Chapter IX

CHOICE OF THE TAX UNIT
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A base erosion study remains incomplete without a consideration of the tax unit. For even with a comprehensive base, in a progressive tax system, equity cannot be ensured unless the tax unit is properly defined. In fact taxation according to ability to pay can have no meaning unless whose ability is being measured is specified first. Though independent of the comprehensive base concept, "definition of the taxable unit has its logic", to quote Musgrave, "derived... from the underlying concept of ability to pay." Failure to define the taxable unit appropriately provides scope for splitting the base and thereby defeating progression.

Tax entities in Indian Income Tax - Consequences of multiplicity

The scheme of income taxation in India centres around the 'individual'. The Indian income tax law however recognizes, besides the 'individual', six other tax entities, namely, the 'Hindu Undivided Family' (HUF), 'Company', 'Firm', 'Association of Persons', 'Local Authority', and 'Artificial Juridical Person', not falling within any of the other categories. Cooperatives

3 Sec. 2(31) of the Income-tax Act, 1961.
are assessed as 'Association of Persons' but there is a special rate schedule for cooperatives. There are six other rate schedules applicable to different entities. For HUFs alone there are two schedules, one for HUFs with at least one member having taxable income and one for others. Firms are classified as registered and unregistered. Income of a registered firm (RF) is included in that of its partners and taxed although the firm itself is required to pay some tax on its income, while that of an unregistered firm (URF) is aggregated with the partners' other incomes only for rate purposes. The URF itself is liable to tax like an individual. The tax rates for not only the individuals and HUFs but the intermediaries like RFs, are marked by a degree of progression. Even the tax on companies which was made an 'absolute tax' (i.e. with no credit to shareholders) from 1959-60 is graduated, even though mildly.

While companies are taxed independently of the shareholders, levy of income-tax separately on intermediaries like RFs reflects the response of the policy-makers to the widespread use of these entities as devices to reduce tax

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4 Firms which follow a certain discipline as laid down in the Act (Sec. 184) are called 'registered'; others are treated as 'unregistered'.

5 Income of registered firms (net of income tax paid if any) is allocated to the partners and taxed in their hands (vide Sec. 67).
liability through income splitting (e.g. by setting up dummy partners) and the failure of the authorities to counter such practices otherwise. Continuous effort to contain it notwithstanding, erosion of the income tax in India through income and wealth splitting seems to continue unabated. Among the factors which frustrate the efforts to counter avoidance through income-splitting, the major ones are: 1) absence of any arrangement to treat the family as the basic unit for personal taxation; 2) continued recognition of the HUF as a tax entity, and 3) failure to integrate the taxation of intermediaries with that of individuals or households. These factors have also been responsible for a good deal of confusion about the implications of equity in taxation and needless complications in the tax laws. The first two factors are dealt with in this chapter. Treatment of intermediaries is considered in the next.

That in a tax system in which the individual is the basic unit progression can be defeated through income splitting among family members or other devices is amply recognized in the Indian income tax as is evident from the elaborate provisions in the Income-tax Act designed to counter avoidance through transfer of assets among family members (vide Sec. 64). It is however not realized that any attempt to counter such

6 'Family' as contemplated here means the nuclear family, that is, the family consisting of the husband, wife and minor children.
avoidance, indeed the very notion that reduction in one's tax liability achieved through income or asset splitting among family members amounts to avoidance, reveals an implicit recognition that equity in progressive taxation can have no meaning without reference to the family. It is also not realized that if avoidance through income-splitting is to be countered effectively there is no alternative to treating the family itself as the basic unit. For no amount of anti-avoidance legislation can take care of the avoidance possibilities which are opened up by taxation on the individual basis coupled with the recognition of entities like HUF. A brief review of the ways in which legislation designed to counter avoidance of income tax through income splitting has been circumvented would bring out the futility of attempting to prevent the erosion of the income tax simply through such measures.

Measures to counter avoidance through intra-family transfers and their limitations

With a view to countering avoidance through transfer of assets among family members, the Indian income tax has provided, since 1937, that income arising from assets transferred by an individual to his wife and minor children (excluding daughters, if married) otherwise than for adequate consideration shall be aggregated with the income of the transferor.  

7 Sec. 16(3) of the Indian Income-tax Act, 1922 and Sec. 64 of the Income-tax Act, 1961.
Income arising to a wife or minor children of an individual from the partnership (or from admission to the benefits of partnership) in a firm in which he himself is a partner has also to be aggregated with the income of the individual. Possibility of avoidance by forming a registered firm consisting of one's wife and children was noticed by the Todhunter Committee and a measure to defeat such attempts was suggested by that Committee. Numerous ways have however been found to get round these legal impediments to avoidance.

One handy method of achieving this is to resort to 'cross transfer', that is, a scheme of transfer of assets by two taxpayers to each other's wife or minor children. Of course, where the two transfers are so intimately connected that they cannot but be regarded as parts of a single transaction, the courts have held that the tagging provisions of the law will apply. But these provisions cannot be applied unless the arrangement is 'palpable'. In a case where the assessee made a gift of Rs.1,50,000 to the wife and minor children of his son ('K') by his first wife and five months later the son transferred an exactly similar sum to the assessee's second wife ('K's' step mother), the Bombay High Court refused to treat the arrangement as one of cross-transfer. In another case, the assessee made

10 CIT v. Wadilal Chunilal (1963) 47 ITR 305.
a gift of some shares to his sister and his maternal uncle, both of whom, a few months later, gave away the very same shares to the minor sons of the assessee. The court held that the tagging provisions were not applicable in this case as no interconnection could be established by the Revenue between the two transfers. For similar reasons where a wife received a property from her husband and later transferred the same to her minor son, the income arising to the son from the asset was not allowed to be assessed in the hands of the father. Besides, the tagging provisions do not apply where the cross transfer is made to wife or minor children through the medium of a trust, notwithstanding a provision in the law designed for the purpose, because it has been held that the words 'directly or indirectly' used in the case of direct transfers do not occur in the clause governing a transfer through a trust.

Even the use of the words 'directly or indirectly' has not ensured the aggregation of incomes arising from transfer to one's minor children in all situations. Where a taxpayer retired from a partnership which was reconstituted the next day with three of his minor sons admitted to the benefits of partnership,

12 K. K. Porbunderwalla v. CIT (1972) 85 ITR 385.
13 CIT v. Framji Commissariat (1967) 64 ITR 588.
14 Sec. 64(1)(v).
each contributing to the capital, Rs. 75,000 each, received admittedly from their father as gift, the Supreme Court ruled that income arising to the minor sons from the firm could not be said to arise directly or indirectly from the assets transferred by the assessee. The reason advanced for this decision was that, "there is no nexus between the transfer of the assets and the income in question." For the provision to come into operation the connection between the transfer and the income, it was said, must be 'proximate'. What exactly is implied by 'nexus' in a given situation was however not elaborated. One researcher on judicial attitude to tax avoidance in India felt "the circumstances of the case justified a contrary conclusion." The justification given by the Court for the decision was that the section creates an 'artificial liability' and requires to be given a strict construction.

As a result of this emphasis on strict construction all 'secondary' incomes, (that is income from the investment of income) arising from assets transferred by a taxpayer to his spouse/minor children have been held to be not liable to be

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16 K.D. Gaur (1973). The following observations of Gaur are of interest in this context: "One fails to understand the conflicting statements made by the Court in one and the same para of the judgement. On the one hand, the Court admitted that the amount contributed by each of the minors came from his father's gift to him, but on the other hand, it said that the connection between the gift and the income in question was remote."
aggregated with that of the transferor. Another way of bypassing the provision has been to arrange the transfer in such a way that the benefits arising to the transferee get deferred.

