

**Paper : Direct Tax I****UNIT 1: BASIC CONCEPTS AND DEFINITION**

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**Assessment Year [Sem 2(9)]**

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Assessment Year means the period of twelve months starting from April 1 of every year and ending on March 31 of the next year. For example, the assessment year 2021-22 which will commence on April 1, 2021, will end on March 31, 2022.

The period of assessment year is fixed by statute. Income of Previous year of an assessee is taxed during the following assessment year at the rates prescribed for such assessment year by the relevant Finance Act.

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**Previous Year [Sec 3]**

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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. In other words, it can be said that income earned during the previous year 2020-21 is taxable in the immediately following assessment year (i.e. 2021-22).

Starting date of any previous year : In general any previous year starts from 1st April of any year. E.g. the current previous year starts from 1st April, 2020 (P.Y. is 2020-21). But there is an exception in case of newly set-up business or profession, like –

Previous Year in the case of newly set-up business or profession: In the case of newly set-up business or profession, the first P.Y. will be the period commencing from the date of setting up of business or profession and ending the immediately following 31st March.

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**Person [Sec 2(31)]**

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The term 'person' includes –

- a) An individual,
- b) A Hindu Undivided Family (HUF),
- c) A company,
- d) A firm,
- e) An Association of Persons (AOP) or  
a Body of Individuals (BOP), whether incorporated or not.
- f) A local authority and
- g) Every artificial juridical person, not falling within any of the  
above mentioned persons.

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**Assessee [Sec 2(7)]**

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Assessee means a person by whom any tax or any other sum of money (i.e. penalty or interest) is payable under the Act.

According to Section 2(7) of the Income Tax Act, 'assessee' means the following persons –

- a) a person by whom any tax or any other sum of money is payable under this Act;
- b) a person in respect of whom any proceeding under the Act has been taken –
  - i) either for the assessment of his own income or assessment of fringe benefits or assessment of  
loss;
  - ii) for the assessment of the income or loss of any other person in respect of which he is  
assessable;
  - iii) for the assessment of the amount of refund due to him or to such other person;
- c) a person who is deemed to be an assessee under any provision of this Act;
- d) a person who is deemed to be an assessee in default under any provision of this Act.

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**Income [Sec 2(24)]**

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The term "Income" includes the following –

- a) Profits and gains,
- b) Dividend,
- c) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an institution / fund,
- d) The value of any perquisite or profit in lieu of salary,
- e) Any special allowances or benefits specially granted to the assessee to meet his expenses wholly, necessarily and exclusively for the performance of his duties,
- f) Any allowance granted to the assessee either to meet his personal expenses at the place where he performs his duties or where he ordinarily resides or to compensate him for the increased cost of living,
- g) The value of any benefit or perquisite obtained from a company by a director or a person who has substantial interest in the company or by relative of a director or such person,
- h) The value of any benefit or perquisite, whether convertible into money or not, obtained by a representative assessee or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary,
- i) Any sum chargeable to tax u/s 28(ii), 28(iii) or 41 or 59,
- j) Any sum chargeable to tax u/s 28(iia), 28(iib), 28(iic) and 28(v) i.e. interest, salary, bonus, commission or remuneration due to or received by a partner of a firm,
- k) The value of any benefit or perquisite taxable u/s 28(iv),
- l) Any capital gains taxable u/s 45,
- m) Insurance profit u/s 44,
- n) Profits and gains of any business or banking carried on by a co-operative society with its members,

- o) Winning from lotteries, crossword puzzles, races including horse races, card games and other games,
- p) Any sum received by the assessee from his employees as contribution to any fund,
- q) Any sum received under a keyman insurance policy,
- r) Any gift received by an individual or a HUF without consideration in certain cases,
- s) Any consideration received for issue of shares as exceeds the fair market value of the shares,
- t) Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement by the Central Govt. or a State Govt. or any authority or body or agency in cash or kind to the assessee.

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### **Important Points relating to Concept of Income**

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- a) Taxability of illegal income: Income tax is levied both on legal and illegal incomes.
- b) Income accrues, arises or is received: Incidence of tax arises on income which is received or deemed to be received by the assessee or on the income which accrues or arises or deemed to accrue or arise to him.
- c) Double taxation of income: Unless otherwise expressly provided in the Act, no income can be taxed twice. As a result of this rule, the income which is taxed at the time of accrual cannot be taxed when the same is received.
- d) Tax free income: If an assessee receives any tax-free income from a person who actually pays tax on such income on behalf of the assessee, income is to be grossed up by aggregating the income actually received by the assessee and the tax paid thereon by other person to determine the actual income from that source.
- e) Regular income or lumpsum receipt: Tax incidence arises both on regular income and income received in lumpsum.

