

Basic Tenets of Taxation,  
Interpretation of Taxing Statutes,  
Basis of Charge & Charge of Income-tax,  
Scope of Total Income

**Intensive Study Course on Income-tax**  
**Western India Regional Council of ICAI**

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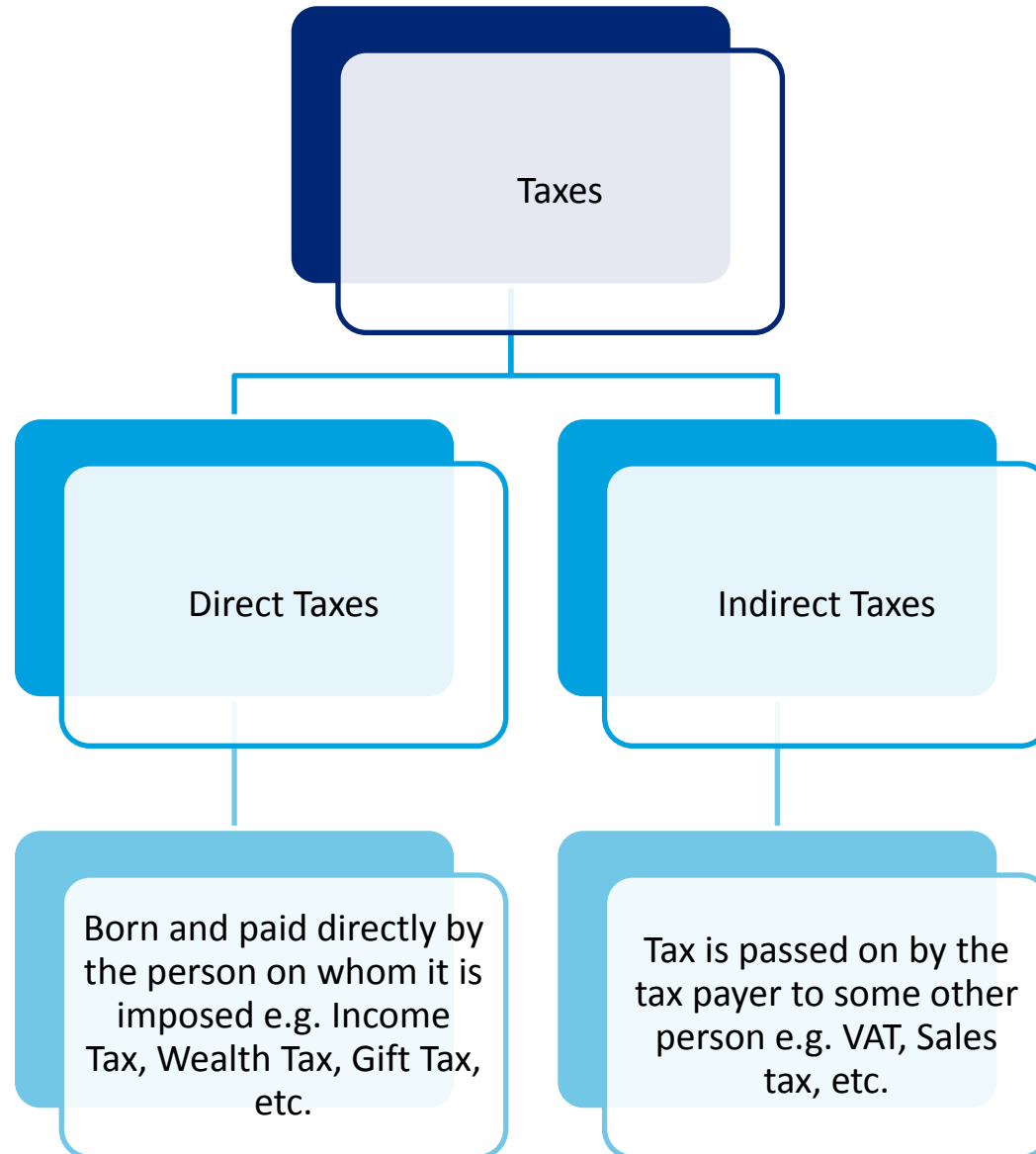
- Basic Tenets of Taxation
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# Basic Tenets of Taxation

# Constitutional Provisions

- The Constitution of India vests the Parliament with plenary legislative powers to impose taxes on matters specifically enumerated in the Union List and all the powers of making any law imposing a tax not mentioned in Concurrent or State Lists, as provided by Article 248(2).
- “Tax on income” is defined in an inclusive manner by Article 366(29) under which the expression includes a tax in the nature of an excess profits tax.
- Under Entry 82 of the Union List, the Parliament has exclusive power to make laws with respect to “Taxes on income other than agricultural income”.
  - Expression “agricultural income” as defined under clause (1) of Article 366 means agricultural income as defined for the purposes of the enactments relating to Indian income-tax.

