PART - I

INCOME TAX - THEORY

1. GENERAL PRINCIPLES/CANONS AND MEANING OF INCOME TAX

SYNOPSIS:

A. Introduction (Income Tax Act and Finance Acts)

B. Difference between Income Tax Act and Finance Act

C. Requisites of valid tax

D. Difference between Tax and Fee

E. Difference between Toll and Tax

F. Difference between Tax and Cess

G. Definition/concept of Income

H. Assessee: [Sec. 2 (7)]

I. Special Class of Assessees under the Income Tax Act, 1961

J. Person [Sec. 2 (31)]

K. Valuation date

A. INTRODUCTION: (INCOME TAX ACT AND FINANCE ACTS):

The Income Tax Act, 1961 is a comprehensive Act and contains 298 Sections, Sub-Sections and 14 Schedules. The Income Tax Act 1961 has been amended several times for accommodating the changing circumstances.

Finance Acts are enacted by the parliament every year reflecting the Government's economic position. Every year the economic situation of the nation changes, and Tax rates like Income tax, Central Excise, Customs, etc., are fixed by the Annual Finance Act and not by the Income Tax Act.

B. DIFFERENCE BETWEEN INCOME TAX ACT AND FINANCE ACT:

1. The Income Tax is a permanent Act, whereas the Finance Act is passed every year and its main purpose is to fix the rates to be charged under the Income Tax Act for that year.

2. Tax is charged for a year in accordance with and subject to the provisions of the Income Tax Act, but the said charge will be in accordance with the rates prescribed under the Finance Act.

3. The liability to tax for any year is imposed under the Income tax Act 1961, and its quantification only being dependent on the Finance Act of the said year.

4. The power to levy income tax need not necessarily be confined to the Income Tax Act 1961 alone but it may be derived even from the Finance Acts.

The law of Indian Income Tax is dealt under the Income Tax Act, 1961 and the rules framed under it. Income Tax is tax on the "Income". The "Tax" is a charge on a person's income or property. So, the meaning of "Income" is a very important one.

C. REQUISITES OF VALID TAX:

I. Taxation:

Taxation is the inherent power of the sovereign, exercised through the legislature, to impose burdens upon subjects and objects within its jurisdiction for the purpose of raising revenues to carry out the legitimate objects of government.

It is defined as the act of levying a tax, i.e. the process or means by which the sovereign, through its law-making body, raises income to defray the necessary expenses of government.

It is a method of apportioning the cost of government among those who have the rights to enjoy its benefits and must therefore bear its burdens.

II. Taxes:

Taxes are the enforced by proportional contributions from persons and property levied by the law-making body of the State by virtue of its sovereignty for the support of the government and all public needs.

III. Essential elements of a valid tax:

1. Tax is levied by authority of law.
2. It is an enforced contribution by people.
3. It is payable in money.
4. It is proportionate in character.
5. It is levied on persons, property, or the exercise of a right or privilege.
6. It is levied by the State which has jurisdiction over the subject or object of taxation.
7. It is levied by the law-making body of the State.
8. It is levied for public purpose or purposes.

IV. Purpose of taxation:

1. The primary purpose of taxation on the part of the government is to provide funds or property with which to promote the general welfare and the protection of its citizens and to enable it to finance its multifarious activities.

2. Taxation is employed for purposes of regulation or control.

a. Imposition of tariffs on imported goods to protect local industries.

b. The adoption of progressively higher tax rates to reduce inequalities in wealth and income.

c. The increase or decrease of taxes to prevent inflation or ward off depression.

V. Theory and basis of taxation:

1. The power of taxation proceeds upon the theory that the existence of government is a necessity; that it cannot continue without means to pay its expenses; and that for these means, it has a right to compel all its citizens and property within its limits to contribute.

2. The basis of taxation is found in the reciprocal duties of protection and support between the State and its inhabitants. In return for his contribution, the taxpayer receive benefits and protection from the government. This is called *"benefits received principle."*

a. Life blood or necessity theory:

The life blood theory constitutes the theory of taxation. It provides that the existence of government is a necessity. A government cannot continue without money to pay for its expenses. For this purpose, it has a right to compel its citizens and property within its limits to pay money in the form of tax to it.

In ***Commissioner v. Algue***, the Supreme Court held that taxes are the lifeblood of the government and should be collected easily without any hindrance. Without taxes, the government functions would be paralyzed. The government, in return, is should give its people tangible and intangible benefits so that the lives of the people are improved materially and in moral values

b. Benefit-received principle:

This principle serves as the basis of taxation. It is founded on the reciprocal duties of protection and support between the State and its people. It is called ***"symbiotic relation"*** between the State and its people.

