Law of Taxation

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Introduction

A tax is a compulsory exaction by the state for public purposes. The proceeds go to the general revenues of the state and the tax payer gets no return for his contribution as in the case of a fee, but only participates in the common benefits derived by all. The power to levy tax has always been allowed to the sovereign, but the citizens of a democratic state have the advantage of being taxed only with the consent of their elected representatives.

Indian taxation : the constitutional scheme

In India's federal Constitution the powers of the centre and the constituent units are well defined. The legislative powers of the Union are enumerated in list I of the seventh schedule and those of the states in list II, the concurrent powers being found in list III.

The powers of taxation exclusively conferred on the Union legislature are in respect of the following subjects : (1) Taxes on income other than agricultural income ; (2) Duties of customs including export duties ; (3) Duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquors and narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol etc. ; (4) Corporation tax ; (5) Taxes on the capital value of assets exclusive of agricultural land, of individuals and companies ; taxes on the capital of companies ; (6) Estate duty in respect of property other than agricultural land ; (7) Duties in respect of succession to property other than agricultural land ; (8) Terminal taxes on goods or passengers carried by railway, sea or air : Taxes on railway fares and freights ; (9) Taxes other than stamp duties on transactions in stock exchanges and futures markets ; (10) Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and

receipts ; (11) Taxes on the sale or purchase of newspapers and on advertisements published in them ; (12) Taxes on the sale or purchase of goods other than newspapers where such sale or purchase takes place in the course of inter-state trade or commerce.

The state list has the following entries relating to taxation ; (1) Land revenue, including the assessment and collection of revenue, the maintenance of land records etc. ; (2) Taxes on agricultural income ; (3) Duties in respect of succession to agricultural land ; (4) Estate duty in respect of agricultural land ; (5) Taxes on lands and buildings ; (6) Duties of excise and countervailing duties on alcoholic liquor ; narcotic drugs and narcotics excluding medicinal and toilet preparations ; (7) Taxes on entry of goods into a local area for consumption, use or sale there ; (8) Taxes on the consumption or sale of electricity ; (9) Taxes on the sale or purchase of goods other than newspapers subject to the provisions of entry 92A of list I ; (10) Taxes on advertisements other than advertisements published in the newspapers ; (11) Taxes on goods and passengers carried by road or on inland waterways ; (12) Taxes on vehicles whether mechanically propelled or not suitable for use on roads, including tramcars, subject to the provisions of entry 35 in list I ; (13) Taxes on animals and boats ; (14) Tolls ; (15) Taxes on professions, trades, callings and employments ; (16) Capitation taxes ; (17) Taxes on luxuries including taxes on entertainments, amusements, betting and gambling ; (18) Rates of stamp duties in respect of documents other than those specified in the provisions of list I with regard to the rates of stamp duty.

In the concurrent list the two entries relating to taxation are entry 35 and entry 44. The former relates to the principles on which taxes on motor vehicles are to be levied. Entry 44 reads 'Stamp duties other than duties on fees collected by means of judicial stamps but not including rates of stamp duty. This means that the Union government and the states have concurrent power to legislate as to stamp duties on non-judicial documents except in regard to the rates of such duties which are to be levied according to entry 91 of list I or entry 63 of list II depending on the nature of the document.

The residuary power of legislation as to the subjects not covered by any of the legislating lists vests by virtue of entry 97 of list I with the central legislature. The Supreme Court has held that wealth tax is not covered by any of the entries in the lists and therefore under entry 97 of list I the central legislature can levy wealth tax on all wealth including agricultural land.[1]

1. *Union of India* v. *H.S. Dhillon*, (1972) 2 S.C.R. 33.

Article 285 (1) provides that the property of the Union shall, save in so far as Parliament may by law otherwise provide, be exempt from all taxes imposed by a State or by any authority within a state. Under sub-clause (2) of the article, property of the Union which was taxable immediately before the commencement of the Constitution would continue to be liable to taxation until Parliament by law otherwise provides.

Under article 289 the property and income of a state shall be exempt from Union taxation. The Union can however tax any trade or business carried on by the state government and the income thereof unless the trade or business is declared by Parliament to be incidental to the ordinary functions of government.

State taxing power is subject to the emergency powers of the central government and two or more states may delegate part of their taxing power to the central government. The application of the Estate Duty Act 1952 to agricultural land was the result of such delegation of state powers.

