

# An introduction to taxation in india essay sample

[Economics](#), [Tax](#)



A person by whom any tax or any other sum of money (including interest and penalty) is payable under the Act • every person in respect of whom any proceeding under this Act has been taken either for the assessment of the amount of his income or of the income (or loss) of any other person in respect of whom he is assessable or of the amount of refund due to him or to such other person. or • every person who is deemed to be an assessee

- every person who is deemed to be an assessee in default

#### Person

- i) An individual
- ii) A Hindu Undivided Family (HUF)
- iii) A Company
- iv) A Firm or Limited Liability Partnership
- v) An Association of persons (AOP) or Body of Individuals (BOI) vi) A local Authority
- vii) Every Artificial Judicial Person not falling under any of the above

#### Assessment year

- the period of twelve months commencing on the 1st day of April every year

#### Previous year

- the financial year immediately preceding the assessment year - in the case of a business or profession newly set up in a financial year, the previous year starts with period beginning with the date of setting up of the business or profession and ends with the said financial year

## Charging of Tax

- Income of previous year chargeable to tax during assessment year
- Income tax rates fixed by Finance Act
- For computing Total Income, provisions of the Act as applicable on 1st April of the relevant Assessment Year will be applied (for procedural matters, provisions of the Act will be applicable from the date of amendment)

## Gross Total Income and Total Income

Total Income = GTI less deductions u/s 80C to 80U

## Exemptions and deductions

- Exempt income not included in the computation of income - Exemption can not exceed the amount of income
- Deduction is generally applied on income chargeable to tax - deduction could be less than, equal to or more than the amount of income - deduction may exceed income in which case the resulting figure will be taken as a loss

## Heads of Income

Income from Salaries

Income from House Property

Profits and Gains of Business or Profession

Capital Gains

Income from Other Sources

## The Income Tax law in India - some observations

Today the Income-tax Act, 1961, is a national disgrace. There is no other instance in Indian jurisprudence of an Act mutilated by more than 3, 300 amendments in less than thirty years. . .

Tens of millions of man-hours, crammed with intelligence and knowledge of tax gatherers, taxpayers and tax advisers are squandered every year in grappling with the torrential spate of mindless amendments.

Our law reports bear witness to the fact that generally a case reaches hearing in the High Court in twenty years, and in the Supreme Court in thirty years, after the relevant assessment year. The situation is continuously aggravated by the deluge of new amendments - the indigestible verbiage; and the flood of litigation is heavier today than ever before. . .

Every government has a right to levy taxes. But no government has the right, in the process of extracting tax, to cause misery and harassment to the taxpayer and the gnawing feeling that he is made the victim of palpable injustice.

### Rates of income tax for the AY 2013-14

#### For Individuals and HUF

#### For Resident Senior Citizens (60 years or more)

| Up to 2, 50, 000 | NIL | | Rs 2, 50, 001 to Rs 5, 00, 000 | 10% | | Rs 5, 00, 001 to Rs 8, 00, 000 | 20% + 25, 000 | | Above Rs 8, 00, 000 | 30% +85, 000 |

For Resident Super Senior Citizens (80 years or more)

| Up to 5, 00, 000 | NIL | | Rs 5, 00, 001 to Rs 8, 00, 000 | 20% | | Above Rs 8, 00, 000 | 30% +60, 000 |

For Other Individuals

| Up to 2, 00, 000 | NIL | | Rs 2, 00, 001 to Rs 5, 00, 000 | 10% | | Rs 5, 00, 001 to Rs 8, 00, 000 | 20% + 30, 000 | | Above Rs 8, 00, 000 | 30% +90, 000 |

Surcharge: No surcharge for Individuals/ HUF

Education Cess: 2% on Income Tax

Secondary and Higher Education Cess: 1% on Income Tax

| For Firm: | 30% |

Surcharge: No surcharge

Education Cess: 2% on Income Tax

Secondary and Higher Education Cess: 1% on Income Tax

For Companies

| Domestic Company | 30% | | Foreign  
Company | 40% |

Surcharge (to be levied only if Total Income exceeds Rs 1 crore):

- for Domestic Company- 5%
- for Foreign Company- 2%

Education Cess: 2% on Income Tax and Surcharge

Secondary & Higher Education Cess: 1% on Income Tax and Surcharge

Indian Company: a Company formed and registered under the Companies Act, 1956 and includes • the corporation established under a central or state act • any institution, association or body which has been declared by the Board to be a Company Provided that the registered/principal office of the company or corporation or institution is located in India.

Domestic Company: an Indian or any other Company which has made prescribed arrangements for declaration and payment within India, of dividends payable out of its Income liable to tax under the Income Tax Act.

Foreign Company: a Company which is not a domestic company.

Tax evasion, avoidance, planning and management

Tax evasion - dishonest means to evade tax liability adopted by unscrupulous citizens. Some common methods are: ■ Concealment of income;

■ Inflation of expenses to suppress income

- Falsification of accounts;
- Conscious violation of rules.

Tax planning - arrangement by which maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws. ■ " Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods..... Justice Ranganath Mishra of Supreme Court ■ compliance with the taxing provisions to take full advantage of exemptions, deductions, concessions, rebates and reliefs permissible under the Act so that incidence of tax minimised. ■ Tax planning is perfectly legal as the object of tax reduction is achieved by making use of the beneficial provisions in the tax laws.

Tax management - compliance with the statutory provisions of law. ■ tax management is mandatory - tax planning is optional

■ Tax management includes maintenance of accounts, filling of return, payment of taxes, deduction of tax at source, timely payment of advance tax, etc. ■ Without proper tax management, an assessee may face levy of interest, penalty even prosecution.