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## Five Heads of Income

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There are five heads of income –

- i) Income from Salary,
- ii) Income from House Property,
- iii) Profit and gains of Business or Profession,
- iv) Capital Gain,
- v) Income from Other Sources.

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## Income Exempt from Tax

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The following incomes are absolutely exempt from tax u/s 10 –

1. Agricultural income u/s 10(1),
2. Receipts by a member from a HUF u/s 10(2),
3. Share of profit from partnership firm u/s 10(2A),
4. Casual and non-recurring receipts – All receipts which are of casual and non-recurring nature, to the extent such receipts do not exceeds Rs.5,000 in aggregate are exempt from tax.,
5. Interest to non-residents u/s 10(4), 10(4B),
6. Leave travel concession to an Indian citizen u/s 10(5),
7. Value of concessional passage to a foreign national employee u/s 10(6)(i),
8. Remuneration received by a foreign diplomat and other foreign nationals u/s 10(6)(ii),
9. Remuneration of a non-resident technician in India u/s 10(6),
10. Salary received by a ship's crew u/s 10(6)(viii),
11. Remuneration of foreign trainee u/s 10(6)(xi),
12. Exemption from tax paid on behalf of foreign companies in respect of certain income u/s 10(6B),
13. Tax paid on behalf of non-resident u/s 10(6B),
14. Foreign allowance u/s 10(7),
15. Gratuity u/s 10(10),
16. Pension and Leave Salary u/s 10(10A), 10(10AA),

17. Retrenchment compensation u/s 10(10B),
18. Compensation received by victims of Bhopal gas lead disaster u/s 10(10BB),
19. Payment from an approved public sector company and other entities at the time of voluntary retirement u/s 10(10C),
20. Tax on perquisite laid by employer u/s 10(10CC),
21. Amount paid on life insurance policies u/s 10(10D),
22. Payment from PF u/s 10(1), 10(12) and from superannuation fund u/s 10(13),
23. House Rent Allowance & Special allowance u/s 10(13A), 10(14),
24. Educational scholarship u/s 10(16),
25. Daily allowance of Members of Parliament u/s 10(17),
26. Income of housing authority u/s 10(20A),
27. Income of scientific research association u/s 10(21),
28. Income of educational institution u/s 10(22),
29. Income of hospitals u/s 10(22A),
30. Income of specified news agency u/s 10(22B),
31. Income of games association u/s 10(23),
32. Income of professional institution u/s 10(23A),
33. Income from Khadi or Village Industries u/s 10(23B),
34. Income of European Economic Community u/s 10(23BBB),
35. Income of SAARC u/s 10(23BBC),
36. Income of certain national funds u/s 10(23C),
37. Income of a mutual fund u/s 10(23D),
38. Income of trade unions u/s 10(24),
39. Income of a member of Scheduled Tribe u/s 10(26),
40. Income of resident of Ladakh u/s 10(26A),
41. Income of a body for promoting interest of SC / ST u/s 10(26B),
42. Income of National Minorities Development and Finance Corporation u/s 10(26BB),
43. Income of marketing authority u/s 10(29),
44. Subsidy from the Tea Board u/s 10(30),
45. Income of minor u/s 10(32),
46. Dividend income and interest from UTI / Mutual Funds u/s 10(33),
47. Dividend from Indian Companies.

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## Capital Vs Revenue Receipts

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Receipts are of two types, viz. Capital Receipts & Revenue Receipts. The distinguish between the two is vital because capital receipts are exempt from tax unless they are expressly taxable [e.g. capital gains are taxable], whereas revenue receipts are taxable unless they are expressly exempt from tax [e.g. income exempt under section 10 to 13A].

A receipt on account of circulating capital is revenue receipt, where as a receipt on account of fixed capital is capital receipt.

Fixed capital is one which the owner keeps in his possession for making profits. It may be in the form of tangible assets [e.g. plant, machinery, building etc.] and in the form of intangible assets [e.g. patent rights, goodwill etc.].

Circulating capital is one which is turned over and in the process of being turned over yields income or loss.

### Instances of capital receipts:

1. Cancellation of pooling agreement,
2. Excess collection by an electricity company,
3. Capital sum payable in installments,
4. Sale of loom hours,
5. License to prospect the land,
6. Partial destruction of assets,
7. Compensation for relinquishing rights,
8. Profit after sale of business,
9. Repatriation from foreign bank account,
10. Compensation for vacating the business premises,
11. Interest on LC for purchasing machine,
12. Los of source of income.