Article 301 of the Constitution provides that trade, commerce and intercourse throughout the territory of India shall be free. It has been held by the Supreme Court in *Nataraja Mudaliar's* case[2] that a tax on trade transactions does not *per se* affect freedom of trade. Restrictions on inter-state trade in public interest may however be imposed by Parliament.[3] Preference to one state or discrimination between one state and another by either Parliament or the state legislatures is not permitted except in a situation where in order to deal with scarcity conditions in India Parliament so provides.[4] A state may impose on goods imported from other states any tax to which similar goods manufactured or produced in that state are subject, so however as not to discriminate between the imported and the local goods.[5] The state may also impose reasonable restrictions on the freedom of trade, commerce or intercourse with or within that state as may be required in the public interest.[6] For the exercise of powers under article 304 (a) and (b), the previous sanction of the President is required.

It will be noticed that the Constitution does not expressly confer powers of taxation on local bodies like municipalities, district boards

2. *State of Madras* v. *Nataraja Mudaliar*, A.I.R. 1969 S.C. 147.
3. Article 302.
4. Article 303.
5. Article 304 (a).
6. Article 304 (b).

and panchayats. These bodies enjoy such powers of taxation as may be delegated to them by the state government for their needs.

Central taxes

Central taxation is direct as well as indirect. The principal direct taxes include income-tax, surtax on companies, wealth-tax, gift tax and estate duty. The scheme of direct taxes is designed to lay a wide net so as to catch the tax-evader at some point or the other. If income-tax is evaded the income will accumulate and show up as wealth liable to be taxed under the Wealth Tax Act. If wealth is sought to be passed on to others it will come within the mischief of the Gift Tax Act. What has escaped assessment in life time will be subjected to duty under the Estate Duty Act 1952. An expenditure tax as recommended by Kaldor was levied for some time but has been withdrawn owing to administrative difficulties.

Indirect taxation consists of duties of excise and customs, central sales tax and stamp duties. Excise duties are levied under the Central Excises and Salt Act 1944 as amended from time to time. Duties of customs are governed by the Customs Act 1962. The Central Sales Tax Act 1956 levies tax on inter-state sales but the proceeds are collected and retained by the state in which the transaction commences. Stamp duties are levied under the Indian Stamp Act 1899.

In this short study it is hardly possible to describe the whole tax system. It is proposed therefore to examine in some detail the tax which arouses universal interest, namely, the tax on income and only briefly to refer to the others.

Income-tax

The governing Act is the Income-tax Act 1961. It was supposed to simplify the law as it had developed under the Income-tax Act 1922. Numerous amendments have, however, followed even in the short period since its enactment, and simplicity seems an unattainable goal.

The charging section:—The Act lays down in section 4 that income-tax shall be charged in every assessment year from every person on the total income of the previous year at the rate or rates laid down by any central Act. Thus the Act itself does not levy the tax; it leaves it to be levied by a central Act. The central legislature therefore passes every year and lately more than once a year, a Finance Act in which the rates of tax on different kinds of assessees and incomes are laid down. The Finance Act is also used to make substantive amendments

in the various taxing statutes — a practice which causes much dismay to those who would have some stability in the provisions subjecting them to an annual tax. As it is, tax planning has become almost impossible because it cannot be predicted with any certainty as to what the tax liability will eventually be.

It will be noticed that income-tax according to section 4 is leviable on every person. 'Person' is defined in section 2 (31) to include an individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals, whether incorporated or not, a local authority and every artificial juridical person not falling within any of the above categories,

Next it will be noticed that under section 4 tax is to be levied in the assessement year (i.e. the financial year in which the tax is leviable) on the income of the previous year or years. Normally 'previous year' means the financial year immediately preceding the assessment year *e.g.* for the assessment year 1972-73 the previous year is the financial year 1971-72. But if an assessee keeps his accounts on the basis of an accounting period not coinciding with the financial year he can claim as his financial year the accounting period ending during the previous financial year. To give an instance: if an assessee keeps his accounts from 1st October to 30th September each year, then his previous year, if he so opts, for the assessment year 1972-73, will be the period from 1st October 1970 to 30th September 1971. This would be so in normal cases. There are special provisions for cases where a business is commenced or discontinued. Further, the Central Board of Direct Taxes has got power to determine the previous year in the case of any person or business or classes of persons or business in suitable cases. An assessee can have different previous years for each different source of income for which he keeps accounts. The previous year once adopted can be changed only with the consent of the Income-tax Officer and on such terms as he may impose.

