CHAPTER 1

INTRODUCTION

Government has to play an important role in all round development of society in the modern era. It has not only to perform its traditional functions (defence, maintenance of law and order) but also to undertake welfare and development activities such as health, education, sanitation, rural development, water supply etc. It has also to pay for its own administration. All these functions require huge public finance. Taxes constitute the main source of public finance whereby government raises revenue for public spending. Taxes have been broadly categorized into direct and indirect taxes. ‘Direct taxes’ include those taxes which are paid by the person on whom these are levied like income tax, wealth tax etc. On the other hand, ‘indirect taxes’ are levied on one person, but paid by another e.g. sales tax, excise duty, custom duty etc.

Income tax is the most important of all direct taxes and with the application of progressive rate schedule, provision of exemption limit and incorporation of a number of incentive provisions. It can be used not only to satisfy all the canons of a sound tax system but may also go a long way in realising variety of socio economic objectives set out by the economic system [Gopal, M.H., p. 20]. It also helps in bringing distributional justice through higher rate of tax on the rich class of the society. It may also act as a tool for controlling inflation. Due to all these factors, income tax has assumed great
importance in the structure of direct taxation. Therefore, all politically advanced democracies impose some form of personal taxation, generally based on income.

1.1 ORIGIN AND EVOLUTION OF INCOME TAX IN INDIA

1.1.1 ANCIENT PERIOD

There is enough evidence to show that taxes on income in some form or the other were levied even in primitive and ancient communities. References to taxes in ancient India are found in ‘Manusmriti’ and ‘Kautilya’s Arthashastra’. Manu the ancient sage and law giver stated that king should levy taxes according to sastras. He advised that taxes should be related to income and should not be excessive. He laid down that traders and artisans should pay 1/5\(^{th}\) of their profits in gold and silver, while the agriculturists were to pay 1/6\(^{th}\), 1/8\(^{th}\) and 1/10\(^{th}\) of their produce depending upon their circumstances. The detailed analysis given by Manu on the subject clearly shows the existence of a well planned taxation system, even in ancient times. Kautilya’s Arthasastra was the first authoritative text on public finance, administration and the fiscal laws. Collection of income tax was well organized during Mauryan Empire. Schedule of tax payment, time of payment, manner and quantity were fixed according to Arthasastra. It is remarkable that the present day system of taxation is in many ways similar to the system of taxation given by Kautilya 2300 years ago.

1.1.2 INITIAL PERIOD (1860-1886)

Income tax in its modern form was introduced in India for first time in 1860 by the British Government to overcome the financial crisis following the events of 1857. Initially Government introduced it as a temporary measure of
raising revenue under the Income Tax Act 1860 for a period of five years. Different tax rates were prescribed for different heads of income. In the year 1867, it was transformed as licence tax on trade and profession. In the year 1869, the licence tax was replaced by Income Tax again. The assessments were made on arbitrary basis leading to inequality, unpopularity and widespread tax evasion. Income Tax was withdrawn in the year 1874. After the great famine of 1876-78, the Government introduced local Acts for income tax in different provinces. With several amendments these Acts remained in force till 1886. Thus, the period from 1860 to 1886 was a period of experiments in the context of income tax in India.

1.1.3 PRE INDEPENDENCE PERIOD (1886-1947)

In 1886, a new Income Tax Act was passed with great improvements than the previous Acts. This Act with several amendments in different years continued till 1918. In 1918, a new Act was passed repealing all the previous Acts. For the first time, this Act introduced the concept of aggregating income under different heads for charging tax.

In 1921, the Government constituted ‘All India Income Tax Committee’ and on the basis of recommendation of this committee a new Act (Act XI of 1922) was enacted. This Act is a landmark in the history of Indian Income Tax system. This Act made income tax a central subject by shifting the tax administration from the Provincial Governments to the Central Government. During this period the Board of Revenue (Central Board of Revenue) and
Income Tax Department with defined administrative structure came into existence.

