

Detailed concept notes on CA-Final
Paper-4 : Direct Tax Laws

Direct Tax Laws

Paper-4

Part-A : Income Tax Act, 1961
Part-B : International Taxation

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CH-1 : Basic Concepts

Tax

- ↔ A compulsory payment made by a person under a law
- ↔ Payment made to government
 - Government has the authority to levy tax
- ↔ Purpose to levy tax
 - Fund various public expenditures
 - Fulfill developmental needs like infrastructure, education, military etc.,

Powers to levy tax

- ↔ Government has authority to levy tax given under the Article 265 of The Constitution of India
- ↔ Article 265 : No tax to levied without authority of law
- ↔ Authority to make laws : VIIIth Schedule of Article 246
 - List-I : Union list : Central Government has authority to make laws
 - Total entries : 97 entries
 - List-II : State list : State Government has authority to make laws
 - Total entries : 66 entries
 - List-III : Concurrent list : Both Central & State Government has authority to make laws
 - Total entries :
- ↔ Power to levy tax on income
 - Entry No. 82 of List-I : Tax on income other than agricultural income
 - Entry No. 46 of List-II : Tax on agricultural income

Taxation in India

- ↔ Broadly classified into :-
 - Direct Tax Laws
 - Indirect Tax Laws

Direct Tax Laws

- ↔ Imposed directly on the income of the taxpayer
- ↔ Paid to government directly by the person on whom tax burden is imposed
 - Burden of tax cannot be shifted to any other person by taxpayer
- ↔ Progressive in nature
 - More income - More tax
- ↔ Ex. : Income tax, Wealth tax etc.,

Indirect Tax Laws

- ↔ Imposed directly on goods & services
- ↔ Incidence of tax shifted from supplier to end consumer
 - Burden of tax shall be borne by the ultimate consumer
 - i.e., person who consumes the goods [or] services
- ↔ Regressive in nature
 - Equal impact of tax irrespective of income
- ↔ Ex. : GST, Customs etc.,

Income Tax Law

- ↔ Components of Income Tax Law
 - Income tax Act, 1961
 - Income tax rules, 1962
 - Notifications & Circulars
 - Judicial decisions
 - Finance Act

Income Tax Act, 1961

- ↔ Income tax levy shall be governed by the Income Tax Act, 1961
- ↔ Undergoes changes every year by the Annual Finance act passed by parliament
- ↔ Contains sections

Income Tax Rules, 1962

↔ Notifies the procedures, rates, forms etc., that shall be applied in implementation of the Income Tax Act, 1961

Notification

↔ Enables the government to

→ Give effect to provisions of the act during the year

→ Unless waiting for them to be introduced till the next budget

↔ Binds both assessee & department i.e., officers of the department

Circulars

↔ Clarifies the ambiguity between the officers of the income tax department in interpretation of the act

↔ Binds only on the department i.e., officers of the department

→ Assessee may make advantage of the circulars

Judicial Decisions

↔ Decision given by court on any issue during the implementation of the law

↔ Supreme court being apex court no decision given shall be overridden

Finance Act

↔ Changes in Income Tax Act shall be made by passing finance act

→ Finance Act : Finance bill [+] passed in both houses of parliament [+] Assent of president

↔ Generally, finance act shall be introduced in

→ Non-Election year : February

→ Election year

→ Pre-election budget : February [Not detailed]

→ Post election budget : July [Detailed]

↔ First schedule of Finance Act contains four parts that specify the rates of tax

→ Part-I : Rates of tax applicable to current assessment year

→ Part-II : Rates of tax deductible at source for current financial year

→ Part-III : Rates for calculating income tax for deducting tax & computation of advance tax for CFY

→ Part-IV : Rules for computing net agricultural income

Section-1 : Title, Extent and Commencement of the Act

↔ Title : Income Tax Act, 1961

↔ Extent : Extends to whole of India, including Jammu & Kashmir [Article 370]

↔ Commencement : Commences from 01-04-1962

Section-2 : Definitions**Sec. 2[7] : Assessee**

↔ Any person by whom any tax [or] any other sum of money is payable under this act

↔ Includes

→ Any proceeding under this act which has been taken for the

→ Assessment of income

→ Determination of the loss

→ Determination of the refund in respect of assessee

→ Includes of any other person in respect of which he is assessable i.e., representative

→ Deemed assessee

→ Assessee in default

Sec. 2[8] : Assessment

↔ Procedure by which the income of an assessee is determined by the assessing officer.

