

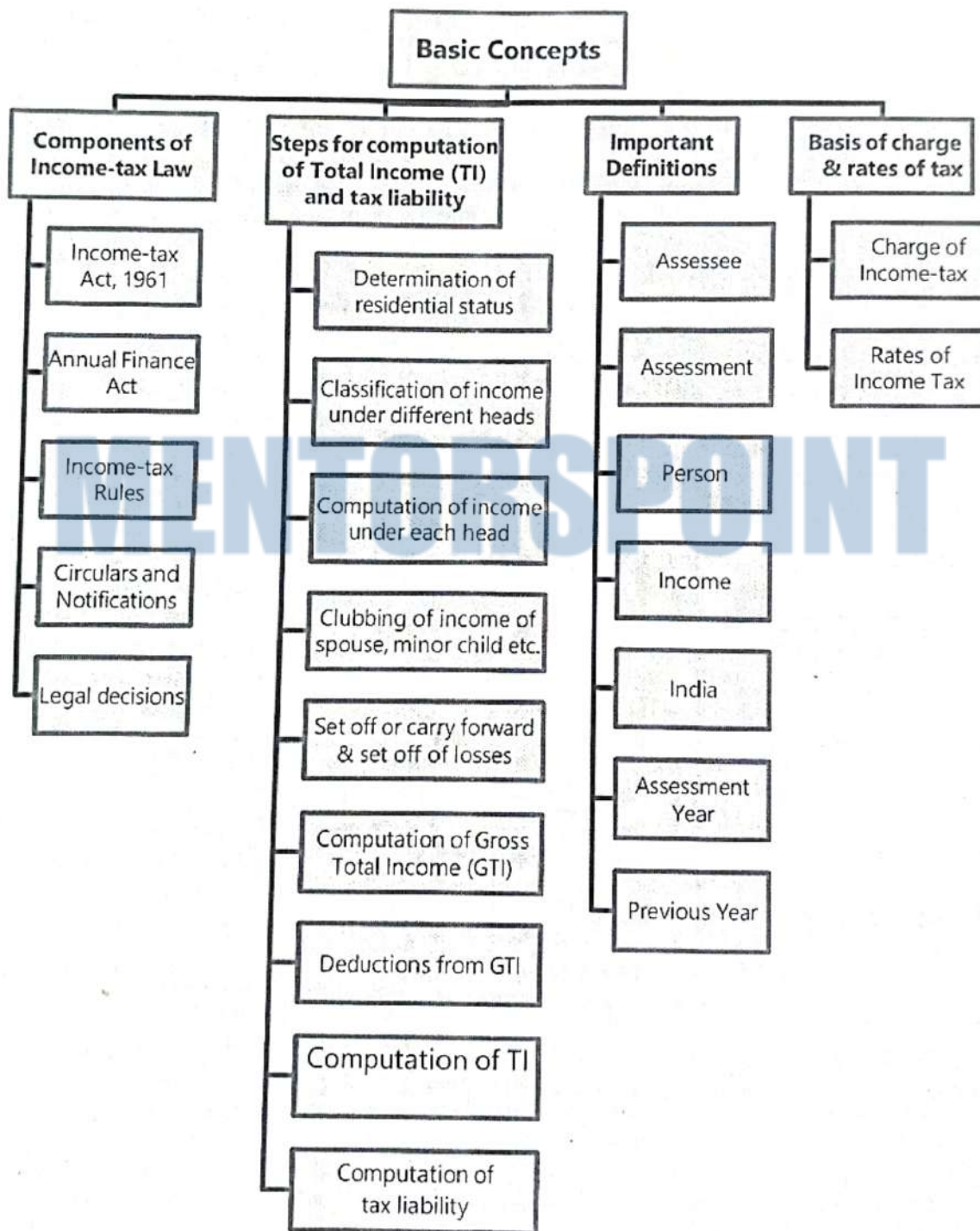
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INCOME TAX UNIT-1 CHP1

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ELEMENTS OF DIRECT TAXES: UNIT 01

OVERVIEW:



