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Sample Preview of the Solved Sample Question Papers

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QUESTION PAPER

June – 2024

(Solved)

INCOME TAX LAW AND PRACTICE

BCOC-136

Time: 3 Hours] ***[Maximum Marks : 100***

Note: *Attempt any* ***five*** *questions. All questions carry equal marks..*

Q. 1. ***(a)*** **"The income of the previous year is taxed in the current year." Explain. What are the exceptions to this rule?**

Ans. Ref.: See Chapter-1, Page No. 4, Q. No. 1.

Also Add: Exceptions to the Rule: While the general rule is that income from the previous year is taxed in the current year, there are certain exceptions where income may be taxed in the same year in which it is earned. These include:

1. Income of Non-Residents Leaving the Country:

- If a non-resident or foreign company earns income in the country and is about to leave the country, the income may be taxed in the year in which it is earned to ensure tax compliance before their departure.

2. Income of Discontinued Business:

- If a business or profession is discontinued in the middle of a financial year, the income earned during that portion of the year may be taxed immediately, rather than waiting for the next assessment year.

3. Assessment in Cases of Death:

- In the case of the death of a taxpayer, the income up to the date of death is taxed in the year of death itself, to settle their tax liabilities promptly.

4. Income of People Transferring Assets or Moving Abroad:

- If someone is transferring assets to avoid taxation or planning to move abroad permanently, the tax authorities may assess and tax their income during the same financial year to prevent tax evasion.

5. Block Assessment in Case of Search/Seizure:

- Under special provisions of tax laws (such as in cases of search or seizure), income can be assessed and taxed for multiple previous years during the year of assessment. This is to curb tax evasion.

(b) **What do you understand by Casual Income? How are they treated under the Income Tax Act?**

Ans. Ref.: See Chapter-2, Page No. 11, Q. No. 3.

Q. 2. ***(a)*** **Explain the provisions regarding Gratuity U/S [10(10)] of Income Tax Act.**

Ans. Ref.: See Chapter-5, Page No. 34, 'Gratuity [Section 10(10)]'.

(b) **What do you understand by Allowances? What are the fully taxable and partially exempted allowances?**

Ans. Ref.: See Chapter-5, Page No. 35, 'Allowances'.

Q. 3. ***(a) (i)*** **What do you mean by annuity?**

Ans. Ref.: See Chapter-5, Page No. 34, 'Annuity'.

(ii) **Mr. Madhur is getting a pension ₹ 4,000 per month from a company. During the previous year, he got two-third pension commuted and received ₹ 1,86,000. Compute the exempted amount, if (1) he also received gratuity. (2) he did not receive gratuity, for the assessment year 2023-24.**

Ans. To calculate the exempted amount of the commuted pension received by Mr. Madhur for the assessment year 2023-24, we need to consider the provisions under Section 10(10A) of the Income Tax Act, 1961.

There are two situations to consider:

1. If Mr. Madhur received gratuity: In this case, the commuted pension that is exempt from tax is one-third of the full value of the commuted pension.

2. If Mr. Madhur did not receive gratuity: In this case, the commuted pension that is exempt from tax is one-half of the full value of the commuted pension.

Steps to compute the exempted amount:

Given Information:

- Mr. Madhur's monthly uncommuted pension: □4,000.
- He commuted **two-thirds** of his pension and received □1,86,000.
- Assessment year: 2023-24.

First, calculate the full value of the commuted pension:

Since Mr. Madhur commuted two-thirds of his pension, the full value of his pension would be:

Full value of commuted pension

$$= \frac{1,86,000}{2/3} = ₹2,79,000$$

Now, let's compute the exempted amount for both scenarios:

1. If Mr. Madhur received gratuity: In this case, the exempted amount is one-third of the full commuted pension:

Exempted Amount = $\frac{1}{3}$ × 2,79,000 = ₹ 93,000.

2. If Mr. Madhur did not receive gratuity: In this case, the exempted amount is one-half of the full commuted pension:

Exempted Amount = $\frac{1}{2}$ × 2,79,000 = ₹ 1,39,500.