# Tax Laws of India



# Principles of good tax system

- Equity
  - There must be an element of re-distribution of resources between high and low income people as well as similar tax burden for taxpayers with similar means
- Economic Efficiency
  - Taxation must impact neutrally on various taxpayer groups and economic sectors, and commercial decision making must not get distorted by the tax considerations
- Adequacy
  - The system should have nexus between the revenue proposed to be raised and the public expenditure needs
- Simplicity
  - Taxpayers must be able to clearly understand the nature and extent of their obligation and consequences of non-compliance.

# Principles of good tax system

- Transparency
  - Taxpayers must know how and when they are paying tax and how much tax they are paying
- Cost
  - Compliance and collection costs must be minimised
- Anti-avoidance
  - The tax scheme should be so framed that there would be minimal incentive and potential for avoidance of taxation

# Interpretation of Taxing Statues



# Tax Laws

- Article 265 of the constitution mandates that no tax shall be levied or collected except by the authority of law. It provides that not only levy but also the collection of a tax must be under the authority of some law
- Tax laws are highly complex, complicated and beyond understanding of a tax-payer. The words and expressions used are not simple. Many sections contain sub-sections, clauses, sub-clauses. Many deeming provisions have been inserted. Meaning of an expression is extended by way of Explanation and is curtailed by way of proviso, sometimes more than one provisos and explanations meaning differently.

# Important Terms

- Charging and Machinery provisions
  - The rule of construction of a charging section is that before taxing any person, it must be shown that he falls within the ambit of the charging section by clear words used in the section. No one can be taxed by implication. A charging section has to be construed strictly.
- Different Considerations
  - It is the basic principle of construction of statute that it should be read as a whole, then chapter by chapter, section by section and words by words. Recourse to construction or interpretation of statute is necessary when there is ambiguity, obscurity or inconsistency therein and not otherwise.
- Deeming Provisions
  - It is well-settled that in interpreting a provision creating a legal fiction, the court must ascertain the purpose for which the fiction is created and having done so, to assume all those facts and consequences which are incidental or inevitable corollaries to the giving effect to the fiction.

# Important Terms

- Explanation
  - The normal principle in construing an Explanation is to understand it as explaining the meaning of the provision to which it is added. The Explanation does not enlarge or limit the provision, unless the Explanation purports to be a definition or a deeming clause.
- Proviso
  - A proviso qualifies the generality of the main enactment by providing an exception and taking out from the main provision, a portion, which, but for the proviso would be part of the main provision. A proviso, must, therefore, be considered in relation to the principal matter to which it stands as a proviso.
- Retrospective or Prospective
  - Now, it is a well-settled rule of interpretation hallowed by time and sanctified by judicial decisions that, unless the terms of a statute expressly so provided or necessarily require it, retrospective operation should not be given to a statute so as to take away or impair an existing right or create a new obligation or impose a new liability otherwise than as regards matters of procedure.

# Important Terms

- **Mandatory or directory**
  - The question as to whether a statute is mandatory or directory depends upon the intent of the Legislature and not upon the language in which the intent is clothed. The meaning and intention of the Legislature must govern, and these are to be ascertained not only from the phraseology of the provision but also by considering its nature, its design, and the consequences which would follow from construing it one way or the other.
- **Non-obstante Clause**
  - The principles governing any non obstante clause are well established. Ordinarily, it is a legislative device to give such a clause an overriding effect over the law or provision that qualifies such clause. When a clause begins with “notwithstanding anything contained in the Act or in some particular provision/ provisions in the Act”, it is with a view to give the enacting part of the section, in case of conflict, an overriding effect over the Act or provision mentioned in the non obstante clause.
- **Ratio Decidendi**
  - It is the principle of a law on which a decision is based. When a judge delivers judgement, in case he outlines the facts which he finds have been proved on the evidence. Then he applies the law to those facts and arrives at a decision, for which he gives the reasons

