Important Definitions In Income Tax Act

Section 2 gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like ‘person’, ‘assessee’, ‘income’, etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like “dividend”, “transfer”, etc. have been given a wider meaning in the Income-tax Act than they are commonly understood.

Some of the important terms defined under section 2 are given below:

Assessee [Section 2(7)]
Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. Sometimes, a person becomes assessable in respect of the income of some other persons. In such a case also, he may be considered as an assessee. This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

Assessment [Section 2(8)]
This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

Person [Section 2(31)]
The definition of ‘assessee’ leads us to the definition of ‘person’ as the former is closely connected with the latter. The term ‘person’ is important from another point of view also viz., the charge of income-tax is on every ‘person’.

The definition is inclusive i.e. a person includes,
(i) an individual,
(ii) a Hindu Undivided Family (HUF),
(iii) a company,
(iv) a firm,
(v) an AOP or a BOI, whether incorporated or not,
(vi) a local authority, and
(vii) every artificial juridical person e.g., an idol or deity.

We may briefly consider some of the above seven categories of assesses each of which constitutes a separate unit of assessment.

(i) Individual - The term ‘individual’ means only a natural person, i.e., a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

(ii) HUF - Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term “person” under section 2(31). The levy of income-tax is on “every person”. Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act. The expression is however defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and unmarried daughters.
The relation of a HUF does not arise from a contract but arises from status. A Hindu is born into a HUF. A male member continues to remain a member of the family until there is a partition of the family. After the partition, he ceases to be a member of one family. However, he becomes a member of another smaller family. A female member ceases to be a member of the HUF in which she was born, when she gets married. Thereafter, she becomes a member of the HUF of her husband.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (karta) are called co-parceners. A Hindu co-parcenary includes those persons who acquire by birth an interest in the joint co-parcenary property.

Only the coparceners have a right to partition.

A Jain undivided family would also be assessed as a HUF, as Jains are also governed by the laws as Hindus.

**Schools of Hindu Law**

There are two schools of Hindu law. They are –

(1) Mithakshara school of Hindu law
(2) Dayabhaga school of Hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus every child born in the family acquires a right/share in the family property.

Dayabagha law prevails in West Bengal and Assam. In Dayabagha law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF.

(iii) **Company [Section 2(17)]** - For all purposes of the Act the term ‘Company’, has a much wider connotation than that under the Companies Act. Under the Act, the expression ‘Company’ means:

(1) any Indian company as defined in section 2(26); or

(2) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or

(3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or

(4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT’s order.

**Classes of Companies**

(1) **Domestic company [Section 2(22A)]** - means an Indian company or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, payable out of such income.
**Indian company [Section 2(26)]** - Two conditions should be satisfied so that a company can be regarded as an Indian company:

(a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and

(b) the registered office or the principal office of the company should be in India.

The expression ‘Indian Company’ also includes:

(i) A corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation),

(ii) An institution or association or body which is declared by the Board to be a company under section 2(17)(iv) provided its registered or principal office is in India.

(iii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State.

(iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

**Company in which public are substantially interested [Section 2(18)]** - The following companies are said to be companies in which the public are substantially interested:

(i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.

(ii) A company which is registered under section 25 of the Companies Act, 1956 (formed for promoting commerce, arts, science, religion, charity or any other useful object).

(iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.

(iv) A company which is not a private company as defined in the Companies Act, 1956 and which fulfills any of the following conditions:

   - its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India; or

   - its equity shares carrying at least 50% (40% in case of industrial companies) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by (a) Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or (d) any wholly owned subsidiary of company mentioned in (c).

(v) A company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act to be Nidhi or a Mutual Benefit Society.
(vi) A company whose equity shares carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

**Person having substantial interest in the company [Section 2(32)]** – is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with or without a right to participate in profits, carrying at least 20% of the total voting power.

**Note:** The main criterion is the ‘beneficial’ ownership and not ‘legal’ ownership. Therefore, the registered holder of even the majority of equity shares, would not fall within this definition if he has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to at least 20% of the equity share capital of a company would fall within this definition even if he is not the registered holder of any shares.

(2) **Foreign company [Section 2(23A)]** - Foreign company means a company which is not a domestic company.

(iv) **Firm** - The terms ‘firm’, ‘partner’ and ‘partnership’ have the same meanings as assigned to them in the Indian Partnership Act. In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually ‘partners’ and collectively a ‘firm’.