***(b)* What is entertainment allowance? What are the provision of Section 16 *(ii)* regarding entertainment allowance for a government employee?**

Ans. Ref.: See Chapter-6, Page No. 48, 'Deductions From 'Salaries' and Page No. 49, Q. No. 6.

Q. 4. Mr. Radheyshyam is employed in a company. He gets the following from the company:

***(i)* Salary ₹ 20,000 p.m.**

***(ii)* Dearness allowance ₹ 2,000 p.m.**

***(iii)* Medical allowance ₹ 5,000 p.m.**

***(iv)* Bonus equal to 2 month's salary.**

***(v)* Commission ₹ 20,000 p.a.**

The following perquisites are provided by the employer:

Ans. To compute the taxable salary of Mr. Radheyshyam for the Assessment Year 2023-24, we will include various components of salary such as salary, allowances, perquisites, and any other benefits provided by the employer. Let's break down the calculation into sections.

1. Basic Salary: Mr. Radheyshyam receives a basic salary of Rs. 20,000 per month.

Annual Salary = 20,000 × 12 = Rs. 2,40,000.

2. Dearness Allowance (DA): The dearness allowance is Rs. 2,000 per month.

Annual DA = 2,000 × 12 = Rs. 24,000.

3. Medical Allowance: Medical allowance is fully taxable. He receives Rs. 5,000 per month.

Annual Medical Allowance = 5,000 × 12 = Rs. 60,000.

4. Bonus: Bonus is given as 2 months' salary (basic salary).

Bonus = 20,000 × 2 = Rs. 40,000.

5. Commission: He receives Rs. 20,000 annually as commission.

Commission = Rs. 20,000.

6. Perquisites: Now, we compute the value of perquisites as they are taxable:

***(i)* A sweeper an a cook getting salary of ₹ 1,500 p.m. each.**

Ans. Sweeper and Cook: The salary of the sweeper and cook (Rs. 1,500 each per month) provided by the employer is fully taxable.

Total Salary for Sweeper and Cook = (1,500 × 2) × 12 = Rs. 36,000.

***(ii)* A car of 1400 CC for his personal use for which the employer pays.**

Ans. Car for Personal Use: The car with an engine capacity of 1400 cc for personal use is considered a perquisite. The taxable value depends on the cubic capacity of the car and the usage. For a car with an engine capacity up to 1,600 cc used for personal purposes and expenses paid by the employer, the perquisite value is fixed at Rs. 2,400 per month.

Car Perquisite = 2,400 × 12 = Rs. 28,800.

***(iii)* Rent-free unfurnished house in Etawah (poplation less than 10 lakhs) owned by employer, annual rental value of which is ₹ 1,00,000.**

Ans. Rent-free Unfurnished House: For a rent-free unfurnished house, we calculate the perquisite as:

- If the accommodation is owned by the employer in a city with a population less than 10 lakh (Etawah qualifies), the perquisite is calculated as 7.5% of the salary.
- For this purpose, "salary" includes basic salary, dearness allowance (if considered for retirement benefits), and bonus.

Salary for house perquisite = 2,40,000 ('Basic') + 24,000 (DA) + 40,000 (Bonus) = Rs. 3,04,000.

Perquisite Value for House = 7.5\% × 3,04,000 = Rs. 22,800.

Since the annual rental value is Rs. 1,00,000, the taxable perquisite will be the lower of the two values: Rs. 22,800.

***(iv)* A gardener whose salary is ₹ 2,000 p.m.**

***(iv)* Gardener:** The salary of the gardener is Rs. 2,000 per month, and this is fully taxable as a perquisite.

Gardener's Salary = 2,000 × 12 = Rs. 24,000.

***(v)* For personal use free gas, electricity and water facility ₹ 20,000 for previous year which employer has paid.**

Compute taxable salary of Mr. Radheyshyam for assessment year 2023-24.

***(v)* Free Gas, Electricity, and Water**:** The cost of free gas, electricity, and water provided by the employer is Rs. 20,000, and it is fully taxable as a perquisite.

Free Utilities (Gas, Electricity, Water) = Rs. 20,000.

7. Total Taxable Salary

Now, let's compute the total taxable salary by summing up all the components:

Total Taxable Salary

= Basic Salary + Dearness Allowance + Medical Allowance + Bonus + Commission + Perquisites.

