CHAPTER 4

ASSESSEE DIMENSION

4.1.1 Introduction

For all levies the paramount consideration is levy "on whom". This subject of the levy from the early phases of history of income tax has been more or less the same viz individual and institutional. But with passage of time there has been anatomical transformation in the subject of the levy. What and how this anatomical transformation took place through the years has been discussed in this chapter.

No levy exists in vacuum. Any tax has to be levied on some entity. That entity is the tax paying unit. Horizontal equity demands that equal treatment be meted out to equals in the tax system. If one assumes the structure of society to be such that composition of the tax paying units were the same, consisting say, of husband, wife and two children the problem of horizontal equity would be solved by defining the index of equality. But the problem in progressive taxation is not that simple for tax liability could be considerably reduced by splitting the income or the assets of the family among the members of the family without losing control over their disposition. It is in this context that the question arises whether the individual or the family should be regarded as the appropriate tax unit, and if it is to be the family what should be its definition.

4.1.2 In deciding whether an individual or a couple or a family (spouses and minor children) or some other group should constitute the tax unit two pertinent considerations are
(i) Tax liability should be unaffected by marital status i.e there should be no financial reward or penalty for marriage and
(ii) Couples with equal incomes should pay the same taxes.

4.1.3 In the case of individual as a unit of taxation, the tax is levied on the income of the individual, with no regard for the individual's family circumstance.

Arguments for individual as tax unit

Following arguments could be advanced in favour of individual as tax unit.

(i) A person's tax liability should be independent of his or her marital status. So that taxation remains neutral with respect to marriage.

(ii) An individual's tax liability should be independent of the earnings and circumstances of others, even those in the same family.
(iii) Individual taxation treats a married man with a non working wife in the same way as a single man with identical income. This implies that no concession is granted to a married man. Ostensibly on the logic that marrying and maintaining a nonearner spouse is one's own choice. The other logic in economics could be that two persons can live of a given income as a single individual without much additional expenditure because of economies of scale.

(iv) The individual basis generally reduces the marginal rate of tax leading to a substitution effect in favour of work effort.

(v) Lastly, taxation on the basis of individual as the tax unit is simpler, both in terms of compliance and administration, as there is no requirement of reporting of income of all members of the family.

4.1.4 As against the aforesaid arguments in favour of individual as a tax unit following arguments could be forwarded against the individual as a basis of taxation:

(i) While it is neutral to marriage, it results in a situation where a married couple's tax liability depends on the relative incomes of husband and wife. Thus a couple with all their income received by one partner pays more tax than a couple with an equal joint income, half received by each partner. This violates the second consideration.

(ii) The individual basis ignores the fact that households and families are the basic units in which civilised societies are organised, and that the needs and characteristics of a household differ fundamentally from those of a single person.

(iii) Lastly, the individual basis runs into difficulties in the assessment of investment income as such income can be split among the members of the family to minimise the tax liabilities of the combined unit.

4.1.5 With family as the basis of taxation, the major advantage is that if all income of the couple is aggregated and then taxed as though it were received by a single person, couples with equal incomes will pay equal amounts of tax.

4.1.6 The couple basis, however, suffers from certain disadvantages. Given a progressive rate schedule, marriage increases the combined liability of both spouses by moving them into a higher tax bracket. Hence such a tax system is not neutral with respect to marriage.

4.1.7 Moreover, couple basis goes against efficiency considerations, as under this system, the marginal tax rate of the second earner (whose earnings are typically below those of the primary earner) is substantially higher than it would be under an individual basis.
4.1.8 Another disadvantage of the couple basis is related to the difficulty of maintaining financial privacy within marriage and the problems of fixing responsibility for compliance. Withholding of information by one of the spouses can put the other in difficulty in compliance with the tax laws. Thus compliance and administration are both difficult in family unit of taxation.

4.1.9 In progressive tax structure both the individual and the family unit basis is bound to result in anomalies and problems. Which set of anomalies and problems is less objectionable is a matter of social choice. However in progressive tax structure some way has to be found out to serve the twin objectives of equity and administrative convenience. On balance of considerations complete integration of the incomes of both the spouses or for that matter of all adult members in the family is not feasible or necessary.

4.1.10 Indian Scenario

In Indian Income Tax law the position as to tax unit runs thus: Income tax is charged in respect of the total income of the previous year of every 'person'. The concept of person becomes pertinent here. The concept of person in Indian Income tax law encompasses:

(i) Individual: a natural human being. He may be a male or a female, minor or a major, sane or insane.

(ii) A Hindu individual family: It consists of all persons lineally descended from a common ancestor and include their wives and unmarried daughters.

(iii) A Company.

(iv) A firm.

(v) An Association of persons or body of individuals whether incorporated or not.

(vi) A local authority.

(vii) Every artificial juridical person, not falling within any of the preceding sub classes. A statutory corporation or a Hindu idol or a Hindu deity falls under this clause.

4.2.1 Conceptual cognates of Assessee

The above brief treatment of tax unit pertained to the theoretical foundations for concretising the concept of assessee in the practical manifestation for carrying out the tax law in real life. How Indian law treats of tax unit has also been referred to above. In the initial development of Income tax in
India the Income Tax Acts have been scheduler. This state of affairs perpetuated in the period of experiment and in the period of legislative consolidation. In the 1922 Act, assessee meant only "a person by whom income-tax is payable. Refundees were for the first time included in the term of assessee in the year 1953. The Present Act further expands and enlarges the scope of the concept so as to include what are defined as "Representative assessees".

4.2.2 In the 1922 Act other persons by whom the income tax was payable did not constitute the original concept of assessee. Such other persons were covered by section 29 of that Act. Then the definition of assessee did not take into account persons who were liable to super tax, penalty, interest or those entitled to a refund. However a person by whom income tax dues of another may be payable, not by virtue of the provisions of the Act but otherwise say, under a bilateral agreement would not be an assessee.

4.2.3 The concept of assessee cannot be consistently interpreted in the above sense throughout the Act and its connotation had to undergo certain variations in the content in which it was used. Thus, for purposes of the depreciation in the context of a succession of a business, the expression was held to connote the predecessor alone. On the other hand, where, for example, one company had amalgamated with another, the amalgamated bank was considered to be the assessee for purposes of pursuing the appeals in respect of refund due to it. A registered firm was held by the Privy Council and Supreme court to be an assessee, though prior to 1956, no tax was payable by it and only its total income was computed.

4.2.4 In the case of a person who is being assessed in respect of another, the question would arise whether the assessee is a person to whom the income belongs or the person who is in actual receipt of income. But by virtue of judicial pronouncements it has been held that no penalty can be imposed on the receiver as an assessee, nor can he be made liable for the payment of tax as the receiver is only the notional assessee whereas the beneficiary is the real assessee. There arose a conflict of opinion as to whether a representative, of a deceased person, who was being assessed in respect of the income earned by the latter in his life time, could be described as an assessee. This conflict perpetuated was then resolved by the Supreme Court & the position clarified. Doubts also arose as to whether there was any
difference between an assessee and a person deemed to be an assessee in default. But it has been resolved that an "assessee" and "an assessee in default" are not two different concepts. A person can be an "assessee in default" only when first he is an assessee or deemed to be an assessee. A "deemed assessee" in default undoubtedly is a "deemed assessee" as well and not a wholly different entity from an assessee.

4.2.5 The concept of assess under the 1922 Act was very narrow. It was amended by the 1953 Amendment Act and further expanded and enlarged by present Act (1961 Act) to comprehend a person against whom proceedings were taken to assess his income or loss or the amount of refund due to him. The definition as widened up to date includes all the three categories of persons viz. i> every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person; ii> every person who is deemed to be an assessee under any provision of this Act; iii> every person who is deemed to be an assessee in default under any provision of this Act.

4.2.6 Despite the widening of the concept to the magnitude described up to now it was held that it will not be possible to treat the manager or karta of a Hindu undivided family as the assessee in respect of the family's income and to detain him in civil prison to recover taxes due from the family. It was held that the Dept. could proceed to recover the taxes due from an unregistered firm by attachment and sale of the properties of the partners, but this may not now be possible, because of the absence of a rule in schedule II corresponding to O. XXI R.50 of the code of civil Procedure.

4.3.1 Individual

Individual in Income-tax law connotes a natural human being. This is manifest from the language used in provisions dealing with the residential status of the assessees. The word individual is wide enough to include a group of persons forming a unit even though it narrower than the word assessee. Income tax provisions of the Indian Income tax law are clearly reflective of indications to show beyond any ray of doubt that individual means human being for in some provisions it has been used to
connote either a wife or a husband or parent or a grand parent. 
Individual under Income tax law also includes a sui non juris. 
The word individual includes a minor or a person of unsound mind, 
if he carries on a business or profession. The machinery for 
assessing such persons is to be found in section 160 (ii) of the 
1961 Act. Every individual can be taxed separately though he may 
happen to be in any of the other units or groups otherwise. The 
share of the profits which each individual gets as a member of a 
company or of an unregistered firm or other association of persons 
or body of individuals is taken into consideration in computing 
the total income of the individual. The share is added to his 
total income. But such portion of his income as has already been 
taxed in the hands of an unregistered firm or an association or 
body of individuals is exempted from fresh taxation in the hands 
of the partner on member.

4.3.2 Personal allowances

During the twenties and early thirties period personal 
allowances of the type found in the west were singularly absent . 
So far individual assesses were concerned in this period only one 
personal allowance was available viz. Insurance allowance. 
Personal allowance cannot be defined as any one single allowance 
or deduction. It is a concept in totality of allowances, 
deduction & even exemptions to equate one assesssee with the other 
in the matter of tax burden. Its object is to offset 
differentials of ability among the equals. But it can not be a 
static concept so as to circumscribe it in the physical pattern of 
allowances deductions and exemptions. It has considerations of 
sociology and the socio politico milieu of the country and times. 
In taxation of individuals the persons marital status also counts 
but as has been already discussed that marriage being a choice of 
one self it has no business to dable with tax matters. 
Theoretically though the bachelors have a greater ability to pay 
than their married counterparts equity dictates that some or other 
relief be granted to the married assesses. But during this 
period no personal allowance to married assesses was available. 
At the same time, one need not make a fetish of a lower exemption 
limit for bachelors. Unlike the west where prolonged bachelordom 
had become an established institution marriage was (and it is true 
even today) had been almost universal in India. It was then 
difficult to find bachelors above the age of 24. Thus out of the 
2,50,000 persons with incomes below Rs.10,000, 25,250 were 
bachelors. It is far more expedient to fix an exemption limit 
suited to 224750 persons rather than fix one suited to 25250 
persons and grant an allowance for the numerically stronger group. 
Considering this expediency as well as the universality of 
marriage then the need for personal allowance must not have been 
felt.
But Prof. V.K.R.V. Rao feels inclined to children allowance on a different plane. He is a hard critique of Prof. Solomon who in his evidence before the Taxation Enquiry committee had pleaded that it will lead to increase of population in the already over populated country. Dr. Rao allays the fears of Prof. Solomon on the ground that Income tax payers come from literate persons and they were town dwellers and to remind one the classic epithet that the elite couple would prefer a baby car rather than baby. Dr. Rao pleads that children allowance be given up to 6 children and he suggested a deduction of Rs. 250 from the assessable income for every child maxima being 6 children. Though his suggestion in early thirties must not have sounded ridiculous one cannot but help laugh away such suggestion today.

During this period which we have been looking upon as legislative consolidation though Income tax law has been resuming refinements compared to the past one notices the fact that during this period in the west in personal taxation personal allowances had developed in the form of higher exemption limit for married assessee. In India there was no personal allowance available to the individual assessee excepting insurance. Dr. Rao ratifies and approved of the situation in the matter of allowance for married assessee yet he pleads for children allowances. But in the context of Indian sociological vogue of universally established institution of early marriages it was but proper that there was no allowance available to the married assessee. Despite his arguments against fears of population increase his recommendation of children allowance in contemporary Indian circumstances also, it was very hard for one to acquiesce in.

4.3.3 Second War:

There were glaring defects in the personal Income taxation in the pre war period. The 1939 Act tried to do away with those defects. For individual assessee during this period exemption of leave salary in the case of persons residing abroad was abolished. This did away with one of the glaring flaw of the taxation of individuals. Also during this period an attempt was made to adjust categories of income tax payers so as to mulct the wealthy minority more, while giving relief to the poor man. The more important change was in setting up of different bases for the assessment of resident and ordinary resident and the global income of the resident was charged to income tax.

With this provision, the theory of residence basis was completed in the taxation of individuals. That those individuals who are residents in a country are subject to the taxation where he resides was complied with and the afore said flaws (viz leave salary of persons living abroad) was done away with.

4.4 End of war & after

After the war in 1946 individual assessee were subjected to
capital gains tax. Capital gains tax was made applicable to
capital gains after 31 March 1946. After a run of two years, till
31 March 1948 it was withdrawn by the finance ACT 1949. As has
been described earlier in this period E.P.T. & B.P.T. were
introduced and subsequently repealed. It would be out of place
here to go into details of those taxes, as they have been earlier
dealt with. Taxation Enquiry Committee did not recommend it. But
Prof. Kaldor in his report on the Indian tax system strongly
recommended it. Consequently the tax on capital gains was
reintroduced with effect from 1st April 1956. The provisions
pertaining to the tax were recast in the present ACT and made
effective from 1-4-1962. The Capital gains were divided into
short term and long term gains. Further amendment Acts changed
the pattern of capital gains.

The tax, immediately after it was introduced in 1947 got
itself engulfed in a legal wrangle as to whether it was,
ultra vires the constitutional provisions embodied in the Govt. of
India Act 1935. There were only two items in the Federal list in
seventh schedule of that Act under which Govt. of India could
claim the authority to impose such a tax. Entry 54 which dealt
with taxes on Agricultural income and Entry 55 which dealt with
"Taxes on the capital value of the assets exclusive of
agricultural land on individuals and companies. It was
contended that income does not signify capital gains, either according to
its natural import or common usage or according to legal
interpretations. Consensus of judicial opinion has always ruled
against the assimilation of capital gains into income and declared
capital accretion to be beyond the pale of income-tax statutes.

Supreme Court held that the word income in Entry 54 should
be given the widest connotation in view of the fact that it occurs
in a legislative head conferring legislative power and that, in
that context, it does not mean the same meaning as is ascribed to
it in cases decided under the income tax statute but includes
capital gains. Thus ended the constitutionality argument.

Capital gains tax was not levied on individual assessees
above it was equally applicable to other assessees also but here
it is discussed in context with the individual assessee only.

As has already been stated that this levy was classified into
two viz short term and long term capital gains. A capital gain
from the transfer of short term asset was called short term C.G.
and vice versa long term capital C.G.

