Highlights: Income Tax Liability

The legal position discussed is as applicable for financial year 2008-09 (Assessment Year 2009-10) unless specified otherwise. Provisions as applicable for financial year 2007-08 (Assessment Year 2008-09) are also given, where these are different from provisions applicable to AY 2009-10.

Income tax is levied under Entry No. 82 of List I of Seventh Schedule to Constitution (Union List), which reads, 'Tax on income other than agricultural income'. Entry No. 46 of List II of Seventh Schedule to Constitution (State List) reads, ' Taxes on agricultural income '.

Income Tax Act, 1961 imposes tax on income other than agricultural income. Tax on agricultural income can be imposed only by State Governments.

Section 4 of Income Tax Act, which is the charging section, states that where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income tax) of this Act (i.e. Income Tax Act) in respect of the total income of the previous year of every person.

Income tax Rates fixed under Finance Act every year - The 'Central Act' as referred to in section 4 of Income Tax Act is the 'Finance Act' enacted every year. Income Tax is payable by every assessee at the rates prescribed by Finance Act every year. The Finance Bill is presented at the time of presenting Budget, usually on last day of February every year. The relation between Finance Act and Budget is so close that often people associate budget only with taxation. Really, taxation is only one of the aspects of the Budget.

1-1 Who is assesse ? - Assessee means a person by whom any tax or any other sum of money is payable under Income tax Act. It includes deemed assessee [section 2(7) of Income Tax Act]

Person - 'Person' includes * Individual * HUF * Company * Partnership Firm * Association of Persons (AOP) or body of individuals whether incorporated or not * Local Authority like Municipality etc. * Artificial Judicial person not falling in any of the aforesaid categories e.g. a Hindu deity [section 2(31) of Income Tax Act]

1-2 Previous Year and Assessment Year

One very confusing aspect of Income Tax for a common man is the difference between Previous Year and Assessment Year.

Assessment year means the period of twelve months commencing on the 1st day of April every year [section 2(9) of Income Tax Act]

Previous year means the financial year immediately preceding the assessment year. If a business/profession is newly set up, previous year is the period from date of setting up that business or profession and ending with the financial year [section 3 of Income Tax Act]

The Financial Year for income tax purposes (called 'Previous Year') is always the year ending 31st March. The 'assessment year' is next to the 'Financial Year' or 'Previous Year' e.g. for Financial Year (FY) 2007-08 (1st April 07 to 31st March 2008), the 'Assessment Year' (AY) is 2008-09.

It may be noted that an assessee can have separate accounting year for his own purposes e.g. a Company can close its accounts on any day of the year, an individual may start his year on Diwali or any other auspicious day. However, for income tax purposes, the accounts must be closed only on 31st March.

1-3 Residential status

Income tax liability depends on residential status of a person.

Income Tax liability of a person depends on the residential status. Assessees are either resident in India, or non-resident in India.

A firm, an association of persons, a company and every other person can be either a resident or a non-resident.

In case of individuals and HUF, if they are residents, they can be either resident and ordinarily resident, or resident but not ordinarily resident.

Section 6 gives the test of residence for various types of assessees e.g. an individual, a Hindu undivided family, a firm or an association of persons or a body of individuals, a company ; and every other person.

An assessee can have different residential status for different assessment years. It is possible that a person who is resident in India for income tax purposes, may be resident in any other country for the same assessment year.

Residential status of an individual - An individual is resident in India in any previous year, if he satisfies at least one of the following conditions - (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 [section 6(1) of Income Tax Act]

However, in case of an Indian citizen who leaves India during the previous year for the purpose of employment outside India or an Indian citizen who leaves India during the previous year as a member of the crew of an Indian ship, or Indian citizen or person of Indian origin, the period of 60 days stands extended to 182 days.

In short, if a person was in India for at least 182 days in the previous year, he will be 'resident' for that year. Otherwise, he will be 'non resident'.

A resident individual will be "resident and ordinarily resident" in India if (a) He has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year **and** (b) He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant previous year [section 6(6) of Income Tax Act].

A resident who does not satisfy any one of the aforesaid conditions, will be 'resident but not ordinarily resident'.

Residential status of a HUF - In case of HUF, if control and management of its affairs is wholly or partly situated in India, it will be 'resident in India'. If control and management of its affairs is wholly out of India, it will be 'non-resident in India' [Sec. 6(2 of Income Tax Act]

A resident Hindu undivided family (HUF) can be either ordinarily resident or not ordinarily resident.

