



BASIC CONCEPTS



LEARNING OUTCOMES

After studying this chapter, you would be able to -

- ❑ **recap** the basic concepts of income-tax law, its components and the meaning of important terms used;
- ❑ **interpret** the provisions of income-tax law by applying the rules of interpretation;
- ❑ **examine** whether a receipt is capital or revenue in nature, in the context of the provisions of income-tax law;
- ❑ **appreciate** the difference between application of income and diversion of income by overriding title;
- ❑ **examine** the circumstances when income of the previous year would be assessed to tax in the previous year itself;
- ❑ **appreciate** the differences in the rates of tax and surcharge applicable to different categories of persons;
- ❑ **apply** the rates of tax applicable to different components of the total income of a person and the rates of surcharge, wherever applicable, and health and education cess for the purpose of determining the tax liability of such person.



1.1 OVERVIEW OF INCOME TAX LAW IN INDIA

The Constitution of India, in Article 265 lays down that “No tax shall be levied or collected except by authority of law.” Accordingly both the levy of tax as well as its collection shall be made under a law framed by the government.

Constitution of India gives the power to levy and collect taxes, whether direct or indirect, to the Central and State Government. The Parliament and State Legislatures are empowered to make laws on the matters enumerated in the Seventh Schedule by virtue of Article 246 of the Constitution of India.

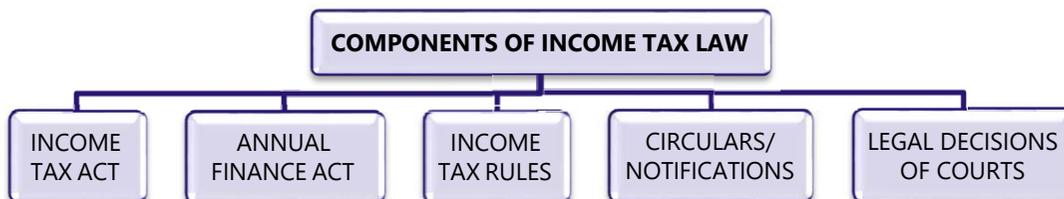
The Seventh Schedule to Article 246 contains three lists which enumerate the matters under which the Parliament and the State Legislatures have the authority to make laws for the purpose of levy of taxes.

The following are the lists:

- (i) **Union List or List I:** Parliament has the exclusive power to make laws on the matters contained in Union List.
- (ii) **State List or List II:** The Legislatures of any State has the exclusive power to make laws on the matters contained in the State List.
- (iii) **Concurrent List or List III:** Both Parliament and State Legislatures have the power to make laws on the matters contained in the Concurrent List.

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

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



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

Income-tax Act, 1961

The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act.

- It extends to the whole of India.
- It came into force on 1st April, 1962.
- It contains sections 1 to 298 and schedules I to XIV.
- It undergoes a change every year by the Annual Finance Act passed by Parliament, and other legislations like the Taxation Laws (Amendment) Act.

The Finance Act

Every year the Finance Minister of the Government of India introduces the Finance Bill in the Parliament's Budget Session. When the Finance Bill is passed by both the houses of the Parliament and gets the assent of the President, it becomes the Finance Act. New provisions are inserted; existing provisions are substituted or amended every year in the Income-tax Act, 1961 and other tax laws by the Finance Act.

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

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

Income-tax Rules, 1962

The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT).

- The CBDT is empowered to make rules for carrying out the purposes of the Act.
- For the proper administration of the Income-tax Act, 1961, the CBDT frames rules from time to time. These rules are collectively called **Income-tax Rules, 1962**.
- It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

Circulars and Notifications

Circulars

- Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of certain provisions of the Act.
- Circulars are issued for the guidance of the officers and/or assesseees. However, it cannot override the provisions of the Act.

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

Notifications

- Notifications are issued by the Central Government to give effect to the provisions of the Act.

Example 1: Under section 10(15)(iv)(h), interest payable by any public sector company in respect of such bonds or debentures and subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in this behalf would be exempt. Therefore, the bonds and debentures, interest on which would qualify for exemption under this section are specified by the Central Government through Notifications.

- The CBDT is also empowered to make and amend rules for the purposes of the Act by issuing notifications which are binding on both department and assesseees.

Example 2: Under section 35CCD, the CBDT is empowered to prescribe guidelines for notification of skill development project. Accordingly, the CBDT has, *vide Notification No. 54/2013 dated 15.7.2013*, prescribed Rule 6AAF laying down the guidelines and conditions for approval of skill development project under section 35CCD.

Case Laws

The study of case laws is an important and unavoidable part of the study of Income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assesseees and the department and give decisions on various issues.

The Supreme Court is the Apex Court of the Country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

Rules of Interpretation

Rules of Interpretation are principles that have evolved over the years, on account of interpretation of provisions of law by various Courts. These rules help in interpretation of law. The object behind use of these rules is to ascertain the intention of the lawmakers. These rules are not static and keep on evolving. At times, there may be more than one rule of interpretation which appear to applicable to a given situation. The Courts then decide the most appropriate one in the given situation considering the facts of the case.

In the ensuing paragraphs, we have made an attempt to discuss the Rules of Interpretation, largely in the context of income-tax law, citing appropriate instances.

I. Significant rules of interpretation used by Courts:

- **Rule of literal interpretation** - This rule is based on the age-old doctrine that "*judges do not legislate, they only interpret law*". It stipulates that the intention of the legislation must be

found in the words used by the legislature itself. Attention must be given to what has been said and also what has not been said. Nothing should be added or subtracted. If the provision is unambiguous and if from that provision the legislative intent is clear, the other rules of construction of statutes need not be called into aid.

Example 3:

The Supreme Court in CIT v. Rajendra Prasad Moody [1978] 115 ITR 519, noted that the plain natural construction of the language of section 57(iii) of the Income-tax Act, 1961, irresistibly leads to the conclusion that to bring a case within that section it is not necessary that any income should in fact have been earned as a result of the expenditure. Section 57(iii) requires that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. The section does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction: it does not say that the expenditure shall be deductible only if any income is made or earned.

Where the assessee borrowed monies for the purpose of making investment in certain shares and paid interest thereon during the accounting period relevant to the assessment year but did not receive any dividend on the shares purchased with those monies: Held, accordingly, that the interest on monies borrowed for investment in shares which had not yielded any dividend was admissible as a deduction under section 57(iii) of the Income-tax Act, 1961, in computing its income from dividend under the head "Income from other sources".

- **Mischief rule** - The mischief rule originated in 16th century in the Heydon's case in the United Kingdom. It is commonly known as the Heydon's Rule or Purposive construction. Under this rule, the position before an amendment or enactment of an Act is examined to find out the mischief sought to be remedied to determine the rationale for the remedy. In order to do so, the following aspects are looked at:
 - What was law before the provision was introduced or amended?
 - What was the mischief or the defect for which the earlier provision of law did not provide a remedy?
 - What remedy has the Parliament effected in the provisions of law to cure the mischief or defect?
 - What is the intended effect of such remedy?

Courts then have to make a construction that suppresses the mischief and advances the remedy.

Example 4:

The Bombay High Court made a landmark judgment in Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107. The Court applied the "mischief rule" on interpretation of statutes and pointed out that the idea behind the introduction of sub-section

(4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm. The High Court observed that the expression 'otherwise' has not to be read ejusdem generis with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets'. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

- **The Golden rule** – It allows a judge to depart from a word's normal meaning in order to avoid an absurd result. It is a compromise between the literal rule and the mischief rule. Like the literal rule, it gives the words of a statute their plain, ordinary meaning. However, if this leads to an irrational result which is unlikely to be the legislature's intention, the court can depart from this meaning.

In such a case, the Court would also look at the context in which a provision appears. The same words may mean one thing in one context and another in a different context. While ascertaining the true intention of the Legislature, the court must not only look at the words used by the Legislature but also have regard to the context and the setting in which they occur. The meaning of words in an enactment is not to be ascertained by reading them in isolation.

Issue: Let us take the issue of whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety. The Delhi High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136*, applied the Rule of Literal Interpretation whereas the Karnataka High Court, in *N. Govindaraju v. ITO (2015) 377 ITR 243*, applied the Golden Rule while deciding this issue.

Provision of law: As per section 147, the Assessing Officer may assess or reassess such income **and also** any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section.

Application of Rule of Literal Interpretation by the Delhi High Court: The Delhi High Court, in *Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136*, observed that the words "and also" used in section 147 are of wide amplitude. The correct interpretation of the Parliament would be to regard the words '**and also**' as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess *such income*". It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjunction with the word 'also'. The words '*such income*' in the first part of the sentence refer to the income chargeable to tax which has

escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148. Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment.

The Delhi High Court, applying the rule of literal interpretation, held that if the income, the escapement of which was the basis of the formation of the “reason to believe” is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

However, the Department’s Special Leave Petition against the above High Court Judgement is admitted on 04/07/2017.

Application of Golden Rule by the Karnataka High Court: On the other hand, the Karnataka High Court took note of *Circular No. 5/2010* issued by CBDT after the amendment in Paragraph 47 with caption ‘Clarificatory amendment in respect of reassessment proceeding under section 147’. Para 47.3 reads as under:

“Therefore, to articulate the legislative intention clearly *Explanation 3* has been inserted in section 147 to provide that the Assessing Officer may examine, assess or reassess any issue relevant to income which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2)”.

Applying the Golden Rule, the Karnataka High Court held that, in effect, once satisfaction of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

- **Rule of Harmonious construction** - The entire statute must be read as a whole. Further, all parts of a section should be read harmoniously. Construction should be such that it provides meaning to all parts of a statute. A construction which creates inconsistency or repugnancy between the various sections or parts of the statute should be avoided.
- **Principle of beneficial construction** - If the court finds that two views are possible construction which is most beneficial to the taxpayer should be adopted. This principle is also widely used in case of interpretation of fiscal laws.

Apart from these rules, there are several other rules such as *ejusdem generis*, *nocitur a sociis* and *stare decisis* which are often used by Courts.