Tax avoidance - Tax avoidance is reducing or negating tax liability in legally permissible ways and has legal sanction. Essential features of tax avoidance measures are as follows: ■ Legitimate arrangement of affair in such a way so as to minimise tax liability ■ Avoidance of tax is not tax evasion - it carries no public disgrace ■ An act valid in law can not be treated as fictitious

merely on the basis of some underlying motive supposedly resulting in lower payment of tax ■ There is no element of mala fide motive or use of 'colourable devices' or dubious methods involved in tax avoidance

Tax planning/Tax avoidance

Duke of Westminster Case

IRC v. Duke of Westminster [1936] AC 1 which reflected the prevalent attitude towards tax avoidance: " Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxgatherers may be of his ingenuity, he cannot be compelled to pay an increased tax."

Pre-McDowell decisions

Every person is entitled to so arrange his affairs as to avoid taxation, but the arrangement must be real and genuine and not a sham or a make-believe - Jiyajeerao Cotton Mills Ltd. v. CIT [1958] 34 ITR 888 (SC).

Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed, is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon consideration of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented - CIT v.



A. Raman & Co. [1968] 67 ITR 11 (SC)/Jiyajeerao Cotton Mills Ltd. v. CIT [1958] 34 ITR 888 (SC)/CIT v. Calcutta Discount Co. Ltd. [1973] 91 ITR 8 (SC).

Mc Dowell case

Planning must be legitimate [Mc Dowell case] - Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges - McDowell & Co. Ltd. v. CTO [1985] 22 Taxman 11/154 ITR 148 (SC).

Tax avoidance - art of dodging tax without breaking the law - the taxpayer minimises tax incidence by means which are within the four corners of the taxation laws but the advantage is taken by finding out loopholes in the laws - the tax payer circumvents the law, without committing criminal offence, by the use of complex schemes, arrangements or colourable devices to defer, reduce or completely avoid the tax liability.

Ethics of taxation - " We now live in a welfare State whose financial needs, if backed by the law, have to be respected and met. We must recognise that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation." - Justice O. Chinnappa Reddy

Consequences of tax avoidance -

- Substantial loss of much needed public revenue, particularly in a welfare State like ours.
- Serious disturbance caused to the economy of the country by piling up of mountains of black money directly causing inflation.
- Large hidden loss to the community by some of the best brains in the country being involved in the perpetual war waged between tax avoider and his expert team of advisers, lawyers and accountants on one side, and the Tax Officer and his perhaps not so skillful advisers on the other side.
- Sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it.
- Ethics (or lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of artful dodgers. [Justice O. Chinnappa Reddy of Supreme Court in McDowell & Co. Lid, v CTO (1985)]

Post-McDowell decisions

Azadi Bachao Andolan and other cases

McDowell decision does not rule out ignoring of genuine/real transactions - Decision in McDowell & Co. Ltd. v. CTO [1985] 154 ITR 148 (SC), and the English decisions which adopted a new approach in the case of a scheme consisting of several transactions, do not rule out a transaction which is real and genuine from being ignored merely on the ground that it results in reducing the tax burden. Where there is a commercial or a business purpose in a transaction which only means that a transaction has the result of reducing the tax burden as a result of or a real deprivation of income as in the case of a family partition, that transaction would be a permissible

attempt for reducing the tax burden - M. V. Valliappan v. ITO [1988] 170 ITR 238 (Mad.).

McDowell decision does not say that taxpayer should arrange his affairs so as to attract maximum tax liability - Banyan & Berry v. CIT [1996] 84 Taxman 515 (Guj.).

[2003] Union of India v. Azadi Bachao Andolan (SC) 263 ITR 706 - We may in this connection usefully refer to the judgment of the Madras High Court in M. V. Valliappan v. CIT [1988] 170 ITR 238 which has rightly concluded that the decision in McDowell & Co. Ltd.'s case cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement which is perfectly permissible under law, which has the effect of reducing the tax burden of the assessee, must be looked upon with disfavour.

Judgment of Gujarat High Court in Banyan & Berry v. CIT [1996] 222 ITR 831/84 Taxman 515 where referring to McDowell & Co. Ltd.'s case, the Court observed: ". . . The court nowhere said that every action or inaction on the part of the taxpayer which results in reduction of tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act; an inference which unfortunately, in our opinion, the Tribunal apparently appears to have drawn from the enunciation made in McDowell case [1985] 154 ITR 148 (SC). The ratio of any decision has to be understood in the context it has been made. The facts and circumstances which lead to McDowell's decision leave us in no doubt that the principle enunciated in the

above case has not affected the freedom of the citizen to act in a manner according to his requirements, his wishes in the manner of doing any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same fall in the category of colourable device which may properly be called a device or a dubious method or a subterfuge clothed with apparent dignity.”

We are unable to agree with the submission that an act which is otherwise valid in law can be treated as non-est merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents. - [2003] Union of India v. Azadi Bachao Andolan (SC) 263 ITR 706

Residence in India: Individuals

Resident and Ordinarily Resident (ROR)

Resident and Not ordinarily resident (RNOR)

The persons who do not get taxed in India for their foreign incomes are:

8 foreign nationals resident and ordinarily resident in India

9 resident persons of Indian origin, working abroad

10 non resident Indians working in foreign countries

11 persons of Indian origin resident and not ordinarily resident in India.

Residential status: Individuals

### Basic conditions

- a) In India for 182 days or more in a previous year
- b) In India for 60 days or more in a previous year and 365 days or more in 4 previous years immediately preceding the previous year

### Exceptions

The period of 60 days will be substituted by 182 days:

- a) For Indian citizens leaving India in any previous year for employment outside India, b) For Indian citizens/persons of Indian origin who have been staying outside India, comes on a visit to India in any previous year

Person of Indian origin - A person is deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India. It may be noted that grand parents include both maternal and paternal grand parents.