A resident Hindu undivided family will be 'ordinarily resident in India' if the karta or manager of the family (including successive karta) (a) has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year **and** (b) has been present in India for a period of 730 days or more during 7 years immediately preceding the previous year.

If even one of the conditions is not satisfied, the HUF will be 'resident but not ordinarily resident in India' [section 6(6)(b) of Income Tax Act].

Residential status of the firm and association of persons - A partnership firm and an association of persons will be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. If control and management of their affairs are situated wholly outside India, it will be non-resident in India. [Sec. 6(2)]

Residential status of a company - A company incorporated in India is an Indian company. It will always be 'resident in India'. A foreign company (i.e. company incorporated abroad), is resident in India **only** if, during the previous year, control and management of its affairs is situated **wholly** in India. [Sec. 6(3) of Income Tax Act]

Residential status of "every other person" - Every other person will be resident in India if control and management of his affairs is wholly or partly situated within India during the relevant previous year. If control and management of his affairs is wholly situated outside India, it will be non-resident [Sec. 6(4) of Income Tax Act]

1-4 Tax liability depending on residential status

Income can be broadly classified as 'Indian Income' and 'Foreign Income'.

'Indian income' is always taxable in India in case of all tax payers, whether resident or non-resident.

'Foreign income' is taxable in India if the assessee is (**a**) resident (in the case of a firm, AOP company and every other person) or (**b**) resident and ordinarily resident (in the case of an individual or a Hindu undivided family) in India.

If an individual or a HUF is resident but not ordinarily resident, foreign income is taxable only if it is (a) business income and business is controlled from India, or (b) professional income from a profession which is set up in India. Otherwise, foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers [section 5(1) of Income Tax Act]

Foreign income is not taxable if the assessee is non-resident in India [section 5(2) of Income Tax Act]

Section 9 of Income Tax Act defines 'income deemed to accrue or arise in India'. It will be 'Indian Income' and taxable in all the cases.

1-5 Different heads of income

All income is classified under following heads of income - * Salaries * Income from House property * Profits and gains of business or profession * Capital Gains * Income from other sources (e.g. interest on securities, lotteries, races) [section 14 of Income Tax Act]

Calculation of income tax - Income from each of these sources is first calculated. All this income is added to find out total income of the assessee. Permissible deductions are reduced and then income-tax payable is calculated at the prescribed rates.

Income from one head can be set off against loss from other head, unless specifically prohibited. In Rajasthan State Warehousing Corporation v. CIT 2000 AIR SCW 629, it was held that if income is derived from various heads, assessee is entitled to claim deduction permissible under respective head whether or not computation under each head results in taxable income. If income to assessee arises under any of the heads of income but from different items e.g. different house properties or different securities etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible. - . - If assessee carries business in various ventures, entire expenditure incurred on all ventures is deductible if all ventures constitute one business

1-6 Broad mode of computation of Income

		Rs.
1	Income from salaries, allowances and perquisites	
2.	Less : Deduction under section 16, entertainment allowance and professional tax:	
3.	Taxable income under the head "Salaries" (1-2)	.
4.	Income from house property - Adjusted net annual value	
5.	Less : Deductions under section 24	
6	Taxable income under the head Income from house property (5-6)	
7.	Profits and gains of business or profession - Profit/loss as per P&L account after deducting amounts not allowable as deduction, adding amounts which are allowable as deduction and adding income taxable under this head, though not credited/debited to P&L account	
8.	Less : Incomes which are credited to P & L A/c but are exempt under sections 10 to 13A or are taxable under other heads of income	
9.	Taxable income under the head Profits and gains of business or profession (7-8)	
10.	Capital gains	
11.	Less : Amount exempt under sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G and 54GA	
12	Taxable income under the head Capital gains (10-11)	
13	Income from other sources	
14.	Less : Deductions under section 57	
15	Taxable income under the head Income from other sources (13-14)	
16.	Total Income (3+6+9+12+15)	
17	Less : Adjustment on account of set-off and carry forward of losses	
18.	Less : Deductions under sections 80C to 80U	
19	Total income or net income liable to tax (16-17-18)	
20	Income subject to special rate of tax (e.g. capital gains)	
21	Balance income subject to normal rate (20+21 = 19)	
	Computation of tax liability	
A1.	Tax on net income at special rates	
A2	Tax on income at normal rates	
B	Less : Rebate under section 88E in respect of STT (available for AY 2008-09 but not available for AY 2009-10)	
C	Add : Surcharge	
D	Add: Education cess and secondary and higher education cess	