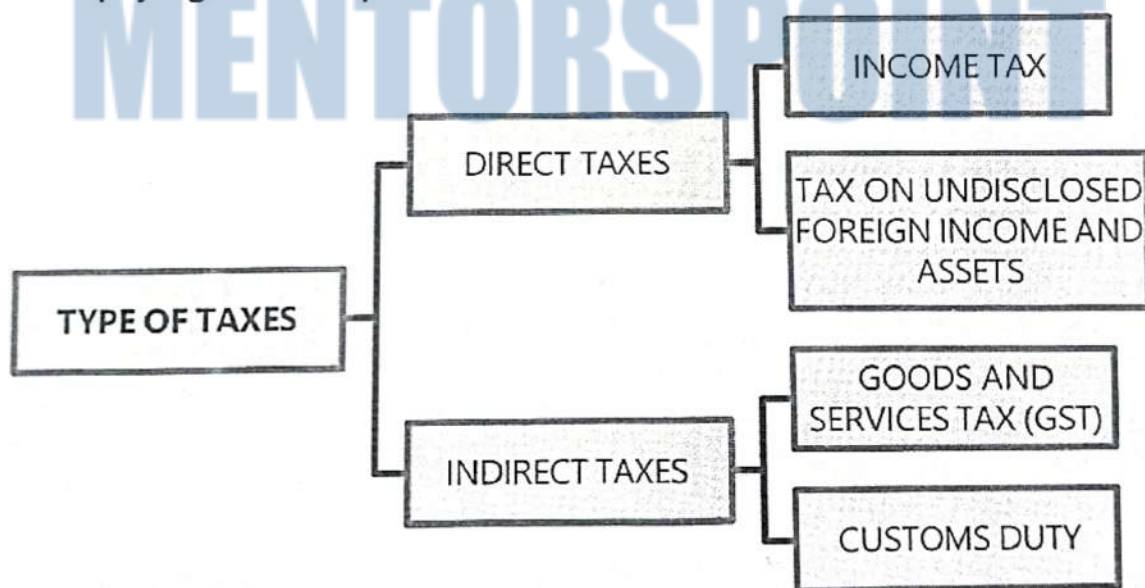
1. INTRODUCTION

1.1 What is the meaning of tax?

Let us begin by understanding the meaning of tax. Taxes are considered to be the "cost of living in a society". Taxes are levied by the Governments to meet the common welfare expenditure of the society. There are two types of taxes - direct taxes and indirect taxes.

Direct Taxes: If tax is levied directly on the income or wealth of a person, then, it is a direct tax. The person who pays the tax to the Government cannot recover it from somebody else i.e. the burden of a direct tax cannot be shifted. e.g. Income- tax.

Indirect Taxes: If tax is levied on the price of a good or service, then, it is an indirect tax e.g. Goods and Services Tax (GST) or Custom Duty. In the case of indirect taxes, the person paying the tax passes on the incidence to another person.



1.2 Why are taxes levied?

The reason for levy of taxes is that they constitute the basic source of revenue to the Government. Revenue so raised is utilized for meeting the expenses of Government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc.

ELEMENTS OF DIRECT TAXES (UNIT -1)

1.3 Power to levy taxes

The Constitution of India, in Article 265 lays down that "No tax shall be levied or collected except by authority of law." Accordingly for levy of any tax, a law needs to be 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.

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.

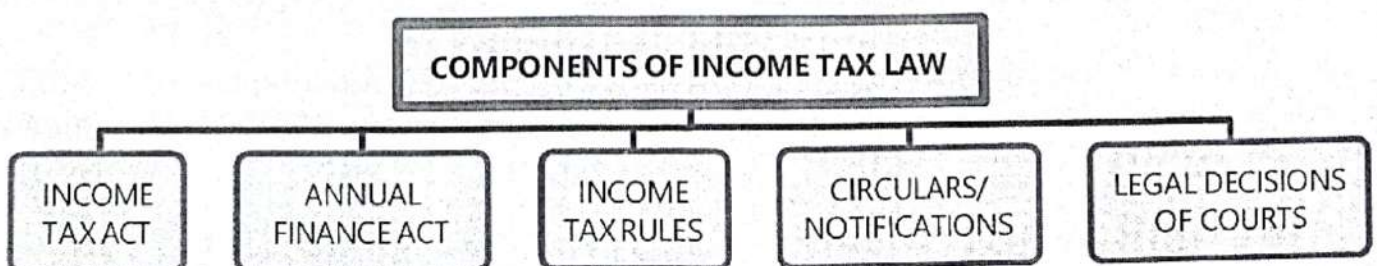
The following are the lists: .

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

1.4 Overview of Income-tax law in India

In this material, we would be introducing the students to the Income-tax law in India. 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 on the next page.

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. 14
 - ❖ A section may have **sub-sections or clauses and sub-clauses.**
 - ❖ A section may also have **Provisos and Explanations.**
- The Income-tax Act, 1961 undergoes change every year with additions and substitutions brought in by the Annual Finance Act passed by Parliament. Sometimes, the Income-tax Act, 1961 is also amended through other legislations like 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. Amendments are made every year to 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 for the current Assessment Year. Accordingly, Part I of the First Schedule to the Finance Act, 2025 specifies the rates of tax for A.Y. 2025-26.
- **Part II** specifies the rates at which tax is deductible at source for the current Financial Year. Accordingly, Part II of the First Schedule to the Finance Act, 2025 specifies the rates at which tax is deductible at source for F.Y. 2025-26
- **Part III** gives the rates for calculating income-tax for deducting tax from income chargeable under the head "Salaries" and computation of advance tax for F.Y. 2025-26.
- **Part IV** gives 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

ELEMENTS OF DIRECT TAXES (UNIT -1)

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.
- Rules also have sub-rules, provisos and *Explanations*. The proviso to a Rule/Sub-rule spells out the exception to the limits, conditions, guidelines, basis of valuation, as the case may be, spelt out in the Rule/Sub-rule. The *Explanation* gives clarification for the purposes of the Rule.
- 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.
- 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. The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications which are binding on both department and assesseees.

Case Laws

Case Laws refer to decision given by courts. 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.

