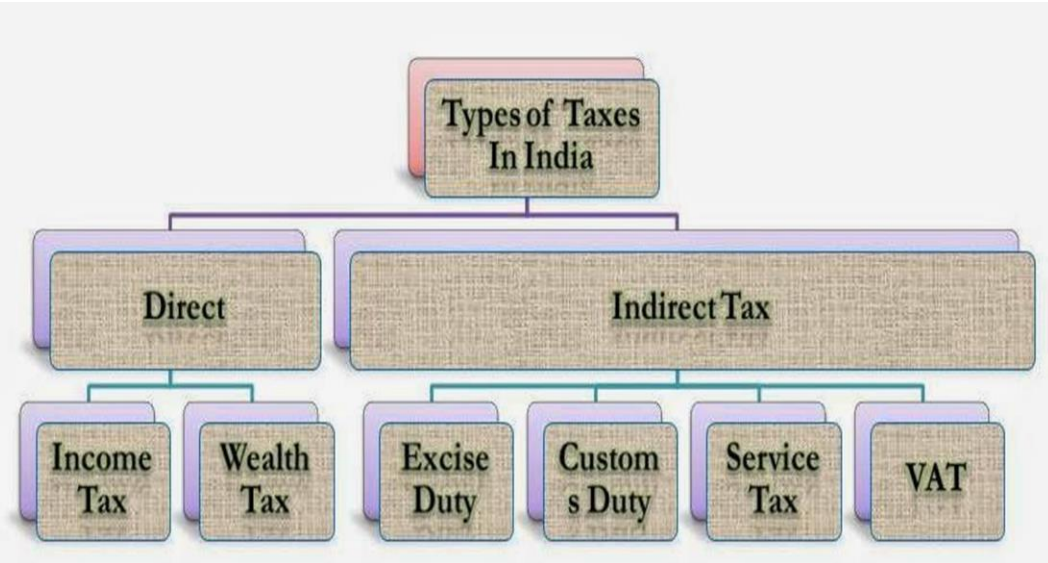
Unit 1 – Definitions under Income Tax Act, 1961

Introduction:

The most important source of revenue of the Government is taxes. The act of levying taxes is called taxation. A tax is compulsory charge or fees imposed by the Government on individuals or corporations. The persons who are taxed have to pay the tax irrespective of any corresponding return from the Goods and Services by the Government. The taxes may be imposed on income and wealth of persons or corporations and the rate may vary.

There are two types of taxes:-Direct taxes and Indirect taxes.

1. Direct Tax:- If tax is levied directly on the income or wealth of a person, than it is a direct tax. e.g. income tax
2. Indirect Tax:- If tax is levied on the price of a goods or service, than it is called an indirect tax. e.g. Service tax, VAT. In case of indirect taxes, the person paying the taxes passes on the incidence to another person.



Income Tax:

Income tax is tax on income. Income tax is a very important direct tax. It is an important and most significant source of revenue of the Government. The government needs money to maintain law and order in the country; safeguard the security of the country from foreign powers and promote the welfare of the people. It is the foremost duty of the government to bring out such welfare and development programmes which will bridge the gap between the rich and the poor. For this purpose, mobilization of funds from various sources is required. These sources may be direct or indirect.

Objectives of Income Tax:

The objectives of income tax may be –

1. To reduce inequalities in the distribution of income and wealth.
2. To bring out equity between classes of tax payers.
3. To accelerate the economic growth and development of country.
4. To make available of funds for economic development.
5. To encourage investment in new capital goods.
6. To channelize investment into those sectors which contribute the most economic growth.

- **SCHEME OF ACT:-**

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. This Act came into force on **1st April,1962**. The Act is divided into **23 chapters** covering sections 1 to 298. Besides it has **14 schedules** also. Each of these **298 sections** is divided into: sub-sections, clauses, sub-clauses and might be have a 'provisons' and 'Explanation.' The amendments are effected through the finance bill introduced in the parliament by the Finance Minister. Once finance bill is approved than it becomes the Finance Act. These undergo change every year with additions and deletions brought about by the Finance Act passed by Parliament.

- Sec. 1 states that this act may be called the **Income Tax Act, 1961; and it extends to the whole of India**. Thus the act is applicable to persons residing in India as well as to the income arising in India. "India", for the above purpose would cover the territory of India; territorial waters, sea bed and sub-soil; continental shelf; exclusive economic zone (EEZ); maritime zone and airspace.