A short term capital asset is an asset held by a person for a
period of 36 months. This period was 12 months upto 31st March
1969. Thereafter it was 24 months and at present it is 36 months.
This period varied in different periods. Upto 31st March 1969 it
was 12 months, Hence upto prior to A.Y. 1974-75 it was 24 months.
From assessment year 1974-75 to 1977-78 it was raised to 60 months and thereafter to date it has been 36 months.

These variations of periods are not merely arithmetical figures they reflect rather what is in Economic Science branded as a problem of dating for differentiating between static and dynamic economics. Undoubtedly after independence our economy is far from a static economy. Now when it has been admitted once and for all that capital gains can be rightfully subjected to tax all efforts in the Income Tax statute to shape and reshape the format and structure of capital gains reflect only their attempts to base it on equity in the economic dynamics gamut of the country.

In financial management short term and long term connote the period ranging up to 12 months as short term; 1 to 3 years as mid term and exceeding 3 years as long term. Now for a pretty long period of the a decade or more 36 months have been accepted as a long term.

In 1962 when the finance minister Mr. Morarji Desai while proposing a change, said, "In an equitable system of taxation capital gains realized during a short period and those not so realized required to be treated differently. It is necessary to secure broad equity in the treatment of different categories of taxpayer. I have proposed that gains which result from disposal of capital assets within a period of one year from the date of acquisition shall be made subject to income tax and super tax like other ordinary income".

From that time onwards short term capital gains came to be taxed like any other income. But equity dictates that long term capital gains be treated on a different pedestal. Under the 1947 law if C.G. did not exceed Rs. 15000 they were not taxable. Excess used to be taxable.

<table>
<thead>
<tr>
<th>Percentage of deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land or Buildings (writing down allowance)</td>
</tr>
<tr>
<td>Any other assets</td>
</tr>
</tbody>
</table>

Under 1957 Law the minimum taxable exemption limit was Rs. 5000, it was further provided that no tax would be charged from a tax payer if his total income including C.G. does not exceed Rs. 10000. Under 1962 Law there was no exemption limit as regards short term capital gains but as regards long term capital gains it was fixed at Rs. 5000 (Whatever the amount of such gains), with the further provisions that no tax would be charged even on capital gains exceeding Rs. 5000 if the total income including such gains of the tax payer did not exceed Rs. 10000. This practice and
practice of taxation at differential rates for different incomes of capital gains yielded place for deduction from gross total income from 1st April 1968 which lasted till A.Y. 1988-89. This deduction was as shown in the table on the previous page.

If the C.G. from Land and Bldg. being less than Rs. 5000 the unabsorbed portion of the basic deduction of Rs. 5000 could be deducted out of other capital gains.

After basic deduction the long term capital gains are treated alike whatever the period of holding by the transferor. This equal treatment of unequals was not fair in equity. An illustration would better clarify the position. Suppose one Mr. X holds a property for more than (exactly so as to only comply with legal requisite period) and after the basic exemption he is eligible for say 45% deduction on the residual. Suppose another Mr. B. holds the property for 15 years and then disposes it off. He, too, under the present rules will be eligible for the same basic exemption and percentage of deduction on the residual. Obviously since the period of holding in the latter case is 5 times that of the former. The price differential of the latter must have naturally been far more than the former case. May be the increment must have far exceeded that of the principal and subsequently the long term capital gains (i.e. the difference between Sale proceeds (Cost of acquisition + cost of improvement) must have been significantly greater. If the uniform basis and the same percentage be applied in both the cases it would naturally violate the basic principles of equity.

In view of the above from A.Y. 1983-84 onwards section 80(T) has been amended to the effect that it considers length of period of holding and the percentage rate of deduction differential shall depends on the length of period of holding. It is disseminated in the following table:

<table>
<thead>
<tr>
<th>Dissiminating Gains</th>
<th>Rates of deduction for long term Capital gains relating to buildings or interests therein</th>
<th>Rate of deduction of long term Capital gains relating to other capital assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period of holding of the capital assets</td>
<td>Rate of deduction in respect of long term Capital gains relating to buildings or interests therein</td>
<td>Rate of deduction of long term Capital gains relating to other capital assets</td>
</tr>
<tr>
<td>i&gt; Not less than 3 years but not exceeding 5 years</td>
<td>25 %</td>
<td>40 %</td>
</tr>
<tr>
<td>ii&gt; Not less than 5 but not exceeding 10 years</td>
<td>28 %</td>
<td>45 %</td>
</tr>
<tr>
<td>iii&gt; Not less than 10 years but not exceeding 10 years</td>
<td>33 %</td>
<td>50 %</td>
</tr>
</tbody>
</table>
### Notes:

1. For the A.Y. 1984-85 the maximum amount deductible for LTCG for golden or bullion jewellary was laid down upto Rs. 50,000 only.

2. Where an assessee had LTCG from Land & Bldg. & from other assets as well the order of:
   - a) Capital gains relating to L&B
   - b) Capital gains relating to gold bullion or jewellary.
   - c) C.G relating to any other assets.

   But from the A.Y. 1988-89 the deduction of LTCG under sec. 80 T was dropped and it was substituted by deduction u/s 48(2) on following lines.

   Rs. 10000 + 50% of the balance for L.T.C.G. for Building or lands, gold, building etc. & Rs. 1000 + 60% of the balance for LTCG. from other assets.

   It may appear erratic to change the basis from period to holding again to percentage basis the reason therefor stated was that this resumption of the percentage basis sought to bring about uniformity for all assessees. This argument does not sound reasonable but shifting of the deduction from G.T.I. to the section 48(2) appears in conformity of the view that deductions be related to the concerned head of income rather than place it under "from G.T.I." for the phenomenon of Income-tax is likened with a train and the "heads of income with bogies thereof" and it is but apt that the pertinent deductions be linked with related bogie.

   Levy and development of capital gains in the income taxation in India with whatever other merits and demerits has undoubtedly gone a long way in providing for differentiation in Indian Income tax system. Its further developments reflect an attempt to base on equitable foundations though at times it assumed an erratic routes.

   In an endeavor to treat likes alike or to serve other ends an individual are granted certain preferential treatment over the others. This preferential treatment may be in the form of exclusions, abatements and deductions. Exclusions abatements and deductions are briefly discussed below:

<table>
<thead>
<tr>
<th>Category</th>
<th>Rate</th>
<th>Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not less than 15 years</td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>but not exceeding 20 years</td>
<td>55%</td>
<td></td>
</tr>
<tr>
<td>Exceeding 20 years.</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>exceeding 15 years</td>
<td>60%</td>
<td></td>
</tr>
</tbody>
</table>
4.5 Exclusion, Abatements and deductions:

Exclusions consist of such incomes which are exempt from the purview of taxation and excluded from the tax base in the interest of certain social and economic objectives.

Deductions are normally permitted because they are in the nature of "expenses to earn income" and also equal incomes do not necessarily represent equal taxable capacity. Underlying principle being that of gross income earned by the taxpayer must be netted for taxation purposes. At times deductions are also allowed to achieve certain socio-economic goals. Exemptions are generally allowed for permitting a minimum standard of living or some amount of money income which does not reflect the tax paying ability of the individual. The grant of a personal exemption introduces, as a by-product, an element of progressivity in the income tax.

Exemptions

In the initial development of Income-tax there were very few personal allowances etc provided to the assessee, then generation of revenue being the prime mover of income tax structure. In the first Income-tax Act 1860 even agricultural income was assessable to income tax. In the first phase of experiment of income-tax in India agricultural incomes were subject to income tax. Levy of I.T. on agricultural incomes continued up to the year 1873. It was for the first time in 1886 Act that agricultural incomes were exempted from taxation. In the first income-tax Act agricultural incomes were taxed with the plea that land revenue was a rent and not a tax or duty. But later on it was treated that agriculture was already overburdened and hence agricultural income was exempt, which exemption is continued to the present day. Since agricultural income is separately dealt with elsewhere here suffice it to state that this exemption perpetuates itself to date.

In the treatment of income-tax in preindependence era revenue and expediency and not equity ruled the roost and hence exemptions and deductions as personal allowances that were available in the West were but for a few exceptions (viz as deduction for insurance premia and provident fund contribution) developed only after independence in India.

As has been already stated exemptions are granted on account of economic, social, political and equity grounds. Exemptions under Income-tax Act vis a vis individual assessee are briefly discussed.

Economic exemptions:

This group covers exemptions for agricultural income, casual income, travel concession, gratuities, commutation of pension, reitrement compensation, payment from statutory or public provident fund, payment from R.P.F, payment from super annuation
funds House rent allowance, special allowance for meeting certain expenditure, scholarships winnings from lotteries etc are the exemption that evolved and developed in Indian Income-tax structure with the stream of times.

i> Agricultural income constitutes a distinct segment of treatment here. Hence discussion thereof shall be found elsewhere.

ii> Casual income : Casual income has been conceptualized something in the nature of a bolt from the blue. It come in without stipulation, contract, calculation or design. It has not been defined anywhere in the Act. It has therefore to be construed in its ordinary parlance. It was described as "any receipts not being capital gains chargeable according to the provisions of section 128(B) and not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non recurring nature or are not by way of addition to the remuneration of an employee". Its transformation in the present Act has been as follows:

Any receipts which are of a casual and non recurring nature, unless they are i> Capital gains, chargeable under the provisions of section 45; or ii> receipts arising from business or the exercise of profession or occupation; or iii> receipts by way of addition to the remuneration of an employee.

Etymologically there are no variations in the concept except that of the section of the two Acts. But further developments were of considerable import:

Sweeping changes were made in 1972. By this Act outright exemption for casual gains was done away with. By this Act casual incomes other than winnings from lotteries (State or otherwise) in excess of Rs. 1000 was taxable as income of the assessee. For individuals winnings from lotteries (state or otherwise) were treated on lines with long term capital gains. Where the gross total income did not exceed Rs. 10000 or winnings from lotteries Rs.5000 the whole of it was deductible while calculating gross total income in other cases it was deductible equal to basic 5000+50 % of balance. (Sec. 80 tt 1961 Act) No such deduction from G.T.I. is available from the A.Y. 1987-88.

If one considers the itinerary of this exemption upto 1972 it was exemptible in full. Later on it came to be partially exemptible upto Rs. 1000 with 5000 rs. deductible in case of lotteries etc. But from A.Y. 1987-88 it ceases to be deductible at all. This reflects that now casual income also is covered in the nucleus of income under Income tax Law. One comes to concur with these developments for it has been a garb for converting black money into white money. This average for such conversion has been brought to an end since A.Y. 1987-88.
Travel concession was available to an assessee under 1922 Act also to an Indian citizen individual 1961 Act continues it. From 1975 this has been made available not only, for the assessee himself, spouse and children only but to an individual's parents also.

Gratuities

Under 1922 Act also gratuities were exempt (received after 16th May 1950) under the revised pension rules of the Central Government or under any similar scheme of state Govt. or local authorities or a corporation established under Central or State Act received after 1st Day of June or under Pension Code applicable to Defense Services.

Under 1961 Act also this exemption continues subject to certain limit which has been varying from time to time. The present position runs as follows:–

Employees are classified under two categories viz. Govt. employees & Employees covered under the payment of Gratuity Act 1972.

If the gratuity be paid to the Govt. employees under the revised pension rules it is exempt.

Gratuity Covered under payment of Gratuity Act 1972 is exempt from tax to the extent given below:–

i) 15 days salary (based on salary last drawn) for every completed year of service or part thereof in excess of six months

ii) 20 months salary or

iii) amount of gratuity actually received; whichever is the least of the above sums.

iv) Commutation of pension:– Commuted value of pension is exempt. According to general principles any sum received in commutation of the whole or a part of a pension received in lump sum and is not of revenue nature and as such it is not chargeable. This was recognised in the 1922 Act.

But the position was altered in 1939 (Amendment Act VII of 1939). The effect of the changes was that any amount representing commutation of pension fell to be charged as income. This position continued in the present Act till amendment act in 1965. Thus the policy of the legislature since Income-tax Act 1939, upto 1965 has been to include the commuted pension in the total income of the employee. That policy still continues by enacting that full payment of commuted pension will not be included from and after 19th August 1965 but only a portion thereof, viz any amount in excess of one-half or one-third (for employees' gratuities in
addition to pension) will be included in the total income of the assessee.

v> Payment of retrenchment compensation:

This exemption is limited to an amount calculated in accordance with the provisions of Industrial Disputes Act 1947. This exemption is available only in case of a "workman" as defined in the Industrial Disputes Act 1947.

vi> Amounts received from Provident Funds: Under 1922 Act any payment from recognised provident fund was exempt. Under the present Act any payment from a provident fund to which Provident Funds Act 1925 applies is exempt. From 1st April 1969 payment from public provident fund is also exempt. With the introduction of the P.P.F. Scheme in 1968 and income tax exemption attached therewith the social security measure available only to salary earner individuals seems to have been extended to those who were beyond the orbit, because they were not salary earners i.e. the self employed class viz. professionals and small traders also came under the scheme of P.P.F. which laid down the minima of 100 Rs. and maxima being changed from time to time. This measure had double advantage viz. of extension of this social security measure and also funds being made available for being channelised to public purposes.

The amounts received by an employee from recognised P.F. are exempt. But this is conditional exemption. Amounts received by an employee on retirement are exempt. But one who leaves the job it is exempt subject to his putting in continuous service of five years.

vii> Payment from an approved super annuation fund: On the death of a beneficiary, or in lieu of or in commutation of an annuity or by way of refund of contributions on the death of a beneficiary or on his leaving the employment this amount is exempt. This exemption was available under 1922 Act also. The 1965 Finance Act gave this exemption a retrospective effect i.e. w.e.f. 1-4-62.

viii> Allowance for payment of rent: This was made exempt from 1964. Originally there was a ceiling of 300 rupees which was enhanced to 400 rs. by Finance Act 1975.

viii> Special allowance to meet expenses of employment. By 1975 Amendment Act it has been given retrospective effect from 1.4.62.

The economic exemptions narrated above are not exhaustive. A few examples cited above go to prove that especially after the enactment of the present Act, economic exemptions have been growing in number and complexion also. These economic exemptions sought to mete out equal treatment among equals. Some times these exemptions catered for providing motivations for channelising savings in the desired directions. Exemptions to interest on
stipulated Govt. securities approved by and published in Central Govt. Gazettes are examples in point.

Social, educational and political exemptions.

Any income of a university or other educational institution, existing solely for educational purposes shall be exempt.

One does come across the definition of the word institution. But legal pronouncements seem to be inclined to give this word a wider import.

Scholarships granted to meet the cost of education stands exempt. If the recipient does not spend the whole amount of scholarship on education or spend a part of it for other purpose, the whole amount is exempt. In the same way now Income Tax Law provides exemptions for awards for literary and scientific work, poor relief etc.