### Instances of revenue receipts:

1. Compensation for loss of a trading asset,
2. Subsidy from Government,
3. Surplus due to reduction in export duty,
4. Lump sum payment in lieu of future rights of royalty,

5. Compensation for loss of commission,
6. Interest under Land acquisition Act,
7. Termination of sole selling agency,
8. Exchange of capital asset for a perpetual annuity,
9. Interest on refund of estate duty,
10. Acquisition of land from dealers and compensation received,
11. Forfeiture of security deposit.

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### **Casual Income**

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Any receipt which is of a casual and non-recurring nature is casual income. It is an income the receipt of which is accidental and without a stipulation. It is in nature of an unexpected windfall.

#### Examples of casual income:

1. Winnings from lottery, crossword puzzles, card games and other games of any sort or form, gambling or betting of any form or nature;
2. Receipts even from habitual betting are non-recurring receipts and assessable as casual income.
3. Prize awarded for coin collection or stamp collection may be a casual income. This income is due to hobby.

#### Casual income does not include:

- Capital gains;
- Receipts arising from business or the exercise of a profession or occupation;
- Receipts by way of addition to remuneration of an employee;
- Voluntary payment received in exercise of an occupation, e.g., tips given in the ordinary way to taxi-drivers.

#### Note:

- Expenses are not deductible from casual incomes.
- Set-off of losses is not permitted against casual income.

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**Agricultural Income [Sem 2(1A)]**


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“Agricultural income” means:

1. Any rent or revenue derived from land which is situated in India and is used for agricultural purposes;
2. Any income derived from land (which is situated in India and is used for agricultural purposes) by agricultural operations. Following are the three instances of this type of agricultural income:
  - a. Any income derived by agriculture from land situated in India and used for agricultural purposes;
  - b. Any income derived by a cultivator or receiver of rent-in-kind of any process ordinarily employed to render the produce raised or received by him to make it fit to be taken to market; or
  - c. Any income derived by such land by the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him in respect of which no process has been performed other than a process of the nature described in (b).
3. Income from farm building

Note: Capital gain arising from the transfer of agricultural land shall not be treated as agricultural income.

Partly Agricultural Incomes

Income	Non-Agricultural Income	Agricultural Income
Growing and Manufacturing tea in India	40%	60%
Sale of Centrifuged Latex or Cenex or Latex Based Crepes	35%	65%
Sale of Coffee Grown and Cured by Seller	25%	75%

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## **CONCEPT OF CAPITAL ASSET [Sec 2(14)]**

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“Capital asset” means –

1. Property of any kind held by an assessee (whether or not connected with his business or profession).
2. Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act.

However, “capital asset” does not include the following -

1. Any stock-in-trade (other than the securities referred to in point 2 above), consumable stores or raw material held for the purpose of business or profession;
2. All personal belongings of the assessee except Jewellery;
3. Agricultural land in India in a rural area;
4. 6½ per cent Gold Bonds, 1977, or 7 per cent Gold Bonds, 1980, or National Defence Gold Bonds, 1980;
5. Special bearer bonds, 1981;
6. Gold Deposit Bonds issued under Gold Deposit Scheme, 1999; and
7. Deposit certificates issued under the Gold Monetisation Scheme, 2015.

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## **Long Term Capital Assets & Long Term Capital Gain**

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“Long-term capital asset” means a capital asset held by an assessee for more than 36 months immediately prior to its date of transfer. However, unlisted shares and immovable property (being land or building or both) will be treated as long-term when these are held by an assessee for more than 24 months (and not 36 months) immediately prior to its transfer. Capital gain arising from the transfer of long-term capital asset is called Long-term capital gain.

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## **Short Term Capital Assets & Short Term Capital Gain**

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“Short term capital asset” means a capital asset held by an assessee for not more than 36 months (or 24 months in case of unlisted shares and immovable property), immediately prior to its date of transfer.

In the following cases, however, such period is taken as 12 months -

1. Equity or preference shares in a company listed on a recognized stock exchange in India.
2. Securities (like debentures, bonds, Government securities, etc.) listed on a recognized stock exchange in India.
3. Units of UTI (whether quoted or not).
4. Unit of an equity oriented mutual fund (whether quoted or not).
5. Zero coupon bonds (whether quoted or not).

In the aforesaid cases, if the asset is held for more than 12 months immediately prior to its date of transfer, then it is "long-term capital asset".

Note: In the case of transfer of a depreciable asset (other than an asset used by a power generating unit eligible for depreciation on straight line basis), capital gain (if any) is taken as short-term capital gain, irrespective of period of holding.