↔ Includes reassessment

Sec. 2[9] : Assessment year

↔ Year in which the income in the previous year is taxable

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

Sec. 2[31] : Person

↔ Includes

- Individual, HUF, Association of Person [AOP] [or] Body of Individuals [BOI]
- Company
- Firm including LLP, Local Authority, Artificial judicial person, trust etc.,

Section-3 : Previous year

↔ Year in which the income is earned

↔ Period of previous year

- Generally : Period of 12 months commencing from 01st April
- Exemption : Period commencing from the date of business setup etc.,
 - Scenario : Commencement of business, new income being part of assessee.

Exemption : Income of previous year assessed in previous year itself

↔ Exemption situations covered

- U/Sec. 172 : Shipping business of non-resident
- U/Sec. 174 : Leaving India for permanent purpose
- U/Sec. 17A : AOP [or] BOI formed for shorter duration
- U/Sec. 175 : Transfer of properties to avoid tax
- U/Sec. 176 : Discontinued operations
 - At the discretion of AO whether to tax in PY [or] AY

Section-4 : Computation of Total Income

Particulars	Section	Amount [Rs.]
Income from head Salary	Sec. 15 – 17	xxx
Income from head House property	Sec. 22 – 27	xxx
Income from head Profit & Gains from business [or] profession	Sec. 28 – 44DB	xxx
Income from head Capital Gains	Sec. 45 – 55A	xxx
Income from head other sources	Sec. 56 – 59	xxx
Adjustments :		
• Clubbing of income	Sec. 60 – 69D	xxx
• Set-off & carry forward of losses	Sec. 70 – 80	xxx
Gross Total Income [GTI]		XXX
Less :		
• Chapter VI-A deduction	Sec. 80C – 80U	[xxx]
• SEZ deduction	Sec. 10AA	[xxx]
Net Total Income [NTI] rounded off U/Sec. 288A		XXX

→ Sec. 288A : Net total income [or] Net taxable income shall be rounded off to nearest multiple of Rs.10

- ↳ Amount up-to Rs. 4 : Downward rounding
- ↳ Amount ≥ Rs. 5 : Upward rounding

→ Taxability of incomes under various head

- Salary : Income from employer & employee relation
- House Property : Income from building/land + Ownership + not used by assessee business
- PGBP : Income from business, profession including vocation
- Capital Gains : Profit arising out of sale of assets
- Other sources : Incomes other than covered under any of above four heads
- Clubbing of income : Adding back income transferred to another purpose in order to avoid tax
- Set-off & C/f of loss : Previous year losses to be adjusted with current year income
- Chapter VI-A Deduction
 - Expense based
 - Invest : U/Sec. 80C, 80CCC, 80CCD, 80CCE, 80CCH
 - Medical : U/Sec. 80D, 80DD, 80DDB, 80U
 - Interest : U/Sec. 80E, 80EE, 80EEA, 80EEB
 - Donation : U/Sec. 80G, 80GGA, 80GGB, 80GGC
 - Other : U/Sec. 80GG, 80JJAA
 - Income based
 - Royalty : U/Sec. 80QQB, 80RRB
 - Interest : U/Sec. 80TTA, 80TTB
 - Industry : U/Sec. 80IA, 80IAB, 80IAC, 80IB, 80IC, 80ID, 80IE
 - Others : 80LA, 80M, 80

Tax on Total income

↔ Tax on total income can be computed under

- Old tax regime
- New tax regime

Old Tax regime

↔ Old tax regime voluntary regime

- Assessee may opt if not willing to be taxed under new regime

New tax regime

↔ Default tax regime for :

- Individual
- HUF
- AOP [other than Co-operative society]
- BOI
- AJP

↔ If not willing to be taxed under new regime, can opt to be taxed under old regime

- Assessee with income chargeable under head PGBP [+] opted old regime
 - Can revoke the option only once [opted old regime & if quitted cannot re-opt for old regime]
 - Later will be chargeable under new regime
- Assessee not having income chargeable under PGBP
 - Option to be taxed under new regime [or] old regime may be exercised in each year

↔ New tax regime for

- Companies
 - U/Sec. 115BA
 - U/Sec. 115BAA
 - U/Sec. 115BAB
- Individual, HUF, AOP [other than Co-operative society], BOI, AJP
 - U/Sec. 115BAC
- Co-Operative society
 - U/Sec. 115BAD
 - U/Sec. 115BAE

Tax rates : Old Tax regime

↔ Total income classified as

- Casual income
- Special income
- Normal income [i.e., Balancing figure]

Tax on Casual income

↔ Income by way of crossword, lottery, betting, gambling, horse races etc., [U/Sec. 115BB]

↔ Tax rate

- Flat rate @ 30%

↔ No deduction of expenses

Tax on special income

↔ Income by way of

- U/Sec. 111A - Short-term capital gain : @ 15%
- U/Sec. 112A - Long-term capital gain : @ 10% in excess of Rs. 1,00,000
- U/Sec. 112 - Other Long-term capital gain : @ 20%

↔ Taxability conditions

- U/Sec. 111A - Short-term capital gain
 - Transfer of Eq. share, Units of Eq. oriented MF, Units of business trust [+] STT paid
 - Period of holding shall be short term
- U/Sec. 112A - Long-term capital gain
 - Transfer of Eq. share, Units of Eq. oriented MF, Units of business trust [+] STT paid
 - Period of holding shall be long term
- U/Sec. 112 - other Long-term capital gain
 - Not covered under 112A [i.e., LTCG on assets other than covered U/Sec. 112A [or] STT not paid]

Tax on normal income - Company

↔ Taxable as per applicable flat rates

↔ Tax rates

→ Domestic company	: @ 30%
→ T/o in P.Y. 2021-22 is up-to Rs. 400 crores	: @ 25%
→ Foreign company	: @ 40%
→ Firm [or] Local authority	: @ 30%

Tax on normal income - Co-operative society

↔ Taxable under slab rates

↔ Tax slab rates : Total income

→ Up-to Rs. 10,000	: @ 10%
→ > Rs 10,000 & up-to Rs.20,000	: @ 20%
→ > Rs.20,0000	: @ 30%

Tax on normal income - Individual, HUF, AOP, BOI, AJP

↔ Taxable under slab rates

↔ Tax slab rates : Total income

→ Up-to Basic exemption limit [BEL]	: @ Nil i.e., 0%
→ > BEL & up-to Rs. 5,00,000	: @ 5%
→ > Rs.5,00,0000 & up-to Rs.10,00,000	: @ 20%
→ > Rs.10,00,000	: @ 30%

↔ Basic exemption limit

→ Individual - Age up-to 60yrs, HUF, AOP, BOI, AJP	: Rs.2,50,000
→ Individual - Age > 60yrs & up-to 80yrs	: Rs.3,00,000 [Senior Citizen + Resident]
→ Individual - Age > 80yrs	: Rs.5,00,000 [Super Senior Citizen + Resident]

Surcharge : Old Tax regime

↔ Tax on tax levied as a percentage of gross tax payable

↔ Applicable if Net taxable income exceeds specified limits

Surcharge rates - Company

↔ Domestic company : Total income

→ > Rs.1 Crore & up-to Rs.10 Crore	: @ 7%
→ > Rs.10 Crore	: @ 12%

↔ Foreign company : Total income

→ > Rs.1 Crore & up-to Rs.10 Crore	: @ 2%
→ > Rs.10 Crore	: @ 5%

Surcharge rates - Co-operative society

↔ Total income

→ > Rs.1 Crore & up-to Rs.10 Crore	: @ 7%
→ > Rs.10 Crore	: @ 12%

Surcharge rates - Firm [incl. LLP] [or] Local authority

↔ Total income : > Rs.1 Crore : @ 12%

Surcharge rates - Individual, HUF, AOP, BOI, AJP

↔ Total income

→ > Rs.50,00,000 & up-to Rs.1 Crore	: @ 10%
→ > Rs.1Crore & up-to Rs.2 Crore	: @ 15%
→ > Rs.2 Crore & up-to Rs.5Crore	: @ 25%
→ > Rs.5 Crore	: @ 37%

↔ Relief : Total income > Rs.2 Crores contains dividend, U/Sec. 112, 112A & 111A

→ Special income i.e., dividend [+] U/Sec. 112, 112A & 111A	: @ 15% [always]
→ Balance income	
→ Up-to Rs.2 Crore	: @ 15%
→ > Rs.2 Crore & up-to Rs.5 Crore	: @ 25%
→ > Rs.5 Crore	: @ 37%

Marginal relief

- ↔ Total income slightly higher than surcharge limit
 - Increase in tax liability > increase in total income
- ↔ Computation of marginal relief
 - Step-I : Tax as per normal provisions [including surcharge & excluding Cess.]
 - Step-II : Tax up-to surcharge limit [+] Income exceeding surcharge limit
 - Marginal relief
 - Applicable : Step-I > Step-II
 - Amount : Step-I [-] Step-II
- ↔ Tax payable