Sample Preview
of
The Chapter

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INCOME TAX LAW AND PRACTICE

Basic Concepts-I

1

INTRODUCTION

The Central Government imposes income tax, which is a type of direct tax. This tax is directly payable by individuals, Hindu Undivided Families, firms, and corporate bodies on the income earned during the previous year or accounting/financial year, and it must be paid in the Assessment Year. It is crucial for any student of income tax to understand the concepts of income, previous year, assessment year, total income, and who is responsible for paying income tax in India. This chapter explores the history of income tax in India and provided definitions for all these terms according to the current provisions of the Income Tax Act.

CHAPTER AT A GLANCE

BROAD MECHANISM OF INCOME TAX IN INDIA

The English Government faced financial difficulties due to the First War of Independence in 1857, and income tax was introduced in India in 1860 to meet financial needs. The Income Tax Act was enacted in 1886 and revised in 1922 after World War I. After India gained independence, the Income Tax Act was overhauled, and a new one came into effect in 1962. The Central Board of Direct Taxes (CBDT) administers the Income Tax Act, and the income tax department is responsible for its implementation. Income tax is a vital source of income for the Central Government, and some of it is distributed among states for their projects. Tax journals and publications should be read to stay up-to-date with the latest provisions.

The Finance Act

The Finance Minister of the Government of India presents a budget to the Parliament each February, which outlines the expected income and expenditure for the coming financial year. A bill known as the Finance Bill is also presented to give legal form to tax proposals, including provisions for direct and indirect taxes. Once the Finance Act is passed, it becomes law, and tax rates are set for the year. Students of income tax should study not only the Income Tax Act and Rules but also the latest Finance Act to stay up-to-date with the tax structure.

Scheme of Income Tax – An Overview

The Income Tax Act is a tax on income that is levied on an individual's previous year's total taxable income. The applicable rates depend on the current year and are divided into various income slabs. Those whose income exceeds the tax-free limit, as prescribed by the relevant Finance Act, are required to pay tax. The Income Tax Act identifies five heads of income, which include salaries, income from house property, profits and gains from business or profession, capital gains, and income from other sources. The Act, along with the Income Tax Rules and Finance Act, covers all possible situations that may arise. The Income Tax Act comprises 298 Sections and 14 Schedules and applies to the entire country.

CONCEPT OF INCOME

Having knowledge about what income is and how it is calculated is crucial since income tax is imposed on an entity's income. In this section, we will discuss the definition of income and some fundamental principles related to it. The process of determining total income will be thoroughly explained in subsequent sections.

Definition of Income

The income tax is levied on an entity's income, and it is important to understand what income is and how to compute it. However, the Income Tax Act does not define income; instead, Section 2(24) of the act specifies certain items that must be included. These items include profits and gains, dividends, income from voluntary contributions received by various institutions, perquisites or profits in lieu of salary to employees, special allowances or benefits, income from units of Unit Trust of India or Mutual Fund, profits generated from any business or profession, capital gains, recovery of bad debts allowed in the past, refunds of excise duty, balancing charges, and many others.

Basic Principles

The Income-tax Act does not provide a comprehensive definition of income but rather specifies what amounts should be included in the term. Due to the broad meaning of the term "income," the Income Tax Department and taxpayers must rely on various court judgments. Not all receipts qualify as income; only those that meet the guidelines established by the courts are considered income. The term "income" refers to a regular, periodical monetary receipt from a productive source that generates income. Income can be in cash or kind, and even if it is tax-exempt, it remains income. Income must come from outside and cannot be fictional or technical. Illegally earned income is taxable, but it does not provide immunity from prosecution.

DEFINITION OF PERSON

Section 2(31) of the Act defines the term "Person", which is an inclusive definition of entities that can be considered as a "person". The term includes the following:

(a) Individuals such as Ramesh, Hari, Sita, etc.
(b) Hindu Undivided Family (HUF)
(c) Companies
(d) Firms
(e) Associations of Persons or a body of individuals, whether incorporated or not, such as a co-operative society.
(f) Local Authorities such as – Municipality, District Board, etc.

Every artificial judicial person not falling within any of the categories mentioned above.