For the development of housing after independence Govt. have been making vociferous attempts. Especially during the planning period these efforts have been noteworthy. Income Tax law from 1970 provided for an exemption of income of planning and development of cities and towns and villages or both. This provision has been inserted from 1970 by Finance Act 1970.

Incomes of an association or institution the object whereof has been the furtherance of the cause of sports and games are exempt.

There were debates in the courts of law questioning the propriety of treating this as charity. But Finance Act 1961 had put this debate at naught by declaring the incomes of the aforesaid associations exempt.

From 1965 incomes of Bar Councils and other professional associations were made exempt from Income tax.

From 1970 incomes of hospital and other institution for treatment of the ill and sick have been exempt.

Income tax Act has also kept pace with the Govt. Policy of amelioration of the downtrodden viz. scheduled tribes. I.T. Act 1961 provides exemption for members of scheduled tribe as defined in the constitution (clause 25 of article 366 of the constitution). However this exemption is available to persons from scheduled tribes residing in any specified area or in the states of Nagaland, Manipur and Tripura, Arunachal Pradesh and Mizoram.

But this exemption is limited to income which accrues or arises to him:
From any source in the areas or states aforesaid or by way of dividend or interest on securities.

This exemption was available under 1922 Act also. The 1961 Act maintained the exemption. But from 1922 to 1961 this exemption extended to number of schedule Tribes in the area stipulated, provided such member was not in the service of the Govt.

This differential treatment for those not in the service of the Govt. was held unconstitutional by the supreme court. Consequently by The Taxation Laws (Amendment) Act 1970 the words "who is not in the service of Govt." were omitted. By this Act retrospective effect was given to this exemption from 1.4.1962. The exemption amended as aforesaid was held to be constitutionally valid.

Any daily allowance received by any person by reason of his membership of parliament or of any state legislature or of any committee thereof shall be exempt.

There has been a change in this exemption provision since 1976. Members of parliaments are entitled to receive, in lieu of additional facilities, an allowance at the rate of Rs. 500 per month. Section 10(17) of I.T has been amended in order to exempt from Income tax the allowance under pertinent rules. This amendment came into force with effect from 1.4.76 and is accordingly applicable in relation to the A.Y. 1976-77. These exemptions have been existing in I.T Act & exemption of facilities there is transformation of allowances to M.Ps & MLAs etc. Be that as it may, but time has come to give a second thought to these exemptions as the MPs and MLAS reside in the headquarters during the sessions. The justification of this exemption has been questioned by Chelliah Committee and recommended that the allowance paid to legislators be brought fully into income tax net. This, they suggested, in context with broadening the tax base.

But astonishingly enough the Govt. did not accept this recommendation of the committee. This reminds one of the pensions received in England by the British officers being exempt in gross violation of the principle of residence & accrual. This reflects the universality of trend of ruling class. "May it be an alien rule of the Britishers the self rule. But rulers (legislators in democracy) have a peculiar psyche and it does not change even in welfare state democracies.

It is no use to comment at any greater length on the exclusions and the concomitant ramifications thereof of the Income tax in India. Dr. Rao during the thirties commented that India has to tread a long path in bringing about changes in exclusions in Income tax on line with Western countries. But one
can now say that we do not lag behind any other country in providing for judicious exemptions to individual assessees to fit him on egalitarian platform in socio-economic milieu of the country in tune with the changing times. Now after consideration of exclusions viz-a-viz individual assessees it would be proper to turn to abatements and deductions.

Abatements:

Abatement implies certain cuts to equate the similarly dissimilar and vice versa or on any other equity ground. With a view to accomplishing this objective certain allowances are made permissible. Conspicuous example of this is found in case of an individual in connection with the person owing residential house property and residing out side on account of his calling. In such a case the abatement to the full extent of the annual value is allowed provided the property is not actually let out and no other benefit is derived therefrom.

Sometimes the abatement may assume the form of a rebate also. For example the share in unregistered firm is taxable at the hands of the partner in his individual assessment. But if the firm paid tax on its income the individual partner is eligible to rebate on his share at an average of tax applicable to him. Similarly if an employee received arrears of salary he too is eligible rebate.

Deductions:

Deductions could be classified into two viz. deductions in the computation of income under individual head and deductions from gross total income.

Deductions relating to particular head:

Deductions while computing income of a particular head are mostly alike for all assessees, so treatment of all the deductions is impertinent. But deductions from salary in the nature of things pertain to individuals hence consideration in details thereof shall not be out of place here.

Rationale of deductions from Salary:

In the course of performance of his duties a person is required to incur certain expenses. These expenses are not defrayed to his personal ends. They are incidental to employment. Deductions from gross salary therefore, on account of incidental to employment could hardly be disputed. Following items of deductions from salary were originally incorporated in the deductions from salary viz.

i> Expenditure on Books.
ii> Entertainment Allowance
iii> Professional Taxes
iv> Expenditure on Conveyance
v> Any other actual payment warranted by conditions of employment.

So far as expenditure on books is concerned from 1.4.62 to 1.4.75 there was no change in the treatment and magnitude of this item deduction was allowed upto Rs. 500 on account of purchase of books incidental to employment. Even under the 1922 Act, the same treatment was given.

Deduction for Entertainment Allowance:

Strangely enough right from the 1922 Act to date the provision pertaining to this deduction stands unchanged. This deduction visualizes the categorization of the employees into two viz. the government employees and others. To the Government employees this deduction is available as under:

i> upto Rs. 5000 or

ii> 20% of salary (exclusive of any allowance, benefit or other perquisite whichever is less. But for other (than Govt. ones) employees the deduction runs thus:

   i> Rs. 7500 or
   ii> 20% of salary (exclusive of any allowance, benefit or other perquisite)
   iii> the amount of entertainment allowance received by the employee from his present employer prior to 1.4.1955 or
   iv> The amount of such entertainment allowance, received during the previous year whichever is the least.

There is no reason to comment on other sub clauses of this deduction provision but clause iii of this provision warrants special attention. Deduction contained in clause iii has remained static with the flux of times and it could, without any hesitation be opined that it not only trangresses the circumference of reasonable differentiation but also amounts to gross discrimination against those employees that do not fit in the framework of this clause. One therefore, feels inclined to opine that there is no reason to differentiate between a govt. and non govt. employee so afar as this clause is concerned. This sub clause therefore be removed from SEC. 16(ii). Upto 1.4.75 there was no change in profession tax provision. As to other items of this deduction viz. expenditure on conveyance upto 1.4.1975 there was no change. The position changed from time to time. From 1.4.62 to 1.4.68 deduction for conveyance expenditure was allowable on estimate basis. The estimate of the I.T.O Would decide the quantum of this deduction. But during the later period the amount of this deduction varied as shown below.
a. Where the conveyance is a motor car and the amount of the salary due to the assessee in respect of the previous year:

i) Does not exceed Rs. 15000
Rs. 150 p.m.

ii) Exceeds Rs. 15000 but does not exceed Rs. 25000
Rs. 200 p.m.

iii) Exceeds Rs. 25000
Rs. 250 p.m.

b) Where the conveyance is a motor cycle scooter or other moped
Rs. 50 p.m.

c) Where conveyance is bicycle
Rs. 5 P.M.

As from 1.4.1970:

There was a slight modification in deduction for expenditure on conveyance brought about by Finance Act 1969. An employee drawing less than Rs. 15000 and a person owning a car was entitled to a deduction of Rs. 200 p.m. as against Rs. 150 p.m. earlier.

As from 1.4.1971:

Following changes are made by the Finance Act 1970 w.e.f 1.4.1971.

i) Where the assessee owns a motor car which is used for the purpose of his employment (irrespective of any salary) Rs. 200 p.m.

b) Where the assessee owns a motor cycle, scooter or other moped which is used for the purpose of his employment Rs. 60 P.m.

c) In any other case Rs. 35 P.M.

Even an employee not owning a conveyance was entitled to deduction for the first time.

From 1.4.1972 to 1.4.75

The Finance (No.2) Act, 1971 w.e.f 1.4.1972 raised the deduction admissible to an employee owning a motor cycle, scooter or a moped from Rs. 60 to Rs. 75 and in any other case from Rs. 35 to Rs. 50.

The above schemata of deductions was undoubtedly inconvenient for this type of arrangement of deduction warranted periodic revision of pattern and quantum. This would have to go endlessly. It is only these types of schematas that made Income Tax Law
complicated cumbersome and difficult to comprehend. As has been pointed out earlier this was a period of rationalization of Income tax. Reasonably enough, this provision of deduction complicated and cumbersome as it became with flux of time could hardly escape the rationalization move. The Finance Act 1974 w.e.f. 1.4.1975 brought about a major change in the system of deduction from salaries under section 16 from 1.4.75 no separate deduction is available to salaried employees in respect of expenditure on books, profession tax, expenditure on conveyance and any other expenditure. Instead a consolidated standard deduction is allowed under the substituted sub clause (i) of section 16 and deduction for entertainment allowance remains the same and it has been placed in subclause (ii) of section 16. Other sub clauses viz. (iii), (iv) and v of section 16 have been deleted.

The above step taken in the Finance Act 1974 was a desideratum. It was then but in fitness of things that this deduction was simplified and it was quite in tune with the move of rationalization during this period.

Scheme of Standard deduction:

From 1.4.75 new scheme (viz. standard deduction) was introduced. From 1.4.75 to the A.Y. 1982-83 the scheme was as under.

In respect of expenditure incidental to the employment of the assessee the quantum of standard deduction is determined as follows :-

In respect of first Rs. 10000 of salary - 20% -
On the balance of the salary 10%.

The maxima was laid down to Rs. 3500. But in case the employee received conveyance allowance or a motor car or any other vehicle from his employer for use otherwise than wholly or exclusively in the performance of his duties it was limited to Rs. 1000 only. For the A.Y. 1983-84. The percentage was increased from 20% to 25% maxima remaining the same. For A.Y. 1984-85 & 1986-87 with percentage remaining 25% maxima was increased to Rs. 6000 for A.Y. 1987-88 & 1988-89 the percentage was raised to 30% and maxima to Rs. 10000. From the A.Y. 1989-90 the percentage is raised to 33.33% of salary or Rs. 12000. At present the maxima remains at the aforesaid stipulations only and reduction in the maxima on account of conveyance allowance or a conveyance shall not reduce to any degree.

But in the budget of 1992 a slight modification is made to this deduction. The maxima for male employees remains as it is but for female employees it is raised to Rs. 15000. This differential treatment of men and women does not stand to any test of reason and it appears to be in violation of equal treatment visualised under Article 14 of the constitution.
DEDUCTIONS FROM GROSS TOTAL INCOME:

Income Tax Law treats of certain favoured income. The intendment is that the balance of income excluding "favoured income" be assessed at rate applicable to total income. In effect relief is given in much the same way as rebate on "favoured expenditure", namely by deducting from total tax, tax attributable to "favoured income" at the average rate. The Income Tax Act, 1961 also accords favoured treatment to certain types of expenditure, it does so by allowing, as a deduction, in the computation of the total income of the assessee, certain expenditure – which would otherwise not be allowable – so as to reduce pro tanto the quantum of the total income chargeable to tax. In effect, it constitutes an exception to the general rule that the Revenue is concerned with the point of emergence of income and is usually not concerned with the mode of application of that income. In the case of income, the Income-tax Act leaves out of account certain portion out of the incomes earned by the assessee from certain sources so as to reduce the quantum of income liable to tax.

The above two kinds of relief have been the subject matter of treatment for tax purposes from the days of Income-tax Amendment Act, 1939. The field of operation of these two principles has been widening through the years.

Before 1965 the method of according relief was, by and large, as and by way of rebates and concessional rates of tax. A rebate is an abatement of an amount equal to tax calculated on items (included in income) at the average rate. By 1965 it was realised that straight deductions instead of rebates and concessional rates would simplify things as the rebates and concessional rates involved complicated and confusing arithmetic. The Finance Act, 1965 therefore, inserted a scheme entitled "Deductions to be made in computing total income".

This policy was augmented, pursuant to the recommendations of the Bhoothlingam committee (1967) for rationalisation and simplification of the Income Tax Act. According to the committee relief is given in a variety of ways yet ways of relief could be classified into two viz. Rebates and concessional rates. Rebates and concessional rates, though ostensibly appear quite a simpler fact yet in reality they entail complications and intricacies of treatment. Some rebates are full while a few others are partial in varying degrees, Moreover rebate is not given at any prescribed rate, average rate has therefore to be found out which brings in its train the concomitant complications. In nutshell, the committee preferred a schemata of straightway deductions which also varied in form and magnitude with the stream of times. As originally introduced in 1965 (w.e.f. 1.4.65) the straightway deductions in chapter VIA comprised of sections 80A to 80D only. 80E was introduced in 1966, 80F by Finance Act 1967. With effect from 1968 the scheme of straightway deductions was divided into two viz. "A" "Deduction in respect of certain payments". and B -
"Other deductions" the former comprising of sections 80A to 80D and the latter of sections 80E and 80F. With the enactment of Finance Act 1967 with effect from 1.4.1968 the schemata is on following lines:

"A" General --> Sections 80A & 80B
'B' Deductions in respect of certain payments
Deductions in respect of certain incomes
Sections 80(C), 80D, 80 E, 80F and 80G.
Sections 80H, 80-I, 80J, 80K, 80L,
80Q,80R,80S,80T

Since, 1969 a new deduction for handicapped persons, income was provided for in sec. 80U which constituted "D" other deductions.

However here it is not proposed to discuss in details the philosophical foundations and other ramifications of all straightaway deductions. The principal concern here is the schemata of straightaway deductions vis a vis individual assessee.

It has already been stated that before 1965 the income tax practice was to give rebate on certain types of "favoured expenditure". The breakthrough the age long practice was made by the Finance Act 1965. And the straightway deductions while computing total income developed since then. It has already been discussed that these straightway deductions developed as an honourable exception to the cardinal principle of deduction that Revenue is concerned with the point of emergence of income and is usually not concerned with the mode of application of that income. Indian Income Tax law allows to an individual assessee the following straightaway deductions:

For motivating savings viz. payment of life insurance permia contribution to provident fund and savings in other schemes enunciated or approved of by the central Government for income tax purpose. Before 1965 these payments were eligible for rebates from income tax. But since 1967 with effect from 1st April 1968 a straightway deduction has been granted sections 80 C is omitted by the Finance Act 1990 with effect from 1st April 1991. But an individual does not altogether cease to get benefits which he used to get under former 80(c). In a modified from as placed in sec. 188 the individual gets those benefits even today.

ii> Investment in equity shares of new public companies engaged in production or manufacture or construction work or units of Mutual Fund. The quantum of this deduction was 50% of such shares or Rs. 10000 whichever being less. This deduction was inserted in 1978 with effect from 1.4.1978. But this deduction is not available to individual assessee from 1-4-1990. Instead a rebate has been granted. (u/s 88 A inserted w.e.f. 1.4.1991).