The doctrine of 'strict construction' thwarted the application of the tagging provisions in several other instances of transfer arranged for the benefit of the transferor's wife and minor children. Reference may be made to the ruling which negated aggregation where the transfer was made through the medium of the HUF of which the transferor was a member along with his wife and minor children. This decision was premised on the

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17 Popatlal Bhikam Chand v. CIT (1959) 36 ITR 577. In this case bonus shares were issued against shares transferred by the taxpayer. Dividend on the bonus shares could not be assessed in the transferor's hands as it was not income derived directly from the transferred asset. See also, CIT v. Phirozshaw Pallonji Mistry (1959) 36 ITR 582.

18 Deferred benefit can now be tagged in the hands of the transferor if the transfer is made to a trust for the benefit of one's spouse or minor child. That is possible because of an express provision in the law enacted to override the decision of the Supreme Court in CIT v. Manilal Dhanji (1962) 44 ITR 876 (S.C.). One tribunal judgement however suggests that the change has probably misfired (C. M. K. Joshi v. ITO, Taxation, Sept. 1972). The Appellate Tribunal has held that when the benefit is deferred till say the attainment of majority of the beneficiaries, no income arises to them until they become major.

reasoning that throwing of one's individual property into the HUF common stock or the receipt of one's share on a partition of joint family property does not constitute 'transfer' in law. Since the provisions have to be strictly construed, a disposition of assets must be clearly a transfer in law if they are to be invoked. Hence, not every kind of passing of property from one to another will come under the mischief of the provisions. Thus where a tax payer who had life interest in certain property under his father's will released his interest in favour of his sons, it was held that the release did not constitute transfer.

The law has been changed from time to time in order to plug the loopholes. But not all of them are closed yet. A major obstacle to the enforcement of these provisions is the doctrine that there must be a 'proximate' link between the transfer and the income. The requirements laid down by the courts in this regard are so exacting that it is often impossible to satisfy them. Because of this requirement, it is often difficult to include the income arising to a minor from a firm in which his father is a partner even though there is

20 Gift tax too was held inapplicable when a member of a HUF impressed his own property with HUF character. Goli Eswariah v. CGT (1970) 76 ITR 675.

a provision to this effect. Following the principle of proximity a distinction is drawn by the courts between accumulation of profit in a minor's account in a firm and amounts kept in deposit in the minor's account by an express contract, interest on the latter alone being liable to be included in the income of the father even if the original sum comes from the latter.

Factors facilitating income-splitting - Recognition of HUF as tax entity

Attempts to prevent avoidance of tax through intra-family splitting of income and wealth/assets have encountered difficulty almost everywhere. What compounds the difficulty in this country is the recognition of the HUF as a tax entity. Where a taxpayer can have two sources of income, taxed independently, avoidance becomes obviously easy. Avoidance through this medium is greatly facilitated by the peculiar character of the rights of a 'coparcenary' and the extraordinary ease


24 This is how the members of a Hindu Undivided Family belonging to the 'Mitakshara School' who are entitled to claim partition are described. In families governed by the other principal school of Hindu law viz. Dayabhaga, the members are merely co-owners and not 'coparceners'. The bulk of the Hindus however are governed by the Mitakshara School.
with which HUFs can be formed as well as broken, and one's personal assets can be mingled with the joint family stock. Through successive rulings of the courts it came to be established that the assets of a HUF can be parcelled into as many slices as there are members or even more. It is also possible to effect a partial partition of the assets simply by going through a motion of partition - when the asset happens to be a business, by merely dividing the capital in the account books without any division by 'metes and bounds'. Assets can also be transferred by a Karta (or the head) of a HUF out of the joint stock to the members or their wives without inviting the description of 'transfer' in law and conversely. What is more, no formality of writing or registration is needed for such re-designation of the title to the assets. Moreover, a HUF can be brought into existence by a Mitakshara Hindu without the requirement of the existence of a family corpus or of any lineal male descendant. It is also possible for a Hindu of the Mitakshara School to belong to more than one HUF simultaneously.

25 Bhimraj Bansidhar v. CIT (1954) 26 ITR 185; Charandas Haridas v. CIT (1960) 39 ITR 202 (S.C.). Where the asset consists of the HUF's interest in a firm, it can be partitioned among the members merely by dividing the capital invested by the HUF in the firm in its own (HUF's) account books, opening ledger accounts in the names of the separating members and crediting the said accounts with their respective shares. No entry to reflect this change is needed in the account books of the firm.


27 Gowli Buddanna v. CIT (1966) 60 ITR 293.
each representing a separate taxpaying unit apart from the individual himself. For the courts have held that there can be a smaller HUF within a large HUF which can hold property as a unit to the exclusion of the large family and that separate property of any of the coparceners of the large HUF can be impressed with the character of joint property of the smaller family. Thus, where an individual belonging to a HUF consisting of his father, himself and his two sons claimed that some of his assets (moneys received by him from his maternal grandfather as gift) had been thrown by him into the common stock of the smaller family consisting of himself and his sons, the High Court upheld the claim. Conversely, where an assessee at first filed his return of income in the status of a HUF but subsequently filed two returns for the same year, claiming that a portion of the income shown originally as belonging to the HUF in fact belonged to him in his 'individual' capacity as it was derived from assets received through a settlement made by his grandfather, the contention was accepted by the Gujarat High Court. The decision turned on the nature of interest which was conveyed through the settlement. An earlier decision of the Supreme Court laid down that it all depended on the intention of the settlor or the donor, viz. whether he intended that the donee should take the property in his own absolute

right or as the head of the family to which he belongs. Where so much turns on mere intention, it is evident that taxpayers can create new units virtually as and when it suits them. That the HUF as an institution survives only as an avoidance device is recognized even by those who do not accept the suggestion for marital unit taxation.

**Quantitative Significance**

It is difficult to specify in precise quantitative terms the significance of avoidance practised through intra-family dispositions as there is no reliable information on the family-wise distribution of income according to income-range or about the spouses and minor children of individuals whose incomes exceed the exemption limit or would be taxable if aggregated with those of their family members. An attempt may however be made to estimate the probable dimensions of avoidance practised through the HUF medium.

Estimates made by I. S. Gulati & K. S. Gulati some years ago showed that on certain assumptions the annual loss to revenue on account of 'tax avoidance action of the HUFs' ranged between Rs. 30 crores and Rs. 150 crores. The estimates related

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30 Arunachala Mudaliar v. Murugantha Mudaliar, AIR 1953 S.C. 495.

31 See for example S. Bhoothalingam, "Family as a Taxable Unit", in *Family As A Taxable Unit* (1974), ed. L. M. Singhvi.

to the years 1957-58 and 1958-59 and were made by comparing what the tax liability of the families would have been had there been no partition or intra-family transfers of joint family assets with the tax which becomes payable after such partitions or divisions are gone through. The estimates varied according to the assumptions about the number of tax units created on partial partition. In a subsequent study I. S. Gulati estimated that the gain to revenue might be of the order of ₹.22.45 crores, if the HUF was 'de-recognized' as a tax entity and the income was allocated among the members entitled to ask for partition and if incomes arising to wives and minor children were aggregated with that of the husband.33

There may be a bias in Gulati's estimate since he proceeds on the assumption that each HUF income recorded in a tax assessment represents the remnant of a bigger HUF's income left over after going through the process of splitting on the assumed pattern, which may not be true of every family. On the other hand, the possibility that the income of some of the HUFs may have become non-taxable after partition (so that the number of such HUFs would not be reflected at all in the tax data) suggests that the figure arrived at by Gulati may be underestimate. Again HUFs carrying on business often pay salary to the family members for looking after the business and the courts have ruled that

such remuneration must be assessed separately as the income of the members. Gulati's estimates do not take the effect of these practices into account. Studies carried out at the instance of the Wanchoo Committee also revealed that the number of income tax files in respect of each family was more than the total number of members in the family and in one case the income tax and wealth tax avoided was as high as 60 per cent and 50 per cent respectively. The Committee however did not explain what exactly it meant by 'avoidance' in this context. As an estimate of the gain to revenue likely to result if HUF's are derecognised and the incomes thereof, aggregated with that of their members, the figure of Rs. 22.45 crores arrived at by Gulati in his later estimate seems to be on the conservative side. An alternative estimate attempted below suggests so.

