

CA Umang Thakker

Introduction & Basic Concepts

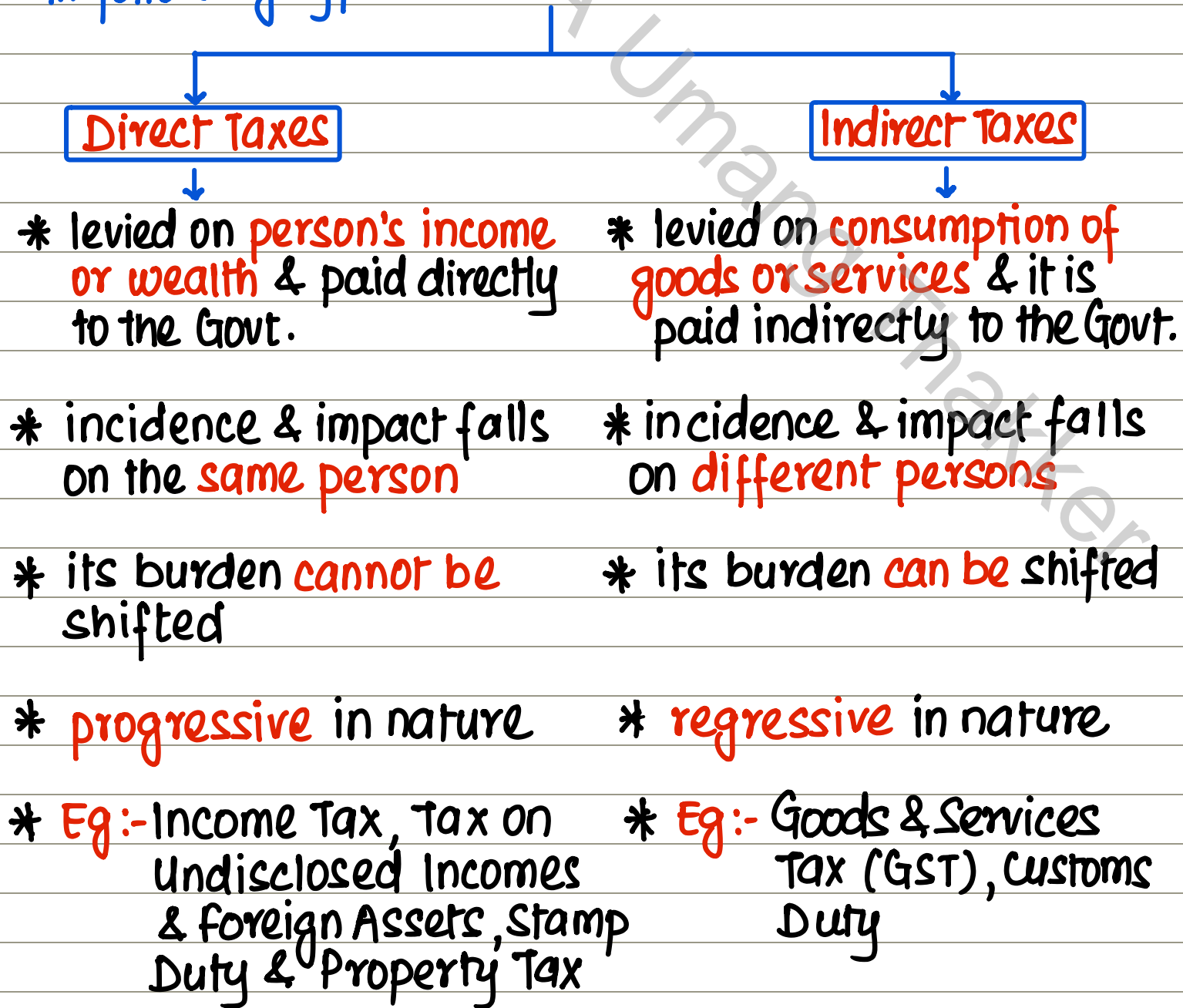
Concepts & Sections to be Studied in this Chapter :-

- Meaning & Classification of Taxes
- Why Taxes are levied ?
- Power to levy & Collect Taxes
- Components of Income Tax Law in India.
- Section 1 :- Short Title, Extent & Commencement
- Section 2 :- Definitions
- Section 3 :- Definition of 'Previous Year' (PY)
- Section 4 :- Charging Section
- Section 2(31) :- Definition of 'Person'
- Section 2(7) :- Definition of 'Assessee'
- Section 2(9) :- Definition of 'Assessment Year' (AY)
- Revenue Receipts v/s Capital Receipts
- Section 2(45) :- Definition of 'Total Income'
- Process for determining Total Income
- Gross Total Income v/s Total Income
- Process for determining Tax Liability
- Exemption v/s Deductions
- Normal Rates of Income Tax prescribed under the Annual Finance Act
- Section 87A :- Concept of Rebate u/s 87A
- Concept of Marginal Relief
- Section 288A :- Concept of Rounding-off of 'Total Income'
- Section 288B :- Concept of Rounding-off of 'Tax liability'

Meaning & Classification of Tax :-

Tax = Financial charge → levied by the Government
↓
on any product,
activity, service,
income, wealth etc.

Based on the mode of collection, taxes can be classified in following types :-



Why Taxes are levied ?

Tax is a **basic source of revenue** for the Govt., which is used for the purpose of :-

- * providing benefits like education and healthcare facilities or various other assistance to economically backward classes of the society
- * development & maintenance of infrastructural facilities like roads, dams, bridges etc. in India

- * meeting expenditure on defense of the nation & various contingencies
- * preservation of natural resources and places of artistic or historic importance etc.

Power to levy & collect Taxes :-

Constitution of India

Article 265

No taxes can be levied or collected in India except the authority of law

Article 246

Empowers the **Parliament & State legislatures** to make laws with respect to various matters including levy & collection of taxes. These matters are mentioned under **3 lists** enumerated in the **Seventh Schedule** to the Article 246 namely :-

list 1

Union list

Parliament has exclusive power to make laws on the matters contained in list 1.

list 2

State list

State legislature has exclusive power to make laws on the matters contained in list 2.

list 3

Concurrent list

Parliament and State legislatures, both have power to make laws on the matters contained in list 3.

∴ Law to be made applicable for whole of India

enacted by the
Parliament

executed by the
Central Govt.