IMPORTANT DEFINITIONS

Under Sec. 2 and 3 of the Income Tax Act, 1961, definitions of important terms are given..

- **INCOME [Sec.2(24)]:-**

Income tax is a tax on income. Thus under section 2(24) Income includes:-

1) Profits and Gains,
2) Dividend,
3) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes, Research association, Universities and other educational institutions etc.
4) The value of any perquisite or profit in lieu of salary taxable under sec.17.
5) Any special allowance or benefit received by an employee to meet official expenses.
6) The value of any benefits or perquisite received from employer or company by director or a person having substantial interest in company.
7) Profits and gains of business or profession chargeable to tax under section 28.e.g.recovery of bad-debts.
8) Any capital gains chargeable under section 45.
9) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a co-operative society, computed in accordance with Section 44.
10) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature.
11) 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.)
12) Any sum received by the employer from his employees salaries as contributions to any Provident Fund or Superannuation Fund.
13) The profit and gains of any business banking (including providing credit facilities) carried on by a co-operative society with its members.
14) Any sum exceeding ₹ 50,000 received without consideration (i.e. gift) by an individual or an HUF, taxable u/s 56(2)(vi).

To understand the concept of income in a better way, one should keep in mind the following important points:-

a. Normally, income is expected to be a periodical monetary return of regular nature from a definite source.
b. Income may be received in cash or kind which will be treated as different forms of income.
c. Income from illegal activities such as smuggling, black marketing too is taxable.
d. Income may be taken either on accrual basis or on receipt basis depending upon the facts and nature of income.

- **e.** Personal Gifts, such as gift at the time of marriage is not income chargeable to tax in the hands of the person who receive it. However, gift received by professionals in appreciation of their professional skill is considered as an income.
- **f.** The term income also includes loss. Loss is to be taken as minus income.
- **g.** Income should be real and not fictional (imaginary).
- **h.** Pin money received by wife for her personal expenses is not treated as income.
- **i.** Awards received by a professional sportsman is an income. However, the award received by him in the nature of gift or personal testimonial is not liable to tax.

➢ **PERSON [Sec.2(31)]:-**

The definition of 'assessee' leads to the definition of 'person'. The term 'person' is important to charge of income tax is on every 'Person'. The term 'Person' includes the following:-

- **a.** An individual,
- **b.** A Hindu undivided family,
- **c.** A Company,
- **d.** A Firm,
- **e.** An association of persons or body of individuals, whether incorporated or not,
- **f.** A Local authority, and
- **g.** Every artificial juridical person not falling in the categories mentioned above.

a. Individual:-

The term 'individual' means a human being. It includes a male, female, even a minor or a lunatic.

b. Hindu undivided family:-A Hindu undivided family is a unit of assessment under the Income Tax Act. It consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.

c. Company:-

The term company is well defined under Sec.2 (17) to mean the following:-

1. An Indian company ;
2. Anybody corporate incorporated under the laws of foreign country; or
3. Any institution, association or body which is assessed or was assessable as a company for assessment year 1970-71 or before ;
4. Any institution, association or body whether incorporated or not and whether Indian or Non Indian which is declared by general or special order of the Central Board of Direct Taxes (CBDT) to be a company.

d. Firm:-

The terms 'Firm', 'Partner' and 'Partnership' have the same meaning as assigned to them in the Indian Partnership Act. The persons who have entered into partnership with one another are called individually 'Partners' and collectively a 'firm'.

e. Association of persons (AOP):-

AOP means two or more persons who join for a common purpose with a view to earn income. They do not in law constitute a partnership. Following are the examples of associations of persons:-

i) Firm attempted to be formed but where due to legal defect in partnership deed, partnership is not valid (ii) Joint venture (iii) A Trust (iv) A club (v) a Co- op. Society.

f. Body of Individuals (BOI):-

BOI means a group (team) of individuals who carry some with the objective of earning some income. An association of persons may consist of non-individuals but a Body of individual consists only of "individuals" or human being and cannot have any other person (e.g. a firm, a HUF etc.) as a member.

g. **Local Authority:-**
The term means a municipality, district board, a port commissioner or other authority legally entitled to or entrusted by the government with the control or management of a municipal or local fund.

h. **Artificial juridical person:-**
Any entity having a separate legal existence, not covered under any of the above categories, falls under this category, e.g. a Deity, an IDOL, A corporation established under a special act (e.g. Life Insurance Corporation), a University, a Bar Council etc.

