under 'Profits and Gains of Business and Profession':</u>

Sections 30-37 of the Act enumerates the details of deductions allowed under this head.

Section	Nature of Expenditure	Quantum of Deduction	Assessee

30	Rent, repairs (excluding capital expenditure) and insurance of premises, rates, taxes	Actual expenditure incurred, excluding capital expenditure	All assessees
31	Repairs (excluding capital expenditure) and insurance of furniture, machinery & plant	Actual expenditure incurred, excluding capital expenditure	All assessees
32 (1)(i)	Depreciation on (i) tangible items like plant, building, machinery, furniture (ii) intangible assets like trademarks, patents, copyrights, know-how, licenses, franchises, etc.	Allowed at specified percentage on straight line method for each asset but if the asset was acquired in the previous year and not used 180 days in that year, then the deduction for it shall be restricted to 50% of the amount	Assessees engaged in generation and/or distribution of power; they can opt for written down value method or straight line method to claim depreciation
32 (1)(ii)	Depreciation on (i) tangible items like plant, building, machinery, furniture (ii) intangible assets like trademarks, patents, copyrights, know-how, licenses, franchises, etc.	Allowed at specified percentage on written down value (WDM) method but if the asset was acquired in the previous year and not used 180 days in that year, then the deduction for it shall be restricted to 50% of the amount	All assessees manufacturing or producing any article or thing, or into generation, transmission or distribution of power

32 (1) (iia)	Additional depreciation on new machinery and plant (subject to certain conditions and excluding office appliances, aircrafts, ships)	Additional depreciation shall be available at 20% of the actual cost but if the asset was acquired in the previous year and not used 180 days in that year, then the deduction for it shall be restricted to 50% in the year of acquisition and remaining 50% would be permitted in the next year	All assessees who take up manufacturing or production of any article or thing in any notified backward area in the sates of Bihar, West Bengal, Andhra Pradesh or Telangana
32AC	Deduction under this is available to a company which invests more than Rs 100 crores on new plant and machinery (subject to certain conditions)	15% of the actual cost of the new assets	Any company engaged in production, manufacturing or business of any article or thing
32AD	Investment allowance shall be given to any investment in new machinery and plant if the unit is set up in the notified backward area in the states of Bihar, West Bengal, Andhra Pradesh or Telangana (subject to certain conditions)	Investment allowance shall be provided in the year of installation at the rate of 15% of the actual cost of plant and machinery (subject to certain conditions)	All assessees who purchase new plant and machinery for setting up a manufacturing unit in any notified backward area in the sates of

			Bihar, West Bengal, Andhra Pradesh or Telangana
33AB	Deduction allowed to assessees involved in growing and manufacturing tea/coffee/rubber in India	Deduction shall be applicable on deposits made with NABARD or deposit account of Tea Board, Coffee Board or Rubber Board; 40% on profits from these businesses before deductions (subject to certain conditions)	All assessees involved in growing and manufacturing tea/coffee/rubber in India
33ABA	Deduction allowed to assessees involved in prospecting, extraction or production of petroleum or/and natural gas	Deduction shall be applicable on deposits made with SBI/Site Restoration Account; 20% on profits from these businesses before deductions (subject to certain conditions)	All assessees involved in prospecting, extraction or production of petroleum or/and natural gas
35(1)(i)	Assessees shall be given deduction for the revenue spend on scientific research	Entire amount spent on scientific research is deductible 3 years before commencement of business, in the year the said business commenced	All assessees

35(1)(ii)	Any contributions for the purpose of scientific research to any college, institution, university or association, shall be allowed as deduction (subject to certain conditions)	150% (175% before 01-04-2018) of the amount contributed to such college, institution, university or association is allowed as deduction. (Note: from assessment year 2021 the same shall equal to the sum donated	All assessees
35(1) (iia)	Any contributions for the purpose of scientific research to any company registered in India shall be allowed as deduction (subject to certain conditions)	125% of the amount contributed to such a company Entire sum eligible for deduction from AY 2018-2019	All assessees
35(1)(iii)	Any contributions towards statistical research or in social sciences to any college, institution, university or association, shall be allowed as deduction (subject to certain conditions)	125% of the amount contributed to such a company Entire sum eligible for deduction from AY 2018-2019	All assessees
35(1)(iv) read with 35(2)	Any capital expenditure incurred on scientific research related to the business shall fetch deduction	100% deduction is allowed in the commencement year (expenditure that occurred within 3 years before commencement)	All assessees

35(2AA)	Deduction allowed on in-house scientific research and development by a scientific research company approved by prescribed authority	150% (200% before 01-04-2018) of the total expenditure	Any company engaged in production of eligible articles or things
35ABA	Deduction allowed on capital expenditure incurred for acquiring the rights to use spectrum	Equal instalments will be deducted from the year of payment to the year in which it shall end	All companies providing telecommunication services
35ABB	Deduction allowed on capital expenditure incurred for acquiring a license or rights to operate telecommunication services	Equal instalments will be deducted from the year of payment to the year in which the license shall end	All companies providing telecommunication services
35AD	Specified businesses are allowed deductions in respect of expenditure incurred- cold chain facility, warehouse for agricultural produce, a hospital (at least 100 beds), housing projects under affordable housing, production of fertilizers in India (subject to certain conditions)	100% (150% before 01-04-2018) of the capital expenditure on such specified businesses (subject to certain conditions)	All assessees

