

THE BEARER BONDS CASE: ARE WE TILTING AT WINDMILLS?

AN EARLIER note¹ contains an analysis of an important aspect of the Special Bearer Bonds (Immunities and Exemptions) Act 1981—criticism based on the premise that it was against fundamental moral and ethical principles of taxation, as the Act discriminated between honest tax-payers and tax-evaders. The discrimination in the Act, it has been argued, was in favour of the latter. The note is also a critique of the majority decision of the Supreme Court in *R.K. Garg v. Union of India*² upholding the constitutional validity of the Act, rejecting both the pleas, viz., (i) of the unsustainability of the implied classification of tax-payers inherent in the Act; and (ii) of the relevancy of moral arguments, even if there is no classification, in deciding the validity of a law under article 14 of the Constitution. This paper seeks to show that the Act did not confer such material advantages on the investor in the Special Bearer Bonds as would encourage tax-evasion in future and condone such evasion committed in the past and that the attack on the Act is largely misconceived.

In this context we may first briefly set out the scheme of the Income-tax Act 1961 relating to the obligations of the tax-payers and the corresponding sanctions. This Act requires that every earner of taxable income has to declare his true income every year and pay taxes on such income.³ Failure to declare one's annual income and filing of false tax returns are both visited with liability to pay, in addition to the proper tax, interest which is penal-cum-compensatory in nature,⁴ penalties which are quite severe⁵ and prosecutions in criminal courts.⁶ The three types of sanctions—interest, penalties and prosecution—are *not* mutually exclusive.

In the very nature of things, undeclared income is either secreted in the form of cash and valuables, or otherwise invested or spent away. The manipulations done to suppress income and the ways of its application are varied, complex and secretive. The Income-tax Act incorporates provisions investing the tax authorities with wide powers to investigate⁷ including those of search and seizure.⁸ If by pressing into service their

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1. 27 *J.I.L.I.* 496 (1985).
 2. (1981) 133 *I.T.R.* 239.
 3. S. 139, Income-tax Act.
 4. *Id.*, ss. 139, 215, 217.
 5. *Id.* ss. 271(1)(a), 271(1)(c) and 273.
 6. *Id.* ss. 276B, 277.
 7. *Id.* ss. 142, 131-133, 133A, 133B.
 8. *Id.* s. 132.

investigating powers and investigative skills or through information received or by a combination of both, the income-tax authorities succeed in linking unexplained cash or valuables to a particular year in which the income is earned and suppressed, they have the power to reopen the past assessments within sixteen years⁹ and levy the proper amount of tax. Furthermore, the provisions regarding interest, penalties and prosecutions are pressed into service. This type of situation, we will call—*situation I*.

If the tax authorities do not succeed in linking unexplained wealth to that particular year in which the income was earned and suppressed, as it mostly happens, they press into service the provisions of section 69A of the Income-tax Act. Under this section the amount of unexplained cash or valuables is deemed as income of the specific year in which they *are found*. Application of the section would not entail any penal consequences whatsoever, unless the tax-payer, even after being found in possession of such wealth, chooses to file a tax return contesting the inference that such were unexplained and the contest ultimately fails. This type of situation, we will call—*situation II*. It may be mentioned here that there is no scope in the Income-tax Act for a tax-payer who has been taxed through application of the provisions of section 69A, to contest on a future date the taxation of income earned and suppressed in a particular year (from which the amount brought to tax under this section really arose) when the tax authorities stumble on evidence of such suppression. In other words, the tax-payer cannot plead: 'You have assessed this amount by applying the provisions of section 69A and you cannot, now that you have got evidence, tax it again as the income of the year in which the income was earned.' He can, however, make a mercy plea for having the taxation through that section set aside. Accepting the imposition of interest, penalties and prosecution for past suppression would be the price to pay.

The Special Bearer Bonds Act did nothing to disturb the aforesaid position under the Income-tax Act. As regards the liability under the latter Act of the tax-payer against whom evidence exists or may become available on a future date showing the non-filing of the returns or falsity of earlier income declarations and supporting manipulations therefor, the Bearer Bonds Act advisedly and scrupulously adopted a 'no immunities' policy. Thus, as between an honest tax-payer on the one hand, who had declared his true income year after year and paid the taxes, and the tax-evader on the other, who had indulged in falsification of income records, fabrication of evidence, non-filing of tax returns or false income declarations, the Act did not provide for a preference in favour of the latter. One who had evaded tax continues to carry on his shoulders the burden to pay proper taxes along with compensatory interest and the liability to penalties and prosecution. The majority

9. *Id.*, s. 148.

judgment of the Supreme Court in *R.K. Garg* takes due note of this most relevant feature of the Act. In short, *situation I* is left to be dealt with under existing provisions of the Income-tax Act.

The Bearer Bonds Act dealt with *situation II*. Let us illustrate. A tax-payer who had undisclosed cash of Rs. 2,00,000 did not choose to invest in Special Bearer Bonds when such opportunity was available, but was in the meanwhile subjected to a search under section 132 of the Income-tax Act. Being unable to explain the possession of this amount he would be liable to tax, applying provisions of section 69A as the income of the year in which it was found. He would be lawfully relieved of about 50 per cent of the said amount of Rs. 2,00,000, and then, be left with Rs. 1,00,000. If he invests the said Rs. 1,00,000 in three to four year deposits at 15 per cent interest (interest compounded half-yearly) and gets taxed on the interest at a rate of 50 per cent at the end of ten years he would be left with Rs. 2,10,750. It may be mentioned incidentally that the rate of interest allowed under the Income-tax Act on tax paid in excess is 15 per cent. If he had chosen to invest in Special Bearer Bonds and in the meanwhile his house was searched and he had in his possession such bonds valued at Rs. 2,00,000, there would be no liability to pay any income-tax and at the end of the period of ten years he would be left with an amount of Rs. 2,40,000. The advantage he will gain by investing in Special Bearer Bonds is Rs. 29,250 on Rs. 2,00,000 over a period of ten years. If any other incriminating evidence that could prove falsification of earlier tax-returns or non-filing of such returns is discovered, his investing or not investing in Special Bearer Bonds would not make any difference as to the ultimate consequences under the Income-tax Act. If such things were discovered, the situation would be transformed into *situation I*, which the Act allows to be dealt with under the existing scheme of sanctions under the Income-tax Act.

In the final analysis the Act was a trade-off between two options. *One*, launching a nationwide search of residences to unearth undisclosed cash; and *two*, encouraging, through a small incentive, declaration of undisclosed cash. The trade-off was not coupled with any immunity which renders nugatory past or future independent investigations into the manipulation of records, fabrication of evidence, non-filing of tax returns for earlier years or false income declarations. It passes one's comprehension how, in all fairness, a legislation which had such intended or actual effect can be branded as immoral and subversive of public policy.

Inappropriate comparisons lead to wrong inferences. The honest tax-payer has discharged his obligations under the Income-tax Act and has no undeclared cash to vie for a berth in the Special Bearer Bonds scheme. The position as regards the tax-evader is *vice-versa*. He can, before he is nabbed by the tax authorities, always get amnesty from penalties and

prosecution by invoking section 273A of the Income-tax Act which requires stating the whole truth about his suppressed income (not confining his disclosure to the amount of undeclared cash) and paying up the proper taxes. Therefore, it can be said that the attack on the Special Bearer Bonds Act is an example of 'tilting at windmills'.

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