REFORMS NEEDED IN INDIAN INCOME-TAX LAW

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"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

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The Income-tax Act of 1961 which replaces the Indian Income-tax Act, 1922, which has remained in operation for 40 years is based on the recommendations of the Law Commission and the Direct Taxes Administration Inquiry Committee. This Act, after having undergone amendments, still lacks some of the canons of taxation.

It is true that the old canons of taxation, viz., simplicity, certainty and reference to ability to pay, have got to undergo a change with the changing society. But if the Act is examined in detail, it will be seen how it leaves very wide gaps, which remain to be filled either by administration or by legislature. In a developing economy, tax laws should not only perform the function of getting revenue for meeting the Government's expenditure, but they should also act as a very effective instrument by narrowing the gap between the extremely rich and the extremely poor. They should also aim at encouraging the development of business and industries in the right direction. However, before the tax laws act as an instrument in bringing about economic equality, they should first help to develop the economy and then aim at equality. Poverty cannot be distributed. The country must first economically develop before it can think in terms of redistribution.

In view of this, it is necessary that great care should be taken in drafting the taxation laws. Tax Law should be (i) Simple and clear. (ii) Certain and unambiguous, and (iii) Equitable and bearable. Let us examine the Income-tax Act, 1961, to see how far it conforms to these principles.

Simplicity and Clarity

It has been stated that the law is being amended, reframed, redrafted, etc, to make it simpler and clearer, but unfortunately with every such attempt it has become more

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and more complicated and ambiguous. If one compares the Income-tax Act, 1922, with the Income-tax Act, 1961, one fails to understand how, what was couched in 67 Sections when stated in 297 Sections, can be said to be simple and clear. Let us examine the aspects of simplicity and clarity under five different heads: (a) Language, (b) Tax Calculation, (c) Procedure, (d) Administration, and (e) Quick and piecemeal amendments.

(a) Language: The language of any law must be clear and unambiguous. It is true that often the ambiguity is noticed only after the law operates for some time. But then, once the ambiguity is noticed it should be for the administrators to take immediate steps to set right the position by taking steps to amend the law so that the ambiguity is cleared one way or the other. But in practice it is found that the ambiguity is continued and no definite guidance is available to the assessee. Let us examine few instances.

Section 6(6)(a) defines a person who is "Not Ordinarily Resident" in India. This Clause, which is a model of ambiguous and obscure drafting, is reproduced from the **1922** Act verbatim:

> "Section 6(6)(a) — an individual who has not been resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more."

According to one view, the assessee should be non-resident in India in nine out of the ten years next preceding, in order to acquire the status of being "Not Ordinarily Resident." The other view is that residence in India for less than nine out of ten years is sufficient to enable the assessee to be "Not Ordinarily Resident." There has also been a controversy as to whether the two conditions, viz., the period of residence as well as the period of stay, are cumulative or alternative. It is true that the Courts as well as the Department have accepted as correct the construction which is more favourable to the tax-payer, but that should not be a ground to continue the same ambiguous provisions in the new Act, when the Income-tax Act was being simplified.

Another example of lack of simplicity and clarity is the provision dealing with creation of a development rebate reserve. The relevant Section 34(3)(a) reads as under:—

> "Sec. 34(3)(a) — The deduction referred to in Section 33 shall not be allowed unless an amount equal to seventy-five per cent. of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of eight years next following for the purposes of the business of the undertaking, other than—
>
> (i) for distribution by way of dividends or profits; or
>
> (ii) for remittance outside India as profits or for the creation of any asset outside India."

The words "actually allowed" create complications. This would suggest that the reserve should be created only in the year in which the actual allowance of the development rebate falls due. Ths would create hardship because the company will have to estimate correctly its income to find out what amount of development rebate will absorb that income and then create a reserve equal to 75% of such amount. Experience shows that it is impossible to predict in advance the figure at which the total income of an assessee for a particular year would be computed. On the other hand, if the reserve falls short even by a very small margin, the assessee is faced with the risk of being disallowed the whole of the development rebate on the ground that the condition of the Section is not fulfilled. This provision which was in the 1922 Act was again incorporated with same ambiguity in the 1961 Act. Suffice it to say that instances of this nature can be multiplied. However, it is clear that the law as drafted in 1961 Act is not as simple and clear as claimed to be. On the other hand, one feels that no attempt is being made to clear the existing ambiguities often noticed even by the Courts.