35CCC	Deduction shall be allowed for agricultural extension projects for training, educating and guiding the farmers and the expected expenditure is to be more than Rs 25,00,000 (subject to certain conditions)	150% of the expenditure (subject to certain conditions) (Note: 100% from 01-04-2021)	All assessees
35DD	Demerger or amalgamation of a company after 31-03-1999, can amortize the expenditure incurred in doing so	Starting with the year in which amalgamation or demerger took place, expenditure shall be deducted in five equal installments	Indian companies
35DDA	Deduction allowed on expenditure incurred on Voluntary Retirement Scheme (VRS)	Deduction on each payment under VRS is allowed in 5 equal installments in 5 previous years	All assessees
35E	Deductions shall be allowed on exploring minerals or other natural deposits (subject to certain conditions)	Deduction on eligible expenditure is allowed in 10 equal installments in 10 previous years	Resident Persons
36(1)(i)	Insurance premium that covers risk to destruction or damage of stores or stocks	Actual expenditure incurred	All assessees
36(1)(ia)	Insurance premium for covering the life of a cattle that is owned by a member	Actual expenditure incurred	All assessees

	of a co-operative society supplying milk to a milk federation		
36(1)(ib)	Premium of Employees health insurance scheme (subject to certain conditions)	Actual expenditure incurred	All assessees
36(1)(ii)	Bonus and/or commission paid to employees which otherwise wouldn't be payable	Actual expenditure incurred	All assessees
36(1)(iii)	Interest on borrowed capital (subject to certain conditions)	Applicable on all businesses and profession on the interest payable on the borrowed capital (subject to certain conditions)	All assessees
36(1)(iv)	Employers contributions to approved superannuation fund and recognized provident fund (subject to certain conditions)	Actual expenditure incurred	All assessees
36(1)(v)	Employers contributions (exclusively for the benefit of employees) paid towards gratuity fund (subject to certain conditions)	Actual expenditure not exceeding 8.33% of the employee's salary	All assessees - employers
36(1) (va)	Employer's contribution to employee's respective provident fund or any other	Actual amount credited to employees account on the due date	All assessees - employers

	fund set up under Employees' State Insurance Act, 1948		
36(1) (vii)	Such bad debts that have been written off	All bad debts that have been written off in the Books of accounts (subject to certain conditions)	All assessees
37(i)	Any other expenditure (which does not fall in the category of personal or capital expenditure or mentioned in Sections 30-36) is shelled out completely for the purpose of profession or business	Actual expenditure incurred	All assessees

Expenses Deductible Based On Actual Expenditure:

If the expenditure has already taken place on or before the date of filing of return of income, then the following expenses are deductible-

Section	Particulars
43B (a)	Any Cess, Fees, Duty or Tax under any law
43B (b)	Any contributions to Welfare Fund, Superannuation Fund, Gratuity Fund or Provident Fund
43B (c)	Commission or bonus paid to employees which would not have been given as dividend or profit
43B (d)	Interest on borrowings or loans from state or public financial institutions, etc.

43B (e)	Interest on advance or loan from banks
43B (f)	Payment of leave encashment
43B (g)	Sum payable, for the use of its assets, to Indian railways

Capital Gain Taxation

Sections 45-55 of the Income Tax Act, 1961 deals with Capital Gains and the relevant taxation rules.

What is Capital Asset?

Section 2(14) of the Act elucidates the definition of capital asset. It is any property that is held by an assessee for the purpose of profession or business, or not. It includes all movable or immovable, tangible or intangible properties, like vehicles, patents, trademarks, land, building, house property, leasehold rights, machinery, jewelry, debentures, securities, shares, mutual funds, etc.

These are not considered as Capital Asset-

- Any stock, raw material or consumables held for the purpose of business or profession.
- Personal belongings such as clothes or furniture held for self-use (excluding drawing, paintings, sculptures, jewelry, archeological collections).
- Agricultural land in rural India.
- Deposit certificates issued under the Gold Monetization Scheme, 2015 or Gold deposit bonds issued under Gold Deposit Scheme (1999).

What is Capital Gains?

'Capital Gains' refers to any profit or gain arising from the sale or transfer of a capital asset. Such gain or profit is taxable under income tax and is called as 'Capital Gain Tax'.

There are two types of capital gain tax; short-term and long-term. The tax rate on capital gains depends on the period for which the asset is held.

Short-term Capital Assets: Shares, units and other securities if held for less than 12 months then they are termed as short-term capital assets. In cases of immovable property like building, house

property, land, etc. and unlisted shares less than 24 months of holding shall make it short-term capital asset. Other capital assets if held for less than 36 months shall fall in this category.

Profits made by sale of any such asset is termed as short-term capital gains and will be taxed accordingly.

Long-term Capital Assets: Securities like shares, units, debentures, zero coupon bonds, etc. if held more than a year i.e. 12 months, then shall be considered long-term capital asset. Fixed assets like land, building, house property when held more than 24 months shall be regarded as long-term capital asset. Other capital assets need to be held for more than 36 months to qualify as long-term capital asset.

Any profit arising from the sale of such assets falls in the category of capital gains and shall be taxed thus.