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## **Earned Income & Unearned Income**

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Earned income includes wages, salaries, bonuses, commissions, tips, and net earnings from self-employment. It can also include long-term disability and union strike benefits and, in some cases, payments from certain deferred retirement compensation arrangements.

Unearned income is income from investments and other sources unrelated to employment. Examples of unearned income include interest from savings accounts, bond interest, alimony, and dividends from stock. Unearned income, known as a passive source of income, is income not acquired through work.

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## **Gross Total Income (GTI)**

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Gross total income (GTI) is the sum of incomes computed under the five heads of income i.e. salary, house property, business or profession, capital gain and other sources after applying clubbing provisions and making adjustments of set off and carry forward of losses.

**GTI = Salary Income + House Property Income + Business or Profession Income + Capital Gains + Other Sources Income + Clubbing of Income - Set-off of Losses**

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## Gross Total Income Vs. Total Income

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**Total Income:** The income arrived at after claiming all allowable deductions from Gross Total Income is known as Total Income.

Gross Total Income is the sum of all of the income a person receives during a year, whereas Total income is the amount of income that is subject to taxation, after all allowable deductions or exemptions have been subtracted from the Gross Total Income.

Total income = Gross Total Income – Allowable Deductions

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**"Income tax is charged on income of the previous year". Do you fully agree? If not, what are the exceptions?**

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Relation between A.Y. and P.Y : In general the income of previous year of an assessee is taxed during the following assessment year at the rates prescribed for such assessment year by the relevant Finance Act. But there are some exceptions. These exceptions have been incorporated in order to ensure smooth collection of income tax from these taxpayers who may not be traceable if tax assessment procedure is postponed till the commencement of the normal assessment. These exceptions are –

- i) Shipping business of Non-residents [Sec. 172]: Here 7.5% of amount paid on account of carriage to the non-resident shall be deemed to be the income of the non-resident. For this purpose, the master of the ship shall submit a return of income before the departure of the ship from the Indian port. Unless the tax has been paid, the Collector of Customs shall not grant a port clearance. Income is, thus, taxable in the same year in which freight, fare, etc. is collected and not in the immediately following assessment year.
- ii) Persons living India [Sec. 174]: Section 174 is applicable as follows –
  - a) It appears to the A.O. that an individual may leave India during the current A.Y. or shortly thereafter.
  - b) He has no present intention of returning to India.
  - c) The total income of such individual up to the probable date of his departure from India shall be chargeable to tax in that A.Y.

iii) Bodies formed for short duration [Sec. 174A]: Section 174A is applicable as follows –

- a) There is an AOP or a BOP or an artificial juridical person, formed or established or incorporated for a particular event or purpose.
- b) It appears to the A.O. that the above-mentioned association, body, etc, is likely to be dissolved in the A.Y. in which such association of persons or body of individuals or artificial juridical person was formed or established or incorporated or immediately after such A.Y.
- c) The total income of such association or body or juridical person for the period from the expiry of the P.Y. for that A.Y. up to the date of its dissolution shall be chargeable to tax in that A.Y.

iv) Person likely to transfer property to avoid tax [Sec. 175]: Section 175 is applicable as follows –

- a) It appears to the A.O. during any current A.Y. that a person is likely to charge, sell, transfer, and dispose of any of his asset.
- b) Such asset may be movable or immovable.
- c) The taxpayer is likely to part with the asset with a view to avoiding payment of any liability under the Income Tax Act.
- d) The total income of such person from the first day of the A.Y. to the date when proceeding is started u/s 175 is taxable in that A.Y.

v) Discontinued business [Sec. 176]: Section 176 is applicable as follows –

- a) A business or profession is discontinued in any A.Y.
- b) Income of the business / profession from April 1 of the A.Y. to the date of discontinuation may be taxable in the A.Y. which the business / profession is discontinued.
- c) The above income is taxable at the discretion of the A.O. in the A.Y. in which business is discontinued or it may be taxed in the normal A.Y.
- d) If it is taxable in the assessment year in which the business / profession is discontinued, then it is chargeable to tax at the rate applicable to that A.Y.

Note: It may be noted that in the first 4 exceptions discussed earlier tax shall be charged in the previous year itself (i.e. it is mandatory to the A.O.). But in the case of discontinued business (i.e. 5th exception), it is at the discretion of the A.O.