E	Less : Rebate under sections 86, 89, 90, 90A and 91	
F	Net Tax payable (A1+A2-B+C+D-E)	
G	Tax paid on self-assessment	
H	Tax deducted or collected at source	
I	Tax paid in advance	
J	Balance Tax payable (F-G-H-I)	
		________

Rates of Income Tax

2 Major types of assessees and the rates of tax applicable is summarised here.

2-1 Individual - An individual may get income from salary, house rent, business, profession, interest etc. He does not have to pay income tax on dividend income at all. An individual may carry out business under some different name. However, this is only for convenience of business or trade. The income of a proprietary firm is added to his income for purpose of income tax. If a person gets salary from a partnership firm where he is a partner, the income is treated as 'business income' though termed as 'salary'.

The income tax rates are as follows :

Tax rates for the assessment year 2011-12 (FY 2010-11) are as follows -

For resident woman (who is below 65 years at any time during the previous year), rates for AY 2011-12 are as follows –

Net income	Income-tax rates
Up to Rs. 1,90,000	Nil
Rs. 1,90,000 – Rs. 5,00,000	10% of (total income minus Rs. 1,90,000)
Rs. 5,00,000 – Rs. 8,00,000	Rs. 31,000 + 20% of (total income minus Rs.
Above Rs. 8,00,000	Rs. 91,000 + 30% of (total income minus Rs.

For resident senior citizen (who is 65 years or more at any time during the previous year), rates for AY 2011-12 are as follows –

Net income range	Income-tax rates
Up to Rs. 2,40,000	Nil
Rs. 2,40,000 – Rs. 5,00,000	10% of (total income minus Rs. 2,40,000)

Rs 5,00,000 – Rs 8,00,000	Rs 26,000 + 20% (total income minus Rs. 5,00,000)
Above Rs. 8,00,000	Rs. 86,000 + 30% of (total income minus Rs. 8,00,000)

For any other individual, every HUF/AOP/BOI/artificial juridical person, rates for AY 2011-12 are as follows –

Net income range	Income-tax rates
Up to Rs. 1,60,000	Nil
Rs. 1,60,000 – Rs. 5,00,000	10% of (total income minus Rs. 1,60,000)
Rs. 5,00,000 – Rs. 8,00,000	Rs. 34,000 + 20% of (total income minus Rs. 8,00,000)
Above Rs. 8,00,000	Rs. 94,000 + 30% of (total income minus Rs. 8,00,000)

Education cess and SAH Education Cess - Education cess payable is 2 per cent of income-tax and surcharge. Secondary and higher education cess is 1 per cent of income-tax and surcharge. This is in addition to income tax.

2-2 HUF - An Hindu Undivided Family (HUF) consists of all persons lineally descended from a common male ancestor. It is assessable in respect of income derived from the joint family corpus. However, income earned by individual members of HUF in their individual and personal capacities is taxed as their personal income. Such income is not treated as income of HUF. Thus, it is possible to have an income from a proprietary firm (in individual capacity) as well as income from a business of HUF. Both are eligible for separate tax exemptions. Business of HUF can, of course, be conducted in a different name. In such case, the HUF will be proprietor of the firm in the name of which business is being conducted.

It may be noted that there is no question of 'forming' an HUF, as every male Hindu automatically has 'HUF'. A Hindu male can have his own separate HUF even if his father or son has separate HUF. One HUF with only one male member is permissible. Any 'HUF' can have business run by head of the HUF called 'karta'.

If an individual throws his separate property into the property of HUF, income from such converted property will be included in the total income of such individual. Hence, the HUF business should be from independent source of capital and not from the funds provided by an individual member of the HUF. Thus, if an HUF intends to conduct a business, its financial resources have to be carefully planned.

HUF should start business with loans / gifts from unrelated persons / bankers. Accounts and finances of HUF business should be kept separate. Otherwise, there is a possibility that income of HUF will be clubbed with the income of an individual.

The income of HUF is chargeable at the same rate as individual income as stated above. Thus, if an individual splits his business - partly in his individual capacity and partly in name of firm owned by HUF, considerable tax saving is possible, if done systematically and carefully.

2-3 Partnership Firm - Income of the partnership firm has to be calculated after deducting salary and interest payable to partners at prescribed rates. Specific provisions in respect of partnership firm have been explained later.