- **Rule of *ejusdem generis*** is used when particular words pertaining to a class, category or genus are followed by general words. In that case general words are construed as limited to things of the same kind.
- The principle of ***noctur a socius*** implies that meaning of a word may be ascertained by reference to words associated with it. Words derive colour from the surrounding words.
- The principle of ***stare decisis*** stipulates that a view which is operating for long and is accepted and acted upon should not be easily departed from.

II. Interpretation of different provisions of the Income-tax Act, 1961

In context of the Income-tax Act, 1961, the ensuing table summarizes how different types of provisions are typically construed by Courts.

Type of provision	Interpretation
Charging provisions	Tax is levied by a charging section i.e., it imposes a charge or liability to pay tax. If a person has been brought to tax within the ambit of the charging section by clear words, he has to be taxed, subject to specific exemption/ deduction, if any, available under the provisions of the Act. Charging sections should be strictly construed.
Machinery provisions	Machinery provisions provide machinery for assessment and collection of charge created by the charging section. Machinery and charging provisions constitute an integrated code. The machinery provisions should be construed in a way that makes the machinery workable.
Penal provisions	Penal provisions are required to be construed in a strict manner. In case of ambiguity, the taxpayer should be entitled to the benefit of doubt.
Deeming provisions	Deeming provision is intended to enlarge the scope of chargeability of income under a particular head or scope of coverage of a certain provision. It includes matters which otherwise may or may not fall within the provision. Deeming provision should be strictly construed. It should be given its full effect and carried to its logical conclusion.
Appeal and refund provisions	The taxpayer has a right to appeal only if there is a statutory provision for the same. It cannot be implied. Appeal provision should be liberally construed in a reasonable and practical manner. Similarly, provisions granting refund must also be read liberally, in favor of the taxpayer.
Provisions giving exemptions and reliefs	Provisions giving deduction, exemption or relief should be interpreted liberally and in favor of taxpayers. They should be construed to effectuate the object of legislature and not to defeat it.

III. Aids to interpretation

An aid is a device that helps or assists Courts in interpretation of statutes. They can be broadly classified as:

- **Internal Aids**
- **External Aids**

Internal aids to construction

Internal aids of construction refer to aids present within the statute itself, such as the long title, the preamble, heading, marginal notes, punctuations, definition sections, provisos and explanations. Let us now examine some of these:

- **Explanations** – Explanation is generally meant to explain or clarify the meaning of certain words and expressions contained in the main provision. Explanation appended to a section is an integral part of the section. It does not have independent existence apart from the section. In exceptional cases an explanation may widen the scope of the main section by introducing a legal fiction.
- **Provisos** – Generally the function of a proviso is to carve out an exception/ condition to qualify a provision. A proviso cannot control the enactment. A proviso is not applicable unless the main provision is applicable to the facts of the case. It must be construed harmoniously with the main provision.

Examples:

5. *Sections 80GGB and 80GGC provides for deduction from gross total income in respect of contributions made by companies and other persons, respectively, to political parties or an electoral trust.*
6. *The proviso to sections 80GGB and 80GGC provide that no deduction shall be allowed under those sections in respect of any sum contributed by cash to political parties or an electoral trust. Thus, the provisos to these sections spell out the circumstance when deduction would not be available thereunder in respect of contributions made.*
7. *The Explanation below section 80GGC provides that for the purposes of sections 80GGB and 80GGC, “political party” means a political party registered under section 29A of the Representation of the People Act, 1951. Thus, the Explanation clarifies that the political party has to be a registered political party.*

- **Non-obstante clause** – Non-obstante clause is a clause which begins with the phrase “notwithstanding anything contained in any other provision of the Act” or “notwithstanding anything contained in a particular provision(s) of the Act”. Use of this phrase shows that the intent of lawmakers is to give it an overriding effect, in case of a conflict, over the other provisions of the statute mentioned in the provision.

Example 8:

*Section 43B provides deduction of certain specified sums for computing of income under the profit and gains from business or profession on actual payment basis. It begins with the phrase “notwithstanding anything contrary in any other provision of this Act”. Thus, it overrides the other provisions of the Act and provides deduction of payments or expenditures specified therein **only on the basis of actual payment.***

- **Marginal notes and headings** - Headings may be prefixed to a section or a group of sections. Marginal notes are the notes which are inserted at the side of the sections in a statute and express the effect of the sections stated. Headings and marginal notes cannot control the plain words of the provisions. Only in the case of ambiguity they may be referred to throw light on intention of legislature.
- **Definition clauses and undefined words** –The object of a definition clause is to avoid the necessity of frequent repetitions in describing the subject matter in the statute. When the statute defines a particular word, the same should be used, unless the context otherwise requires. A word occurring more than once in a statute should be generally given the same meaning, unless the context requires otherwise. Words not specifically defined must be taken in their legal sense, dictionary meaning, commercial or common meaning. Definition from any other statute cannot be borrowed and used ignoring the definition contained in the statute itself.

In the Income-tax Act, 1961, definitions contained in section 2 are for the purposes of the Income-tax Act. However, definitions contained in a particular Chapter of the Income-tax Act, 1961 are generally relevant only in the context of the provisions relating to that Chapter, unless reference to such definition(s) has been made in any other provision(s)/ Chapter of the Act.

External aids to construction

External aids refer to aids which are external to the statute such as legislative history, dictionaries, foreign decisions, reference to other statutes. Let us examine some of them:

- **Legislative history** - Historical setting cannot be used as an aid if the words are plain and clear. If the wordings are ambiguous, one can look at the historical facts and circumstances that prevailed at the time when the law was passed for determining the object and purpose. Reports of Commissions including Law Commission or Committees including Parliamentary Committees preceding the introduction of a bill can also be referred to as evidence of historical facts, surrounding circumstances or mischief intended to be remedied.
- **Circulars** - CBDT Circulars issued under section 119 of the Income-tax Act, 1961 are binding on the tax officers and persons employed in the execution of the Income-tax Act 1961. They express the views of CBDT on any issue. They are, however, not binding on the Appellate Authorities, Tribunal, Courts or the taxpayer. Taxpayers can however take benefit of the beneficial circulars.

- **Speech** - The speech made by the mover of the Bill can also be used to ascertain the mischief sought to be remedied, the object and purpose of the legislation. However, speeches made by the Members of the Parliament at the time of consideration of a Bill, are not admissible as an aid.
- **Explanatory Memorandum** - Notes on clauses and memorandum explaining the provisions of the Finance Bill can also aid in construction, in case of ambiguity.
- **Dictionary meaning** - The dictionary meaning of a word should not be looked at where the word has been statutorily defined or judicially interpreted. However, when there is no such interpretation or definition, the Court may take aid of dictionaries to ascertain a meaning of the word.



1.2 IMPORTANT DEFINITIONS

In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'assessment year', 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act.

Terms defined in the Act: Section 2 gives definitions of the various terms and expressions used therein. If a particular definition is given in the Act itself, we have to be guided by that definition. For e.g. the term 'perquisite' has been defined under section 17(2) for the purpose of taxation of salaries.

Terms not defined under the Act: If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries.

Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income-tax Act, 1961 than they are commonly understood.

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

(1) **Assessee [Section 2(7)]**

"Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes –

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

- Every person who is deemed to be an assessee-in-default under any provision of this Act.

(2) **Assessment [Section 2(8)]**

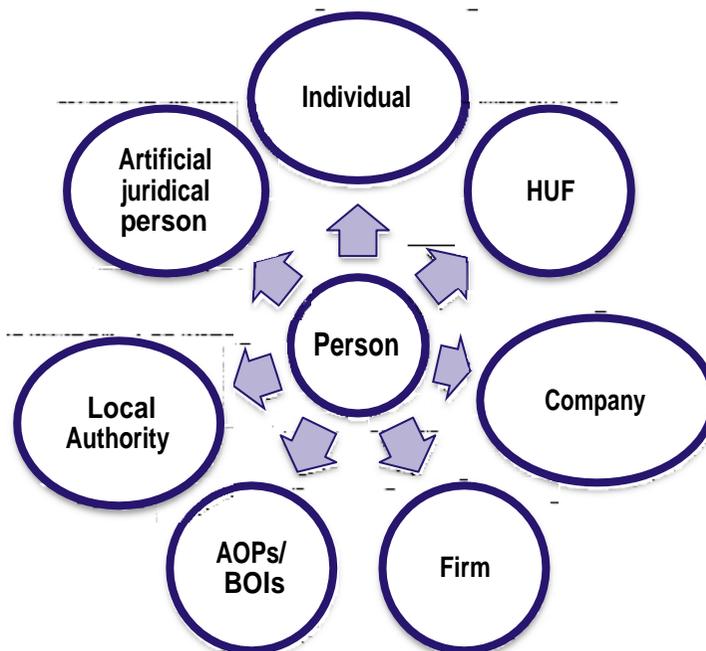
This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

Types of income-tax assessment:

1. Self-assessment under section 140A
2. Summary assessment under section 143(1)
3. Scrutiny assessment under section 143(3)
4. Best judgment assessment under section 144
5. Re-assessment or income escaping assessment under section 147
6. Assessment in case of search under section 153A

(3) **Person [Section 2(31)]**

The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also viz., the charge of income-tax is on every 'person'. The definition of the term 'person' is inclusive and not exhaustive. The different types of persons recognized under the Act are provided in the diagram below:



We may briefly consider some of the above seven categories of assessee each of which constitute a separate unit of assessment or a separate tax entity.

(i) Individual

The term 'individual' means only a natural person, *i.e.*, a human being.

- It includes both males and females.
- It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic who is entitled to receive his income. In the case of deceased person, assessment would be made on the legal representative.

(ii) HUF

Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF.