(b) **Tax** Calculations: The number of calculations involved even in the case of an ordinary tax-payer are so many that one has actually to do the calculations to realise it. Firstly, the Finance Act, which every year prescribes the rates, used to provide for Income-tax and Super-tax and add to it the calculation of surcharge. It also provides that the income

from salary is to be assessed at the rates in force in the last year and not the current year. If a salaried man, therefore, has other income, there will be two calculations; one under ance Act. The average rates thus found out will be applied resance Act. The average rates thus found out will be applied respectively to the two types of income. The previous year's rate would apply to the salary income and the current year's to the other income. There will also have to be separate calculations for giving reliefs and rebates to which the assessee may be entitled, like donations, life insurance, etc.

Let us take the example of a company. The Finance Act used to provide for a flat rate of income-tax and also a flat rate of super-tax. But from the flat rate of super-tax, the companies are entitled to certain rebates depending on the fulfilment of certain conditions, as to quantum and quality of income as well as whether it is a company in which the public are substantially interested or not. These rebates are again to be reduced or withdrawn, if that company has either distributed bonus shares to its shareholders or distributed dividends in excess. Today, nobody even in the Tax Department who has seen or done calculation of tax would be prepared to say that it is simple and clear. As a matter of fact, in case of a company the calculation of tax is being made more and mow complicated by introduction of several classes of rates.

(c) Procedure: The Income-tax Act also abounds in a number of procedures which an assessee is required to follow. The law provides that if there is a firm constituted by an instrument of partnership specifying individual shares of partners, it may on application be registered by the Income-tax Officer. Once the firm is registered, the partners are individually assessed on their share of the firm's profit and hence, it results in a benefit to the partners. However, the procedure of filing an application for a fresh registration as well as of claiming renewal of registration is so ambiguous that the assessee is usually left with no remedy but to file both the applications in respect of each of the assessment years which are pending before the Income-tax Officer, in cases where there is a change in the constitution of the firm or where there is succession.

Another instance of such procedure is the application which

a charitable or a religious trust is required to make if it wants to accumulate or set apart a larger portion of its income, i.e., in excess of 25% of its income. The object sought to be achieved is looked after by the provisions of the Public Trust Act. The procedure under tax law creates hardship leaving aside the question of the law requiring a trust to spend during the year 75% of its income which is known only at the end of the year.

(d) Administration: Even as regards the administration of the law, one finds a number of procedures which confuse rather than help an assessee. Let us examine one such glaring example which in substance effects no improvement over the old one except that it often confuses assessees.

The Income-tax Act of 1961 provides that when the minimum penalty imposable under Section 271 (1) (c) exceeds Rs. 1,000/-, the penalty shall be imposed by the Inspecting Assistant Commissioner. In such cases, the appeal will lie to the Tribunal and not the Appellate Assistant Commissioner. It will be interesting to note that in all other matters the law provides for an order by an Income-tax Officer against which there is an appeal to the Appellate Assistant Commissioner and a further appeal to the Tribunal. Why such a departure has been made in the new Act is not very clear, particularly in view of the fact that under old law penalty could be levied only after the approval of the Inspecting Assistant Commissioner. However, this procedure is bound to confuse rather than help an assessee.

In actual practice, it has sometimes been found that the law is being administered on the basis of least or minimum risk without any regard for the assessee with whom the Department is dealing. A number of instances are available to show that the authorities refuse to exercise discretion vested in them. No one is questioned for not exercising discretion, whether rightly or wrongly.