# Important Terms

- Eiusdem Generis
  - A person is known by the company he keeps. Similarly, a word is to be interpreted after considering the other words used and in its context. The principle of *eiusdem generis* is applicable when particular words pertaining to a class, category or genus are followed by general words.
- Finance Minister's Speech
  - It is true that the speeches made by the Members of the Legislature on the floor of the House when a Bill for enacting a statutory provision is being debated are inadmissible for the purpose of interpreting the statutory provision but the speech made by the mover of the Bill explaining the reason for the introduction of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be remedied by the legislation and the object and purpose for which the legislation was enacted

# Rules and Special Maxims Aiding Interpretation

- Rules
  - Liberal Construction
  - Harmonious Constructions
  - Beneficial Constructions
- Special Maxims
  - Rule of Eiusdem Generis
  - Reddendo Singula Singulis
  - Contemporanea Expositio
  - Casus Omissus
  - Autrefois Acquit / Autrefois Convict

# Rules for interpretation of tax laws

- Rule of Strict Construction
  - As tax laws impose liability on the subject they have to be strictly construed. The subject is not to be taxed, unless the words of the taxing statute unambiguously impose the tax. The subject is not to be taxed without clear words for that purpose. If the person sought to be taxed comes within the letter of the law, he must be taxed however great the hardship may appear to the judicial mind.
- Golden rule of strict construction
  - The Courts have disregarded the rule of strict and literal construction, if such construction leads to an absurd result or defeats the very purpose of the Act. In such cases, the Courts have adopted what is known as “Golden rule of Construction.”
- Mischief rule
  - In case of ambiguity in the matter of construction the literal rule of construction will also give way to mischief rule of construction, which is better known as Hyden’s rule of construction. As per this rule while construing a provision of a statute, one has to consider the law before coming into force of the Act, what was the mischief and defect for which the law did not provide, what remedy had the legislature resolved and appointed to cure the disease and the true reason of the remedy.

# Rules for interpretation of tax laws

- Statutes dealing with procedures
  - In contrast to statutes dealing with substantive rights, statutes dealing with merely matters of procedure are presumed to be retrospective, unless such a construction is inadmissible. No person has a vested right in any course of procedure. He has only the right of prosecution or defense in the manner prescribed for the time being by or for the Court in which the case is pending and if, by an Act of Parliament the mode of procedure is altered, there is no other right than to proceed according to the altered mode.
- Theory of Form and Substance
  - The assesses under the Income-tax Act have legal right to plan the affairs in appropriate manner so as to attract least amount of tax. Tax planning is permissible and only tax avoidance/tax evasion is punishable under the Act.
- Construction in favour of the subject
  - If two constructions of a provision of a statute are possible, the construction in favour of the assessee has to be accepted. If a section in a taxing statute is of doubtful and ambiguous meaning, it must be resolved in favour of the assessee.



# Rules for interpretation of tax laws

- Res Judicata
  - Res judicata means a matter adjudged, a thing judicially acted upon or decided; a thing or matter settled by the judicial decision. The principle of res judicata is to bring finality to litigation; that a time should come when litigation shall cease, in order that the decree of the Court may be carried out.
- Estoppel
  - For similar reasons the principle of estoppel strictly does not apply to income tax proceedings. The question would arise how far the promise given by the tax authorities would fall within doctrine of promissory estoppel.
- Construction against double taxation
  - There is always presumption against double taxation. Broadly stated the principle of a taxing statute is to charge income or wealth only once in one hand. Accordingly such construction is preferred which avoids double taxation.
- Integrated Scheme
  - Where there are different statutes in *pari material* though made at different times, they will be taken and construed together as one system and explanatory to one another.

# Rules for interpretation of tax laws

- Circulars of the Department
  - Section 119 of the Income-tax Act, 1961 specifically empower the Central Board of Direct Taxes to issue general instructions for the general administration of the Act and such instructions issued are binding on the subordinate officers and not on the assessee.
- Penal Statutes
  - Penal statutes which create offences or which have the effect of increasing penalties for existing offence will only be prospective by reason of the constitutional restriction imposed by Article 20 of the Constitution
- *Mens rea*
  - When a statute creates an offence a normal question that arises is as to whether '*mens rea*' is a necessary element of such offence. The question is whether the statute dispenses with *mens rea* and creates a strict liability. Answer to this question depends on the proper interpretation of the provision in question.
- Interpretation of Rules
  - Under the direct tax laws, the Central Board of Direct Taxes has been empowered to make proper rules for the purpose of administration of the various direct tax laws. Accordingly, the Board is delegated with legislative power to make rules.