Deposits under National Saving scheme or payment to a deferred annuity plan qualified for 100% deduction. This was
inserted in the Act in 1987 w.e.f. 1.4.1988. In the year 1990 investment made by an individual under Equity linked savings scheme qualified for 100% deduction.

Income Tax Law recognises the social responsibility of an individual to take care of his dependents for which a deduction for medical treatment was introduced in 1965. There has been changes of the amount and mode of this deduction. In the present form an individual is eligible for deduction regarding premia paid for insurance on the health of self, spouse, dependent children and parents. Maximum deduction at present allowed is Rs. 3000.

In the treatment of personal allowances and deductions generally salaried class is prominent. Small shop keepers and other petty professional at times appear to have been ignored. But this has been cared for while granting deductions from gross total income. Regarding expenditure on house rent by self employed persons and salaried person not getting house rent allowance in excess of 10% of total income a deduction of 25% of total income or Rs. 1000 p.m. whichever is less is allowed to a person.

This deduction was inserted by Finance Act 1979 w.e.f. 1.4.1980. It was sought to be omitted by the Direct Tax Laws (Amendment) Act 1987 w.e.f. 1.4.1989. But on second thoughts restored to its original version by the Direct Tax Laws (Amendment) Act 1989.

Deduction in respect of dividends in certain cases :- This was for the first time introduced in the year 1967. The deduction was allowed provided the dividends income included in gross total income did not exceed five hundred rupees. If it did, deduction was not available. Total amount of five hundred rupees was allowed as deduction. By finance Act 1969 the limit of Rs.500 was raised to Rs. 1000. This provision was designed to encourage persons in the lower and middle income brackets to make larger investments in the shares of Indian companies and also to improve the investment climate. The scope of this deduction was increased with passage of time. From 1.4.1971 an increase in the quantum of exemption from tax of income from certain categories of investments viz. income upto Rs. 1000 from Unit Trust of India, income upto Rs. 1000 by way dividends on shares in Indian companies and the whole of interest on securities of approved financial corporation, has been effected. The widening of the scope of this deduction year after year had aimed at promoting investment among middle income brackets to desired channels. The position upto A.Y. 1991-92 of this deduction was :

i> Deduction for income from certain specified securities - maximum Rs. 7000.

ii> Further deduction for income of Units of U.T.I subject to overall limit of Rs. 3000 - &
Further deduction of maximum Rs. 3000 in case of interest on deposits under notified National deposits scheme etc is allowable.

But in the budget of 1992 deductions under sec. 80 L stands withdrawn. However after protest the Finance Minister conceded to retention of the provision limited to maxima of Rs. 7000 only.

This deduction was introduced in 1967 and subsequent year after year quantum of deductions reduced the prime object being to create congenial investment climate for middle income group. One fails to understand how the withdrawal of such a provision could help further the cause of creation of congenial investment climate.

The Finance Act, 1979 introduced a deduction for authors of University text books in Indian languages to the tune of 25% of their income from royalty of such work or any lumpsum in connection with such work. Originally it was available for five years viz. 1980-81 to 1984-84. It was further extended for five years i.e. for A.Y. 1985-86 to 1989-90. From A.Y. 1990-91 this deduction has been done away with. Removal of such deduction can not be endorsed for it still retains its utility.

Between 1 April 1966 to 31 March 1968 tax relief in respect of remuneration received by resident individuals of Indian citizenship for serving in foreign Universities and other educational institutions as professors, teachers or research workers was available. Section 80 F was inserted by the Finance of 1967 with retrospective effect from Act 1.4.1966 by the same Act it was also omitted w.e.f. 1.4.68 and the present provision was inserted. Thus it presented curious spectacle of a provision being inserted as well as omitted, though for purpose of reenactment in another section by the same enactment. Shift from 80F to 80R and subsequent modifications therein are only of a mechanicistic character and are of no much of practical import. The quantum of this deduction is 50% of the remuneration received by the Professors, teacher or research worker.

Similarly a deduction equal to 25% of the income received in or brought into, India in foreign exchange is allowed to a resident individual being an author playwright, artist, musician, sportsman, actor etc.

In order to provide a further incentive for bringing foreign exchange into India by these categories of taxpayers, the benefit of deduction in sections 80R & 80RR has of late been enhanced. With effect from 1 April 1991 the deduction is being made uniform viz. 50% of the remuneration or 75% of the remuneration brought into India. This is quite in tune with the Govt. policy in the 1991 & 92 to tide over the foreign exchange crisis.
Deduction for income of totally blind or physically handicapped persons:

The Finance Act 1968 introduced a new deduction w.e.f. 1.4.69 for providing tax relief to totally blind individuals resident in India. Initially a straight way deduction of Rs. 2000 was allowed. In 1980 the quantum of this deduction was raised to 10000 Rs. from A.Y. 1988-89 the deduction is raised to Rs. 15000. The requisite qualification for making one eligible for this deduction are that the assessee is 1> totally blind or 2> suffers from a permanent physical disability; or 3> Mental retardation. In nutshell this deduction has changed both in complexion and quantum with passage of time. For assessment years 1969-70 and 1970-71 it was Rs.2000 and that too only to a totally blind assessee. The scope of this deduction subsequently widened to include other kinds of permanent physical disabilities. The amount of deduction available was increased to Rs. 5000 from A.Y. 1971-72 & Rs. 10000 from A.Y. 1981-82 one further increased to Rs. 15000 from A.Y. 1988-89.

The above narration of exclusions, abatements and deductions show that during its long itinerary Indian Income tax has taken strides to cope up with its changing economic policy from only revenue generator to Welfare and development oriented approach. Effort has been made to reduce complications from which straightaway deductions in place of rebates and concessional rates have been adopted. Development and changes of section 80 since 1965 is reflective of this change.

A mention has been made of a controversy as to whether tax unit be individual or a family. Merits and demerits of both have been enumerated. Upto now the discussion is made with the assumption of single individual. But an individual hardly lives in isolation. Individual generally lives as a component of a family. And there is economic interaction between members of family. This has a far reaching effect on taxation of income. An individual may transfer his income or assets and may make an appearance that he has far less an income than what he actually has and thereby understake the quantum of income. This window display through familial adjustment and readjustments may prove to be an engine of tax avoidance. If this be not counteracted it would do a great deal of injury to revenue. Income tax law has provided ways and means of this counteraction vis a vis individual assessees. This scheme of counteraction is discussed below.

Income tax statute provides that certain income accruing or arising to a person "B" shall be included in the total income of another assessee "A". One can visualize the following circumstances where for legal provisions have been devised through the years:

(i) "A" was the owner of the assets which yield income and has transferred the income above unaccompanied by a transfer of the assets yielding the income to B.
(ii) A was the owner of the assets and he has transferred them to "B" but by means of a revocable transfer of assets.

(iii) "B" is the spouse of "A" and derives share income from a firm in which he/she is a partner along with "A".

(iv) "B" is the spouse of "A" and derives remuneration from a concern in which "A" has substantial interest and such remuneration does not flow from the utilisation of any professional or technical knowledge or experience possessed by "B".

(v) "B" is a minor child and derives share income from a partnership to the benefits of which he/she is admitted.

(vi) "B" is the spouse or minor child (other than a married daughter) of "A" and the income arises from assets transferred, without adequate consideration by "A" to "B" directly or indirectly.

(vii) "B" is the wife or minor child of A's son and the income arises from assets, directly or indirectly transferred without adequate consideration, by "A" to "B" such transfer being effected after 1st January 1973.

(viii) "B" is a person (or group of person) to whom the income in question arises from assets directly or indirectly transferred by "A" otherwise than for adequate consideration and the income is held by "B" for the immediate or deferred benefit of the spouse or a minor child (other than a married daughter) of "A".

(ix) "B" is "A"s spouse and is the beneficiary under a trust, the trustee of which is a partner along with "A" and holds the share income, wholly or partly for the immediate or deferred benefit of "B".

(x) "B" is A's minor child and is the beneficiary under the trust, the trustee of which is a partner in a firm and holds the share income, wholly or partly in trust for benefit of "B".

(xi) "B" is a Hindu Undivided family of which "A" is a member and its income is derived from assets which constituted the separate property of "A" but was subsequently thrown into the hotchpot of, or transferred to, family "B" on or after 1 January 1970 otherwise than for adequate consideration.

(xii) "B" is the spouse or minor child of "A" and "B" income is derived from assets which, having been the separate property of "B" are transferred by "A" or thrown by A into the hotch-pot of his joint family on or after 1 January 1971 and subsequently got partitioned between "A" and the other members of the family as a result of which some of the assets are received by "B".
The above visualizations which are manifested in the provisions of sections 60 to 64 had their parallel provision contained in the 1922 Act.

The aforesaid discussion clearly brings out the rationale of aggregation and clubbing of other persons income with that of the other assessee. Though not in the other fields of jurisprudence but in this area the taxation jurisprudence admits of vicarious liability in the tax domain. As is clear from above [(v), (ix), (xi)] any income accruing to a minor from any asset transferred to him by the parents or the grand parents is included in the income of the parent or grand parent who transferred such income generating asset. However in respect of all other income accruing to him, the minor is a separate taxable entity. Keeping in view the rationale for aggregation of minor's income with that of the parents, the Chelliah Committee recommends that all income of a minor, other than wage income be aggregated with the total income of—

i> The parent having the higher income where the total income of one parent or of both the parents happen to fall below the exemption limit for individuals.

ii> Any one of the parents at the option of the parents where the income of both the parents exceeds the exemption limit; and

iii> If over time the income of the parent, with whom the income of the minor was aggregated earlier, goes below the exemption limit, the parent having the higher income.

In view of the tax payers attitude of tax avoidance through showing income or part of their income in the name of their minor children the aforesaid recommendations of the committee appear to be well founded and have been accepted by the Central Government.

The elaborate provisions of the Income Tax Law have been evolved, over the years, step by step. The legislative history of these sections is a glaring example of moves in the 'battle of manoeuvre' waged between the legislature on one had and assessees, who seek to take advantage of loop holes in statutory language, on the other.

Despite the demerits of individual as a tax unit certain mitigation of those demerits through aggregation and clubbing provisions have been made through years. Individual continues to be and shall ever continue to be a tax unit in tax statues. Family as a unit is generally not preferred but Indian Income tax Law has always been accepting. "Hindu undivided family" as a tax unit because of the peculiarities of this age old institution. In the following pages H.U.F. shall be discussed as a distinct assessee.
4.6 Hindu Undivided Family

4.6.1

The Hindu Undivided Family is an institution peculiar to the Hindu community. Till recently, the family in India consisted not only merely of the father, mother and unmarried sons, it used to also include in addition, married sons with their wives and children, the father and grand father of the head of the family; and also nephew, cousins and other relative living with the family.

4.6.2 Anatomy of the H.U.F.

The property of a H.U.F. is joint; in other words, the right of sharing in its proceeds is vested not in any one member of the family but belongs to all its members who are coparceners in the property. Every member of a H.U.F. however is necessarily not a coparcener. Only those who are three generations next to the holder in unbroken male descent can be coparceners; in other words, only the sons, grand sons and great grand sons of the holder of the joint property constitute coparcenery.

The number of such coparceners is a thing impossible to assert with any degree of definiteness. If one assumes a normal Hindu family to consist of two sons, and if one further assumes A to be the holder of a joint property "A" will have to share the income of the joint property along with the 14 coparceners as shown in the following demonstrative chart.

**Chart 4.1 Structure of Coparcenary**

```
  A
     |
    1 2
     |
  3 4 5 6
     |
  [Grand Sons]
     |
  7 8 9 10 11 12 13 14
     |
  [Great-Grand Sons]
```

The above chart however presents at best an illustration only. The number may vary. The actual number may be less. Some marriages may result in no children while others may not be productive of male children; at times the marriages may be
productive of more than two male issues. Here two sons have been assumed in view of the general atmosphere of having two issues only in an optimal family size. Number of caparencers refers to those who have a right to share in the property. It is certainly not identical with the dependents whose number is much larger. A joint Hindu Family consists of all persons lineally descended from a common ancestor and their wives and unmarried daughters. A Hindu coparcener is a much narrower body than the joint family. The coparencer need not be only adults; any member provided he satisfies the condition set forth in above shown chart, can claim a share of property. It does not matter if such claimants are minors, babies in the arms or even children in their mothers’ wombs. A son who was in his mothers’ womb at the time of partition is entitled to a share, though born after partition, as if he was in existence at the time of partition. The estates are managed by the father or in his absence the senior male member of the family who is called a Karta. He has considerable discretion in managing the property and provided he spends its income only for family purposes, is not under any obligation to economise or save, as paid agent would be. Conventionally the eldest male member is the Karta. Hindu Law permits any other junior male member of the family, to work as manager with the consent of other members of the coparcenary. In a family consisting of minor male members and a widowed mother, for the tax law purposes, the widowed mother can act as a guardian of the minors and can file the return of the incomes of the minor.

To constitute a H.U.F. the second basic tenet is the coparcenary property. Discussion of coparcenary property is significant as Hindus are not forbidden from holding separate property. Joint Hindu property can be of two types: 1) Ancestral; and 2) Separate property of members thrown into the common coparcenary stock. However as discussed earlier under sec.6(2)(b) of late it is treated to be a property as a source of income chargeable to only the transferor.

The nature of such ownership is a thing unique to Hindu Law. The ownership of the coparcenary property is in the whole body of the family. There is community of interest and unity of possession between all the members of the family. No one member of the family can claim any specific share of the joint property. Consequently no member is entitled to any definite share of the income from the property. The entire income of the joint family belongs to the common purse, and is available for the use of all the members; the interest of any one member is a fluctuating interest being enlarged by deaths in the family and liable to be diminished by births in the family. As these two factors are both uncertain as to time and frequency of their occurrence, it is absolutely impossible to predict any fixed proportion for each of the members on a partnership basis. The only thing that the members are entitled to - apart from partition whereafter the
family shall cease to be joint one—is joint possession of the family property, and the right to be maintained at the expense of the joint income.

As has been referred to above the H.U.F. ceases to be a joint family after partition or after the shares of the income defined and set apart for the different members. Otherwise the presumption is that a family once joint continues to be joint.

Thus, the Hindu Undivided Family is an association of many individuals related to one another by ties of blood living together and owning property jointly. It is a separate legal unit; and its fundamental feature is its oneness—the fact that the joint family income belongs to all the members of the joint family the members of the joint family regarded as one, and not in any defined individual proportions.

Curiously enough, Indian Income Tax statute (neither 1922 Act nor the present 1961 Act) has explicitly defined this tax unit. Inferentially only one has to gather it. In the concept of person this tax unit appears to have been enumerated.

Schools of Hindu Law:

Tax statutes do not clearly define a H.U.F. One has therefore to fall back upon the concept as concretised in the Hindu Law and the ancient scriptures. However, treatment in further details shall not be within the purview of discussion here. The aforesaid anatomy of H.U.F. vis a vis tax unit for Income taxation is based on the concept as evolved in the Hindu Law.

According to Hindu Law Hindu Undivided families are governed by two main schools, viz. Mitakshara & Dayabhaga. Mitakshara school applies to the whole of India except the states of Bengal, Assam and some parts of Orissa. According to this school the son acquires an interest in his father's ancestral property by mere birth and has a right to demand portion. But the self acquired property of the father remains his personal property.

Second school is Dayabhaga school. According to this school of Hindu Law the son does not acquire any interest by birth in the ancestral property held by his father unlike Mitakshara. Son's right arises only on the death of the father. After the death of his father son acquires a right in both properties viz. ancestral and self acquired by father. Another important element is that they get the shares in defined proportions and not equal, owing to this therefore, a son is not entitled to claim partition during the lifetime of father, who alone is the absolute owner of the property. This school prevails in Bengal, Assam & some parts of Orissa, since the shares of persons are defined they may continue to enjoy unit of possession or may prefer to seek partition. Under this school father has unfettered right to dispose of the property in any way he likes. It applies to both ancestral as well as self acquired property.
Jain and Sikh undivided families are also treated as Hindu Undivided families, unless under special circumstances the assessee claims not to be treated as such. If such claim be made the onus of proof shall be on the assessee to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu Undivided family.

Taxation of H.U.F. — A historical overview:

If one takes a peep into taxation of H.U.F., two phases distinctly emerge. One phase is up to 1917-20 and the other is after 1922.

H.U.F. for all legal purposes constitutes one unit. The income tax law sought to treat it in the same manner; and taxed H.U.F.'s on the same basis and scale as individuals; the members of these families were of course exempted from tax on their income from such property but there was no scheme of refunds if the member's rate was lower than that of the family. This did not result in great injustice for, till 1916, there was practically no graduation in the tax. After 1916, the rates rose sharply on a progressive basis and were again raised in 1921 and finally consolidated in 1922. In spite of the change in the position, Hindu joint families were treated as before, on the same basis as individuals, and taxed at the personal rates.

It makes all the difference when one comes to the imposition of supertax on the HUFs. Law here pays attention to the peculiar nature. When the supertax on incomes above Rs. 50,000 was first introduced in 1917, the HUFs were placed on the same footing as companies and partnership firms. Companies were taxed to super tax only on their undistributed profits; on a similar analogy, HUFs were subjected to tax only on that portion of their income which was not paid or finally allotted to their members. Total income was defined as meaning "Income accruing in the previous year from all sources except that in the case of a HUF; so much of joint income of such family as has been actually expended or paid for the maintenance and other expenses of any member of such family or paid or finally allotted to any such member." Just as shareholders of companies were directly assessed to super tax on their dividends, similarly, members of Hindu undivided families were also directly assessed in respect of their joint family income. HUFs, thus, for purposes of super tax were regarded as association of individuals and treated just like companies. There was thus an anomaly of the HUF being treated as an individual for purposes of income tax and as an association for purposes of super tax. The super tax was revised in 1920. The companies under this Act were relieved of the graduated of the super tax on their undistributed income, and subjected to a flat rate of one anna in the rupee on their total profits. The Hindu Undivided Families were deprived of the concessions given by the 1917 Act, and treated on the same basis as individuals, even for purposes of
super tax. Individuals receiving joint family income were exempted from super tax on such income. In short, the HUFs have been uniformly treated as individuals for income tax purposes; as regards super tax, they were for a time treated as associations but after 1920 were treated as individuals. Since 1922 HUFs are treated as single individuals for the purposes of both income tax and super tax. Subsequently after integration of super tax with income tax the issue lost its basic substance so far as aforesaid anomaly is concerned.

Post 1922 Position:

After 1922 HUFs have been being treated on line with individuals and taxed at graduated personal rates. There is no provision for refunds if the individual’s personal rate is less than that applicable to the joint family. Nor is there any provision for the individual to pay the excess to the state if his personal rate is higher than that relevant to the family. Members of HUFs are not only exempted from personal liability in respect of their joint family income, but such income is completely excluded from the consideration of his personal rate. An example would better illustrate this. If a member of a joint family has a total income of Rs. 50000, Rs. 30000 being received from joint family income, joint family pays tax on Rs. 30000, and on the remaining Rs. 20000 the individual pays not at the rate applicable to Rs. 50000 but only at the rate applicable to Rs. 20000. Thus a member of a joint family pays tax on his separate income at a rate which has no reference to his total income. Besides a special concession was granted to HUFs, the taxable minimum for super tax in their case being Rs. 75000.

Prof. Rao’s appraisal of taxation of H.U.F.:

Analysing the incidence of taxation during the thirties Dr. Rao pinpoints the following flaws inherent in the taxation of HUF.

In the eyes of Law H.U.F. constitutes a single tax unit. But in actual practice there are many families that do not live jointly. This makes a world of difference. One must deal separately with the two types of HUFs viz.

1> Families joint in estate as well as living.
2> Families joint in the estate, but not on living.

1> Families joint in estate as well as in living:

Such a family not only constitutes a taxable entity but it is a single unit for living also. All the members live together and none of the members receive individually any specified shares of the joint income. The Karta handles the whole of family income and is at liberty to spend it provided he does so for the purposes of the family. Apparently, then, the law does not ignore facts when it taxes such a family as an individual. But it does ignore one essential factor, that the manager of a HUF has, unlike an ordinary individual, to spend without any option a portion of the
family income on maintenance of the coparceners. Coparceners have a right to enforce this right of theirs in the court of law (if need be). The expenditure so incurred by the Karta is a necessary expenditure, for which an allowance should be made. This is not done, and the system of taxing HUFs leads to taxation of necessary expenditure which may be said to fall on the gross income of such families.

2) **Families joint in estate, but not in living:**

These families are joint in estate only. Members live apart only receiving joint family income in certain informally agreed shares. The law treats these families as individuals, and there are no provisions of refunds. Following important consequences flow from this state of things:

i) Individuals with incomes below Rs. 2000, who are totally exempted from the ordinary income tax, are yet taxed on that portion of their income which is derived from such HUFs. The extent of this grievance becomes greater, the higher the rate at which HUFs pay tax. For example if a HUF pays tax at the rate of one anna per rupee and if a part of its income is distributed among persons whose total income is below Rs. 2000, these latter persons pay tax at this high rate, though under the ordinary income-tax law they would be totally exempt.

ii) Where the personal rate of tax payable by the beneficiary of HUF property is higher than the rate at which the joint family is taxed, the individual pays at the higher rate on his joint family income.

iii) Where the personal rate of the tax payable by the beneficiary of joint family property is higher than the rate at which the joint family is taxed, the individual pays at a lower rate on his joint family income than warranted by his ability.

iv) The exclusion of the individual’s joint family income in determining his personal rate of tax makes him pay at less than his real ability even on his other income.

Thus, Dr. Rao concludes, the incidence of taxation of such HUFs is totally different from the normal incidence of income-tax. Poorer persons pay at a higher rate on their joint family income, while richer persons pay at a lower rate not only on their joint family income, but on their other income as well. Income tax, though levied on progressive scale on HUF assumes the regressive nature (as described above) on the shares of such joint family income, the net effect being against joint family income in the case of the poorer assesses and in its favour in the case of richer assesses thus grossly violating the doctrine of ability to pay.

The Schemata of taxation depicted above and shown to have been a position evolved since 1922 continues to this day with only
minor changes in rate structure which has a significant bearing as described above had remained uniform for all the HUFs irrespective of the consideration of members' separate incomes. This placed those HUFs whose members have independent income exceeding the present exemption limit in a relatively better position than those whose members have lesser personal incomes.

Accordingly, in view of the recommendations of the Wanchoo Committee the Finance Act of 1973 has provided with effect from the assessment year 1974-75 a separate rate schedule in the case of HUFs having one or more members with independent total income exceeding Rs. 5000 with effect from A.Y. 1975-76 this has been raised to Rs. 6000. At various slabs the differential rates are greater for these specified HUFs. Thereby this flaw of taxing poorer persons greater and the richer the less has been mitigated to some extent. But this does not suffice in the interest of the doctrine of ability to pay.

One more characteristic of a HUF is that the HUF shall continue till the time the members composing the HUF desire it to continue as HUF. After partition the HUF comes to be disrupted and thereafter the members are taxed as individuals. Partition can be total or partial. The legal compass of partition could thus be described (a) Partition means: i> Where the partition admits of a physical division, a physical division of the property but a physical division of the income without a physical division of the property producing income shall not be deemed to be a partition ii> Where the partition does not admit of a division by metes and bounds such division as the property admits of, but a mere severence of status shall not be deemed to be a partition; (b) partial partition means a partition which is partial as regards the persons constituting the HUF or the properties belonging to the HUF or both. Under the present scheme of taxation of the HUF, an HUF may be composed of smaller or branch undivided families which may hold properties in their own right and may themselves be assessed as distinct from the apex HUF. This, as has been said earlier, is possible because a Hindu even if he be a member of a joint family is not proscribed from holding separate property. So, due to partition many small HUF units possibly may emanate from the original genus HUF. But all these species of HUFs under the present scheme of taxation of HUF get the advantages of higher quantum of deductions from gross total income. Upto A.Y. 1973-74 HUF enjoyed higher exemption limit of Rs. 7000 against one of Rs. 5000 for the individual and a higher monetary limit of Rs. 30000 as deduction on account of contribution towards life insurance premia as against the quantum of Rs. 20000 for the individuals. Thus partition benefits the HUF more compared to individual assesses. In the words of Gulati and Gulati what makes the position of HUF more favourable as compared to that of individual is the rule permitting partial as well as total partition of the family.

Partition paves the way of splitting the property and income of the HUF. If this splitting could be stopped higher
rates would help increase the revenue of the exchange or else splitting of HUF into smaller units would nullify the effect of higher rate. "Since an HUF can be divided and sub-divided into smaller units of HUFs each such unit comprising a separate taxable entity in addition to the main HUF the incidence of the higher rates can in fact be avoided quite easily, particularly if the main HUF has not been divided earlier into the maximum permissible number of HUFs.

Partial partition is permissible under the present scheme of taxation of HUF. This assumes several forms. The family may be partially broken up not only into one or more registered firms but also into one or more HUFs. Further, the HUF may over and above the benefits it derives from partitioning, avail itself of transfer inter vivos making the total benefit much larger. Thus loss of revenue in case of partial partition would exceed the loss through complete partition and when the technique of partial partition is fully developed it would exceed the loss through transfer. It should be noted that the rigours of transfer inter vivos shall be brought under control to some extent through the recent amendments of Sec.64.

HUF is a sacred and age old institution of India. This provides an umbrella of Social security to its members. [In the absence of the extension of modern security measures the Hindus under the protection of this institution enjoyed the fruits which the modern welfare state extends to its subjects under its security schemes.] Yet this institution has been being abused as an engine of tax evasion. The above narration of taxation of HUF quite brings home this fact.

Despite this abuse of HUF one cannot venture to suggest altogether its elimination as an unit from the horizons of income taxation. It should undoubtedly be retained albeit with certain modifications in the scheme of taxation of HUF.

Suggested scheme of taxation of HUF:

Astonishingly the recent Tax Reforms Committee do not seem (Chelliah committee 1991) to have taken note of these flaws in the taxation of HUF. They did not pay any attention to this important tax, unit. With a view to ameliorating the scheme of taxation and minimising the prevalent flaws following scheme of taxation of HUF is suggested herewith:—

1) Hindu undivided families, as tax unit be divided into two viz.
   i) HUFs joint in estate but living apart &
   ii) HUFs joint in living and joint in estates.
   As to former type of HUFs i.e. joint in estate but living apart:
   Such families behave some what on lines with association of
individuals. It is, as a matter of fact, no longer, one unit, though spiritually it may continue to be so. The injustice of treating such a family as a single person immediately becomes patent. Such families be treated for taxation analogous to companies. They may be taxed at the maximum rates and refunds allowed to members whose personal rates are less than maximum. Members be made to include in their personal income. Such a system will bring share from HUF the taxation of these H.U.F.s into line with individuals ability to pay. To avoid the creation of fraudulent shares of the joint family income, it may be provided that the proportion of the shares returned for income tax purpose, shall be regarded as holding good also for the purpose of partition. This treatment, however shall not be apt for the HUFs joint in estate as well as living.

2> HUFs joint in estate as well as joint living:

Any scheme out to suggest taxation of HUF as an "association of individuals" for such a specie of HUFs shall be ending in the comprehension of the fact that HUF is not only a mechanistic association of individuals but it has attributes much more than that. Community of interest and unity of possession are the essential features of the joint Hindu Family. The company orientation of scheme of taxation of such HUFs shall not be in consonance with the intrinsic nature of such families. They therefore, warrant a differential line of treatment of taxation. The income of such a joint family, though it may not be divided among its members, has much more expenditure laid on it, for the coparceners of the property have the right of maintenance on the income. Such an HUF therefore be taxed as an individual, but it should be taxed only on the excess of its income over what is necessarily spent on the maintenance of the coparceners. For complying with this maintenance allowance foundational concepts of personal allowances elsewhere may be made use of and thereupon could be based the calculus of this allowance. To prevent fraud, it may be provided that any person for whom an allowance is claimed as a coparcener will be so treated for purposes of partition as well. The excess of the joint family income over this expenditure will be its taxable income. Allowances for children and marriage should not be given in case of such families unless the allowances claimed are on behalf of persons who are themselves not coparceners. This will prevent duplication of allowances.

Members of these families should be allowed, as at present to exclude their joint family income from the computation of their personal rate, as they are really not in receipt of the joint family income.

This scheme of taxation of HUF may be based on correct understanding of their true position as taxable units. There are some other tax units (organisational tax units) of which partnership firms are important ones. Partnership firms as tax units are discussed below:
Partnerships:

The Income Tax in India has from its very inception taken into account the partnership relationship. Even to this day this form of business organization has not only survived but continues to be a dominant form of business organization. Particularly amongst the trading community it has an added importance as forming basis of a separate taxable entity. Its nature is discussed below:

Partnership Firm:

Assessee organization overviewed & X rayed.

One finds the definition of the expression partnership in Indian Contract Act. No separate definition was afforded in the Indian Income Tax Act 1922, as it was first enacted. Doubts were raised in 1923 as to the adaptability of the definition in the contract Act for the purposes of the Income Tax Act. Income tax (Amendment Act, 1930 therefore introduced new definitions of the "firm", "partner" and partnership " as having the same meanings respectively assigned to them in the Contract Act, 1872. With enactment of a distinct statute viz. Indian Partnership Act in 1932 the definition in the Contract Act was removed and was enacted on the partnership Act defining the words 'partnership', 'partner', 'firm' and 'firm name'. Accordingly the Income Tax Act adopted these definitions as they were defined in the Partnership Act. 1932. These definitions have continued since, and the present Act of 1961 substantially re-enacts the definitions as they stood under the Income Tax Amendment Act 1939.

The Partnership Act, 1932 defines partnership as the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. "Persons who have entered into partnership with one another are called individually 'partners' and collectively a firm' and the name under which its business is carried on is called the Firm name.

Present 1961 Act substantially adopts it with a little variation that it also includes in the expression partner, unlike the Partnership Act, a minor admitted to the benefits of partnership.

It would, however, amount to digression if an indepth and in details analysis of the concept of partnership is attempted. It could only be stated that interpreting literally we get the following essentials to constitute a partnership:

1> Agreement:

Agreement is a crux of partnership. H.U.F. arises out of status and partnership out of agreement. If there be no agreement partnership can not exist.

2> Two or more persons:
It is rather an etymologically warranted that there must be 
at least two to constitute partnership. If by any reason 
whatsoever viz. death, retirement, expulsion or bankruptcy of a 
partner or partners and the number of partners comes to less than 
two the partnership (relntj relation) ipso facto comes to an end.

3> Sharing of profits :-
The aforesaid agreement must be to the effect of sharing of 
profits. Prima facie the organisation must aim at profit making 
or in other words it must have commercial orientation or else if 
the organisation has altruiistic objectives it may amount to 
philanthropic association. Profits must not only be made but 
shared also. Thus profit sharing is a crux of the matter. But 
one can not go by the surface appearance of the sharing of profits 
alone one is required to probe deep into the true relationship 
subsisting amidst the persons. Thus one comes to the conclusion 
that sharing of profits is sine-qua non but not the conclusive 
evidence of the existence of partnership. A cognate issue is that 
of sharing of losses sharing of losses is a matter to be decided 
by and between the partners. According to Accounting approach 
profit includes losses. At best it is a negative profit. Sharing 
of losses, though not a necessary feature of partnership, has been 
held to be a strong prima facie evidence of partnership.

But no hard and fast rules can be laid down in this 
connection. Despite sharing of profits or losses relationship 
between persons may not be a partnership. Whether or not 
partnership exists will have to be determined in the light of 
facts of the situation. One should not crave for a well knit, 
well carved out touchstone for deciding the existence of partnership. 
All the three tests viz. ownership test, power test 
and drawings test will have to be applied to gauge whether a group 
of persons constitutes a partnership or not.

As has been said earlier for fear of digression no indepth 
treatment of partnership is warranted. But in view of the Supreme 
Court pronouncement that it is only partnerships constituted 
according to the partnership Act that can be considered as 
partnerships under the Income-tax Act discussion to the extent 
herewith was undoubtedly needful.

4> Agency foundation : The nature of firm :

A pertinent question about nature of firm that poses itself 
is whether a firm is a juristic entity. This problem has two 
dimensions. viz. the first one is the nature of firm in 
partnerships and the other is the nature of firm in Income-tax 
Law. Under the Law of Partnership, a firm has no legal existence 
apart from its partners and it is merely a compendious name to 
describe its partners. The law with respect to retiring partners 
as enacted in the partnership Act is, to a certain extent, a 
compromise between the strict doctrine of English Common Law which 
refuses to see anything in the firm but a collective name for 
individuals carrying on business in partnership and the English
mercantile usage which recognises the firm as a distinct person or a quasi corporation.

But under the Income-tax Act the position is somewhat different, and a firm can be charged to tax as a separate assessable entity distinct from its partners who can also be assessed individually. A partnership as the firm as such is a separate and distinct unit for purposes of assessment. The technical view of nature of a partnership under English law or Indian law has been held not applicable to the law of income-tax. Thus, it has been held that a firm is not a legal entity even though it has some attributes of personality, but, for purposes of income tax law, it has been held to have a separate personality and existence of its own de hors the partners. The truth is that it is not possible to give a categorical answer in all contexts basing it merely on the general proposition that under the income-tax law, a partnership firm is a distinct entity or that in general jurisprudence a firm is not invested with a legal personality, but it is a mere compendious name for the partners.

To reflect in nutshell on the nature of firm it can be said that Indian Law in its partnership Law endorsed the English common Law (compendious of individuals) view but in Income-tax domain the Indian Law seems to have endorsed the English mercantilite usage.

This anatomy of partnership assessee gives rise to one more question of plurality of firms with identical partners. This question arises on account of the anomalous legal personality attaching to a firm. It is not a separate juristic person. The firm is only a compendious mode of designating the persons who have agreed to carry on business jointly and the business and the income therefrom are owned by persons who constitute the firm. From this standpoint it would follow that whenever there are same persons behind the back of two or more firms, the profits arising them from all would have to be consolidated and taxed in the hands of one entity irrespective of the quality or nature of the business of the profit sharing ratio of the common individuals at the back of different concerns. There are divergent views about the aforesaid proposition. Sir George Rankin differs from the above proposition. In his view the proposition that the same persons in the same shares can not for income tax purposes be partners of two entirely separate firms is a highly abstract proposition.

The other viewpoint is to treat, for purposes of income tax, the plurality of firms be recognised and treated as separate taxable entity. This proposition is logical and simple. But it is too transparent a proposition and would easily lend itself to be taken up with avidity by the taxpayer to divide the profits of what in substance belongs to a single taxable entity. This proposition also has not received a wide and undisputed acceptance.
Thus, real solution of the problem will have to be found construing the true intention of the parties whether to constitute themselves into same unit or they truly intended to remain separate entities. No hard and fast rules could be expected in this connection. Ultimate decision would be mixed both of fact and law.

While probing into the anatomy of partnership organization only the concept as evolved in the partnership law with its ramifications for income tax purpose has been discussed. The concept of partnership (with its cognates) as defined in the present (1961) Act presents itself divisible into two limbs. Upto now only the first limb viz. "firm", "partner" and partnership have the meanings respectively assigned to them in the Indian Partnership Act (9 of 1932)" has been considered. But the later limb viz "but the expression" partner" shall also include any person who, being a minor, has been admitted to the benefits of partnership" remains and it warrants a little more elaboration.

Position of minor:

Position of minor in Indian law, especially after the decision in Mohri Bibi Vs. Dharamdas Ghose case is crystal clear. Agreements with a minor are ab initio void. Implications of this dictum need hardly be gone into in any more details here. The impact of this theory is patent. Setting aside any effects of sections 64 & 65 of the contract law agreements with minors are void (and not voidable as is visualized in the aforesaid sections). And agreemental foundation of partnership is also patent. For partnership agreement is a sine qua non and for agreement "majority" of the concerned party is an inevitable prerequisite. Thus, it is clear that ostensibly and in the nature of things a minor can not be a (full fledged) partner. If this would be accepted in income tax treatment also it would have posed number of practical difficulties in the world of commerce. Moreover Partnership law itself provided a way out for minors. A minor though can not be a (full fledged) partner, could be admitted to the benefits of a firm with the consent of all partners. If a minor could procure benefits he could be deemed to have had his income and if a person earns income he is amenable to the charge of income tax. So a minor's income in the form of share in the firm's income can be brought within the purview of income tax domain. The incomes of minors admitted to the benefits of any partnership is included in the income of the parent irrespective of whether or not either parent is a partner in the same firm. Hence the addition of the second limb to the definition of partner in the year 1961. This, as has been said earlier, is a substantial change brought about by the present Act over the definition as given in the Income Tax Amendment Act 1939.

Taxation of partnership:

For purposes of Indian Income Tax firms are divided into two
classes viz.
1> Registered firms and
2> Unregistered firms

Registered firms are those firms which have been registered with the Income tax authorities (in consonance with the provision viz. at present under section 184 of the 1961 Act) a regular deed specifying the respective shares of each of the partners. Up to the thirties the partnerships were treated alike companies for purpose of income tax, being charged at the maximum rate while the partners were allowed refunds if their personal rates were less than the maximum. Registered firms were not subject to super tax, but the partners were directly assessed to super tax in respect of their income from such firms up to this period as in the case of companies, registered firms had no taxable minimum and all of them were subject to income tax. It hardly needs be repeated here that after the integration of super tax with income tax in the year 1965 the reference to super tax thitherto is rendered redundant.

But under the present Act the situation has changed. Upto 1968-69 the share of a partner in the income of a registered firm was computed without making any deduction for the tax borne by the firm on its income. However a partner was entitled to a rebate of tax (under section 86(iv) calculated at the average rate of tax on the proportionate amount of tax borne by the registered firm. With a view to simplifying the calculation of tax in the case of partners of registered firm a change has been brought about from 1st April 1969. According to this change income tax payable (if any) was to be deducted from the total income of the firm and the balance was to be apportioned among the partners. This change resulted in tax benefit to the partners. This benefit was on these lines: a partner after this change would secure a tax benefit on the basis that the proportionate amount of tax borne by the firm is in effect deducted from the topmost bracket of the partners income. Such tax benefit would, obviously, be higher than the rebate of tax available (upto 1968) to the partner from A.Y. 1969-70 therefore provision of rebate (u/s. 86 (v)) has been omitted.

An abortive change in 1987:

A drastic change was proposed in the year 1987. The change was proposed from 1 April 1990. Under the changed scheme where a firm satisfied certain requirements, it was to be assessed directly and the partner was not to be assessed in respect of this share of income. Were this scheme implemented it would have rendered the provisions of assessment of firms redundant in respect of firms. But this proposed scheme was dropped and the original scheme restored in 1989 w.e.f. 1 April 1989. And therefore the pre 1987 position still continues. The provision for the assessment of registered firm and its partners does not violate Article 14 and are thus
valid and constitutional. Since the 1987 proposals could not materialise this attempt to directly assess the firms and exclude partners (so far as their share in the firm is concerned) proved only abortive in the history of income taxation of partnership.

**Rate structure for registered firms:**

Registered firms get different treatment. For income tax rates purposes registered firms are divided into two viz. as professional firms and non-professional firms. Professional firms are those firms whose major income of which is earned through carrying on professions viz. professions of physicians and surgeons, architecture, chartered Accountancy etc. Firms are subjected to rate structure for professional firms only when at least 51% of total income is derived from professions and all other registered firms are subjected to different rate structure.

The rate structure upto A.Y. 1990-91 was as shown on the adjoining page.

<table>
<thead>
<tr>
<th>Rate applicable to Professional Firm</th>
<th>Rates</th>
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<tbody>
<tr>
<td>i) On the first Rs. 10000 of the total income</td>
<td>Nil</td>
</tr>
<tr>
<td>ii) On the next Rs. 15000 of the total income</td>
<td>4%</td>
</tr>
<tr>
<td>iii) On the next Rs. 25000 of the total income</td>
<td>7%</td>
</tr>
<tr>
<td>iv) On the next Rs. 50000 of the total income</td>
<td>13%</td>
</tr>
<tr>
<td>v) On the next Rs. 25000 of the total income</td>
<td>22%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rates applicable for other firms</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) On the first Rs. 1000 of the total income</td>
<td>Nil</td>
</tr>
<tr>
<td>2) On the next Rs. 15000 of the total income</td>
<td>5%</td>
</tr>
<tr>
<td>3) On the next Rs. 25000 of the total income</td>
<td>7%</td>
</tr>
<tr>
<td>4) On the next Rs. 50000 of the total income</td>
<td>15%</td>
</tr>
<tr>
<td>5) On the balance of the total income</td>
<td>24%</td>
</tr>
</tbody>
</table>

From A/Y 1991-92 rate structure has been changed. It is on following lines since.

<table>
<thead>
<tr>
<th>Rates for Professional Firms</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) On the first Rs. 25000 of total income</td>
<td>Nil</td>
</tr>
<tr>
<td>2) On the next Rs. 35000 of total income</td>
<td>5%</td>
</tr>
<tr>
<td>3) On the next Rs. 50000 of total income</td>
<td>10%</td>
</tr>
<tr>
<td>4) On the balance of the total income</td>
<td>15%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rates applicable to other Registered firms</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) On the first Rs. 15000 of total income</td>
<td>Nil</td>
</tr>
<tr>
<td>ii) On the next Rs. 35000 of total income</td>
<td>6%</td>
</tr>
<tr>
<td>iii) On the next Rs. 50000 of total income</td>
<td>12%</td>
</tr>
<tr>
<td>iv) On the balance of the total income</td>
<td>18%</td>
</tr>
</tbody>
</table>

Upto A/Y 1991-91 a surcharge was levied at 8% the amount of income tax if the total income of a firm (professional or other)
exceeds Rs. 50000 from A.Y. 1991-92 if the total income of a firm (professional or other) exceeds Rs. 75000 a surcharge @ 12% of the amount of income tax shall also be charged.

The above rate structure shows that of registered firms the professional firms get a preferential treatment over the other type of firms one fails to understand and appreciate the rationale of such a differential treatment of rate structure. Upto now the registered firms only have been dealt with the second category is that of the unregistered firm.

Taxation of unregistered & registered firms:

Unregistered firms are treated like individuals so far as their taxation is concerned. Here there is no distinction between a professional firm and other firms. Total income of the firm without deducting the tax payable on its total income, the share of the partner shall be included in his total income. If the firm did not pay tax on its total income the partner is liable to pay tax on his share. If the firm paid tax on its income, he will be eligible for rebate at the average rate of tax applicable to him. Unlike partners in the registered firm it is not allowed for partners here to set off or carry forward their share of loss severally with a few exceptions. Personal loss is an exception to this rule. Concept of personal loss requires a little more elucidation. At times the unregistered firm makes profit but in the scheme of apportionment among the partners per partnership deed some partners end up with losses. In such a situation when there is a loss to a partner such loss is a personal loss.

Unlike the registered firm, an unregistered firm is not required to retain maximum 30% share of each partner for payment of tax in case of default by the partner because in this case it is the firm itself that pays the tax. Again unlike the registered firm there is no obligation on an unregistered firm to file the return and pay the tax on behalf of a non resident partner (if there be one).