∴ Law to be made applicable in a particular State

enacted by the
State legislature

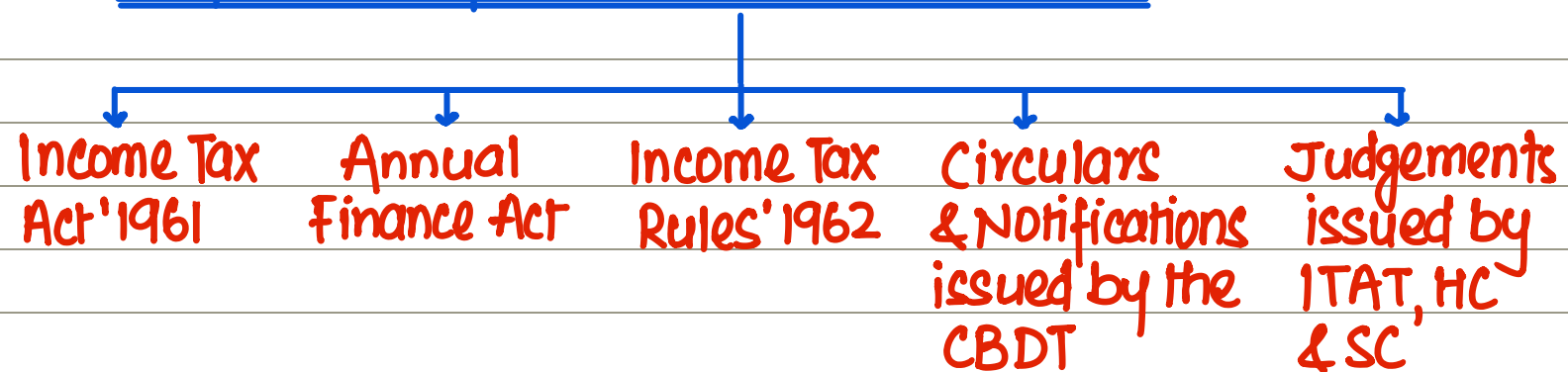
executed by the
State Govt.

Note :-

Entry No. 82 of Union list has empowered the Parliament to make law with respect to levy & collection of taxes on incomes other than agricultural incomes.

By exercising this power the Parliament enacted the Income Tax Act' 1961 which has authorised the Central Govt. to levy & collect income tax.

Components of Income Tax Law in India :-



CBDT = Central Board of Direct Taxes

ITAT = Income Tax Appellate Tribunal

HC = High Court

SC = Supreme Court

Income Tax Act' 1961 :-

- * It contains provisions for levy, computation & collection of tax on income and Other Miscellaneous Provisions.

- * It is divided into xxiii chapters containing 298 sections and 14 schedules.

Annual Finance Act :-

- * It contains changes (amendments) brought every year in various taxation laws in India including the Income Tax Act' 1961.

- * Process of enacting Annual Finance Act is as follows :-

↓
in the Budget Session of the Parliament (1st February every year)

↓
Finance Minister presents the Finance Bill (Budget) containing the financial proposals of the Govt. for the next year including the changes proposed in various taxation laws

↓
Discussion is held in the Parliament on the above proposals followed by voting on the same

↓
Finance Bill (Budget) is passed in both the houses of Parliament with majority of the votes casted in favour of such changes

↓
After the President's assent such Finance Bill becomes the Finance Act.

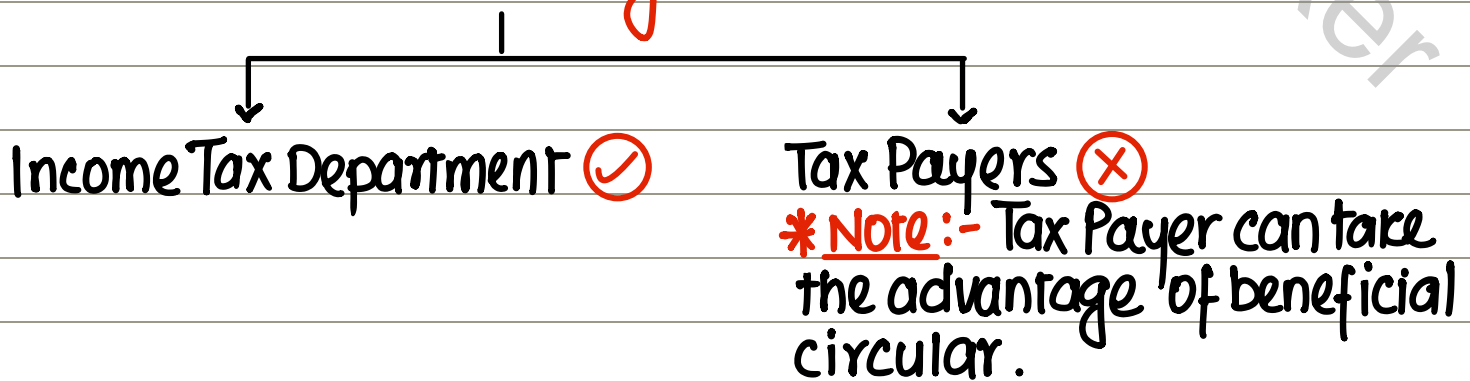
Income Tax Rules' 1962 :-

- * For **proper administration of direct taxes** in India; the CBDT from time to time frames rules which are collectively known as the Income Tax Rules' 1962.

Circulars issued by CBDT :-

- * To **deal with certain specific issues** & to **clarify certain specific doubts** while implementing the provisions of the Income Tax Act '1961.

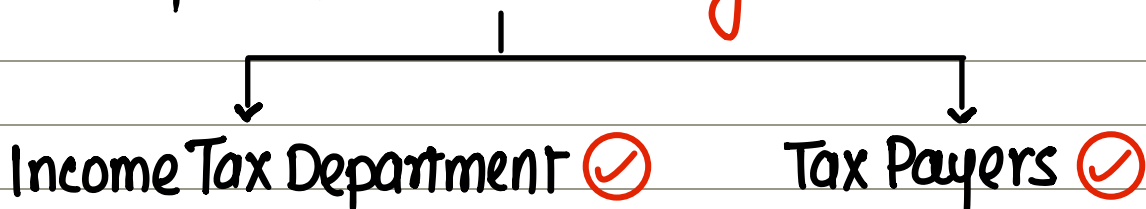
- * Circulars are **binding on :-**



Notifications issued by CBDT :-

- * To **give effect to the provisions** of the Income Tax Act' 1961 or to **make or amend** the Income Tax Rules' 1962.

- * Notifications are **binding on :-**



Judgements of ITATs/Hcs/SC :-

- * When any **dispute** arises between the **Tax Payer & the Income Tax Department** then, the judiciary (courts) provide the correct interpretation in their judgements to **clarify the real intent of the provision**.