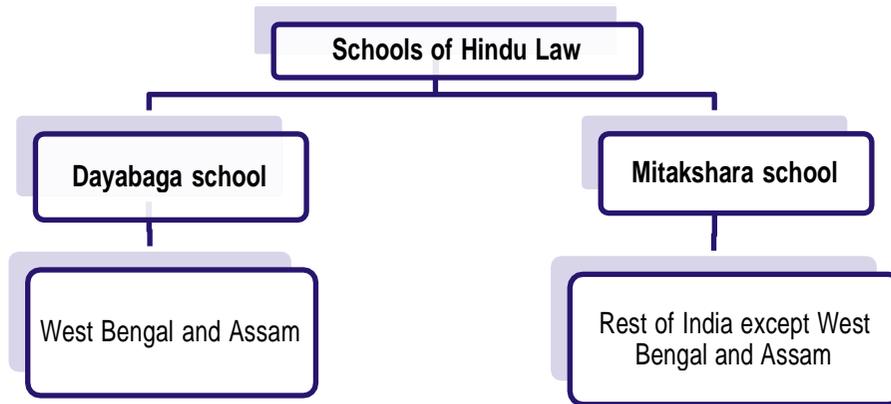
"Hindu undivided family" has not been defined under the Income-tax Act, 1961. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

Some members of the HUF are called **co-parceners**. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendants were considered as coparceners. With effect from 6th September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to demand partition.

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

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

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



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

Dayabaga school of law	Mithakshara school of law
Prevalent in West Bengal and Assam.	Prevalent in rest of India.
Nobody acquires the right, share in the property by birth as long as the head of family is living.	One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living.
Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Hence, the father and his brothers would be the coparceners of the HUF.	Thus, every child born in the family acquires a right/ share in the family property.

(iii) Company [Section 2(17)]

For all purposes of the Act, the term 'Company', has a much wider connotation than that under the Companies Act. Under the Act, the expression 'Company' means:

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

Classes of Companies

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

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

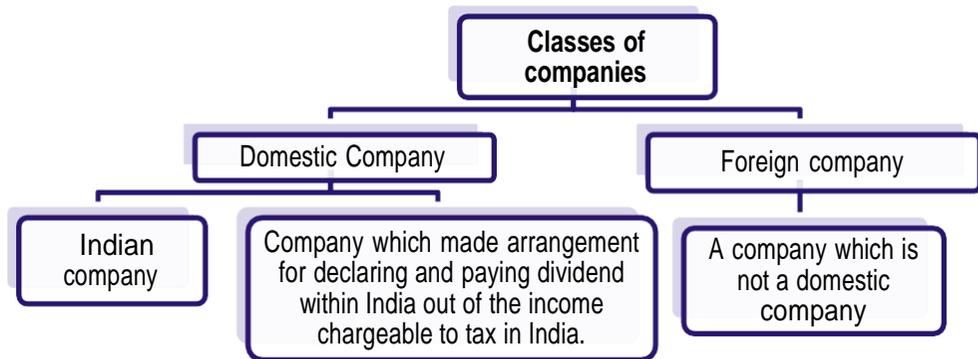
- (a) the company should have been formed and registered under the Companies Act, 1956¹ and
- (b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes the following provided their registered or principal office is in India:

- (i) a corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation);
- (ii) an institution or association or body which is declared by the Board to be a company under section 2(17)(iv);
- (iii) a company formed and registered under any law relating to companies which was or is in force in any part of India [other than Jammu and Kashmir and Union territories mentioned in (v) below];
- (iv) in the case of Jammu and Kashmir, a company formed and registered under any law for the time being in force in Jammu and Kashmir;
- (v) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

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

¹ Now Companies Act, 2013



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

- (a) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.
- (b) A company which is registered under section 25 of the Companies Act, 1956² (formed for promoting commerce, arts, science, religion, charity or any other useful object and which prohibits payment of dividends to its members).
- (c) A company having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.
- (d) A mutual benefit finance company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956³ to be *Nidhi* or a Mutual Benefit Society.
- (e) A company whose equity shares (not being shares entitled to a fixed rate of dividend) carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.
- (f) A company which is not a private company as defined in the Companies Act, 1956⁴ and which fulfills any of the following conditions:
 - its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India;

² Section 8 of Companies Act, 2013

³ Section 406 of Companies Act, 2013

⁴ Now Companies Act, 2013

- its equity shares (not being shares entitled to a fixed rate of dividend) carrying at least 50% (40% in case of industrial companies) of the voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by
 - I Government or
 - II a Statutory Corporation or
 - III a company in which public are substantially interested or
 - IV any wholly owned subsidiary of company mentioned in III.

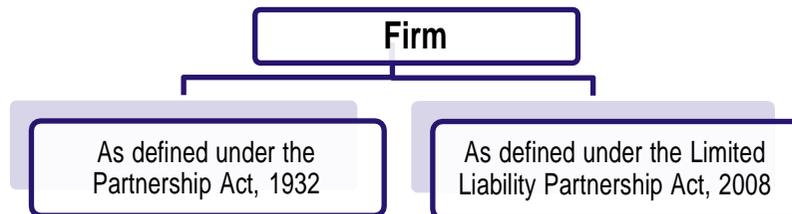
(4) **Person having substantial interest in the company [Section 2(32)]** – A person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with or without a right to participate in profits, carrying at least 20% of the total voting power.

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

The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act, 1932. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner.

A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.



(v) **Association of Persons (AOP)**

When persons combine together for promotion of joint enterprise they are assessable as an AOP, when they do not in law constitute a partnership. In order to constitute an association, persons must join for a **common purpose or action** and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP. For e.g., Mr. Yash, AB & Co. (Firm) and X (P) Ltd. Join together to carry on construction

activity otherwise than as a partnership firm, such an association will be recognized as an association of persons.

(vi) Body of Individuals (BOI)

Body of individuals refers to a conglomeration of individuals who carry on some activity with or without the object of producing income. It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus, co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI. For e.g., mutual trade associations, members club, etc.

Section 2(31) further explains that an association of persons/body of individuals or a local authority or an artificial juridical person shall be treated as a person, whether or not it is formed with the object of deriving income, profits or gains. Accordingly, even if such entities have been formed not for earning any income/ profit still they are "person" for the purpose of the Act and are covered by the provisions of the Act.

Difference between AOP and BOI:

In case of a BOI, only individuals can be the members, whereas in case of AOP, any person can be its member i.e. entities like company, firm etc. can be the member of AOP but not of BOI. In case of an AOP, members voluntarily come together with a common will for a common intention or purpose, whereas in case of BOI, such common will may or may not be present.

(vii) Local Authority

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

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

(viii) Artificial Juridical Persons

Artificial Juridical Persons are the entities which are not natural persons but are separate entities in the eyes of law. This is a residual category could cover all artificial persons with a juristic personality not falling under any other category of persons. Deities, Bar Council, Universities are some important examples of Artificial Juridical Persons.

(4) Income [Section 2(24)]**(i) Definition of Income**

The definition of income as per the Income-tax Act, 1961 begins with the words "Income includes". Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term.

Section 2(24) of the Act gives a statutory definition of income. At present, the following items of receipts are specifically included in income:—

- (a) **Profits and gains;**
- (b) **Dividends;**
- (c) **Voluntary contributions** received by a trust/ institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or by a fund or institution referred to in section 10(23C)(iiiad)/(iiiiae)/(iv)/(v)/(vi)/(via) or an electoral trust;

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

- (d) The value of any **perquisite or profit in lieu of salary** taxable under section 17(2) and (3), respectively;
- (e) Any **special allowance or benefit**, other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;
- (f) Any **allowance granted to the assessee** to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;
- (g) The value of **any benefit or perquisite**, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

- (h) The value of **any benefit or perquisite**, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay;
- (i) **Deemed profits** chargeable to tax under **section 41 or section 59**;
- (j) **Profits and gains** of business or profession chargeable to tax under section 28;
- (k) Any **capital gains** chargeable under section 45;
- (l) The **profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society**, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act;
- (m) The **profits and gains of any business of banking** (including providing credit facilities) carried on by a co-operative society with its members;
- (n) Any **winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting** of any form or nature whatsoever. For this purpose,
 - i. “Lottery” includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
 - ii. “Card game and other game of any sort” includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.
- (o) Any sum received by the assessee from his employees as **contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees**;
- (p) Any sum received under a **Keyman insurance policy** including the sum allocated by way of bonus on such policy will constitute income;

“Keyman insurance policy” means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former’s business. It also includes such policy which has been assigned to a person with or without any consideration, at any time during the term of the policy.
- (q) **Any sum referred to in section 28(va)**. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique

likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head “profits and gains of business or profession”;

- (r) **Fair market value of inventory** as on the date on which it is **converted into, or treated as, a capital asset**, determined in the prescribed manner [Section 28(iva)];
- (s) Any consideration received for **issue of shares as exceeds the fair market value** of the shares [Section 56(2)(viib)];
- (t) Any **sum of money received as advance**, if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset [Section 56(2)(ix)];
- (u) Any **sum of money or value of property received without consideration or for inadequate consideration** by any person [Section 56(2)(x)];
- (v) Any **compensation or other payment**, due to or received by any person, by whatever named called, in **connection with termination of his employment** or the modification of the term and conditions relating thereto [Section 56(2)(xi)];

[For details, refer to Chapter 8 “Income from Other Sources”]

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

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

Subsidy or grant or reimbursement taken into account for determination of actual cost of depreciable asset in accordance with *Explanation 10* to section 43(1)

Subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by a Central Govt. or State Govt., as the case may be.

(ii) Concept of Income under the Income-tax Act, 1961

- **Regular receipt vis-a-vis casual receipt:** Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, 1961, even certain incomes which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.
- **Revenue receipt vis-a-vis Capital receipt:** Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income in general parlance. However, the Income-tax Act, 1961 has specifically included certain

capital receipts within the definition of income e.g., Capital gains i.e., gains on sale of a capital assets like land.

- **Net receipt vis-a-vis Gross receipt:** Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head is prescribed under the Income-tax Act, 1961. Income from certain eligible businesses/ professions is also determined on presumptive basis i.e., as a certain percentage of gross receipts.
- **Due basis vis-a-vis receipt basis:** Income is taxable either on due basis or receipt basis. For computing income under the heads “Profits and gains of business or profession” and “Income from other sources”, the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system. Some receipts are taxable only on receipt basis, like, income by way of interest received on compensation or enhanced compensation.

(iii) Concept of revenue and capital receipts

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

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

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

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

Criteria for determining whether a receipt is capital or revenue in nature

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

Fixed capital or Circulating capital: A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is not taxable while the latter is taxable. Tangible and intangible assets which the owner keeps in his possession for making profits are in the nature of fixed capital. The circulating capital is one which is turned over and yields income or loss in the process.