CAPITAL ASSET	Minimum Period For Holding
Listed Equity Share	12 months
Listed Preference Share	12 months
Equity Oriented Mutual Fund	12 months
Unlisted Equity Share	24 months
Listed Preference Share	24 months
Immovable property (land, house)	24 months
Debt mutual Fund	36 months
Debentures, Bonds	36 months
Others (jewelry, etc.)	36 months

Income Tax Act, 1961, provides a standard format to calculate Short-Term Capital Gains (STCG) and Long-Term Capital Gains (LTCG).

Computation of LTCG:

	Sale Value	XXX
Less	Cost of acquisition	XXX
Less	Cost of improvement	XXX

Less	Expenditure incurred on transfer or sale	XXX
	Long-Term Capital Gains	XXX

Computation of STCG:

	Sale Value	XXX
Less	Cost of acquisition	XXX
Less	Cost of improvement	XXX
Less	Expenditure incurred on transfer or sale	XXX
	Short-Term Capital Gains	XXX

Related Terms-

Cost of acquisition: The value at which the capital asset was acquired by the seller.

Cost of Improvement: the expenditure incurred in improvement of the capital asset by the seller.

Understanding Short-term Capital Loss (STCL) and Long-term Capital Loss (LTCL):

It is pertinent to understand the concept of STCL and LTCL. When the transfer price of any capital asset is less than compared to the acquisition price then the said amount shall be termed as loss. It would be termed Short-term Capital Loss (STCL) and Long-term Capital Loss (LTCL) based on the holding period.

Long-Term Capital Gains Tax Exemptions

Sections 54, 54EC and 54F deal with the provisions on exemption from LTCG.

Section 54:

Exemption on Old Asset- Residential property; Investment in New Asset- Residential property.

Eligibility to avail exemption under Section 54- To claim benefits under this Section of the Income Tax Act, the taxpayer needs to satisfy following certain conditions-

- The taxpayer i.e. the seller should be an individual or an HUF, firms, LLPs, companies cannot avail this exemption.
- The said asset should fall in the category of long-term capital asset.

- The asset should be a residential house property.
- The taxpayer should have purchased another residential house within one year of before or two years after the transfer of the asset, or had constructed a residential house within a three year period from the date of transfer of the old asset.
- The seller cannot invest in a residential property abroad as to avail the exemption, the asset should be in India.

All those taxpayers who shall fulfill all the above given conditions can avail exemption under this Section.

The amount of exemption available under Section 54- The amount shall be the lower of-

Amount of capital gains that has arisen out of transfer of the residential house

OR

Amount invested in construction or purchase of a new residential house property.

Illustration:

- Mr. XYZ sold his bungalow (house property) for Rs. 65,00,000.
- He purchased an apartment for Rs. 45,00,000 from the proceeds of the sale of asset.
- The computation shall be done as given below-

Particulars	Amount (Rs)
Capital gain on transfer of residential house	65,00,000
Less- investment made in residential house property	45,00,000
Balance- capital gains	20,00,000

The balance capital gains of Rs 20,00,000 shall be taxable.

In cases where the purchase amount of the new residential house property is more than the capital gain from the transfer, then the entire amount of capital gain shall be exempt.

Consequence on transfer of new asset: The new property purchased has to be held for at least three years and if transferred within three years of acquisition or construction, then the exemption shall be taxable in the year of sale. The capital gain arising shall be considered as short-term capital gain.

Number of houses that can be purchased for claiming exemption under Section 54:

- This exemption can be availed if the capital gains arising out of the transfer of residential house is utilized for purchase or construction of one residential house property.
- As an exception to the above, the Budget of 2019 has brought in an amendment and now an assessee can invest in two residential house properties if the capital gain arising out of the transfer of residential house is up to Rs. 2 crores. This exemption is a one time opportunity which any taxpayer can avail only once in a lifetime.

Capital Gains Deposit Account Scheme:

Section 54 specifies the provisions to avail exemptions of capital gains from the sale of a residential property, yet it may happen that an assessee shall not be able to utilize the amount in the year in which the property was sold. Under such circumstances, the unutilized amount can be deposited in Capital Gains Deposit Account Scheme in any public sector bank. The deposit can be withdrawn for the purpose of construction or purchase, but if the deposit is not utilized within the specified time period then the amount shall be taxable.

Case Law:

***K.C. Kaushik* v. *P.B. Rane (ITO)*[3]**

The Case: K. C. Kaushik as an individual assessee had claimed exemption as per Section 54 of the Income Tax Act, 1961. He had purchased more than one house in the prescribed period and his claim was rejected by the Assessing Officer on the flat mentioned by the assessee had not utilized more than the gains from the sold asset. The assessee then revised and applied for claim in the other flat bought in the same period on the grounds that it was not used as residence. His petition was rejected by the CIT.

[3] 1990 (3) Bom CR 160.

Date of Verdict: 2 April, 1990

Judges: T. D. Sugla, Bombay High Court

The Verdict: Giving the judgement on the writ petition, the Judge held the assessee had the right to choose which property to claim the benefit and further opined that if for reasons beyond his control, the individual was unable to reside in the said property for three years, then also he should not be denied the exemption.

Section 54F:

This Section specifies exemption on capital gain pertaining to transfer of any long-term capital asset other than residential house but on investment on purchase of purchase of residential house property.

Eligibility to avail exemption under Section 54F-

- It is available only to an individual or HUF and can be availed on the net consideration if the taxpayer has purchased another residential house within one year of before or two years after the transfer of the asset, or has constructed a residential house within a three-year period from the date of transfer of the old asset.