What is income? — Section 4 mentions 'total income'. But what is 'income' itself ? Under the Act income is taken in the widest sense. The definition of 'income' in section 2 (24) is inclusive and not exhaustive. It includes in the concept of income not only profits and gains as well as dividends but also certain other artificial categories which are not normally regarded as income—such as capital gains, the surplus of a mutual insurance association, annuities and perquisites in lieu of salary. Dividend too is artificially defined to include certain types of distribution or payment out of accumulated profits. Nor is the concept of income confined to legally earned income. Profits from smuggling,

illicit trafficking in drugs or liquor are liable to be treated as income. Unexplained cash credits in account books are to be treated as income of the previous year in which they are entered.[7] By the Finance Act 1972 lottery prizes and income from several kinds of bettings have been made taxable.

Total income

The definition of total income in section 2 (45) has two ingredients : (i) the income must comprise the total amount of income, profits and gains mentioned in section 5 and, (ii) it must be computed in the manner laid down in the Act. In total income certain incomings which fall within the ordinary meaning of income may be excluded by some provisions of the Act ; equally some incomings which are outside the ordinary concept of income may be included. It is after giving effect to the various exclusions and exemptions and applying the rules as to computation of income that 'total income' is arrived at. The whole of 'total income' may again not be taxable as a result of certain provisions ; a part of it may be included only for working out the rate of tax.

Residence and total income

Section 5 of the Act provides for what constitutes total income with reference to the residential status of the assessee concerned. Total income under the section is different for those who are "resident and ordinarily resident", those who are "resident but not ordinarily resident", and thirdly those who are "non-resident". What is to be seen is the residential status in the previous year. It becomes necessary at this stage to examine the concept of residence as envisaged under the Act.

An individual is said to be resident in India in any year if he (a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or (b) maintains or causes to be maintained for him a dwelling place in India for a period or periods amounting in all to one hundred and eighty-two days or more in that year and has been in India for thirty days or more in that year ; or (c) having within the four years preceding that year has been in India for periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year. These tests are alternative and not cumulative i.e. only one of the three tests has to be satisfied for the individual to be treated as a resident.

7. The Income Tax Act, section 68.

A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where *during that year the control and management of its affairs is* situated wholly ouside India.

A company is said to be resident in India in any previous year if (i) it is an Indian company as defined in the Act, or (ii) during that year the control and management of its affairs is situated wholly in India.

A person who is a resident in India will be treated as not ordinarily resident in the previous year if such person is an individual who (a) has not been resident in India in nine out of the ten previous years preceding that year, or (b) 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. A Hindu undivided family is not ordinarily resident in India in the previous year if its manager or *karta* is not ordinarily resident in India according to the above definition.

The total income of persons who are resident and ordinarily resident in the previous year consists under section 5 of : (a) income received or deemed to be received in India, (b) income which accrues or arises or is deemed to accrue or arise in India, (c) income which accrues or arises outside India during the accounting year even if it is not received or brought into India. Persons who are not ordinarily resident differ from those ordinarily resident in that their foreign income is taxed only if it is derived from a business controlled in or a profession or vocation set up in India or it is deemed under the provisions of the Act to accrue in India or is received or deemed to be received in India. Non-residents are taxable only in respect of income which accrues or arises in India or deemed to be so, and income which is received or deemed to be received in India.

The computation of income — amounts totally excluded

Receipts which fall within the definition of income are not *ipso facto* treated as part of total income under the Act for section 10 excludes certain categories of income from consideration. Some of the important items so excluded are agricultural income, casual and non-recurrent receipts up to one thousand rupees, gratuity and provident fund accumulations received on retirement, any sum received on retirement as commuted pension, interest on investments in certain types of government securities specified in the section, and several similar items which are not taxed in order to encourage particular types of savings. Foreign personnel serving in India are given some special concessions.

Heads of income for computation of income

The Act divides income into six categories or heads, namely, salaries, interest on securities, income from house property, profits and gains of business or profession, capital gains, and income from other sources. There are different rules for computation of income under each of these heads.

Salaries

For a payment to be treated as salary it must be paid by an employer to an employee. A regular payment for services received by an agent is not salary, nor is the remuneration received by the director of a company unless the terms of the contract create a relationship of master and servant.

Salary includes not only the payment received in cash as wages from the employer but also the value of perquisites like rent-free house or other amenities or concessions. It also includes any commission, gratuity, amenity or advance of salary. Profit in lieu of salary like compensation in connection with termination of services and the employer's contribution to the provident fund (not exempted under section 10) are also salary within the definition.