Income from transfer of capital asset or trading asset: Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessee's business or the transaction constitutes an adventure in the nature of trade.

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

- (a) **Transaction entered into the course of business:** Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax.

Example 9: A banker's or financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ship in his own name, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. Whereas building and land would constitute capital assets in the hands of a trader in shares, the same would constitute stock-in-trade in the hands of a property dealer.

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

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

- (c) **A single transaction - Can it constitute business?** Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising therefrom would be taxable. Purchase of any article with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature

depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

- (d) **Liquidated damages:** Receipt of liquidated damages directly and intimately linked with the procurement of a capital asset, which lead to delay in coming into existence of the profit-making apparatus, is a capital receipt. The amount received by the assessee towards compensation for sterilization of the profit earning source is not in the ordinary course of business. Hence, it is a capital receipt in the hands of the assessee.
- (e) **Compensation on termination of agency:** Where an assessee receives compensation on termination of the agency business being the only source of income, the receipt is a capital nature, but taxable under section 28(ii)(c). However, where the assessee has a number of agencies and it acquired such agencies in the normal course of business; and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer or from any person for premature termination of the service contract is a capital receipt, but is taxable as profit in lieu of salary under section 17(3) or as income from other sources under section 56(2)(xi), respectively. Compensation received or receivable in connection with the termination or the modification of the terms and conditions of any contract relating to its business shall be taxable as business income.
- (f) **Gifts:** Normally, gifts constitute capital receipts in the hands of the recipient. However, certain gifts are brought within the purview of income-tax.

For example, any sum of money or value of property received without consideration or for inadequate consideration by any person, other than a relative, is chargeable under the head "Income from Other Sources" [For details, refer to Chapter 8 on "Income from Other Sources"].

(5) **India [Section 2(25A)]**

The term 'India' means –

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

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

(6) Maximum marginal rate and Average Rate of tax

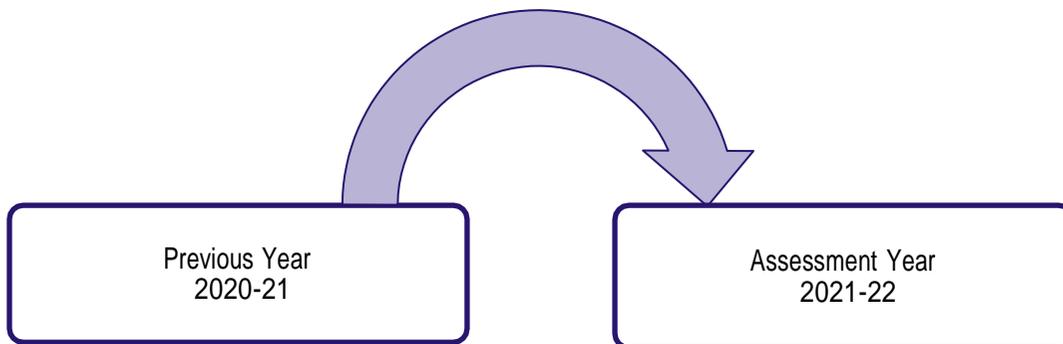
As per section 2(10), "**Average Rate of tax**" means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Example 10: Total Income of Mr. A is ₹ 6,00,000 and tax payable on it including cess is ₹ 33,800, the average rate of tax works out to be **5.63%**.

Section 2(29C) defines "**Maximum marginal rate**" to mean the rate of income-tax (including surcharge on the income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, AOP or BOI, as the case may be, as specified in Finance Act of the relevant year. The maximum marginal rate for A.Y. 2021-22 is 42.744% [Tax rate@30% plus surcharge@37% on tax rate plus health and education cess@4% on tax rate and surcharge].

**1.3 PREVIOUS YEAR AND ASSESSMENT YEAR**

The concepts have been dealt with at the Intermediate level. Let us have a quick recap of these concepts -

**(1) Assessment year [Section 2(9)]**

The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which income is earned is the previous year and such income is taxable in the immediately following year which is the assessment year. Income earned in the previous year 2020-21 is taxable in the assessment year 2021-22.

Assessment year always starts from 1st April and it is always a period of 12 months.

(2) Previous year [Section 3]

It means the financial year immediately preceding the assessment year. As mentioned earlier, the income earned during the previous year is taxable in the assessment year.

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

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

Examples:

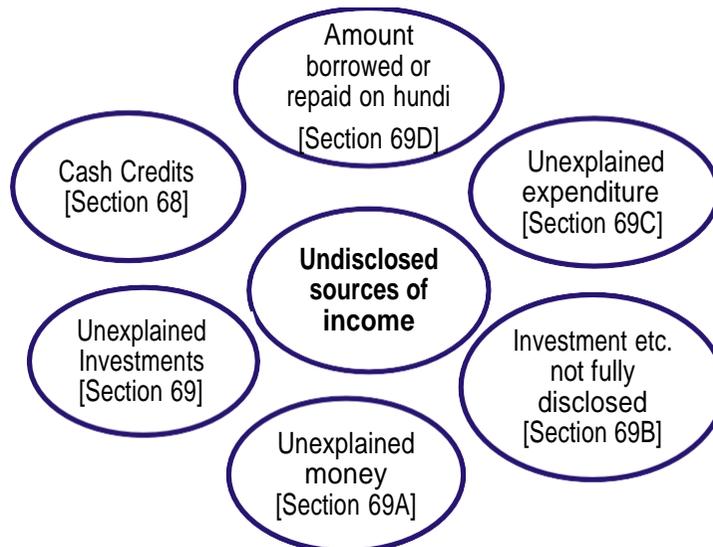
11. A is running a business from 1993 onwards. Determine the previous year for the assessment year 2021-22.

Ans. The previous year will be 1.4.2020 to 31.3.2021.

12. A chartered accountant sets up his profession on 1st July, 2020. Determine the previous year for the assessment year 2021-22.

Ans. The previous year will be from 1.7.2020 to 31.3.2021.

(3) Undisclosed sources of income



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

(a) Cash Credits [Section 68]

Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC)⁵.

(b) Unexplained Investments [Section 69]

Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the value of the investments are taxed as deemed income of the assessee of such financial year.

(c) Unexplained money etc. [Section 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(d) Amount of investments etc., not fully disclosed in the books of account [Section 69B]

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory in the opinion of the Assessing Officer, such excess may be deemed to be the income of the assessee for such financial year.

Example 13:

If the assessee is found to be the owner of say 300 gms of gold (market value of which was ₹ 25,000) during the financial year ending 31.3.2021 but he has recorded to have spent ₹ 15,000 in acquiring it, the Assessing Officer can add ₹ 10,000 (i.e., the difference of the market value of such gold and ₹ 15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

⁵ defined under section 10(23FB)

(e) Unexplained expenditure [Section 69C]

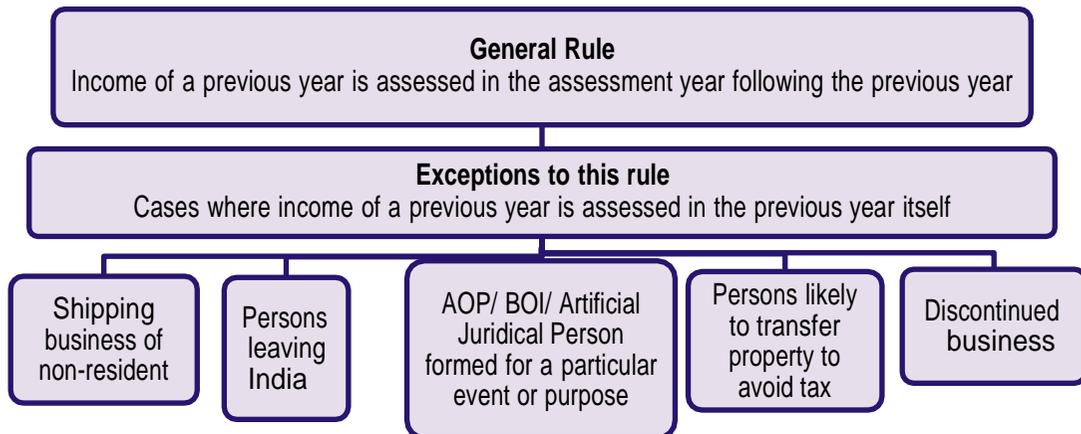
Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory in the opinion of the Assessing Officer, Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

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

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

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

Section 115BBE provides the rate at which such cash credits, undisclosed income, undisclosed expenditure etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be subject to tax. See Special rates of tax in para 1.5 of this Chapter.

(4) Certain cases when income of a previous year will be assessed in the previous year itself

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. For instance, income of previous year 2020-21 is assessed during 2021-22. Therefore, 2021-22 is the assessment year for assessment of income of the previous year 2020-21.

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

(a) Shipping business of non-resident [Section 172]

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

(b) Persons leaving India [Section 174]

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

Example 14:

Suppose Mr. X is leaving India for USA on 10.6.2020 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X may be asked to pay income-tax on the income earned during the P.Y. 2019-20 as well as the total income earned during the period 1.4.2020 to 10.06.2020.

(c) AOP/ BOI/ Artificial Juridical Person formed for a particular event or purpose [Section 174A]

If an AOP/ BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/ BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

Example 15:

Red Flakes is an AOP formed on 14.11.2020 by X and Y for a limited purpose of organizing a musical concert of a British band "Hotplay" on 14.06.2021. The AOP is likely to be dissolved after the concert. In such a case, the Assessing Officer can make the assessment for the income earned from 14.11.2020 to 14.06.2021 during the A.Y. 2021-22 itself.

(d) Persons likely to transfer property to avoid tax [Section 175]

During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid

payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

Example 16:

The Assessing Officer is informed that Mr. X, a defaulter of a leading bank, is likely to sell all his luxury cars on 02.10.2020 with a view to avoid payment of Income-tax. In such case, the Assessing Officer can commence proceedings to tax the income of the year commencing from 01.04.2020 to 02.10.2020 during A.Y. 2020-21 itself.

