

SUBJECT:
UGC NET COMMERCE

UNIT-10:
INCOME TAX AND CORPORATE TAX PLANNING

Chapter No.	Title	Page No.
1	Income-tax: Basic concepts – Residential status and tax incidence; Exempted incomes; Agricultural income; Computation of taxable income under various heads; Deductions from Gross total income; Assessment of Individuals; Clubbing of incomes	3-21
2	Corporate Tax Planning: Concepts and significance of corporate tax	22-30

	planning; Tax avoidance versus tax evasion; Techniques of corporate tax planning	
3	Tax Planning and Financial Management Decisions: Retain; Renewal or replacement of asset; Shut down or continue operations	31-33
4	Tax Management with Reference to- planning; Tax considerations in specific business situations: Make or buy decisions; Own or lease an asset;	34-36
5	International Taxation: Double taxation and its avoidance mechanism; Transfer pricing	37-39
6	Deduction and collection of tax at source	40-42
7	Advance payment of tax	43-49
8	E-filing of income-tax returns	50-55
	MCQs	56-65
	Special Notes	66-69

CHAPTER-1: TAX- BASIC CONCEPTS

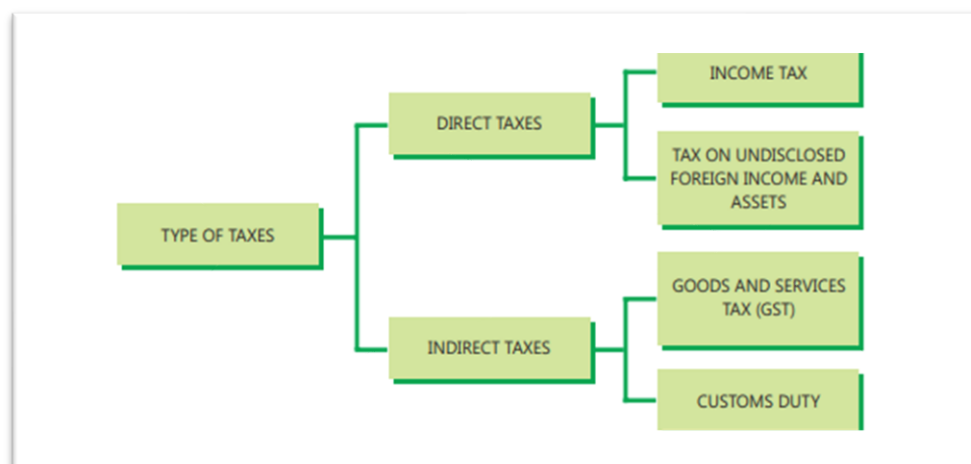
INCOME-

INTRODUCTION

Tax is a fee charged by a Government on a product, income or activity. There are two types of taxes – direct taxes and indirect taxes.

Direct Taxes: If tax is levied directly on the income or wealth of a person, then, it is a direct tax e.g. income-tax.

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



The reason for levy of taxes is that they constitute the basic source of revenue to the Government. Revenue so raised is utilized for meeting the expenses of Government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc. Constitution of India gives the power to levy and collect taxes, whether direct or indirect, to the Central and State

Government. The Union and State Government are empowered to levy taxes by virtue of Article 246 of the Constitution of India.

Seventh Schedule to Article 246 contains three lists which enumerate the matters under which the Union and the State Governments have the authority to make laws for the purpose of levy of taxes.

The following are the lists:

(i) Union List: Central Government has the exclusive power to make laws on the matters contained in Union List.

(ii) State List: State Government has the exclusive power to make laws on the matters contained in the State List.

