

## Direct Tax Concepts

### Chapter 1: Basic Concepts

#### Difference between Direct and Indirect Tax:

Sr. No.	Point of Distinction	Direct Tax	Indirect Tax
1	Meaning	Impact and Incidence is on the same person i.e. the burden of tax cannot be shifted.	Impact is on one person, and incidence is on another person i.e. the burden of tax can be shifted
2	Kind of Tax	Direct Taxes are progressive i.e. Tax is on basis of income level.	Indirect Taxes are regressive i.e. tax is the same for every income level.
3	Ultimate Taxpayer	The income earner is the Taxpayer.	Generally, the final consumer is the ultimate taxpayer.
4	Input Tax Credit	Not Available.	Available for everyone, except final taxpayer.
5	Administering Body	Governed by Central Board of Direct Taxes(CBDT)	Governed by Central Board of Indirect Taxes and Customs(CBIC)
6	Example	Income Tax	Goods and Services Tax

**Tax:** A proportion of income, given to the government.

**Income Tax** refers to a tax on Income earned. Income Tax is governed by the provisions of:

1. Income Tax Act, 1961
2. Income Tax Rules, 1962
3. Circulars and Notifications issued by CBDT
4. Judicial Judgements

The Income Tax rates are listed in the Finance Act every year.

**Income Tax Act, 1961:**

- Income Tax Levy is governed by the Income Tax Act, 1961.
- It came into effect from 1<sup>st</sup> April, 1962.
- It contains 298 Sections and XIV Schedules.
- A section may contain sub-sections, or clauses and subclauses.

**Income Tax Rules, 1962:**

- Income Tax Rules, 1962 are framed from time to time by CBDT(Central Board of Direct Taxes) for facilitating smooth working of the Income Tax Act, 1961.
- Rules may have sub-rules, proviso, and explanations.
- Many rates and limits, such as allowances under Section 14 are given as per Income Tax Rules.

**Circulars and Notifications:**

- Circulars are issued by CBDT to provide clarifications on points and solve problems regarding the scope and meaning of certain provisions of the Act.
- Circulars are compulsorily required to be adhered by the Income Tax Department, while assesseees have no such obligation. Assesseees however can take advantage of beneficial circulars.
- Central Government issues notifications to give effect to the provisions of the Act. Rules and Amendments can also be made by CBDT, by issuing notifications.

**Judicial Judgements:** These case laws reflect the decisions made by the court. Any judgement of the Supreme Court is construed as 'Law of Land'.

**Previous Year (PY):** Defined under section 3. Previous Year refers to the financial year in which income is earned. It can also be stated as the financial year preceding the assessment year.

**Assessment Year (AY):** Section 2(9) defines assessment year as "The period of 12 months, beginning on 1<sup>st</sup> April every year." Assessment Year is the year in which, income is assessed to tax.

Generally, the assessment year is subsequent to the previous year. For instance, For PY 2019-20, AY is 2020-21.

**Assessee:** According to Section 2(7), A person whose income is assessed to Tax is called as an Assessee.

**Assessment:** According to Section 2(8), Assessment is a procedure by which the income of an assessee is determined by the Assessing Officer.

**Person:** As per section 2(31), Person includes:

1. Individual
2. Hindu Undivided Family
3. Firm
4. Company
5. Association of Person(AOP) /Body Of Individuals(BOI)
6. Local Authority
7. Artificial Juridical Person

An assessee is a person, but a person may not be an assessee.

Explanation with Example:

Person Type	Explanation
Individual	A living human being. Eg. Mr. Rao, Ms. Sunaina
Hindu Undivided Family	A joint family as per Hindu Law. Sharma and Sons HUF, ABC HUF
Firm	Could be a sole-proprietory or partnership firm. LLP included. X & Sons, a sole proprietor. Ambiguza LLP
Company	A public or private company as per the provisions of Companies Act, 2013. Even Foreign companies are considered here. Eg. Sindhu Ltd., Raja Pvt. Ltd.
AOP/BOI	Association of Persons includes any combination of persons. Body of individuals can have only individuals as members.  AOP- Trust, Charitable Institution, etc.