Salary is taxable in the previous year when it falls due though not paid, and also in the year when it is paid though not due. Arrears of salary of an earlier year if not charged when they fell due are liable to be taxed when paid. If on account of such payments of arrears, hardship is caused to the employee i.e. by rise in rate of tax, the Commissioner of Income-tax is authorised to give relief.

The employer of a salaried employee is under a duty to deduct the tax due on the aggregate amount of salary paid or due during a previous year. The rate at which salary is fixed is the rate laid down in the Finance Act of the previous year itself. This is to be contrasted with the taxation of other types of income where the income of the previous year is taxed at rates laid down in the Finance Act or Acts of the assessment year. The previous year for salaries is always the financial year preceding the assessment year and the assessee has no choice in the matter.

The deduction allowable against income from salary are as follows: (i) In respect of expenditure incidental to the employment of the assessee a sum equal to 20% of the salary is allowed on salaries upto Rs. 10,000. Above that sum the rate is reduced to 10% but the total deduction must not exceed Rs. 3,500. The maximum deduction will not be more

than Rs. 1,000 where a conveyance allowance is received by the assessee from his employer or where the employer provides a vehicle to the employee or gives one for his use otherwise than wholly or exclusively in the performance of his duties. (ii) Entertainment allownce in the case of government employee is deductible to the extent of one-fifth of the salary or Rs. 5,000 whichever is less. In the case of other assessees the maximum permissible deduction is Rs. 7,500 unless the allownce is being received from a date earlier than 1 April 1955 from the same employer.

Interest on securities

The following amounts are chargeable under this head : (i) Interest on securities issued by the central government or a state government not being interest on annuity deposits payable under section 280D of the Act ; (ii) Interest on debentures or other securities for money issued by or on behalf of a local authority or a company or corporation set up by a central, state or provincial Act. Interest on securities is chargeable in the year in which it becomes due even though it is received later. However if it is not received in the year when it falls due it may be taxed in the year of receipt, The deductions admissible against this source of income are : (i) any reasonable sum expended for the purpose of realising the interest ; (ii) any interest payable on borrowings for investment in the securities.

Income from house property

Under this head the annual value of house — property of which the assessee is the owner but which is not occupied by him for the purpose of any business or profession carried on by him is chargeable as income from house property. The term annual value means the rent for which the property can be let out on rent from year to year, or the rent actually received if it is higher.

The deductions normally allowable under this head are : (i) one-sixth of the annual value for repairs ; (ii) insurance premia paid in respect of the property ; (iii) the amount of any charge on the property not being a capital charge or a charge voluntarily created by the owner; (iv) interest payable on the capital invested in the property ; (v) land revenue or other tax levied by State Government ; (vi) rent collection charges upto 6%; (vii) rent not realised owing to vacancy ; (viii) rent not realisable from tenant ; (ix) local taxes and ground rent paid by owner.

Concessions are given to owners occupying their own houses, and in respect of residential houses construction of which is begun after 1 April 1961 for the first three years. In the case of houses whose construction was begun after that date and completed before 1 April

1970, the annual value is reduced for the first three years after completion by a sum not exceeding six hundred rupees, while in the case of houses completed after 30 March, 1970 such allowance for a period of five years is upto twelve hundred rupees. The maximum deduction for a house constructed after 1 April 1978 is Rs. 2,400.

Persons who own house property as co-owners in definitely ascertainable shares have to pay tax only in respect of their own separate shares.

Profits and gains of business or profession

The income under this head consists of: (a) the profits and gains of any business or profession carried on by the assessee at any time during the previous year, (b) compensation for termination of services as a manager of a company or as agent of another person, (c) income of a trade, professional or similar association from specific services performed for its members, (d) value of any benefit or perquisite whether convertible into money or not arising from business or the exercise of a profession.

The income under this head is computed by deducting the various allowances granted under the Act. The deductible items stated in broad terms are ; (a) rent and repairs of business premises, (b) land revenue, local rates and municipal taxes, (c) premium paid for insurance of premises, (d) current repairs to machinery and insurance thereof, (e) depreciation as allowable, (f) investment allowance as provided for and development rebate where still allowable, (g) other development allowances, (h) rehabilitation allowanee where due, (i) expenditure on scientific research to the extent allowable, (j) expenditure on acquisition of patent rights or copyrights, (k) export market development allowance, (l) agricultural development allowances. Further deductions are permissible on account of (i) premium paid in respect of insurance of stock, (ii) sums paid towards bonus or commission, (iii) interest paid on capital borrowed, (iv) employer's contributions to employee's provident funds, (v) contributions to any gratuity fund, (vi) loss on animals which have been used for the purpose of business, (vii) bad debts, (viii) expenditure on family planning among employees, (ix) entertainment expenditure within permissible limits, (x) expenditure on advertisement or maintenance of residential accommodation within prescribed limits, (xi) any other expenditure not of a capital nature which can be justified as having been laid out wholly and exclusively for the business or profession.