Particulars	Amount [Rs.]
Tax as per normal provisions	xxx
Less : Marginal relief	[xxx]
Gross Tax Payable	XXX
Add : Health & Education Cess @ 4%	xxx
Net Tax Payable	XXX

Section-87A : Rebate

- ↔ Provides rebate from the tax payable by an assessee
 - Rebate reduced before Cess.
 - Eligible assessee : Resident Individual
- ↔ Restriction : No rebate on income taxable U/Sec. 112A

Old Tax regime

- ↔ Condition - Total income : Does not exceed Rs.5,00,000
- ↔ Amount of rebate : Lower of
 - Actual tax payable on total income for A.Y.
 - Rs.12,500

New Tax regime : U/Sec. 115BAC

- ↔ Scenario-I - Total income : Does not exceed Rs.7,00,000
 - Amount of rebate : Lower of
 - Actual tax payable on total income for A.Y.
 - Rs.25,000
- ↔ Scenario-II - Total income : Exceeds Rs.7,00,000
 - Condition : Tax payable on total income > Total income in excess of Rs.7,00,000
 - Computation of rebate
 - Step-I : Total income [-] Rs.7,00,000
 - Step-II : Compute tax liability on total income
 - Rebate
 - Applicable : Step-II > Step-I
 - Amount : Step-II [-] Step-I

Important notes

Note-I : Availing unutilized Basic Exemption Limit

- ↔ Applicable : Normal income < Basic Exemption limit
- ↔ Benefit : Normal income falling short of BEL shall be adjusted against special income
- ↔ Order of utilization : Set-off against income with highest rate of tax
 - First : Against income U/Sec. 112
 - Second : Against income U/Sec. 111A
 - Last : Against income U/Sec. 112A

Note-II : Restriction of deduction U/Chapter VI-A

- ↔ Maximum amount of deduction under Chapter VI-A shall not exceed normal income
- ↔ i.e., Deduction U/Sec. 80C to 80U available only on normal income & not on special [or] casual income

Note-III : Partial Integration

- ↔ Partial integration : Taxing agricultural income, where assessee has both Non-agricultural & agricultural income
- ↔ Applicable assessee : Individual, HUF, AOP, BOI & AJP
- ↔ Conditions
 - Agricultural income : > Rs.5,000
 - Other income : > Basic exemption limit
- ↔ Computation of Tax payable
 - Step-I : Compute tax on total income i.e., Tax on Other income + Agricultural income
 - Step-II : Compute tax on [Agricultural income + Basic Exemption Limit]
 - Tax payable : Step-I [-] Step-II

Note-IV : Exemption vs. Deduction

- ↔ Exemption will not be part of gross total income
- ↔ Deduction will be part of gross total income and will be reduced from such gross total income ?

Note-V : Health & Education Cess

- ↔ Health & Education Cess levied on all assessee
- ↔ Levied to fulfill the commitment of government to provide & finance quality health & education
- ↔ Health & Education Cess : @ 4%
 - Health Cess : @ 1%
 - Primary education Cess : @ 2%
 - Secondary education Cess : @ 1%

Note-VI : Concept of income under Income Tax Act, 1961

- ↔ Casual incomes i.e., incomes which do not raise regularly are treated as income
- ↔ Capital receipts other than Capital gains shall not deemed to be income
- ↔ Income means net income
 - i.e., Gross income - Expenditure incurred in connection with earning such receipts

Note-VII : Diversion of income vs Application of income

- ↔ Diversion of income : Diverting of income before earned by assessee - Not chargeable to tax in hands of assessee
- ↔ Application of income : Spending of income after earned by assessee - chargeable to tax in hands of assessee

Note-VIII : Maximum Marginal Rate of tax [MMR]

- ↔ U/Sec. 2[29C] : Maximum Marginal Rate of tax means rate of tax applicable in relation to the highest slab of income
- ↔ Applicable in case of Individual, AOP, BOI
- ↔ Maximum Marginal Rate of Tax for A.Y.2024-25 : 42.744%

Note-IX : Average Rate of tax

- ↔ U/Sec. 2[10] : Average rate of tax means the rate of tax arrived by dividing the amount of tax on total income by such total income
- ↔ Average rate of tax : $[\text{Tax on total income} / \text{Total income}] \times 100$