# Rules for interpretation of tax laws

- Rule of *audi alteram partem*
  - Both parties should be heard before any decision. The right to fair hearing has been used by the Court as the base on which to build a kind of code for administrative procedure comparable with due process of law. A proper hearing must always include a fair and adequate opportunity to those who are parties in the controversy for correcting and contradicting anything prejudicial to their view.

# Binding Precedents

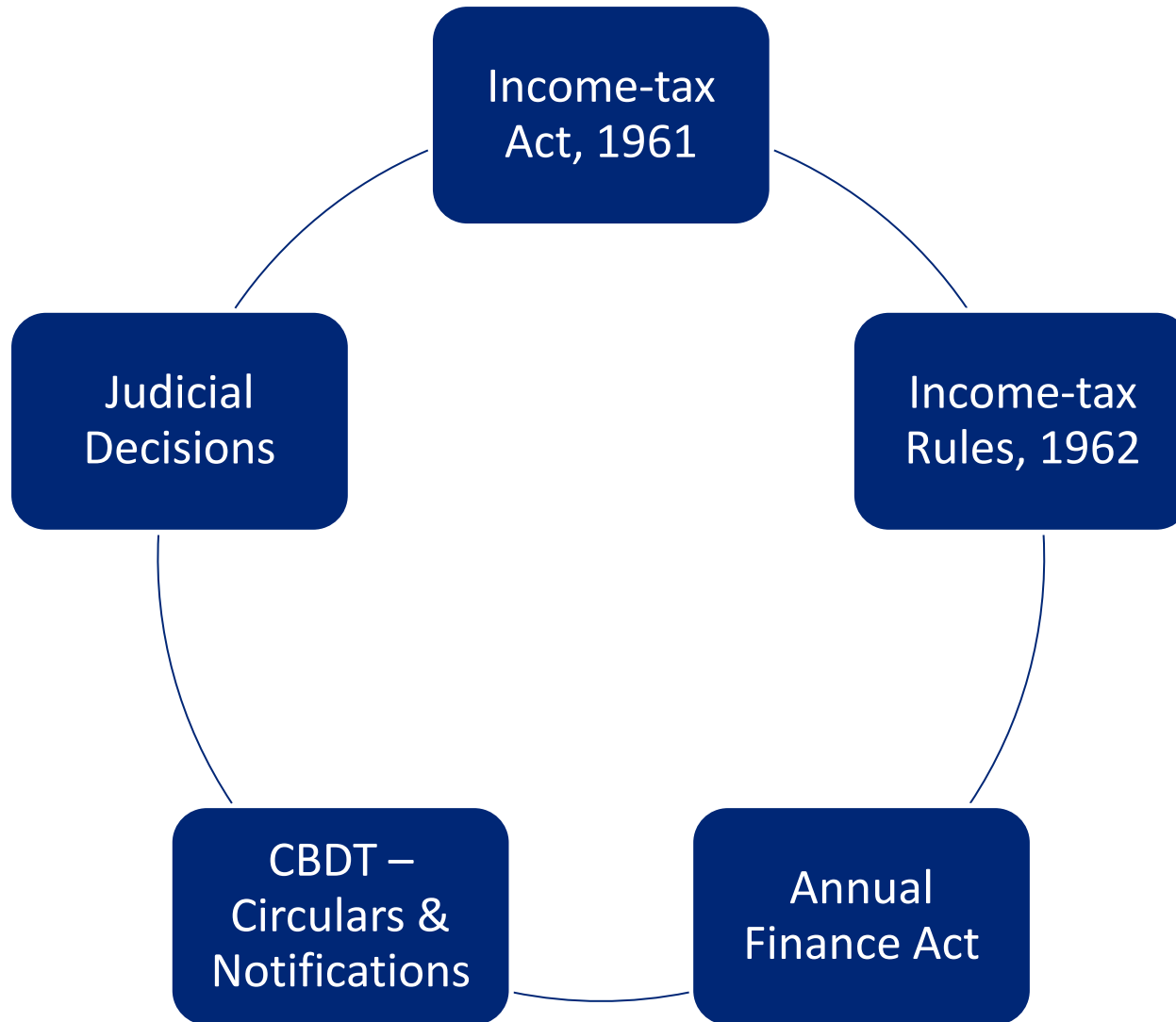
- Supreme Court decisions – Article 141
  - As mentioned earlier the Article 141 embodies the doctrine of precedent as law. Article 141 of the Constitution of India provides that the law declared by the Supreme Court shall be binding on all the Courts in India. The law as interpreted by the Supreme Court is binding on all Courts and Tribunals in India.
- *Obiter dictum*
  - It is an expression of opinion by a Judge on a question immaterial to the *ratio decidendi*, and unnecessary for the decision of the particular case. It is in no-way binding on any Court but may receive attention as being an opinion of higher authority. Thus, the observations made in a judgement which are not relevant to the *ratio decidendi* DO NOT HAVE ANY BINDING FORCE. However, *obiter dicta* of the Supreme Court are binding or are entitled to the highest respect.
- High Court`s judgement
  - The doctrine of precedent is applicable to the decisions delivered by the High Court. The law declared by the High Court is binding on all the Courts subordinate to it within its territorial jurisdiction. Where there are two decisions of the same High Court holding two different views, the latter decision should be followed.