The number of HUF's assessed to income tax, income assessed in their hand and the tax levied in 1969-70 and the preceding five years are as follows:

34 Supreme Court in Jugal Kishore Baldeo Sahai v. CIT (1967) 63 ITR 238 (S.C.)
36 That is, whether the avoidance referred to by the Committee was measured with reference to what a bigger HUF would have to pay had it not undergone any partition or with reference to what the individual members would have to pay had the HUF income/wealth been allocated among them in their respective shares.
37 I. S. Gulati, op. cit., Sec. VI.
<table>
<thead>
<tr>
<th>Year</th>
<th>No. of HUFs</th>
<th>Total Income (Rs. crores)</th>
<th>Tax levied (Rs. crores)</th>
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<td>1964-65</td>
<td>75508</td>
<td>94.0</td>
<td>14.2 (15.1)</td>
</tr>
<tr>
<td>1965-66</td>
<td>93651</td>
<td>111.6</td>
<td>15.2 (13.6)</td>
</tr>
<tr>
<td>1966-67</td>
<td>80049</td>
<td>111.1</td>
<td>18.8 (16.9)</td>
</tr>
<tr>
<td>1967-68</td>
<td>73570</td>
<td>110.3</td>
<td>20.5 (18.5)</td>
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<tr>
<td>1968-69</td>
<td>87637</td>
<td>133.5</td>
<td>23.2 (17.4)</td>
</tr>
<tr>
<td>1969-70</td>
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<td>140.55</td>
<td>26.2 (18.6)</td>
</tr>
<tr>
<td>1971-72</td>
<td>84192</td>
<td>149.1</td>
<td>33.8 (22.7)</td>
</tr>
</tbody>
</table>

Source: All India Income Tax Revenue Statistics (Government of India).

Note: Figures in brackets indicate average tax rates (in percentages).

Going by the trend, the total income of HUF assesseses in 1974-75 may be taken to be around Rs.180-200 crores. The average tax rate on HUFs, it may be presumed, has gone up as a result of the introduction of special rates for HUFs with a member having taxable income. Even so, the average rate is unlikely to be more than 20 or 22 per cent. It may not be wrong to assume that if allocated to that of the respective members, the HUF incomes would, in most part, bear tax at rates ranging from 40 to 60 per cent (assuming that...
splitting among minors and spouses would not be permitted), for the maximum advantage of the HUF medium is taken by taxpayers in the upper brackets and in the upper ranges of income the marginal gain to such taxpayers may be as high as 20 to 40 per cent of the incomes shown in HUF returns. For instance, if an individual having income exceeding Rs. 50,000 also derives income of say Rs. 5,000 from a HUF along with three brothers (each representing a smaller family), all similarly placed, at 1975-76 rates, the HUF income (Rs. 20,000) would bear tax at the rate of 15.5 per cent (Rs. 3,100 over Rs. 20,000) whereas, if the shares of the smaller HUFs were aggregated with that of the smaller families, the rate of tax would have been 50 per cent or more. On an average the gap between the two rates may therefore be taken to be about 25-30 per cent. The gain to revenue from derecognition of HUF can thus be put safely at Rs. 45-60 crores. This takes no account of HUFs whose income has been pushed below the taxable limit because of splitting.

By a similar calculation, the increase in wealth tax revenue likely to result from derecognition may be put at around Rs. 7-8 crores.

Measures to counter HUF avoidance

Several measures have been taken in recent years to counter avoidance through the medium of the HUF. First, the law has been amended to ensure that conversion of one's individual
assets into family property (made after December 31, 1969) will amount to transfer for purposes of income tax. Secondly, higher marginal rates of income tax have been prescribed since 1973 for HUFs any member of which has taxable income of his own.

Apart from being inadequate, the provision intended to thwart avoidance through conversion of one's assets into HUF property is much too complicated to be workable. Application of the provision in situations where the asset originally converted into family property undergoes sale or any other transformation will not be easy. The mode of determination of income in such cases is supposed to be governed by rules. No rule seems to have been framed in this regard so far. The higher rates of tax prescribed for HUFs having any member with taxable income would also be of little avail in meeting the problem of avoidance for the simple reason that the higher marginal rates will not be applicable unless the HUFs themselves have sufficiently large income. Cases where the HUF itself has a large income are not likely to be many, since most HUFs split their incomes to low levels. The 1961 Act sought to import some rigour into the matter of recognition of partial

38 Sec. 64(2) of the Income tax Act 1961 inserted by the Taxation Laws (Amendment) Act, 1970.

39 The Act contemplates that suitable rules will be framed for the purpose.

partitions but according to commentators, the position has not really changed. Avoidance through the HUF medium thus continues both in income tax and wealth tax, apart from the fact that the availability of this facility to only a particular section of the tax payers - viz., the Mitakshara Hindus - is a source of discrimination.

41 See Iyengar, op. cit., p. 1696.

42 The Gulatis think that avoidance through transfers is far easier for Dayabhaga families (Gulati & Gulati, op. cit., p. 33, f.n. 2) but this does not seem to be the case. For when the Karta of a Dayabhaga family transfers any property to his wife and children the transfer is squarely hit by the provisions of Sec. 64 of the Act since in such families the father is the absolute owner of the properties during his life time.

43 It is interesting to note that neither Jains nor Hindus converted to Christianity even when governed by Hindu law in the matter of succession can constitute an HUF for tax purposes (CWT v. Champa Kumari Singh (1968) 67 ITR 561; P. F. Pinto v. CWT (1967) 65 ITR 123). In the case of Dayabhaga Hindus the HUF status cannot be secured as easily as under the Mitakshara law. For, unlike Mitaksharas, a Dayabhaga does not acquire any interest in the family property during the life time of his father. Nor do the heirs of a Dayabhaga male form an HUF automatically on the death of their father (CWT v. G.S. Bhar (1968) 68 ITR 345). The discrimination is particularly acute in the incidence of estate duty. For as between two families, one governed by the Mitakshara law and the other, non-Mitakshara, both having assets worth Rs. 8 lakhs to start with, it can be easily seen that the Mitakshara family has to pay by way of estate duty in the course of two generations, not more than Rs. 96,600 whereas in the case of the non-Mitakshara one the burden exceeds Rs. 3 lakhs, assuming that each family consists of a husband and wife and two sons and the sons again beget two sons each.
Widespread avoidance through intra-family splitting of incomes and transfer of assets via the HUF or otherwise prompted the Wanchoo Committee to make several recommendations to plug the loopholes. Many of these recommendations have been accepted by the Government. Higher marginal rate for certain HUFs is one of them. Highlights of the further measures proposed in the Bill recently passed by Parliament are:

(i) income arising to the spouse of an individual by way of salary, commission, fees, or any other form of remuneration from a concern in which the individual has 'a substantial interest' will be included in the income of the individual,

(ii) income arising to a minor child from any partnership will be aggregated with that of his/her father or mother depending on whose income is greater, irrespective of whether any one of the parents is a partner in the firm or not;

(iii) income arising to one's son's wife or son's minor child from assets transferred directly or indirectly by him will be included in the income of the transferor;

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44 Clause (ii) of Sec. 64(1) as redrafted under Taxation Laws (Amendment) Act, 1975. The Select Committee amended the provision in order to exclude incomes earned by a spouse by virtue of technical or professional qualification.