	BOI- Coming together of individuals for specific purposes such as Dividing Property among family members, etc.
Local Authority	Municipal Corporation, Council, Gram Panchayat, Cantonment Board etc. concerned with civic administration.
Artificial Juridical Person	Anyone not covered under any of the above. Eg. University, Deity, Idol etc.

**Inclusive Definition:** A definition that intends to include things, over and above than what is ordinarily said is known as Inclusive Definition. It contains the words ‘means and includes’. Example: Definition of Person u/s 2(31) of Income Tax Act, 1961.

**Exhaustive Definition:** A definition confined to its statement is called as exhaustive or exclusive definition. It would contain the word ‘means’. Example: Share as per Companies Act, 2013.

Charging section of Income Tax is given under **Section 4**.

**Entry 82** provides that no tax can be levied or collected by anyone, except by law.

**Income:** Defined under section 2(24). Income includes the following:

1. Profits and Gains
2. Dividends
3. Interest
4. Commission
5. Voluntary Contributions received by a trust
6. Rental receipts, whether for House Property or otherwise
7. Amount received as Salaries
8. Allowances/Benefits/Perquisites associated with Salaries
9. Winnings from lotteries, crossword puzzles, games, etc.
10. Capital Gains
11. Sum received under Keyman Insurance Policy
12. Gifts from employer and others
13. Subsidies
14. Forfeited Advance, and so on

**Exemptions:** The Amounts that are not included in the income at all. Exemptions are provided under Section 10. Example: Agricultural Income under Section 10(2)

**Deductions:**

- Initially included in income, then reduced.
- Deductions could be Specific or General.
- Deductions could be head specific or from the Gross Total Income. Eg. Standard Deduction u/s 24 can be claimed only from Net Annual Value of House Property-Specific Deduction, While Deduction under Chapter VI A, can be claimed generally against any income-General Deduction.

**Assignment:**

Explain the following terms:

1. Income Tax
2. Assessment Year
3. Previous Year
4. Assessee
5. Person
6. Assessment
7. Income
8. Exemption
9. Deduction

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## Chapter 2: Residential Status and Scope of Total Income

### Residential Status(Section 6):

- The Tax implications on persons and Scope of Taxability of Income is determined on the basis of residential status.
- Residential status is different from citizenship, and is determined for every Previous Year (PY).
- The category to which a person belongs is reflected by legal status.
- Individuals/HUF could be either **Resident and Ordinarily Resident(ROR)**, **Resident and Not Ordinarily Resident(RNOR)** or **Non-Resident(NR)**.
- Other Persons(Company/Firm etc.) can be Resident or Non-Resident.

### Residential Status for Individuals [Section 6(1)]:

**Basic Conditions:** To find out whether individual is resident or non-resident.

An individual is said to be a resident if he fulfils any one of the two basic conditions:

- i)stays in India for a period of 182 days or more during the PY.
- ii)stays in India for a period of 60 days or more during PY,

**AND**

365 days or more during 4 PYs immediately preceding relevant PY.

However, option (ii) is not available in the following cases:

- a. An Indian citizen leaving India during relevant PY for the purposes of employment or as crew member of an Indian ship.
- b. An Indian citizen or Person of Indian Origin, coming to India on a visit during relevant PY.

In other words, individuals in cases (a) and (b), have to compulsorily fulfil 182 days condition in order to be a resident.

**Person of Indian Origin:** If an individual or his/her parents or grandparents are born in India or Undivided India(India, Bangladesh, Pakistan)

If assessee is fulfilling any basic condition, then he is a resident. If none of the basic conditions are fulfilled, assessee becomes non-resident.

Once an individual is classified as a resident, further subclassification of ROR and RNOR is required, using fulfilment of **both additional conditions**, prescribed as follows:

- a. Must have stayed in India for 730 days or more, during 7 PYs immediately preceding relevant PY.
- b. Must be a resident in 2 out of 10 PYs immediately preceding relevant PY.

If both additional conditions are fulfilled, assessee becomes ROR, else RNOR.

