SM

1 LESSON 1 BASIC CONCEPTS

1. LESSON 1

BASIC CONCEPTS

Naveen Mittal

Audio

The purpose of this chapter is to make the students familiar with the common terms and concepts used in the Income-tax Act, 1961. After reading this chapter, students would be able to understand the common terms used in day-to-day transactions relating to income tax.

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

Under section 2(24), the term "income" specifically includes the following

- Profits and gains;
- Dividend;
- Voluntary contributions received by a trust in the following cases
  - Such contribution is received by a trust created wholly or partly for charitable or religious purposes; or
  - Such contribution is received by a scientific research association; or
  - Such contribution is received by any fund or institution established for charitable purpose and notified under section 10(23C)(iv)/ (v); or
  - Such contribution is received by any university or other educational institution or hospital referred to in section 10(23C)(iiiad)/ (vi)/ (iiiea)/ (iva); or
  - Such contribution is received by an electoral trust.
- The value of any perquisite or profit in lieu of salary under section 17(2) and 17(3) in the hands of employee;
- Any special allowance or benefit, other than the perquisite included under the point given above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of and office or employment;
- City compensatory allowance/ dearness allowance;
- 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;

- The value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee (like a trustee appointed under a trust);
- Capital gains;
- The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society;
- The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;
- Any winnings from lotteries, crossword puzzles or races including horse race (not being income from the activity of owning and maintaining race horses) or card game and other game of any sort or from gambling or betting of any form or nature;
- Employees contribution towards provident fund

Any sum received by an employer from his employees as employees' contribution to the following is treated as "income" of the employer

- Employees' contribution to any provident fund (recognized or unrecognized)
- Employees contribution to superannuation fund
- Employees contribution to any fund set up under the provisions of the Employees' State Insurance Act, 1948
- Employees contribution to any other fund for the welfare of employees

- Any sum received under a keyman insurance policy;
- Amount exceeding 50,000 by way of gift or property subject to the conditions of section 56(2)(vi) and (vii).

–

Concept of "Income"

The definition of the term "income" in section 2(24) is inclusive and not exhaustive. Therefore, the term "income" not only includes those things which are included in section 2(24) but also includes other things. Further, it is not the gross receipts but only the net receipts arrived at after deducting the related expenses incurred in connection with earning such receipts that have made the base of taxation.

Following are some of the important principles/ characteristics which explain the importance of income for income-tax purposes

a. Regularity of income- Income connotes periodical monetary return coming in with some sort of regularity or expected regularity from definite sources. However, this does not mean that income which does not arise regularly will not be treated as income for tax purposes, e.g., winnings from lotteries.

–

b. Form of income- Income may be received by the assessee in cash or kind. When income is received in non-cash form i.e., in kind, its valuation will be made according to the rules prescribed in the Income-tax rules. If, however, there is no prescribed value given in the rules, valuation thereof is made on the basis of market value.

c. Illegal income- The income-tax law does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality. Even illegal income is taxed just like any legal income.

d. Disputed income- Income-tax assessment cannot be held up or postponed (for the assessment of the income in the hands of the recipient) merely because of existence of a dispute regarding the title of income.

e. Diversion of income Vs. Application of income- Any expenditure/ investment, after income is received, is an application of income. “Income” under the Income-tax Act, which is chargeable to tax, is income before application of income; so such income is chargeable to tax in the hands of the assessee. Any expenditure/ investment out of such income is deductible only if it is permitted by a provision under the Income-tax Act or Income-tax Rules.

“Diversion of income” is where by an obligation, income is diverted to some other person. When an assessee on behalf of some other person receives income and later on it is diverted to such person, it is known as diversion of income and consequently, it is not chargeable to tax.

f. Contingent income- A contingent income is not an income. Until the contingency has happened, it cannot be assumed that income has accrued or arisen in the hands of the assessee.

g. Basis of income- Income can be taxed on receipt basis or on accrual basis. In case of income from business or income from other sources, the taxability would depend upon the method of accounting adopted by the assessee whereas in other cases, it would generally be taxed receipt or accrual basis, whichever happens earlier.

h. Income must come from outside- A person cannot make taxable profits out of a transaction with himself. Income must, therefore, come from outside.

i. Income includes loss- While income, profits and gains represent “plus income”, losses represent “minus income”.