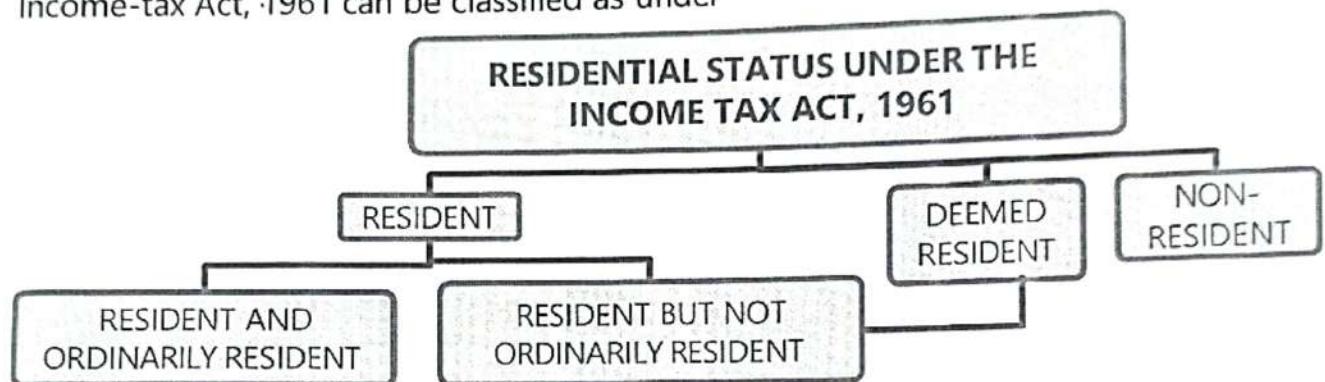
The Supreme Court is the Apex Court of the Country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

Note – Case laws are dealt with at the Final level.

Steps for computation of Total Income (TI) and tax liability

Step 1 – Determination of residential status

The residential status of a person has to be determined to ascertain which income is to be included in computing the total income. The residential status as per the Income-tax Act, 1961 can be classified as under –



In the case of an individual, the duration for which he is present in India determines his residential status. Based on the days spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

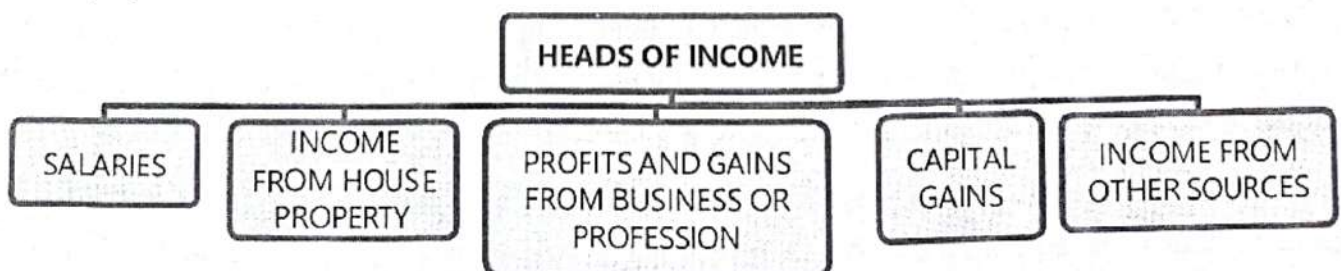
The residential status of a person determines the taxability of the income. For e.g., income earned and received outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

The concept of deemed resident has been discussed in Chapter 2. A deemed resident is always a resident but not ordinarily resident in India.

Step 2 – Classification of income under different heads

A person may earn income from different sources. For example, a salaried person earns income by way of salary. He also gets interest from bank savings account/fixed deposit. Apart from this, if he has invested in shares, he would be getting dividend and when he sells these shares, he may earn profit on such sale. If he owns a residential property which he has let out, he would earn rental income.

Under the Income-tax Act, 1961, for the computation of total income, all income of a taxpayer is classified into five different heads of income. These are shown below–



ELEMENTS OF DIRECT TAXES (UNIT -1)

There is a charging section under each head of income which defines the scope of income chargeable under that head. These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Accordingly, income earned is classified as follows:

1. Salary, pension earned is taxable under the head "**Salaries**".
2. Rental income is taxable under the head "**Income from house property**".
3. Income derived from carrying on any business or profession is taxable under the head "**Profits and gains from business or profession**".
4. Profit from sale of a capital asset (like land) is taxable under the head "**Capital Gains**".
5. The fifth head of income is the residuary head. Income which is chargeable to tax but not taxable under the first four heads will be taxed under the head "**Income from other sources**".

The tax payer has to classify the income earned under the relevant head of income.

Step 3– Computation of income under each head

Income is to be computed in accordance with the provisions governing a particular head of income.

Exemptions: There are certain incomes which are wholly exempt from income-tax e.g. agricultural income. These incomes have to be excluded and will not form part of Total Income.

Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income. *For details, refer to Chapter 3: Incomes which do not form part of Total Income.*

Deductions: There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head. *For details, refer to Chapter 7: Deductions from Gross Total Income.*

Step 4 – Clubbing of income of spouse, minor child etc.

In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e., as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden.

In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability. *For detailed discussion, refer to Chapter 5: Income of other persons included in assessee's total income.*

Step 5 – Set-off or carry forward and set-off of losses

An assessee may have different sources of income under the same head of income. He may have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head "Profits and gains of business or profession".

Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another heads of income, say, profits and gains of business or profession. There are provisions in the Income-tax Act, 1961 for allowing inter-head adjustment in certain cases.