1.1.4 POST INDEPENDENCE PERIOD

The Income Tax Act 1922 continued to be applicable to independent India. During the early post independence period, the Income Tax legislation had become very complicated on account of innumerable changes. During this period tax evasion was wide spread and tax collection was very expensive. In 1956, the Government of India referred the Act to a Law Commission to make the Income Tax Act simpler, logical and revenue oriented. The Law Commission submitted its report in September 1958 and in the meantime the Govt. also appointed a Direct Taxes Administration Enquiry Committee to suggest the measures for minimizing the inconvenience to the assessees and prevention of tax evasion. This committee submitted its report in 1959. The recommendations of the Law Commission and the Enquiry Committee were examined and extensive tax reform programme was undertaken by the Government of India under the supervision of Prof. Nicholas Kaldor. The Income Tax Bill 1961, prepared on the basis of the Committee’s recommendations and suggestions from Chamber of Commerce, was introduced in the Lok Sabha on 24.4.1961. It was passed in September 1961 by Lok Sabha. The Income Tax Act 1961 came into force on April 1, 1962. It applies to whole of India including the state of Jammu and Kashmir. It is a comprehensive piece of legislation having 23 Chapters, 298 Sections, various sub sections and 14 schedules. Since 1962, it has been subjected to numerous amendments by the Finance Act of each year to cope with
changing scenario of India and its economy. Moreover the Central Board of Direct Taxes is empowered to amend rules and to clarify instructions as and when it becomes necessary.

Besides this, amendments have also been made by various Amendment Acts e.g. Taxation Laws Amendment Act 1984, Direct Taxes Amendment Act 1987, Direct Taxes Law (Amendment) Acts of 1988 and 1989, Direct Taxes Law (Second Amendment) Act 1989 and at last the Taxation Law (Amendment) Act 1991. As a matter of fact, the Income Tax Act 1961 has been amended drastically. It has therefore become very complicated both for administration and taxpayers.

1.1.5 RECENT TAX REFORMS

The economic crisis of 1991 led to structural tax reforms in India with main purpose of correcting the fiscal imbalance. Subsequently, the Tax Reforms Committee headed by Raja Chelliah (Government of India, 1992) and Task Force on Direct Taxes headed by Vijay Kelkar (Government of India, 2002) made several proposals for improving Income Tax System. These recommendations have been implemented by the government in phases from time to time. As regarding the personal income tax, the maximum marginal rate has been drastically reduced, tax slabs have been restructured with low tax rates and exemption limit has been raised. In addition to this, government rationalised various incentive provisions and widened TDS scope. In case of corporate tax, the government has reduced rates applicable to both domestic and foreign companies, introduced depreciation on intangible assets and rationalised various
incentive provisions. Some new taxes have been introduced such as Minimum Alternative Tax and Dividend Distribution Tax, Securities Transaction Tax, Fringe Benefit Tax and Banking Cash Transaction Tax. However, Fringe Benefit Tax and Banking Cash Transaction Tax were withdrawn by Finance Act, 2009.

The Income tax administration was restructured with effect from August 1, 2001 to facilitate the introduction of computer technology. Further, keeping in mind the global developments, the department has made considerable efforts for reforming the tax administration in recent years. Some important measures in this direction are introduction of mandatory quoting of Permanent Account Number (PAN), e-filing of returns, e-TDS, e-payment, Tax Information Network (TIN), Annual Information Return (AIR) for high value transaction, Integrated Taxpayer Profiling System (ITPS), Refund Banker Scheme in certain cities etc. The main objective of these reforms has been to enhance tax revenue by expanding the taxpayer base, improving operational efficiency of the tax administration, encouraging voluntary tax compliance, creating a taxpayer friendly atmosphere and simplifying procedural rules.

1.2 SCHEME OF TAXATION OF INCOME IN INDIA

The constitution authorises the Central Government to levy and collect tax on income other than agricultural income under Income Tax Act, 1961. The proceeds of income tax are shared between the Union and the State Governments as per the recommendations of the Finance Commission. Income tax is
chargeable on the total income of the previous year of a person at the rates
prescribed by Finance Act every year.

