

## Unit -1

### Brief history income tax in india

In India ,this tax was introduced for the first time in 1860,by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857.Thereafter ,several amendments were made in it from time to time. In 1886,a separate Income tax act was passed. This act remained in force up to, with various amendments from time to time. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922.This Act remained in force up to the assessment year 1961-62 with numerous amendments. The Income Tax Act 1961 has been brought into force with 1 April 1962.It applies to the whole of India and Sikkim(including Jammu and Kashmir).Since 1962 several amendments of far-reaching nature have been made in the Income Tax Act by the Union Budget every year.

### Income tax

Annual charge levied on both earned income (wages, salaries, commission) and unearned income (dividends, interest, rents). In addition to financing a government's operations, progressive income taxation is designed to distribute wealth more evenly in a population and to serve as automatic fiscal stabilizer to cushion the effects of economic cycles. Its two basic types are (1) Personal income tax, levied on incomes of individuals, households, partnerships, and sole-proprietorships; and (2) Corporation income tax, levied on profits (net earnings) of incorporated firms. However, presence of tax loopholes (whose number increases in direct proportion to the complexity of tax code) may allow some wealthy persons to escape higher taxes without violating the letter of the tax laws.

jagannath ramanuj das v/s state of orissa AIR 1954

supreme court held “a tax is undoubtedly in nature of a compulsory exaction of money by public authority for public purpose”

### **important concepts in income tax**

**Income:** Income is money that an individual or business receives in exchange for providing a good or service or through investing capital

under section 2 (24) "income" includes—

- (i) profits and gains;
- (ii) dividend;
- (iii) the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17;
- (iv) 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;
- (v) any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 or section 41 or section 59;
- (vi) any capital gains chargeable under section 45;
- (vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule;

In commissioner of income-tax v/s shaw wallace and company 1923

Sir george lowndes defined income as follows

“Income, in this Act connotes a periodical monetary return " coming in" with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall.”

### Agricultural income

As per section 2(1A), agricultural income generally means:

- (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.
- (b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.
- (c) Any income attributable to a farm house subject to satisfaction of certain conditions

specified in this regard in section 2(1A).

Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

Mustafa Ali Khan v/s CIT 1948 :Held, rent of agricultural land received from subtenant by mortgage in possession is agricultural income

CIT V/s cidanbaran pillai(1970): Held ,share of profit of a partner from firmengaged in agricultural operation is agricultural income

following is not agricultural income

- a) Income from poultry farming.
- (b) Income from bee hiving.
- (c) Income from sale of spontaneously grown trees.
- (d) Income from dairy farming.
- (e) Purchase of standing crop.
- (f) Dividend paid by a company out of its agriculture income.
- (g) Income of salt produced by flooding the land with sea water.
- (h) Royalty income from mines.
- (i) Income from butter and cheese making.
- (j) Receipts from TV serial shooting in farm house is not agriculture income.

Certain points to be remembered;

- (a) Agricultural income is considered for rate purpose while computing tax of Individual/HUF/AOP/BOI/Artificial Judicial Person.
- (b) Losses from agricultural operations could be carried forward and set off with agricultural income of next eight assessment years.

(c) Agriculture income is computed same as business income.

### **Assessee Section 2(7)**

Is a noun derived from verb “assess” dictionary meaning of which is “to evaluate or estimate the value”

" assessee" means a person by whom any tax or any other sum of money is payable under this Act, and includes-

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

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

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

CIT v/s udhoji Shri Krishanadas (M.P high court, 2004)

Held from section 2(7), its clear that term assessee includes actual as well as deemed assesses under provisions of Act.

### **Assessment year S.2(9) Income Tax**

Assessment year is basically a 12 months period starting from April 1, during which an assessee is required to file the return of income (ITR) and the ITO has to initiate assessment proceedings for income as per ITR and tax thereon. Since Income Tax is on income of a financial/ previous year or period, so tax filings and assessment can start thereafter. Probably, that’s why it’s called assessment year/ period.

As per S.2(9) of the Income Tax Act, 1961, unless the context otherwise requires, the term “assessment year” means the period of twelve months commencing on the 1st day of April every year

What is the difference between Financial Year and Assessment Year?

AY is the assessment year and FY is the financial year. From an income tax perspective, FY is the year in which you earn an income. AY is the year following the financial year in which you have to evaluate the previous year's income and pay taxes on it.

For example, if your financial year is from 1 April 2015 to 31 March 2016, then it is known as FY2015-16. The assessment year for income earned during this period would begin after the financial year ends—that is on 1 April 2016 till 31 March 2017. Hence, the assessment year would be AY2016-17.