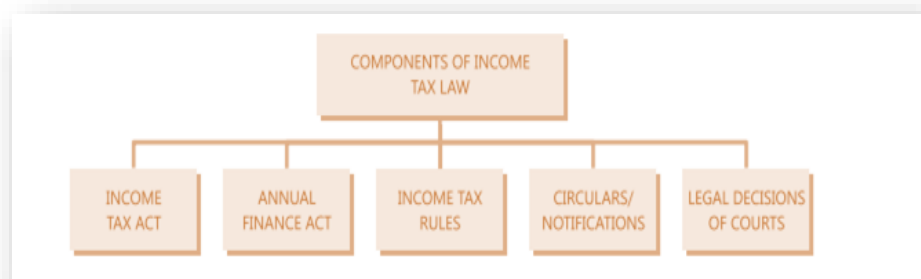
(iii) Concurrent List: Both Central and State Governments have the power to make laws on the matters contained in the Concurrent list.

Income-tax is the most significant direct tax. Entry 82 of the Union List i.e., List I of Seventh Schedule to Article 246 of the Constitution of India has given the power to Central Government to levy taxes on income other than agricultural income.

OVERVIEW OF INCOME-TAX LAW IN INDIA

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

The income-tax law in India consists of the following components—



The various instruments of law containing the law relating to income-tax are explained below:

Income-tax Act, 1961

The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act.

- It came into force on 1st April, 1962.
- It contains 298 sections and XIV schedules.

A section may have sub-sections, clauses and sub-clauses. For example, The clauses of section 2 define the meaning of terms used in the Income-tax Act, 1961. Clause (1A) defines “agricultural income”, clause (1B) defines “amalgamation” and so on.

Likewise, the clauses of section 10 contain the exemptions in respect of certain income, like clause (1) provides for exemption of agricultural income and clause

(2) provides for exemption of share income of a member of a hindu undivided family and so on.

Section 5 defining the scope of total income has two sub-sections (1) and (2). Sub-section (1) defines the scope of total income of a resident and sub-section (2) defines the scope of total income of a non-resident.

A section may also have Provisos and Explanations.

The Proviso(s) to a section/sub-section/clause spells out the exception(s) to the provision contained in the respective section/subsection/clause.

The Explanation to a section/sub-section/clause gives a clarification— relating to the provision contained in the respective section/subsection/clause.

For example,

Sections 80GGB and 80GGC provides for deduction from gross total income in respect of contributions made by companies and other persons, respectively, to political parties or an electoral trust

The proviso to sections 80GGB and 80GGC provide that no deduction shall be allowed under those sections in respect of any sum contributed by cash to political parties or an electoral trust. Thus, the proviso to these sections spells out the circumstance when deduction would not be available thereunder in respect of contributions made.

o The Explanation below section 80GGC provides that for the purposes of sections 80GGB and 80GGC, “political party” means a political party registered under section 29A of the Representation of the People Act, 1951. Thus, the Explanation clarifies that the political party has to be a registered political party.

- The Income-tax Act, 1961 undergoes change every year with additions and deletions brought out by the annual Finance Act passed by Parliament.

The Finance Act

Every year, the Finance Minister of the Government of India introduces the Finance Bill in the Parliament’s Budget Session. When the Finance Bill is passed by both the houses of the Parliament and gets the assent of the President, it becomes the Finance Act. Amendments are made every year to the Income-tax Act, 1961 and other tax laws by the Finance Act.

The First Schedule to the Finance Act contains four parts which specify the rates of tax –

- Part I of the First Schedule to the Finance Act specifies the rates of tax applicable for the current Assessment Year.
- Part II specifies the rates at which tax is deductible at source for the current Financial Year.
- Part III gives the rates for calculating income-tax for deducting tax from income chargeable under the head “Salaries” and computation of advance tax.
- Part IV gives the rules for computing net agricultural income.

Income-tax Rules, 1962

The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT).

- The CBDT is empowered to make rules for carrying out the purposes of the Act.
- For the proper administration of the Income-tax Act, 1961, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962.
- Rules also have sub-rules, provisos and Explanations. The proviso to a Rule/Sub-rule spells out the exception to the limits, conditions, guidelines, basis of valuation, as the case may be, spelt out in the Rule/Sub-rule. The Explanation gives clarification for the purposes of the Rule.
- It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

Circulars and Notifications

Circulars

- Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of certain provisions of the Act.
- Circulars are issued for the guidance of the officers and/or assesseees.
- The department is bound by the circulars. While such circulars are not binding on the assesseees, they can take advantage of beneficial circulars.