The Income Tax Act '1961

Section 1 :-

Short Title :- The Income Tax Act '1961

Extent :- Applicable to whole of India

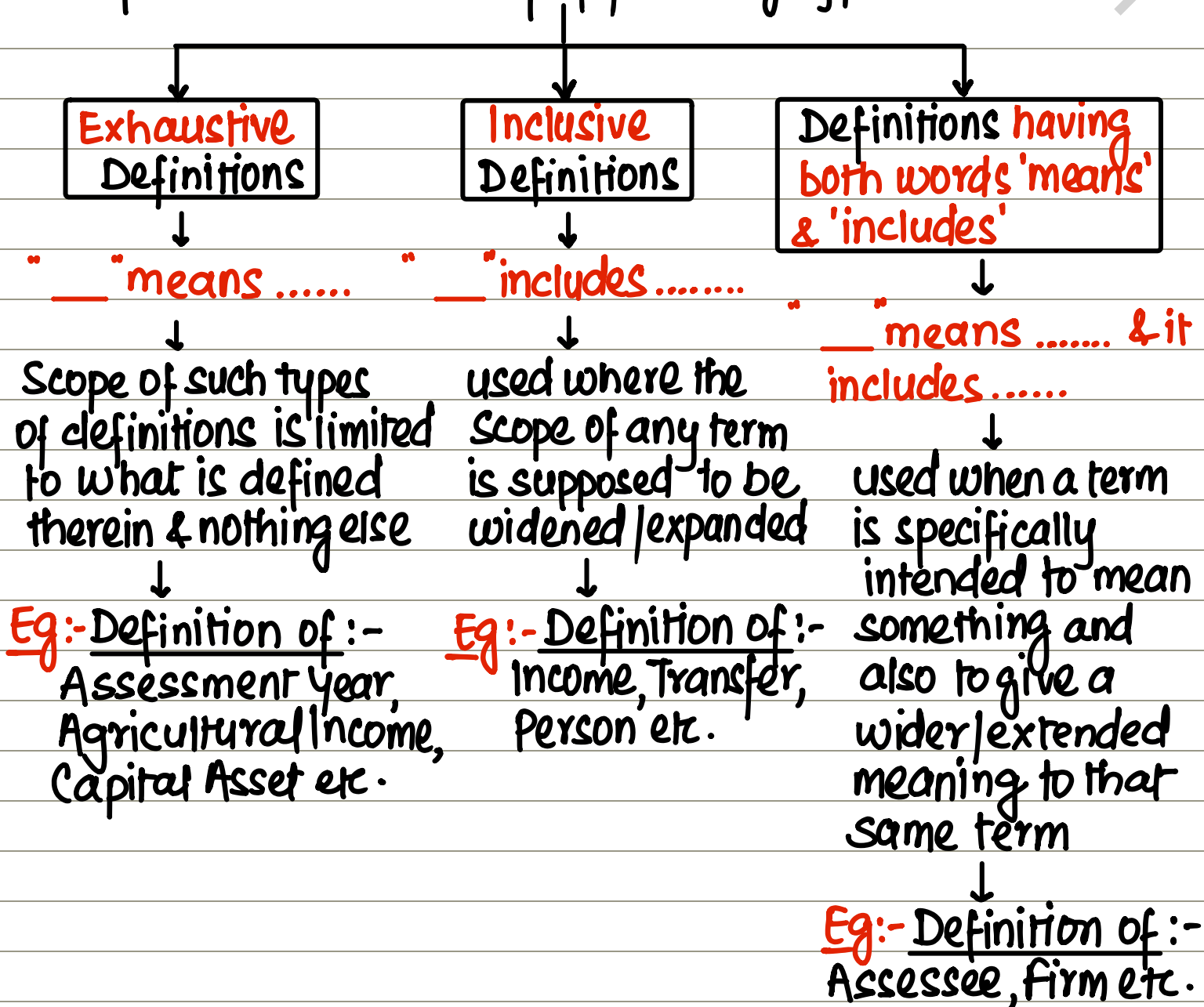
Commencement :- w.e.f. 01.04.1962

Section 2 :-

Definitions of Various terms :-

* To be referred as and when needed while studying the provisions of the Income Tax Act '1961.

* Definitions are normally of following types :-



Section 3 :-

Definition of 'Previous Year' :-

To be discussed later on along with the definition of Assessment Year.

Section 4 :-

Charging Section :-

The **Total Income** of the **Previous Year** of every **Person** shall be assessed to tax during the **Assessment Year** at **Prescribed Rates**.

Section 2(31) :-

Definition of 'Person' :-

The term 'Person' includes :-

- 1.) **Individual** i.e. Natural Human Being
[Male ✓ / Female ✓ / Transgender ✓ / Minor ✓ /
Person of Unsound Mind ✓]
- 2.) Hindu Undivided Family (**HUF**)
- 3.) **Company**
(Private or Public ✓ / listed or Unlisted ✓ / Indian or foreign ✓)
- 4.) **Firm** [includes limited liability partnership (**LLP**)]
- 5.) Association of Person (**AOP**) & Body of Individuals (**BOI**)
↓
Group ✓ (+) P'ship Deed ✓ (=) P'ship Firm ✓
Group ✓ (+) P'ship Deed ✗ (=) AOP / BOI ✓

AOP

* Two or more **persons** come together for a common purpose.

* Any Person can form AOP.

BOI

* Two or more **individuals** combined together by operation of law or compulsorily.

* Only Individuals can form BOI.

Examples :-

* Group of Mr. A & Mr. B

* Group of Mr. X & M/s ABC & Co.

* Group of M/s ABC & Co. & M/s P Ltd.

AOP

✓

✓

✓

BOI

✓

X

X

6.) **Local Authority** i.e. an authority which manages the local funds (locality) on behalf of the State Govt.

Eg :- Municipalities, Nagar Palikas, Cantonment Boards, Gram Panchayats.

* Note :- Central Govt. } \neq Person under the Income
State Govts. } Tax Act' 1961.

7.) Artificial Judicial Person (**AJP**) covers every entity which has come into existence as per any law and not covered in point no. ① to ⑥ above.

Eg :- ICAI, ICSI, SEBI, Trusts etc.

* Note :- The above classification is done on the basis of legal status which is necessary to fix the tax liability as different rates of tax are applicable for different persons.

* Note :- Profit motive is not necessary to constitute a person. Hence, AOP or BOI or local authority or AJP shall always be treated as a person whether or not they are formed/established with the objective of deriving income or profit or gain.