The Act contains provisions for setting off of losses in one business against gains of other business as also for setting off of loss against other

heads of income. The loss in business which remains after setting it off against other business or other heads in the manner permissible, can be carried forward for a maximum of eight years. Speculation business is, however, to be treated as a separate business for this purpose and loss in speculation business can be set off only against similar business. It can be carried forward and set-off in succeeding eight years against speculation business only.

Capital gains

Profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset as defined in the Act are deemed to be income of the previous year in which, they took place and are taxable under the head capital gains. Such gains do not fall within the ordinary concept of income but have been made chargeable by specific provision. The levy has been held by the Supreme Court as *intra vires* on the reasoning that the word 'income' in Entry 54 of List I of the seventh schedule must be interpreted in the widest sense and cannot be limited to the meaning given to it under the income-tax statutes.[8]

Exemptions granted under the head 'Capital Gains' include, (a) gains arising from the transfer of house property where the total property owned by the transferror does not exceed Rs. 50,000 and the property transferred does not exceed Rs. 25,000, (b) capital gains other than short-term assets of less than Rs. 5000 in the accounting year; (c) capital gains other than from short-term assets where the tax-payer's taxable income including these gains does not exceed Rs. 10,000. A short-term capital asset (apart from special provisions) is one held by the assessee for not more than 24 months immediately preceding the date of transfer. The word transfer includs compulsory transfer such as by acquisition.

The capital gain is worked out by deducting from the amount realised on the asset (or fair market value in certain cases of under-statement of price) the expenses of the sale, transfer etc. and the cost of the asset including expenditure, if any, on additions, alterations etc. From this excess amount a deduction is given of Rs. 5000 plus 25% of the excess where it relates to buildings and land and Rs. 5000 plus 40%[9] of the excess where it relates to other capital assets. Losses on sale and transfer of capital assets can be carried forward under different provisions for short-term and long-term capital assets.

8. *Navinchandra Mafatlal* 26 I.T.R. 758.
9. Percentages per Finance (No. 2) Act 1974 with effect from 1 April 1975.

Taxation of Different Kinds of Assessees

Individuals

An individual is liable to pay tax if his income exceeds the prescribed minimum, which under the Finance Act 1977 is Rs. 8000. In preceding years there was an allowance based on marital and parental status but that has been abolished. There is as yet no provision for joint taxation of husband and wife as in some other countries though proposals have been made to that effect. However, income from assets transferred by a male assessee to his wife or minor child is taxed in his hands. If the wife or minor child is partner in the same firm as the assessee the income of the wife or minor child is taxed in the assessee's hands. So is income derived from a revocable transfer of assets, as well as income from a trust created by the assessee under which the assessee derives direct or indirect benefit. However the income of a trust created by the assessee which is not revocable for the life-time of of the beneficiary or the transferee will not be taxed in the hands of the assessee, nor will income of a trust created before 1961 be taxed in his hands if it was not revocable for a period of six years.

Hindu undivided families

Because of the peculiar features of Hindu undivided families the Income-tax Act makes special provisions for their taxation. A joint family consists of all male Hindus descended in the male line from a common ancestor, their wives and their unmarried daughters. Usually the eldest male member of the family manages its affairs and is called the *karta*. He enjoys wide powers to manage and dispose of property under Hindu law. Members of the undivided family are entitled to a partition of the family assets and to enjoy their separate shares of the property.

The income of Hindu undivided family is assessed on the family as a whole with the *karta* as the assessee. The individual members of the family are not taxed on any amounts distributed to them from the family income. Any income earned by an individual member of the family by his own exertion is taxable in his own hands. Where the separate property of an individual is converted after 31 December 1961 into Hindu undivided family property, the income from such property shall for assessment year 1972-73 and onwards continue to be treated as income of that individual. Where a person receives a salary from a partnership concern in which the family is represented by one or more of its members as partners the question arises whether such salary is the

income of the family or of the individual. A similar question has arisen in cases when a member of the family is in receipt of salary as manager or director of a company in which the family has holdings. The principle laid down by the Supreme Court in such cases is that the salary would be income of the family if it is not so much a return for the individual's services as for the money invested by the family in the partnership or the company.