Note-X : Undisclosed sources of income

- ↔ Tax on Undisclosed source of income : @ 60%
 - Effective rate of tax : @ 78% [60% + 25% + 4%]
- ↔ Restriction :
 - No benefit of basic exemption limit shall apply in computing such deemed income
 - No set-off of any loss shall be allowed against such undisclosed source of income.
- ↔ U/Sec. 68 : Cash Credits
 - Sum found credited in the books of assessee & assessee offers no explanation [or] unsatisfactory explanation
 - Such sum deemed to be income of the assessee of the previous year
 - Sum found credited if recorded as loan [or] borrowing : Explanation by assessee shall not be satisfactory unless
 - Person on whose name credited provide explanation of nature & source of such sum
 - And such explanation shall be satisfactory to Assessing officer
 - These conditions shall not apply if person in whose name credited is venture cap fund [or] venture cap Co
 - Sum found credited if provided explanation as share capital etc., : Explanation by assessee shall not be satisfactory unless :
 - Person on whose name credited is resident, offers explanation of nature & source of such sum
 - And such explanation shall be satisfactory to Assessing officer
 - These conditions shall not apply if person in whose name credited is venture cap fund [or] venture cap Co

↔ U/Sec. 69 : Unexplained investments

- Investments made by assessee that are not recorded in books of accounts
- Explanation of nature & source of investments not offered [or] not satisfactory in opinion of AO
 - Deemed to be income of the assessee

↔ U/Sec. 69A : Unexplained money

- Assessee found to be the owner of any money, bullion etc., and the same not recorded in books of account
 - Possession is not enough, ownership shall be important
- Explanation of nature & source of investments not offered [or] not satisfactory in opinion of AO
 - Deemed to be income of the assessee

↔ U/Sec. 69B : Amount of investments etc., not fully disclosed in books of account

- Assessee found to be the owner of any money, bullion etc., and the same not fully recorded in books of account
 - i.e., Amount spent on making such investments etc., exceeds the amount recorded in books of assessee
- Explanation of nature & source of investments not offered [or] not satisfactory in opinion of AO
 - Such excess amount deemed to be income of the assessee

↔ U/Sec. 69C : Unexplained expenditure

- Assessee incurred expenditure & no explanation for such has been offered [or] explanation not satisfactory
 - Such amount shall not be allowed as deduction under any head of income

↔ U/Sec. 69D : Amount borrowed [or] repaid on hundi

- Situations where deemed to be income of the assessee
 - Amount borrowed on a hundi
 - Amount due is repaid other than through account-payee cheque
- Amount deemed to be income at the time of borrowing shall not be liable to be assessed at the time of repayment
- Amount repaid shall include interest paid on the amount borrowed

Case Laws

CIT vs Saurashtra Cement Ltd. [2010] 325 ITR 422 [SC]

- ↔ Issue : Nature of receipt i.e., Capital receipt [or] Revenue receipt
 - Scenario : Liquidated damages received from supplier for failure to supply machinery within stipulated time
- ↔ Analysis : Damages directly & intimately linked with procurement of capital asset
 - ↳ Not a receipt in the course of profit earning process
- ↔ Decision : Amount received by assessee towards compensation for sterilization of the profit earning source
 - ↳ Not in ordinary course of business
 - ↳ Deemed to be capital receipt in hands of assessee

Honda Siel Cars India Ltd vs. CIT [2017] 395 ITR 713 [SC]

- ↔ Issue : Nature of receipt i.e., Capital receipt [or] Revenue receipt
 - Scenario : Technical fee paid under a technical collaboration agreement for setting up a joint venture company in India upon termination of the agreement, the joint venture would come to an end
- ↔ Analysis : The very purpose of the technical collaboration agreement, in this case, was to set up the Joint Venture.
 - ↳ The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit.
 - ↳ Upon termination of agreement, the joint venture itself would come to an end
- ↔ Decision : Technical fee is capital in nature
 - ↳ Since upon termination of agreement, joint venture itself would come to an end

Mahle Anand Filter Systems Pvt. Ltd. v. ACIT [2023] 456 ITR 29 [SC]

- ↔ Issue : Nature of receipt i.e., Revenue expenditure [or] Capital expenditure
 - Scenario : Foregoing of security deposit to settle a dispute
 - ↳ Assessee sought to vacate certain leased premises, disputes arose
 - ↳ To the end of disputes, assessee agreed not to claim security deposit of Rs.5.8 Crores
- ↔ Decision : Foregoing of security deposit to settle a dispute is in capital nature
 - ↳ Not to be treated as revenue expenditure merely because paid in course of dispute