j. Pin money- Pin money received by wife for her dress/ personal expenses and small savings made by a woman out of money received from her husband for meeting household expenses is not treated as income.

k. Award received by a sportsman- In the case of a sportsman, who is a professional, the award received by him is in the nature of a benefit in exercise of his profession and, therefore, it is chargeable to tax. In the case of non-professional sportsman, however, the award received by him is in the nature of gift and/ or personal testimonial which is taxable subject to the conditions of section 56(2)(vi) and (vii).

l. Revenue receipt Vs. Capital receipt- A revenue receipt is taxable as income unless it is expressly exempt under the Act. On the other hand, a capital receipt is generally exempt from tax unless it is expressly taxable.

Assessment year [Sec. 2(9)]

> "Assessment year" means the period starting from April 1 and ending on March 31 of the next year.

For instance, the assessment year 2011-12 which commenced on April 1, 2011, will end on March 31, 2012.

Income of previous year of an assessee is taxed during the next following assessment year at the rates prescribed by the relevant Finance Act.

Previous year [Sec. 3]

> Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year and the next year in which income is taxable is known as assessment year.

For instance, for the assessment year 2011-12, the relevant previous year is 2010-11.

Previous year in the case of newly set-up business/ profession

In the case of a newly set-up business/ profession or in the case of a new source of income, the first previous year commences on the date of setting up of the business/ profession or on the date when the new source of income comes into existence and ends on immediately following March 31. However, second and subsequent previous years are always financial years i.e., from April to March.

For instance, if a new business is set up on January 2, 2011, then the first previous year for that business will be the period starting from January 2, 2011 to March 31, 2011. Therefore, the first previous year of a newly set-up business/ profession or a new source of income will be either 12 months or less than 12 months. It can never exceed a period of 12 months.

When income of previous year is not taxable in the immediately following assessment year

The rule says the income of previous year is assessable as the income of the immediately following assessment year or in other words, it can be said that income of previous year is chargeable to tax in the next following assessment year.

The above rule, however, has certain exceptions which are given below

1. Income of non-resident from shipping- A non-resident who is carrying on a shipping business and earns income from carrying passengers/ livestock/ mail/ goods from a port in

India, will be chargeable to income-tax before the ship is allowed to leave the Indian port.

2. Income of persons leaving India either permanently or for a long period of time;

3. Income of association of persons or a body of individuals or an artificial judicial persons formed for short duration;

4. Income of a person trying to alienate his assets with a view to avoiding payment of tax; and

5. Income of a discontinued business.

In these cases, income of a previous year may be taxed as the income of the assessment year immediately preceding the normal assessment year.

These exceptions have been incorporated in order to ensure smooth collection of income-tax from the aforesaid taxpayers who may not be traceable if tax assessment procedure is postponed till the commencement of the normal assessment.

Double role of financial year

It can be said that a financial year plays a double role - it is a previous year as well as an assessment year. For example, financial year 2011-12 is previous year for the income received or accrued during April 1, 2011 to March 31, 2012. Also, financial year 2011-12 is the assessment year for the income received or accrued in the immediately preceding previous year (i.e., April 1, 2010 to March 31, 2011).

Person [Sec. 2(31)]

The term "person" includes

- an individual;
- a Hindu undivided family (HUF), e.g., a joint family of A, Mrs. A and their sons B and C;
- a company;
- a firm, e.g., AB & Co., firm of A and B;
- an association of persons (AOP) or a body of individuals (BOI), whether incorporated or not, e.g., XYZ Group Housing Co-operative Society;
- a local authority, e.g., MCD; and
- every artificial juridical person not falling within any of the preceding categories, e.g., Delhi University

Assessee [Sec. 2(7)]

"Assessee" means a person by whom income-tax or any other sum of money is payable under the Act. It includes

- every person in respect of whom any proceedings under the Act has been taken for the assessment of his income or loss or the amount of refund due to him;
- a person who is assessable in respect of income or loss of another person;
- a person who is deemed to be an assessee, or an assessee in default under any provision of the Act. A person is said to be an assessee in default if he/ she fails to comply with the duties imposed upon him/ her under the Income-tax Act.

Miscellaneous points to be noted

1. Income-tax is an annual tax on income.
2. Tax rates are fixed by the annual Finance Act and not be the Income-tax Act. For instance, tax rates for the assessment year 2011-12 are fixed by the Finance Act, 2011. If, however, on the first day of April of the assessment year, the new Finance Bill has not been placed on the statue book, the provisions in force in the preceding assessment year or the provisions proposed in the Finance Bill before Parliament, whichever is more beneficial to the assessee, will apply until the new provisions becomes effective.
3. Tax is levied on the "Total income" or "Net taxable income" of every assessee computed in accordance with the provisions of the Act.
4. Total income is calculated in accordance with the provisions of the Income-tax Act, as they stand on the first day of April of the assessment year. This above rule is applicable only for the purpose of computing taxable income. If, however, an amendment is made which is purely procedural (not for computing taxable income), then it is applicable from the date of amendment.

Miscellaneous points regarding computation of "gross total income"

1. If income is not chargeable to tax, any expenditure for earning such income is not deductible. From the assessment year 2007-08, the Assessing Officer will determine the expenditure pertaining to tax-free income, in accordance with a method prescribed by Central Board of Direct Taxes (CBDT).

2. Rules of set-off and carry forward of losses are applied before computation of gross total income and after adding all the five heads of income.

Rounding-off of income [Sec. 288A]

The taxable income shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of paise shall be ignored.

For instance, if income comes out to be 9,23,436, it will be treated as 9,23,440. If income comes out to be 9,23,434, it will be treated as 9,23,430. If income comes out to be 9,23,435, it will be treated as 9,23,440.

Rounding-off of tax [Sec. 288B]

The amount payable by the assessee and the amount of refund due, under the provisions of the Act shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of paise shall be ignored.

Exemption vs. Deduction

If an income is exempt from tax, it is not included in the computation of income. Exemption can never exceed the amount of income. Deduction is generally given from income chargeable to tax. Deduction can be less than or equal to or more than the amount of income. If amount deductible is more than the amount of income, the resulting amount will be taken as loss.

Capital receipts vs. revenue receipts

- A receipt in lieu of source of income is a capital receipt. A receipt in lieu of income is a revenue receipt. For instance, compensation for loss of employment is a capital receipt, whereas compensation for temporary disablement is a revenue receipt.
- Lump sum payment, large payment or periodic payment is not relevant in determining whether a receipt is capital or revenue in nature.
- Treatment of a receipt under company law is not relevant while deciding whether a receipt is capital or revenue in nature under tax laws.
- The fact that the amount paid is not allowed as permissible deduction in the assessment of a person making payment, cannot determine the character of receipt in the hands of the recipient.

Relevance of method of accounting in computing income

Mainly there are two types of accounting methods – mercantile system and cash system. Income chargeable under the head "Profits and Gains of business or profession" or "Income from other sources" is to be computed in accordance with the method of accounting regularly employed by the assessee.

In case of income chargeable under the heads "Salaries", "Income from house property" and "Capital gains", method of accounting adopted by the assessee is not relevant in calculating taxable income. For calculating taxable income under these heads, one has to follow the statutory provisions of the Income-tax Act which expressly provide whether revenue (or expenditure) is taxable (or deductible) on "accrual basis" or "cash basis".

Computation of net taxable income and tax liability of an individual/ HUF

Computation of net taxable income of an individual/ HUF for the assessment year 2011-12

Particulars	Amount
Income under the head "Salaries"	XX
Income under the head "House Property"	XX
Income under the head "Profits and gains of business or profession"	XX
Income under the head "Capital Gains"	XX
Income under the head "Income from other sources"	XX
Gross total income	XX

Less	Deductions under sections 80C to 80U	XX
	Net taxable income	XX

Computation of tax liability of an individual/ HUF for the assessment year 2011-12

	Particulars	Amount
	Tax on net taxable income	XX
Add	Surcharge	XX
	Total	XX
Add	Education Cess	XX
Add	Secondary and Higher Education Cess	XX
	Total tax liability	XX
Less	Pre-paid taxes	XX
	Net tax payable	XX

Tax slabs for an individual/ HUF for the assessment year 2011-12

Situation 1 For resident women (who is below 65 years on the last day of the previous year 2010-11)