As from the tax rate structure of the registered firms cited above it is clear that the rates of registered firm are less compared to those of unregistered firm. Because the unregistered firms are amenable to the progressive rate structure applicable to the individual assessee. Thus the incidence of income tax is more on the partners of the unregistered firm. V.K.R.V Rao proves that the poorer partners of unregistered firm pay at a higher rate than is warranted by their total income. Thus the taxation of firms (based on classification of registered and unregistered ones) are directly in contrast with individual’s ability to pay unless one assumes rather improbable assumption that the partners of unregistered firms have no other income and also that their shares of the income from such firm are absolutely equal. Rigours of unequal incidence among poor & richer taxpayers of surtax were more then the patent if one analyses the incidence of super tax on unregistered firms for purposes of income tax, partners of
unregistered firms are required at least to add their total income and their share in the firm so that the rate of the tax may have direct reference to their ability to pay. As regards super tax, on the other hand, while the unregistered firms continue to be treated as individuals partners of such firms were permitted to exclude their income from such partnerships from their total income. In other words individuals paid super tax on their partnership income at the partnership rate and on their other income at a rate determined with reference to only the amount of their other income. This benefited the richer tax payer in two ways: first he could get his business divided into numerous unregistered firms and could reap benefits of exemptions, the rate of tax paid by each of these firms would be much less than its real rate; which was the one which would apply to collective income, as they all belonged to one person. Secondly, rich individuals whose income was derived from unregistered firms not only paid at a lower rate on their partnership income, but owing to the exclusion of such profits from their total income subject to super tax, the super tax paid even on their other income is at a lower rate, than that warranted.

But from 1965 with total integration of super tax with income tax this has lost it practical significance and the issue rendered itself redundant and of academic interest only.

The treatment of unregistered firms on line with individuals, though they are associations of more than one person results in making the income tax on such partnership income regressive. It presses hard on the poorer partners due, while taxing the richer ones as determined by total income. Undoubtedly the taxation of unregistered firms on the same lines as individuals conflicts with doctriae of ability to pay.

A registered firm enjoys a concessional tax treatment compared to that of an unregistered one. However, when other income of the partners is high in comparison to income of the firm it is in the interest of the individual to keep the firm unregistered. When this is done the firm pays tax at the lower rates while rebate on the individuals share is claimed at a higher rate and thus for richer tax payers (partners) keeping firms unregistered becomes an engine of tax avoidance. To remedy this flaw a change has been brought about in the year 1971 w.e.f. 1.4.1971 the Assessing officer has been empowered to assess an unregistered firm as a registered one.

The above discussion must have explained the scheme of taxation of registered and unregistered firms. But there is a missing link left in the discussion. This missing link has been deliberately kept or rather this segment of discussion has been deliberately deferred to this point. This is because of the element of commonality of treatment between registered and unregistered firm. Upto now the segment of inclusion of share in firms income in the partners total income and ramifications thereof in the treatment of partners only has been dwelt upon.
But the fact should not be lost sight of that determination of total income is very important for without it income can not be apportioned amongst the partners income. This aspect has been dealt with. It would be inapt here to go into all the details of how total income of the firm (both registered and unregistered) is calculated. Admissibility or other wise of deductions about other expenses does not warrant any special comments. But remuneration to partners in the shape of salary, interest on capital and advances etc. require a special mention. Upto A.Y. 1991-92 these charges are treated inadmissibles and added back to firms’ profit as shown by their books (Profit and loss account to arrive at profit from business of the firm) Chelliah committee suggests and it has been accepted and implemented through the 1992 budget (vide F.M’s Budget Speech 1992) these expenses to be treated as admissible ones. It would be advantageous to discuss what Chelliah Committee has to say on taxation of partnership firms as a whole.

**Chelliah Committee recommendations:**

The Committee took a birds eye view of scheme of taxation of partnership firms. (Segment 6.109 Page 75 of the Interim Report of the committee)

The committee opines that present scheme of taxation results in double taxation. (Page 76) According to the committee, the present scheme is administratively burdensome also as it entails rectification of partner’s tax assessments as a consequence of any change in the declared income of the firm. According to them any laxity on the part of the tax administration in carrying out such rectification can lead to loss of revenue. They think of the alternative scheme and deem it fit not to tax the partnership firm but to tax the partners in respect of their shares in the profits of the firm. This alternative scheme seems to uphold the theory that the firm has no separate existence and it is a compendium of the partners composing the firm. But practically all the income tax systems in the world acquiesce in the separate tax unit theory of the firm albeit with varying degrees of details of scheme of taxation. In view of this treatment of theirs they suggest:–

a) Scheme of registration of firms for income tax purposes should be abolished. All firms should be treated alike for income tax.

b) The existing separate tax on the income of the firm should be abolished. The firm should be required to calculate capital gains and its income other than capital gains separately. The income other than capital gains should be apportioned amongst the partners in the ratio of their share in the profits of the firm, for taxation in their hands at the appropriate income tax rates. In computing the income of the firm, it should be allowed, as against the present practice, to claim as a deduction any payment
of interest, salary bonus, commission or remuneration to any of its partners.

c> Where new partners are admitted to the benefits of partnership at any time during the accounting year the end of the first three months, share of the new partners in the profits of the firm should be ignored and profits should be apportioned amongst the old partners in the revised ratio of shares. However, this should only be in respect of the financial year in which the new partners have been admitted. This however will not apply when a firm is reconstituted on the death of a partner.

d> Where a firm has any income from capital gains it will be eligible to claim "roll-over" relief wherever permissible. Any capital gain (after allowing for the roll over relief) or loss incurred by the firm should be apportioned amongst the ratio of their share in profits of the firm. However the partners should not be allowed any roll over relief in respect of such share in the capital gains. The relief for bunching of gains should be allowed to be claimed by the partners in their personal assessments.

e> All associations of persons and bodies of individuals should be taxed in the same manner as firms.

f> Where the shares of partners in a firm or of members in AOP or BOI are not specified they should be presumed to be equal amongst them and no partner or member should be allowed to claim differently at anytime in the future in respect of profits of the year for which such presumption is made.

g> The firm or AOP or BOI should not be allowed any credit for the tax deducted at source from payments received by it. However it should be allowed to apportion the same amongst its partners in the ratio of their share in its profits.

h> The firm should be required to pay advanced tax on behalf of the partners in respect of the income of the partner from the firm and income from all other sources along the same lines as the facility available under sub section (2), (2B) and of section 192, to both the employer and employee in respect of deduction at source. The advance tax paid by the firm on behalf of the partners should be deposited with the Central Government through a single challan. The firm should, after the end of the previous year be required to submit separate annual statement regarding advance tax paid on behalf of the partners.

i> Every firm should be required to issue a certificate to every partner indicating the amount of interest salary bonus, commission or remuneration paid by it, the share of the partner in the profits of the firm, the share of the partners in the tax deducted at source on payments received by the firm and the advance tax paid by the firm in respect of the partners.
Notwithstanding the fact that there would be no tax liability on the part of the firms AOPs and BOIs they should be required to file the returns of income where the firm files the return of income voluntarily but after due date, they should be required to pay one half percent of the computed income of the firm subject to a minimum of Rs. 200, as a late fee for every month of default. If the return is filed in response to a notice issued after the end of the assessment year and the firm has not deposited the advance tax in the appropriate manner, the firm should be assessed to tax at the maximum marginal rate of tax for individuals and also be required to pay late fee as indicated above. In such a case, distribution of income in the partners hand would not arise.

Theoritic tenets of taxation of Partnership (firms)

Any tax levied on them should result in the same incidence of taxation on the partners as will be caused by a general income tax. If the taxation of partnerships brings about any other result, it is inconsistent with individual’s ability to pay.

As the partnership organisation has been X rayed it, s intrinsic nature be gauged by any scheme of taxation and the scheme of taxation must be commensurate with the inner self of the organisation. The X ray in this connection clearly brings home the nature of partnership organisation. Agency relationship is the cornerstone of partnership organization. Any scheme of taxation should not lose sight of this basic relationship of partnership organisation.

Critique of Chelliah Committee recommendations:

One finds 10 Sub segments of recommendations in segment 6.113 of the interim report of Chelliah Committee. Below will be found clause wise appraisal of the recommendations of the committee.

a> This recommendation, it is felt, will be readily agreed on all hands. The classification of partnerships into registered and unregistered firms is peculiar to the Indian laws. The weight of foreign practice is undoubtedly against Indian system. The All India Income Tax committee as long back as 1921 saw the absurdity of it and the elimination of this classification and differential treatment of the two types of firms. This is therefore the most constructive recommendation and must be accepted and acted upon.

b> This recommendation implies a scheme of taxation which is in no way consistent with the nature and temperament of the partnership organisation. As has already been remarked this approach very much upholds the theory that partnership is not separate from the partners and hence advocates taxation of partner severally. This recommendation does not appear to be well founded so far as the theoretical tenants of the taxation of partnership organisation is concerned. And it is therefore not possible to agree to the proposition set forth in this clause.
c> One feels inclined to agree to this recommendation into to for it recommends apportionment of firm income among the old partners only on the occasion of admission of a new partners.

d> This part of the scheme is rendered unnecessary in view of the alternative scheme of taxation proposed herewith. Hence this recommendation appears far from required.

e> Equal treatment of AOPs and BOIs in line with firms appeals to reason and hence this can be accepted into to.

f> Recommendation contained in clause A is quite compatible with the accounting approach and is generally adhered to in practice.

g> This is an offspring of recommendation set out in B and is not in tune with the proposed scheme of taxation of firms. It is, therefore difficult to agree to this proposition.

h> As an innovation over the prevalent practice this recommendation can be accepted.

i> This is not in tune with the proposed scheme and it would unnecessarily add to the burden of the already overburdened department. It is difficult to agree to this proposition.

j> At present unregistered firms are taxed as individuals and here only lies the bone of contention. Even by way of penal step it is difficult to accept individual treatment of taxation of firms. Any other deterrent penalty could be looked for but the above suggestion can not be agreed to.

Suggested scheme of taxation of Firms:

In view of the above criticism of the Chelliah Committee recommendations and the discussion upto now the following scheme for the taxation of partnership is proposed:--

1> Classification of firms into registered and unregistered ones is an absurdity. It does not appeal to reason as to why the factum of registration only should lead to the differential treatment of firms, which, as has been brought out, amount to gross violation of the doctrine of ability to pay which is the foundation stone of any optimal scheme of income taxation.

2> The firm should be taxed as a separate tax unit and be not taxed severally as suggested by the Chelliah Committee. This is the prevalent practice and as suggested by the Chelliah Committee it amounts to double taxation. Despite agreement with this proposition the rigour could be mitigated by some other measures. It is suggested that the firm along with its own return should submit the return of the partners showing their other income and on the basis of this joint scheme. The firm should be made to deduct the amount of tax payable from the share income (if positive) and if his other income is negative there should not be
any question of deduction if his share income is less than exemption limit. On line with salary (this in no way should suggest existence of employer employee relationship between partners and firm) deduction of tax at source scheme could be framed.

3> Present provision of adding back in case of salary, bonus, commission and other remuneration be retained, as against the recommendation. It is propitious from two points of view viz. in the first place it may be abused as a tool of tax avoidance and secondly it is based on sound theory. As recommended by the commission if salary be made admissible. The admissibility thereof may be tantamount to the acceptance of the proposition that there is a relationship of employer employee between the firm and the partners. But this is not a truism. The crux of partnership relationship, it is agreed on all hands, is that of agency. An agreement that a partner is to receive a salary does no more than to regulate the mode in which accounts are to be taken for the purpose of the division of profits among the partners. It, in no way mars the proprietary role (albeit in part) of a partner. Same logic could be extended to bonus. In the same way interest on Capital and advances are also a specie of financing of business by the partner and therefore by any stretch of imagination transaction of payment of interest by firm to partner can not attribute the relationship of creditor debtor between the partner and the firm. Partner's role, is, above all, that of proprietor of the business (albeit in predeterminate shares in profits & assets) this fact cannot be lost sight of in framing the theory of deductions for a firm. This theory is both explicitly (in the legal provision) and implicitly (by legal interpretation thereof by courts) has been upheld and it is a sound theory so far as partner - partnership relationship is concerned and therefore as against the clear recommendation of the Chelliah Committee. Acceptance of this proposition may amount to giving way by them to expediency only. It is, therefore, proposed that so far as scheme of deductions of salary, bonus commission, interest on capital and loan by partners & other remuneration are concerned status quo ante deserves be maintained.

4> The present rate structure for registered firms may be maintained. All firms shall be uniform type & firms be taxed as per provision applicable at present to registered firms. The few variations suggested above coupled with those of the recommendations accepted herewith in toto both may present the optimal (theoretically and practically) scheme for taxation of partnership organization.

Among the organisational assessee a cognate assessee is Association of persons or Body of Individuals. A brief discussion of it is necessary.

Association of Persons & Body of Individuals.

Before the 1961 Act, this category of assessees was described
as an association of persons simpliciter. Many groups of individuals escaped assessment to tax as groups just because the element of association was lacking amongst the members of the group even though the individuals composing the group were taxed in their individual capacity and status. To overcome this situation the 1961 Act enlarged the scope of this provision as to include within its ambit any body of individuals, whether incorporated or not. The significance-attaching to the interpretation of association of persons has as a result now disappeared. Thus, if the group does not fall within the ambit of the association it is now covered under the expression body of individuals per legal pronouncement to constitute an A.O.P. In order to be amenable to tax, there should be definite acts of management, on the part of the members constituting that association, as a consequence of which income is earned from the properties. Two or more persons should join in a common purpose or action with the object of producing income, profits and gains. Where the members joined voluntarily and not under compulsion, it was held that there was association of persons. But where two owners, who were tenants in common, did not do anything, which an owner of the property would not do to convey title, and there are no materials to suggest that there was any concerted action to earn capital gains the group could not be held to constitute A.O.P.

**Body of Individuals Conceptualized.**

As has been stated earlier to get over the escape of group of persons who could not be taxed because they could not in the eyes of law constitute A.O.P. this is an improvement over the provisions up to 1960 that this addition came to be made in the present Act.

The B.O.I unlike AOP can only consist of individuals or human beings. AOP could include non individual members too. A common purpose, a common tie, a potential or actual capacity to hold properties or disposable income would be the minimum requirement of a body of individuals. Approaching the issue from a different angle, it has been pointed out that the expression body of individuals should be given a wide interpretation and that it is the absence of the feature of common design or common will that distinguishes it from an association of persons. It may not be wide enough to include a combination of individuals who merely received income jointly without anything further e.g. Coheirs inheriting shares or securities. It would however be wide enough to include a combination of individuals but who are not actuated by a common design and one or more of whom produce or help to produce income for the benefit of all. The crux of the line of demarcation between A.O.P. and B.O.I. could thus be described. Association implies a voluntary getting together for a definite purpose, a body of individuals would be just a body without any common design or intention to get together, but doing something which results in income.
The above discussion has lost much of its relevance in view of the change brought about by the 1961 Act. Irrespective of the banding together for a common purpose or a joint activity if a group of persons is found to be in receipt of unit of income, the group itself is regarded as a unit and is liable to be taxed as a body of individuals whether incorporated or not. Thus if several persons jointly acquire a property without specifying their respective shares in the deed of purchase or even without reciting a consideration put up by each of them, they are liable to be taxed as a body of individuals in respect of the income from such property.