# Aids to interpretation

- Preamble
- Headings
- Illustrations
- Definition Sections
- Proviso
- Explanation
- Schedules
- Context
- Other Provisions of the same statute
- Amendments
- Non-obstante clause
- References to other statutes
- Judicial decisions
- Dictionaries and Text Books

# Basis of Charge & Charge of Income-tax

# Sources of income-tax law



# Introduction of Income-tax

- The Income tax Act 1961 replaces the Indian Income tax Act, 1922
- Applicable to whole of India.
- S. 2(25A) of the Act defines India.
  - Includes all States, Union Territories, Territorial waters and air space above its territory and territorial waters.
- Consists of Twenty three chapters – 298 sections and 14 schedules.
- Section 2 defines 48 terms
- Definition can be inclusive definition or exclusive definition
- Definition of one term may lead to the definition of another term



## Definitions – Section 2

- Some of the important definitions contained in section 2 are
  - Person – section 2(31)
  - Assessee – section 2(7)
  - Total Income – section 2(45)
  - Assessment Year – section 2(9)
  - Previous Year – section 2(34)
  - Assessment – section 2(8)
  - Income – section 2(24)

## Definitions – Section 2

- Person – section 2(31)

The term 'person' includes

- An individual;
- A HUF;
- A Company;
- A Firm (includes LLP);
- An Association of Persons (AOP) or body of individuals whether incorporated or not;
- A local authority;
- Every artificial juridical person, not falling within any of the preceding sub-clauses

Explanation : For the purposes of this clause, an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a person, whether or not such person or body or authority or juridical person was formed or established or incorporated with the object of deriving income, profits or gains.

## Definitions – Section 2

- Assessee – section 2(7)

The term 'assessee' means

- A person liable to pay any tax or any other sum of money under this act.
  - Every person in respect of whom any proceeding under this act has been taken for the assessment of (1) his income or (2) the loss sustained by him or (3) the amount of refund due to him.
  - Every person in respect of whom any proceeding has been taken under this act for the assessment of (1) the income of any other person in respect of which he is assessable or (2) the loss sustained by such other person or (3) the refund due to such other person
  - A person who is deemed to be an assessee under any provisions of this act.
  - A person who is deemed to be an assessee in default under any provisions of this act.
- Total Income – section 2(45)
    - It means the total amount of income referred to in section 5, computed in the manner laid down in this Act.

## Definitions – Section 2

- **Assessment Year – section 2(9)**
  - It means the period of 12 months commencing on the 1<sup>st</sup> day of April every year
  - It is a year in which the income of previous year is to be assessed
  - The current assessment year 2014-15 relevant to the previous year 2013-14
- **Previous Year – section 2(34)**
  - It means the previous year as defined in section 3 of the Act.
  - Previous Year means the financial year immediately preceding the assessment year. The current assessment year is 2014-15 which commenced on 1-4-2014 and will be end on 31-3-2015; the previous year for this assessment year would be 2013-14.
  - In case of a newly setup business or source of income newly coming into existence, the previous year commences from the date of set up of business or the date on which the source of income comes into existence.
- **Assessment – section 2(8)**
  - It includes reassessment
  - It is a process of determining the correctness of income of an assessee and of assessing the amount of tax payable by him and procedure for imposing tax liability

# Definitions – Section 2

- Income – section 2(24)
  - The definition of income as per the Income-tax Act begins with the words “Income includes”. Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. Certain important principles relating to income are as under.
  - Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, even certain income which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles, etc.
  - Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income-tax Act has specifically included certain capital receipts within the definition of income e.g. Capital gains – gains on sale of a capital asset like land.
  - Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts.
  - Income is taxable either on due basis or receipt basis, whichever is earlier. For computing income under the heads ‘Profits and gains of business or profession’ and ‘Income from other sources’ the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.