However, there are also restrictions in certain cases, like business loss is not allowed to be set-off against salary income. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act. Generally, brought forward losses under a particular head cannot be set-off against income under another head i.e., brought forward business loss cannot be set-off against income from house property of the current year. *For detailed discussion, refer to Chapter 6: Aggregation of income, set-off and carry forward of losses.*

Step 6 – Computation of Gross Total Income

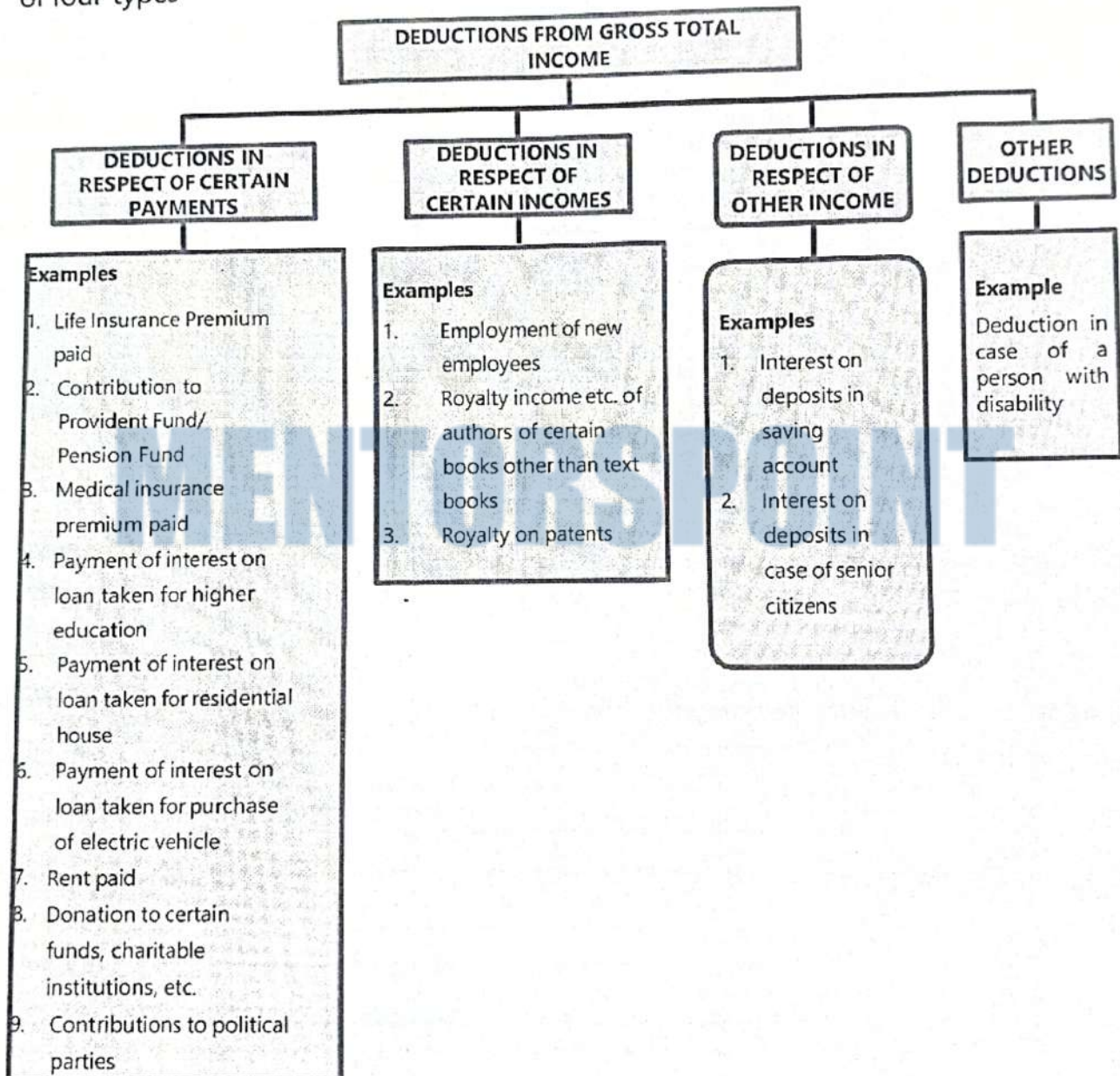
The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving

ELEMENTS OF DIRECT TAXES (UNIT -1)

effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 7 – Deductions from Gross Total Income