An assessee whose accounting year ended on 31st December incurred loss in certain transactions which he closed without delivery, say, in December, while payment for losses were made in January, February and March of the next year. Entries were passed in the books of account in the year when payment was made and the losses were claimed in that year. The Income-tax Officer disallowed them as speculation losses

on the ground that there was no delivery. On appeal, the Appellate Assistant Commissioner allowed the assessee's claim holding that the losses incurred were in ordinary course of assessee's business which he was carrying on even in the earlier year. The Department, however, appealed against the order of the Appellate Assistant Commissioner to the Tribunal. At the time of hearing, a point was raised that all these losses related to earlier year as transactions were closed in December and hence, losses could not be considered in the year of appeal. The Tribunal, very rightly, realising the plight of the assessee no doubt, upheld the Department's contention but at the same time made very emphatic observation in its order to the following effect:—

> "We are sure the Department having taken up this point before us would, as a logical consequence of what is contended before us, take steps to set right the assessment for **1952-53** especially when there is no dispute about the genuineness of the loss and make adjustment for the carried forward loss in the year under appeal. We are, however, powerless to give any direction in this behalf, as the assessment for **1952-53** is not before us. The matter has necessarily to wait till the assessment for **1952-53** is revised."

Inspite of all this, when a revision petition was made both the Commissioner of Income-tax and the Board refused to condone the delay, and that too without assigning any reasons. This shows with what respect the remarks of a body like the Tribunal are treated.

Many instances should be considered in the light of the power that the Department has taken under Section **147-148** to reopen assessment for as many as **16** years, so that nothing is likely to escape tax, yet the just demands of an assessee can be negatived by just a two-line order indicating refusal ot interfere, without any reason.

This trend is really a very serious development and needs to be nipped in the bud. If it is the Government audit which results in this lack of initiative to exercise discretion some way should be devised to counter this, by requiring the auditor also to see cases where relief was patently due and tha discretion was not exercised. The law, which is claimed to be made simpler at every stage of amendment, is in reality one

of the most complicated pieces of legislation. It is difficult for even an honest assessee not to falter and commit technical breach or sometimes follow a wrong procedure or remedy.

It is said that once a junior advocate who had just started practice was tried for contempt of the Court on some breach. A very eminent counsel who was engaged to defend him, when called upon, only stated that "this young man who has tried to do a right thing in a wrong way has come to this, while so many of us who do the wrong things but in the right way are left free," and closed the case. The young advocate was set free. Such should be the attitude in administering the law. Law must be administered by a stern and strong hand but the strength should be matched by a equally strong desire to do justice by making careful study of every case with an open mind.

On the other hand, one is really surprised at the number of instances indicating inertia in the administration but for which High Court decisions contrary to administration's expressed views would not have been invited.

For example, a company in which public are substantially interested is defined by Section **2**(22) of the Income-tax Act. One of the conditions to be fulfilled is that its shares should be freely transferable by the holder to other members of the public. However, some time back, the Department sought to raise the point that as the Articles of Association of the company concerned empowered the directors to refuse without assigning any reason to register transfer of a share in favour of a person when they consider undesirable, the shares are not freely transferable within the meaning of the aforesaid sub-section. This was challenged by writ petitions which were withdrawn as the Department agreed to regard such shares as freely transferable.

After all this, one is really surprised to find a decision obtained by the Commissioner in C.I.T. vs. Tona Jute Co. Ltd., [1963 **(48)** I.T.R. p. **9021** holding that in view of the restrictions contained in the articles shares are not freely transferable and the companies are, therefore, those in which the public are not substantially interested. Articles of public companies usually contain such power to refuse to register a transfer, which by itself should not lead to the conclusion that shares are not freely transferable. Here one finda that a mat-

ter is being pursued right up to High Court and a decision taken quite contrary to administration's views on the matter.

There is yet another example under the law as it stands. There is absolutely no clear guidance as to, between unabsorbed loss, depreciation and development rebate, which one comes earlier and which one can be set off against income under other heads in subsequent years. There are some decisions which are conflicting. This creates a lot of uncertainty for the assessee who cannot judge and know in advance where he stands. Even an eminent author on taxation comments on this aspect saying that it is debatable whether unabsorbed development rebate of an earlier year should be deducted before the carried forward loss of an earlier year. This sort of uncertainty in the taxation law creates a lot of confusion.

The administrative authority must be very vigilant as to both tax evadors as well as to see that no honest assessee is denied just relief. Administration is most effective only when both the honest and the dishonest get the treatment they deserve. If the administration shows complete lack of initiative on questions or relief or gives decisions against the assessee on technical grounds, then honest assessees are bound to feel frustrated and disappointed.