Partnership firms

A partnership is not a separate juristic entity like a company but an aggregation of the individuals composing it. Each partner is an agent of the other and the property of the firm belongs to the individual members according to their respective shares. Hence the liability to pay tax on behalf of the firm is that of all the partners individually and collectively.

The Income-tax law provides for registration of partnerships by the Income-tax officer. An application for this purpose has to be made in the prescribed form signed by all the partners within the prescribed period. If the partnership is genuine and the formalities have been complied with, the Income-tax officer must register it. Where the firm is found guilty of concealment of income or non-compliance with notices under the statute the Income-tax officer can cancel the registration.

The practical effect of registration is that in the case of a registered firm tax is levied on the firm at comparatively low rates ; the income of each partner is taxed in his individual hands. In the case of an unregistered firm the tax is levied on the whole income of the firm as in the case of an individual and this in most cases will lead to a higher incidence of tax. In those cases where the individual incomes of the partners are high the Income-tax Officer may tax the income of even unregistered firms in the hands of the partners after allocating the income to their individual shares.

A Hindu undivided family as such is not a person under the Indian Partnership Act and therefore it cannot, in its own right, become a member of a partnership firm whether through all or some or one of its members. For the purpose of registration and all other purposes of the Income-tax Act the member of the family who is a partner will be treated as the partner. He alone will have to sign the application for registration and the application cannot be rejected on the ground that all the members of the family which was represented through him

had not signed it. The latter view requiring signatures of all the members of the family, taken in some earlier cases, has now been rejected by the Supreme Court.

Association of persons

When a number of persons or individuals, whether incorporated or not, join together in income-producing activity and they do not in law constitute a partnership they are assessable as an "association of persons". Co-owners of property are to be separately taxed in respect of their respective shares if the shares are definite and ascertainable. If not, they are liable to be assessed as an association of persons. The income of the association is taxed as a unit as in the case of an unregistered firm, but the Income-tax Officer has the option in the interests of the revenue to tax the members separately on their shares. Illegality of an association does not affect its liability to be taxed as such; therefore a partnership which is otherwise void may be taxed as an association of persons.

Corporations

Although the income of a corporation or company is determined in the same manner as that of an individual there is no minimum taxable limit with the result that the whole profit is taxable. The tax is levied at a flat rate. Super-tax on companies is also called corporation-tax. Since 1964 companies are also liable to pay surtax on their net chargeable profits under the provisions of the Companies (Profits) Surtax Act, 1964. The chargeable profits are worked out by making various specified deductions from the total income of a company. A closely-held company is liable (when not expressly exempted) to pay additional supertax where the dividends distributed within twelve months after the end of any year amount to less than the statutory percentage of the distributable income of that year. The Income-tax Officer will, however, not make an order to this effect if he is satisfied that the payment of dividend (or greater dividend) would have been unreasonable in the light of previous losses or smallness of profits.

A company is under a legal duty to deduct tax on the dividend paid to its shareholders. A certificate is issued to the shareholder showing the tax deducted and the shareholder gets credit for the same in his assessment.

Income-tax authorities

The key-figure is the income-tax officer who is the assessing authority under the Act. He issues notice to file return, examines

accounts, determines the income of the assessee and recovers tax. He is aided in his work by Inspectors of Income-tax who are subordinate to him and perform such duties—e.g. survey, search or examination of accounts—as he may assign to them. The work of Income-tax Officers is supervised by the Inspecting Assistant Commissioners of Income-tax whose jurisdictional area comprises that of several Income-tax Officers. Appellate Assistant Commissioners hear appeals against the assessment orders of the Income-tax Officers. So that they may be free in the exercise of their function, they are directly under the control of the Central Board of Direct Taxes, unlike Inspecting Assistant Commissioners who are controlled by the Commissioner of Income-tax. The Commissioner has power of revision on an order passed by the Income-tax Officer and can order an appeal to be filed by the Income-tax Officer before the Income-tax Appellate Tribunal against the orders of the Appellate Assistant Commissioner. He is empowered to file an application for reference to the High Court on a question of law arising out of the order of the Tribunal. Above the Commissioners are Directors of Inspection and the final authority at the top is the Central Board of Direct Taxes the functions of which are regulated by the Central Board of Revenue Act, 1963.

The Central Board of Direct Taxes has power to issue general instructions to the various departmental authorities under it. But it cannot give instructions to an officer to decide a question in a particular case in a particular way because in the exercise of his powers the officer must act according to the discretion vested in him.