45 Clause (iii) of Sec. 64(1) of Income-tax Act, 1961, as it stands after the amendment.

46 Clause (vi) of Sec. 64(1) as amended.
(iv) indirect transfers for the benefit of spouse or minor children (i.e., transfer through trusts etc.) will now be covered by the tagging provisions;

(v) where the asset transferred directly or indirectly by an individual to his spouse or minor child is utilized in any business, income arising therefrom will be aggregated in the income of the transferor;

(vi) secondary income from transferred assets will also be taxed in the hands of the transferor.

The provision introduced in 1970 to extend the tagging provisions to transfers via HUF has also been amended to secure that the income arising from an individual's self-acquired property converted into HUF property will be included in full in the assessment of the individual. All these measures, it is stated, are intended "to curb tax avoidance practised through transfer of assets or income to members of one's family."

47 Clause (vii) of Sec. 64(1).

48 Explanation 3 inserted in Sec. 64(1).

49 Proposed Explanation 4 to Sec. 64(1). This change was not proposed in the Wanchoo Committee Report. The proposal was however dropped by the Select Committee.

50 Section 13(b) of the Taxation Laws (Amendment) Act, 1975.

It is doubtful whether avoidance through intra-family transfers can be curbed effectively even with all the changes in the law recently carried out. For as past experience shows so long as the individual continues to be the basic unit of assessment, and the courts adhere to the 'strict construction' rule, ways can always be found of circumventing the legal hurdles to income splitting within the family.

Then there are practical difficulties for which the legal provisions within the existing framework cannot provide any solution. Identification of the corpus of a gift or the income therefrom after it is mingled with other investment or after it has undergone reinvestment in other forms is not easy. Hence, the proposals to rope in secondary incomes (since dropped), would give rise to questions as to whether a given investment of the wife or minor children who had once received some assets from their husband/father, represented the accumulated income from those assets and the onus would be on the Revenue to prove that it was so. As it is, recognition of 'Stridhana' (assets

In a case decided by the M.P. High Court investments standing in the name of the wife were explained by her husband as financed from gifts received by her from her father without any supporting evidence. The court rejected the Revenue's attempt to tax the undisclosed income in the husband's hands on the ground that there was nothing to show that the investments were financed out of the husband's money. Prem Dutt Ahuja v. CIT (1970) 78 ITR 530/.

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derived by women from various sources like parents etc.) makes it virtually impossible to identify these assets transferred by the husband. The new provisions would add to the complications. Again, the requirement of establishing a proximate relationship between the income and the asset transferred would have to be satisfied even with the recent changes in the law. This test alone can frustrate the application of anti-avoidance measures in most cases. In any event, since 'transfer' does not include transactions of loan or advance, nothing can prevent an individual from splitting his income by camouflaging a transfer as an advance of loan to his spouse or minor children. The courts have held that such transactions would be outside the scope of the anti-splitting provisions. To prove that a loan transaction of the kind is not genuine presents virtually insuperable difficulties for the revenue authorities. Even where a loan was advanced by an individual to his minor son and the same was accepted by the individual himself as the guardian of the son, the ITAT held that the interest on the investment made with the loan could not be included in the income of the father. One High Court

53 R. K. Murthy v. CIT (1961) 42 ITR 379. Judicial decisions holding that a loan is not a transfer of property were referred to by the Carter Commission as one of the anomalies resulting from the failure to tax the family as a unit (Report of the Royal Commission on Taxation (1966), vol. 3, p. 121).

54 ITAT, Delhi Bench in XYZ v. ITO, Taxation, Nov. 1972.
was even persuaded that transfer of assets to minor children meant for their maintenance according to their status and accustomed standard of comfort constituted transfer for adequate consideration and therefore fell outside the purview of the tagging provisions.

The foregoing discussion shows why attempts to counter avoidance through income splitting cannot succeed unless income is assessed family-wise. Such attempts not only create burdensome complications in the law but lead to incongruities and anomalies. Take, for instance, the recent amendment to the law which will have the effect of aggregating in the incomes of an individual the income arising to minor children from the benefit of any partnership irrespective of whether the individual is a partner in that firm. If income of this type is aggregated then what is the logic for not aggregating income arising to a minor from other types of investments? Similarly, if salary, commission or any other form of remuneration received by the spouse or minor children from a concern

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55 Viswasam v. CIT (1963) 50 ITR 503.

56 In every such case the tax-officers have to keep track of the identity of the assets originally invested and the incomes therefrom. Where both the spouses have income of their own aggregation has to be made in the hands of the spouse whose income is larger and so on. Decision taken once in this regard cannot be changed. It is quite possible that this will serve as an avoidance device and will be a source of constant friction between the taxpayer and the tax collector.
in which the taxpayer has substantial interest is included in the income of the taxpayer what is the justification for not including the income arising to the spouse or minor children from a business connection (say a selling agency) with a such concern? The dilemma here is obvious. Absence of such a provision opens up scope for avoidance while, if avoidance is to be countered effectively, there is no alternative but to widen the range of incomes to be aggregated going beyond those arising from transferred assets. Again, when transfers to major sons do not entail tagging of income in the hands of the transferor, it is hard to see why transfer to a major son's wife or minor children should invite aggregation.

A little reflection would show that the anomaly stems from an ambivalence in the matter of choice of the tax unit. While taxation on an individual basis reflects a reluctance to look upon the family as the proper unit the measures intended to defeat transfers and alienation of income within the family are indicative of an implicit recognition of the family as the basic unit. It does not make sense to say that any income-split

57 It may be said that the law contains a provision authorizing disallowance of expenditure in business involving payment to any relative of the owner or to any relative of one having substantial interest in the concern, if the expenditure is considered by the ITO to be excessive or unreasonable [Sec. 40A(2)]. But such a provision obtains in the Act also in respect of remuneration paid by companies [Sec. 40(c)]. There was no need to enact a separate provision in respect of remuneration paid to wife and minor children through a business while leaving out income arising through a business connection.
resulting from an intra-family transfer constitutes tax avoidance unless one assumes that all incomes arising to the members of a family should be regarded as that of one unit viz. the family. The proposal to disregard transfers to daughters-in-law and grandchildren goes even beyond that and implies that treating the bigger family also as one unit may be justifiable. The fact is that unless it is recognized that a system where individuals are taxed as separate units is essentially unfair, "attempts to prevent abuses of the system", to quote the Carter Commission, produces "serious anomalies and rigidities". Though the case in equity for treating the family as the tax unit is fairly straightforward discussions on the issue in India tend to ignore it. It is therefore necessary to take note of the basic equity reasons that argue for levying the progressive income tax (or for that matter any progressive tax) on a family basis.

Family as the tax unit - The case in equity

Contrary to the idea propagated by opponents of family taxation in this country, viz. that it violates equity, in the

58 Report of the Royal Commission on Taxation (1966), vol. 3, Ch. X.
59 The study group on Australian taxation also ran into such anomalies when they recommended the aggregation of all incomes (other than salary and wages received by members from employers at arms length) to be aggregated with the largest wage or salary income of the family. Downing, Arndt, Boxer and Mathews, Taxation in Australia (1964), paras 318-19.
opinion of many public finance experts the unit which accords best with the ability to pay principle is the family. Most of the well known studies on the question conclude in favour of adopting the family as the basic unit. The two British Royal Commissions on Taxation (of 1920 and 1955) supported retention of the marital unit for taxation of income. The Carter Commission too argued strongly in its favour. The fundamental consideration which weighs in favour of family unit taxation is, as two British authors put it, that —

...most married couples pool and share their incomes, acting as a common income and expenditure unit, so that the economic well-being of each member of the unit is a function of joint rather than independently received income. If the equity criterion is to be observed, it follows logically from the sharing and joint-budgeting argument that a married couple should be treated as a single unit for determining their ability to pay income tax.

There may of course be instances of husbands and wives acting as independent units, but such instances cannot be regarded as common in a country like India. Moreover even

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61 Marshall & Walsh, op. cit.
in advanced societies "the enjoyment of economic, political and social opportunities attributable to income are more a function of marital income than the income received by each spouse."

That in judging the relative economic position of citizens differences in family circumstances cannot be ignored is underscored by the consideration invariably given to the family context for purposes of social security arrangements (as in the U.K. National Assistance Act of 1948). It is not without reason that measurements of inequality generally proceed on a household or family basis. The argument put forward by the Carter Commission while recommending family unit taxation was also based ultimately on considerations of equity. "Taxation of the individual in almost total disregard for his inevitably close financial and economic ties with the other members of the basic social unit of which he is ordinarily a member, the family", the Commission remarked, "is in our view another striking instance of the lack of a comprehensive and rational pattern in the present tax system."

62 Marshall & Walsh, op. cit. This argument was put forward earlier by Thorson, op. cit.

63 Vide, for example, Thomas Stark, The Distribution of Personal Income in the United Kingdom 1949-1963 (1972). In this study, the 'nuclear' or 'the inner family' as the author calls it, is taken to be the definition of the income recipient.

64 Report of the Royal Commission on Taxation (1966), vol. 3, Ch. 10.
Objections to the family unit

Objections to taxation on family basis centre usually around two points viz. i) that it violates the equality of man and woman, and ii) it transgresses the individual's right to hold property. None of these arguments however bears scrutiny.

The charge of discrimination against women, it can be easily be seen, is based on fallacious reasoning. Since a husband and his wife are treated as the same for purposes of calculating the tax on the married couple as a unit, no violation of the principle of equality of sexes is involved if the marital couple is treated as one for purposes of taxation.

To think otherwise is to miss the fact that in the aggregation process no weight is attached to the income of the husband just because he is the male spouse.

The argument in favour of taxation according to individual title to income or property is equally indefensible. Apart from the fact that the family income is essentially a joint product, taxation on individual titles produces gross disparity in the incidence of the tax burden as between two

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65 Oldman & Bird, op. cit.

66 cf. "Who is to say that the economic gains that follow marriage are attributable more to the efforts of one spouse who holds the job than to the partner who supplies the inspiration and the care of home and children". H. Groves, "Taxing the Family Unit: The Carter Commission's Proposals and US Practice", NLI, March 1969.
similarly circumstanced families, depending on whether the income of the family is earned by one spouse or both or by 67 minor children as well. Moreover, the fact is that "in the vast majority of cases the spending habits and living standards of husband and wife are dependent on the same factors" and "income is meaningful to each of them more on the basis of relative needs than according to which of them earned it".

For equitable distribution of the tax burden, title is not the only significant aspect of property. What matters more than the legal technicality of ownership is control and enjoyment, and many will be inclined to agree with Groves that in these matters the safest presumption is that the family as a whole (at least its adult members) is the decision-making unit, the male spouse playing the larger role in the management of investments - even of those owned by the wife - and the wife having the decisive role in determining the consumption budget. Separate title is thus no ground for treating the incomes of family members separately for taxation.

67 Under the system prevailing at present the tax liabilities of two families (of the same size) both with incomes of Rs.20,000 per annum may differ by as much as Rs.1,397, if the income in one family is earned by one spouse and in the other by both, in fact, the liability of the latter is less than half of the former's.

68 Oldman and Bird, op. cit.

69 Groves, "Taxing the Family Unit", op. cit.
Problems of Marital Unit Taxation

It should be recognized however that taxation on the basis of the marital unit gives rise to problems bearing on the equity and the neutrality criteria. The problem in equity arises because, for various reasons, families with the same income may not be equally well-off. The question of neutrality figures in this context for two reasons: (1) because of the omission of imputed income of housewives from the tax base, taxation of married women's income earned through employment outside the home tends to distort their choice between staying at home and working outside, and (2) when both the spouses happen to be earning, marital taxation usually entails a heavier tax burden on a married couple than what they would have to pay if assessed separately; this, it is argued, tends to cause a bias against marriage. In India an additional argument used against taxation on family basis is that it would be violative of the fundamental rights guaranteed under the Constitution. Since the merit of family-wise taxation is often obscured by doubts raised on these grounds it will not be out of place to consider how sound they are.

Two families with the same income may not have the same taxable capacity either because of differences in size

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See for example, Manjula Bose, "Aggregation of Income of Spouses", in Family as a Taxable Unit, op. cit.
or because the income is earned wholly by one spouse in one family and by two spouses in the other. The family in which only one of the spouses works outside would presumably be better off than the other. The inequity would not arise if the value of the wife's domestic services was included in the taxable income of the family in which the wife is not employed.

But imputing a value to a housewives' domestic services is not simple. If the transfer earning of the wives (viz. the market return at which the tax unit would be indifferent between the wife remaining at home and undertaking full-time employment) could be evaluated, it would remove the inequity and also ensure optimal allocation of married women's services. But valuation of wives' domestic services in this fashion is administratively infeasible. Another solution is to take the 'unrealised market earnings' of the wife as equivalent to her value to the unit. This also is not a practicable solution because assessment of potential earning power in the case of wives having no formal training in market skill would be open to large degrees of error. In many cases they may be simply unable to find work or unemployable.

71 Marshall & Walsh, op. cit.
72 Ibid.
A workable solution to the problem can however be found in a system of deduction designed to take account of the extra cost entailed by the wife's taking up employment. Problems arise in the determination of such costs too, for in many cases they reflect a consumption choice afforded by the increased spending power (e.g., hire of a baby-sitter). The Carter Commission took the view that many of the expenses of a working wife are of this nature. Because of insuperable problems involved in distinguishing the element of cost from consumption in such expenditures the child-care expense deduction permitted in US income tax (these were liberalised in 1971) has come in for criticism as a source of base erosion. It cannot be denied however that so long as imputed income from house-wives' domestic services remain excluded from the tax base denial of deduction of expenses on child-care where both the spouses are employed whole-time creates a bias against employment of married women outside the home. A standard deduction in the form of an allowance expressed as a percentage of the wife's (or the second spouse's) earned income with a lower and an upper limit would meet the requirement.


77 Thorson, op. cit. Raj Committee's recommendation for permitting a deduction of 10 per cent of the (f.n. contd.)
The inequity involved in taxing the wife's earned income without allowing any deduction for costs of earning does not however seem to be of such significance in India as is often made out for the simple reason that in the Indian families of the lower and middle income groups the wife continues to do most of the household chores even when employed outside while in the upper income groups ladies generally do not perform anything that suffers on account of their working outside. Child care expenses are incurred in such families irrespective of whether the wife works outside or not which shows that they are clearly in the nature of consumption.

Differentiation

Differentiation among tax units according to their size, where family is adopted as the basic unit, presents a

(footnote contd.)

wife's income with a minimum of Rs.1,000 and maximum of Rs.2,000 ran on these lines. In U.K. a wife's earned income allowance was granted on the recommendation of the Royal Commission of 1920. While criticising the provision for deduction of child care expense in USA, Feld agreed that a partial deduction for such expenses would not be so objectionable (Feld, "Another Word on Child Care", 28 Tax Law Review .1973).