### **Illustrations:**

1. **Ms. Aashna Desai, aged 21 years, an Indian Citizen, living in Mumbai, Maharashtra, leaves India for the first time, for acting in Spanish Films in Valencia, Spain, on 31<sup>st</sup> May, 2019 and has not returned as on 31<sup>st</sup> March, 2020. Ascertain the residential status of Ms. Aashna Desai.**

### **Solution:**

#### **(a) Background:**

- i. Ms. Aashna Desai is an Indian Citizen.
- ii. She is a film actress who has left India for purposes of employment (Acting in films) on 31<sup>st</sup> May, 2019.
- iii. She remains outside India as on 31<sup>st</sup> March, 2020.

#### **(b) Provisions:**

An individual is said to be a resident if he/she fulfils any one of the basic conditions:

- i. Stay in India for 182 days or more during PY 2019-20.
- ii. Stay in India for 60 days or more during PY 2019-20

AND

365 days or more during 4 PYs immediately preceding PY 2019-20.

An individual is said to be ROR if he/she fulfills both additional conditions:

- i. Stay in India for 730 days or more during 7 PYs immediately preceding PY 2019-20.
- ii. Resident in atleast 2 out of 10 PYs immediately preceding PY 2019-20.

**(c) Analysis:**

Ms. Aashna Desai has stayed for 61 days in India in PY 2019-20 (April-30 days+May-31 days). Though she fulfils the second basic condition of 60+365 days, the same cannot be considered as she's leaving the country for purposes of employment. Hence, only first basic condition is available, which is not fulfilled.

**(d) Conclusion:**

Since Ms. Aashna Desai does not fulfill any basic condition, she is a Non-Resident for the PY 2019-20.

**2. In above example (1), what would be your answer if Ms.Aashna Desai has gone on a World Tour(not for employment), covering each and every African and European country.**

**Solution:****Analysis:**

In this case, Ms. Aashna Desai fulfils the second basic condition. Hence, She's a Resident for PY 2019-20.

As she is leaving India for the first time in 21 years, it is understood that she would have lived for 730 days and also been a resident for atleast 2 out of 10 PYs preceding PY 2019-20, in India.

**Conclusion:**

Ms. Aashna Desai fulfils second basic condition and both additional conditions. Hence, she is a Resident and Ordinarily Resident for PY 2019-20.

**3. Mr. AB De Villers, a South African Cricketer, comes to India on a visit for 100 days every year since PY 2008-09. Determine his residential status.**

**Solution:**



**1. Background:**

- i. Mr. AB De Villers is a South African Cricketer.
- ii. He visits India for 100 days every year since PY 2008-09.
- iii. He is neither an Indian Citizen nor Person of Indian Origin.

**2. Provisions:**

An individual is said to be a resident if he/she fulfils any one of the basic conditions:

- i. Stay in India for 182 days or more during PY 2019-20.
- ii. Stay in India for 60 days or more during PY 2019-20

AND

365 days or more during 4 PYs immediately preceding PY 2019-20.

An individual is said to be ROR if he/she fulfills both additional conditions:

- i. Stay in India for 730 days or more during 7 PYs immediately preceding PY 2019-20.
- ii. Resident in atleast 2 out of 10 PYs immediately preceding PY 2019-20.

**3. Analysis:**

1. Mr. AB De Villers, has stayed for 100 days in India in PY 2019-20 and 400 days in 4 previous years preceding PY 2019-20. Fulfilling second basic condition, he is a resident in India for PY 2019-20.

2. Calculation of no of days prior to PY 2019-20

Previous Year	No of days	Cumulative No of days	Resident/Non-Resident
2018-19	100	100	Resident
2017-18	100	200	Resident
2016-17	100	300	Resident
2015-16	100	400	Resident
2014-15	100	500	Resident
2013-14	100	600	Resident

2012-13	100	700	Resident
2011-12	100	800	Non-Resident
2010-11	100	900	Non-Resident
2009-10	100	1000	Non-Resident

In 7 years, he stays only for 700 days in India. Hence, first additional condition is not fulfilled.

In 10 years, he is a resident in 7 years in India. Hence, second additional condition is fulfilled.

#### 4. Conclusion:

Mr. AB De Villers fulfills basic condition criteria but does not fulfil the first additional condition. Hence, Mr. AB De Villers is a Resident and Not Ordinarily Resident.