**Note:**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Consequently, the following definitions in section 2(23) have been amended -

1. The definition of ‘partner’ to include within its meaning, a partner of a limited liability partnership;
2. The definition of ‘firm’ to include within its meaning, a limited liability partnership; and
3. The definition of ‘partnership’ to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a ‘partner’ as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(v) **Association of Persons (AOP)** - When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.
**Body of Individuals (BOI)** – It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

**(vi) Local Authority** - The term local authority means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

**Note** : A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority’s own jurisdictional areas is exempt from tax.

**(vii) Artificial Persons** - This category could cover every artificial juridical person not falling under other heads. An idol, or deity would be assessable in the status of an artificial juridical person.

**Income [Section 2(24)]**
Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:—

1. Profits and gains.
2. Dividends.
3. Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section (23C)(iiiad)/(iiiiae)/(iv)/(v)/(vi)/(via) or an electoral trust—

<table>
<thead>
<tr>
<th>Research association approved under section 35(1)(ii)</th>
<th>10(21)</th>
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<tr>
<td>Universities and other educational institutions</td>
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<td>Hospitals and other medical institutions</td>
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<td>Notified funds or institutions established for charitable purposes</td>
<td>10(23C)(iv)</td>
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<tr>
<td>Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes</td>
<td>10(23C)(v)</td>
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<td>Electoral trust</td>
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4. The value of any perquisite or profit in lieu of salary taxable under section 17.

5. Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.

6. Any allowance granted to the assessee 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.

7. The value of any benefit or perquisite whether convertible into 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 or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.
(8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.

(9) Deemed profits chargeable to tax under section 41 or section 59.

(10) Profits and gains of business or profession chargeable to tax under section 28.

(11) Any capital gains chargeable under section 45.

(12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act.

(13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

(14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose,

(i) “Lottery” includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) “Card game and other game of any sort” includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

(15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.

(16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.

“Keyman insurance policy” means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former’s business.

(17) Any sum referred to clause (va) of section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head “profits and gains of business or profession”.

(18) Any sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viia).

(19) Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in section 56(2)(viib).

Students should carefully study the various items of receipts included in the above definition.
Some of them like capital gains are not revenue receipts. However, since they have been included in the definition, they are chargeable as income under the Act. The concept of revenue and capital receipts is discussed hereunder –

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. The distinction between capital and revenue receipts is somewhat blurred. Even then, capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction remains real and most material for tax purposes.

Certain capital receipts which have been specifically included in the definition of income are Compensation for modification or termination of services, income by way of capital gains etc.

It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

**Distinction between capital and revenue receipts:** The following are some of the important criteria which may be applied to distinguish between capital and revenue receipts.

1. A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is exempt from tax while the latter is taxable. In cases where a capital asset is transmuted into income and the price realized on its sale takes the form of periodic payments (e.g., annuities and annual installment of capital), the receipt would be taxable even though it is referable to a capital asset.

2. Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assesseee’s business or the transaction constitutes an adventure in the nature of trade.

3. Profits arising from transactions which are entered into in the course of the business regularly carried on by the assesse, or are incidental to, or associated with the business of the assesse would be revenue receipts chargeable to tax. For example, a banker’s or financier’s dealings in foreign exchange or sale of shares and securities, a shipbroker’s purchases of ship in his own name, a share broker’s purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. If transactions are partly in the course of and partly outside the regular trading activity of the assesse, the income arising there from must be segregated and allocated between the two parts and treated accordingly for tax purposes.

4. In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would be a taxable receipt. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

5. Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assesse’s business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising there from would be taxable. Purchase of any article with no intention to resell it, but resold under changed
circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

(6) In the case of annuities which are payable in specified sums at periodic intervals of time the receipt would be of a revenue nature even though it involves the conversion of capital into income for an annuity means the purchase of an income. An annuity received from an employer is taxable as “Income from salaries” whereas all other annuities are chargeable under the head “Income from other sources”.

Annual payments, as distinguished from annuities, are in fact annual installments of capital.

The purchase price of a business or property may be agreed to be paid in installments annually or otherwise. In such cases, the amount of installment received would be of capital nature not liable to tax. Thus, on the sale of property or business in consideration of annual payment:

(i) if the sale is for a price which is to be paid in installments, the installments would be capital receipts;

(ii) if the property is sold for an annuity payable regularly, the property disappears and the annuity which takes its place would be chargeable to tax;

(iii) if the property is sold for what looks like an annuity but actually there is no transmutation of the principal sum into income and the annual payments are merely installments of the principal sum with interest only so much of the amount of installments as representing the interest payable would be income chargeable to tax, the balance being capital receipt; and

(iv) if the property is sold for a consideration which is share of the profits or gross receipt of a business, the receipt of the share of profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However, if the circumstances of the case show that the receipts were only installments of a capital nature, though fluctuating in amount and measurable with reference to profits, they would not be taxable.