Section 2(7):-

Definition of 'Assessee' :-

Assessee means any person by whom **any tax or any other sum** is payable under the provisions of the Income Tax Act' 1961 and it includes :-

(a) every person in respect of whom any proceedings under the Income Tax Act' 1961 are undertaken for assessment of :-
- his income/loss/refund; or
- income/loss/refund of any other person in respect of whom he is assessable.

(b) every person who is deemed to be an assessee as per the provisions of the Income Tax Act' 1961.
Eg :- A Representative Assessee

(c) every person who is deemed to be an assessee in default as per the provisions of the Income Tax Act' 1961.
Eg :- A person who contravenes any provision of the Income Tax Act' 1961.

* Note :-

Every Assessee must be a Person. However, every Person need not be an Assessee.

Section 2(9):-

Definition of 'Assessment Year' (AY):-

AY means a period of **12 months** starting from **1st April** every year.

Example:- 01.04.2025 to 31.03.2026

12 months

= AY 2025-26

Section 2(34):-

Definition of 'Previous Year' (PY):-

PY means the PY as **defined** up **3.**

↓
PY means the FY **immediately preceding** the AY.

Example:-

FY immediately preceding the AY 2025-26 = PY 2024-25

* Note:- The Income Tax Act' 1961 as amended by the Finance Act' 2024 is applicable for May'25 attempt.
∴ The questions in the examination would be framed for PY 2024-25 i.e. AY 2025-26.

* Note:- * AY - Always a period of 12 months

* PY - Normally a period of 12 months

However, the first PY of a New Business or a New Profession or a New source of income can be a period of < 12 months.

Section 2(45):-

Definition of 'Total Income' :-

Total Income means total of incomes referred to in Section 5, computed in the manner as prescribed under the Income Tax Act' 1961.

* Note :- Incomes referred to in Section 5 are the incomes which are covered in the scope of total income of the assessee based on the place & time of accrual or receipt thereof and the residential status of the assessee.

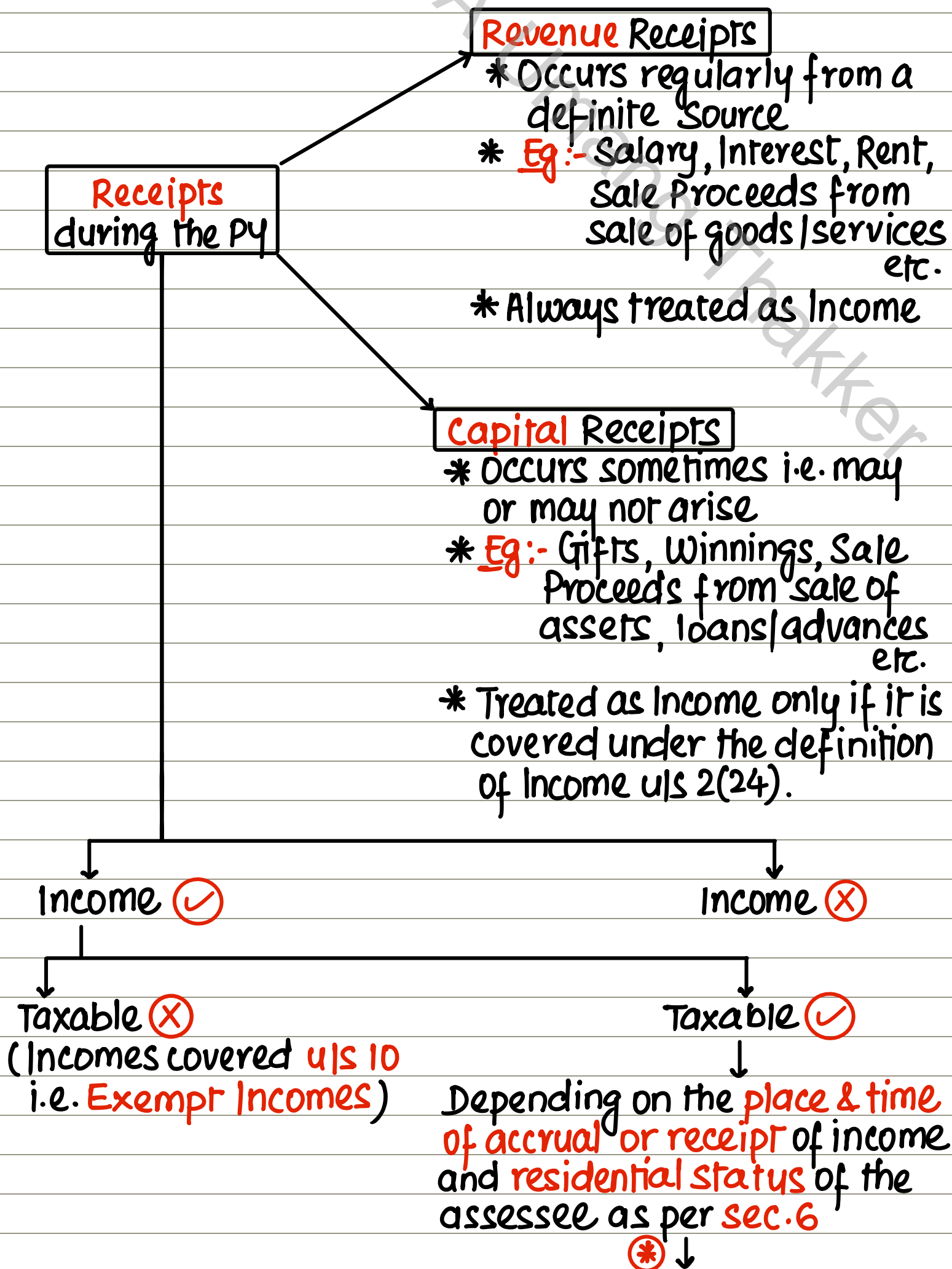
* Note :- The manner laid down under the Income Tax Act' 1961 for computation of total income is as under :-

Gross Total Income (-) Deductions u/c VI-A (=) Total Income		
↓	↓	↓
Aggregate of Incomes computed under the 5 Heads of Income	covers deductions available under Section 80C to 80U	charge of income tax is on this amount
* Salaries (Sec. 15 to 17)		XX
* House Property (Sec. 22 to 27)		XX
* Business or Profession (Sec. 28 to 44DB)		XX
* Capital Gains (Sec. 45 to 55A)		XX
* Other Sources (Sec. 56 to 59)		XX
Gross Total Income		<u>XX</u>

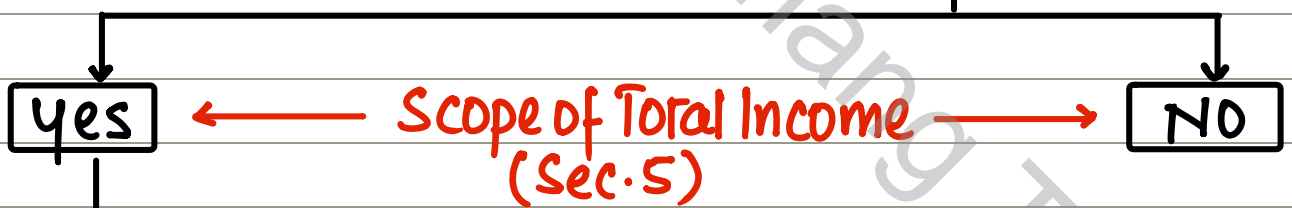
while aggregating the incomes under 5 heads; effect must be given to :-

- * Clubbing Provisions (Sec. 60 to 65); and
- * Provisions related to set-off and carry-forward of losses (Sec. 70 to 80)

Detailed Process for Computation of Total Income:-



(*) ↓
Above incomes **to be included**
in the computation of Total
Income of the assessee



These incomes shall now be **classified into 5 heads of income** and computational provisions of each head of income shall be applied to compute the taxable income under each head

↓
Aggregate of incomes computed under 5 heads **after** taking into consideration the provisions of **clubbing and set-off & carry-forward of losses** shall be treated as **Gross Total Income (GTI)**.

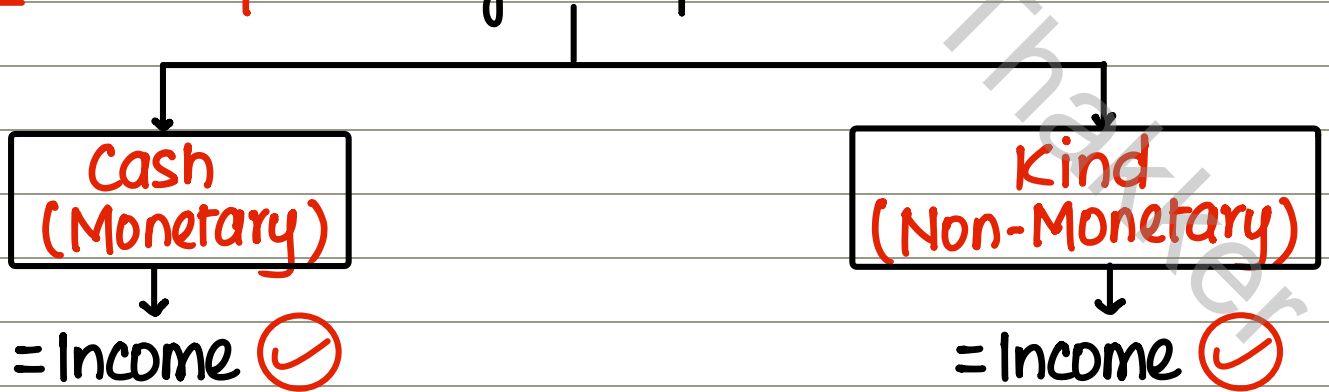
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From the GTI computed as above; **Deductions u/c VI-A i.e. u/s 80C to 80U are claimed** and the balance amount shall be treated as the **Total Income (TI)**.

Important Points to remember:-

- * Pt. 1 :- Income ordinarily means something which is received on a regular basis from a definite source. However, the term income is also defined u/s 2(24) to include certain specific receipts as income so that such receipt could be charged to tax. Hence, it could be said that the meaning of the term 'income' is much wider than what is normally understood.

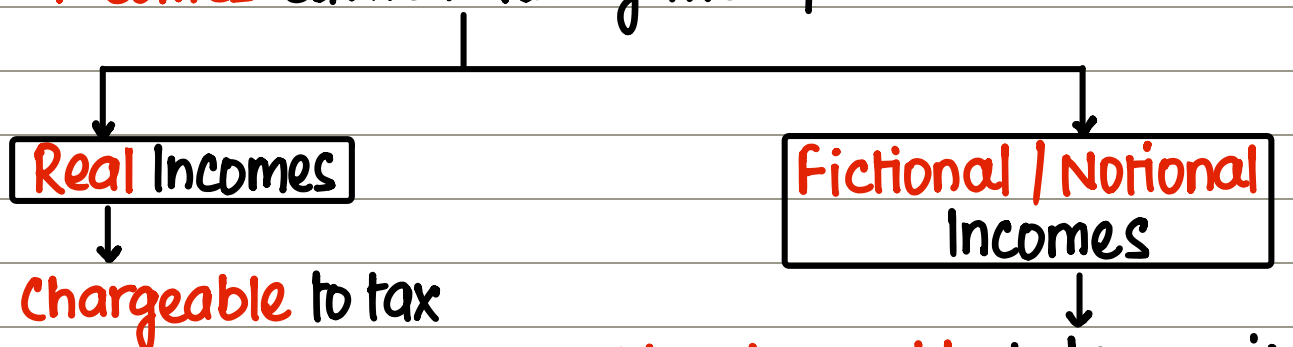
* Pt. 2 :- As and when the Govt. wish to charge tax on a specific receipt which otherwise may not be treated as income, it amends section 2(24) and includes such receipt in the definition of 'income' and creates a charge on it under any of the 5 heads of income.

* Pt. 3 :- Receipts during the PY can be in :-



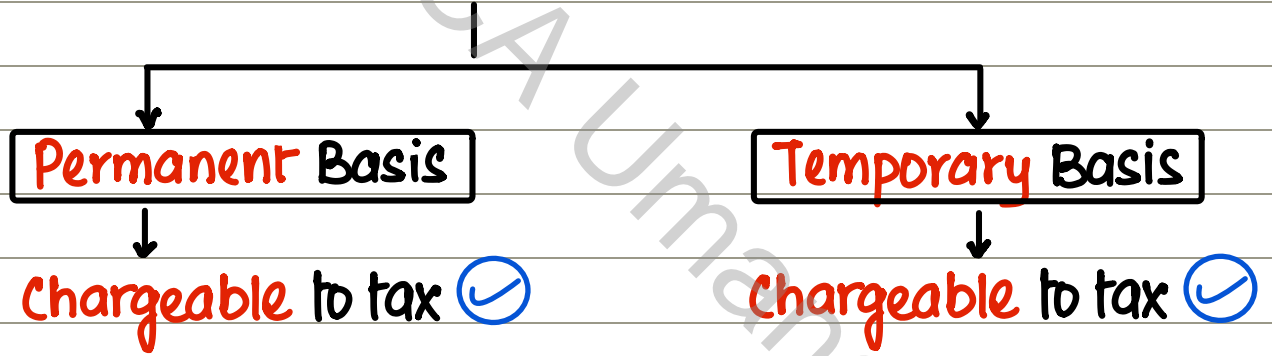
value needs to be determined as per prescribed valuation rules. If no rules prescribed for valuation then FMV may also be adopted.