Appeals and references

Appeals against the orders of the Appellate Assistant Commissioner may be filed by the assessee as well as the Income-tax Officer before the Income-tax Appellate Tribunal which is an authority independent of the Income-tax Department, its members being appointed by the Ministry of Law and Justice. The working of the Tribunal is regulated by the Income-tax Appellate Tribunal Rules, 1963. On a question of law arising out of the order of the Tribunal a reference can be made at the instance of the assessee or the Commissioner of Income-tax to the High Court. With the certificate of the High Court appeal against its order in reference can be filed in the Supreme Court. If the High Court refuses to grant a certificate an appeal may be filed in the Supreme Court by special leave under article 136 of the Constitution.

Assessment procedure

Every assessee whose income in the previous year is above the minimum taxable limit is under a legal duty to file his return of income.

The return must ordinarily be filed by June 30 of the assessment year, but where the assessee has income from business the return must be filed within six months of the end of the previous year or June 30, whichever is later. The Income-tax Officer can on application extend the time for filing return within certain limits. Extension beyond those limits is conditional on payment of interest on the tax chargeable. Where the assessee does not file a return the Income-tax Officer can by notice ask for a return to be filed within thirty days of the service of the notice.

If the amount of tax payable on the income returned by an assessee as reduced by any tax already paid is more than Rs. 500 the tax must, by way of self-assessment, be paid by the assessee wlthin thirty days of filing the return. The Income-tax Officer may on the basis of the return and the documents accompanying it make a provisional summary assessment and ask the assessee to pay the tax so assessed subject to adjustment when the regular assessment is made. A provisional assessment may also be made when the assessee has filed a return claiming refund.

For the purpose of making an assessment the Income-tax Officer can ask the assessee to produce such accounts and documents and to give such information as necessary. With the previous approval of the Inspecting Assistant Commissioner the Income-tax Officer can ask the assessee to give a full account of his assets and liabilities. The assessee, however, cannot be asked to produce accounts for a period more than three years prior to the previous year. If the Income-tax Officer has as a result of his enquiries collected any material which he proposes to use for the purpose of the assessment he must give the assessee an opportunity to be heard in respect of it. This provision was introduced in the Income-tax Act, 1961 in deference to judicial pronouncements under the 1922 Act where no such provision existed.

When the assessee fails to file a return or fails to comply with notices issued to him the Income-tax Officer may make what is called a 'best judgment assessment'. This must necessarily be guesswork to a certain extent but it must be honest guesswork. The assessee can ask for such an assessment to be re-opened on showing sufficient cause for not filing return on complying with notices.

Where income has escaped assessment in past years the Income-tax Officer can issue notice to the assessee for the purpose of showing cause as to why assessment or reassessment should not be made. The Income-tax Officer can issue such notice in his own discretion up to period of

four years prior to the assessment year in which the notice is issued. For a period longer than four years the notice can only be issued if there has been failure on the part of the assessee to file a return or an omission to furnish fully and truly all material facts. The notice in respect of a period between four and eight years can be issued only with the prior approval of the Commissioner of Income-tax. Notice for a period from eight to sixteen years prior to the assessment year can be issued only if the income escaping assessment is rupees fifty thousand or more and the previous approval of the Central Board of Direct Taxes has been obtained.

Remedies outside the Act

Section 293 of the Act lays down that no suit shall be brought in any civil court to set aside or modify any assessment made under the Act. A suit, however, lies if the provision under which the income-tax authority is acting is *ultra vires*, or the authority abuses its power and acts not under the Act but in violation of its provisions. A writ petition under article 226 of the Constitution lies if the authority is acting outside its powers and jurisdiction e.g. when the conditions prior to the issue of a notice for re-assessment are not satisfied. A writ petition under article 226 also lies if the action taken is *mala fide*, against natural justice or patently erroneous. A writ petition to the Supreme Court under article 32 of the Constitution lies only if there is an infringement of a fundamental right. The mere fact that an assessment is made on a wrong interpretation of valid provisions of the Act does not amount to contravention of any fundamental right. A tax can be levied under article 265 of the Constitution only under a valid law, and the validity of the law can be tested in the light of the fundamental right provisions in Part III of the Constitution.