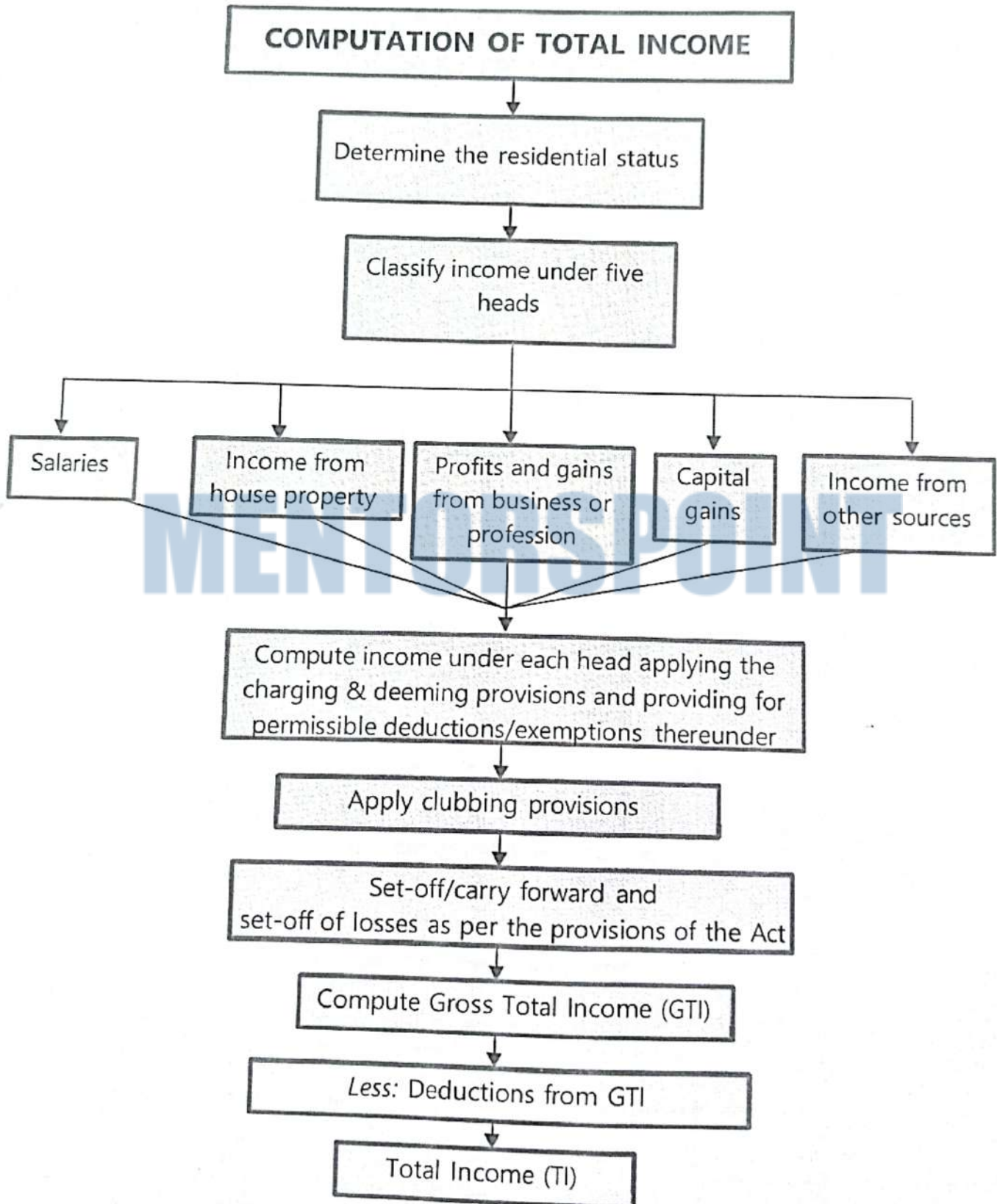
There are deductions prescribed from Gross Total Income. These deductions are of four types –



Step 8 – Total income

The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It should be rounded off to the nearest multiple

of Rs. 10 as per section 288A. The process of computation of total income is shown hereunder –



ELEMENTS OF DIRECT TAXES (UNIT -1)

Step 9 – Application of the rates of tax on the total income

The rates of tax for the different classes of assessee are prescribed by the Annual Finance Act.

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 '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:

2.1 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 –

- (a) **Tax Payable:** Every Person by whom any **tax** or **any other sum** of money **is payable** under this Act whether or not any proceeding under this act has started against him.
- (b) **Proceeding started:** Any Person in respect of whom any **proceeding** under the act has been **taken** whether or not any tax, interest or penalty is payable by him under this act.

Proceeding may be taken for/of -

- Assessment of his income (or loss) sustained by him;
 - Income (or loss) of any other person in respect of whom he is assessable;
 - Refund due to him or to such other person.
 - Assessment of Fringe Benefits.
- (c) **Deemed Assessee:** Sometimes, a person becomes assessable in respect of the income

of some other persons. In such a case, he may be deemed as an assessee.

- (d) **Representative Assessee:** Sometimes a person may be assessed for Income of another person. Such person is known as representative assessee.

Ex: Legal Heir is assessable for the income of deceased person.

- (e) **Assessee in default:** Any person who does not deduct tax at source or after deducting tax, fails to pay deducted tax to the government or who fails to pay advance tax is deemed to be assessee in default u/s [201(1)]/218.

Examples:

1. Income of X (Age: 35 years) is Rs. 2,50,000 for AY 2025-26. He does not file his ROI since his income is below BEL. No action/proceeding is initiated by IT Department. He is not assessee because no tax/any other sum is due from X.
2. Income of Y (Age: 38 years) is Rs. 2,55,000 for AY 2025-26. He does not file his ROI. Since he is supposed to pay tax by filing ROI, (income being more than BEL of Rs. 2,50,000), he is an "assessee".
3. Income of Z (Age: 51 years) is Rs. 75,000 for AY 2022-23. He files his ROI (even if his taxable income is < BEL). Assessment order is passed by AO without any adjustment. Z is an "assessee" since he files his ROI.
4. Income of A for AY 2025-26 is (Rs. 60,000). He files his ROI to carry forward such loss. He is an "assessee".
5. Income of B (Age: 28 years) is < BEL for AY 2025-26. He files his ROI to claim refund of TDS by X Ltd. on interest paid to him. B is an "assessee".
6. Income of C (Age: 30 Years) is < BEL for AY 2025-26. He does not file his ROI. During PY 2024-25, he has paid salary of Rs. 2,90,000 to an employee. Though he was supposed to deduct tax at source, yet due to ignorance of law, no tax is deducted by him. C is an assessee as he has failed to deduct tax at source. [Assessee in Default].