Notifications

Notifications are issued by the Central Government to give effect to the provisions of the Act. The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications.

Case Laws

The study of case laws is an important and unavoidable part of the study of Income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assesseees and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

An assessee may get income from different sources, eg:- salaries-house property income-profits and gains of business or profession - capital gains income from other sources like interest on securities, lottery winnings, races etc.

Income from each of these sources calculated first to find out the gross total income, and then permissible deduction allowed arriving in total income according to sec 80 c to 80 u. Every person whose taxable income in the previous

year exceeds the minimum taxable limit is liable to pay income tax during the current financial year at the rates applicable to the current financial year.

ASSESSMENT YEAR SEC 2(9)

Assessment year means the period of 12 months commencing on the first day of April every year and ending on 31st march of the next year.

PREVIOUS YEAR SEC 3

Previous year means the financial year immediately preceding the assessment year

PERSONS SEC 2(34)

1. Individual
2. Hindu undivided family
3. Company
4. Firm
5. Association of persons or body of individual
6. Local authority
7. Artificial juridical person

ASSESSEE SEC 2(7)

Assessee is a person, who has liability to pay tax or any other sum of money under Income Tax act of 1961, so the afore said persons include in the category of Assessee. Every Assessee whose taxable income in the previous year exceeds the minimum taxable limit is liable to pay income tax during the current financial year at the rates applicable to the current financial year.

EXCEPTIONS TO THE GENERAL RULE

Generally income earned in the previous year is taxed in the assessment year. But there are certain exceptions to the general rule. Ie the previous year and assignment year are same; the Assessee is liable to be assessed in the same year in which he earns the income in the following case,

1. Income from non-resident shipping company
2. Income of person leaving India
3. Income of person likely to transfer assets to avoid tax
4. Income from discontinued business.

GROSS TOTAL INCOME

It is the aggregate taxable income under the different heads of income such as income from salary, income from house property, income from profits or gains of business, capital gains and income from other sources. Ie total income computed in accordance with the provision of the act before making any deductions under Sec 80 C to 80 U

TOTAL INCOME SEC 2(45)

Total income is arrived after making various deductions from gross total income under section 80 C to 80 U. It is computed on the basis of residential status of an Assessee

RESIDENTIAL INCOME AND TAX INCIDENCE

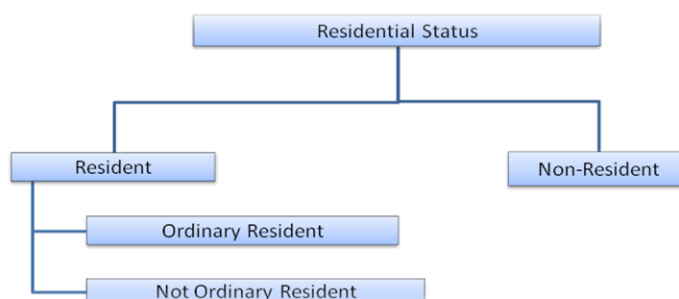
RESIDENTIAL STATUS

The residential status of a person is required to be determined for each assessment year in order to determine the scope of total income. The basis of determination of residential status in respect of each person is laid down under the provisions of section 6 which are analyzed hereinafter.

Residential status of an Individual under Income Tax Act, 1961

Residential status of an individual for income-tax purposes depends on the physical stay of the individual in India. Based on the period of stay in India in a given financial year, an individual may be classified as:

- Resident
- Not ordinarily resident (NOR)
- Non-resident (NR).



Tax incidence of an assessee depends upon his residential status rather than on his citizenship.

However, two types of categories of assessee (i.e., individual and HUF), if resident in India, will be either:

- i. Resident and ordinarily resident in India; or
- ii. Resident but not ordinarily resident in India.