* Pt. 4 :- Incomes earned during the PY :-

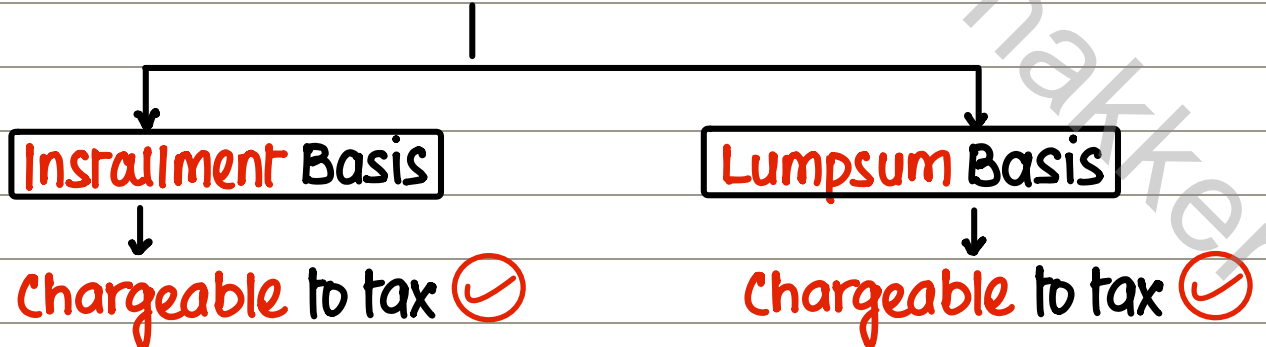


Nor chargeable to tax until & unless specifically provided under the provisions of the Income Tax Act '1961.

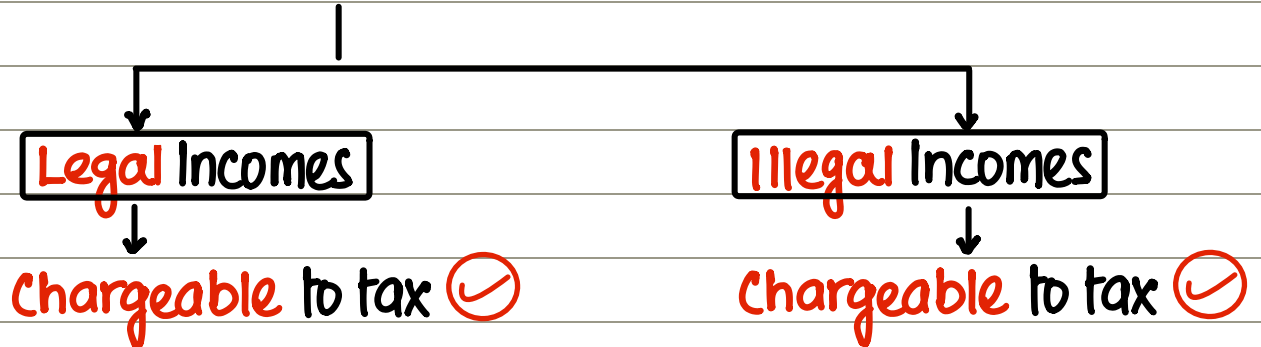
* Pt.5 :- Incomes can be earned on :-



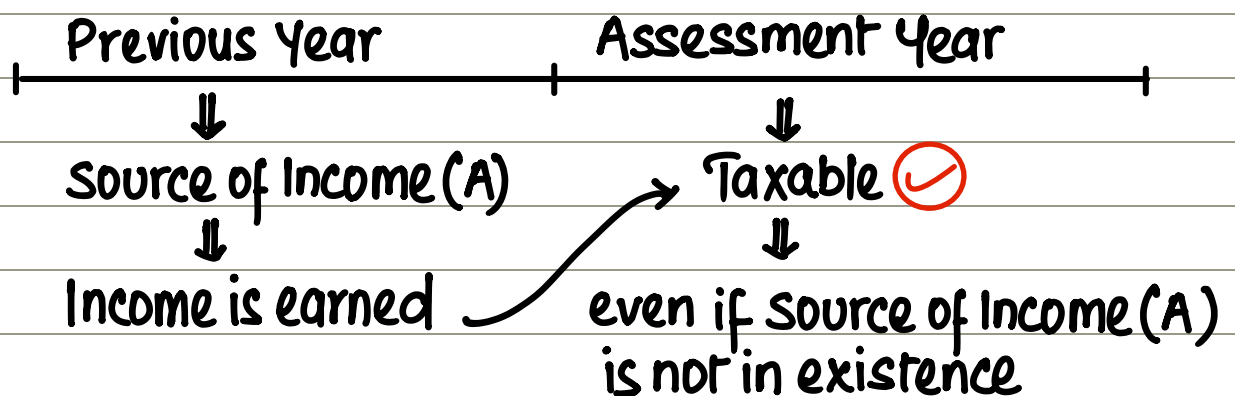
* Pt.6 :- Incomes can be earned on :-



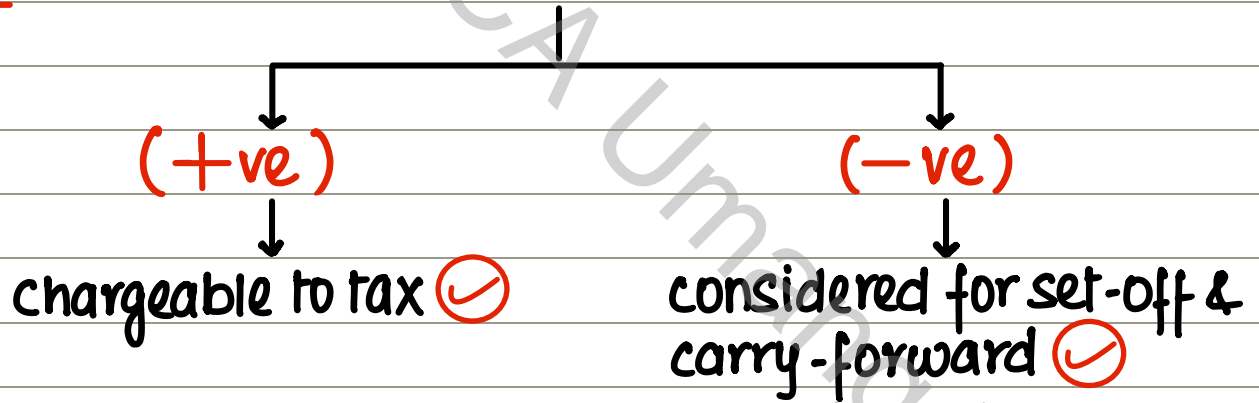
* Pt.7 :- Incomes can be :-



* Pt.8 :- If the income from any source is earned in the PY; then, such income shall be charged to tax during the AY even if such source of income ceases to exist during the AY.