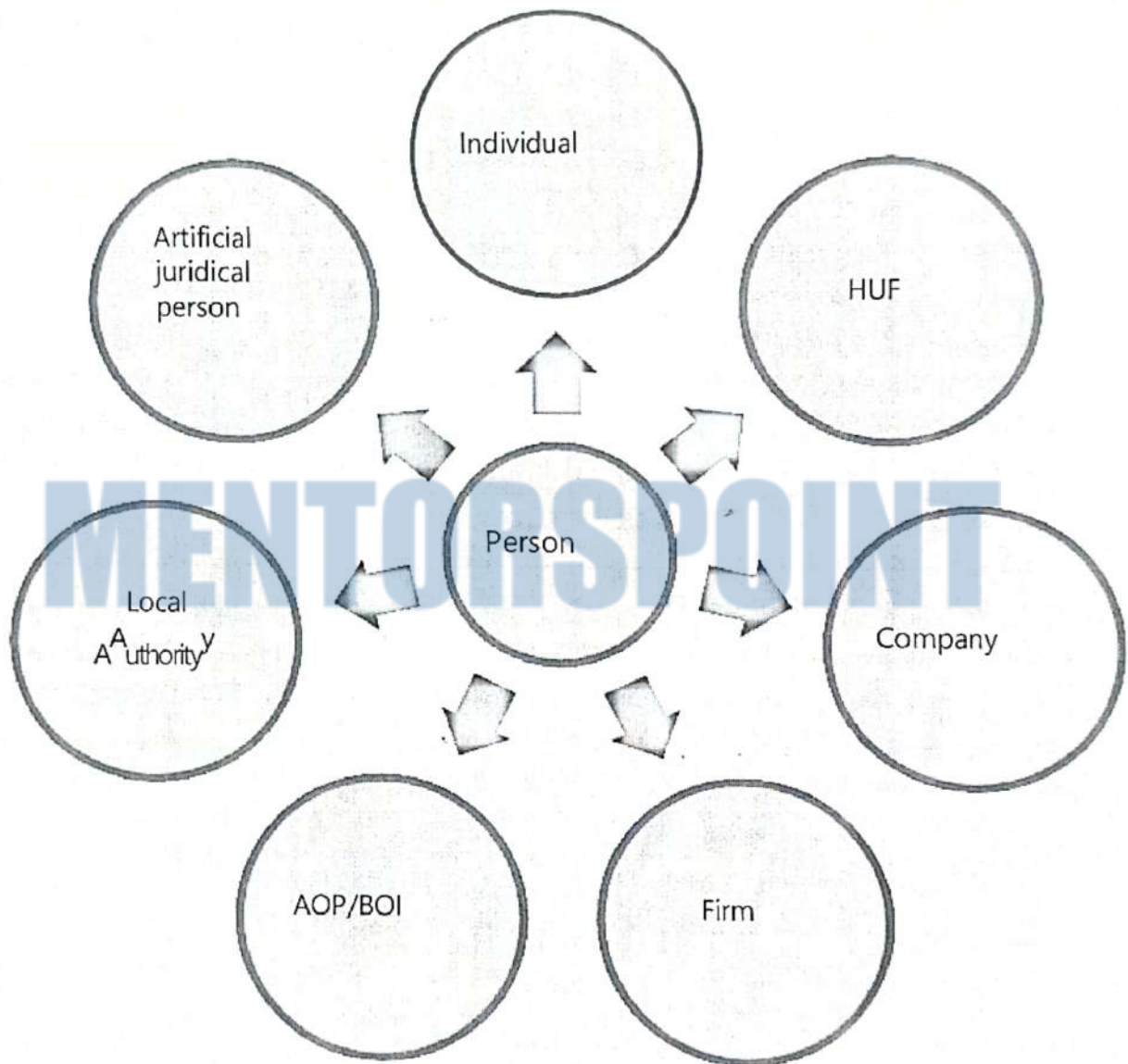
2.2 Assessment [Section 2(8)]

This is the procedure by which the income of an assessee is determined. It may be by way of a normal assessment or by way of reassessment of an income previously assessed. Assessment Procedure will be dealt with in detail at the Final level.

2.3 Person [Section 2(31)]

ELEMENTS OF DIRECT TAXES (UNIT -1)

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'.



We may briefly consider some of the above seven categories of assesses, each of which constitutes 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 made¹ 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. 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.

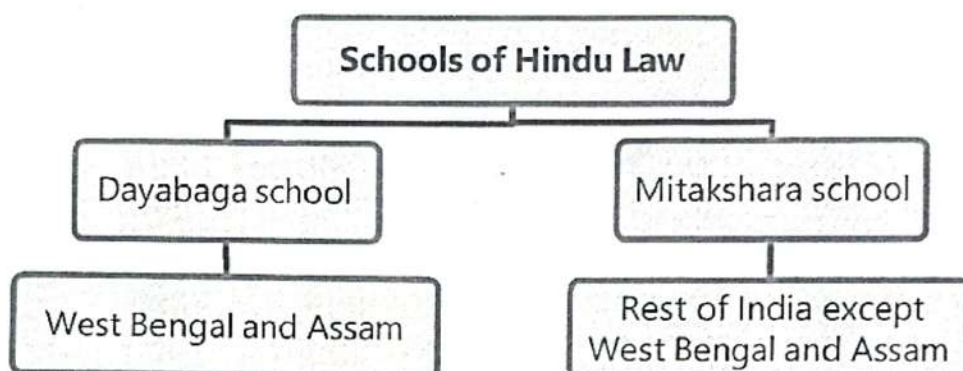
Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co- parceners. A Hindu Coparcenary includes those persons who acquire an interest 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 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 not eligible for such coparcenary rights.