Annual net taxable income	Tax
Up to 1,90,000	Nil
1,90,001 – 5,00,000	10% of income exceeding 1,90,000
5,00,001 – 8,00,001	31,000 + 20% of income exceeding 5,00,000
Above 8,00,000	91,000 + 30% of income exceeding 8,00,000

Situation 2 For resident senior citizens (who are 65 years or more of age at any time during the previous year 2010-11)

Annual net taxable income	Tax
Up to 2,40,000	Nil
2,40,001 – 5,00,000	10% of income exceeding 2,40,000
5,00,001 – 8,00,001	26,000 + 20% of income exceeding 5,00,000
Above 8,00,000	86,000 + 30% of income exceeding 8,00,000

Situation 3 For other individuals

Annual net taxable income	Tax
Up to 1,60,000	Nil
1,60,001 – 5,00,000	10% of income exceeding 1,60,000
5,00,001 – 8,00,001	34,000 + 20% of income exceeding 5,00,000
Above 8,00,000	94,000 + 30% of income exceeding 8,00,000

Surcharge for an individual/ HUF for the assessment year 2011-12

Nil

Education cess for an individual/ HUF for the assessment year 2011-12

2% of income-tax irrespective of any income

Secondary and Higher education cess for an individual/ HUF for the assessment year 2011-12

1% of income-tax irrespective of any income

Tax slab for FIRM for the assessment year 2011-12

Income of a firm is taxable at the rate of 30%.

Surcharge for FIRM for the assessment year 2011-12

Nil

Education cess for FIRM for the assessment year 2011-12

2% of income-tax irrespective of any income

Secondary and Higher education cess for FIRM for the assessment year 2011-12

1% of income-tax irrespective of any income

References

1. Singhania, Vinod. K. and Singhania, Monica, "Students Guide to Income-tax", Taxmann Publications Pvt.Ltd. (latest edition).
2. Ahuja, Girish and Gupta, Ravi, "Simplified Approach to Income-tax", Flair Publications (latest edition).
3. Chandra, Mahesh and Shukla, D.C., "Income-tax Law and Practice", Pragati

Publications (latest edition).

–

–

–

–

–

QUESTIONS

Case 1

Mr. X, a senior citizen (age 67 years), has an income of 10,00,000 in the assessment year 2011-12. How much will be his tax liability.

Solution

Tax on 10,00,000 is calculated as follows

Up to 2,40,000		Nil
	2,40,001 to 5,00,000	@ 10% i.e., 26,000
	5,00,001 to 8,00,000	@ 20% i.e., 60,000
	8,00,001 to 10,00,000	@ 30% i.e., 60,000
	Total tax	1,46,000
Add	Education cess @ 2%	2,920
Add	SHEC @ 1%	1,460
	Total tax payable	1,50,380

–

Case 2

Mrs. X, age 57 years, has an income of 10,00,000 in the assessment year 2011-12. How much will be her tax liability.

Solution

Tax on 10,00,000 is calculated as follows

Up to 1,90,000	Nil
1,90,001 to ` 5,00,000	@ 10% i.e., 31,000
5,00,001 to ` 8,00,000	@ 20% i.e., 60,000
8,00,001 to ` 10,00,000	@ 30% i.e., 60,000
Total tax	1,51,000

Add	Education cess @ 2%	3,020
Add	SHEC @ 1%	1,510
	Total tax payable	1,55,530

Case 3

Mr. X, age 57 years, has an income of 10,00,000 in the assessment year 2011-12. How much will be his tax liability.

Solution

Tax on 10,00,000 is calculated as follows

Up to 1,60,000	Nil
1,60,001 to 5,00,000	@ 10% i.e., 34,000
5,00,001 to 8,00,000	@ 20% i.e., 60,000
8,00,001 to 10,00,000	@ 30% i.e., 60,000

	Total tax	1,54,000
Add	Education cess @ 2%	3,080
Add	SHEC @ 1%	1,540
	Total tax payable	1,58,620

Case 4

X established a new business on October 13, 2010. What is the previous year for the assessment year 2011-12?

Solution

For the assessment year 2011-12, previous year starts from October 13, 2010 and ends on March 31, 2011.

Case 5

X joins an Indian company on December 15, 2010. Prior to December 15, 2010, he was not in employment. He has no other source of income. What are the previous years for the assessment years 2011-12 and 2012-13?

