CHAPTER - II

PROFILE OF INCOME-TAX

2.1 A Brief Study of Income-Tax Law

2.2 Concept of Deduction

2.3 Significance of Deductions

2.4 Rebate and Exemptions

CHAPTER - II

PROFILE OF INCOME TAX

2.1 A brief Study of Income-Tax Law :

History of Income-Tax Act :

In the year 1886, the first Income-Tax Act came in to existance. The provisions made under this Act for lavying tax continued to operate up to 1918. Even subsequent Acts are based on this original Act. In the year 1918 another Income-Tax Act was passed. This was replaced in the year 1922. Income-Tax Act of 1922 was remained in force up to 31st March,1961. In September, 1961 new Income-Tax Act was passed. This new Act consists of 298 Sections, and number of sub-sections, schedules, rules, sub-rules. This Act has also been amended from time to time.

Scheme of Taxation :

Income-tax is levied on total income of person. Income tax is not levied on gross total income. It is levied on the income which is calculated as per provisions of the Act and Income-tax is to be levied as per prevailing rates. The rates are declared in Finance Act of each year. Income tax Act is administered by the Central Government through the body called Central Board of Direct Taxes. Through this Act Government had made efforts to levy higher rates of tax on such persons whose total income is more and it also gives several incentives to savings and investments to curbs down the unnecessary and wasteful expenditure.

Income :

It is very necessary to know the concept of 'Income' because law of income tax is based on this concept. Section 2(24) defines the concept of income in a following manner.

'Income includes'

(i) Profits and gains

(ii) Dividend

(iii) Any voluntary contributions received by a charitable or religious trust or other institution (except in case where such contributions have been received with a specific direction that these sums would form part of the corpus of the trust or institution).

(iii) The value of any perquisite or profit in lieu of salary taxable under clauses(2) & (3) of Section 17.

(iiia) Any special allowance or benefit, other than perquisites included under Sub-Clause (iii), specially granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

(iiib) any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.

(iv) Value of any benefit or amenity, whether convertible in to money or not, obtained by a representative assessee or by any person on whose behalf such benifit is received by representative assessee and sum paid by representative assessee in respect of any obligation which but for such payment would have been payable by the person on whose behalf representative assessee has made such payment.

(iva) The value of any benifits or perquisites, whether convertible in to money or not, obtained from a company either by a director or by a person, who has a substantial interest in the Company, or by a relative of the director of such person, and any sum paid by such company in respect of any obligation but for which, such payment would have been payable by the director other person aforesaid.

(v) Any sum chargeable to income-tax under Clauses (ii) and (iii) of Section 28 or Section 41 or Section 59.

(va) The value of any benifit or perquisite taxable under Clause (iv) of Section 28.

(vi) Any capital gains taxable under Section 45.

(vii) The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with Section 44 or any surplus, taken to be such profits and gains by virtue of provisions contained in first schedule.

(viii) Any annuity due or commuted value or any annuity paid under the provisions of Section 280 D.

(ix) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

(x) Any sum received by the assessee from his employees contributions to any provident or superannuation fund or any fund set-up under the provisions of the employees State Insurance Act 1948 or any other fund for the welfare of such employers.

Assessee Section 2(7)

Assessee means a person by whom any tax or any other sum of money (i.e. penalty or interest) is payable under the Act. The term includes the following persons

(1) Every person in respect of whom any proceding under the Act has been taken for the assessment of his income (or loss) or of the income or loss of any other person inrespect of which he is assessable.

(2) Every person in respect of whom any proceding under the the Act has been taken for computation of refund due to him or to such person in respect of whom he is assessable.

(3) Every person who is deemed to be an assessee under any provision of the Act.

(4) Every person who is deemed to be an assessee in default under any provision.

Assessment Year Section 2(9)

Assessment year means the period of twelve months starting from April 1 of every year and ending on 31 March of the next year. The period of assessment year is fixed and it remains so irrespective of the accounting year adopted by the assessee.

Previous Year Section 3

The word previous means 'coming before'. According to the Income-Tax Act income earned during previous year which is to be assessed to tax in the assessment year or previous year is the financial year immediately preceding the assessment year or any other year ending within that financial year.

Assessment Section 2(8)

'Assessment' is defined to include reassessment. In general context, the word 'assessment' means computation of tax and procedure for imposing tax liability.

Total Income Section 2(45)

Total income of an Assessee is gross total income which includes income from salaries, income from house property, profits and gain of business or profession, capital gains and income from other sources, interest on securities as this reduced by amount deductible under verious sections and under Sections 80C to 80U.

Business

Section 2(3) has defined the term Business as "any trade commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture".

Profession

A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator. e.g. Financial accountants, cost Accountants, Management Accountants, Engineers, Journalists, Lawyers, Authors etc. So profession refers to those activities whether the livelihood is earned by the persons through their intellectual or manual skill. As per Section 2(36) profession also includes vocation, where vocation means any type of activity in which a person is engaged and he earns his livelihood from such activity.