For his contribution of money to State, the tax payers do not receive any special benefit directly but they and others (under exempted category)receive general advantages and protection in common. [***Lorenzo v. Posadas***]

No one is allowed to object to or resist payment of taxes solely because no personal benefit has been given to him in return of his payment of tax. [***Lorenzo v. Posadas***]

D. DIFFERENCE BETWEEN TAX AND FEE:

A tax and a fee are not the same thing. Tax is levied for the public at large. The money collected from a tax payer does not help him directly in any way. It goes to the consolidated fund of India and it is used for the general welfare of the public. There is no direct return to the tax payer.

In other words, there is no ***quid pro quo*** (something in return). A fee is a specific charge for some direct services rendered. There is quid proquo and the fee payer gets some special services or treatment.

For e.g., payment of college fees, payment of temple worship fee, have the element of quid pro quo. A fee does not go to the consolidated fund of India. It is not used for the welfare of the common people.

A tax is a charge on the person's income or property, whereas fees is a payment for special services rendered. Tax is a compulsory payment for which the tax payer does not get direct benefit, whereas payment of fees is for some work done for the benefit of the person who pays the fees.

Though tax can be levied only within the tax entries, fees can be collected for a non tax entry. The fees collected for the various services go to the particular department whereas tax collected is merged in the general revenue.

Eg. of Tax: Income Tax, fixed sum collected by the Municipality for supply of water, amount charged for registration of document, etc.

Eg. of fees: Fee for getting a licence as a Stamp vendor, supply of water by a municipality according to the meter reading and collection of charges according to the water supplied, etc.

Government may charge user fees, tolls, or other types of fees in exchange of particular goods, services, or use of property. These are generally not considered taxes, as they are levied as payment for a direct benefit to the individual paying. For eg., toll fee.

TOLL FEE:

1. This is a fee charged to travel via a road, bridge, tunnel, canal, waterway or other transportation facilities.

2. Toll fee are used as fee to pay for public bridge, road and tunnel projects.

3. Such toll fee are used to construct and maintain private transport links.

4. The toll fee is a fixed charge, varied depending on the vehicle type, or the distance covered on long routes.

E. DIFFERENCE BETWEEN TOLL AND TAX:

Toll fee is collected from the transport users for the use of the transport links like roads, bridges, water way etc., and the toll so collected are used to construct new transport links, maintenance existing transport links etc., which are of direct use to the transport users.

Tax collected, on the other hand, is used for overall national development and there is no direct benefit to the tax payer.

F. DIFFERENCE BETWEEN TAX AND CESS:

Cess means "tax on tax". Tax is calculated as a percent from income/transaction, whereas Cess is calculated on tax.

For eg., In India, to give a lift to primary education in the country, education cess of two percent on Income tax, Corporation tax, Excise and Customs duties and service tax is levied.

The entire amount is allocated for education including nutritious cooked mid-day meal.The education cess is 2 per cent surcharge on the total payable tax, and not 2 per cent of total income.

The other small cesses collected are-

Cess on Bidis, iron ore, Limestone and dolomite, Feature films, Coal and coke, Copra, Coffee, Oil and oil seeds, Vegetable oil, Jute, Rubber, Salt, Sugar, tea, Cotton, Textiles, Handloom cess, woolen fabrics, cotton fabrics, Manmade fabrics, Tobacco, Paper, Straw board, Automobiles and Matches.

Duty:

It is an indirect tax. The Central Government or the State Government imposes the duty to collect payment for import, export, sale of goods, transfer of property, etc. E.g.: Stamp duty, Customs duty, estate duty, etc.

Fine:

Any person who fails to pay tax, fees, duties, etc., within the time specified by the statute, shall be liable to pay fine. Fine is called penalty under Income Tax Act and dealt under sections 140 A (3), 133 (1A), 221 (1) and 271 to 273.

The **difference between tax and fine** is that tax is payable to the Government on a person's income or property whereas fine is payable when the person fails to pay the tax within the time specified by the respective Act or Statute.

G. DEFINITION/CONCEPT OF INCOME:

"Tax" is a charge on a person's income or property. So, the meaning of "Income" is a very important one.

1. Income:

Income means a periodical monetary return, coming in with some sort of regularity from definite sources. The source need not be continuously productive, but it must be one whose object is the production of money at definite return.

2. Heads of Income:

The income of an individual is assessed into six categories known as heads of income. They are:

a. Salaries

b. Interest on Securities

c. Income from house property

d. Profits and gains of business or profession

e. Capital Gains

f. Income from other sources

Computation must be made under particular head of Income and any item of income which cannot be considered under any of the first 5 heads may be included under the head "Income from other Sources".