Solution

- For assessment year 2011-12, previous year starts from December 15, 2010 and ends on March 31, 2011.
- For assessment year 2012-13, previous year starts from April 1, 2011 and ends on March 31, 2012.

Case 6

Compute the tax liability of X, a resident for the assessment year 2011-12 with the following income details

		Amount
	Salary income	9,00,000
	House property income	2,60,000
	Short-term capital gain	90,000
	Long-term capital gain	10,000
	Winnings from lottery	5,00,000
	Gross total income	17,60,000
Less	Deductions under section 80C to 80U	1,00,000
	Net taxable income	16,60,000

Solution

Tax

Tax on LTCG (10,000 @ 20% under section 112)	2,000	
Tax on Lottery (5,00,000 @ 30% under section 115BB)	1,50,000	
Tax on remaining income (16,60,000 – 10,000 – 5,00,000 i.e., 11,50,000)		
[94,000 + 30% of (11,50,000 – 8,00,000)]		1,99,000
Total		3,51,000
Add Education Cess @ 2% of 3,51,000		7,020
Add Secondary and Higher Education Cess @ 1% of 3,51,000		3,510
Tax payable		3,61,170

Case 7

a. Mrs. X, age 36 years, has an income of 13,60,000 in the assessment year 2011-12. How much will be her tax liability.

b. What would be the tax liability if Mrs. X is a non-resident for the assessment year 2011-12?

Solution

a. Tax on 13,60,000 is calculated as follows

Up to 1,90,000	Nil
1,90,001 to 5,00,000	@ 10% i.e., 31,000
5,00,001 to 8,00,000	@ 20% i.e., 60,000
8,00,001 to 13,60,000	@ 30% i.e., 1,68,000

	Total tax	2,59,000
Add	Education cess @ 2%	5,180
Add	SHEC @ 1%	2,590
	Total tax payable	2,66,770

b. Since Mrs. X is a non-resident, the basic exemption limit in her case shall be 1,60,000 instead of 1,90,000.

Tax on 13,60,000 is calculated as follows

Up to 1,60,000	Nil
1,60,001 to 5,00,000	@ 10% i.e., 34,000
5,00,001 to 8,00,000	@ 20% i.e., 60,000
8,00,001 to 13,60,000	@ 30% i.e., 1,68,000

	Total tax	2,62,000
Add	Education cess @ 2%	5,240
Add	SHEC @ 1%	2,620
	Total tax payable	2,69,860

Case 8

a. Mr. X, a senior citizen (age 67 years), has an income of 16,70,000 in the assessment year 2011-12. How much will be his tax liability.

b. What would be the tax liability if Mr. X is a non-resident for the assessment year 2011-12?

Solution

a. Tax on 16,70,000 is calculated as follows

Up to 2,40,000	Nil
2,40,001 to 5,00,000	@ 10% i.e., 26,000
5,00,001 to 8,00,000	@ 20% i.e.,` 60,000
8,00,001 to 16,70,000	@ 30% i.e., 2,61,000

	Total tax	3,47,000
Add	Education cess @ 2%	6,940
Add	SHEC @ 1%	3,470
	Total tax payable	3,57,410

b. Since Mr. X is a non-resident, the basic exemption limit in his case shall be 1,60,000 instead of 1,90,000.

Tax on 16,70,000 is calculated as follows

Up to 1,60,000	Nil
1,60,001 to 5,00,000	@ 10% i.e., 34,000
5,00,001 to 8,00,000	@ 20% i.e., 60,000
8,00,001 to 16,70,000	@ 30% i.e., 2,61,000

	Total tax	3,55,000
Add	Education cess @ 2%	7,100
Add	SHEC @ 1%	3,550
	Total tax payable	3,65,650

Case 9

Mrs. X, a senior citizen (age 67 years), has an income of 20,50,000 in the assessment year 2011-12. How much will be her tax liability.

Solution

Tax on 20,50,000 is calculated as follows

Up to 2,40,000	Nil
2,40,001 to 5,00,000	@ 10% i.e., 26,000
5,00,001 to 8,00,000	@ 20% i.e., 60,000
8,00,001 to 20,50,000	@ 30% i.e., 3,75,000

	Total tax	4,61,000
Add	Education cess @ 2%	9,220
Add	SHEC @ 1%	4,610
	Total tax payable	4,74,830