* Pt. 9 :- **Income** under the Income Tax Act '1961 can be :-



* Pt. 10 :- **Pin Money** = Amount received by a wife from her husband to meet her personal expenses or to meet household expenses

↓
≠ **Income** of the wife ∴ **Not Taxable** in her hands

* <u>Pt. 11</u> :- <u>Gross Total Income</u>	v/s	<u>Total Income</u>
Aggregate of incomes computed under the heads of incomes after applying the provisions of clubbing and set-off & carry-forward but before claiming chapter VI-A deductions.		That part of Gross Total Income which remains after claiming Chapter VI-A deductions.

* <u>Pt. 12</u> :- <u>Diversion of Income</u>	v/s	<u>Application of Income</u>
* By an obligation which exists prior to the receipt of income; the income is diverted to some other person after its receipt.		* Expenditure/Investment out of the income after it is received.
* Income diverted is not taxable in the hands of the assessee.		* Income applied is taxable in the hands of the assessee.

Example :-

X & Y are joint authors of a book. They entered into an agreement whereby they decided to equally distribute the royalty income of book co-authored by them.

Publisher gives a cheque of ₹10,00,000 on the name of X (being the first author of the book).

$\frac{1}{2} = ₹5,00,000$ kept by X

Taxable to X even if he received ₹10,00,000 from the publisher.

Out of the above ₹5,00,000; if X has spent/invested say ₹2,00,000; then, it would be treated as application of income by X.

$\frac{1}{2} = ₹5,00,000$ given to Y

Taxable to Y & not to X
∴ It would be treated as diversion of income by X.

* Pt. 13 :- Exemption

v/s

Deduction

* Income which is not to be included in the computation of total income.

* Exemption \leq Income ✓

Exemption $>$ Income ✗

* Income remaining after exemption can be :-

+ve ✓ Nil ✓ -ve ✗

* Part of income which is allowed to be reduced out of the income after such income is included in the computation of total income

* Deduction \leq Income ✓

Deduction $>$ Income ✓

* Income remaining after deduction can be :-

+ve ✓ Nil ✓ -ve ✓

Process of determining Income Tax Liability:-

Total Income computed for the PY

Special Incomes

Taxable @ Special Rates prescribed under the Income Tax Act'1961

Balance Total Income (Normal Total Income)

Taxable @ Normal Rates prescribed under the Annual finance Act.

Tax on Special Incomes @ Special Rates = XX

(+)

Tax on Normal Total Income @ Normal Rates = XX

Aggregate of above taxes = Tax on Total Income

XX

OR [Add:- Surcharge (if applicable)

XX

less:- Rebate u/s 87A

(XX)

Tax on Total Income including Surcharge or after Rebate u/s 87A

XX

Add:- Health & Education Cess @ 4 %.

XX

Gross Tax Liability

XX

less:- TDS / TCS during the PY (if any)

(XX)

less:- Advance Tax paid during the PY (if any)

(XX)

less:- Relief u/s 89 (if any)

(XX)

less:- AMT Credit u/s 115JD

(XX)

Net Tax Liability / (Refund Due)

XX / (XX)

* Note:- Special Rates of tax available under the Income Tax Act'1961 are income specific rates applicable uniformly to all types of assesseees.
(To be discussed later on).

Whereas the **Normal Rates of tax** available under the Annual Finance Act are **assessee specific rates** which are different for different types of assessees (**Discussed as below**).

Normal Rates of Tax as per the Annual Finance Act:-

(A) In case of Individuals | HUFs | AOPs & BOIs | AJP's :-

<u>Normal Total Income</u>	<u>Tax Rate</u>
→ Upto ₹ 2,50,000 (Basic Exemption limit)	Nil
→ From ₹ 2,50,001 to ₹ 5,00,000	5%
→ From ₹ 5,00,001 to ₹ 10,00,000	20%
→ Above ₹ 10,00,000	30%

(B) In case of Individuals being Senior Citizen :-

<u>Normal Total Income</u>	<u>Tax Rate</u>
→ Upto ₹ 3,00,000 (Basic Exemption limit)	Nil
→ From ₹ 3,00,001 to ₹ 5,00,000	5%
→ From ₹ 5,00,001 to ₹ 10,00,000	20%
→ Above ₹ 10,00,000	30%

(C) In case of Individuals being Super Senior Citizen :-

<u>Normal Total Income</u>	<u>Tax Rate</u>
→ Upto ₹ 5,00,000 (Basic Exemption limit)	Nil
→ From ₹ 5,00,001 to ₹ 10,00,000	20%
→ Above ₹ 10,00,000	30%

Senior Citizen = Resident Individual whose age is **≥ 60 years** at any time during the PY.

Super Senior Citizen = Resident Individual whose age is **≥ 80 years** at any time during the PY.

*** Note :-** A resident individual whose 60th or 80th birthday falls on 1st April of the next PY shall be treated as having attained the age of 60 years or 80 years as on the 31st March of current PY itself and not in the next PY.

Accordingly, higher basic exemption limit of ₹3,00,000 or ₹5,00,000 shall be available w.e.f. current PY itself in the case of such individual.

*** Note :-** The above normal slab rates are optional tax rates which are applicable only when the assessee has shifted out of the default tax regime u/s 115BAC. If the assessee does not shift out of the default tax regime given u/s 115BAC; then, in that case the total income of the assessee shall be computed without giving effect to certain specified deductions and exemptions and the rates of tax applicable on such total income shall be concessional slab rates as given u/s 115BAC (To be discussed later on).

Rates of Surcharge applicable in the case of assessee covered in (A), (B) & (C) above are as follows :-

<u>If the amount of Total Income is</u>	<u>Surcharge @</u>
→ upto ₹ 50,00,000	Nil
→ > ₹ 50,00,000 but ≤ 1,00,00,000	10%
→ > 1,00,00,000 but ≤ 2,00,00,000	15%
→ > 2,00,00,000 but ≤ 5,00,00,000	25%
→ > 5,00,00,000	37%

*** Note :-** Higher rates of surcharge i.e. 25% and 37% are not applicable on the amount of tax on STCG u/s 111A or LTCG u/s 112 or LTCG u/s 112A or Dividend Income.