- 4. Mrs. Sanjana Balasubramanian is a Canadian Citizen, born in Vancouver, Canada. Her husband, Mr. Balasubramanian Ramanathan was born in Chennai, India but settled in Toronto, Canada. Her Parents and Grandparents were born in the United States. Her Parents in Law, were born in India. Her daughter, Samaira, was born in India. Is Mrs. Sanjana Balasubramanian an Indian citizen or Person of Indian Origin, according to Income Tax Act, 1961.**

#### Solution:

A person is said to be Person of Indian Origin, if she, her parents or grandparents were born in India or Undivided India. Spouse, Children and parents of spouse's place of birth is immaterial in this regard.

Mrs. Sanjana Balasubramanian is a Canadian Citizen, as given in the question. And she was born in Canada, and her parents and grandparents were born in United States. Since none of them are born in India or undivided India, Mrs. Sanjana Balasubramanian is neither an Indian Citizen nor Person of Indian Origin.

In case of HUF, Karta's Residential Status is considered. Eg. If Karta is ROR, HUF is ROR.

## Scope of Total Income

The scope of income, under section 5, lists the incomes that are considered in total income, depending on a person's residential status.

Income can be either Indian Income or Foreign Income.

**Indian Income:** If the income is:

- Accrued in India,
- Arised in India,
- Received in India,
- Deemed to be accrued in India,
- Deemed to be arised in India, or,
- Deemed to be received in India

Then such income is treated as Indian Income.

**Foreign Income:** Incomes other than Indian incomes are foreign incomes.

**Incomes deemed to accrue or arise in India:**

- Income through or from any property situated in India
- Income through or from any business connection in India
- Income through or from any capital asset situated in India
- Income through or from any asset or source of income in India
- Interest, Royalties, Fees for Technical Services if payable by Government of India or any person resident in India
- Any income from Government of India for services outside India
- Dividend Income of Indian Companies received outside India,

are examples of Income deemed to accrue or arise in India.

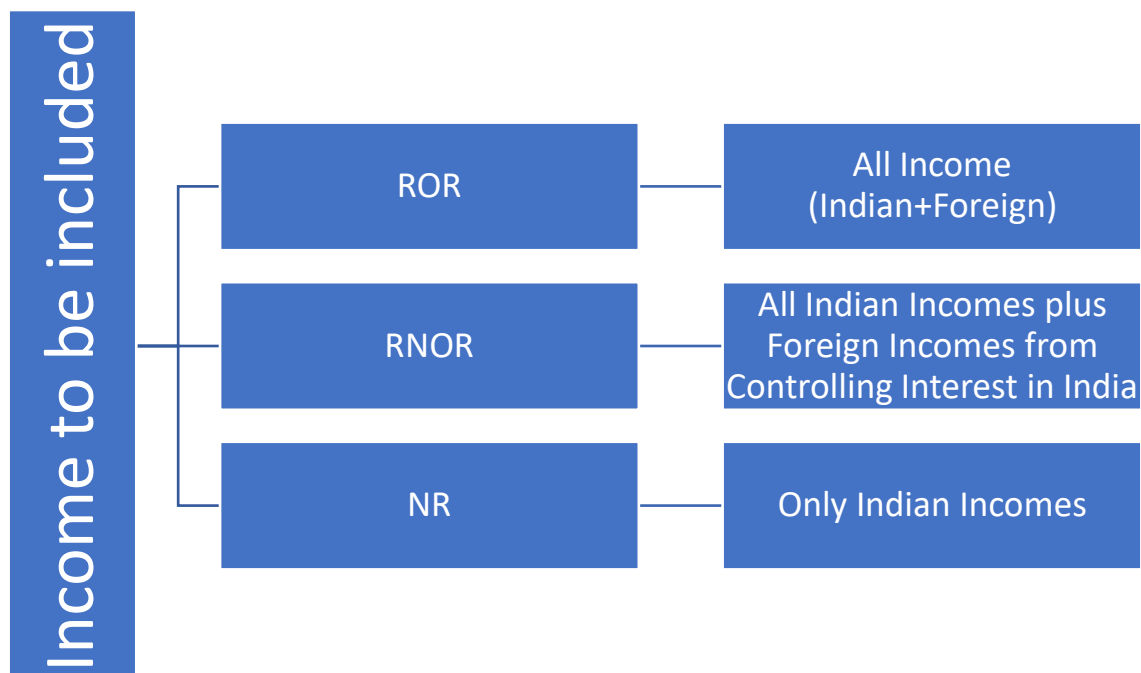


Figure 1: Income Inclusion in Scope of Total Income

Incomes, however, do not include any **exempt income** or remittances (Past untaxed profits brought to India during the previous year).