➢ **ASSESSEE [Sec.2(7)]:-**

"Any person who is liable to pay any tax or any other sum under the Income Tax Act, 1961."

❖ Assessee means a person who liable to pay tax or interest or penalty for late payment of tax.
❖ Assessee includes:-

1) Every person in respect of whom any proceeding has been taken for the assessment of
  - **a)** His income or of the income of any other person.
  - **b)** Loss sustained by him or other person
  - **c)** Refund due to him or other person

2) Every person who is deemed to be an assessee under the act e.g. a representative assesse.
3) Every person who is deemed to be an assessee in default under the Act. e.g. an employer who fails to deduct tax at source from the salaries paid to the employees)

➢ **ASSESSMENT YEAR [Sec.2(9)]**

The term has been defined under section 2(9). This means

"A period of 12 months commencing on 1st April every year".

The year in which tax is paid is called the assessment year.
The current assessment year 2022-23, relating to previous year 2021-22

➢ **PREVIOUS YEAR [Sec.3]:-**

Previous year means

"The financial year immediately preceding the Assessment Year."

The year in respect of the income on which tax is levied is called previous year.
The present Previous Year 2021-22 and its Assessment Year is 2022-23.

➢ **ASSESSEMENT [Sec.2(8)]:-**

Section 2(8) defines assessment as

"Assessment includes Reassessment."

Normally, an assessment means the process of determining and computing the amount of income and the tax due of a person.
An "assessment" thus fixes the liability of the "assessee" to pay the "assessed" tax on the "assessed" income for the "assessment" year.
This is done in two stages:-
1. Assessing the taxable Income or Loss, if any, and
2. Finding out the tax payable by the assessee or refundable to the assessee.
The definition intends to include reassessment of an income previously assessed.

- **<u>GROSS TOTAL INCOME (SEC. 14):</u>**

  Income of a person is computed under the following five heads –

  1. Salaries.
  2. Income from house property.
  3. Profits and gains of business or profession.
  4. Capital gains.
  5. Income from other sources.

  The aggregate income under these heads is termed as 'Gross Total Income'.
  In other words, gross total income means total income derived from the above five sources before making any deduction under section 80C to 80U.

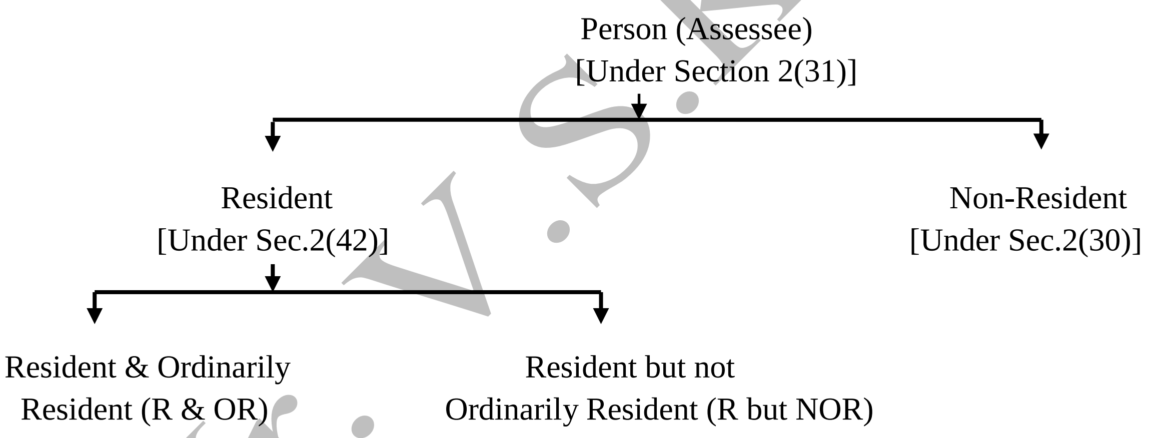
- **<u>TOTAL INCOME:</u>**

  Total income means the amount of income left after making the deductions under sections 80C to 80U from the gross total income. The amount so arrived is rounded off to the nearest multiple of ten rupees.