(e) Discontinued business [Section 176]

Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

Example 17:

The Assessing Officer is informed during the course of assessment by X Pvt. Ltd. that they have discontinued their business from 31.05.2020. In such a case, the Assessing Officer may exercise his discretion and tax the income of the company from 01.04.2020 to 31.05.2020 during the A.Y. 2020-21. It may be noted that the income of the P.Y. 2019-20 will be also be taxed in A.Y. 2020-21. However, as the Assessing Officer has discretion under section 176, he could alternatively wait till the completion of the assessment year and tax the income of the period commencing from 01.04.2020 to 31.05.2020 in the A.Y. 2021-22.



1.4 CHARGE OF INCOME TAX

Section 4 of the Income-tax Act, 1961 is the charging section which provides that:

- (1) Tax shall be charged at the rates prescribed for the year by the annual Finance Act.
- (2) The charge is on every person specified under section 2(31);
- (3) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176 discussed above);
- (4) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

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



1.5 RATES OF TAX

Income-tax is to be charged at the rates fixed for the year by the Annual Finance Act.

Section 2 of the Finance Act, 2020 read with Part I of the First Schedule to the Finance Act, 2020, seeks to specify the rates at which income-tax is to be levied on income chargeable to tax for the assessment year 2020-21.

Part II lays down the rate at which tax is to be deducted at source during the financial year 2020-21 from income subject to such deduction under the Income-tax Act, 1961;

Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "Salaries" and the rates for computing advance tax for the financial year 2020-21.

Part III of the First Schedule to the Finance Act, 2020 will become Part I of the First Schedule to the Finance Act, 2021 and so on.

The slab rates applicable for A.Y.2021-22 are as follows:

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

(i)	where the total income does not exceed ₹ 2,50,000	NIL
(ii)	where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 2,50,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 12,500 <i>plus</i> 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,12,500 <i>plus</i> 30% of the amount by which the total income exceeds ₹ 10,00,000

It is to be noted that for a senior citizen (being a resident individual who is of the age of 60 years but not more than 80 years at any time during the previous year), the basic exemption limit is ₹ 3,00,000. Further, resident individuals of the age of 80 years or more at any time during the previous year, being very senior citizens, would be eligible for a higher basic exemption limit of ₹ 5,00,000.

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

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

(i)	where the total income does not exceed ₹ 3,00,000	NIL
(ii)	where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 3,00,000

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

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

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

Clarification regarding attaining prescribed age of 60 years/ 80 years on 31st March itself, in case of senior/very senior citizens whose date of birth falls on 1st April [Circular No. 28/2016, dated 27.07.2016]

An individual who is resident in India and of the age of 60 years or more (senior citizen) and 80 years or more (very senior citizen) is eligible for a higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000, respectively.

The contentious issue is regarding the attainment of the aforesaid qualifying ages for availing higher basic exemption limit in cases of the persons whose date of birth falls on 1st April of calendar year. In other words, the broader question under consideration is whether a person born on 1st April of a particular year can be said to have completed a particular age on 31st March, on the preceding day of his/her birthday, or on 1st April itself of that year.

The Supreme Court had an occasion to consider a similar issue in the case of *Prabhu Dayal Sesma vs. State of Rajasthan & another 1986, AIR, 1948* wherein it has dealt with on the general rules to be followed for calculating the age of the person. The Apex Court observed that while counting the age of the person, whole of the day should be reckoned and it starts from 12 o'clock in the midnight and he attains the specified age on the day preceding, the anniversary of his birthday. In the absence of any express provision, it is well settled that any specified age in law is to be computed as having been attained on the day preceding the anniversary of the birthday.

The CBDT has, vide this Circular, clarified that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday. In particular, the question of attainment of age of eligibility for being considered a senior/very senior citizen would be decided on the basis of above criteria.

Therefore, a resident individual whose 60th birthday falls on 1st April, 2021, would be treated as having attained the age of 60 years in the P.Y.2020-21, and would be eligible for higher basic exemption limit of ₹ 3 lakh in computing his tax liability for A.Y.2021-22. Likewise, a resident

individual whose 80th birthday falls on 1st April, 2021, would be treated as having attained the age of 80 years in the P.Y.2020-21, and would be eligible for higher basic exemption limit of ₹ 5 lakh in computing his tax liability for A.Y.2021-22.

Note – As per section 115BAC, individuals and HUF have an option to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII) at following concessional rates, if they do not avail certain exemptions/deductions like Leave Travel Concession, standard deduction under the head “Salaries”, interest on housing loan on self-occupied property, deductions under Chapter VI-A [other than 80CCD(2) and section 80JJAA] etc. –

(i)	Upto ₹ 2,50,000	NIL
(ii)	From ₹ 2,50,000 to ₹ 5,00,000	5%
(iii)	From ₹ 5,00,000 to ₹ 7,50,000	10%
(iv)	From ₹ 7,50,000 to ₹ 10,00,000	15%
(v)	From ₹ 10,00,000 to ₹ 12,50,000	20%
(vi)	From ₹ 12,50,000 to ₹ 15,00,000	25%
(vii)	Above ₹ 15,00,000	30%

Individuals and HUF exercising option u/s 115BAC are not liable to alternate minimum tax u/s 115JC.

For detailed discussion on section 115BAC, refer to Chapter 12 in Module 2 of the Study Material.

ILLUSTRATION 1

Mr. Raj has a total income of ₹ 13,00,000 for P.Y. 2020-21, comprising of income from house property and interest on fixed deposit. Compute his tax liability for A.Y. 2021-22 assuming his age is -

- 37 years
- 65 years
- 83 years

Assume that Mr. Raj has not opted for the provisions of section 115BAC.

SOLUTION

(a) Computation of tax liability of Mr. Raj (age 37 years)

Tax liability:

First ₹ 2,50,000	- Nil	
Next ₹ 2,50,001 – ₹ 5,00,000	- @5% of ₹ 2,50,000	= ₹ 12,500
Next ₹ 5,00,001 – ₹ 10,00,000	- @20% of ₹ 5,00,000	= ₹ 1,00,000
Balance i.e., ₹ 13,00,000 minus ₹ 10,00,000	- @30% of ₹ 3,00,000	= ₹ 90,000
		= ₹ 2,02,500

Add: Health and Education cess@4%	=	₹ 8,100
	=	<u>₹ 2,10,600</u>

(b) Computation of tax liability of Mr. Raj (age 65 years)

Tax liability:

First ₹ 3,00,000	- Nil	
Next ₹ 3,00,001 – ₹ 5,00,000	- @ 5% of ₹ 2,00,000	= ₹ 10,000
Next ₹ 5,00,001 – ₹ 10,00,000	- @ 20% of ₹ 5,00,000	= ₹ 1,00,000
Balance i.e., ₹ 13,00,000 <i>minus</i> ₹ 10,00,000	- @ 30% of ₹ 3,00,000	= ₹ 90,000
		= ₹ 2,00,000
Add: Health and Education cess@4%	=	₹ 8,000
	=	<u>₹ 2,08,000</u>

(c) Computation of tax liability of Mr. Raj (age 83 years)

Tax liability:

First ₹ 5,00,000	- Nil	
Next ₹ 5,00,001 – ₹ 10,00,000	- @ 20% of ₹ 5,00,000	= ₹ 1,00,000
Balance i.e., ₹ 13,00,000 <i>minus</i> ₹ 10,00,000	- @ 30% of ₹ 3,00,000	= ₹ 90,000
		= ₹ 1,90,000
Add: Health and Education cess@4%	=	₹ 7,600
	=	<u>₹ 1,97,600</u>

(2) Firm/ LLP

On the whole of the total income 30%

(3) Local authority

On the whole of the total income 30%

(4) Co-operative society

(i)	Where the total income does not exceed ₹ 10,000	10% of the total income
(ii)	Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000	₹ 1,000 <i>plus</i> 20% of the amount by which the total income exceeds ₹ 10,000
(iii)	Where the total income exceeds ₹ 20,000	₹ 3,000 <i>plus</i> 30% of the amount by which the total income exceeds ₹ 20,000

Note - Co-operative society, resident in India, can opt for concessional rate of tax @25.168% [i.e., tax@22% plus surcharge@10% plus health and education cess (HEC)@4%] under section 115BAD in respect of its total income computed without giving effect to deduction under section 10AA, 32AD, 33AB, 33ABA, 35(1)(ii)/(iia)/(iii), 35(2AA), 35AD, 35CCC, additional depreciation under section 32(1)(iia), deductions under Chapter VI-A (other than section 80JJAA) etc. and set off of loss and depreciation brought forward from earlier years relating to the above deductions. The provisions of alternate minimum tax under section 115JC would not be applicable to co-operative society opting for section 115BAD. **This section is dealt with in detail in Chapter 12 in Module 2 of the Study Material.**

(5) **Company**

(i) **In the case of a domestic company**

If the total turnover or gross receipt of the company in the P.Y.2018-19 ≤ ₹ 400 crore	25% of the total income
In any other case	30% of the total income
In both the cases, Minimum Alternate Tax (MAT)@15% of book profit would be attracted, if income-tax payable on total income is less than 15% of book profit.	

Alternative Tax Regime

Domestic company can opt for section 115BAA or section 115BAB, as the case may be, subject to certain conditions. The total income of such companies would be computed without giving effect to deductions under section 10AA, 32AD, 33AB, 33ABA, 35(1)(ii)/(iia)/(iii), 35(2AA), 35(2AB), 35AD, 35CCC, 35CCD, deductions under Chapter VI-A (except section 80JJAA and section 80M), additional depreciation under section 32(1)(iia) etc. and without set-off of brought forward loss and unabsorbed depreciation attributable to such deductions.

- **In case of a domestic manufacturing company (set up and registered on or after 1.10.2019 and commences manufacture of article or thing before 31.3.2023) exercising option u/s 115BAB:** 15% of income derived from or incidental to manufacturing or production of an article or thing [MAT not applicable]
- **In case of a domestic company exercising option u/s 115BAA:** 22% of total income [MAT not applicable]

For details relating to section 115BAA and 115BAB, refer Chapter 12 in Module 2 of the Study Material.