As per the Income Tax Act, 1961, the term 'income' includes the following also namely:

a. Profits and gains of Business or Profession

b. Dividend

c. Profit in lieu of salary, perquisites

d. Allowances granted to the assessee to meet his expenses incurred for performance of his duties like HRA, Medical allowance, etc given by an employer to his employee.

e. Any capital gains

f. Winning from lotteries, crossword puzzles, races, card game, T.V. Show, etc

g. Any sum whether in cash or kind received for fund created for welfare of employees.

h. **Illegal income:** The Income Tax Act does not make distinction between legal source of income or illegal source of income. This means that gambling, smuggling income is also chargeable to tax under the Income Tax Act.

i. Gifts of personal nature for eg. birthday/ marriage gifts are not treated as income, but there are some exceptions in this rule.

CIT Vs. K. Thangamani , T. C. (A) Nos. 391 & 392 of 2004:

The Madras High Court held that the primary function of the Income Tax Act is to bring the income of various kinds into the tax net; illegality tainted with the earning has no bearing on its taxability; even if the assessee has acquired income by unethical manner or by resorting to acts forbidden by law, such income earned by the offender is still an income liable for assessment.

Incomes which are not "Includible" in the total income of the assessee is dealt in Sec. 10 of the I.T. Act.

Sec. 4 of the Income Tax Act provides that tax charged for any year shall be at any rate or rates for the year in accordance with the provisions of the finance Act of the year.

3. Computation of Income Tax:

An assessee has to pay tax on all incomes put together and not by reference to the income under particular heads.

(E.g.): Tax is not paid as 'tax on salaries', 'tax on house property', etc., but paid on the total income consisting of all the incomes or loss falling under the different heads of income.

Thus Income Tax is one Tax and not a collection of Taxes levied separately on income computed under each head of income separately.

H. ASSESSEE: [Sec. 2 (7)]

"Assessee" means a person by whom any tax, or other sum of money is payable under the Act. It includes:

a. every person in respect of whom any proceeding under the Income Tax Act, has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, loss sustained by him, or by such other person.

b. every person who is deemed to be "an assessee under the Income Tax Act" and

c. every person who is deemed to be "an assessee in default".

The term **"Assessee"** includes every person who is liable to pay tax or any other sum of money, like penalty interest etc; and every person against whom Assessment proceedings are taken for his own assessment or for the assessment of any person.

An assessee need not necessarily have liability to pay tax; the proceedings of assessment may even result in refund. The term "assessment" includes "re-assessment".

I. SPECIAL CLASS OF ASSESSEES UNDER THE INCOME TAX ACT, 1961:

Chapter XV Sections 159 to 181(29 Sections) of The Income Tax Act, 1961 deal with Special Class of Assessees.

The following are the "Special Class of Assessees "and"Special Assessees under the Income Tax Act, 1961.

A. SPECIAL CLASS OF ASSESSEES:

1. Legal representatives
2. Reprentative Assesses (general)
3. Reprentative Assesses (special)
4. Agents
5. Unknown beneficiaries
7. Oral Trust
8. Firms, association of persons, body of individuals
9. Executors
10. Succession of business or Profession.

B. SPECIAL ASSESSEES:

1. Partition
2. Profits of non-residents from occasional shopping business!
3. Non-residents
4. Person Leaving India
5. AOP orBOI or AOP formed for a particular event or purpose
6. Persons trying to alienate their assets.

7. Discontinuance of association of Business.

8. Private Companies in Liquidation

9. Certain types of incomes.

J. PERSON: [Sec. 2 (31)]

The term "person" includes:

a. an individual

b. a Hindu Undivided Family

c. a Company

d. a firm

e. an association of persons or body of individuals whether incorporated or not

f. a local authority, and

g. every artificial judicial person.

Thus, Income Tax is a chargeable on the income derived by the assessee in the **previous year,** and the year of taxation is known as "**Assessment Year"**. (defined and explained in chapter No. 3)

The liability of Income Tax depends on the residential status of a person during the previous year whether he is "resident", "not ordinarily resident" or "non-resident". (refer chapter 2).

K. VALUATION DATE:

Sec. 2(q) "valuation date", in relation to any year for which an assessment is to be made under this Act, means the last day of the previous year as defined in Section 3 of the Income-tax Act, if an assessment were to be made under that Act for that year.

However, in the case of a person who is not an assessee within the meaning of the Income-tax Act, the valuation date for the purposes of this Act is the 31st day of March immediately preceding the assessment year.

UNIVERSITY QUESTIONS FOR REVIEW:

1. *Write a note on the general principles and meaning of Income Tax.*
2. *Define "Income". Who is an Assessee?*
3. *Critically examine the principles and objects of taxation. What are the kinds of taxation? Critically examine the principles and objects of Taxation.*
4. *Define tax. Explain the nature and characteristics of tax. Distinguish between tax and fee, tax and fine*
5. *Write short note on: (a) Heads of Income (b) Illegal income*