- **RESIDENTAL STATUS [SECTION 6]:-**

The incidence of tax on assessee depends upon his residential status under the Act. The taxability of a particular receipt would thus depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee's residential status.For the purpose of income tax, taxpayers are classified into three broad categories on the basis of their residential status. Viz.

1. Resident and ordinarily resident
2. Resident but not ordinarily resident
3. Non-Resident



It should be noted that:-

1. The residential status of an assessee must be ascertained with reference to each previous year. Residential status of the assessee depends on the stay of the assessee in India during the previous year.
2. It is depend upon the number of days a person is in India during the concerned previous year.
3. Residential status is different from citizenship. An individual may be the citizen of Britain, but a resident in India. Similarly, an Indian citizen may be a non-resident in India.
4. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice-versa.
5. As per the income tax law residential status of the assessee decides the chargeability of Foreign income.

- **RESIDENT INDIVIDUAL [SECTION 6(1)]:-**

An individual will be treated as resident in India in any previous year, if he fulfils any one of the following two BASIC conditions:-

1. He has been in India during that previous year, for a period of 182 days or more; OR
2. (a) he is in India for 365 days or more during the 4 years immediately preceding the previous year; AND

   (b) he is in India during the previous year for a period of 60 days or more.

If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Note: As per explanation to Section 6(1) of the Income Tax Act, The following categories of individuals will be treated as residents only if the period of their stay during the relevant previous year amounts to 182 days. In other words, second basic condition given above doesn't apply in both the categories, while deciding residential status.

a. Indian citizens, who leave India in any previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or

b. Indian citizen or person of Indian origin engaged outside India in an employment or a business or profession or in any other vocation, who comes on a visit to India in any previous year.

- **RESIDENT AND ORDINARILY RESIDENT INDIVIDUAL [SECTION6(6)]:-**

An individual who is a resident in India is termed as an 'Ordinarily Resident' if he follows both of the additional following conditions:

1. He has been a resident in India for at least 2 years out of 10 years immediately preceding the previous year, and

2. He has been in India for a period of 730 days or more during 7 years immediately preceding the previous year.

- **RESIDENT BUT NOT ORDINARILY RESIDENT INDIVIDUAL:**

An individual who is a resident in India, but who fails to satisfy any one or both the additional conditions given above, is called a 'Resident', but Not Ordinary Resident.

- **NON-RESIDENT INDIVIDUAL [SECTION 2 (30)]:-**

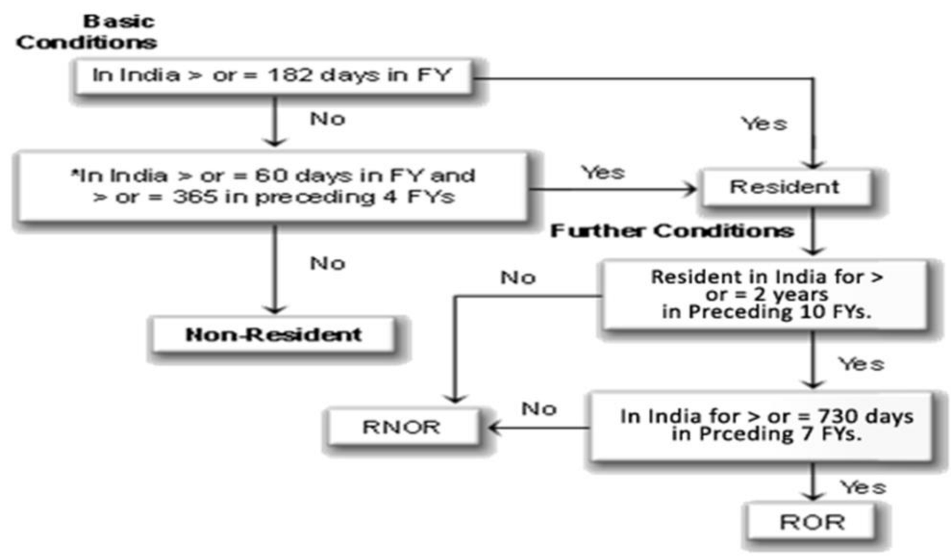
"Non-resident" means a person who is not resident. An individual is non-resident in India if he does not satisfy any of the two basic conditions as stated Under Section 6(1).