As per this broad definition, even a minor could be included under certain circumstances. All the entities listed above are required to pay income tax under the provisions of the Income Tax Act, 1961.

DEFINITION OF ASSESSEE

The Income Tax Act, 1961 defines the term "assessee" in Section 2(7) as a person who is liable to pay any tax or sum under the Act. The term encompasses a wide range of individuals, including those who are being assessed for their income, those who are being assessed for someone else's income, those who are entitled to a tax refund, those who are deemed to be an assessee under the Act, and those who are deemed to be an assessee in default under any provision of the Act. An assessee in default refers to a person who is obligated to deduct tax at source but fails to do so, who deducts tax but does not remit it to the government, or who does not pay the installments of advance income tax on time. The definition is very broad and includes anyone who is involved in any way with the payment or refund of tax.

PERMANENT ACCOUNT NUMBER

A Permanent Account Number (PAN) is a unique identification number assigned to individuals by the Income Tax Department, which does not change even if the person changes their residence. Every person who is required to pay tax or carry out business with sales turnover likely to exceed Rs. 50,000 is required to have a PAN. In case they have not been allotted a PAN, they need to apply for it using Form No. 49A.

Ten Digit Permanent Account Number: The CBDT introduced a new scheme for the allotment of a computerized 10-digit permanent account number. Although people who were already allotted a PAN under the new series did not have to apply for a new one, everyone else was required to apply for a fresh PAN. The Assessing Officer may allot a PAN to any person liable to pay income tax, and it must be quoted on all correspondence and documents relating to the Income Tax Department.

ASSESSMENT YEAR

Section 2(9) of the Income Tax Act, 1961 defines the Assessment Year (AY) as a 12-month period starting from April 1st of each year and ending on March 31st of the following year. In the current AY of 2022-23, an assessee is required to pay tax on the income earned in the previous year of 2021-22 according to the tax rates prescribed by the Annual Finance Act. There are a few exceptions to this general rule.

PREVIOUS YEAR

To understand income tax, it is important to know the meaning of "Previous Year" which is defined in Section 3 of the Income Tax Act. The previous year is the year in which income is earned and received, and the year in which it is taxed is called the Assessment Year. The Assessment Year always starts on April 1st, so the previous year must end by March 31st. The previous year is also known as the Financial Year or Accounting Year and lasts for a maximum of twelve months.

1. Preceding Financial Year: The preceding financial year refers to the financial year immediately preceding the assessment year. For instance, the financial year 2019-20 will be the previous year for the assessment year 2020-21.

2. Previous year for every source of income: Before the Direct Tax Amendment Act of 1987, assesses had the option to select any previous year for each source of income. However, since the amendment came into force from the assessment year 1989-90, assesses can only have one uniform previous year for all sources of income, which is from 1st April to 31st March.

3. Separate Account Year: If an assessee does not maintain accounts on a financial year basis, but on some other basis, he may continue doing so. However, he must maintain separate accounts for income tax purposes until 31st March every year. Nonetheless, most assesses keep their accounts on a financial year basis.

4. Previous Year for newly started business or profession: If a business or profession commences on any day during the financial year, then the duration from the start date to the next 31st March will be treated as the previous year for the relevant assessment year.

5. Previous Year for new source of income: If a new source of income arises during the financial year, then the period from the start date to the next March will be treated as the previous year for the relevant assessment year.

6. Previous Year undisclosed money: Undisclosed or unexplained money found in an account by an income tax officer, which the assesses cannot satisfactorily explain, is treated as undisclosed income and considered as the assessee's income. The previous year for this income is the same as the previous year of the business in which this unexplained income is found.

7. Previous Year for the share in firm's profits: In the case of sharing profits in a firm, the previous year of the firm's business is treated as the previous year.

TAXATION OF PREVIOUS YEAR'S INCOME DURING THE SAME YEAR

Certain types of incomes are exceptions to the rule that income of the previous year is taxed in the assessment year. These exceptions include: the income of non-resident shipping companies, income of persons leaving India, income of associations or bodies formed for a particular event or purpose, income of persons trying to dispose of their assets to avoid paying taxes, and income of a discontinued business. The Income Tax Act provides specific rules for each of these types of income.