Meaning of net consideration:

The term 'net consideration' refers to full value of the consideration received on transfer of a capital asset after deductions of expenditure incurred on transfer.

Full value of consideration (-) expenditure= net consideration

The amount of exemption available under Section 54F-

If the complete amount of net consideration is invested towards purchase or construction of a residential house, then the entire amount shall be exempted under Section 54F.

In case, the net consideration is only partially utilized towards purchase or construction of a residential house, then exemption shall be proportional.

Long term capital gain x amount reinvested/net consideration= exempt under Section 54F.

Capital Gains Deposit Account Scheme:

If the taxpayer is unable to utilize the entire amount in the same year as the asset was transferred, then the unutilized amount can be deposited in Capital Gains Deposit Account Scheme in any of the public sector banks. If the deposited amount is not utilized within the stipulated period then it becomes taxable.

Consequence on transfer of new asset: if the new residential house is transferred within three years then the capital gains shall be charged and made taxable as long-term capital gains in the year in which it was sold.

Case Laws:

1. ***Commissioner of Income Tax* v. *Kamal Wahal***[4]

The Case: An appeal filed by the Commissioner of Income Tax (CIT), New Delhi, against the order of the Income Tax Appellate Tribunal on the appropriateness of interpretation of Section 54F of the Income Tax Act, 1961. The assessee who is an individual who sold an inherited house and gained proportional capital gains which he invested acquiring a vacant plot and purchase of a residential house in the name of his wife. The assessing officer disallowed the claim as the purchase was not made in the name of the assessee. The CIT (Appeals) accepted the assessee's argument and allowed the claim. The Tribunal confirmed the same and hence, the appeal reached the court.

Date of Verdict: 11 January, 2013

Judges: Badar Durrez Ahmed and R.V. Easwar, JJ, Delhi High court

The Verdict: The honourable judges ruled that for the purpose of Section 54F is reinvestment of the gains but it may not necessarily be in the assessee's name. The stand of CIT and Tribunal was reiterated by the Court; thus, the exemption claim was ruled in favour of the assessee.

2. ***Commissioner of Income Tax* v. *Ravinder Kumar Arora***[5]

The Case: Ravinder Kumar Arora purchased a residential house in joint name with his wife from the proceeds of sale of a property and as capital gains claimed exemption. The Assessing Officer allowed only 50% exemption as the wife was the owner of the other half. The CIT (Appeals) allowed full exemption on the ground that the entire amount of capital

[4] ITA 4/2013.

[5] 342 ITR 38 / 75 DTR 406 / 252 CTR 392.

gains was utilized towards the purchase of the house and within the stipulated period, the joint name of wife shall not make him ineligible for exemption.

Date of Verdict: 27 September, 2011

Judge: A. K. Sikri, Delhi High Court

The Verdict: The Judge agreed full heartedly with the CIT (Appeals) stand and concluded in favor of the assessee. He further commented that such conduct should be encouraged as it empowers the women.

Section 54B:

The definition of capital asset as in Section 2(14) of the Income Tax Act, 1961, excluded rural agricultural land from its scope, hence, there is no capital gains on its sale. But at the same time, the urban agricultural land is covered under capital assets and attracts capital gains and Section 54B deals with the exemptions given on sale of such agricultural land.

Eligibility to avail exemption under Section 54B-

- This exemption can be availed only by an individual or HUF and is applicable on both long-term and short-term capital gains.
- To claim exemption, the said land must have been used by the assessee or his parents for agricultural purpose at least for two years before its transfer. In case of a HUF, it must have been used as agricultural land by any of its member.
- The exemption can be availed if the taxpayer utilizes the money in acquiring another agricultural land within two years. He has the privilege of investing in rural or urban land.

The amount of exemption available under Section 54B-

The amount shall be the lower of-

Amount of capital gains that has arisen out of transfer of the urban agricultural land,

OR

The amount invested in acquiring another agricultural land, urban or rural.

Capital Gains Deposit Account Scheme:

A two year period has been given to the taxpayer, and if the entire amount is not utilized in the same year then it can be deposited in Capital Gains Deposit Account Scheme in any of the public sector banks.

Consequence on transfer of new asset:

If the newly acquired agricultural land is transferred within a period of three years then the amount that was claimed as exemption shall be deducted from the cost of the new acquisition and would be taxed accordingly.

UNIT IV: RESIDUAL INCOME AND PROCEDURE FOR ASSESSMENT

Income from Other Sources

Income that is chargeable to tax under IT Act that does not fall under any of the other four heads can be charged to tax as "income from other sources". Therefore, this head is a residuary head of income. Income is computed under this head only after verifying the inability to assess the particular item of income under any of the other heads.

Section 56 to 59 of the IT Act also provides for a list of income item are to be charged to tax under the head in specific cases. Section 56 defines the scope of "income from other sources", whereas, sections 57 and 58 give the basis for the computation of such income.

The following items of income can be included under the head "Income from other sources":

1. **Dividends (Section 56(2)(i))**- Dividend income other than those mentioned under section 10(34) are to be included under income from other sources.
2. **Keyman Insurance policy**- Amount from a Keyman Insurance Policy, including bonus on each Policy is to be taxed under Income from other sources if it does not qualify under any other head.
3. **Winnings from lotteries (Section 56(2)(ib))**- Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature is taxed as "income from other sources".