Illustration:

Mr. Harsh Jobanputra, an Indian Citizen, has worked for 3 months in the Indian Embassy, located at Kuwait, before opening his own business of apparels, and has earned the following incomes during PY 2019-20.

You are required to determine his total income if he is i)ROR, ii)RNOR, iii)NR.

Particulars	Amount(Rs.)
1. Income from Business in Dubai received in Mumbai	5,00,000
2. Income from Business in Delhi received in Singapore	3,00,000
3. Income from Business in Sydney received in London	2,00,000
4. Income from Business in Berlin, controlled from Bengaluru	7,00,000
5. Indian Agricultural income, received in India	5,00,000
6. Agricultural Income from farm in Sri Lanka, received in India	10,00,000

7. Dividend from Grower Palms Ltd., a Canadian Company received in Buenos Aires, Argentina(50% each received in India and Canada)	3,00,000
8. Dividend of Tata Motors Ltd., an Indian Company received in Tokyo	2,00,000
9. Past Untaxed Profits in Kuwait brought to India	8,00,000
10. Salary received from Indian Embassy in Kuwait	12,00,000

**Solution:**

**Statement showing Computation of Total Income**

Particulars	ROR (Rs.)	RNOR (Rs.)	NR (Rs.)
1. Income from Business in Dubai received in Mumbai	5,00,000	5,00,000	5,00,000
2. Income from Business in Delhi received in Singapore	3,00,000	3,00,000	3,00,000
3. Income from Business in Sydney received in London	2,00,000	Nil	Nil
4. Income from Business in Berlin, controlled from Bengaluru	7,00,000	7,00,000	Nil
5. Indian Agricultural income, received in India	Nil	Nil	Nil
6. Agricultural Income from farm in Sri Lanka, received in India	10,00,000	10,00,000	10,00,000
7. Dividend from Grower Palms Ltd., a Canadian Company received in Buenos Aires, Argentina(50% each received in India and Canada)	3,00,000	1,50,000	1,50,000
8. Dividend of Tata Motors Ltd., an Indian Company received in Tokyo	Nil	Nil	Nil
9. Past Untaxed Profits in Kuwait brought to India	Nil	Nil	Nil
10. Salary received from Indian Embassy in Kuwait	12,00,000	12,00,000	12,00,000
<b>Total</b>	<b>42,00,000</b>	<b>38,50,000</b>	<b>31,50,000</b>

**Explanation:**

1. Incomes under entries 1,2 and 10 are treated as Indian Income.
2. Income in entry 3, is foreign income, and hence included only in ROR.
3. Dividend from Indian Company is exempt under section 10(34).
4. Indian Agricultural Income is exempt under section 10(2).
5. Foreign Agricultural Income is fully taxable, and treated as Indian income as received in India.
6. Dividends from Foreign companies are fully taxable, and the 50% received is treated as Indian Income and taxable in India.
7. Past untaxed profits are not incomes at all.

**Exercise:**

1. Explain Basic Conditions in Residential Status.
  2. Explain Additional Conditions in Residential Status.
  3. Scope of Total Income in case of ROR, RNOR and NR.
  4. Indian Income.
  5. Foreign Income.
  6. Income deemed to accrue or arise in India.
  7. Amounts excluded from Scope of Total Income.
  8. Person of Indian Origin.
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### Chapter 3: Heads of Income

As per section 14, Incomes under Income Tax Act are classified into five major heads, namely:

- Income from Salaries: Any Income derived from Employer.
- Income from House Property: Any income derived from House property owned by the assessee.
- Profits and Gains from Business and Profession: Any business or professional income.
- Income from Capital Gains: Profit or Loss on transfer of a Capital Asset.
- Income from other Sources: Residuary Head. Incomes not covered in the above heads are covered here.

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