The following points should be noted in this regard:

1. All taxable entities are divided in the following categories for the purpose of determining residential status:
 - An individual;
 - A Hindu undivided family;
 - A firm or an association of persons;
 - A joint stock company; and
 - Every other person.
2. Residential status of an assessee is to be determined in respect of each previous year as it may vary from previous year to previous year.
3. In view of section 6(5), if a person is resident in India for one of the sources of income, he will be deemed to be resident in India for all other sources of income in the same assessment year.

4. An assessee may enjoy different residential status for different assessment years.
5. It is not necessary that a person who is “resident” in India cannot become “resident” in any other country for the same assessment year. A person may be resident in two (or more) countries at the same time. It is, therefore, not necessary that a person who is resident in India will be non-resident in all other countries for the same assessment year.
6. Whether an assessee is a resident or a non-resident is a question of fact and it is the duty of the assessee to place all relevant facts before the income-tax authorities.

How to determine residential Status of an individual (Sec. 6):

An individual may be resident or non-resident. Further, if an individual is resident, he may be resident and ordinarily resident or resident but not ordinarily resident.

Following are the rules to determine the residential status of an individual:

a. Resident and ordinarily resident (ROR):

Must satisfy at least one of the basic conditions and both of the additional conditions

b. Resident but not ordinarily resident (RNOR):

Must satisfy at least one of the basic conditions and one or none of the additional conditions

c. Non-resident (NR):

Must not satisfy any of the basic conditions

Basic conditions [Sec. 6(1)]:

- a. He is in India in the previous year for a period of 182 days or more; or
- b. He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year.

Exception:

In the following two situations, basic condition (b) is not applicable:

1. An **Indian citizen** who **leaves** India during the previous year
 - for the purpose of employment outside India or
 - as a member of crew of an Indian ship.
2. An **Indian citizen or a person of Indian origin** who **comes** on a visit to India during the previous year.

Additional conditions [Sec. 6(6)]:

- a. He has been **resident** in India in at least 2 out of 10 previous years immediately preceding the relevant previous year.
- b. He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant previous year.

Points to be noted:

- For the first point of exception, the requirement is not leaving India for taking employment outside India but leaving India for the purpose of employment (the employment may be in India or outside India).
- A person is deemed to be of **Indian origin** if he, or either of his parents or any of his grand-parents, was born in undivided India. It may be noted that grand-parents include both maternal and parental grand-parents.
- Where a person is in India only for a part of a day, the calculation of physical presence in India in respect of such broken period should be made on hourly basis. A total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day. If, However, data is not available to calculate the period of stay of an individual in India in terms of hours, then the day on which he enters India as well as the day on which he leaves India shall be taken into account as stay of the individual in India.

How to determine the residential status of a HUF [Sec. 6(2)]:

A Hindu undivided family (like an individual) is either resident in India or non-resident in India. A resident Hindu undivided family is either ordinarily resident or not ordinarily resident.

Following are the rules to determine the residential status of a Hindu undivided family:

- a. A Hindu undivided family is said to be **resident** in India if control and management of its affairs are situated –
 - Wholly in India or
 - Partly in India and partly outside IndiaA resident Hindu Undivided family is an **ordinarily resident** in India if **karta or manager** of the family (including successive kartas) satisfies the two additional conditions given above.
- b. A Hindu undivided family is said to be **non-resident** in India if control and management of its affairs are situated wholly out of India.

Control and management for this purpose refers to the decisions taken regarding affairs of the HUF. The control and management is situated at a place where the head, the seat and the directing powers are situated.

How to determine the residential status of firm and association of persons [Sec. 6(2)]:

- a. A partnership firm and an association of persons are said to be **resident** in India if control and management of their affairs, during the relevant previous year, are situated –
 - Wholly in India or

- Partly in India and partly outside India
- b. A partnership firm and an association of persons are said to be **non-resident** in India if control and management of their affairs, during the relevant previous year, are situated wholly out of India.