Other direct taxes

Wealth tax is levied under the Wealth Tax Act, 1957. It is levied on individuals and Hindu undivided families. Corporations though originally taxed were exempted with effect from the assessment year 1960-61. The tax is annually levied on the net wealth of a tax payer as on the valuation date. That valuation date in relation to any year for which an assessment is to be made under the Wealth Tax Act means the last day of the previous year as defined in the Income-tax Act, and where an assessee has different assessment years for different sources of income, the valuation date is the last day of such previous years. Where an assessee does not maintain accounts the valuation date is the last day of the previous financial year *i.e.* the 31st day of March. The value

of an assets for the the purpose of the Act is the market value as on the valuation date. Where regular accounts are maintained for a business, the Wealth-tax Officer may determine the net value of the assets for the business as a whole as shown in the balance-sheet, subject to adjustments. Assets upto Rs. 1,00,000 are exempt in the case of individuals as well as Hindu undivided families. The tax is on a graduated scale, the rates varying between ½% and 3½ % in the case of individuals and 1½% and 3½% in the case of Hindu undivided families.

Gift-tax is levied under the Gift-tax Act, 1958. Gifts upto Rs. 10,000 in any previous year are exempt. Taxable entities are individuals, Hindu undivided families, corporations and associations of individuals. The tax is levied on the donor and not the donee. A gift is defined as any voluntary transfer of existing property for less than full consideration in money or money's worth. A gift of property other than cash is valued at the price at which, in the opinion of the Gift-tax Officer, it could be sold in the open market on the date in which the gift was made. The gifts made by an assessee in the previous year are aggregated and and taxed on a graduated scale. From 1971-72 the rates range from 5% on the first Rs. 20,000 to 75% on the excess over Rs. 20,00,000.

Estate duty is levied under the Estate Duty Act, 1953. The duty is chargeable on the principal value of the estate of a deceased person as determined under the provisions of the Act. It is payable by the person accountable for the estate of the deceased. The term 'accountable person' includes every person in respect of whom any proceeding under the Act has been taken for the assessment of the principal value of the estate of the deceased. The concept of 'estate' covers all property settled or not settled which passes on the death of a person. Agricultural land is included in 'estate' in the territories of the state in the First Schedule which have passed resolutions agreeing to the levy under article 252 of the Constitution. Other states can be included in the Schedule on passing such resolutions. Estates below Rs. 50,000 are not liable to duty. The rate between Rs. 50,000 and Rs. 1,00,000 is 4%. Above Rs. 20,00,000 the rate is 85%. The chief assessing authority is the Controller of Estate Duty which term includes Assistant Controller and Deputy Controller.

The powers under these three Acts—namely the Wealth Tax Act, the Gift Tax Act and the Estate Duty Act—are in practice invested in the authorities under the Income-tax Act. The powers have to be exercised under the supervision of the Central Board of Direct Taxes. Provisions for appeals and references are similar to those under the Income-tax Act.

The problem of tax evasion

Owing to lack of full and reliable data it is difficult to quantify the extent of tax evasion. The Wanchoo Committee in its report published in December 1971 estimated the evasion in respect of income-tax for the year 1968-69 at Rs. 1400 crores. The Committee has made various suggestions for preventing evasion of tax. The most important of its suggestions—namely, the reduction of the maximum rate of income-tax to 75%[10] was for the first time given effect to in the 1976 budget which N.A. Palkhivala has described as "our first modern Budget".[11] The maximum rate of income-tax applicable to individual incomes above Rs. 70,000 was reduced by the Finance Act 1976 to 70%. The Finance Act 1977 taxes incomes above Rs. 100,000 at a maximum of 60%. Time will show whether this bold attempt to meet the evil of tax evasion will be successful. There is a vicious circle of lack of confidence between the tax-payer and the government. 'Black money' has become a fact of economic life. No solution seems in sight except a drastic change of outlook on the part of both tax-payer and tax-collector. The common man can only wait wishfully for such a miracle to happen.

Suggested Readings

1. Direct Taxes Enquiry Committee (Wanchoo Committee), *Report*.
2. *Income-taxes outside the United Kingdom* Vol. 4, India to Jamaica (Compiled by direction of Board of Revenue, London).
3. Nicholas Kaldor *Indian Tax Reform—Report of a Survey*.
4. Kanga and Palkhivala: *The Law and Practice of Income-tax*.
5. Kanga and Palkhivala : *The Law and Practice of Income-tax*. Students' edition, Edited by H.P. Ranina.
6. Sukumar Mitra: *Income-Tax*.
7. A.L. Sampath Iyengar: *The Three New Taxes*—The Wealth Tax Act, 1957. The Gift Tax Act, 1958, The Companies (Profits) Surtax Act, 1969—Revised by A.C. Saksena.
8. V.S. Sundaram: *The Law of Income-Tax in India*.

10. From the prevalent 98% in the highest slab.
11. Kanga and Palkhivala, *The Law and Practice of Income Tax*, Preface (7th ed. 1976).