(e) Quick and Piece-meal Amendments: When the Income-tax Act, 1961, was framed, all felt that now there will be an end to the spate of amendments we used to have in every Finance Act. But to the surprise of all, this Act of 1961 had to be amended no sooner it came into force!

The provisions relating to capital losses contained in the Income-tax Act, 1961, were amended to provide for different treatment to long-term capital losses and short-term capital losses, by Finance Act, (No. 2) 1962, which received the assent of the President on 22nd June, 1962, while the Income-tax Act, 1961 was brought into force only on 1st April, 1962.

Another such example is of taxation of Bonus Shares. Section 2(22) which defines dividend was amended by Finance Act, to include Bonus Shares received by Preference Shareholders. Within a short period, the law was again amended in 1964 to tax Bonus Shares recived by Ordinary Shareholders as Capital Gain. One fails to perceive the rationale or logic behind two different treatments to Bonus Shares, viz., treated as dividend if received by Preference Shareholders ana Capital Gains if received by Ordinary Shareholders. It appears to be a complete oversight on the part of the draftsman.

Often it is seen that the law is being amended merely to overcome the effect of some High Court or Supreme Court decision in such a great hurry ignoring many-sided effects of such quick and piece-meal amendments.

Let us leave alone these minor amendments to the law which create confusion and uncertainty about their correct interpretation. There are instances of major changes in law in such quick succession that one really starts thinking whether such changes have any relation to real effect on revenue or nation's economy. Any one reason given for the amendment is completely forgotten the very next year when that very position is sought to be altered. One such glaring example is of the machinery of grossing of dividends. Till 1960 dividends paid by companies who were themselves liable to tax were being grossed up. This system of the grossing of dividends was abolished in 1960, when even the effective rate of tax on companies was reduced from 51.5% to 45%, on the ground that the yield therefrom will be equal to the gross annual yield less annual credit hitherto given to the shareholders. On the other hand it was argued that the shareholders will not be the losers as with lower rate of taxation the companies will have larger distributable surplus. All this was quite good, for assessment years 1960-61 and 1961-62. All of a sudden an upward rise in rates of tax on companies from 45% to 50% was effected which is continued till now. This has again to be viewed in the light of the Preference Shares Dividend Regulation Act which came to the rescue of preference shareholders whose dividends were fixed to enable them to share in the additional surplus created by lowering the rate of tax on companies in 1960. Thus grossing has gone but the company rate of tax has come back almost to its original position resulting in total disadvantage to ordinary shareholders. How can any one, under such uncertain state of laws, ever plan or advise? Where is that basic certainty about tax laws?

Certainty and Unambiguity

Any tax law in order to be effective in achieving the object must be precise, certain and unambiguous. Lack of certainty, and unambiguity often arises due to (a) Drafting

errors defeating objectives or creating avoidable hardship; (b) Contrary and inequitable provisions; and (c) Disregard for basic.accountancy principles and general law.

(a) Drafting errors defeating objectives or creating avoidable hardships: A number of instances are available to show that so often the draftsman in his zeal to cover a mischief drafts the law which goes much further than the objective that was sought to be achieved.

One such instance is the right to carry forward losses on change of shareholders in excess of 50%. One can well realise the anxiety to stop the mischief of buying over loss-making companies to avail of a huge loss to be absorbed against profits. However, there appears to be no valid justification for taking away the right of a new shareholder who buys over the company and improves the same business and by his business acumen and ability brings about profits in the same business. Why should such a person be denied the right to set off past losses?

Another illustration is given by Section 34(3)(b) which provides for withdrawal of development rebate allowed, if the asset in respect of which the development rebate was allowed is "sold or otherwise transferred". Now it is easy to understand the selling but reference to any other mode of transfer is really difficult to follow. If the intention is to cover all modes of transfer governed by the Transfer of Property Act, the Section will create great hardship for in that event a mortgage of assets would be covered exposing the assessee to the risk of withdrawal of development rebate.

Similarly, if one goes through different sections scattered over the Act prescribing time limit for doing certain acts, it will be seen that such provision is usually accompanied by a power to the authority to condone the delay for reasonable cause. It will be seen that inspite of this provision there are still a number of instances where there is complete absence of such power.