Control and management for this purpose is usually situated at a place where the head, the seat and the directing powers are situated. While in the case of a firm, control and management is vested in partners, in the case of an association of persons it is vested in principal officer.

How to determine the residential status of a company [Sec. 6(3)]:

- a. An **Indian company** is **always resident** in India.
- b. A **foreign company** is **resident** in India only if, control and management of its affairs, during the relevant previous year, is situated **wholly** in India.
- c. A foreign company is **non-resident** in India, if control and management of its affairs, during the relevant previous year, is situated –
 - wholly out of India or
 - partly in India or partly outside India.

Control and management for this purpose refers to “head and brain” which directs the affairs of policy, finance, disposal of profits and vital things concerning the management of a company. Usually control and management of a company’s affairs is situated at a place where meeting of its board of directors are held. Therefore, in the case of a foreign company, if all the meetings of the Board of Directors are generally held in India and crucial decisions regarding the management of the company are taken in India, then the foreign company shall be a resident in India.

How to determine the residential status of every other person [Sec. 6(4)]:

- a. Every other person is **resident** in India if control and management of its affairs, during the previous year, is situated –
 - Wholly in India or
 - Partly in India and partly outside India
- b. Every other person is **non-resident** in India if control and management of its affairs, during the previous year, is situated wholly out of India.

Relationship between residential status and incidence of tax (Sec. 5):

Under the Act, incidence of tax on a taxpayer depends on his residential status and also on the place and time of accrual or receipt of income.

MEANING OF “INDIAN INCOME”:

Any of the following three is an Indian income:

1. If income is received (or deemed to be received) in India during the previous year and at the same time it accrues or arises (or is deemed to accrue or arise) in India during the previous year.

2. If income is received (or deemed to be received) in India during the previous year but it accrues or arises (or is deemed to accrue or arise) outside India during the previous year.
3. If income is received outside India during the previous year but it accrues or arises (or is deemed to accrue or arise) in India during the previous year.

Meaning of “Foreign Income”:

If the following two conditions are satisfied, then such income is “foreign income” –

1. Income is not received (or not deemed to be received) in India and
2. Income does not accrue or arise (or is deemed to accrue or arise) in India.

Conclusions regarding taxability:

1. **Indian Income:** Indian income is always taxable in India irrespective of the residential status of the taxpayer.
2. **Foreign Income:** Foreign income is taxable in the hands of resident (in case of a firm, an association of persons, a joint stock company and every other person) or resident and ordinarily resident (in case of an individual and a Hindu Undivided Family) in India. Foreign income is not taxable in the hands of non-resident in India.

In the hands of resident but not ordinarily resident taxpayer, foreign income is taxable only in any of the following two situations –

- a. If it is **business income** and business is controlled wholly or partly from India, or
- b. If it is **professional income** and profession is set up in India.

In any other case (like salary, rent, interest etc.), foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers.

Points to be noted regarding the concept of “receipt of income”:

Income received in India is taxable in all cases irrespective of residential status of an individual.

The following points should be noted in this regard:

1. The term “receipt” of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in “receipt” at the other place. In other words, it can be said that an assessee after receiving an income outside India cannot be said to have received the same again when he brings or remits the same to India.
2. It is not necessary that income should be received in cash. Income may be received in cash or in kind.
3. Receipt is not the sole test of chargeability to tax. If an income is not taxable on receipt basis, it may be taxable on accrual basis.

4. It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India in the previous year is also included in the taxable income of the assessee. The Act enumerates the following as income deemed to be received in India –
- a. Interest credited to recognized provident fund account of an employee in excess of 9.5%;
 - b. Excess contribution of employer in the case of recognized provident fund (i.e., the amount contributed in excess of 12% of salary);
 - c. Transfer balance from the unrecognized fund to a recognized provident fund;
 - d. Contribution by the Central Government or any other employer to the account of an employee under a notified pension scheme referred to in section 80CCD;
 - e. Tax deducted at source;
 - f. Deemed profit under section 41 and 59.