A firm is taxable at the rate of 30 per cent for the assessment year 2010-11 and 2011-12. There is no surcharge. In addition, Education cess is 2 per cent of income-tax and Secondary and higher education cess is 1 per cent of income-tax.

2-4 Company - The tax on income is as follows -

In case of domestic company, income tax is @ 30% for assessment year 2010-11 and 2011-12. Surcharge @ 7.5% of income-tax for AY 2011-12 (It was 10% for SY 2010-11), if net income exceeds Rs. 1 crore

In case of foreign company, income tax is @ 40% for assessment year 2010-11 and 2011-12. Surcharge @ 2.5% of income-tax, if net income exceeds Rs. 1 crore.

Marginal relief is available where net income exceeds Rs. 1 crore.

In addition, Education cess is 2 per cent of income-tax and Secondary and higher education cess is 1 per cent of income-tax and surcharge.

Dividend Distribution Tax - A domestic company paying dividend will have to pay dividend distribution tax u/s 115-O. The rate applicable for FY 2010-11 is 15% plus surcharge @ 1.125% plus education cess @ 2% plus SAH education cess of 1% of income tax. Total 16.60875%.

Dividend distribution tax is payable within 14 days from date of declaration/distribution/payment of dividend whichever is earlier. The dividend will be tax free at the hands of assessees.

Mutual funds have to pay dividend distribution tax u/s 115R of Income Tax Act. The rate as applicable for financial year 2010-11 is 12.5% on income distributed to any individual or HUF and 20% on income distributed to any other person. In addition, surcharge, education cess @ 2% and SAH education cess @ 1% will be payable. Total is 13.840625% in case of individual or HUF unit holder and 22.145% in other cases.

In case of money market mutual fund or a liquid fund, rate is 25%. Including surcharge and education cess, it is 27.68125%.

The dividend will be tax free at the hands of assessees.

2-5 Minimum Alternate Tax

Many companies charge depreciation in their books on straight line method. Thus, the profit shown is higher in the accounts maintained for company law purposes and they can declare dividend. However, for income tax purposes, they charge depreciation on WDV which is higher. Thus, for income tax purposes, they may show low profit or even loss, while in balance sheet prepared for company law purposes, they will show high profits, which is called 'book profits. Hence, such companies have to pay minimum income tax [section 115JB]. This tax is termed as 'Minimum Alternate Tax' (MAT).

In Apollo Tyres v. CIT (2002) 122 Taxman 562 (SC 3 member bench), it was held that the assessing officer cannot reopen the accounts certified by auditors and adopted in general meeting. He has limited powers of making additions and reductions as provided in the section. [In this case, it was held that assessing officer cannot add back the depreciation for earlier years provided in accounts].

Rate of minimum alternate tax, as % of book profit is as follows, for Assessment Year 2011-12 -

	If book profit does not exceed Rs. 1 crore			If book profit exceeds Rs. 1 crore			
	IT %	EC and SAHC %	Total	IT	SC	EC and SAHC	Total
Domestic company	18	0.54	18.54	18	1.35	0.5805	19.9305
Foreign company	18	0.54	18.54	18	0.45	0.5535	19.0035

Marginal Relief - If book profit of a company exceeds Rs. 1 crore, the minimum alternate tax cannot exceed the following : (Rs. 15 lakh + Book profit – Rs. 1 crore) + EC + SAHC.

2-6 Co-operative societies - Following rates are applicable to a co-operative society for the assessment year 2010-11 and 2011-12-

Net income	**Rate of income-tax**
Up to Rs. 10,000	10
Rs. 10,000 - Rs. 20,000	20
Rs. 20,000 and above	30

No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

Various exemptions are available to cooperative societies u/s 80P of Income Tax Act. However, there is no exemption to urban cooperative banks.

7 Local authorities - Tax rate is 30%. No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

2-7 Capital gains

In case of short term gains covered under section 111A of Income Tax Act , the rate is 15% for Assessment Year 2010-11 and 2011-12. Section 111A is applicable in respect of securities transactions which are subject to securities transaction tax.

In case of long term capital gains, tax rate is 20% for AY 2010-11 and 2011-12[section 112].

There is no surcharge for AY 2010-11 and 2011-12.

In addition, education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

2-8 Wealth-tax - Wealth tax for individual, HUF or a company is 1% in respect of wealth over Rs 30 lakhs for Assessment Year 2010-11 and 2011-12. There is no surcharge or education cess.

One house or part of house belonging to an individual or HUF is excluded for purpose of wealth tax. The assets have to be valued as per Valuation Rules.