- **COUNTING OF DAYS:-**

While counting the number of days in all the cases above, the following points should be kept in mind-

1) The stay need not be at the same place.
2) The stay need not be continuous.
3) Where the stay is for part of a day, physical presence should be calculated on hourly basis. Stay of 24 hours wilI be counted as stay for a day. Where such hour-wise information is not available, both the days of entry and exit will be counted as full days in India.
4) A stay in a boat anchored in the territorial waters of India is treated as stay in India.
5) For February, count 29 days in a leap year (e.g. 2020).

➢ STEPS TO ASCERTAIN RESIDENTIAL STATUS:-



➢ SCOPE OF TOTAL INCOME [SECTION.5]:-

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The term "Scope of total income" means which items of income are included and which items are excluded while computing taxable income.

Nature of Income	Resident & Ordinary Resident	Resident But Not Ordinary Resident	Non Resident
1. Income received in India:			
Earned in India	Taxable	Taxable	Taxable
Earned in abroad	Taxable	Taxable	Taxable
2. Income earned (i.e. accrued in India)			
Received in India	Taxable	Taxable	Taxable
Received in abroad	Taxable	Taxable	Taxable
3. Income "deemed" to be received in India	Taxable	Taxable	Taxable
4. Income "deemed" to be accrue or arise in India	Taxable	Taxable	Taxable
5. Income "earned" abroad and "received" abroad			
a. Other than from business or profession	Taxable	Non Taxable	Non Taxable
b. From business controlled from India	Taxable	Taxable	Non Taxable
c. From profession set up in India	Taxable	Taxable	Non Taxable
d. From business controlled from abroad	Taxable	Non Taxable	Non Taxable
e. From profession set up abroad	Taxable	Non Taxable	Non Taxable
6. Past untaxed profits brought or received in India in the previous year.	Non Taxable	Non Taxable	Non Taxable
7. Exempt Income (Dividend from Indian Co. , UTI, Mutual fund, Income from Agriculture land in India, Gift received from relatives).	Non Taxable	Non Taxable	Non Taxable

- **EXEMPTIONS [SEC.10]:-**

1. **GRATUITY [S.10(10)]:-**

Gratuity is a lump-sum amount paid to an employee, on the basis of the duration of his employment, on termination of service due to retirement, resignation, death etc. It is exempt from tax, either fully or partly, depending on the type of employee receiving it Gratuity received while still in service is not exempt; it is taxable as salary.

Case 1: Govt. Employees: Any death cum retirement Gratuity received by the Govt. employee is **fully exempt from tax.**

Case 2: Employees covered by Payment of Gratuity Act, 1972, To the **extent of least** of the following Amounts:-

a. Gratuity actually received;

b. ₹ 20, 00,000 (Notified limit);

c. Salary last drawn x $\frac{15 \text{ days}}{26 \text{ days}}$ x No. of completed year

Salary = Basic Salary + Dearness Allowance

Note:- **1.** Basically gratuity is equal to 15 days salary (based on last salary drawn), for every completed year of service (part of year exceeding 6 months is treated as one year).

2. 26 days refer to the working days per month.

Case 3: Gratuity to any other Employee:-

To the **extent of the least** of the following amounts is exempt from tax –

a. Gratuity actually received during previous year;

b. ₹ 20,00,000 (Notified limit);

c. Half months salary for each completed year of service, on the basis of average salary for the 10 months immediately preceding the month of retirement.

Salary = Basic Salary + Dearness allowance (eligible for retirement benefits) + Commission

Note:- " Completed year of service " means only completed years ; part of year, even if more than 6 months is to be ignored and not rounded off.

2. **PENSION [Section 10(10A)]:-**

PENSION is a periodical (Monthly) payment made by the employer to his employee after his retirement. This is taxable under the head, Salaries. Pension can be divided in two groups:-

a. Uncommuted Pension :- Means periodical payments.

b. Commuted Pension :- means receipt of any lump-sum amount in lieu of periodical pension.

Exemption of Pension u/s. 10(10A)

- Uncommuted Pension
  - Govt. Employees
    - No exemption
  - Others
    - No exemption
  - Uncommuted Pension is taxable under the Head "Income from Salary"
- Commuted Pension
  - Govt. Employees
    - Exemption = Actual Amt. received
  - Others
    - If Gratuity is received
      - Exemption = $\frac{1}{3} \times \frac{\text{Amt Received}}{\text{Commutation \%}}$
    - If Gratuity is not Received
      - Exemption = $\frac{1}{2} \times \frac{\text{Amt Received}}{\text{Commutation \%}}$