### **Previous Year: S.2(34) Income Tax**

Previous basically indicates an event previous to another event. Under Income Tax main event is assessment, i.e. filings by assesseees and their review by the ITO, which may start after end of the year / period during which earnings are made and that period is called previous year / financial year. Those earnings are subjected to tax in the following period / year which is called assessment year / period.

As per S.2(34) of Income Tax Act, 1961, unless the context otherwise requires, the term “previous year” means the previous year as defined in section 3.

In view of above, we need to visit definition of previous year under Section 3 also, as under:

As per S.3 of Income Tax Act, 1961, for the purposes of this Act, the term “previous year” means the financial year immediately preceding the assessment year.

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

What is the difference between previous Year and Assessment Year?

assessment year is the year in which income is evaluated and taxed. This evaluation and taxation is done on income that is earned in the previous year, which is known as the financial year.

## **Definition of ‘Business’**

As per S.2(13) of the Income Tax Act, 1961, unless the context otherwise requires, the term “business” includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Pari mangaldas Girdharidas v/s CIT(1978)

In this case following tests are suggested to ascertain if an activity is business or not-

1. Whether the initial acquisition of the subject matter of transaction was with intention of dealing in item in question or with a view to finding an investment?
2. The purpose, manner and object of subsequent sale
3. The manner in which the assessee dealt with the subject matter of transaction.
4. The manner of filing return of income from such source by assessee.
5. The volume, frequency, continuity and regularity of transactions of purchase
6. In case of partnership firms or companies; whether the partnership deed or memorandum of association authorized the firm or company to purchase and/or sell the commodity in question.

## **Dividend Section 2(22)**

Dividend refers to a reward, cash or otherwise, that a company gives to its shareholders. Dividends can be issued in various forms, such as cash payment, stocks or any other form. A company's dividend is decided by its board of directors and it requires the shareholders' approval. However, it is not obligatory for a company to pay dividend. Dividend is usually a part of the profit that the company shares with its shareholders

After paying its creditors, a company can use part or whole of the residual profits to reward its shareholders as dividends. However, when firms face cash shortage or when it needs cash for reinvestments, it can also skip paying dividends. When a company announces dividend, it also fixes a record date and all shareholders who are registered as of that date become eligible to get dividend payout in proportion to their shareholding.

The term dividend is not defined under the ACT. Under Section 2(22) following income is included in dividend-

" dividend" includes-

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

(b) any distribution to its shareholders by a company of debentures, debenture- stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;

(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933 , whether such accumulated profits have been capitalised or not;

(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987 , by way of advance or loan to a shareholder, being 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) holding not less than ten per cent of the voting power, or to any concern, in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)] or any payment by any such company on behalf, or for- the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits; but" dividend" does not include--

(i) a distribution made in accordance with sub- clause (c) or sub- clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets;

(ia) a distribution made in accordance with sub- clause (c) or sub- clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares

allotted to its equity shareholders after the 31st day of March, 1964 , and before the 1st day of April, 1965 ];]

(ii) any advance or loan made to a shareholder or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company;

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub- clause (e), to the extent to which it is so set off. Explanation 1-The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946 , or after the 31st day of March, 1948 , and before the 1st day of April, 1956 . Explanation 2.-- The expression " accumulated profits" in sub- clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub- clauses, and in subclause (c) shall include all profits of the company up to the. date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place]. Explanation 3.- For the purposes of this clause,-

(a) " concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern;]

Capital Asset[ section 2(14)]

capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include-

(i) any stock- in- trade, consumable stores or raw materials held for the purposes of his business or profession;

(ii) For personal effects, that is to say, movable property (including wearing apparel and furniture, but excluding jewellery) held for personal use by the assessee or any member of his

family dependent on him. Explanation.- For the purposes of this sub- clause," jewellery" includes-

(a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semiprecious stone, and whether or not worked or sewn into any wearing apparel;

(b) precious or semi- precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;]

(iii) agricultural land in India, not being land situate-

(a) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(b) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette;]

(iv) 6 per cent Gold Bonds, 1977 , or 7 per cent Gold Bonds, 1980 ,] or National Defence Gold Bonds, 1980 ,] issued by the Central Government;]

(V) Special Bearer Bonds, 1991 , issued by the Central Government;]

### **Person [section 2(31)]**

person" includes-

(i) an individual,

(ii) a Hindu undivided family,

(iii) a company,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,

(vi) a local authority, and

(vii) every artificial juridical person, not falling within any of the preceding sub- clauses;

(i) Individual. It refers to a natural human being whether male or female, minor or major.

(ii) Hindu Undivided Family. It is a relationship created due to operation of Hindu Law. The manager of HUF is called “Karta” and its members are called ‘Coparceners’.