(7) A receipt in substitution of a source of income is capital receipt not chargeable to tax.

Thus compensation received for restraint of trade or profession is a capital receipt. Where an assessee receives compensation of termination of the agency business being the only source of income the receipt is a capital nature but taxable under section 28(ii). But where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the service contract is a revenue receipt taxable under section 15. In case where the compensation received is partly of a capital and partly of a revenue nature, the two will have to be segregated and treated accordingly for tax purposes.

Awards in the case of a sportsman, who is not a professional, will not be liable to tax in his hands as it would not be in the nature of income.

A lump sum payment made gratuitously (i.e. gratuity, leave encashment) or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Act.
A lumpsum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads. Amount received under a policy of insurance would be a capital or revenue receipt depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally of a revenue nature since they would be to supplement the income from business. But where a grant is received for specific purpose but not as a supplementary trading receipt (e.g., to enable the company to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax.

Premium or discount received by a debenture holder, being a capital receipt, would not be chargeable to tax. Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lump sum or by way of a fixed annual sum or a tonnage royalty or the minimum royalty. Similarly, royalties paid for use of whether paid in lump sum or in installments of fixed or varying amounts would be taxable as income whereas the payment received in lieu of total or partial assignment of patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt.

Premium on issue of shares or debentures, profit on forfeiture of shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax. The amount received by a shareholder on the winding up is a capital receipt (except where the receipt is a dividend under section 2(22)). But in case of a partnership, the amount receivable by an outgoing partner in respect of his share of the firm’s profit whether, before or after its dissolution would be a revenue receipt chargeable to tax. Compensation received by a partner for relinquishing all his interests in the firm and amounts received in settlement of claim to an interest in the capital of a firm are capital receipts.

It is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the particular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact.

Normally, gifts constitute capital receipts in the hands of the recipient. However, it is possible that gifts may partake the character of income under certain circumstances.

Example:
(i) Gifts received by doctors from their patients is taxable under the head Profits and Gains from Business or Profession.
(ii) Any sum of money or value of property received without consideration or for inadequate consideration by an individual or a HUF from any person, other than a relative, is chargeable under the head “Income from Other Sources”.

India [Section 2(25A)]
The term 'India' means –
(i) the territory of India as per article 1 of the Constitution,
(ii) its territorial waters, seabed and subsoil underlying such waters,
(iii) continental shelf,
(iv) exclusive economic zone or
(v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

Infrastructure Capital Company [Section 2(26A)]
“Infrastructure capital company” means such company which makes investments by way of acquiring shares or providing long-term finance to –
Important Definitions In Income Tax Act

(1) any enterprise or undertaking wholly engaged –

(a) in the business referred to in section 80-IA(4) i.e. business of
   (i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
   (ii) providing telecom services, whether basic or cellular
   (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.

(b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.

(2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.

(3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or

(4) a project for constructing a hospital with at least 100 beds for patients.

**Infrastructure Capital Fund [Section 2(26B)]**

Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

(1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or

(2) an undertaking developing and building a housing project referred to in section 80-IB(10); or

(3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or

(4) a project for constructing a hospital with at least 100 beds for patients.

**Manufacture [Section 2(29BA)]**

‘Manufacture’, with its grammatical variations, shall mean a change in a non-living physical object or article or thing,—

(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.
CONCEPT OF PREVIOUS YEAR AND ASSESSMENT YEAR

Meaning of Assessment Year And Previous Year
(i) Assessment year - The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. For example, for the assessment year 2014-15, the relevant previous year is 2013-14 (01.04.2013 to 31.03.2014).

(ii) Previous year [Section 3] – It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

Business or profession newly set up during the financial year - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

Illustration:
1. A is running a business from 1993 onwards. Determine the previous year for the assessment year 2014-15.
   Ans. The previous year will be 01.04.2013 to 31.03.2014.

   Ans. The previous year will be from 01.07.2013 to 31.03.2014.

Previous year for undisclosed sources of income
There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(i) Cash Credits [Section 68] : Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands. Otherwise, the explanation offered by the assessee-company shall be deemed as not satisfactory, consequent to which the sum shall be treated as income of the company. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

(ii) Unexplained Investments [Section 69]: Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the investments are taxed as income of the assessee of such financial year.
(iii) **Unexplained money etc. [Section 69A]**: Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(iv) **Amount of investments etc., not fully disclosed in the books of account [Section 69B]**: Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market value of which is `25,000) during the financial year ending 31.03.2014 but he has recorded to have spent ` 15,000 in acquiring it, the Assessing Officer can add ` 10,000 (i.e. the difference of the market value of such gold and ` 15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(v) **Unexplained expenditure [Section 69C]**: Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(vi) **Amount borrowed or repaid on hundi [Section 69D]**: Where any amount is borrowed on a hundi or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

**Unexplained money, investments etc. to attract maximum marginal rate of tax @ 30% [New section 115BBE]**

(i) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the maximum marginal rate of 30% (plus surcharge and cesses) with effect from A.Y.2013-14.