* Note :- The above surcharge rates are applicable when the assessee has shifted out of the default tax regime u/s 115BAC i.e. to be applied along with the optional (Normal) slab rates.

However, if the assessee does not shift out of default tax regime u/s 115BAC; then the concessional tax rates given u/s 115BAC are applicable and the surcharge rates applicable along with such concessional tax rates are discussed later on.

Concept of Rebate u/s 87A :-

A Resident Individual whose Total Income is $\leq ₹5,00,000$ can claim Rebate u/s 87A.

Amount of Rebate u/s 87A shall be least of the following:-

(a) 100% of Tax on Total Income = XX

OR

(b) Maximum Amount of Rebate u/s 87A = ₹12,500



* Note :- If the assessee has not shifted out of the default tax regime of section 115BAC i.e. he has opted to pay tax at concessional rates given u/s 115BAC; then, the Rebate u/s 87A shall be available even if the total income of such assessee is $> ₹5,00,000$ but it should be $\leq ₹7,00,000$.

And the maximum amount of rebate u/s 87A in such cases shall be ₹25,000 and not ₹12,500. (To be discussed later on).

* Note :- Tax on LTCG u/s 112A cannot be claimed as Rebate.

(D) In case of Partnership Firms (including Limited Liability Partnerships) / Local Authorities :-

- * Entire Amount of Normal Total Income shall be taxable @ flat rate of 30% without any basic exemption limit.
- * Rate of surcharge shall be @ 12% if the total income of the assessee is $> ₹1,00,00,000$.

(E) In case of co-operative societies :-

Normal Total Income

Tax Rate

→ Upto ₹10,000	10%
→ From ₹10,001 to ₹20,000	20%
→ Above ₹20,000	30%

- * Rate of surcharge shall be @ 12% if the total income of the assessee is $> ₹1,00,00,000$.

(F) In case of Domestic Companies :-

- * Entire Amount of Normal total Income shall be taxable @ flat rate of 30% without any basic exemption limit.

* Note :- However, the rate of tax shall be 25% in the case of those domestic companies whose turnover for the PY2022-23 is ≤ 400 crores.

- * Rate of surcharge shall be 7% if the total income is $> ₹1,00,00,000$ but $\leq ₹10,00,00,000$.
However, the rate of surcharge shall be 12% if the total income is $> ₹10,00,00,000$.

(G) In case of Foreign Companies :-

* Entire Amount of Normal total Income shall be taxable @ flat rate of 40% without any basic exemption limit.

* Rate of surcharge shall be 2% if the total income is $> ₹1,00,00,000$ but $\leq ₹10,00,00,000$.
However, the rate of surcharge shall be 5% if the total income is $> ₹10,00,00,000$.

Concept of Marginal Relief :-

* Marginal Relief is available to all types of assessee where surcharge is applicable.

* It is to be claimed out of tax on total income before adding Health & Education Cess.

* Steps to calculate the amount of Marginal Relief :-

1. Compute the Total Income of the assessee.
2. Compute Tax on Total Income including Surcharge i.e. Tax 1.
3. Compute Tax on Total Income including Surcharge (if any) on Total Income of ₹50 lakhs or ₹1 crore or ₹2 crores or ₹5 crores or ₹10 crores; as the case may be i.e. Tax 2.
4. Calculate \uparrow in Tax i.e. Tax 1 (-) Tax 2.
5. Calculate \uparrow in Total Income i.e. Actual Total Income (-) Total Income of ₹50 lakhs or ₹1 crore or ₹2 crores or ₹5 crores or ₹10 crores; as the case may be.
6. If the \uparrow in Tax is $>$ \uparrow in Total Income

Marginal Relief ✓

Amount of Marginal Relief = \uparrow in Tax (-) \uparrow in Total Income

Examples to understand the concept of Marginal Relief :-

* Example 1 :-

$\uparrow \text{in TI} = ₹1,00,000$

Total Income	₹51,00,000	₹50,00,000
Tax on above Total Income	₹13,42,500	₹13,12,500
(+) Surcharge on above Tax	₹1,34,250	-
Tax on Total Income incl. Surcharge	₹14,76,250	₹13,12,500

$\uparrow \text{in Tax} = ₹1,64,250$

$\therefore \uparrow \text{in Tax is} > \uparrow \text{in TI} \therefore \text{Marginal Relief} \checkmark$

$$\uparrow \text{in Tax} (-) \uparrow \text{in TI} = ₹1,64,250 (-) ₹1,00,000 = ₹64,250$$

$$\begin{aligned} \therefore \text{Gross Tax Liability} &= ₹14,76,250 (-) ₹64,250 = ₹14,12,500 \\ (+) \text{Health \& Education Cess @ 4\%} &= ₹56,500 \\ &= \underline{₹14,69,000} \end{aligned}$$

* Example 2 :-

$\uparrow \text{in TI} = ₹1,00,000$

Total Income	₹1,01,00,000	₹1,00,00,000
Tax on above Total Income	₹28,42,500	₹28,12,500
(+) Surcharge on above Tax	₹4,26,375	₹2,81,250
Tax on Total Income incl. Surcharge	₹32,68,875	₹30,93,750

$\uparrow \text{in Tax} = ₹1,75,125$

$\therefore \uparrow \text{in Tax is} > \uparrow \text{in TI} \therefore \text{Marginal Relief} \checkmark$

$$\uparrow \text{in Tax} (-) \uparrow \text{in TI} = ₹1,75,125 (-) ₹1,00,000 = ₹75,125$$

$$\begin{aligned} \therefore \text{Gross Tax Liability} &= ₹32,68,875 (-) ₹75,125 = ₹31,93,750 \\ (+) \text{Health \& Education Cess @ 4\%} &= ₹1,27,750 \\ &= \underline{₹33,21,500} \end{aligned}$$

Section 288A & 288B :-

Rounding-off of Total Income & Tax Liability :-

The amount of Total Income and Tax Liability (including the amount of TDS/TCS or Advance Tax), interest, penalty, fine or any other sum payable by the assessee or the amount of refund due under the provisions of the Income Tax Act 1961

↓
shall be rounded-off to the **nearest multiple of ₹10**

If the amount of Total Income | Tax Liability is not in the multiple of ₹10 and the last digit is :-

5 or more



Round-off to the **next higher amount** which is a multiple of ₹10.

less than 5



Round-off to the **previous lower amount** which is a multiple of ₹10.

Examples :-

* ₹6,15,572 → R/O to ₹6,15,570

* ₹12,08,858 → R/O to ₹12,08,860

* ₹9,43,335 → R/O to ₹9,43,340