4. **Contribution to Provident fund-** Income earned from any provident fund or superannuation fund or any fund set up under the provisions of the ESI Act or any other fund for the welfare of such employees received by the assessee is chargeable to income-tax under this head.
5. **Income earned as interest on securities**- Wherever income earned from interest on securities is not charged under "Profits and gains of business or profession", such income is taxable under Income from other sources.
6. **Income from hiring of machinery, etc. (Section 56(2)(ii))**- Income from machinery, plant or furniture belonging to the assessee and let on hire.
7. **Money Gifts (Section 56(2)(vi))**- Any sum of money which, in total, exceeds fifty thousand rupees, and is received without consideration, by an individual or a HUF, in any previous year from any person or persons on or after the 1st day of April, 2006 but before 1st day of October, 2009,the whole value of such sum shall be taxable under Income from other sources.
8. **Advance money received-** Any sum of money, received as an advance or during negotiations for transfer of a capital asset is charged to tax under "Income from other sources", whenever such sum is forfeited due to negotiations not resulting in transfer of such capital asset.

A. **<u>Casual Income</u>**

Casual income includes income that are winnings from lotteries, crossword puzzles, races including horse races; gambling and betting of any nature or form, card games, game show or entertainment program on television or electronic mode and any other game of any sort. All such incomes are chargeable to tax under the head income from other sources.

However, following income are not chargeable under "income from other sources":

1. **Lottery held as stock in trade-** Winning of an agent or trader from lottery held as unsold stock of tickets is treated as incidental to business and taxed under the head "profit and gains of business or profession."
2. **Income of jockey-** Income of jockey from such profession is not treated as winning from the horse races.

3. **Winning from a motor car rally**- Winning from a motor car rally is a return for skill and effort and cannot be created as casual income, these are taxable as normal income.
    - Casual income cannot be subject to any deduction or exemption (Section 58 (4))
    - No deduction can be claimed from casual income even if such expenditure is incurred exclusively for earning such income
    - Deduction under section 80C to 80U is also not available from such income

Casual income is liable to TDS. The casual income is taxed at a flat rate of 30% plus surcharge(if any), plus education cess plus secondary and higher education cess.

B. <u>Family pension</u>

Family Pension is a regular amount payable by the employer to a family member of a deceased employee. It is taxed under the head income from other sources. Such income is eligible for a standard deduction under section 57(iia) which is either 1/3rd of such pension or Rs. 15000 whichever is lower.

Family pension received by the widow or children or nominated heirs of a member of the armed forces (including paramilitary forces), where the death of such member has occurred in the course of operational duties, is exempt from tax subject to conditions prescribed. Income by way of family pension of an individual who has been in the service of Central or State Government and has been awarded Param Vir Chakra or Maha Vir Chakra or Vir Chakra or such other gallantry award as may be notified is also exempt from tax.

C. <u>Deductions allowed under the Head</u>

The following deductions can be made under the head:

1. **From interest on securities (Section 57(i) and (iii))**- any reasonable sum paid as commission or remuneration to a banker or any other person for the purpose of realizing such interest on behalf of the assessee. Interest on money borrowed for investment in securities can be claimed as a deduction.
2. **From the contributions received by employer from employees towards Provident Fund or Superannuation or other funds (Section 57(ia))**- Deduction is allowed in accordance with the provisions of Section 36(1) (va), that is, if the

3. employer has credited the employee's accounts with the amounts of contributions received, the employer shall be allowed credit thereof.
4. **Income derived from letting (Section 57(ii))**- Where income is derived from letting out of machinery, plant or furniture on hire and also buildings where the letting of building is inseparable from the letting of such machinery, plant or furniture and the income from such letting is not chargeable to Income tax under the head "Profits and Gains of Business or profession", the following expenses incurred in respect of those assets:

   (a) Current repairs of buildings.

   (b) Insurance premium against risk of damage or destruction of the premises.

   (c) Repairs and insurance of machinery, plant or furniture.

   (d) Depreciation.

   Where the expenses referred to at (a) to (d) hereinabove are incurred on property used partly for the business of the assessee, a proportionate deduction shall be allowed.
4. **Income in the nature of family pension (Section 57(iia))**- A sum equal to 33% of the income or Rs. 15,000, whichever is less, is allowed as a deduction.
5. **Interest on compensation or enhanced compensation (Section 56(2)(viii))**- A deduction equal to 50% of such income and no deduction shall be allowed under any other clause of this section.
6. **Other deductions (Section 57(iii))**- Any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income as per *Smt. Virmati Ramkrishna* v. *C.I.T*[6].

<u>Set Off and Carry Forward of Losses</u>

The assessee, at times, incurs a loss from a source of income. Principles of natural justice state that a set-off should be available for loss incurred. The IT Act recognizes this and provides for

[6] (1981) 131 ITR 659(Guj).

adjustment and utilization of the losses. For this the IT Act contains specific provisions (Sections 70 to 80) for the setoff and carry-forward of losses.

A. <u>Section 70: Intra-Head Adjustment</u>

When the losses from one source of income are set-off against another source of income, both incomes belonging to the same head, such an arrangement is called an intra-head adjustment. For example, adjustment of loss from business A against profit from business B.

Income of a person is classified under five heads. The 'sources' of income or the items of income earned by an individual may be many but they can be classified under the same head. Thus, generally, if the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head.

However, the following are the exceptions to general rule:

1. **Losses from a Speculative Business**- Loss from a speculation business cannot be set-off against profit from a non-speculation business. However, the reverse is possible, that is, loss from a non-speculative business can be set-off against speculation income
2. **Long-term capital Loss**- Long Term Capital Loss (LTCL) can be set-off only against Long Term Capital Gain (LTCG) and cannot be set off against Short term Capital Gain (STCG). However, STCL can be set off against LTCG
3. **Casual Income-** No loss can be set-off against casual income such as income from lotteries, crossword puzzles, race including horse race, etc. Expenses cannot be claimed against casual income.
4. **Losses from the activity of owning and maintaining race horses-** Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses.
5. **Loss from an exempted source cannot be set off against taxable income**- If income from a particular source is exempt from taxation, then loss from such source cannot be set off against any other income which is taxable. For example, agricultural income is exempt from tax, hence, if the taxpayer incurs loss from

6. agricultural activity, then such loss cannot be adjusted against any other taxable income.
7. **Income Losses of specified Business**- Loss from business specified under section 35AD, such as setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc., can be set off only against income from another specified business.

B. <u>Section 71: Inter-Head Adjustment</u>

Once the intra-head adjustments, if any, are made, then taxpayer can proceed to make the inter-head adjustments. Losses incurred under one head of income can be adjusted against income from another head. For example, loss under the head of house property can be adjusted against salary income.

Loss under one head of income is generally allowed to be set-off against income under another head. Section 71 provides certain exceptions to the general rule:

1. **Loss under the head "capital gains"** cannot be set off against income under any other head. It must be set-off only against income from "capital gains".
2. **Loss under the head "Profits and gains of business or profession**" cannot be set-off against the head "income from Salaries."
3. **Where the assessee incurs any loss under the head "income from house property"** it can be set-off against the assessee's any other income under other head during the previous years where such loss is not fully adjusted under other heads of income in the same assessment year, then the balance loss shall be allowed to be carried forward and set off in subsequent years subject to a limit of eight assessment years against income from house property.
4. **Loss incurred by an assessee from a source of income which is exempt**, cannot be set-off against income from a taxable source.
5. **Loss from speculative business** cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business.
6. **Business loss** cannot be set-off against salary income. It can be set-off against other incomes

7. **Loss under the head Capital Gains** (LTCL or STCL) cannot be set-off against any other head. However loss from other heads can be set-off against Capital Gains.

C. **Carry-Forward of Losses**

It may happen that after making intra-head and inter-head adjustments, there are still some losses which remain unadjusted. Such unadjusted loss can be carried forward to next year for adjustment against subsequent year/s income.

Separate provisions have been framed under the IT Act for carry-forward of loss under different heads of income.

Losses can be set-off against the income of following years provided that they have been suffered by assessee. Also the losses must be determined as per returns filed by the assessee. Also it is strongly advisable that return on income during loss incurring years is to be filed on time.

The following losses can be carried forward :

1. Loss in non-speculation business or profession.
2. Loss in speculation business.
3. Loss in transfer of capital assets [whether short-term or long-term].
4. Loss from activity of owning and maintaining of race horses.
5. Loss under the head 'Income from House Property'.

However, losses suffered under the following heads are not allowed to be carried forward and set off:

1. Losses under the head 'salaries'.
2. Losses under the head 'Income from other sources' (except loss suffered from the activity of owning and maintaining race horses).

Filing for carry-forward of losses is an elaborate process that is to be carried out separately under each head in a specific order.

Deduction, Refund and Tax Authorities

A. Deduction

The IT Act provides for various tax exemptions and deductions. Chapter VI A contains deductions from gross total income under section 80C to 80U in respect of certain payments, investments, incomes and other deductions. Deduction helps in reducing the taxable income. It decreases the overall tax liabilities and helps to save tax.

Depending on the type of claim for tax deduction, the amount of deduction varies. The deductions are available only to the assessees who have a positive gross total income. Negative gross total income indicates a loss position and not deductions are allowed.

The expression 'gross total income' means the total income of the assessee computed in accordance with the provisions of the IT Act, before making any deduction under Chapter VIA.

Sections 80C to 80U of the IT Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. The income arising after deduction is called Total Income.

Some commonly allowed deductions are listed below:

1. Life insurance premium
2. Sum paid towards notified annuity plan of LIC or other insurer, a contract for a deferred annuity
3. Contributions towards Employees' Provident Fund Scheme, Public Provident Fund Account, a recognized provident fund, an approved superannuation fund, notified unit-linked insurance plan of LIC Mutual Fund, participation in unit-linked Insurance Plan of UTI, any pension fund set up by any mutual fund which is referred to in section 10(23D) or by the UTI
4. Subscription to any notified security, notified deposit scheme of the Central Government, notified savings certificates, notified pension fund set up by National Housing Bank
5. Tuition fees paid by an individual to any university, college, school or other educational institution situated in India, for full time education of any 2 of his/her children
6. Certain payments for purchase/construction of residential house property

7. Contribution to pension scheme notified by Central Government up to 10% of salary
8. Expenses actually paid for medical treatment of specified diseases and ailments subject to certain conditions, etc.

B. Refund

In cases where the taxpayer has paid excess tax against the tax required to be paid by him, the taxpayer is granted refund of the excess tax paid by him. The tax paid by the taxpayer could be in the form of advance tax or tax deducted/collected at source or self-assessment tax or payment of tax on regular assessment. Sections 237 to 245 deal with the provisions relating to refund of tax.

As per section 237, if the taxpayer is able to satisfy the Assessing Officer that the amount of tax paid by him for any year exceeds the amount of tax payable by him, he will be entitled to a refund of the excess tax paid by him.

The taxpayer may appeal in cases where the Assessing Officer denies refund. Delay in refund leads to tax authorities paying interest on refund amount.

C. Tax Authorities

The provisions of the IT Act in Sections 117 to 136 state the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. In addition to the various provisions contained in these sections, the Income-tax Department follows the system of functional allocation and distribution of work with focus on specializing and concentrating in the various areas of income-tax assessment, procedure, collection, recovery, refund, appeals, etc.

The following are the income-tax authorities who are statutorily empowered to administer the law of Income-tax :

1. The Central Board of Direct Taxes, constituted under the Central Boards of Revenue Act, 1963; Principal Director General of Income-tax or Principal Chief of Commissioners of Income-tax
2. Directors-General of Income-tax or Chief Commissioners of Income-tax

3. Principal Director of Income-tax or Principal Commissioners of Income-tax
4. Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals)
5. Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals)
6. Joint Directors of Income tax or Joint Commissioners of Income-tax.
7. Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals)
8. Assistant Directors of Income-tax or Assistant Commissioners of Income-tax
9. Income-tax (Assessing) Officers
10. Tax Recovery Officers
11. Inspectors of Income-tax.

For implementing the IT Act, the Income Tax authorities are vested with the various powers which are vested in a Court of Law under the Code of Civil Procedure while trying a suit in respect of any case. They are vested specifically with the powers of the Court with regard to:

a. Discovery and inspection
b. Enforcing the attendance, including of any officer of a bank and examining him on oath
c. Compelling the production of books of accounts and the documents
d. Collecting certain information
e. Issuing commissions and summons

Return of Income and Assessment

A. Return of Income

A Return of Income, also called an Income Tax Return (ITR) is a form in which a taxpayer discloses details of his income, claims applicable deductions and exemptions and taxes that are payable on the taxable income.

Details of taxes paid also reflect in the return. Any excess tax paid for a year can be also be claimed as a refund in the return of income.

It is mandatory for a company and a firm to file an ITR. However, individuals, HUF, AOP, BOI are mandatorily required to file ITR if the income exceeds the basic exemption limit of Rs 2.5 lakhs. This limit is different for senior citizens and super senior citizens.

The filing of ITR is optional for:

- Taxpayers aged 80 and above
- Taxpayers having an income less than Rs. 5 lakhs and not claiming a refund

The deadlines for filing ITR have also been prescribed.

B. <u>Assessment</u>

There are six types for assessments that can be made under the IT Act:

1. **Self assessment (Section 140A)**

   Self assessment is the primary step in the process of assessments. It is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits an IT Return to the department.

   A person has to self-assess his income and pay tax under the following provisions:

   a. Under sections 139- Filing a return of income
   b. Under section 142(1) and 148- When a notice has been issued stating that income has escaped assessment
   c. Under section 153A- Assessment in case of search or requisition

   The total tax payable is calculated on the total income of the assessee after considering the following amount:

   a. The amount of tax already paid under any provision of the Act
   b. Any tax deducted or collected at source
   c. Any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India
   d. Any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section, and
   e. Any tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD.

   Where there is delay in furnishing of return of income, self-assessment should also take into consideration the interest for delay and fee for delay under section 234F.

2. **Regular (Scrutiny) assessment (Section 143)**

Once a self-assessed return has been filed under section 139, or in response to a notice under section 142 (1), the Assessing Officer, if he considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return.

Such a notice is to be served within six months from the end of the financial year in which the return is furnished.

After hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

3. **Best judgement assessment (Section 144)**

The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment in the following cases :

a. If any person fails to make the return required under section 139(1) and has not made a return or a revised return under section 139(4) or 139(5)
b. When a person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited
c. If any person having made a return, fails to comply with all the terms of a notice issued under section 143(2)
d. The accounts books are incorrect, false or incomplete

e. If the accounting method employed is such that the profit cannot be derived from it correctly
f. Where the method of accounting adopted by the assessee is not followed by him regularly or income has not been computed in accordance with notified standards
g. If the assessee has not followed the income computation and disclosure standards notified by the government

4. Income escaping assessment or reassessment (Section 147)

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153:

a. assess or reassess income which has escaped assessment or
b. recompute the loss or the depreciation allowance or any other allowance, as the case may be for the relevant assessment year

The following are deemed to be cases where income chargeable to tax has escaped assessment:

a. where no return of income has been furnished by the assessee although his total income during the previous year exceeded the maximum amount which is not chargeable to income-tax
b. where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return
c. where the assessee has failed to furnish a report in respect of any international transaction which he was so required under section 92E
d. where a person is found to have any asset (including financial interest in any entity) located outside India, etc.

5. Precautionary assessment

Where it is not clear as to who has received the income and prima facie, it appears that the income may have been received either by A or by B or by both together,

the Assessing Officer can commence proceedings against both A and B, as a precaution, to determine the question as to who is responsible to pay the tax.