One such example is Section 154 dealing with rectification of error apparent on the record. Section 154(7) provides that no amendment under this section shall be made after expiry of four years from the date of the order sought to be amended. Once the period of four years expires, the Income-tax Officer is powerless.

It may also be noted that the aforesaid section as drafted has most serious consequences which apparently are not discernible. As the section provides for no order to be made after four years, even if an assessee makes an application for rectification within time he will be not safe, for if the Income-tax Officer does not pass rectification order within a period of four years, he will thereafter be powerless. Hence, at least in this case, there is very urgent need for amendment to provide that only the application by the assessee should be within the period prescribed. When the rectification is at the instance of the assessee the time limit should only apply to his application while when the Income-tax Officer wants to rectify the order, the time limit should apply to his passing of the order. This will be most reasonable, for the poor asses. see cannot compel the Income-tax Officer to pass orders within four years!

Let us examine yet another such complication that has arisen on account of the draftsman using certain expressions which cover only one case and no other.

Under Section 2(22)(e), any loan to a shareholder of a company in which the public is not substantially interested to the extent of accumulated profits with the company is to be treated as a dividend in the hands of the shareholder. Thereafter, when that shareholder who has been assessed on this loan, subsequently receives dividend from the company, the law naturally wanted to safeguard him against double taxation of same income in his hands. However, in trying to provide for this protection what is stated is that "any dividend paid by a company which is set off by the company against the whole or part of any sum previously paid by it and treated as dividend" will not be regarded as dividend. The words "set off" create in practice great hardship; often a temporary loan taken by a shareholder of a non-public company is actually paid back. Hence, the dividend that he receives is not set off but paid to him. Is this sufficient to deny such a shareholder any relief? One who takes a loan for a short time to meet his urgent needs and pays back is a better shareholder than the one who keeps the loan outstanding to be wiped off only from subsequent dividends as and when declared and in the meantime uses and enjoys the company's funds as his own. Yet the law as drafted protects the latter, leaving the former to raise issues in appeals and references to seek re-

lief which ultimately he may not get on strict interpretation of the law.

At a number of places in one section reference is made to others and often to other laws. It is true that this is done to avoid repetition. But in practice it has often been found that this drafting of sections by reference to other sections of the same Act or often to other laws creates unsurmountable problems of interpretation when both the laws undergo changes at different point of time. In order to understand this difficulty, it has to be experienced rather than merely discussed. However, it appears that the law should as far as possible make things clear as to what it wants to say rather than refer to other sections or laws.

(b) Contradictory or inequitable provisions: Income-tax and logic are strangers. But one expects the law itself to be logical in its own scheme. If law requires the assessee to declare larger dividends based on a certain percentage of its income it would startle one's reasoning if one finds that having made the aforesaid provision the law goes on to stipulate that the assessee who has distributed dividends in excess of certain percentage would be liable to pay additional tax! Yet the Income-tax Act abounds in such provisions.

One glaring example of contradiction is the provision relating to registration of a firm. The law provides that an Income-tax Officer, if he is satisfied about the genuineness of the firm and its constitution as specified in the instrument of partnership, may register a firm (Sec. 185). If he is not so satisfied, then the firm is to be treated as an unregistered firm. One is surprised to find a provision in Section 183(b) empowering the Income-tax Officer to treat an unregistered firm as a registered firm if in his opinion the aggregate amount of tax payable by partners treating the firm as registered is larger than the tax that would be payable by the unregistered firm. How can law take such a somersault?

There are number of such contradictory and inequitable provisions scattered over the Act which often result in immense hardship to the assessee. In all such cases the only remedy one has is of going to Court by way of a writ petition. That is the reason why these days one finds a flood of petitions pending before the Courts.

(c) Disregard for basic accountancy principles and general law: A study of the Income-tax Act 1961 as well as practice in the Department clearly reveals a number of instances where normal accountancy principles are thrown overboard and other basic laws like partnership or company law are ignored. This position arises because of certain provisions in the Act itself and sometimes because of the interpretation given by the Department. Let us first examine the instances in the law itself.