¹ under section 161(1)

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

(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:

- (1) any Indian company as defined in section 2(26); or

- (2) anybody corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
- (3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1961 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
- (4) 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, 1956² and
- (b) The registered office or the principal office of the company should be in India.

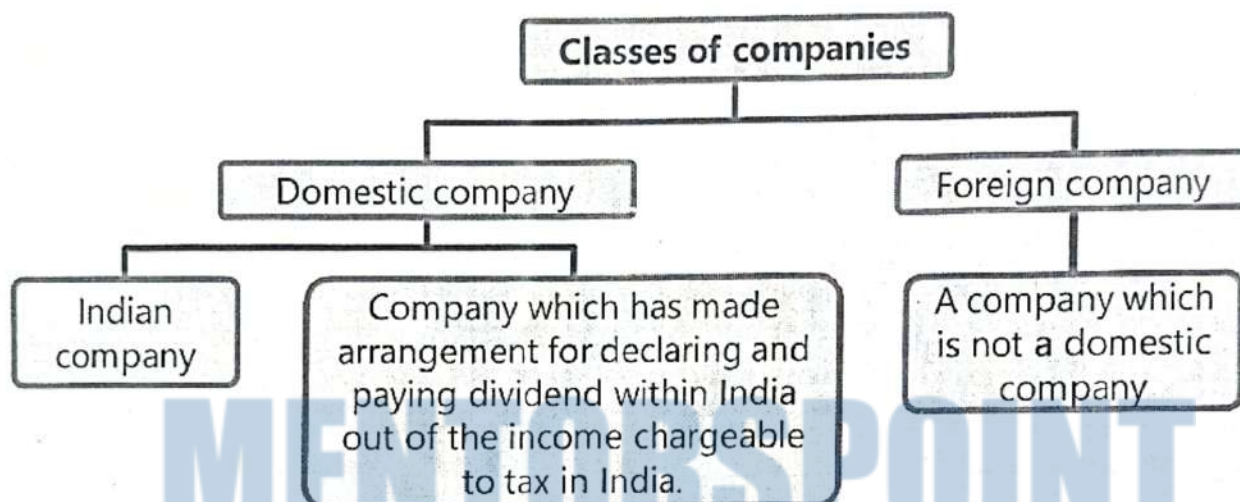
The expression 'Indian Company' also includes the following, provided their registered or principal office is in India:

- (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 sub-clause (v) below];

² Now Companies Act, 2013

- (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, Daman and Diu, and Pondicherry or State of Goa, a company formed and registered under any law for the time being in force in that Union territory or State, respectively.

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

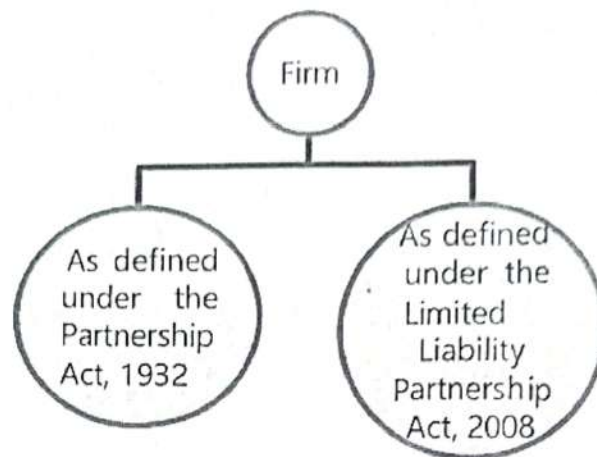


(iv) **Firm [Section 2(23)]**

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 and 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, if 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)

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 was 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 companies, firms, etc., can be the members 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 the case of BOI, such a 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 area is exempt from tax.

(viii) Artificial Juridical Persons

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

2.4 Income [Section 2(24)]

(1) 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:

- (1) Profits and gains;
- (2) Dividends;

- (3) Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by certain research associations or universities and other educational institutions or hospitals and other medical institutions or an electoral trust;
- (4) The value of any perquisite or profit in lieu of salary taxable under section 17(2)/(3);
- (5) 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;
- (6) 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;
- (7) 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;
- (8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee³ or by any beneficiary and any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.
- (9) Deemed profits chargeable to tax under section 41 or section 59;
- (10) Profits and gains of business or profession chargeable to tax under section 28;
- (11) Any capital gains chargeable under section 45;
- (12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society⁴ or any surplus taken to be such profits and gains by virtue of the provisions contained in the First Schedule to the Act;

³ mentioned in section 160(1)(iii)/(iv)

⁴ computed in accordance with Section 44

- (13) The profits and gains of any banking business (including providing credit facilities) carried on by a co-operative society with its members;
- (14) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature 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;
- (15) 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;
- (16) 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 of former 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.
- (17) 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";
- (18) Fair market value of inventory which is converted into, or treated as a capital asset [Section 28(iva)];
- (19) Any consideration received for issue of shares as exceeds the fair market value of the shares [Section 56(2)(viib)];

- (20) 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)];
- (21) Any sum of money or value of property received without consideration or for inadequate consideration by any person [Section 56(2)(x)];
- (22) Any compensation or other payment, due to or received by any person, 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 Unit 5 of Chapter 4: Income from Other Sources]

- (23) 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.

However, subsidy or grant or reimbursement which has been taken into account for determination of the actual cost of the depreciable asset in accordance with *Explanation 10* to section 43(1) shall not be included in the definition of income.