Income Tax can be classified in two parts viz. Personal Income Tax and
Corporate Tax. Income tax levied on individuals, hindu undivided families
(HUFs), firms, association of persons (AOPs), body of individuals (BOIs), local
authorities and artificial juridicial persons is called Personal Income Tax and
income tax levied on companies is called Corporate Tax. The incidence of tax
on any person depends upon the place of origin of income and the residential
status of the taxpayer. According to their residential status, persons have been
classified into three broad categories:

1. Resident
2. Resident but not ordinarily resident
3. Non-Resident

The residential status of an assessee is ascertained with reference to each
previous year. A non-resident is required to pay tax in respect of income
received or deemed to be received in India and accrued or deemed to accrue to
him in India. A resident of India is charged to tax in respect of all the income i.e.
received or deemed to be received in India or outside India, accrued or deemed
to accrue in India or outside India during the relevant previous year. However,
the total income of a resident but not ordinarily resident is not to include income
which accrues to him outside India, unless it is derived from a business or
profession controlled in India. For the purpose of computing total income and
charging tax thereon, income from various sources is classified under the following heads:

1. Income from salary
2. Income from house property
3. Profits & Gains of business or profession
4. Capital gains
5. Income from other sources

These five heads of income are mutually exclusive. If any income falls under one head, it cannot be considered under any other head. Income under each head has to be computed as per the provisions under that head. Aggregate of assessable income of all heads, after giving effect to the provisions for clubbing of income and set off and carry forward of losses, is called the gross total income (GTI). Out of GTI, deductions under chapter VI-A are allowed and the balance amount left is called total income. Gross amount of income tax payable is calculated on total income according to the rates prescribed by the Finance Act for the relevant assessment year and the rates prescribed under different sections of the Act. From the gross tax payable, tax rebate under Section 88E and relief under Section 89(1) is to be deducted. The balance is the net tax liability subject to any advance tax paid or tax deducted or collected at source.

Every individual and HUF has to furnish the return of his income if his total income before allowing deduction under Chapter VI-A exceeds the maximum amount which is not chargeable to income tax. An essential feature of
the Indian Income Tax law is that it provides various tax incentives to ensure savings, development of particular industry and areas, exports etc. in the desired manner. Income tax is levied at a flat rate in case of corporate, firms and body of individual assesseees. Income tax is levied on slab system in case of individuals and HUFs assessees. Thus, the income tax system is progressive i.e. the applicable tax rate increases as total income increases.

1.3 ORGANISATIONAL SET UP OF INCOME TAX DEPARTMENT

The overall responsibility for the administration of Income Tax lies with the Department of Revenue, Government of India which functions through the Income Tax Department. The Income Tax Department has a network of 745 offices in 510 cities and staff strength of around 59000. This Department administers direct tax laws under the control and supervision of Central Board of Direct Taxes (CBDT). The department is engaged in the tasks of educating and assisting taxpayers in filing tax returns, assessing tax liability, demanding pending taxes, penalising dishonest taxpayers and disposing of tax disputes. The role of this department in tax system of India is rapidly increasing as the share of direct taxes in the revenue of the country has registered a steady increase over the past decade. It has increased to Rs. 314000 crore during the financial year 2007-08 from Rs. 48280 crore during the financial year 1997-98. It has also for the first time surpassed the collection of indirect taxes during the same year. The Income Tax Department has a three tier organisational structure as shown in the Figure 1.1
FIGURE 1.1

ORGANISATIONAL SET UP OF THE INCOME TAX DEPARTMENT

CBDT

CHAIRMAN
(Ex-officio Spl. Secy. to the Govt. of India)

Member (IT)  Member (Revenue)  Member (Audit & Judicial)  Member (Legislation & Computerisation)  Member (Investigation)  Member (Personnel)

ATTACHED OFFICES OF CBĐT

DGIT (Administration)  DGIT (Systems)  DGIT (Training)  DGIT (Legal & Research)  DGIT (Business Process Re-engineering)  DGIT (Intelligence)  DGIT (HRD)

DITs

1. PR, PR, QL
2. Inspection & Examination
3. Audit
4. Recovery
5. TDS

DITs (Agencies)

1. Systems
2. O&M
3. Infrastructure

DITs (Training)

North Zone
East Zone
South Zone
West Zone

All Regional Training Institute

DITs (Legal & Research)

North Zone
East Zone
South Zone
West Zone

DITs (IT)

North Zone
East Zone
South Zone
West Zone

DITs (Intelligence)

North Zone
East Zone
South Zone
West Zone

DITs (HRD)

Field Formation of CBĐT

CDTs

CDTs / CIT(A)

Addl./Joint CIT

Deputy/Assistant CIT Income Tax Officer

DGIT

DITTs (Investigation)

Addl./Joint CIT

Deputy/Assistant CIT Income Tax Officer

DGIT (Exemption)

DITTs (Exemption)

Addl./Joint CIT

Deputy/Assistant CIT Income Tax Officer

DGIITs (International taxation)

DITTs (International taxation)

Addl./Joint CIT

Deputy/Assistant CIT Income Tax Officer
1.3.1 THE CENTRAL BOARD OF DIRECT TAXES (CBDT)

The Central Board of Direct Taxes (CBDT) is the apex body in the Direct Tax set up. It provides essential inputs for policy and planning of direct taxes in India and administers direct taxes through Income Tax Department. The Board consists of a chairman and six members and has several attached and subordinate offices throughout the country.

Member (Income Tax)

Member (Investigation)

Member (Audit & Judicial)

Member (Legislation & computerisation)

Member (Personnel & Vigilance) Member (Revenue)

Various functions and responsibilities of the CBDT are distributed amongst chairman and six members, whereas fundamental issues are reserved for collective decision by CBDT.

1.3.2 ATTACHED OFFICES OF CBDT

There are 8 Directorates working as attached offices of the CBDT. These Directorates function under Directors General of Income Tax (DGITs). They play a vital role by monitoring the day to day functioning of field formations in their respective charges. They also develop a positive liaison between the field formations and CBDT. The following DGITs are attached to CBDT:

1. Directors General of Income Tax (Administration)

2. Directors General of Income Tax (Systems)

3. Directors General of Income Tax (Vigilance)
4. Directors General of Income Tax (Training)

5. Directors General of Income Tax (Intelligence)

6. Directors General of Income Tax (Business Process Re-Engineering)

7. Directors General of Income Tax (Legal & Research)

8. Directors General of Income Tax (HRD)

Further, various Directors of Income Tax (DITs) for specified jobs have been placed under respective Directors General of Income Tax.

1.3.3 FIELD FORMATION OF CBDT

The field formation of CBDT consists of three Directorates [DGIT (Investigation), DGIT (Exemption), DGIT (International Taxation)] and 18 cadre controlling Chief Commissioners of Income Tax. The Chief Commissioners of Income Tax are stationed at different locations all over the country. They are incharge of supervision, control and administration of their respective regions. The Chief Commissioners of Income Tax are assisted by Commissioners of Income Tax in their respective jurisdictions. DGIT (Investigation), DGIT (Exemption) and DGIT (International Taxation) are also stationed in different parts of the country, who are incharge of their specified duties in their respective jurisdictions. DGITs are assisted by Directors of Income Tax (DITs) in their respective jurisdictions. The first appellate machinery comprises Commissioners of Income Tax (Appeals), who perform the work of disposal of appeals against the orders of the assessing officers. Thus, the following income tax authorities have been constituted under the Act to discharge executive and administrative functions:
1. The Central Board of Direct Taxes.

2. Directors General of Income Tax or Chief Commissioners of Income Tax.

3. Directors of Income Tax or Commissioners of Income Tax or Commissioners of Income Tax (Appeals).


5. Joint Directors of Income Tax or Joint Commissioners of Income Tax.

6. Deputy Directors of Income Tax or Deputy Commissioners of Income Tax or Deputy Commissioners of Income Tax or (Appeals).

7. Assistant Directors of Income Tax or Assistant Commissioners of Income Tax.

8. Income Tax Officers.


10. Inspectors of Income Tax.

The Central Government may appoint such persons as it thinks fit to be income tax authorities. The Central Government may authorise the Board or Directors General of Income Tax or Chief Commissioners of Income Tax or Directors or Commissioner to appoint income tax authorities below the rank of an Assistant Commissioner or Deputy Commissioner according to rules and orders of the Central Government.