Under Section 104, the companies in which the public is not substantially interested are compulsorily required to distribute a statutory percentage of their distributable income. The distributable income is based on total income. It may now be noted that a company may own a building whose income from rent will be computed under the head "income from property" for purpose of tax. Under the Income-tax Act, there is no provision for allowing depreciation on such property in calculating income. On the other hand, the Company Law authorities require the companies to provide depreciation on all its assets including the buildings referred to above. It will be appreciated that thus the company is required to distribute dividend based on income which is computed without deducting depreciation when the Company Law requires it to ascertain profits after providing depreciation. This creates hardship specially in case of property-owning companies.

As a matter of fact, the Income-tax Act does not provide for any deduction by way of depreciation in respect of house properties whose income is computed under the head "income from property". This itself is opposed to sound accountancy principles of determining the correct income.

The Triple-shift depreciation allowance has also been more than once granted and withdrawn not realising that the companies which run their machinery for three shifts depreciate their machinery larger than those companies which do not run three shifts. What the law should provide is that the depreciation mill be given in respect of machinery which has actually worked for three shifts. This is because industrialists do not run their machinery for the third shift only if triple-shift allowance is granted to them. Hence, in the year in which it is not allowed by the tax authorities the position becomes inequitable because the profits arising on

production in the third shift are no doubt taxed without allowing an appropriate charge against such profits in respect of depreciation.

Yet another glaring instance is provided by Section 37 of the Income-tax Act which provides for allowance of entertainment expenditure in the case of companies on the basis of a prescribed scale with reference to the company's profits. On principle itself, such treatment of an item of expenditure is not correct. No amount of reason or logic can suppori such a provision. When the law seeks to limit a deduction in respect of bona fide business expenditure, it is nothing short of saying that an assessee having particular capital in business must earn a particular percentage of proflt. If the expenditure on entertainment was found to be in excess of legitimate needs of business, the Income-tax Officer did have power to disallow what he considered as not related to business.

The item of entertainment expenditure is itself not so material but it has to be viewed from a broader angle for it is a departure from the general practice, of leaving it to the Income-tax Officer to decide what expenditure is reasonable in connection with a business. This trend has gained momentum. The principle of allowance itself is not reasonable, as allowance is based on certain percentage of the profits of the company. In reality the company may have to spend large amounts on entertainment only when it is not making good profits. This shows how law strays far away from the basic principle and purpose of expenditure itself!

Yet it will be surprising to note that Section 37 is amended by Finance Act, 1964 to provide for limiting the allowance of expenditure incurred on advertisement or maintenance of any residential accommodation or guest-house or travelling by employees including hotel expenses, on a scale which may be prescribed. Thus it will be seen that this is a very serious trend which converts real income of an assessee into an artificial figure, far from reality, involving the assessee into large payment of tax non-commensurate with his income and hence litigation.

This clearly shows that the law as it stands today ignores legitimate allowance while when it comes to taxing some items it goes out of its way to create a fiction ignoring all principles of general law and accountancy.

Another illustration of a provision which disregards the principle that a limited company is a separate legal entity independent of the shareholders constituting it is contained in Section 79 of the Income-tax Act, 1961. This section provides that where a change in shareholding has taken place in the previous year in case of non-public companies (Section 104), no loss incurred in prior years shall be carried forward and set of if 50% shares are not beneficially held by persons who were also the shareholders in the years in which loss was incurred. This provision seeks to negative a right to carry forward past losses if at least 51% of the shares change hands. The object behind the introduction of this section appears to be to counter mischief by people purchasing companies having large losses so that such losses may be set off against profits of new activity they may start in this newly purchased company. It throws overboard an age old principle of treating a company as a separate legal entity for all purposes. The theory based on which the entity of the company is linked up with that of its shareholders evaporates no sooner the question of allowance of losses incurred by the company to shareholders is concerned or where question of double taxation of profits, once in the hands of the company and again in the hands of the shareholders, is concerned. This clearly shows how the law itself in parts adopts principles quite contrary to those which it accepts so far as other parts are concerned.

The above illustrations will go to show clearly that the Income-tax Law at a number of places has sacrificed general law as well as accountancy principles merely with a view to collecting more tax, causing greater uncertainty and ambiguity about the correct position in law.