(ii) **In the case of a company other than a domestic company**

Royalties and fees for rendering technical services (FTS) received from Government or an Indian concern in pursuance of an agreement, approved by the Central Government, made by the company with the Government or Indian concern between	50%
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1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS)	
Other income	40%

The above rates are prescribed by the Finance Act, 2020. However, in respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates –

Special rates of Tax

S. No.	Section	Income	Rate of Tax						
(a)	112	Long term capital gains (other than LTCG taxable as per section 112A) (For details refer Chapter 7 on “Capital Gains”)	20%						
(b)	112A	Long term capital gains on transfer of – <ul style="list-style-type: none"> • Equity share in a company • Unit of an equity oriented fund • Unit of business trust Condition for availing the benefit of this concessional rate is securities transaction tax should have been paid –	10% [On LTCG > ₹ 1 lakh]						
		<table border="1"> <thead> <tr> <th>In case of (Capital Asset)</th> <th>Time of payment of STT</th> </tr> </thead> <tbody> <tr> <td>Equity shares in a company</td> <td>both at the time of acquisition and transfer</td> </tr> <tr> <td>Unit of equity oriented fund or unit of business trust</td> <td>at the time of transfer</td> </tr> </tbody> </table>		In case of (Capital Asset)	Time of payment of STT	Equity shares in a company	both at the time of acquisition and transfer	Unit of equity oriented fund or unit of business trust	at the time of transfer
		In case of (Capital Asset)		Time of payment of STT					
		Equity shares in a company		both at the time of acquisition and transfer					
Unit of equity oriented fund or unit of business trust	at the time of transfer								
Note: LTCG upto ₹ 1 lakh is exempt. LTCG exceeding ₹ 1 lakh is taxable @10%. (For details, refer Chapter 7 on “Capital gains”)									
(c)	111A	Short-term capital gains on transfer of – <ul style="list-style-type: none"> • Equity share in a company • Unit of an equity oriented fund • Unit of business trust The conditions for availing the benefit of this concessional rate are – <ol style="list-style-type: none"> the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and such transaction should be chargeable to securities transaction tax. 	15%						

(d)	115BB	Winnings from <ul style="list-style-type: none"> • Lotteries; • Crossword puzzles; • Race including horse races; • Card game and other game of any sort; • Gambling or betting of any form. 	30%
(e)	115BBE	Unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D (See discussion below)	60%

Unexplained money, investments etc. to attract tax @60% [Section 115BBE]

- (i) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the rate of 60% plus surcharge @25% of tax. Thus, the effective rate of tax (including surcharge@25% of tax and cess@4% of tax) is 78%.
- (ii) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income.
- (iii) Further, no set off of any loss shall be allowable against income brought to tax under sections 68 or section 69 or section 69A or section 69B or section 69C or section 69D.



1.6 SURCHARGE

The rates of surcharge applicable for A.Y.2021-22 are as follows:

(1) Individual/ HUF/ AOP/ BOI/Artificial juridical person

Income-tax computed in accordance with the provisions of sub-para (1) of para 1.5 or section 111A or section 112 or section 112A **or section 115BAC** would be increased by surcharge given under the following table –

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income (including dividend income and capital gains chargeable to tax u/s	10%	Example 18	
			<ul style="list-style-type: none"> • Dividend ` 5 lakhs; • STCG u/s 111A ` 25 lakhs; 	Surcharge would be levied @10% on income-tax computed

	111A and 112A) > ₹ 50 lakhs but ≤ ₹ 1 crore		<ul style="list-style-type: none"> • LTCG u/s 112A ₹ 20 lakhs; and • Other income ₹ 35 lakhs 	on total income of ₹ 85 lakhs.
(ii)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A and 112A) exceeds ₹ 1 crore but does not exceed ₹ 2 crore	15%	Example 19	
			<ul style="list-style-type: none"> • Dividend ₹ 30 lakhs; • STCG u/s 111A ₹ 50 lakhs; • LTCG u/s 112A ₹ 60 lakhs; and • Other income ₹ 55 lakhs 	Surcharge would be levied @15% on income-tax computed on total income of ₹ 1.95 crores.
(iii)	Where total income (excluding dividend income and capital gains chargeable to tax u/s 111A and 112A) exceeds ₹ 2 crore but does not exceed ₹ 5 crore	25%	Example 20	
	The rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A and 112A	Not exceeding 15%	<ul style="list-style-type: none"> • Dividend ₹ 50 lakh; • STCG u/s 111A ₹ 60 lakh; • LTCG u/s 112A ₹ 55 lakh; and • Other income ₹ 2.5 crores 	<p>Surcharge would be levied @ 15% on income-tax on:</p> <ul style="list-style-type: none"> • Dividend of ₹ 50 lakhs; • STCG of ₹ 60 lakhs chargeable to tax u/s 111A; and • LTCG of ₹ 55 lakhs chargeable to tax u/s 112A. <p>Surcharge @25% would be leviable on income-tax computed on other income of ₹ 2.5 crores included in total income</p>
(iv)	Where total income (excluding dividend income and capital gains chargeable to tax u/s 111A and 112A) exceeds ₹ 5 crore	37%	Example 21	
	Rate of surcharge on the income-tax payable on the portion of dividend	Not exceeding 15%	<ul style="list-style-type: none"> • Dividend ₹ 50 lakhs; • STCG u/s 111A ₹ 55 lakhs; • LTCG u/s 112A ₹ 65 lakhs; and • Other income ₹ 6 crore 	<p>Surcharge @15% would be levied on income-tax on:</p> <ul style="list-style-type: none"> • Dividend of ₹ 50 lakhs; • STCG of ₹ 55 lakhs chargeable to tax u/s 111A; and

	income and capital gains chargeable to tax u/s 111A and 112A			<ul style="list-style-type: none"> • LTCG of ` 65 lakhs chargeable to tax u/s 112A. <p>Surcharge@37% would be leviable on the income-tax computed on other income of ` 6 crores included in total income.</p>
(v)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A and 112A) exceeds ` 2 crore in cases not covered under (iii) and (iv) above	15%	Example 22	<ul style="list-style-type: none"> • Dividend ` 60 lakhs; • STCG u/s 111A ` 55 lakhs; • LTCG u/s 112A ` 50 lakhs; and • Other income ` 1.20 crore <p>Surcharge would be levied @15% on income-tax computed on total income of ` 2.85 crore.</p>

Note - Rates of surcharge applicable on tax on total income of individuals/ AoP/ Bol/ Artificial Juridical Persons (having any income under section 115AD) for payment of advance tax for A.Y.2021-22 is given in Chapter 2 – Non-resident Taxation in Module 4 of the Study Material.

Concept of Marginal relief

The tax system is progressive in nature i.e., as the income increases, tax also increases. Assessee having higher income than the prescribed limit are required to pay extra amount of tax in the form of Surcharge. Different threshold limits have been prescribed based on the total income and the type of assessee. For instance, if the assessee is an individual and his total income exceeds ` 50 lakhs, surcharge is leviable @10%. While if the same individual earns more than ` 1 crore but less than ` 2 crore, the surcharge is leviable @15%. In case of even a small increase in the total income of an assessee beyond threshold limit, surcharge would be applicable on the income-tax on total income. Hence, marginal relief has been provided in such cases. Let us understand with the help of the following example.

Example 23:

Compute tax liability of Mr. X, an individual aged 40 years, for the A.Y. 2021-22 for total income of ` 50,00,000 and ` 50,01,000 without considering marginal relief.

	Particulars	Case I	Case II	Increment
1	Total Income	50,00,000	50,01,000	+1,000
2	Income-tax	13,12,500	13,12,800	+300

3	Surcharge*	NIL	1,31,280	+1,31,280
4	Income-tax and Surcharge (without marginal relief)	13,12,500	14,44,080	+1,31,580
5	Health and Education cess @ 4%	52,500	57,763	+5,263
6	Total Tax Liability	13,65,000	15,01,843	+1,36,843

With a small increase of ` 1,000 in total income of Mr. X, the total tax liability of Mr. X has increased by ` 1,36,843. In order to mitigate this undue hardship to the assessee, provision has been made to provide for marginal relief in such cases by restricting the amount of incremental income-tax and surcharge payable, to the extent of incremental total income.

Marginal relief is available in case of such persons referred to above i.e., -

	Particulars	Marginal relief	Illustration No.
(i)	Where the total income > ` 50 lakhs but ≤ ` 1 crore	<p>Step 1 - Compute income-tax payable on total income; and add surcharge @10% on such income-tax (A)</p> <p>Step 2 - Compute income-tax payable on ` 50 lakhs</p> <p>Step 3 - Total income (-) ` 50 lakhs</p> <p>Step 4 - Add the amount computed in Step 2 and Step 3 (B)</p> <p>Step 5 – Income-tax payable on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., A) or Step 4 (i.e., B). Consequently, if A > B, the marginal relief would be A – B.</p>	Refer illustration 2
(ii)	Where the total income > ` 1 crore but ≤ ` 2 crores	<p>Step 1 - Compute income-tax on total income; and add surcharge @15% on income-tax (C)</p> <p>Step 2 - Compute income-tax payable on total income of ` 1 crore + surcharge on such income-tax @10%</p> <p>Step 3 - Total income (-) ` 1 crore</p> <p>Step 4 - Add the amount computed in Step 2 and Step 3 (D)</p> <p>Step 5 – Income-tax payable on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., C) or Step 4 (i.e., D). Consequently, if C > D, the marginal relief would be C – D.</p>	Refer illustration 3

(iii)	Where the total income > ` 2 crores but ≤ ` 5 crores	<p>Step 1 - Compute income-tax on total income; and add surcharge @25% on income-tax (E)</p> <p>Step 2 - Compute income-tax payable on total income of ` 2 crore + surcharge on such income-tax @15%</p> <p>Step 3 - Total income (-) ` 2 crore</p> <p>Step 4 - Add the amount computed in Step 2 and Step 3 (F)</p> <p>Step 5 – Income-tax payable on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., E) or Step 4 (i.e., F). Consequently, if E > F, the marginal relief would be E – F.</p>	Refer illustration 4
(iv)	Where the total income > ` 5 crores	<p>Step 1 - Compute income-tax on total income; and add surcharge @37% on income-tax (G)</p> <p>Step 2 - Compute income-tax payable on total income of ` 5 crore + surcharge on such income-tax @25%</p> <p>Step 3 - Total income (-) ` 5 crore</p> <p>Step 4 - Add the amount computed in Step 2 and Step 3 (H)</p> <p>Step 5 – Income-tax payable on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., G) or Step 4 (i.e., H). Consequently, if G > H, the marginal relief would be G – H.</p>	Refer illustration 5

Note – It is presumed that the total income referred to above does not include dividend income, long term capital gains taxable under section 112A and short term capital gains taxable under section 111A. In case the total income includes dividend income, long term capital gains taxable under section 112A or short term capital gains taxable under section 111A, surcharge on tax payable on such dividend income and capital gains cannot exceed 15%. This must be kept in mind while computing marginal relief in cases referred to in (iii) and (iv) above.

ILLUSTRATION 2

Compute the tax liability of Mr. Raja (aged 42 years), having total income of ` 51.5 lakhs for the Assessment Year 2021-22. Assume that his total income comprises of salary income, income from house property and interest from saving bank account. Also, assume that Mr. Raja has not opted for the provisions of section 115BAC.

SOLUTION

Computation of tax liability of Mr. Raja for the A.Y. 2021-22

(A) Tax payable including surcharge on total income of ₹ 51,50,000		
₹ 2,50,000 – ₹ 5,00,000@5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000@20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 51,50,000@30%	<u>₹ 12,45,000</u>	
Total	₹ 13,57,500	
Add: Surcharge @10%	<u>₹ 1,35,750</u>	₹ 14,93,250
(B) Tax Payable on total income of ₹ 50 lakhs (₹ 12,500 plus ₹ 1,00,000 plus ₹ 12,00,000)		₹ 13,12,500
(C) Total Income less ₹ 50 lakhs		₹ 1,50,000
(D) Tax payable on total income of ₹ 50 lakhs plus the excess of total income over ₹ 50 lakhs (B+C)		₹ 14,62,500
(E) Tax payable: Lower of (A) and (D)		₹ 14,62,500
Add: Health and education cess @4%		<u>₹ 58,500</u>
Tax Liability		<u>₹ 15,21,000</u>
(F) Marginal Relief (A – D)		₹ 30,750

Alternative Method:

(A) Tax payable including surcharge on total income of ₹ 51,50,000		
₹ 2,50,000 – ₹ 5,00,000@5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000@20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 51,50,000@30%	<u>₹ 12,45,000</u>	
Total	₹ 13,57,500	
Add: Surcharge @10%	<u>₹ 1,35,750</u>	₹ 14,93,250

(B) Tax Payable on total income of ₹ 50 lakhs (₹ 12,500 plus ₹ 1,00,000 plus ₹ 12,00,000)	₹ 13,12,500
(C) Excess tax payable (A)-(B)	₹ 1,80,750
(D) Marginal Relief (₹ 1,80,750 – ₹ 1,50,000, being the amount of income in excess of ₹ 50,00,000)	₹ 30,750
(E) Tax payable (A)-(D)	₹ 14,62,500
Add: Health and education cess @4%	₹ 58,500
Tax Liability	₹ 15,21,000

ILLUSTRATION 3

Compute the tax liability of Mr. Akash (aged 55 years), having total income of ₹ 1,02,00,000 for the Assessment Year 2021-22. Assume that his total income comprises of salary income, income from house property and interest from fixed deposit account. Also, assume that Mr. Akash has not opted for the provisions of section 115BAC.

SOLUTION

Computation of tax liability of Mr. Akash for the A.Y. 2021-22

(A) Tax payable including surcharge on total income of ₹ 1,02,00,000		
₹ 2,50,000 – ₹ 5,00,000@5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000@20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 1,02,00,000@30%	₹ 27,60,000	
Total	₹ 28,72,500	
Add: Surcharge @15%	₹ 4,30,875	₹ 33,03,375
(B) Tax Payable on total income of ₹ 1 crore (₹ 12,500 plus ₹ 1,00,000 plus ₹ 27,00,000)	₹ 28,12,500	
Add: Surcharge @10%	₹ 2,81,250	₹ 30,93,750
(C) Total Income less ₹ 1 crore	₹ 2,00,000	

(D) Tax payable on total income of ₹ 1 crore plus the excess of total income over ₹ 1 crore (B+C)	₹ 32,93,750
(E) Tax payable: Lower of (A) and (D)	₹ 32,93,750
Add: Health and education cess @4%	₹ 1,31,750
Tax Liability	₹ 34,25,500
(F) Marginal Relief (A – D)	₹ 9,625

Alternative Method:

(A) Tax payable including surcharge on total income of ₹ 1,02,00,000		
₹ 2,50,000 – ₹ 5,00,000@5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000@20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 1,02,00,000@30%	₹ 27,60,000	
Total	₹ 28,72,500	
Add: Surcharge@15%	₹ 4,30,875	₹ 33,03,375
(B) Tax Payable on total income of ₹ 1 crore (₹ 12,500 plus ₹ 1,00,000 plus ₹ 27,00,000) plus surcharge @10%		₹ 30,93,750
(C) Excess tax payable (A)-(B)		₹ 2,09,625
(D) Marginal Relief (₹ 2,09,625 – ₹ 2,00,000, being the amount of income in excess of ₹ 1,00,00,000)		₹ 9,625
Tax payable (A) - (D)		₹ 32,93,750
Add: Health and education cess @4%		₹ 1,31,750
Tax Liability		₹ 34,25,500

ILLUSTRATION 4

Compute the tax liability of Mr. Deepak (aged 57 years), having total income of ₹ 2,02,00,000 for the Assessment Year 2021-22. Assume that his total income comprises of salary income, income from house property and interest from fixed deposit account. Also, assume that Mr. Deepak has not opted for the provisions of section 115BAC.

SOLUTION

Computation of tax liability of Mr. Deepak for the A.Y. 2021-22

(A) Tax payable including surcharge on total income of ₹ 2,02,00,000		
₹ 2,50,000 – ₹ 5,00,000 @5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000 @20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 2,02,00,000 @30%	<u>₹ 57,60,000</u>	
Total	₹ 58,72,500	
Add: Surcharge @25%	<u>₹ 14,68,125</u>	₹ 73,40,625
(B) Tax Payable on total income of ₹ 2 crore (₹ 12,500 plus ₹ 1,00,000 plus ₹ 57,00,000)		₹ 58,12,500
Add: Surcharge @15%		<u>₹ 8,71,875</u>
		₹ 66,84,375
(C) Total Income less ₹ 2 crore		<u>₹ 2,00,000</u>
(D) Tax payable on total income of ₹ 2 crore plus the excess of total income over ₹ 2 crore (B+C)		₹ 68,84,375
(E) Tax payable: Lower of (A) and (D)		₹ 68,84,375
Add: Health and education cess @4%		<u>₹ 2,75,375</u>
Tax Liability		<u>₹ 71,59,750</u>
(F) Marginal Relief (A – D)		<u>₹ 4,56,250</u>

Alternative Method:

(A) Tax payable including surcharge on total income of ₹ 2,02,00,000		
₹ 2,50,000 – ₹ 5,00,000 @5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000 @20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 2,02,00,000 @30%	<u>₹ 57,60,000</u>	
Total	₹ 58,72,500	
Add: Surcharge @25%	<u>₹ 14,68,125</u>	₹ 73,40,625

Tax Liability	₹ 1,94,64,250
(F) Marginal Relief (A – D)	<u>₹ 16,59,700</u>

Alternative Method:

(A) Tax payable including surcharge on total income of ₹ 5,02,00,000		
₹ 2,50,000 – ₹ 5,00,000 @5%	₹ 12,500	
₹ 5,00,000 – ₹ 10,00,000 @20%	₹ 1,00,000	
₹ 10,00,000 – ₹ 5,02,00,000 @30%	<u>₹ 1,47,60,000</u>	
Total	₹ 1,48,72,500	
Add: Surcharge @37%	<u>₹ 55,02,825</u>	₹ 2,03,75,325
(B) Tax Payable on total income of ₹ 5 crore (₹ 12,500 plus ₹ 1,00,000 plus ₹ 1,47,00,000) plus surcharge @15%		<u>₹ 1,85,15,625</u>
(C) Excess tax payable (A)-(B)		₹ 18,59,700
(D) Marginal Relief (₹ 18,59,700 – ₹ 2,00,000, being the amount of income in excess of ₹ 5,00,00,000)		<u>₹ 16,59,700</u>
Tax payable (A) - (D)		₹ 1,87,15,625
Add: Health and education cess @4%		<u>₹ 7,48,625</u>
Tax Liability		<u>₹ 1,94,64,250</u>

(2) Firm/ Limited Liability Partnership/ Local Authorities/ Co-operative society

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of 12% of income-tax computed in accordance with the provisions of sub-para (2)/(3)/(4) of para 1.5 or section 111A or section 112 or section 112A.

Marginal relief

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

(3) Domestic company**(a) In case of a domestic company which has exercised option under section 115BAA or section 115BAB**

Surcharge of 10% would be leviable on the income-tax computed on the total income of a company opting for the provisions of section 115BAA or 115BAB.

(b) In case of a domestic company, other than that referred to in (a) above, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 7% of income-tax computed @25% or 30% of total income, as the case may be, or income-tax computed under section 111A or section 112 or section 112A.

Marginal relief

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

ILLUSTRATION 6

Compute the marginal relief available to X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 1,01,00,000 for A.Y.2021-22 and the total income does not include any income in the nature of capital gains. Assume that the company has not exercised option under section 115BAA or 115BAB.

[Note - The gross receipts of X Ltd. for the P.Y.2018-19 is ₹ 402 crore]

SOLUTION

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

(c) In case of a domestic company, other than a company referred to in (a) above, whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 12% of income-tax computed @25% or 30% of total income, as the case may be, or income-tax computed under section 111A or section 112 or section 112A.

Marginal relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax payable (together with surcharge) on such income should not exceed the amount

of income-tax and surcharge payable on total income of ₹ 10 crore by more than the amount of income that exceeds ₹ 10 crore.

ILLUSTRATION 7

Compute the marginal relief available to Y Ltd., a domestic company, assuming that the total income of Y Ltd. for A.Y.2021-22 is ₹ 10,01,00,000 and the total income does not include any income in the nature of capital gains. Assume that the company has not exercised option under section 115BAA or 115BAB.

[Note - The gross receipts of Y Ltd. for the P.Y.2018-19 is ₹ 410 crore]

SOLUTION

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

(4) Foreign company

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

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 2% of income-tax computed in accordance with the provisions of sub-para (5)(ii) of para 1.5 or section 111A or section 112 or section 112A.

Marginal relief

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

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

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with the provisions of sub-para (5)(ii) of para 1.5 or section 111A or section 112 or section 112A.

Marginal relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax payable (together with surcharge) on such income should not exceed the amount of income-tax and surcharge payable on total income of ₹ 10 crore by more than the amount of income that exceeds ₹ 10 crore.



1.7 REBATE OF UP TO ₹ 12,500 FOR RESIDENT INDIVIDUALS HAVING TOTAL INCOME OF UP TO ₹ 5 LAKH [SECTION 87A]

In order to provide tax relief to the individual tax payers who are in the 5% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 5,00,000.

- (1) The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 12,500, whichever is less.

(Rebate under section 87A is allowed from tax payable before adding Health and education cess on income-tax).

- (2) Further, the aggregate amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

Note: Rebate under section 87A is, however, not available in respect of tax payable @10% on long-term capital gains taxable under section 112A.

“Health and Education cess” on Income-tax

The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the “Health and Education cess on income-tax”, calculated at the rate of 4% of such income-tax and surcharge, if applicable. Education cess is leviable in the case of all assessees i.e. individuals, HUF, AOPs/ BOIs, firms, local authorities, co-operative societies and companies.

It is leviable to fulfill the commitment of the Government to provide and finance quality health services and universalised quality basic education and secondary and higher education.

ILLUSTRATION 8

Mr. Sanjay aged 30 years, has a total income of ₹ 4,50,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2021-22.

SOLUTION

Computation of tax liability of Mr. Sanjay for A.Y.2021-22

Tax on total income of ₹ 4,50,000	
@5% of ₹ 2,00,000 (₹ 4,50,000 – ₹ 2,50,000)	₹ 10,000
Less: Rebate u/s 87A (Lower of tax payable or ₹ 12,500)	₹ 10,000
Tax liability	<u>Nil</u>

SIGNIFICANT SELECT CASES

1. **Whether technical fee paid under a technical collaboration agreement for setting up a joint venture company in India is to be treated as revenue or capital expenditure, where, upon termination of the agreement, the joint venture would come to an end?**

Honda Siel Cars India Ltd. v. CIT [2017] 395 ITR 713 (SC)

Facts of the case: The assessee, Honda Siel Cars India Ltd., is a joint venture company between Honda Motors, a Japanese company and Siel Ltd., an Indian company. The assessee and Honda Motors entered into a technical collaboration agreement (TCA) on May 21, 1996 under which a technical fee of 30.5 million USD was payable by the assessee in five equal instalments on a yearly basis. Under the agreement, TCA Honda Motors had to provide manufacturing facilities, know-how, technical information, information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee, without any proprietary rights. The assessee treated the technical fees as revenue while the Revenue authorities contended that it is capital in nature.

Issue: Whether the technical fee of 30.5 million USD payable by the assessee is in the nature of revenue expenditure or capital expenditure?

Appellate Authorities' views: The Tribunal held that the assessee had acquired only a limited right to use and not a proprietary right, and hence, the expenditure was revenue in nature. It did not matter that the agreement was entered into at the time of setting up the business. The High Court, however, held that though the rights were in the nature of a right to use, the joint venture's business was set up pursuant to the agreement, and hence, the expenditure was capital in nature.

Supreme Court's Observations: From a review of relevant precedents, the Court observed that if a limited right to use technical know-how is obtained for a limited period for improvising existing business, the expenditure is revenue in nature. However, if technical know-how is obtained for setting up a new business, the position may be different. There is no single principle or test for determining the nature of expenditure; it is a question to be answered based on the circumstances in each case.

In the given facts, the very purpose of the TCA was to set up the Joint Venture. The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit. Upon termination of TCA, the joint venture itself would come to an end. Though the TCA is framed in a manner to look like a licence for a limited period having no enduring nature but a close scrutiny into the said agreement shows otherwise.

Supreme Court's Decision: Affirming the decision of the High Court, the Supreme Court held that, in this case, technical fee is capital in nature since upon termination of TCA, the joint venture itself would come to an end.

Note – In this case, since the amount paid for obtaining limited right to use technical know-how for a limited period is held to be capital in nature, it would be an intangible asset eligible for depreciation @25%.

2. **What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?**

CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)

Facts of the case: The assessee, a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received ₹ 8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The Department assessed the amount of liquidated damages to income-tax. However, the Appellate Tribunal held that the amount was a capital receipt and the High Court concurred with this view.

Supreme Court's Decision: The Apex Court affirmed the decision of the High Court holding that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, is not in the ordinary course of business, hence it is a capital receipt in the hands of the assessee.

3. **Can capital contribution of the individual partners credited to their accounts in the books of the firm be taxed as cash credit in the hands of the firm, where the partners have admitted their capital contribution but failed to explain satisfactorily the source of receipt in their individual hands?**

CIT v. M. Venkateswara Rao (2015) 370 ITR 212 (T & AP)

Facts of the case: The assessee-firm was constituted in the year 1982 and its return for the assessment year 1993-94 was selected for scrutiny under section 143(3). The controversy was in relation to the capital contribution of ten partners aggregating to ₹ 76.57 lakhs. The assessee-firm's explanation that the partners have paid various amounts towards contribution of their share in the capital was not accepted since the source of income for the partners was not explained. The Commissioner (Appeals) observed that the amounts credited in the names of four partners were valid and that cash credits in the accounts of six other partners in the books of the firm were to be considered afresh by the Assessing Officer.

Issue under consideration: The issue before the High Court was whether the Assessing Officer was justified in treating the capital contribution of partners as income of the firm by invoking section 68?

High Court's Opinion: Section 68 directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the amount so contributed constitutes the very substratum for the business of the firm and it is difficult to treat the pooling of such capital as credit. It is only when the entries are made during the course of business, they can be subjected to scrutiny under section 68.

Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service. At the most, the Assessing Officer can make an enquiry against the individual partners and not the firm when the partners have also admitted their capital contribution in the firm. The High Court made reference to decision in the case of *CIT v. Anupam Udyog 142 ITR 130 (Patna)* where it was held if there are cash credits in the books of the firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partner, then, in the absence of any material to indicate that they are the profits of the firm, the cash credits cannot be assessed in the hands of the firm, though they may be assessed in the hands of individual partners.

High Court's Decision: The High Court, accordingly, held that the view taken by the Assessing Officer that the partnership firm has to explain the source of income of the partners as regards the amount contributed by them towards capital of the firm, in the absence of which the same would be treated as the income of the firm, was not tenable.

TEST YOUR KNOWLEDGE**Question 1**

Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with ` 5 lakhs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.

Answer

In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head "Profits and gains of business or profession".

Question 2

XYZ Ltd. took over the running business of a sole-proprietor by a sale deed. As per the sale deed, XYZ Ltd. undertook to pay overriding charges of ` 15,000 p.a. to the wife of the sole-proprietor in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of XYZ Ltd., who had accepted that obligation as a condition of purchase of the going concern. Is the payment of overriding charges by XYZ Ltd. to the wife of the sole-proprietor in the nature of diversion of income or application of income? Discuss.

Answer

This issue came up for consideration before the Allahabad High Court in *Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 267 ITR 370 (All)*. The Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e., the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Question 3

MKG Agency is a partnership firm consisting of Mr. Mohan and his three major sons. The partnership deed provided that after the death of Mr. Mohan, the business shall be continued by the sons, subject

to the condition that the firm shall pay 20% of the profits to their mother, Lakshmi. Mr. Mohan died in March, 2020. In the previous year 2020-21, the reconstituted firm paid ` 1 lakh (equivalent to 20% of the profits) to Lakshmi and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.

Answer

The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income-tax law. In the instant case, the amount of ` 1 lakh, being 20% of profits of the firm, paid to Lakshmi gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm.

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of Lakshmi, who possesses the overriding title. Therefore, the amount paid to Lakshmi should be excluded from the income of the firm. This view has been confirmed in *CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom)*.

Question 4

Anand was the Karta of HUF. He died leaving behind his major son Prem, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons would become co-owners?

Answer

In the case of *Gowli Buddanna v. CIT (1966) 60 ITR 293*, the Supreme Court has made it clear that there need not be more than one male member to form a HUF as a taxable entity under the Income-tax Act, 1961. The expression "Hindu Undivided Family" in the Act is used in the sense in which it is understood under the personal law of the Hindus.

Under the Hindu system of law, a joint family may consist of a single male member and the widows of the deceased male members and the Income-tax Act, 1961 does not mandate that it should consist of at least two male members. Therefore, the property of a joint Hindu family does not cease to belong to the family merely because the family is represented by a single co-parcener who possesses the right which an owner of property may possess.

Therefore, the HUF would retain its status as such.

Question 5

Mr. C borrowed on Hundi, a sum of ` 25,000 by way of bearer cheque on 11-09-2020 and repaid the same with interest amounting to ` 30,000 by account payee cheque on 12-10-2020.

The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of the Assessing Officer valid?

Answer

Section 69D provides that where any amount is borrowed on a hundi or any amount due thereon is repaid otherwise than by way of an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount for the previous year in which the amount was so borrowed or repaid, as the case may be.

In this case, Mr. C has borrowed ₹ 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2020-21. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

Question 6

The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to ₹ 60,000, which was not debited in the books of account for the year ending 31.3.2021. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of ₹ 60,000 in the hands of the firm for the assessment year 2021-22. The firm claims that even if the addition is made, the sum of ₹ 60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

Answer

The claim of the firm for deduction of the sum of ₹ 60,000 in computing its business income is not tenable. The action of the Assessing Officer in making the addition of ₹ 60,000, being the payment of rent not debited in the books of account (for which the firm failed to explain the source of payment) is correct in law since the same is an unexplained expenditure under section 69C. The proviso to section 69C states that such unexplained expenditure, which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income. Therefore, the claim of the firm is not tenable.