(iii) Company. It is an artificial person registered under Indian Companies Act 1956 or any other law.

(iv) Firm. It is an entity which comes into existence as a result of partnership agreement between persons to share profits of the business carried on by all or any one of them. Though, a partnership firm does not have a separate legal entity, yet it has been regarded as a separate entity under Income Tax Act. Under Income Tax Act, 1961, a partnership firm can be of the following two types

(i) a firm which fulfill the conditions prescribed u/s 184.

(ii) A firm which does not fulfill the conditions prescribed u/s 184.

It is important to note that for Income Tax purposes, a limited liability partnership (LLP) constituted under the LLP Act, 2008 is also treated as a firm.

(v) Association of Persons or Body of Individuals.: Co-operative societies, MARKFED, NAFED etc. are the examples of such persons. When persons combine together to carry on a joint enterprise and they do not constitute partnership under the ambit of law, they are assessable as an association of persons. Receiving income jointly is not the only feature of an association of persons. There must be common purpose, and common action to achieve common purpose i.e. to earn income. An AOP. can have firms, companies, associations and individuals as its members.

A body of individuals (BOI) cannot have non-individuals as its members. Only natural human beings can be members of a body of individuals.

Whether a particular group is AOP. or BOI. is a question of fact to be decided in each case separately.

(vi) Local Authority. Municipality, Panchayat, Cantonment Board, Port Trust etc. are called local authorities.

(vii) Artificial Juridical Person. A public corporation established under special Act of legislature and a body having juristic personality of its own are known to be Artificial Juridical Persons. Universities are an important example of this category.

#### **Charge of income-tax s(4).**

(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :

Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.

(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

Balmukund Acharya vs DCIT (2009)

Where the assessee erroneously offered capital gains to tax and the same was accepted by the AO vide Intimation u/s 143 (1)(a) and the assessee thereafter filed an appeal against such assessment of capital gains and the same was held not maintainable by the Tribunal, HELD, reversing the order of the Tribunal that:

(1) In view of the Explanation to s. 143 (prior to its deletion w.e.f. 1.6.1999) an Intimation is deemed to be an appealable order and appeal is maintainable;

(2) The authorities under the Act are under an obligation to act in accordance with law. Tax can be collected only as provided under the Act. If any assessee, under a mistake, misconceptions or on not being properly instructed is over assessed, the authorities under the Act are required to assist him and ensure that only legitimate taxes due are collected. If

particular levy is not permitted under the Act, tax cannot be levied applying the doctrine of estoppel.

### **Residential status of Assessee**

Income tax is imposed on the basis of duration of residence of assessee in india. citizenship is not precondition for liability to income tax. subject of income tax is person as defined under income tax Act, depending on his residence in india and not citizen.

Section 5 in The Income- Tax Act, 1995

#### Scope of total income

(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which-

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) accrues or arises to him outside India during such year: Provided that, in the case of a person not ordinarily resident in India within the meaning of sub- section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non- resident includes all income from whatever source derived which-

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1-Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India. Explanation 2.- For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that

it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

### Residential status of Assessee

the residential status of an assessee as defined in income tax act 1961. the residential status will be helpful in determining the taxable income in India. Residential status of an assessee is defined in Section 6 Of Income Tax Act, 1961.

The residential status of an assessee is classified into two parts:

1. Resident
2. Non- Resident

### Residential Status of an Individual and HUF

An Individual & HUF which are resident are further classified under two headings:

- Ordinarily resident
- Not Ordinarily resident

Now we are going to understand the residential status assessee wise.

### Residential Status of an Individual

#### Who will be Indian Resident Individual?

According to section 6(1) of the I.T. Act, 1961 an individual can be treated as Resident Indian in the previous year if he fulfils any of the following conditions:

Condition 1 – He is in India in the previous year for a period of 182 days or more or

Condition 2 – He is in India in the preceding four years for a period of 365 days or more & he is in India in the previous year for a period of 60 days or more

Special condition for Indian Citizen – The residential status of an individual who is citizen of India rendering service outside India & who visit India during leave or vacations in the previous year or an individual who is citizen of India or a person of Indian origin is outside

India & comes to India for visit in the previous year will be treated as resident in India if he stays in India for a period of 182 days or more in the previous year (instead of 60 days or more).

#### Amendment in Budget 2015

Following Clause have been inserted by Finance Bill-2015 in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed.”

#### Who will non resident Individual?

The Individual who does not satisfies both the conditions laid down under section 6(1) then he will be treated as Non Resident Indian. The Individual which satisfy any of the conditions mentioned under section 6(1) then he will be treated as resident Indian & he is further classified either as Ordinarily resident Or Not Ordinarily Resident.