Depreciation

Income-Tax Act 1961 defines the term depreciation as "It is the process of allocating the cost of long term asset to the time periods in which it used in a systematic and rational manner. As time passes, the value of a capital asset goes on decreasing and depreciation measures this decrease in monetary value which in turn is treated as business expenditure and debited to Profit and Loss Account of the Assessee.

Block of Asset

Under Section 2(11) Block of Assets means the group of assets falling within a class of assets in respect of which the same rate of depreciation has been prescribed.

Written Down Value

According to Section 43(6) written down value means

(a) In the case of asset acquired in the relevant previous year, the actual cost to the assessee shall be deemed as written down value.(W.D.V.)

(b) In case of assets aquired before the previous year, the written down value is the actual cost less total amount of depreciation (i.e. normal depreciation, extra shift allowance, initial depreciation claimed after 31-3-1983).

(c) Written down value for the assessment year 1988-89.

For the purposes of calculation of depreciation for the assessment year 1988-89, it shall be calculated as under :

(i) Take the aggregate of the written down value of all the assets falling within that block of assets at the beginning of previous year.

(ii) Add the actual cost of any asset acquired during the previous year and falling in the same block of assets.

(iii) Deduct the money receivable by assessee together with the scrap value in regard to any asset of same block which is sold, discarded, demolished or distroyed during the previous year.

The balance amount shall be the written down value for calculating depreciation.

2.2 Concept of Deduction :

Deductions refer to an amount to be deducted from income in respect of an amount of expenditure incurred in earning a particular income. It is an act or process of deducting an amount sacrificed for earning a particular income.

Thus the cost of deriving any income is deducted from respective heads of income under different sections.

Almost all expenses actually incurred by the tax payer to earn his income are allowed as deductions subject to statutory limits. Following are the related sections and nature of deductions available under income tax.

- Section 16(i) & (ii) provides deduction against salary.
- Section 19(i)&(ii) & Section 20 provides deductions against interest on securities.
- Section 23(i) to 24(i) to (x) provides various deductions against income from House Property.
- Section 28 to 43 B provide number of deductions against business income.
- Section 48(i) & (ii) gives deductions against capital gains to all assessees.
- Section 57(i) to Section 57(iii) provides deductions against income from other sources.
- Section 80 C to 80 GGA provides deductions against certain payments.
- Section 80 HH to 80 U provides deductions for certain incomes.

Sometimes deductions are also allowed to achieve certain social and economic objectives. Deductions may be viewed as an incentive to encourage expenditures on items which generate external benifits. Deductions are allowed as a means of encourageing or for channalising certain payments or contributions and investments in certain direction. Say for example, investment in backward areas or in Government Securities, such as National Defence Bonds etc. or in Unit Trust of India etc.

2.3 Significance of Deductions :

(1) Facilitates Balanced Economic Development -

A country is said to be well developed provided its present and potential sources of income and wealth are equally distributed. Deductions allowed in respect of new industrial units set up in a industrially backward areas attracts investment in such specified backward areas. This enables Government to remove the regional disparity and to have balanced economic development of country.

(2) Advancement of Science and Technology -

Deductions to the donors of approved institutions established for undertaking research work in approved projects, contributes for promotion and development of Science and Technology.

(3) Promotes Export Trade -

Deductions extended to export oriented units attract investments in production of export goods and thereby increasing export trade. Increase in export trade brings more foreign exchange and improves balance of payment position.

(4) Accelerates the rate of savings, investment and capital formation -

Aim of every Government is to achive faster economic development. Faster economic development requires higher rates of capital formation. Huge amount of funds are to be provided from various sources. Taxation Policy of developing countries aims at providing required revenue progressive rates of taxation and falling value of a rupee on the one hand and various incentives offered in form of deductions allowed on the other hand restricts consumption and attracts large scale savings, investments. Deductions for investments in specified areas fasters the capital formation and economic growth.

(5) Development of Research & Technology on various Sectors -

Deduction of expenditure made on scientific research by a business,weighted deductions etc. will enhance the potential for scientific research in the country, resulting in developing a high Technology.

2.4 Exemptions and Rebate :

Deductions are different from exemptions and rebates. I will not go in detail regarding these terms, but I will explain meaning of these two terms.

Exemptions :

Exemptions mean the incomes which are to be taken in to computation for the purpose of determining either the taxable income or the rate of tax; except agricultural income for which considered for rate.

Examples of exempted incomes -

1) Income derived from trust property.
2) Income of local authorities.

Rebate :

Rebate is a concession given on payment of tax against incomes farming part of total income on which no tax is payable. The object of giving rebate is to avoid either double taxation or give effect to the income exempted from tax. Rebate is given in respect of levy of tax on certain incomes on which tax is already paid by at some one at its origin; or which not tax is payable. Rebate is allowed at an average rate of income tax or at $27\frac{1}{2}$ % whichever is less.

Examples of incomes against which rebate is available

1) Share of profit from unregistered firm
V/s 86(iii)

2) Tax free Government or Tax free commercial securities.