1. Income of non-resident shipping companies (Section 172): Section 172 of the Income Tax Act, 1962 specifies that the income earned by a non-resident shipping company in India will be taxed in the year in which it is earned. The master of the ship must prepare and furnish a return of the full amount paid or payable to the owner on account of the carriage of passengers or livestock, etc. before the ship departs from the Indian port. The Assessing Officer will then assess the income and determine the tax payable, with 7.5% of the local freight earned at the Indian port by the owner or charter or any other person on their behalf deemed as taxable income of the shipping business of the non-resident shipping company.

2. Income of Persons leaving India (Section 174): Section 174 of the Income Tax Act allows the Assessing Officer to determine the total income of an individual who may leave India without the intention of coming back. The officer will compute the tax payable on this income and ask the individual to pay it before leaving the country. The income to be taxed is calculated from the date of expiry of the previous year to the date of intended departure.

3. Income of an association of persons or body of individuals or artificial juridical person formed for a particular event or purpose (Section 174A): Section 174A of the Income Tax Act, 1962 provides that if an assessing officer believes that any Association of Persons (AOP), Body of Individuals (BOI), or artificial juridical person formed for a particular event or purpose is likely to be dissolved in the assessment year immediately after such formation, the total income of such association or body or juridical person for the period from the end of the previous year for that assessment year up to the date of its dissolution, shall be taxable in that assessment year.

4. Income of Persons trying to alienate their assets (Section 175): Section 175 of the Income Tax Act provides for the taxation of income of a person who is likely to dispose of assets to avoid payment of tax. The assessing officer will determine the income from the previous year to the day the proceedings start and serve a demand notice on the assessee.

5. Income of discontinued business: This section states that when a business or profession is discontinued in any year, the income earned from the date of expiry of the previous year to the date of discontinuance shall be taxed. It is the responsibility of the person discontinuing the business to inform the Assessing Officer of such discontinuance within 15 days.

CONCEPT OF TOTAL INCOME

The term 'total income' is defined in Section 2(45) of the Income Tax Act as the total amount of income, profits, and gains computed in the manner laid down in the Act. It is the income that is put to tax. The total income is computed by adding the taxable incomes from various heads of income, deducting expenses incurred by the assessee, and taking into account various deductions allowed under Section 80 C to 80 U. The net income remaining after all such deductions is termed as total income or taxable income and is used to compute the tax liability.

ACCOUNTING METHOD

There are three types of accounting methods: cash system, accrual system, and mixed system. Section 145 of the Income Tax Act, 1961, provides that income should be computed in accordance with the method of accounting employed by the assessee. However, if the assessing officer believes that the method employed by the assessee does not permit proper computation of income, the computation shall be made upon such basis and in a manner that he may determine. This is to ensure that the assessee does not change his method of accounting in a way that is prejudicial to the interests of the Revenue.

The Assessing Officer cannot impose his own method of accounting on the assessee, even if he does not accept the method used by the assessee. An assessee who wants to change his method of accounting must apply to the Assessing Officer and prove that the change is genuine. If the change is genuine, the Assessing Officer cannot reject it. Additionally, if the Department has been accepting the assessee's method of accounting for a number of years, they cannot suddenly take him on a different basis in a particular year.

CHECK YOUR PROGRESS

Q. 1. Read the following carefully and tick mark the correct answers:

***(a)* Income tax is:**

(i) Levied by the State Governments
(ii) A Direct tax
(iii) An Indirect tax

Ans. *(ii)* ✓

***(b)* Budget of the country is presented to the Parliament:**

(i) In the month of March
(ii) In the month of February
(iii) In the month of April

Ans. *(ii)* ✓

***(c)* Income tax rules are framed by:**

(i) Central Government
(ii) Income Tax Department
(iii) Central Board of Direct Taxes

Ans. *(iii)* ✓

***(d)* TDS on Casual income is exempted:**

(i) Up to Rs. 10,000

(ii) Fully

(iii) Up to Rs.15, 000

Ans. *(i)* ✓

***(e)* A PAN number stands for:**

(i) Permanent Account Number

(ii) Personal Account Number

(iii) Personal Access Number

Ans. *(i)* ✓

Q. 2. Define the term Person.

Ans. The term "Person" is defined in Section 2(31) of the Income Tax Act, 1961. It is an inclusive definition that covers various entities that can be considered as a "person." This includes individuals, Hindu Undivided Family (HUF), companies, firms, Association of Persons (AOP) or Body of Individuals (BOI), local authorities, and every artificial judicial person not falling within any of the mentioned categories. This broad definition also includes minors under certain circumstances. All these entities are required to pay income tax under the provisions of the Income Tax Act, 1961.