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**"There are three stages in the imposition of a tax in the context of Indian Income Tax Laws" – Explain.**

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Stages in the imposition of tax: There are three stages in the imposition of tax as described by the Lord Dunedin in Whitney & commissioner of Inland Revenue (1926) as follows –

- i) Declaration of liability: The first stage is to determine what persons in respect of what property are liable. In other words, firstly it is necessary to determine with the relevant provisions of the Act the particular person who is liable to pay tax and the incomes for which the person is liable.
- ii) Assessment: This is the second stage where assessment is made in accordance with the relevant provisions of the Act to determine the exact sum which a person liable has to pay. After the identification of the person liable and the incomes for which such person is liable, it is necessary to assess the total income of such person as well as the amount of tax payable by him.
- iii) Recovery of tax: Lastly comes the method of recovery of tax. The person liable generally discharges his tax liability voluntarily. But if he fails to do so, proper method prescribed by the Act will be applied for the recovery of the same.

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**What do you know about "Income from other sources" as stated in the I.T. Act, 1961?**

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'Income from Other Source' - is the residual head of charge. Any taxable income from whatever source derived which does not specifically fall under any of the other four heads of income (viz. 'Salaries', 'Income from house property', 'Profits and gains of business or profession', or 'Capital gains') shall be assessed and brought to charge u/s 56 under the head 'Income from other sources'.

Types of income chargeable under this head [Sec. 56(2)]: The following income shall be chargeable to income tax under the head 'Income from other sources' –

- i) Dividends.
- ii) Any winning 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.

- iii) Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 or any other fund for the welfare of such employees, if such income is not chargeable to tax under the head 'Profits and Gains of business or profession'.
- iv) Income by way of interest on securities, if the income is not chargeable to tax under the head 'Profits and against of business & profession'.
- v) Income from machinery, plant or furniture belonging to the assessee and let on hire, if such income is not chargeable to tax under the head 'Profits and gains of business or profession'.
- vi) Income by way of letting on hire of machinery, plant or furniture along with the buildings if the letting of building is inseparable from the letting of the said machinery, plant or furniture, if such income is not chargeable to tax under the head 'Profits and gains of business or profession'.
- vii) Income by way of any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policy, if the same is not chargeable under the head 'Profits and gains of business or profession' or under the head 'Salaries'.
- viii) Fees received by a director.
- ix) Agricultural income outside India.
- x) Remuneration received by a teacher for acting as an examiner.
- xi) Honorarium for writing an article.
- xii) Income from royalty, if not chargeable under section 28.
- xiii) Income from sub-letting.
- xiv) Income from undisclosed sources.
- xv) Insurance commission.
- xvi) Gratuity received by a director.
- xvii) Income from mining royalty.
- xviii) Family pension payable on the death of the employee.
- xix) Commission earned by a solicitor for guaranteeing the overdraft of a third party to a bank.
- xx) Interest received by the legal heirs of a money-lender on the loans advanced by him where they do not carry on a money-lending business.
- xxi) Interest on excess advance tax paid.

xxii) Interest on bank deposits and loans.

Mode of computation of Income: The different sources of income chargeable under this head would require separate computation in respect of each source of income. For example, both the income from dividend and income from lottery are chargeable under this head but such incomes are to be assessed separately. Similarly, dividend from shares of two different companies would require separate computation. Expenses relating to one source of income shall not be deducted against income from another source.

Admissible deductions [Sec. 57]: For computation of taxable income under this head, the following deductions are to be made –

a) Deduction for computing income from dividend: Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realizing such dividend or interest on behalf of the assessee shall be deducted.

b) Deduction in respect of rental income from machinery, plant or furniture let on hire: The following deductions shall be deducted from such rental income –

i) Current repairs and insurance premium paid in respect of the premises.

ii) Amount paid in respect of repairs and insurance of machinery, plant and furniture.

iii) Depreciation of buildings, machinery, plant or furniture owned by the assessee.

c) Deduction in respect of income by way of family pension: One third of such pension or Rs.15,000, whichever is less, will be allowed as deduction.

d) Residuary provision for deduction: Any other expenditure of revenue nature laid out or expended wholly and exclusively for the purpose of making or earning such income shall be allowed as deduction. For example –

i) Interest paid on borrowings for investment in shares is deductible from dividend income from such shares.

ii) Expenses incurred by a director to defend his position as a director are deductible from the income of the director.

iii) Interest on borrowings is deductible against income earned by utilizing such borrowings.

iv) Expenses for amenities provided to the tenant are deductible against the composite rent received from the tenant chargeable under the head 'Income from other sources'.

v) Railway fare incurred for the purpose of earning income is deductible.

Expenses not deductible u/s 57:

- i) Interest paid on moneys borrowed for personal purposes.
- ii) Water rate or road cess is not deductible against income from royalties.
- iii) Interest paid on loan taken for payment of income tax or wealth tax.
- iv) Municipal tax on property.
- v) Interest refunded to the bank for premature termination of fixed deposit.