Points to be noted regarding the concept of “accrual of income”:

Income accrued in India is chargeable to tax in all cases irrespective of residential status of an assessee. Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

Points to be noted regarding the concept of “income deemed to accrue or arise in India”:

In some cases, income is deemed to accrue or arise in India under **section 9** even though it may actually accrue or arise outside India. Section 9 applies to all assesseees irrespective of their residential status and place of business.

The categories of income which are deemed to accrue or arise in India are as under –

1. Income from business connection in India:

If the following two conditions are satisfied, then the income which arises outside India because of “business connection” in India, is deemed to accrue or arise in India-

- a. The taxpayer has a “business connection” in India and
- b. By virtue of “business connection” in India, income actually arises outside India.

Meaning of business connection

It includes a person acting on behalf of a non-resident and who performs any one or more of the following –

- He exercises in India an authority to conclude contracts on behalf of the non-resident (it does not cover only purchase of goods or merchandise for the non-resident).

- He has no such authority but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident.
- He habitually secures order in India (mainly or wholly) for the non-resident or for non-residents under the same management.

2. Income through or from any property, asset or source of income in India

3. Income through the transfer of capital asset situated in India

4. Income under the head “Salaries”:

Income of an individual which falls under the head “Salaries” is deemed to accrue or arise in India if service is rendered in India. Any salary payable for rest period or leave period which is both preceded and succeeded by service in India, will also be regarded as salary earned in India.

5. Salary payable abroad by the Government to a citizen of India

6. Dividend paid by an Indian company:

Any dividend paid by an Indian company outside India is deemed to accrue or arise in India. In case of a company, other than an Indian company, dividend shall be deemed to accrue or arise at a place where the register of members is kept.

7. Income by way of interest:

Interest income of the following types are deemed to accrue or arise in India –

a. Received from Government:

Interest received from the Central Government or any State Government is deemed to accrue/ arise in India in the hands of recipient.

b. Received from resident:

Income received from a resident shall be deemed to accrue/ arise in India in the hands of recipient in all cases **except** in the following:

- Interest received from a resident in respect of any debt incurred, or any money borrowed and used by the payer of the interest, for the purpose of a business or profession carried on by the payer outside India; and
- Interest received from a resident in respect of any debt incurred, or any money borrowed and used by the payer of interest for the purpose of making or earning any income from any source outside India.

c. Received from a non-resident:

Interest received from a non-resident shall be deemed to accrue/ arise in India in the hands of recipient if it is in respect of any debt incurred, or money borrowed and used, for the purpose of a business or profession carried on by the payer in India.

8. Income by way of royalty:

Royalty income in the following situations is deemed to accrue or arise in India in the hands of the recipient –

a. Received from Government:

Royalty received from the Central Government or any State Government is deemed to accrue/ arise in India in the hands of recipient.

b. Received from resident:

Royalty received from a resident (**except** where the payment is relatable to a business or profession carried on by the payer outside India or to any other source of his income outside India) shall be deemed to accrue/ arise in India in the hands of recipient.

c. Received from a non-resident:

Royalty received from a non-resident (if the payment is relatable to a business or profession carried on by the payer in India or any other source of his income in India) is deemed to accrue/ arise in India in the hands of recipient.

9. Income by way of fees for technical services:

Income by way of “fess for technical services” of the following types are deemed to accrue or arise in India in the hands of the recipient –

a. Received from Government:

Fees for technical services received from the Central Government or any State Government is deemed to accrue/ arise in India in the hands of recipient.

b. Received from resident:

Fees for technical services received from a resident (**except** where the payment is relatable to a business or profession carried on by the payer outside India or to any other source of his income outside India) is deemed to accrue/ arise in India in the hands of recipient.

c. Received from a non-resident:

Fees for technical services received from a non-resident (if the payment is relatable to a business or profession carried on by the payer in India or any other source of his income in India) is deemed to accrue/ arise in India in the hands of recipient.