Ability to Pay

Any tax, in order to be an effective instrument in a developing economy, must have relation to the ability of a person to pay such tax. The Income-tax Act 1961 read with Finance Acts departs even from this basic canon of taxation. Firstly, if the Income-tax Act is read as a whole one finds that a person is virtually called upon to pay tax measured on an artificial income which is calculated under the Act and not on his real income. This is because of the following:— (a) Fictions; (b) Power to disallow expenditure; (c) Artificial

method of computation; and (d) Discretion and powers of tax authorities.

(a) Fictions: The Act abounds in "deeming" provisions. There is a fiction of place by which income which is not accruing in India is deemed to accrue in India. There is also a fiction as regards accrual and receipt of income by which the income which has not accrued or is not received is deemed to have accrued or received as the case may be. Under the Act, there is also a fiction which provides that income of one person is to be regarded as that of another for purpose of tax. There are also a number of instances where a receipt or a transaction which does not result in income is deemed to be income for purpose of taxation, and so also there is a fiction as to application of income. However, it is clear that these fictions add to the real income of the person and make him pay tax not on real income but on an artificial figure computed for purposes of tax. This naturally ignores the concept of ability to pay.

As stated earlier, the Income-tax Act contains fictions of various types. With the development of human ingenuity to evade tax, the tax laws, in order to circumvent such evasion, have often to resort to deeming provisions. A deeming provision would be justified if it is to overcome a practical difficulty or a possible contention on the part of the assessee or where but for the deeming provision, income would have escaped tax, e.g., when the law provides that a dividend will be deemed to be the income of the previous year in which it is declared, distributed or paid, it overcomes a possible argument on the part of the assessee that it should be related to profits of the years out of which the dividend has been declared.

Similarly, when the law provides that the income of the minor from a partnership in which the father is also a partner has to be aggregated in father's income, it tries to cover up a possible loophole by which assessees would have evaded tax. However, what is most objectionable is the type of fiction which deems a receipt as income chargeable to tax although such a receipt at general law or accountancy principles is not an income at all. There are a number of such instances in the Act. One is the taxation of capital gains, including the recent amendment relating to taxation of bonus

shares when received. The Act also seeks to tax perquisites not convertible into money, distribution by limited companies on reduction of capital or in liquidation, remission of bona fide business liabilities, etc. When one goes through these fictions, one feels that the Income-tax law is framed in such a fashion that an assessee is required to pay tax on a large number of items which are otherwise not taxable as income under the commercial principles of accountancy or general law.

(b) Power to disallow expenditure: On going through the Income-tax Act, it will be clear that at various places uncontrolled power is given to the tax authorities to disallow bona fide business expenditure, e.g., remuneration, entertainment expenses, advertisement, travelling, guest-house expenses, etc. This also adds to the burden of taxes.

(c) Artificial method of computation: The Act provides the losses in business which are carried forward will be set off only against business income in the succeeding years, and that too only for a limited period. This often leads to a peculiar position, viz., that even if an assessee has got a large carry forward of loss in business he will still be required to pay taxes on an income under other heads like property or dividends. There is also a provision under which speculation losses are to be segregated and set off only against speculation tion profits. This, it will be appreciated, clearly adds to the burden of taxes, as, an assessee who, if an overall account is taken, has incurred a net loss is still required to pay tax on account of the aforesaid artificial method of computation. The above factors go to show that if a man is called upon to pay tax on not what his real income is, but on a figure computed under the provisions of the Act, full of fictions, discretion and rigid scale for allowance of expenditure, such tax can have no relation to his real ability to pay taxes. All these hit at the very root of the principle underlying ability to pay.

Even the tax rates are high. These high rates on the other hand are sought to be counterbalanced by some reliefs but most of them are illusory. There is a relief provided for new industrial undertaking by giving it an exemption from tax on its income calculated at the rate of six per cent (6%) of the capital employed for a period of 5 years. However,

the new industry very rarely shows such a high profit after allowance of full depreciation and development rebate on its assets in the initial period so as to get the full benefit of this exemption.

(d) Discretion **and** powers of tax authorities: Although it is not possible to frame the law leaving no discretion and giving no powers to the tax authorities, a perusal of the Income-tax Act, 1961, would make it clear that at a number of places wide discretion is given to the tax authorities as well as equally wide powers with very little or no check. Let us examine a few instances.