Q. 3. Who is an 'Assessee in default'?

Ans. Under the Income Tax Act, an assessee in default is someone who has a legal obligation to pay taxes but fails to do so, including those who are obligated to deduct tax at source but do not fulfil this obligation.

For example, if an employer deducts tax from the salary of its employees but fails to deposit the deducted amount to the government, it is considered an assessee in default. Similarly, if a person is required to pay advance income tax in installments but fails to pay them on time, they will be considered an assessee in default.

An assessee in default may also include individuals or entities who are required to deduct tax at source but fail to do so, or deduct tax but do not remit it to the government. This could include businesses that fail to deduct tax on payments made to vendors, landlords or contractors.

Q. 4. Fill in the blanks.

(a) Assessment year is the financial year in which the.................. takes place.

(b) Assessment year ends on................ every year.

(c) Previous year is the................immediately, preceding the assessment year.

(d) Total income is.................... income in respect of which income tax is payable.

(e) Income of discontinued business is taxed in the .... year.

Ans. *(a)* assessment, *(b)* March 31st, *(c)* financial year, *(d)* taxable, *(e)* same.

Q. 5. X sets up a new business on October 1, 2019 and does not close his books on March 31, 2020. What will the period of previous year for the assessment year 2020-21.

Ans. The previous year for the assessment year 2020-21 would be the financial year 2019-20, which runs from April 1, 2019 to March 31, 2020. Since X started his business on October 1, 2019, his previous year for the assessment year 2020-21 would be from October 1, 2019 to March 31, 2020.

TERMINAL QUESTIONS

Q. 1. "The income of the previous year is taxed in the current year". Explain.

Ans. The statement "the income of the previous year is taxed in the current year" means that an assessee is required to pay tax on the income earned in the previous year during the current Assessment Year. The Assessment Year starts from April 1st and ends on March 31st of the following year. For example, for the Assessment Year 2020-21, the income earned in the previous year of 2019-20 is taxed according to the tax rates prescribed by the Annual Finance Act. It is important to note that the previous year cannot extend beyond March 31st, and assesses can only have one uniform previous year for all sources of income, which is from 1st April to 31st March.

Q. 2. Distinguish between:

***(i)* Gross total income and total income**

***(ii)* Previous year and Assessment year**

Ans. ***(i)* Gross total income and total income:** Gross total income and total income are two terms used in the computation of income tax in India. The main difference between the Gross Total income and total income are:

Gross Total Income (GTI) is the sum total of all income received or accrued during a financial year. It includes all sources of income such as salary, house property, business or profession, capital gains, and other sources of income. However, it does not include deductions or exemptions that are allowed under the Income Tax Act.

On the other hand, Total Income (TI) is the income that is chargeable to tax after all deductions and exemptions have been claimed. It is computed by subtracting the deductions and exemptions allowed under the Income Tax Act from the Gross Total Income.

In simpler terms, Gross Total Income is the total income earned by an individual during a financial year, whereas Total Income is the income on which tax is actually payable after taking into account the deductions and exemptions allowed under the Income Tax Act.

***(ii)* Previous year and Assessment year:** The main difference between the Previous year and Assessment year is that: *(a)* The Previous year is the year in which income is earned and received, while the Assessment year is the year in which the income of the Previous year is taxed. *(b)* The Previous year starts from April 1st and ends on March 31st, whereas the Assessment year starts from April 1st and ends on March 31st of the following year. *(c)* The Previous year is the year of earning, while the Assessment year is the year of taxation. For instance, the income earned during the Previous year of 2020-21 is taxed in the Assessment year of 2021-22.

Q. 3. Are the following incomes as defined under the Income Tax Act, 1961: