RATIONALISING THE INCOME TAX STRUCTURE

An attempt has been made in the present chapter to identify the superfluous, outdated, illogical and unjust provisions in our income-tax law, and suggests suitable modifications in order to make the tax structure simple, rational and justifiable.

Indian income-tax structure is not only complicated but also far from rationality.1 Efforts have always been made to make it simple and rational. Almost all the committees appointed to examine the tax structure have emphasised on the need of simplification of income-tax law2. Recently, the Tax Reform Committee, popularly known as Chelliah Committee, also observed that the tax system and laws should be as simple as possible and it must be rational from the economic point of view3. The Finance Minister has also stressed the government's commitment to simplify and rationalise the tax laws4. Few steps have been taken in this direction but the task is still incomplete.

The income-tax can become very iniquitous method of raising revenues if the tax provisions result in unfair and unequal treatment of different individuals in similar economic circumstances5. As is well known, the existing income-tax structure is riddled with anomalies, which make the system unfair as between equals. The income tax law contains some
provisions which have become superfluous, outdated or inconsistent with the underlying objectives of these provisions. An important step towards the simplification and rationalisation of the tax structure, can be the withdrawal or modification of these superfluous and outdated provisions. Such type of provisions have been discussed here and suggestions have been given for suitable modification.

HOUSE RENT ALLOWANCE

It cannot be gainsaid that the salaried persons constitute the most honest class of taxpayers\(^6\). The burden of income-tax on employees is much more in comparison to other categories of taxpayers. The framers of our income-tax law were not ignorant with this situation and they had designed certain provisions particularly for the salaried persons with an intention to give tax relief to this honest class of taxpayers. One such type of relief-providing provision is under section 10 (13A) which is related to tax exemption of House Rent Allowance received by an employee\(^7\).

Section 10 (13A) was introduced by Finance Act. 1964 to exempt a specific amount of house rent allowance received by an employee from his employer. The contents of the provision were:

"Any allowance specifically granted to an assessee by his employer to meet the expenditure actually incurred on payment of rent in respect of residential
accommodation occupied by the assessee, to such extent as may be prescribed having regard to area or place in which such accommodation is situated and other relevant considerations."

Four criteria were laid down in Rule 2 A for fixing the amount of exemption and the income-tax officer had to apply the one which was most beneficial to revenue, namely:-

i) the actual amount of the allowance received by the assessee.

ii) So much of the actual rent paid to the landlord, which is in excess of ten per cent of the salary.

iii) ten per cent of the salary or twenty per cent of the salary for some more thickly populated cities.

iv) Rs. 300 per month which was substituted by Rs.400 per month in 1975.

From the above mentioned criteria, the Department had inferred that non-payment of rent would disentitle the assessee from exemption under section 10 (13 A) and therefore an assessee, who occupies his own house was not entitled for the exemption of house rent allowance. But the Punjab and Haryana High Court did not agree with this conclusion of the Income-Tax Department. Delivering a very significant judgment, the Hon'ble High Court observed:

"The provision of section 10 (13 A) of the Act have
been enacted to compensate the assessee regarding the expenditure incurred on payment of rent in respect of residential accommodation occupied by him. The main object for enacting this provision appears to be in case an assessee suffers a monetary loss by way of expenditure or otherwise in respect of residential accommodation occupied by him and if he is compensated by his employer, in that case the allowance paid to him by the employer shall be exempt from income-tax. An assessee, who occupies his own house, has disentitled himself from the rent which he would have been entitled to if he had not occupied the same himself and in that sense, he suffered expenditure in that regard. In that sense, an assessee occupying his own house, if compensated by the employer by payment of House Rent Allowance, the compensation paid to the assessee by his employer, cannot be subjected to tax".

The intention of the framers of the Act was brought out clearly by the High Court and now, those occupying their own houses were also entitled for exemption under section 10 (13 A).

But unfortunately, with an intention to setting aside the judgment of the Court, an amendment was introduced in the Income-Tax law, in 1984, with retrospective effect from April 1976, by inserting an explanation in section 10 (13 A), declaring that nothing contained in this clause shall
apply in a case where the residential accommodation occupied by the assessee is owned by him or the assessee has not actually incurred expenditure on payment of rent in respect of the residential accommodation occupied by him.

The rule which regulates the exemption in respect of House Rent Allowance has also been changed by Finance Act 1986 and from the assessment year 1987-88, the least of the following is exempt from tax ¹¹

(a) Actual House Rent Allowance received in respect of the period during which rental accommodation is occupied by the employee;
(b) an amount equal to 50 per cent of salary, where residential house is situated at Bombay, Calcutta, Delhi or Madras, and an amount equal to 40 per cent of salary where residential house is situated at any other place;
(c) the excess of rent paid over 10 per cent of salary.

For granting the above relief the department insists on production of rent receipts to prove that the rent paid by the employee is more than 10 per cent of his salary and the problem of the assessee starts from here. In the present environment of scarcity of houses in urban areas, it is a very tough job to get a rented accommodation. The landlords hesitate in letting their houses with the apprehension of it being captured by the tenant and if the receipt is asked for
by the tenant, the landlord will not let his house. In these circumstances, the employee will have no option except to forget the rent receipts and consequently, he will not be able to get relief for House Rent Allowance. In such a situation, is it necessary to prove that the rent paid by the employee is more than 10 per cent of salary? In a survey of 100 employees residing in rented accommodations, it was found that on an average, they were paying about 50 per cent of their salary (basic pay) as rent. It is almost impossible to have a rented house in 10 per cent of the basic pay. Then what is the need to prove that the rent paid by the employee is more than 10 per cent of salary?

The tax treatment of House Rent Allowance creates discrimination between employees posted in metropolitan cities and rural areas. On the basic pay of Rs. 4000 per month the house rent allowance in class 'A' city is Rs. 800 per month, whereas it is only Rs. 200 per month in non-classified areas. Taking into account the CCA, the tax liability of a person posted in a metropolitan city (basic pay Rs. 4000) will be Rs.2520 more than the person posted at non-classified areas. On the equal real income the tax liability should also be equal. The tax liability of a person posted in metropolitan city should not be more than the tax liability of the person posted in rural area, because the higher amount of H.R.A. and C.C.A. in metropolitan cities is given only to compensate the employees for the additional personal expenditure.
necessitated by higher cost of living in big cities. Also there is great discrimination under the Income-Tax Act, between employees getting H.R.A. and those having living accommodation from their employers in lieu of house rent allowance.

The central government, state governments and several other employers provide house accommodation to their employees at very nominal rate. But the employees, who do not get accommodation from their employers, receive house rent allowance. These employees have to pay huge amount of rent on one hand and income-tax on part of the house rent allowance on the other. Those who have employer's accommodation at nominal rents, take double advantage i.e. better accommodation at nominal rent and relief from income-tax as no H.R.A. no tax. The Chelliah Committee also observed that

"A proportion of government servants ........... are provided with living accommodation for which they are charged very nominal rents although the market rent for the accommodation would be far far higher than the rent charged. Here again those who are lucky enough to have such accommodation receive high income in kind which is entirely free from tax." 15A

The present way of providing exemption in respect of house rent allowance hunts those employees who occupy their own houses, as they are not entitled to get exemption under this
provision. An employee occupying his own house suffers from monetary loss in two ways: firstly, he has to incur expenditure on the maintenance of his house accommodation in the form of municipal taxes and secondly, he has to incur opportunity cost in the sense that he disentitled from the rent which he would have been entitled to if he had not occupied the same himself and in that sense he incurs expenditure to that extent. So an assessee occupying his own house, if compensated by the employer by way of house rent allowance, the compensation paid to the assessee by his employer, should not be subjected to tax. In 1980, the Punjab and Haryana High Court was also of the same view.16

To sum up, it may be said that due to a number of ifs and buts, the provision has lost its effectiveness. The genuine and deserving assesses do not get any relief from this provision. To make this provision meaningful, the amount of H.R.A. received by government and semi-government employees should be fully exempted without taking into consideration whether any rent is being paid or not by the employee for his residence and to prevent the misuse of this provision, some ceilings may be imposed for private sector employees, taking H.R.A. of central government employees as standard. The salaried taxpayers will find some relief by this revision.

ENTERTAINMENT ALLOWANCE

Section 16 (ii) of Income-Tax Act, provides deduction from
the entertainment allowance received by an employee. In case of government employee the entertainment allowance is deductible up to 20 per cent of salary, subject to a maximum ceiling of Rs. 5000 per annum. In case of non-government employees, the least of the following is deductible:

(a) Rs. 7500;
(b) 20 per cent of salary;
(c) amount of the entertainment allowance granted during the previous year; and
(d) the amount of entertainment allowance received during the financial year 1954-55.

In case of non-government employees, to avail deduction under this provision, an assessee has to satisfy two conditions namely;

(i) he has been in continuous service with the present employer from a date prior to 1st April, 1955; and
(ii) he has been receiving entertainment allowance from his present employer continuously from a date prior to April 1, 1955 till the year for which income is to be taxed.

The provision of providing deduction for entertainment allowance to government employees is meaningless because most of the government employees do not get any entertainment allowance. So the deduction is useless and fictitious.

For non-government employees, the provision contains so many
ifs and buts that make it far far away from the access of employees. The conditions that, the employee should have been in continuous service with the present employer from a date prior to 1st April, 1955 and he should have been receiving entertainment allowance from his present employer continuously from a date prior to 1st April, 1955, are completely nonsense. At present there is hardly any employee in job who joined the service prior to 1955 and never changed his employer till date. One more nonsensical condition in this provision is that the quantum of deduction cannot exceed the amount he received during the year 1954-55 as entertainment allowance. One can imagine, what would have been the quantum of entertainment allowance in 1954. Is it meaningful to give deduction of the same amount even after 40 years?

The intention of the government behind this provision is not understandable. If the government does not want to give any deduction under this provision, it can simply drop this section and what is the need to impose so many restrictions. It may be concluded that the provision related to the deduction from entertainment allowance, does not serve any purpose and just complicates the tax structure. This provision should be deleted without any delay and let the entertainment allowance be fully taxable.
VALUATION OF PERQUISITES

Another outdated provision is related to the valuation of perquisites like motor car and domestic servants. These perquisites are taxable only in the hands of specified employees and non-specified employees do not pay any tax on the value of perquisites related to car and domestic servants.\textsuperscript{17} This exemption is totally illogical and useless, because nobody is going to provide a car and servant to a non-specified employee i.e. an employee drawing taxable salary not more than Rs. 24,000 per annum and who is neither a director of the company nor has a substantial interest in the company\textsuperscript{18}. And if anyone provides car and servant to non-specified employee, the objective may be more of avoiding tax than to extend facility, so there is hardly any use of providing such exemption. For specified employees, valuation of perquisite, in the case where the domestic servants are provided by the employer along with rent free accommodation, is done as under:

\begin{itemize}
  \item \textbf{SWEEPER} : 75\% of salary paid to sweeper or Rs. 60 per month, whichever is less.
  \item \textbf{WATCHMAN} : 50\% of salary paid to watchman or Rs. 60 per month, whichever is less\textsuperscript{19}.
\end{itemize}

These limits were fixed in 1969 and there has been no revision in these rates since then\textsuperscript{20}. If these figures would have been revised on the basis of prices, the amounts would have been around Rs.500 per month\textsuperscript{21}. The services of
a servant can be hired only for a single day for Rs. 60, while in our income-tax law these amounts are fixed for month long period. How much revenue does the government earn by taxing this perquisite at the rate of Rs.60 per month. It can just compensate the cost of paper work increased by this provision.

The valuation of perquisite in the case of car provided by the employer partly for official and partly for personal use, is also very interesting. The method of valuation of this perquisite is given below22 :

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Value of perquisite per month</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Where the H.P.</td>
</tr>
<tr>
<td></td>
<td>rating of the Car</td>
</tr>
<tr>
<td></td>
<td>does not exceed 16</td>
</tr>
<tr>
<td>1. Where all the expenses of maintenance and running are also met by the employer.</td>
<td>Rs. 300</td>
</tr>
<tr>
<td>2. Where all the expenses of maintenance and running relating to the private use of the employee are met by the employee himself.</td>
<td>Rs. 100</td>
</tr>
<tr>
<td>3. Salary of chauffeur, if provided by the employer.</td>
<td>Rs. 150</td>
</tr>
</tbody>
</table>

The provisions of valuation of chauffeur driven car, provided to employee partly for official and partly for personal use, have not been revised since 1974 in spite of
steep rise in the prices of cars, petrol, road-taxes, insurance, repair charges etc.\textsuperscript{23} It is not possible to hire a car for Rs.100 even for a single day whereas tax is charged on Rs. 100 for the whole month. Had these values been adjusted on the basis of price index, these would have been higher by more than six times. These amounts have not been raised because the top bureaucrats, who make and control tax policy, are the main beneficiaries of these provisions.

The object of pinpointing the position relating to valuation of perquisites is to highlight that these provisions are not only illogical but awkward also. Taxing the perquisites on the basis of these provisions contribute nothing to revenue but only complicate the tax structure.

The provisions governing the valuation of perquisites in respect of domestic servants and car, have become outdated due to lack of inflationary adjustments. The intention behind enacting these provisions seems to be to check tax avoidance by diverting the salary from cash to kind. These provisions, as they stand now, do not serve this purpose. So the values of these perquisites should be revised taking into account the rise in prices.

**TAX TREATMENT OF INTEREST INCOME**

In a tax system based on global income concept, the interest income also forms a part of the tax base. Following this
principle, the Indian income tax law also recognises the
interest receipts as a source of income for taxation
purposes and tax is levied on the interest income since the
very beginning of taxation history. But in an inflationary
environment, the tax treatment of interest income may become
a typical problem, as the inflation distorts the base of tax
on interest income and this distorting impact remains
significant as long as the rate of inflation continues to
be high.

To make this problem easily understandable, let us imagine
three different situations. In the first situation, the
prices are stable and an individual deposits Rs.1,00,000 in
a bank at 12 per cent interest. After one year he receives
Rs. 12,000 as interest and pays Rs.5,400 as income tax (if
the marginal income tax rate for this individual is 45 per
cent) and he will be left with Rs.6,600 as real income with
a 6.6 per cent after-tax-return on his investment (Table
3.3).

In the second situation, there is inflation in the country
at a rate of 7 per cent p.a. and the rate of interest and
amount of investment is same as it is in the first
situation. The individual will be left with Rs.6,600 as
after-tax nominal income. Due to inflation, the real value
of his original investment will decrease by 7 per cent and
thus he needs Rs.7,000 to compensate the loss resulted by
the inflation, but after payment of tax he is left with
only Rs.6,600 not sufficient even to offset the impact of
inflation. Consequently, after tax real return will be negative (Table 3.3).

Now, let us consider the third situation when the rate of interest and the rate of inflation is equal, say 12 per cent. The individual receives Rs. 12,000 as interest and at the same time the real value of his investment will also decrease by Rs. 12,000 due to inflation. Hence the nominal income received in the form of interest is just enough to compensate him for the erosion in the real value of his investment. But he will be required to pay Rs. 5,400 as income-tax on this inflationary gain and it will result in a 5.4 per cent negative return on his investment. (Table 3.3.)

The foregoing analysis clearly shows that inflation has created a very serious problem for the tax-payers and the policy makers. It seems that it has become necessary to recognise the impact of inflation on the interest receipts and distinction must be made between the real income and the inflationary gain, so that the inflationary component of interest-income may be exempted from taxation and tax can be levied only on the real income. This step is of crucial importance for salaried persons, because under inflationary conditions, there is no appreciable return on the investment of hard-earned savings of employees and the real value of their savings is eroded day by day in the environment of rising prices. Commenting on the problem of the tax
"There is an even more difficult problem, that of measuring correctly capital income under conditions of inflation. If the value of the capital invested, such as bank deposits or bonds, depreciates in real terms because of inflation, the interest or return earned must be reduced to the extent of capital depreciation, before applying the indexed rate schedule. But this is not usually done, for example a taxpayer who has a bank deposit of Rs. 10,000 and receives an interest payment of Rs. 1,000 at 10 per cent, has to pay tax on Rs. 1,000, even if inflation during the relevant year has been 10 per cent and the value of his bank deposit has depreciated by 10 per cent. There is no doubt that taxpayers, whose capital income comes mostly from non-appreciating capital assets (e.g. bank deposits, units of the UTI) are treated most unfairly under income tax act under conditions of inflation, and also that investment in such assets is discouraged. Now the question arises, as to what should be the tax treatment of interest income under this situation? There are four different possible tax treatments of interest income.

i) The nominal interest income may be taxed without allowing any adjustment for its inflationary component;
ii) The real interest income may be taxed after allowing adjustment for the inflationary component;

iii) The interest income may not be taxed at all; and

iv) Exemption may be given in respect of interest income received from certain institutions such as banks, Public sector financial institutions and the government bonds.

Which one of the above mentioned tax treatments is better, it depends upon the rate of inflation. If the rate of inflation is very low, taxing nominal interest income without considering the effect of inflation is the best one and there is no need of further complicating the tax structure by introducing the inflation adjustment scheme. But something must be done when the rate of inflation becomes significant. If the rate of inflation remains very high, i.e. either equal or more than the rate of interest, then exempting the interest income from income-tax completely will be the most suitable system. When the rate of inflation is high but it is less than the rate of interest, we may have two options; we may tax the real interest income after allowing adjustment for inflationary component or exempt the interest income received from certain institutions and tax the remaining income at nominal income basis.

As the inflation is a global problem, the other countries also have taken some steps to overcome these problems.
In Argentina, interest income received from bank deposits is exempted from tax on the ground that the interest payment just compensates the depositor of the loss in his investment due to inflation. In other cases, only real interest income is taxable and the inflationary gains are not taxable.\(^\text{26}\)

In Austria, the interest at a rate up to the rate of inflation is not considered income and hence not taxable.\(^\text{27}\)

The Belgium tax system also recognises the fact that the investments suffer an erosion in their real value due to change in prices.\(^\text{28}\) In Brazil, the saving accounts and the government bonds are indexed with wholesale prices and the inflationary portion of interest income is not taxed. For other investments, there is no inflation adjustment but interest from those securities is taxed at a lower rate.\(^\text{29}\)

Canada also recognises the fact that inflation does affect interest income and a certain portion of interest income received by individuals has been exempted from income-tax.\(^\text{30}\)

In Colombia, although the interest income is taxable, yet the inflationary component of interest is kept out of the tax net.\(^\text{31}\) In Chile, monetary corrections are not considered as income and consequently, not taxable.\(^\text{32}\)

Denmark also has a partial monetary correction system for interest incomes.\(^\text{33}\) The inflationary component of interest income is not taxable in Israel also.\(^\text{34}\) In Germany, recognising the erosion in the real value of the investment
due to inflation, certain part of interest income is not taxable. United Kingdom also has a system that protects the investments from inflation and inflationary component of interest receipts is exempted from tax.

The review of the experience of various countries reveals that in a number of countries, either the interest income is fully exempted from income-tax or the inflationary component is excluded from the tax base on the ground that the investments suffer an erosion in their real value due to rise in prices.

Now, the question before us is, whether interest income should be taxed in India under the present inflationary environment or should it be excluded from the tax base?

Global income-tax system, under which all sources of income are treated equally, has been recognised as a best taxation system from the equity and simplicity point of view. Previously, India also had a global income-tax system. But after introducing a separate rate schedule and indexing system for capital gain, the global income-tax system is no more in existence and it has been converted into a schedular income tax system in which different tax treatments are meted out for different sources of income. It does not make good sense to introduce inflation adjustments for one sources of income ignoring others.

Since the government has introduced indexing of capital gain
with inflation, it has placed the interest earner in a disadvantageous position. Now the income-tax system offers a more favourable tax treatment to capital gain than that of to the interest income, as the 75 per cent of inflationary component of capital gain is exempted from income-tax and only 25 per cent of inflationary gain is taxable. On the other hand, the inflationary component of interest-income is fully taxable. This policy of taxation is unjust and inequitable for earners of interest income. This is a discrimination between different categories of taxpayers and is against the spirits of our taxation policy. Today, our Finance Minister is strongly advocating the need of globalisation of Indian economy. He thinks that the tax structure should also be modified on the pattern adopted in other countries. As it has already been stated that in a number of countries, either the interest income is fully exempted from tax or only the real income is taxable after exempting the inflationary component of interest income, such step should be taken by the Government of India also.

Now, it is high time for the Finance Minister to consider this problem of the taxpayers and either the inflation adjustment scheme should be introduced or as an alternative, the interest on deposits in post offices, banks and similar institutions may be exempted from income-tax. As the interest rate on these deposits is low, the tax exemption will compensate the same to some extent and at the same time this rule will simplify the tax system. Exempting interest
income from income-tax will not only do justice, but it will also promote savings.

**STANDARD DEDUCTION**

According to the practical policy of the Indian Income Tax Law, any cost incurred for earning the income, should be subtracted from the aggregate gross income of an individual and tax should be assessed on the remaining portion of income. Following this principle, the expenditures of an individual in course of the income earning activity are also sought to be deducted from income.⁴⁰

In case of businessmen and professionals, there is hardly any problem in identifying the expenditures which can be regarded as incidental to their business or profession. But the problem arises in case of salaried persons, since the expenditure incurred in course of the execution of their duty, is not direct. However, under the income-tax law, certain expenses of salaried persons, are identified as incurred in the course of earning the income form salary. These expenses include, the expenditure on books and other publications, expenditure on conveyance and any other such amount. A deduction upto Rs.500 was available for amount spent on purchase of books and other publications provided they were necessary for the performance of employee's duties.

The conveyance deduction was granted for the first time by
the Finance Act 1968. The rate of deduction was Rs. 150 to 250 P.M. for scooter or motor cycle and Rs. 5 for bicycle. The Finance Act, 1969 fixed the standard deduction for car at Rs. 200 p.m. The standard deduction for scooter, was raised to Rs. 60 per month by the Finance Act, 1970. A deduction of Rs. 35 per month was also prescribed for those who did not own any conveyance and travelled in public transport. For the assessment year 1972-73, conveyance deduction at the rate of Rs. 200 per month for car, Rs. 75 for motor cycle or scooter and Rs. 50 in every other case, was provided.

A separate deduction for expenses actually incurred by employees wholly, necessarily and exclusively in performance of duties and which were not covered under the above mentioned provisions was also available. But the deductions for books and publications, conveyance etc., were allowed at a fixed rate and the actual expenditure incurred on these activities was not deductible, whereas in case of businessmen and professionals, the actual expenditure was allowed.

With an intention to simplify the assessment procedure for salaried taxpayers, it was decided that in lieu of all these deductions, a fixed proportion of salary may be deducted for the expenditures incurred for earning the salary. The Finance Act, 1974 substituted the above separate deductions, for a fixed "standard deduction" at the rate of 20 per cent.
of the salary upto Rs. 10,000 and 10 per cent of the salary in excess thereof, subject to a maximum deduction of Rs. 3,500.

The percentage of salary for standard deduction and its maximum ceiling have been changed from time to time and at present the standard deduction is allowed to an employee irrespective of his designation and regardless of the fact whether any expenditure incidental to employment has actually been incurred by him. The amount of standard deduction is 33.33 per cent of salary income or Rs. 12000 (Rs. 15000 for certain women[^41]) which ever is less. It is proposed to be raised to Rs. 15000 and Rs. 18000 respectively for the assessment year 1994-95[^42].

Today our country is passing through a high inflationary period. Like any other sector of the economy, the tax liabilities of the individuals are also being affected by inflation. The inflation reduces the real value of all deductions, which are fixed in monetary terms[^43]. The Raja Chelliah Committee on tax reforms also realised this fact and recommended an increase in the income-tax exemption limit on the basis of inflation. The committee also recommended an indexation of "exemption limit" with consumer price index[^44]. But unfortunately, the committee has ignored the standard deduction, which is equally important for salaried persons. There is a close relationship between the standard deduction and the exemption limit, because the criteria to determine the quantum is same for both. But
this relationship was not maintained by the Finance Minister. In 1988 the "exemption limit" was Rs. 18,000 and the "standard deduction" was Rs. 12,000. Now the "exemption limit" is proposed to be raised to Rs. 30,000, while the standard deduction is proposed to raise only to Rs. 15,000. If the standard deduction had been raised in proportion to the exemption limit, it would have been increased to Rs. 20,000.

The ceiling of Rs. 12000 on standard deduction was imposed by the Finance Act, 1988 and since then, this has not been raised, despite the fact that there is a steep rise in prices. If the standard deduction had been raised on the basis of consumer price index, taking the quantum of the standard deduction in 1988 as base, it would have been around Rs. 20,000, for the previous year 1993-94.

Upto 1990-91, the amount of standard deduction was restricted to Rs. 1,000 when an employee was provided with any conveyance by his employer. It means that the main objective of providing the standard deduction is to cover the expenditure incurred on conveyance. So the level of standard deduction should be based on the level of expenditure on conveyance. The fare of public transports and the prices of petrol, have almost doubled during last four years. The prices of cars, scooters and motorcycles have also increased substantially, and consequently the cost of maintenance of the conveyance has also increased, but
there is a minor increase in the amount of standard deduction.

The present way of providing the standard deduction places the salaried persons in a disadvantageous position in comparison to businessmen and professionals. Suppose a salaried person has a gross salary amounting to Rs. 1,00,000 and a businessman also has the same gross income. They purchase cars, costing Rs. 1,60,000 each and finance them by taking a loan from a bank. During the previous year they spend Rs. 17,000 each on petrol and maintenance of cars, and pay Rs. 15000 each as interest on loans.

While computing the tax liability as shown in the table 3.1, the businessman claims the deduction of Rs. 17,000 for expenditure on petrol etc., Rs. 15,000 for interest paid on loan taken for the purchase of car and Rs. 40,000 for depreciation on car, reducing the taxable income to zero. On the other hand, the innocent salaried person is allowed deduction only of Rs. 12,000 as standard deduction and is liable to pay Rs. 15,800 as income tax. IS IT FAIR?

The rising prices also place the salaried persons in a disadvantageous position in comparison to the businessmen. The effect of twice increases of 25 per cent and 20 per cent in petrol prices in 1990 and 1991 respectively, is shown in table 3.2. Suppose two assessees, one of them being salaried person and the other a businessman, each spends Rs. 600 per month on petrol before price rise. After rising the
petrol prices they will have to expend Rs. 900 per month on petrol. As shown in table 3.2, before increase in petrol prices both had a taxable income of Rs. 60,000. But after increase in petrol prices, the taxable income of businessman is reduced to Rs. 56,400. This reduction in taxable income is due to the increase in cost of turnover resulted by the increase in the prices of petrol. Table 3.2 shows that when the prices of petrol were increased, the tax liability of businessman decreased, but the tax liability of salaried person remained constant. This is due to the constant standard deduction in case of a salaried person.

The standard deduction is not a rebate or an incentive given to salaried person. It is given in lieu of expenditure incurred for earning the salary and therefore, it is their right and its quantum should not depend on the mercy of the Finance Minister. The standard deduction was introduced by withdrawing all the other deductions of expenditure incidental to service, only for the convenience of tax collection machinery. If once it is fixed at a certain level, it does not mean that it should not be raised even if the expenses incurred for earning the salary, have increased.

As discussed earlier the standard deduction was allowed mainly for the expenditure on conveyance and the expenses on conveyance depend largely on the income of a person. But our income tax law provides the same amount of standard deduction for all, whatever his income may be. It is not
fair to provide same deduction for a person having salary Rs. 36,000 and the other having salary Rs. 1,00,000. Providing equal standard deduction for unequal income creates discrimination among salaried persons too. It is not so in case of businessmen, where small businessmen claim less expenditure and the bigger claim more. Imposing a ceiling on the standard deduction is not justifiable when there is no restriction on the admissibility of expenses on conveyance for businessmen and professionals.

To sum-up, it may be said that the existing provision of providing standard deduction is arbitrary, discriminatory and inconsistent with the objective, for which the provision was introduced. The ceiling of Rs. 12,000 on standard deduction should be lifted and let it continue as 33.33 per cent of salary without any minimum amount. It will not only be justifiable but also provide great relief to the salaried taxpayers.

SURCHARGE

While framing the tax structure, care must be taken to ensure that the basic principle governing the tax policy is not violated by any provision of the tax law. In India, the rate structure of personal income tax is based on 'slab system' which was introduced in 1939 on the recommendations of the Income-Tax Enquiry Committee (1936). Here it is
necessary to define the 'Slab System' of the rate structure. A rate structure may be based on the 'Step System' or on the 'Slab System'. Under the 'Step System', once the taxable income exceeds the lower slab even by one rupee, the entire income will be taxed at the rate prescribed for the higher slab in which the taxable income falls. Under the 'Slab System', tax on each slab is calculated separately and then added up. Thus, under the former system, a person would be much worse off after paying the tax, in comparison to a person whose income is just below that slab on which the high rate is applicable. To simplify, it may be said that under the 'Slab System' the marginal increase in the tax liability should not be more than the marginal increase in the taxable income at any point.

The method of computing surcharge, on personal income tax in India, violates the basic principle of 'Slab System'. Under the income tax law, surcharge @ 12 per cent is leviable, if the taxable income of an individual or an Hindu Undivided Family exceeds Rs. 1,00,000. The surcharge is computed at the prescribed rate, on the tax liability before surcharge. So the surcharge is levied on the tax payable on entire income and not only that of on the income that exceeds Rs. 1,00,000. This method of calculating the surcharge has converted the 'Slab System' into the 'Step System' and it creates hardships for the taxpayers specially where the taxable income exceeds Rs. 1,00,000 marginally say by Rs. 100. In such situation entire income tax on Rs. 100100,
which amounts to Rs. 19440, would become liable to a surcharge of 12 per cent. An increase of Rs. 100 in income will result in additional tax liability of Rs. 2373 and consequently, while the taxable income increases by Rs. 100, the after tax income decreases by Rs. 2273. As shown by the table 3.4, after earning an income of Rs. One Lakh, the additional income up to Rs. 4220, will not increase the after tax income. This method of computing the amount of surcharge is inconsistent with the basic principle of our tax policy. The taxpayers in such cases may be prompted to evade tax by reducing their income to Rs. 1,00,000 by all means. To remove this anomaly, it is suggested that the surcharge may be merged with the tax rate applicable on that income level at which surcharge is applicable. It will never result in negative marginal income (Table 3.4) and the tax structure will become rational.

RELIEF TO SENIOR CITIZENS

A similar anomaly exists in Sec. 88 B, that provides a rebate in income tax in the case of individuals, who have attained the age of 65 years. The rebate is equal to 10 per cent of their tax liability if their gross income does not exceed Rs. 50,000. In the Finance Bill 1993, the rate of rebate is proposed to be 20 per cent and the income ceiling to Rs. 75,000. The enhanced tax rebate now would work to be Rs. 2,380 maximum. But if the income of such person is more than Rs. 75,000, just by Rs. 10, the rebate
will not be available. This will certainly induce the taxpayer to indulge in tax evasion to avail the exemption.

The objective of the government behind this provision is influenced more by political reason rather than social, because the provision seems to be introduced by government to gain cheap popularity. If the Minister, really wants to give relief to the senior citizens in respect of their contribution to the development of nation in their young age and considering their increasing expenditure on medical treatment in old age, the pension income must be exempted from tax. The depletion in earning capacity of a retired person also justifies exemption of pension from income tax.

DISCRIMINATION AMONGST EMPLOYEES

Equity is a basic principle of natural justice and to honour this principle, it is necessary to have a common law, so that all persons may be treated equally. It is not a good practice to make separate law for different groups of people. This concept should also be taken into consideration while framing a tax law. But it seems that the concept of equity has been ignored by the architects of our income tax structure. The taxpayers have been divided in several categories and sub-categories. The income-tax law divides the salaried employees in different categories like government employees, semi-government employees, public sector employees and private sector employees. They are
further classified into 'specified' and non specified employees. For some purposes the public sector employees are treated at par with government employees and for some other purposes they are treated like private sector employees. These classifications do not serve any meaningful purpose. On the one hand it makes the tax law complicated and on the other hand, it creates discrimination amongst the assesses. The Chelliah Committee has also criticised this policy. The committee observed:

"The income-tax Act does contain provisions for the taxation of certain fringe benefits such as residential accommodation, conveyance for personal use and gas, water and electricity charges paid for personal use. However, some of the rules are found to discriminate amongst employees in the government, the public sector and the private sector and also between salaried and self employed persons".

To rationalise the income-tax law, it is essential to modify these provisions and equal tax treatment should be given for equal economic status, irrespective of the fact whether the person is a government employee or non government employee, however limited restrictions may be imposed on private sector employees to counteract the apprehension of misuse of the tax provisions.
AMBIGUOUS DEFINITIONS

One more reason responsible for making the tax structure complicated, is the existence of several definitions for one concept. For example, our income tax law contains more than half dozen meanings of the concept 'Salary'. These several meanings of one concept not only make the tax law ambiguous but also encourage litigations.

It is nothing more than a joke, if one asks the difference between 15 days and half month. But it is interesting to note that our income-tax law provides so. Under section 10(10) of the Income Tax Act 1961, there are separate meanings of 15 days and half month. There is no logic behind this superfluous differentiation. To avoid unnecessary litigation and to make the tax law understandable at least by reasonably educated persons and to remove interpretational hazards, it is suggested that one concept must have only one meaning for all purposes.

MISUSE OF I.T. LAW FOR POLITICAL PURPOSES

The most unfortunate part of our income-tax law, is the misuse of tax provisions for political purposes. It has been found that certain provisions have been amended only to achieve certain political gains. For example, Sec. 16(1) of Income-Tax Act, provides standard deduction for the salaried persons. This deduction is given in respect of expenditure incidental to the employment of the assessee and
admissibility of expenditure is allowed on presumptive basis. So this deduction is not a mode of providing relief to the taxpayers, but the Finance Minister has confused this deduction with incentives by prescribing separate quantum of standard deduction for certain women employees. There is no valid justification behind higher amount of standard deduction for women employees. Obviously, one can not afford to oppose any measure taken for upliftment of women, but this is not the way, because the standard deduction is not a mean to give tax relief. So providing higher standard deduction for women employees is against the spirit of the provision under Sec. 16(1) and a discrimination against and injustice against men employees.

Exempting the agricultural income from taxation, is also politically motivated. The recommendation of T.N. Raj Committee for land-holding-tax and the recommendation of the Chelliah Committee to bring agricultural income above Rs. 25000 into tax ambit, has not been accepted with the apprehension of offending the 'VOTE BANK' and because VIP's and VVIP's having large farms run on commercial basis, would suffer, if agricultural income is taxed.

Making contribution to public exchequer, is not only a common man's duty but also of the politicians. The members of parliament and state legislatures are getting a huge amount in the form of daily allowances and constituency allowances which are not taxable under the income tax law.
The Chelliah committee has recommended the inclusion of these allowances in taxable income\textsuperscript{55} but the recommendation has not been accepted by the government. It is heartening to note that even the rulers are not realising their duty towards the public exchequer.

To make the tax structure really fair, just and rational, the political objectives should not be achieved through income-tax and the government should not play with the tax provisions for political reasons.
NOTES AND REFERENCES

1. This fact is well realised in the most recent Tax Reform committee, Interim Report (Dec. 1991) better known as chelliah committee Report at p. 43 para 5.2


3. Chelliah committee Report (Interim) p. 43 para 5.2 (d) & (e).


5. This fact is realised in the Chelliah committee Report (Interim) in para 6.7 p.47.


7. Section 10(13-A) of Income Tax Act 1961 (upto 1986-87)

8. Ibid


11. Section 10(13-A) of Income Tax Act 1961

12. Survey was conducted in Delhi in the month of Feb. March, 1993.


14. Difference in the monetary salary income will be Rs. 8400 annual (600+100= 700x12= 8400) and the marginal rate applicable on those person will be 30% hence 30% of 8400 is = 2520.

15. CIT vs Har Parsad & Co.(P) Ltd. (1975) 99 ITR 118 (125) (SC) and Fundamental Rule 9(5) constitution of India.

15A Chelliah committee report (intrim) para 4.6 page 33.

16. Ibid, CIT vs. Justice S C Mittal
17. Section 17(2) (iii) of Income Tax Act 1961

18. Abid.


20. Ibid

21. Computed on the basis of consumer price Index. The CPI was at 156 points in 1969(1960=100) and at 1198 in Dec. 1992. Indexing Rs. 60 with these point, the figure comes to Rs. 461 (rounded off Rs. 500)

22. Income Tax Rule No. 3


27. Ibid P. 60

28. Ibid P. 61


30. IMF, Inflation and Interest rates, 1984 Washington D.C.


32. VITO TANZI, Ibid p. 61


34. VITO TANZI, Ibid p. 61

35. Ibid p.61

38. Ibid.
39A. Ibid.
41. Working women, whose total income does not exceed Rs.75,000.
43. The problem is discussed in detail in chapter V.
45. In Table 3.2, the tax liabilities are calculated on the basis of Finance Act, 1991, as the situation of petrol price rising is related to that period.
46. It was written in section 16(i) until the Finance Act 1980.
50. Ibid.
52. Chelliah committee Report (Final - Part I) Page 3 para 2.3.
54. Section 10(17) of Income Tax Act 1961, provides exemptions to MPs and MLAs for these allowances.
<table>
<thead>
<tr>
<th></th>
<th>Salaried person</th>
<th></th>
<th>Businessman/Professional</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Salary</strong></td>
<td>1,00,000</td>
<td></td>
<td><strong>Gross Income</strong></td>
<td>1,00,000</td>
</tr>
<tr>
<td><em>Less : Standard</em></td>
<td></td>
<td></td>
<td><em>Less : 1) Exp. on petrol</em></td>
<td></td>
</tr>
<tr>
<td>deduction U/s 16(1)</td>
<td></td>
<td></td>
<td>and maintenance of car</td>
<td></td>
</tr>
<tr>
<td><strong>(33.33% of one lakh or 12000 which ever is less)</strong></td>
<td>12,000</td>
<td></td>
<td><strong>2) Interest on loan taken</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>for car</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>3) Dep. on car</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Net salary</strong></td>
<td>88,000</td>
<td></td>
<td><strong>Net Income</strong></td>
<td>28,000</td>
</tr>
<tr>
<td><strong>Tax liability</strong></td>
<td>15,800</td>
<td></td>
<td><strong>Tax liability</strong></td>
<td>NIL</td>
</tr>
</tbody>
</table>

**NOTE :** Tax liability is computed on the basis of Finance Act. 1992.

**SOURCE :** Developed by Researcher.
TABLE 3.2

Effect of Rises in Petrol Prices on the Tax Liabilities of Salaried Person and Businessman

<table>
<thead>
<tr>
<th></th>
<th>Before increase in petrol prices</th>
<th>After increase in petrol prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaried person</td>
<td>Rs.</td>
<td>Rs.</td>
</tr>
<tr>
<td>Gross salary</td>
<td>72,000</td>
<td>72,000</td>
</tr>
<tr>
<td>Standard deduction</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Turnover</td>
<td>6,00,000</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Cost of turnover</td>
<td>5,40,000</td>
<td>5,43,600*</td>
</tr>
<tr>
<td>Taxable income</td>
<td>60,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Tax liability</td>
<td>11,600</td>
<td>11,600</td>
</tr>
<tr>
<td>Businessman</td>
<td>Rs.</td>
<td>Rs.</td>
</tr>
<tr>
<td>Gross salary</td>
<td>72,000</td>
<td>72,000</td>
</tr>
<tr>
<td>Standard deduction</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Turnover</td>
<td>6,00,000</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Cost of turnover</td>
<td>5,43,600*</td>
<td>5,43,600*</td>
</tr>
<tr>
<td>Taxable income</td>
<td>56,400</td>
<td>56,400</td>
</tr>
<tr>
<td>Tax liability</td>
<td>10,160</td>
<td>10,160</td>
</tr>
</tbody>
</table>

* The cost of turnover is increased due to the 25% and 20% rise in petrol prices.

** Tax liabilities are computed on the basis of provisions of Finance Act 1991.

SOURCE: Developed by Researcher.
<table>
<thead>
<tr>
<th>Rate of Inflation</th>
<th>Nil</th>
<th>7%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of Investment</td>
<td>1,00,000</td>
<td>1,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Less : Reduction in the real value of investment due to inflation</td>
<td>Nil</td>
<td>7,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Balance</td>
<td>1,00,000</td>
<td>93,000</td>
<td>88,000</td>
</tr>
<tr>
<td>Add : Interest @ 12% p.a.</td>
<td>12,000</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Value of Investment after one year</td>
<td>1,12,000</td>
<td>1,05,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Increase in the value of Investment</td>
<td>12,000</td>
<td>5,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Income tax *</td>
<td>54,000</td>
<td>5,400</td>
<td>5,400</td>
</tr>
<tr>
<td>After tax real return on Investment</td>
<td>6,600</td>
<td>-400</td>
<td>-5,400</td>
</tr>
</tbody>
</table>

* Based on the assumption that the marginal income-tax rate for this individual is 45 per cent.

**SOURCE:** Developed by Researcher.
### Table 3.4

**Effect of Surcharge on the 'After Tax Income'**

<table>
<thead>
<tr>
<th>Present System</th>
<th>Suggested System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income 1,00,000</td>
<td>Income 1,00,000</td>
</tr>
<tr>
<td>1,00,100</td>
<td>1,00,100</td>
</tr>
<tr>
<td>1,04,220</td>
<td>1,04,220</td>
</tr>
<tr>
<td>Tax liability  19,400</td>
<td>Tax liability  19,440</td>
</tr>
<tr>
<td>21,773*</td>
<td>23,619**</td>
</tr>
<tr>
<td>After tax income 80,600</td>
<td>After tax income 80,600</td>
</tr>
<tr>
<td>78,327</td>
<td>80,655</td>
</tr>
<tr>
<td>80,601</td>
<td>82,929</td>
</tr>
</tbody>
</table>

* Rs. 19,440 + 12% of 19,440 = Rs. 21,773

** Rs. 21,088 + 12% of 21,088 = Rs. 23,619

**SOURCE:** Developed from the Finance Act, 1992.