Under Section **3,** Sub-section (4), where an assessee intends to change the accounting year in respect of a particular source, he cannot do so except with the consent of the Income-tax Officer and upon such condition as the Income-tax Officer may think fit to impose. The discretion vested in the Income-tax Officer under this sub-section is to be exercised reasonably. However, it has been found that the applications for change of accounting year made by industrial undertakings in order to get maximum benefit of exemption available to them under Section 84 for a period of five assessment years have been rejected on the ground that it is prejudicial to revenue. This is where the power hurts an assessee. When the law grants an exemption to a new industrial undertaking and that undertaking in order to secure maximum benefit to which it is entitled under the law wants to change its accounting year so that the commencement of the accounting year coincides with the commencement of production, it is really not attempting any avoidance or evasion of tax but only striving to get maximum exemption provided by law.

Under Section **220,** the Income-tax Officer is given power to postpone collection of taxes on certain conditions which he may think fit to impose where an assessee has presented an appeal and the tax is in dispute. Assessees had to go to Court in some cases in order to get a stay of collection of taxes, which the tax authorities had refused. In one case, the Court also observed that quick realisation of tax may be an administrative expediency, but by itself it constitutes no ground for refusing a stay. While determining such an application, the authority exercising discretion should not act in the role of a mere tax gatherer. **A** number of such

instances of reported cases could be cited to show how unfettered discretion and excessive powers result in hardship, and give a bad name to the statute.

It is almost impossible to frame the Income-tax Act without leaving discretion and also without giving powers to the Tax authorities to counter various ingenious schemes of assessees to avoid tax. However, such discretion and power should not be unfettered. **It** is wrong to say that the assessee is given a very valuable right of appeal not only before the Appellate Assistant Commissioner but further on to the Tribunal. On questions of law he is also entitled to go to a High Court and the Supreme Court. This would only give relief to the assessee but these rights of appeal and revision do not act as a deterrent to the tax authorities as they would continue to exercise these powers leaving the assessees to pursue whatever legal remedies are available to them for seeking relief, without any responsibility or consequence to the tax authorities who exercise the discretion or the power. There must be some machinery under the Income-tax Act itself under which the tax authority could be called in question if it is found by the Appellate authority that the discretion vested in him or the power was exercised not properly, but wrongly and vexatiously. In this connection, it would be interesting to note that this proposal of introducing some such provision in the Income-tax Act was discussed by the Direct Taxes Administration Inquiry Committee which recommended as follows: "We have given very careful thought to this suggestion and feel that such a provision will, on the whole, have wholesome effect. Apart from serving as a check on the mal-practices of the dishonest, high-handed and unreasonable officials, it would create a fund of confidence amongst the public in the impartiality and fairness of the administration." (Para 8. **125).**

Thus, even if all these powers as weil as sections giving wide discretion to the officers are to be retained in the Income-tax Act, only one provision entitling the assessee to represent before an independent, competent authority on the question of abuse or vexatious use of such power would go a long way in building people's confidence in the fair administration of the tax laws.

We find thus that the income-tax law is positively not what

it claims to be nor what it should be according to the basic canons of taxation. The law, in order to give the least pain while extracting taxes, should be simple, unambiguous, with few fictions and little uncontrolled discretion to authorities administering it. It must always have a direct relation to the ability of a person to pay and not adopt the policy of killing the goose which lays the golden egg. It must encourage honesty and not suspect all to be dishonest. It must have a well-defined scheme to which all sections must stand harmoniously equidistant.

All this obviously presumes an honest citizen. Citizens must also realise their responsibility to the state and help the administrators to administer the law effectively so that everyone pays one's due share of tax. Efforts have got to be made on both the sides. The provisions of law should bring about an air of certainty so that the honest citizen need have no fear and so also the honest administrator. Simple, certain, unambiguous and reasonable provisions of law can certainly bring about a climate favourable to honest citizens who would be assured of a fair deal at any cost and not left to their fate once they falter on technical grounds.

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— A. D. Shroff

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Published by M. R. PAI for the Forum of Free Enterprise, "Sohrab House", 235, Dr. Dadabhai Naoroji Road, Bombay-1. and printed by H. NARAYAN RAO at H. R. MOHAN & CO. (PRESS), 9-B, Cawasjee Patel Street, Bombay-1.

10/Feb./1966

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