(2) **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 casual receipts 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. [We will discuss in detail in Unit 3 of Chapter 4: Profits and gains of business or profession].

- **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.

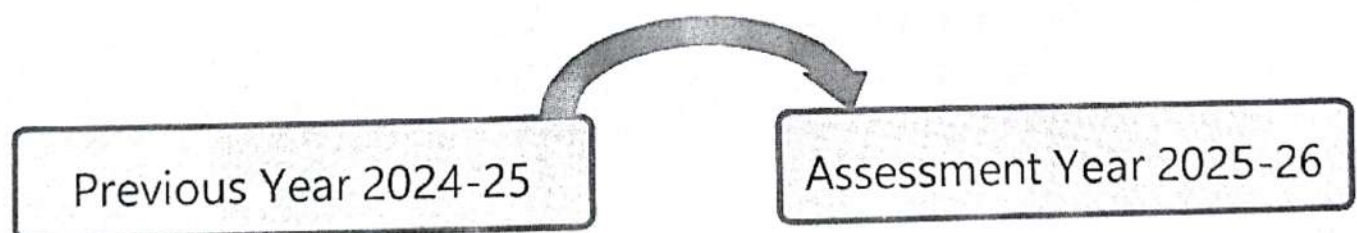
2.5 India [Section 2(25A)]

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.

PREVIOUS YEAR AND ASSESSMENT YEAR



3.1 Assessment year

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 204-25 is taxable in the assessment year 2025-26.

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

3.2 Previous year

The term has been defined under 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:

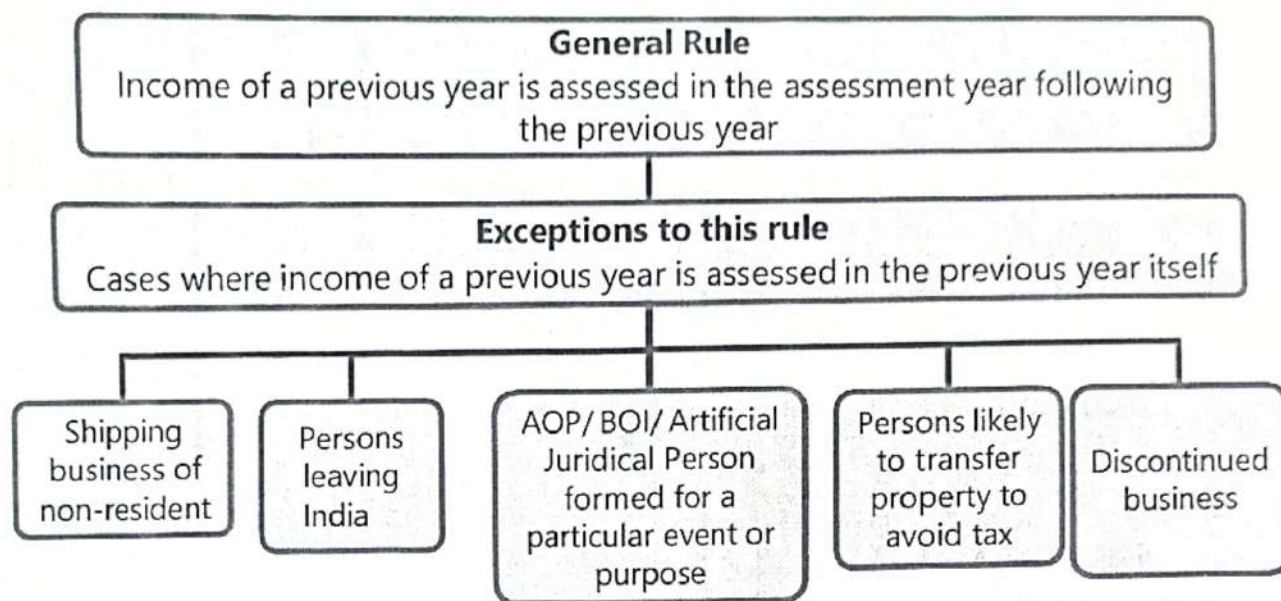
5. A is running a business from 1993 onwards. Determine the previous year for the assessment year 2025-26.

Ans. The previous year will be 1.4.2024 to 31.3.2025.

6. A chartered accountant sets up his profession on 1st July, 2024. Determine the previous year for the assessment year 2025-26.

Ans. The previous year will be from 1.7.2024 to 31.3.2025.

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 2024-25 is assessed during 2025-26. Therefore, 2025-26 is the assessment year for assessment of income of the previous year 2024-25.

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:

(i) **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.

(ii) **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.

(iii) 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 assess the income up to the date of dissolution as income of the relevant assessment year.

(iv) 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.

(v) 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.

4. CHARGE OF INCOME TAX

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

- (i) Tax shall be charged at the rates prescribed for the year by the Annual Finance Act the Income-tax Act, 1961 or both.
- (ii) The charge is on every person specified under section 2(31);
- (iii) Tax is chargeable on the total income earned during the previous year and not the assessment year.
- (iv) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the backbone of the law of income tax insofar as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

4.1 Rates of Tax

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

➤ Tax v/s Duty

TAX	Duty
In the case of tax, a person earns income and then pays tax to the government. E.g., Income tax	In case of duty, a person pays tax, and then he may earn income by selling the product or he may consume it himself. E.g., customs duty

➤ Deduction v/s Exemption

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