(ii) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income.

**Certain cases when income of a previous year will be assessed in the previous year itself**

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in a few cases, this rule does not apply and the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

(i) **Shipping business of non-resident [Section 172]** - Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof.
7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.

(ii) **Persons leaving India [Section 174]** - Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.

**Example:** Suppose Mr. X is leaving India for USA on 10.06.2014 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X will be required to pay income tax on the income earned during the *P.Y. 2013-14* as well as the total income earned during the period 01.04.2014 to 10.06.2014.

(iii) **AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A]** - If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(iv) **Persons likely to transfer property to avoid tax [Section 175]** - During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(v) **Discontinued business [Section 176]** - Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.
PRACTICE PROBLEMS
TOTAL PROBLEMS 6

Problem 1.
Mr. Sanjay Bansal sets up a new business on 20th June, 2013. What is the previous year for the assessment year 2014-15?

Answer = Previous year 20th June, 2013 to 31st March, 2014

Problem 2.
Mr. Abhay Gandhi commences his business on:
(i) 15.01.2014;
(ii) 31.07.2013;
(iii) 31.03.2013;
(iv) 31.03.2014;
(v) 01.05.2014

What will be his assessment year in each case?

Answer = (i) 2014-15; (ii) 2014-15; (iii) 2013-14; (iv) 2014-15; (v) 2015-16

Problem 3.
From the following information, what is the previous year:
(i) Mr. Sahil Chawla joins a multinational company on 15.12.2013 at a salary of `25,000 p.m. Prior to 15.12.2013, he is not in employment and he has no other source of income.

(ii) Mr. Vishesh starts a new business of computer software on 01.01.2014.

(iii) Mrs. Pooja Singh has one house which is let out on 01.09.2013 at `15,000 p.m.

Answer = (i) Previous year 15.12.2013 to 31.03.2014
(ii) Previous year 01.01.2014 to 31.03.2014
(iii) Previous year 01.09.2013 to 31.03.2014

Problem 4.
Determine the status of the following under section 2(31) of the Income Tax Act:

(i) Mr. Amit Jain, a manager in a Private Company
(ii) Delhi University
(iii) Life Insurance Corporation of India
(iv) A joint Hindu Undivided Family of Mrs. & Mr. Swami and their one son and daughter.
(v) Reliance Industries Ltd.
(vi) Mittal Group Housing Co-operative society
(vii) ABC & Co., firm of A, B and C.

Answer = (i) Individual; (ii) Artificial juridical person; (iii) Company; (iv) A Hindu Undivided Family; (v)
Problem 5.
On September 15, 2013, the Assessing Officer comes to know that Mr. Nitin Kumar will leave India on September 25, 2013 with no intention of coming back. Explain how he will be taxed with regard to the income earned between 01.04.2013 to 25.09.2013.

Answer = His income will be assessed in the financial year 2013-14 itself and two separate assessment shall be made, one for the previous year 2012-13 whose assessment year is 2013-14 and another for previous year 01.04.2013 to 25.09.2013 for which assessment year shall also be 2014-15.

Problem 6.
ABC Ltd. is an Indian shipping company. One of its ship leaves Chennai port on January 20, 2014. Discuss in which assessment year the income is taxable.

Answer = Assessment Year 2014-15

EXERCISES
1. The basic source of income-tax law is -
   a) Income-tax Act, 1961
   b) circulars/Notifications issued by CBDT
   c) Judgments of Courts

2. A domestic company means –
   a) Only an Indian company
   b) Only a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India
   c) Indian company and a foreign company which has made the prescribed arrangements for declaration and payment of dividends in India.

3. Define the following terms under the Income-tax Act, 1961 -
   a) Assessee
   b) Person
   c) Previous year

4. Write short notes on the following -
   a) Year of accrual of dividend
   b) Marginal relief
   c) Infrastructure Capital Company
   d) Infrastructure Capital Fund

5. “Income of a previous year will be charged to tax in the assessment year following the previous year” - Discuss the exceptions to this general rule.

6. In certain cases, unexplained cash credit, unexplained investment, unexplained money or unexplained jewellery etc. is detected by the Assessing Officer. What is the previous year for charging such income to tax? Explain.

7. Briefly discuss about the exceptions to the rule that income of an assessee for a previous year will be charged to tax in the subsequent assessment year.

Answers
1. a; 2. c