# Charging section

- Section 4

*“(1) : 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 in respect of the total income of the previous year of every person.*

*Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*

*”(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.”*

- Income-tax is charged in respect of the total income of the previous year of every person.

# Charging section

- Exceptions
  - Shipping business of non residents - (S. 172)
  - Persons leaving India – (S. 174)
  - Persons trying to alienate their assets – (S. 175)
  - Discontinued business or dissolution – (S. 176)

Income-tax is charged in respect of the previous year in that year itself.

- Enables the TDS and advance tax provisions

# Steps for computing Total Income

- Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The steps for computing Total Income are as under.
  - Step 1 Determination of residential status
  - Step 2 Classification of income under different heads
  - Step 3 Exclusion of income not chargeable to tax
  - Step 4 Computation of income under each head
  - Step 5 Clubbing of income of spouse, minor child etc.
  - Step 6 Set-off or carry forward and set-off of losses
  - Step 7 Computation of Gross Total Income.
  - Step 8 Deductions from Gross Total Income
  - Step 9 Total income
  - Step 10 Application of the rates of tax on the total income
  - Step 11 Surcharge
  - Step 12 Education cess and secondary and higher education cess
  - Step 13 Advance tax and tax deducted at source



# Scope of Total Income

# Scope of Total Income

- Section 5
  - The scope of Total Income depends on the Residential Status of the tax payer.
- Resident assessee
  - Income received or deemed to be received in India in such year by or on behalf of such person;
  - Income accrues or arises or is deemed to accrue or arise in India during such year; or
  - Income accrues or arises outside India during such year

For an individual with RNOR status, income which accrues or arises to him outside India shall not be taxable unless it is derived from a business controlled in or a profession set up in India.

# Scope of Total Income

- Non-resident assessee
  - Income received or is deemed to be received in India by or on behalf of such person;
  - Income accrues or arises or is deemed to accrue or arise in India during such year
- Explanation 2

*“ For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India”*

If income is taxed once on accrual basis, it shall not be taxed again merely on receipt basis.

# Scope of Total Income

- Income deemed to be received in India
  - Employer's contribution to RPF in excess of 12% of Salary
  - Interest on RPF in excess of 9.5%
  - Balance transferred from URPF to RPF : taxable component
  - Contribution by an employer under a pension scheme referred to in 80CCD
- Income deemed to accrue or arise in India
  - Income from property / asset / source of income in India.
  - Income from transfer of capital asset situated in India.
  - Income accruing or arising through or from any 'business connection' in India.
  - Income from "Salaries"
    - for services rendered in India
    - for rest / leave period preceded & succeeded by services rendered in India, which is part of contract.
  - Salary paid by Government to an Indian Citizen for services rendered outside India
  - Dividend paid by an Indian Company, outside India

# Scope of Total Income

- Interest payable by:
  - Government
  - Resident person (Except when utilised outside India for business / profession / any other source of income)
  - Non Resident person (Only if utilised in India for business or profession)
  
- Royalty / Fees for technical services payable by:
  - Government
  - Resident person (Except when utilised outside India for business / profession / any other source of income)
  - Non Resident person (Only if utilised in India for business / profession/ any other source of income)

# Scope of Total Income

Particulars of Income		R & OR	R but not OR	NR
		Whether Taxable		
1	Income received or deemed to be received in India whether earned in India or elsewhere	Y	Y	Y
2	Income which accrues or arises or is deemed to accrue or arise in India during the previous year, whether received in India or elsewhere	Y	Y	Y
3	Income which accrues or arises outside India and received outside India from a <b>business controlled from India or Profession set up in India</b>	Y	Y	N
4	Income, which accrues or arises outside India and received outside India in the previous year from any other source.	Y	N	N
5	<b>Past income</b> (whether taxed or untaxed) which accrues or arises outside India and received outside India, remitted to India during the previous year.	N	N	N

# Q&A

*Thank you*



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