The Carter Commission too, though opposed to any deduction to compensate for the loss of imputed income where the wife works outside, nevertheless recommended deduction for child care expenses.
more substantive problem. Need for differentiation arises even when the tax is levied on an individual basis if the personal (family) circumstances of the taxpayer is considered relevant for adjusting the degree of progression. Todhunter Committee's failure to recommend differentiation among taxpayers according to family circumstance evoked strong criticism from Niyogi in the twenties. Indian income tax did provide for some differentiation thereafter through a system of tax credit for dependants but it was discontinued from 1971-72, for the sake of simplicity in tax computation. If, however, the family is adopted as the basic unit, some differentiation is surely called for.

The two well known approaches to the problem of differentiation are: 1) the unit approach and 2) the per capita


79 Family allowance was first introduced in the Indian income tax in 1955-56 in the form of a higher initial tax free slab of Rs.1,000 for married individuals. From 1957-58 an allowance (by way of deduction) of Rs.300 for each dependent child (up to a maximum of Rs.600) was also given. The family allowance was however made available only to those having taxable income of not more than Rs.20,000. From 1965-66 the allowance was redesigned in terms of tax credit of Rs.100 for single taxpayer, Rs.175 for married individuals and an extra Rs.20 for each dependant child (up to two). These were slightly revised upward later. The allowances were however withdrawn from 1971-72 when the initial exemption was raised to Rs.5,000 uniformly for all non-corporate assesses. This was done to make for greater administrative simplicity and to give a small benefit to all income taxpayers (F.M.'s Budget Speech, 1970, part B, para 33).
approach. Under the unit approach a single individual and a married couple enjoying equal taxable income pay tax at the same marginal rate. Under the per capita approach the marginal rates of tax for a married couple and a single person are the same if their per capita taxable income are equal. The 'quotient' system which is in vogue in France represents an extreme form of this approach.

Exemptions provide a way of achieving differentiation under the unit approach. The underlying idea is that once the minimum requirements of families of differing sizes are met through exemptions, given increments of income confer the same taxable capacity irrespective of family status, which, however, is a questionable assumption. Moreover, definition of 'clear income' (that is, income in excess of that required to maintain a standard of minimum necessity) raises difficult questions as such standards are always relative.

The per capita approach, though apparently fair and neutral, suffers from several weaknesses. It fails to take account of the fact that two can live more cheaply per capita.
than one. Thus a system which taxes a bachelor at the same marginal rate as two persons, husband and wife, each earning the same amount of income can hardly be regarded as fair. This approach also ignores the fact that in the upper ranges of income a steadily declining percentage of income is required to maintain an adequate standard of living. It is thus clear that none of the two 'polar' approaches offers a satisfactory method of differentiation in their pure form. The unit method is harsh to the married couples while the per capita approach is harsh to the single individual and fails to take account of the economies of scale in living together.

**Modified per capita plans**

Modifications have therefore been suggested to both the schemes to meet the shortcomings and these modifications also serve to bring the two approaches together. Two proposals recently put forward with this aim are (1) introduction of a dual rate schedule and (2) a 'modified per capita approach'. The suggestion for the modified per capita approach was put forward by Thorson. Carter Commission favoured different rate schedules for single and married tax payers with emphasis on the tax unit's per capita income at the lower and of the scale and per family income at the upper levels. This reflects the view that in the upper levels taxable capacity is not signifi-

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82 Thorson, *op. cit.*
cantly affected by the marital status. Also, the purpose of graduation at higher levels of income is to curb the power and control that goes with higher incomes.

In Thorson's solution the single-marital differentials in the tax burden are based on relative costs in the lower and middle income ranges. The differentials in the marginal rates however taper off to zero in the upper income ranges. Thorson believes, this approach "incorporates and refines the modification of both of the polar approaches." In the modified per capita plan of Thorson tax differentials in the lower and middle income ranges are sought to be based on an objective test of the ability to pay on the assumption that taxable capacity can be ascertained by relating the tax unit's actual income to a computation of the income required to maintain a given standard of living for tax units of different size. To ascertain the cost relatives for units of different sizes Thorson suggests reliance on budget studies. If from the budget studies it is found that the per capita economic well-being for a married couple with income of say Rs.10,000 is equal to that of a single person with income of Rs.8,000 then the couple and single person should be taxed at an equal average rate. In Thorson's plan tax differentials begin to narrow after a point and vanish eventually. The narrowing however should begin where power element becomes important.

83 Thorson, op. cit. 127.
Considering the difficulty of locating the point where the narrowing should start, a generous approach is suggested by Thorson.

From the angle of equity the modified per capita plans (of either variety) are an improvement over both the unit approach as also the unmodified per capita scheme. None of the differentiation plans except the pure per capita one is however completely neutral so far as the marriage choice is concerned. For all of them cast an additional tax liability on couples with both the spouses working compared to what they would have to bear had they lived singly. In other words, the marital unit in taxation implies a tax on marriage.

Taxation on family unit basis thus involves a dilemma. If equity is to be achieved between equal income couples, and single individuals, there has to be some differentiation in the marginal rates applicable to each, so that the single individual has to bear tax at a higher rate. If the differential is very large, it is unfair to the single taxpayer, while if it is too small then marriage between two earning persons leads to a rise in their total tax burden.

This dilemma is sharply brought out by the U.S. experience. As long as married couples were allowed to split their incomes into two and the tax was computed on the basis of a single schedule, marriage involved no tax. But this was harsh to single individuals and also to widowers running a home.
Widowers - 'heads of households' - with dependants were therefore allowed the benefit of a 'half-split' and since 1971 a separate schedule has been introduced for bachelors to ensure that the tax liability of an unmarried person does not exceed that of a couple having the same income by more than a specified margin (for a large part of the income range the differential is not more than 20 per cent). The attempt to ensure horizontal equity has not only led to a proliferation of tax rate schedules but created a new problem in the form of tax on marriage and discrimination against working wives. According to some, however, the single tax rates (and the standard deductions permitted under the US law) do not provide adequate compensation for the discrimination between married and unmarried couples in all situations and the only way out of this problem is to replace the present schedules of rates by one fixed rate with a tax credit. Pechman is of the view that differentiation through exemptions would achieve almost


   Nussbaum makes the proposition that so long as married couples are required to lump their incomes and the tax rates are progressive, equality between married persons and single persons cannot be achieved unless husband and wife have equal incomes.

any degree of differentiation among families while avoiding most of the problems and anomalies produced by income splitting. In Britain apprehensions about the disruptive effect of marital unit income taxation on marriage led to suggestions for change of the long-established system of requiring mandatory joint returns from married couples and finally to a change in the law to permit working wives to file separate returns since 1971.

Dual Rate Scheme

If family unit taxation is based on two schedules—one for single individuals and one for married couples, a reasonable degree of differentiation between taxpaying units can be achieved. Two rate schedules are presented in Table 8.1 to show how differentiation can be achieved in Indian income tax between single and married taxpayers. Part A of the table sets out the tax rates which are now (i.e. in 1975-76) applicable to

87 J. A. Pechman, Federal Tax Policy (1971), Ch. 4.
89 The debate in the British Parliament on the Finance Bill 1971 and the reply of the Solicitor-General to the comments indicated that the object of the provision which brought about the change was to remove the 'tax on morality' which resulted from aggregation. (Vide "Women's Lib", Taxation (London), October 2, 1971).
### Table 9.1

Proposed Schedule of Rates of Income Tax

<table>
<thead>
<tr>
<th>Income range (Rs.)</th>
<th>Rate of tax (%)</th>
<th>Income range (Rs.)</th>
<th>Rate of tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not more than 6,000</td>
<td>Nil</td>
<td>Not more than 4,500</td>
<td>Nil</td>
</tr>
<tr>
<td>6,000-10,000</td>
<td>12</td>
<td>4,500-7000</td>
<td>12</td>
</tr>
<tr>
<td>10,000-15,000</td>
<td>15</td>
<td>7,000-10,000</td>
<td>15</td>
</tr>
<tr>
<td>15,000-20,000</td>
<td>20</td>
<td>10,000-15,000</td>
<td>20</td>
</tr>
<tr>
<td>20,000-25,000</td>
<td>30</td>
<td>15,000-20,000</td>
<td>27</td>
</tr>
<tr>
<td>25,000-30,000</td>
<td>40</td>
<td>20,000-25,000</td>
<td>35</td>
</tr>
<tr>
<td>30,000-50,000</td>
<td>50</td>
<td>25,000-30,000</td>
<td>43</td>
</tr>
<tr>
<td>50,000-70,000</td>
<td>60</td>
<td>30,000-50,000</td>
<td>52</td>
</tr>
<tr>
<td>More than 70,000</td>
<td>70</td>
<td>More than 70,000</td>
<td>70</td>
</tr>
</tbody>
</table>

**Note:**

1. The rates indicated above exclude surcharge which is levied currently at 10 per cent of income tax.

2. The rates in Part A are based on the schedule in operation for individuals for the year 1975-76.
individuals.* If the tax is levied on a family basis these rates may be adopted for family units and heads of households. Rates for single individuals are drawn up in Part B of the table. The differential in the rates between single individuals and married couples is based roughly on the budget data of urban households which show that consumer expenditure of households with two members is 1.27 times that of those with one member. Hence the bracket of Rs.0-6000 for married couples is equated to Rs.0-4500 for bachelors. Comparative incidence of tax under the old and the new rates is indicated in Table 9.2. It will be seen \[ \text{by comparing col. (4) with col. (6)} \] that under the new arrangements the difference in the tax burden between families with same income resulting from separate taxation of the spouses when both are employed would be considerably reduced and in the upper income ranges the difference will almost disappear. Tax payable under the new rates by two earning individuals before marriage and after marriage is indicated in col. (9) and col (5) respectively. Bachelors' liability at various income ranges is shown in col. (10).

Unavoidably there will be an increase in the tax liability of families with both the spouses earning, particularly

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According to NSS survey of consumer expenditure, the expenditure per capita in households of one member is Rs.73.12, for two, it is 46.44 or Rs.92.88 for both which is 1.27 times Rs.73.21 (NSS, 19th Round, Number 189, July 1964-June 1965).

* These are the rates which were in force before the changes introduced through the Finance (Amendment) Act, 1975 were announced.
<table>
<thead>
<tr>
<th>Income Level (Rs.)</th>
<th>Tax payable now* by individuals whether single or married</th>
<th>Tax payable now if earned jointly by husband and wife in the proportion of 3 : 2 **</th>
<th>Col. (3) Tax payable as % of Col. (2) Tax payable by a married couple at proposed rates if earned jointly in the proportion 3 : 2 (Rs.)</th>
<th>Col. (5) Tax payable under the new rates by the husband and wife if assessed as separate individuals (Rs.)</th>
<th>Tax payable by a single individual under the new rates (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7,500</td>
<td>198</td>
<td>Nil</td>
<td>0</td>
<td>Nil</td>
<td>0</td>
</tr>
<tr>
<td>10,000</td>
<td>528</td>
<td>Nil</td>
<td>0</td>
<td>264</td>
<td>50</td>
</tr>
<tr>
<td>15,000</td>
<td>1,353</td>
<td>396</td>
<td>29.3</td>
<td>1,023</td>
<td>76</td>
</tr>
<tr>
<td>20,000</td>
<td>2,013</td>
<td>818.40</td>
<td>40.7</td>
<td>1,573</td>
<td>78</td>
</tr>
<tr>
<td>25,000</td>
<td>2,453</td>
<td>1,122.00</td>
<td>45.7</td>
<td>2,013</td>
<td>82</td>
</tr>
<tr>
<td>30,000</td>
<td>4,103</td>
<td>1,831.00</td>
<td>45.8</td>
<td>3,443</td>
<td>83.9</td>
</tr>
<tr>
<td>35,000</td>
<td>6,303</td>
<td>2,871.00</td>
<td>45.5</td>
<td>5,423</td>
<td>86.0</td>
</tr>
<tr>
<td>50,000</td>
<td>17,303</td>
<td>8,756.00</td>
<td>50.6</td>
<td>16,203</td>
<td>93.6</td>
</tr>
<tr>
<td>70,000</td>
<td>30,503</td>
<td>18,326.00</td>
<td>60.1</td>
<td>29,123</td>
<td>95.7</td>
</tr>
<tr>
<td>100,000</td>
<td>53,603</td>
<td>35,706.00</td>
<td>66.6</td>
<td>52,063</td>
<td>97.1</td>
</tr>
</tbody>
</table>

* At 1975-76 rates. This will be the liability under the proposed rates for families whose income is earned by one spouse only.

** For example when the family income is Rs. 7,500 the husband's earning is Rs. 4,500 and the wife's Rs. 3,000 and so on.

NOTE: Tax liability in col. (5) is worked out after allowing a deduction of Rs. 2,000 from the income of the family of which both the spouses happen to work outside the home.
in the upper ranges. Whether such a tax on marriage will result in a break up of families in a country like India is conjectural. It may be noted that family unit taxation will also encourage marriage by reducing the tax burden on bachelors marrying non-earning wives and this should be set off against the disincentive effect.

In the final analysis, as Marshall and Walsh (op.cit) have remarked, choice of the unit and of any differentiation plan depends upon the standard by which equity burdens are judged. It also depends on how seriously one takes the risk of avoidance inherent in taxation on individual basis. The decision obviously involves a value judgement as most decisions in matters of taxation do. It may be added that differentiation can be carried further to take account of variation in the number of dependants and their requirement through a system of exemption. For this purpose, the Carter Commission's proposal to allow a deduction for dependants if they happen to be dependants of the family (without stipulating any support test of the kind in force in USA for purposes of exemption) seems adequate and at the same time workable.

To counter fictitious splitting of families all minors will have to be treated compulsorily as dependants of their parents, or where both parents are dead, of their nearest

91 The support test involves many difficulties in its operation (See Groves, "Taxing the Family Unit", op.cit., pp. 117-18).
relatives. Unattached adults running a household and having dependants within the specified degree of relationship may also be allowed the privilege of using the rate schedule meant for married couples. Dependents' allowance—preferably a tax credit—may be granted to married couples as also heads of households on a sliding scale (a deduction of say Rs.1,000 for the first child, Rs.750 for the second and so on) up to a certain income level. This will take care of additional burden of dependants like parents or sisters who live with the taxpayer and have no taxable income of their own. Incomes of all dependants other than those from sources like scholarships should be included in the family income.

Any proposal to include minors' income in that of the family may of course evoke strong protest as the experience of the Tax Commissioners of New York State demonstrated. The opposition in USA however derived strength from the fact that income tax is almost a mass tax there and many families have minors who earn from such activities as baby-sitting and caddies' fee. In India such activities are reserved for children of poor families and it is doubtful if a single case can be found where a minor member of an income tax paying family has

92 The Carter Commission recommended child care tax credit of $80 or $200 depending on the age of the child but that was more by way of acknowledgment of additional expenses of working wives.

93 Groves, "Taxing the Family Unit", op. cit., pp. 112-13.
genuinely earned income apart from scholarships. As for investment income, there is no case in equity for their separate assessment independently of the family income.

Derecognition of the HUF as a tax entity

For the proper working of the marital unit taxation it is essential that the recognition of the HUF as a tax unit be withdrawn. Since the basic unit will be the nuclear family consisting of the husband, wife and minor children, withdrawal of HUF recognition will in most cases only mean aggregation of incomes of what is now regarded as the 'smaller' HUF with that of their members. Where the inner family is not assessed separately from the bigger HUF, a notional partition will have to be imputed on the last day of the accounting year. Since the interest of the smaller units in the large family will not be affected by all births and deaths within the constituting units, this procedure will not give rise to any problem of the kind which dissuaded the Income Tax Investigation Commission of 1946 (and also the TEC) from recommending the treatment of HUFs as registered firms. It may be pointed out that even now the aid of a notional partition is invoked for purposes of estate duty and also for aggregation of income from assets thrown into the joint family stock.

The proposal to levy the income tax in India on the

94 Explanation (2) to Sec. 64(2) of the Income-tax Act, 1961.

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family basis, it may be pointed out, is not novel. As early as twenties, the Todhunter Committee had expressed opinion in favour of the family unit in unequivocal terms. The Experts' Committee of 1935 and, later, the Taxation Enquiry Commission too thought it desirable to switch over to the family unit for income taxation.

Legal questions

Apart from cries of 'conspiracy against women' and 'threat to the hard earned independence of Indian women', objections are often raised against the proposal to tax incomes on family unit basis on grounds of constitutional bar. Some of the arguments such as that it will interfere with the rights of women to stridhan or to inherit, acquire and hold separate property seem to be based on an incorrect appreciation of the legal implications of marital basis in taxation. As pointed out by Chitale, family unit taxation would in no way affect such rights of women or their right to employment. The


97 Manjula Bose, "Aggregation of Income of Spouses", op. cit.

98 Bhoothalingam, "Family as a Taxable Unit", op. cit.

99 M. P. Chitale, "Family as the Basic Unit of Taxation of Income", in Family as a Taxable Unit (1974) by L. M. Singhvi (ed.).
real question is, given the existing legal framework, particularly the constitutional rights, can the legislature levy any tax on a family basis whereby the income of one individual is aggregated with that of another? While legal difficulty can be no ground for shying away from desirable reforms in any field - for, given the will, the laws including the Constitution can be suitably changed - it is possible to argue that family unit taxation is permissible even within the existing constitutional guarantee of various rights.

That aggregation of the separate income of individuals is by itself not unconstitutional is now well settled, for it has been held by the Supreme Court that the entry in the Union list (entry 82) of the Constitution which enables the Centre to levy tax on non-agricultural incomes is wide enough to sustain a law made to prevent the evasion of the tax too. Besides, the HUF has been recognized/one of the tax entities since almost the inception of income tax in India.

The Attorney-General of India is reported to have expressed the view that aggregation of income on a family basis may be permissible if it could be established that this is necessary for reducing the scope for avoidance, but he was


101 Balaji v. ITO, op. cit.
not sure whether this could be established in all circum-
stances. Our review of the operation of the provisions
designed to counter avoidance through income and wealth split-
ting leaves no doubt that none of these measures can succeed
in achieving this objective unless the family itself is
treated as the basic tax unit.

It is difficult to see, however, why the family
cannot be a unit of taxation on equity grounds alone when
HUFs and partnership firms are taxed as such. It may be
argued that the HUF stands on a different footing since it is
recognized in our country as a legal entity. Besides, where
the legal title to the income belongs to individual members,
it may offend the constitutional rights if the income of such
members is assessed as that of an entity like the nuclear
family. The provisions of the Punjab Land Reforms Act, 1973
seeking to lay down ceilings on land holdings according to
families consisting of husband, wife and minor children were
struck down recently as unconstitutional by the Punjab and
Haryana High Court mainly on the ground that the definition of
the family which excludes adult children is an 'artificial' and
not a natural one. The objection taken to that enactment

This was indicated in a reply given to a
question in the Lok Sabha some time ago
(Vide Family as a Taxable Unit by L. M.
Singhvi (ed.), p. 128/.
however was that there was not adequate arrangement to safeguard the interests of the family members when the lands standing in their names are pooled and the ceiling applied. These arguments cannot apply if the incomes of family members are merely aggregated with a view to determining the rate of tax applicable to each member's income. If thought necessary, option may be allowed to each member to file return separately, as is allowed to married couples in USA, subject to a charge for each separate return. It is also pertinent to note that the 'family' is included in the definition of persons in the land ceiling legislation of most States.

It would therefore appear that aggregation of incomes of family members for purposes of taxation would not require any constitutional amendment. Even if it does, there is no reason to put aside such a reform when it seems so urgently desirable in equity and for effective administration of the direct taxes.

Implications of family unit taxation for Wealth tax and Capital Transfer Taxes (Estate Duty and Gift Tax)

Considerations which furnish the rationale for the family unit in income tax are valid for wealth tax too. The

Wealth-tax Act contains provisions designed to secure aggregation of the value of assets transferred by an individual for the benefit of his minor children and spouse without adequate consideration. But these are inadequate. If avoidance is to be countered effectively there is no real alternative to family unit taxation and that, as we have seen, has ample sanction in principles of equity too.

As for estate duty and gift tax, as Groves has argued in the U.S. context, it is possible to adapt the existing estate and gift taxes to the family unit for income and wealth taxation through such measures as integration of gift and estate taxes - a reform which is considered overdue by many - and exemption of all inter-spousal gifts and bequests.

The estate duty itself has, however, come in for good deal of criticism in recent years. For purposes of redistribution - which is supposed to be the principal aim underlying the estate duty, - a better course, it is widely felt, is to levy an accession tax or a capital receipts tax. We need

104 Secs. 4 and 4(lA) of the Wealth Tax Act, 1957.

105 Groves, "Taxing the Family Unit", op. cit., pp. 118-20.

106 This proposal has received powerful support from tax experts in U.K. and U.S.A. vide, Meade (1964), Stutchbury (1966), Sandford (1971), Atkinson (1972) Andrew (1967); Rudick (1950) and C. S. Shoup (1966). A capital transfer tax has been proposed in Britain to replace death duty.
not go into the relative merits of the capital receipt tax and estate duty here. The point is that family unit taxation should pose no problem for any reform towards a capital receipt tax, rather that would be more appropriate. Even if capital receipts are integrated in the scheme of income taxation, as the Carter Commission desired, by treating all gifts and bequests as income, family again would be the most appropriate unit. It will however be necessary in such a scheme to indicate clearly the situations where the family unit will terminate. The Carter Commission specified the circumstances under which a family unit will be regarded as terminated.


108 See Atkinson, op. cit.

109 It is possible to integrate such receipts with ordinary income either through averaging or by translating the capital sum received into a stream of annual income with the help of annuity tables based on the life expectancy (Graeme Macdonald, "From Estate Duty to Inheritance Tax - Towards an Income Tax on Capital?", BTR, 1973, no. 5). In the case of a family it may be based on the life expectancy of the member on whose death the family unit may be supposed to terminate. If, however, it is thought that capital receipts like gifts and casual gains need not be treated like ordinary income, but taxed at a higher rate because of their windfall character, a supplementary levy in the form of a surcharge can be imposed (See James Cutt, Taxation and Economic Development in India (1969), pp. 236-37, for such a proposal).

110 Death or divorce of a spouse is one such event.
Properties received by the members (or other tax unit) on the termination of a unit would be regarded as the income of the respective new units.

To repeat, there is nothing inherently incompatible between family unit for income taxation and any scheme of estate/gift taxes. Taking everything into account the case for family unit taxation seems to be overwhelming.