6. **Assessment in case of search or requisition (Section 153A)**

   Notwithstanding anything contained in sections 139, 147, 148, 149, 151 and 153, in case of a person where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, the Assessing Officer shall assess or reassess the total income of six assessment years immediately preceding the assessment years relevant to the previous year in which such search is conducted or requisition is made.

Penalty and Prosecution for Tax Evasion

Tax evasion is the illegal non-payment or underpayment of tax by an individual.

Following are the different kinds of Tax Evasions and the penalties prescribed thereof:

1. **Not Filing ITRs**

   If a taxpayer is required to file income tax returns before the due date as required under section 139 (1) of IT Act and fails to do so, the assessing officer can impose a penalty of INR 5,000 or more.

2. **Failure to Pay Tax as Self-Assessment**

   As per section 140 A (1) of the IT Act, if a taxpayer fails to pay self-assessment tax, the taxpayer is declared as a defaulter. The assessing officer can as per section 221(1) declare the taxpayer as a defaulter and impose a fine that does not exceed the tax in arrears. However, if the taxpayer is able to provide sufficient proof for default, the assessing officer can exempt the taxpayer from paying the penalty.

3. **Failure to Comply with Demand Notice**

   Once a taxpayer receives a demand notice asking for tax payment, the taxpayer has to pay the amount in 30 days. Failure to do so will result in further penal provisions and the taxpayer will be treated as a defaulter.

4. **Tax Evasion**

Section 276C of the Act provides that if a person willfully attempts in any manner whatsoever to evade any tax, penalty or interest or under-reports his income, he shall be punishable:

a. In a case where amount sought to be evaded or tax on under-reported income exceeds ₹ 25 lakh, with rigorous imprisonment for a term which shall not be less than 6 months but which may extend to 7 years and with fine
b. In any other case with rigorous imprisonment for a term which is not less than 3 months but which may extend to 2 years and with fine.

The scope of "willful attempt to evade any tax, penalty or interest chargeable or imposable under this Act" includes a person who:

a. has in his possession or control books or other documents containing false entry
b. makes or causes to be made any false entry in the books or documents or
c. willfully omits or causes to be omitted any relevant entry; or
d. causes any other circumstances which will have the effect of enabling such person

- **McDowell & Co. Ltd. v. CTO**[7]

The Case: McDowell & Co. Ltd was a licensed manufacturer of Indian Liquor. Buyers of liquor used to obtain passes for release of liquor after making payment of excise duty directly to excise authorities and present said passes before appellant whereupon bill of sale was prepared by the appellant showing price of liquor but excluding excise duty. Sales tax was paid by appellant to sales tax authorities on basis of turnover but excluding excise duty. The method followed by the appellant resulted in reduction of sales tax amount on liquor.

Date of Verdict: 17 April, 1985

Judges: Five Judge Bench of the Supreme Court

The Verdict: This decision remains landmark in terms of explaining the difference between tax avoidance and tax evasion. It confirmed that tax planning, as long as it is legal, is permissible. Tax avoidance is a legal way of avoiding tax. The Supreme Court frowned upon such practices. The Court also stated that colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid

[7] [1985] 154 ITR 148 (SC)

the payment of tax by resorting to dubious methods. Tax evasion is commission of offences defined under IT Act.

Search and Seizure

Search and seizure is conducted by an authorized officer who is duly empowered by a search warrant. He may conduct a search if he has in his possession any information through which he has reason to believe that:

1. A person to whom a summon, under section 131(1) or, a notice under 142(1) has been served to produce books of accounts or other documents, has failed or omitted to produce the said books of accounts or other documents, or,
2. A person is in possession of money, bullion, jewelry or other valuable article or thing and such property represents wholly or partly income or property which has not been disclosed or would not be disclosed.

- ***Mamchand and Co.* v. *Commissioner of Income-tax***[8]

  The case: Mamchand Agarwal and 2 others carried on a partnership firm under the name and style of Messrs. Mamchand and Company in Calcutta. Prior to 31st January, 1967 the assessment of the firm of Mamchand and Co. had been completed upto the assessment year 1963-64 and returns had been filed for the assessment years 1964-65 and 1965-66. The assessment in respect of the same has not yet been completed. On the 30th of January, 1967, the Commissioner of Income-tax, West Bengal, issued two warrants of authorization under Section 132 of the Income-tax Act, 1961 read with Rule 112 (1) of the Income-tax Rules, 1962 authorizing search at No. 21-A, Canning Street, Calcutta.

  Date of Verdict: 09 November, 1967

  Judges: Two Judge Bench, Calcutta High Court

  The Verdict: The assessing officer must have a reason to believe that the person, whether or not a notice has been served on him, is not likely to produce his books, etc. In such a case, the basis is that the person will suppress books of account and other documents which may be useful and relevant to an income tax proceedings. Here the authorizing authority, if challenged, has to prove the basis of belief.

[8] (1968) 069 ITR 0631 (CAL).

Commissioner of Income Tax v. Ramesh Chander[9]

Date of Judgment: 22 November, 1972

Judges: Two judge bench, Punjab High Court

The Verdict: For an authority to issue a search and seizure warrant, he must have information relating to two matters. One, the person should be in possession of money and secondly such money represents either wholly or partly income or property which has not been disclosed. No other information is required.

Surbhi Aggarwal
(Founder & CEO, School of Legal Education)
Thankyou

[9] (1974) 93 ITR 450 (PUN).