1.4 NEED FOR THE STUDY

Income Tax deserves significant attention in a developing economy as it is one of the major sources of government revenue. Tax system of
India has come a long way, dating back to the colonial era till now. A number of committees have been constituted from time to time to suggest changes in the existing tax structure. Thus, tax policymakers and tax administrators have been continuously adapting tax system to reflect changing economic, social and political circumstances. Moreover, restructuring of tax system has been a major component of fiscal reforms initiated since 1991 in an effort to keep pace with the changing global scenario on the basis of recommendations of Raja J. Chelliah Committee and Kelkar Committee. The main objective of these changes has been to enhance tax revenue by enlarging tax base, encouraging voluntary tax compliance and simplifying procedural rules. The review of literature on existing subject reveals that many researchers have directed their efforts to study various aspects of income tax system mainly with regard to tax buoyancy, tax structure, capital gains taxation, tax incentives, compliance cost, unaccounted income etc. These studies have highlighted some weaknesses of Income Tax System such as inadequate structure of Income Tax Department to meet the challenges posed and responsibilities cast on it, overburdened income tax officials, unhealthy service conditions in the department, lack of systematic plan for computerization, increase in number of pending assessments, outstanding refunds etc. However, it is worth mentioning that existing studies are either limited in scope or sufficient period has elapsed since these were conducted. Hence, the present study entitled “TAXATION OF INCOME IN INDIA: A STUDY OF POST LIBERALISATION PERIOD” is being undertaken.

1.5 OBJECTIVES OF THE STUDY
The main aim of the study is to examine taxation of income in India during post liberalisation period with the following specific objectives:

- To examine Indian Income Tax System and policy perspective in this regard.
- To study the growth of income tax revenue during the period of study.
- To evaluate the performance of the Income Tax Administration.
- To study the perception of tax professionals with regard to Income Tax System.
- To make recommendations to improve the system of taxation of income in India on the basis of findings of the study.

1.6 CHAPTER SCHEME

The study has been divided into the following eight chapters:

- **Chapter one**, the present chapter, is introductory in nature. It discusses the scheme of taxation of income, historical perspective of Income Tax System in India and administrative organization of Income Tax Department. Further, it explains briefly the need for study, objectives of the study and chapter scheme.

- **Chapter two** entitled ‘Income Tax Policy’ appraises income tax policy on the basis of various measures taken by the Government for social welfare, economic development, simplification of tax system and widening of tax base during the study period. Further, it briefly highlights key provisions of Direct Taxes Code.
• **Chapter three** entitled ‘Review of Literature’ deals with review of literature. In this chapter important studies covering different aspects of income tax system such as personal income tax, capital gains taxation, agricultural taxation, efficiency of income tax administration and reports of important committees constituted by Government of India have been reviewed.

• **Chapter four** entitled ‘Research Methodology’ explains Research Methodology used in the present study. It includes sample and sampling design, methods of data collection, data analysis and limitations of the study.

• **Chapter five** entitled ‘Growth of Income Tax Revenue in India’ analyses growth of income tax revenue in terms of Indian tax structure, category-wise growth in number of personal assessees and corporate assessees, income tax to GDP ratio, tax buoyancy coefficient, state-wise share and growth of income tax revenue and state-wise income tax to State Domestic Product (SDP) ratio.

• **Chapter six** entitled ‘Performance Evaluation of Income Tax Administration’ evaluates performance of Income Tax Department on the basis of selected indicators such as variation between budget estimates and actual collection, collection of income tax at pre assessment and post assessment stage, TDS modes of personal income tax, cost of collection, disposal of assessments, refunds outstanding, arrears of tax, tax recovery, execution of deterrence measures i.e. penalty and prosecution
proceedings, position of appeals and mistakes in assessments and their impact on tax revenue.

- **Chapter seven** entitled ‘Perception of Tax Professionals Regarding Income Tax System in India’ presents the background information of the tax professionals surveyed and examines the perception of tax professionals regarding Income Tax System in India.

- **Chapter eight** entitled ‘Summary, Conclusion and Suggestions’ highlights the major findings and conclusion that emerge from the study. Some suggestions to improve the Income Tax System have also been made in this chapter.