According to section 6(6)(a) of I. T. Act, 1961 a Resident Individual will be treated as Not Ordinarily resident if he satisfies both of the following conditions:

- He is Non resident for a period of 9 out of 10 Preceding years of the previous year or
- He is India for a period of 729 days or less in immediately preceding 7 Years of the previous year.

The Resident Individual Who does not satisfy any of the conditions mentioned in section 6(6)(a) will be treated as Ordinarily Resident.

#### Example to determine residential status of an assessee

Mr. Akshay an Indian citizen Comes to visit India on 1<sup>st</sup> April, 2014 & left India on 02<sup>nd</sup> Oct, 2014.

Further he is in India for following days in following years:

2008-09: 130 days

2009-10: 150 days

2010-11: 165 days

2011-12: 158 days

2012-13: 147 days

2013-14: 49 days

In the above example the residential status of Mr. Akshay for Previous year 2014-15 is Resident but Ordinarily resident in India because he is in India in the previous year for a period of 182 days or more i.e. 185 days (1<sup>st</sup> April to 2<sup>nd</sup> Oct). & he is treated as Ordinarily resident because he does not satisfy all of the conditions mentioned under section 6(6).

**Residential Status of an Hindu Undivided Family (HUF)**

A Hindu Undivided Family will be treated as Non Resident in India if during that previous year the control & management of its affairs is situated wholly outside India. If the above condition is not satisfied then he will be treated as Resident in India.

According to section 6(6)(b) of I. T. Act, 1961 a Resident Hindu Undivided Family will be treated as Not Ordinarily resident if he satisfies both of the following conditions:

- If the Manager of HUF is Non resident for a period of 9 out of 10 Preceding years of the previous year or
- Manager of HUF is in India for a period of 729 days or less in immediately preceding 7 Years of the previous year.

The Resident HUF Who does not satisfy any of the conditions mentioned in section 6(6)(b) will be treated as Ordinarily Resident.

**Residential Status of an Company:**

According to section 6(3) of I. T. Act, 1961 a company is said to be resident in India if it satisfies any of following two conditions:

- It is an Indian Company or
- The control & management of company is wholly situated in India during that previous year
- If both the above conditions are not satisfied then such company is treated as Non Resident Company.

Finance Budget 2015 : From 1<sup>st</sup> April, 2016 a company is said to be resident in India if it satisfies any of following two conditions:

- It is an Indian Company or
- Its place of effective management, at any time in previous year, is in India

Explanation.—For the purposes of this clause “place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.’

If both the above conditions are not satisfied then such company is treated as Non Resident Company.

Residential Status of an Firm & Other associations of Persons:

Firm & Other association of persons will be treated as Non Resident in India if during that previous year the control & management of its affairs is situated wholly outside India. If the above condition is not satisfied then he will be treated as Resident in India.

Vijay malia vs Assistant commissioner High court of Calcutta,(2003)

Held , while deciding the residential status of an assessee the AO should consider the provisions of both section 6(1)(a) and section 6(1)(c) of the said Act and this is mandatory requirement of law. An assessee may not be ordinary resident of india under section 6(1)(a) but may be resident under section 6(1)(c ) of said Act.

Also refer to:CIT and Anr. V. Morgenstern Werner

Subbaya chettair vs CIT 1951

Following propositions are stated in this case:

- I. Generally HUF shall be taken to be resident in india unless control and management of its affairs are situated wholly outside india
- II. control and management means actual control and management and not merely the right to control and manage
- III. place of residence and place of business of HUF
- IV. occasional visits by a non resident 'karta' to the place of HUF business india is not sufficient to make HUF ordinarily resident in india.

### **Deemed Income**

Such incomes which are not actually received by a person, but law considers them as receipt or incomes, are called incomes deemed to be received in India. The term 'Statutory receipts' can be easily used to cover this term. Following are the instances of incomes deemed to be received

- (i) Tax deducted at source is income deemed to be received by a person even though he never receives such income (u/s 198).
- (ii) Section 7 considers the following incomes as deemed to be received by an assessee
  - (a) Employer's contribution to Recognised provident fund in excess of 12% of salary of employee [Section 7(i)1.
  - (b) Interest accrued on recognised provident fund balance in excess of 9.5% p.a. [Section 7(i)].
  - (c) Taxable portion of transferred balance of URPF to RPF [Section 7(u)].
  - (d) The contribution made, by the Central Government in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD [Section 7(iii)].
- (iii) Transfer of income without transfer of assets is deemed to be the income of transferor u/s 60 and 61.
- (iv) Under section 8, the dividend distributed or deemed to be distributed u/s 2(22) will be deemed to be distributed in the previous year.

(v) Income from undisclosed sources [Sections 68, 69, 69A, 69B, 69C and 69D].