**Taxation of A.O.Ps & B.O.Is:**

**Computation of Share of a member of AOP or BOI.**

Share of a member of AOP or BOI in the income of AOP/BOI (When the shares of the members are determinate and known) shall be computed as under:

1> Any interest, salary, commission, or other remuneration paid to any member in respect of the previous year shall be deducted from the total income of the AOP or BOI and balance apportioned among the members.

2> If the amount arrived at in 1> above is a profit, salary interest, commission, or other remuneration paid to the member shall be adjusted against that amount and the result is treated as members share in the income of the AOP/BOI.

3> When amounted apportioned in 1> above is a loss any salary interest, commission or the remuneration paid to the member by the AOP/BOI shall be adjusted against that amount and the result is treated as member's share in income or loss of AOP/BOI.

4> The share of a member (computed as shown in 1 to 3) is apportioned under various heads as on line with that of AOP/BOI.

If the share of a member in the income of AOP/BOI is a loss he is not entitled to set it off against his personal income.

An AOP or BOI is assessed like an individual. The share income received by the members from AOP/BOI is dealt with as follows:

1> Where AOP/BOI is taxed at the maximum rate or any other higher rate the share of member is not included in his total income at all.

2> Where no income tax is chargeable on the total income of AOP/BOI the share of a member therein is chargeable to tax as part of his total income.
3> Where AOP/BOI pays tax at normal rates, income tax shall not be payable on members share in come. However it will be added to his income. It means on such share income tax relief shall be allowed at the average rate of tax.

Change of tax where shares of members in AOP/BOI are unknown.

The position in such cases is as follows :-

1> Where the individuals shares of the members of an AOP or BOI are indeterminate or unknown tax shall be charged on its total income at the maximum marginal rate.

Where the total income of any member of such AOP or BOI is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on its total income at such higher rate.

2> Where in the case of AOP or BOI shares of members is unknown but it is not a case falling 1> above the scheme is as follows :-

i> The total income of any member thereof for the previous year (excluding his share from AOP or BOI) exceeds the minimum taxable limit tax shall be charged on its total income at the maximum marginal rate.

ii> Where any member of such AOP or BOI is chargeable to tax for the previous year at a rate or rates higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the AOP or BOI which is relatable to the share of such member at such higher rate as the case may be and the balance of the total income of the AOP/BOI shall be taxed at the marginal rate.

If shares of members are indeterminate on the date of the formation of AOP/BOI or at any time thereafter the individual shares of members of AOP or BOI shall be deemed to be indeterminate or unknown.

The nature of partnership and AOP/BOIs could be said to be Genus / specie relationship Partnership is a genus of which AOP and BOI are a specie. The difference lies only that of agreement to share in partnership and AOP/BOIs it may be lacking. It is therefore suggested that it should be taxed like firms rather than like individuals.

Among the organisational assesses the importance of company can hardly be over emphasised. It is discussed in the following segment:

Company :

Of all the organisational assesses company assesses enjoy a paramount position. It fetches far more revenue compared to other assesses. Ostensibly the larger forms of ventures are carried by
company form of business organization.

Nature of company for income tax purposes.

Unlike partnership [where but for a few variations definition in partnership Act is explicitly adopted for income tax purposes] the definition of company under the Income tax Act is much wider than in the companies Act. The definition of the term company has undergone many changes from the time it was first introduced in the Act of 1896. Although all earlier definitions of this term have lost all practical significance yet, it would be but apt to discuss the historical background of the changes from time to time.

In the 1922 Act one comes across the definition of company as (i) a company as defined in the Indian Companies Act, 1913 or (ii) formed in pursuance of an Act of British Parliament or of Royal charter, or Letters Patent or an Act of the Legislature of a British Possession and (iii) it included any foreign association carrying on business in British India whether incorporated or not, and whether its principal place of business, was situated in British India or not, which the Central Board of Revenue may by general or special order declare to be a company for the purpose of the Act.

The Income Tax (Amendment) Act, 1940 removed the restriction imposed by the earlier definition to the effect that any foreign association to be treated as company must necessarily be carrying on business in India. In its amended form the ambit of the definition was widened to include even those foreign associations, which, though they were not carrying on business in India, were, in case deriving income from investments in India by way of dividend or interest.

The Income-tax and Business Profits - tax (Amendment) Act 1948 introduced the term Indian company and brought about a change in the definition. It covers in the definition (i) an Indian company as defined in clause (7 A) or (ii) any Indian or non-Indian Association, whether incorporated or not, which the Central Board of Revenue may, by general or special order, declare to be company for the purposes of this Act."

The consequential change brought about by this Act was (i) differentiation was introduced for rate purposes between an Indian company and a non Indian Company, and (ii) companies other than Indian Companies in the absence of recognition by the Central Board of Revenue by a general or special order, lost their status as "Company" and rendered themselves as liable to taxation at personal rates in respect both of income-tax and super tax.

With a view to removing this anomaly the Finance Act 1949 substituted another definition of company with retrospective effect from 31 March 1948 and it read" (i) any Indian company, or (ii) any association on, whether incorporated or not and whether
Indian or non Indian, which is or was assessable or was assessed as a company the assessment year ending on 31 March, 1948, or which was declared by a general or special order of Central Board of Revenue to be a company for the purposes of the Act.

The consequence of this change was that all foreign associations, whether incorporated or not, were granted company status to the extent to which they had been assessed as such under the Indian for the assessment year ending 31 March 1948. If any of them had not been so assessed, but was operating in India during the previous year relevant to the assessment year 1947-48, that is, if it had chargeable Indian income for that year, then too, it would have been treated as company. The emphasis was on chargeable income of such association and not on its assessed income, because the income may not have been assessable to tax all either because the income during the year was nil or because it was below the prescribed taxable limit or even because it was only a loss.

But if such an association or body had not been operating in Indian till then, but it had come to India only later, it had then to apply to the Central Board of Revenue for obtaining permission to be treated as a "company" under the Indian Income-tax Act. The Central Board of Revenue, however, could also pass a general order granting company status to such foreign associations as had corporate existence.

The 1949 definition had reference to one single year viz. ending 31 March 1948. However all companies assessed as such till then, i.e. for the assessment years prior to A/Y. 1947-48, could also automatically rank for company status and be included as "company" within the meaning of this definition, because these companies which had been assessed earlier could in the normal source be assessed or be assessable as companies also for the Assessment year 1947-48. Hence the reference to the year immediately preceding the assessment year 1948-49, from which year alone the distinction between an Indian and a non Indian company came to be drawn.

As a result of the 1949 definition, the laws as to the status of companies ceased to be discriminatory. Such company status conferred automatically on a company under the pre-1939 Act or by a British company formed under an Act of Parliament or on a Royal Charter or Letters Patent or a Legislative of a British Possession, also ceased and such foreign associations had also the status, even as a company of the U.S.A., or of France or of Netherlands, or of any other country, had to do.

After 1949, no discrimination is thus made as between a foreign company and a foreign association. All these bodies have to obtain a declaration from the Central Board of Revenue for obtaining company status. Consequently, since 1949, all non Indian bodies associated in joint enterprises, whether not registered as companies in their homeland, became eligible to be
declared as companies under the Indian Law.

At the commencement of the present Act the concept of company (as covered by Sec.2(17) stood as follows:--

Company means --

i) Any Indian Company, or

ii) Any association, whether incorporated or not and whether Indian or non Indian, which is or was assessable or was assessed under the Indian Income Tax Act 1922, as a company for the assessment year commencing on the 1st day of April 1947, or which is declared by general or special order of the Board to be a company for the purpose of this Act.

The above definition, requires no comment. The historical narrative upto now has been clearly embodied in its unequivocable form in the present Act.

Position as amended by 1971 Act:

The changes introduced by 1971 (Amendment) Act could thus be described. Before 1971 company included i> any Indian company, or ii> Any association, whether incorporated or not or whether Indian or non Indian which is declared by a general or special order of the Central Board of Direct Taxes to be a company for the purposes of the Act.

This power to declare any association to be a company for tax purposes has been made use of for several years past with a view to conferring on foreign companies as also on entities which are not otherwise within the scope of that concept. Such declaration is given by the Board, ordinarily in the case of any entity which possesses the ordinary characteristics of a company limited by shares and which is a legal person according to the laws of the country in which it is incorporated. Besides declaring companies registered in foreign countries to be "companies" for purposes of taxation in India statutory corporations established by Central, provincial or state enactments viz. road transport corporations, air transport corporations etc. have been declared to be companies foreign corporations in which the capital is held wholly or partly by a foreign Government have also been declares companies for the purpose of income tax, where such corporation are legal entities separate from the Government and are capable of holding property independently and of suing and being sued according to the laws of that country. This provision has also been used, on a few occasions, to confer the status of company on bodies such as chambers of commerce, clubs etc. even though these bodies do not possess ordinary characteristic of a company limited by shares. The declaration under this provision has been given in some cases with retrospective effect to cover past years as well.

The requirement that a foreign company could be treated as company for purposes of Income tax Act only if it has been declared as a company by the Board generates unnecessary work. Further giving retrospective effect to declaration made in the
case of foreign companies or other non corporate entities may not be said to be strictly in accordance with the provision of the law. In order to play the existing practice, that has been followed over the last many years, on a statutory footing, and to reduces the number of cases in which declaration as a company has to be given by the Board the definition of 'company' in section 2(17) been amended in 1971.

Under the amended definition the term company will include, besides an Indian company, any body corporate incorporated by or under the laws of any country outside India. The term will also include any institution, association or body which is or was assessable or was assessed under the 1922 Act or 1961 Act as a company for any assessment year up to and including the assessment year 1971-72.

Further, as under the earlier definition, the Central Board of Direct Taxes will have the power to declare by general or special order that any institution, association or body whether incorporated or not and whether Indian or non Indian will be treated as a company for purposes of Income Tax Act. Thus power of the Board has now specifically been made exercisable even in relation to past assessment years (whether commencing on or after 1.4.1971) and the declaration will have effect for any assessment year on years specified therein.

In nutshell the concept company defined for the first time in Act of 1896 traversed a vivid path. From 1922 Act when a foreign association with the condition that it carried on business in British India the horizons of this concept have been being widened with years and today it is a wider concept including in its garb not only Indian Companies and foreign companies but also all association whether incorporated or not, Indian or non Indian and all those association which have been declared to be company by special or general order of the C.B.D.T. The 1971 Act has paved the way for associations (which otherwise could not be branded to be company) to be declared as such with retrospective effect. Thus the company assessee stands to be a very wide concept today. Thus, as has been remarked before the definition of company for income tax purposes is wider than that defined in Companies Act.

Types of Companies:

Certain types of companies are expressly defined in the Act while certain others are merely referred to following are the types of companies of in the framework of Indian Income Tax Law.

i> Indian Company:

Indian company means a company formed and registered under the Companies Act 1956 and includes:

i> A company formed and registered under any law relating to
companies formerly in force in any part of India other than the state of Jammu & Kashmir and other specified place.

ii> a corporation established by or under a Central, State or Provincial Act;

iii> any institution, association or body which is declared by the Board to be a company.

iv> In the state of Jammu and Kashmir a company formed and registered under any law for the time being in force in that state.

v> In all cases, the registered or principal office of the company corporation, Institution, Association or Body has got to be situated in India.

The definition of Indian company was first introduced in 1948. Under the 1948 finance Act it was defined as a company as defined in the Indian Companies Act 1913 the registered office of which was situated in British India. Subsequently with the changing political geography of India during its political evolution from a Dependency to Dominionhood and from Dominionhood to Republic, the definition underwent changes, so as to suit the changed conditions. The 1961 Act brings within its scope all such companies which at one time or another were incorporated in any part of what is now the union of India. For purposes of income tax, an Indian company was given special treatment in as much as a rebate of one anna in the rupee was granted on profits ploughed back. An additional income tax was also levied on excess dividends distributed by such companies small companies (income not exceeding Rs. 25000) were charged at concessional rate of two and half annas in the rupee instead of five annas in the rupee for income tax purpose.

In 1949 (Finance Act 1949) Concession in this respect was withdrawn but concession in respect of rebate was continued. In 1950 after the constitution came into operation this rebate concession was struck down it being discriminatory. From 1950 (Finance Act 1950) rebate was based on whether the company was Indian or non Indian but on whether they had made the prescribed arrangements for the declaration and payment of dividend within the territory of Indian, a technique that had all along been employed in relation to rates of super tax. Thus for and from the A.Y. 1850-51 onwards the significance of the classification of companies into Indian and non Indian companies got lost in respect of tax rates.

The concept of Indian companies is now restricted to such companies as have been incorporated under the Indian Law and as have their registered offices in India. An Indian Company is always a resident.
ii> Domestic company:

Domestic company means an Indian Company, or any other company which in respect of its income liable to tax under the Income-Tax made the prescribed arrangements for the declaration and payment within India, of the dividends (inducing dividends on preference shares) payable out of such income.

It means:

i> All Indian companies are domestic companies.

ii> A foreign company which has made the prescribed arrangements for the declaration and payment of dividends (out of taxable income in India) within India is also a domestic company.

The prescribed arrangements are as follows:

1> The share register of the company for all shareholders shall be maintained regularly at its principal place of business within India, in respect of any assessment year from a date no later than the first day of April of the relevant assessment year.

2> The general meeting for passing the account of the accounting year relevant to the assessment year and for the declaration of the dividends in respect shall be held only at a place within India.

3> The dividends declared if any, shall be payable only within India to all shareholders.

iii> Company in which public are substantially interested:

The parallel of this was found in Explanation 1 to Sec. 23 A of the 1922 Act. Through refinements with lapse of time the present concept is:

The company is said to be a company in which public are substantially interested in the following cases:

1> Govt. owned company: It is a company (Public or Private) owned by the Government or Reserve Bank of India.

2> Govt. participating company: It is a company (Public or Private in which not less than 40% of the shares (by monetary value and not by number) are held whether singly or taken together by the Government or the Reserve Bank of India or a corporation owned by the R.B.G.

3> Company registered under sec. 25 of the companies Act. 1956: Such a company is meant for the furtherance of art, charity, commerce, religion or any like area. It prohibits payment of dividends to its members.

iv> Company without share capital: Such companies are ones having no share capital. In view of its objects and composition they are declared to be so by general or special order of the C.B.D.T.
5. Mutual Benefit Finance company: These companies carried on
the business of acceptance of deposits from its members and is
declared by the Central Govt. to be a Nidhi or Mutual Benefit
Society (u/s. 620A of the companies Act 1956).

6. Company listed on stock Exchange : It is not a private
company and its equity shares were, as on the last day of the
relevant previous year, listed on the recognised stock exchange in
India.

7. Any other public company : It is not a private company and
its equity shares carrying not less than 50% (40% in case of
Industrial company) of the voting power were beneficially held
throughout the relevant previous year by

a> the government , b> a statutory corporation, c> a company in
which public are substantially interested or d> a wholly owned
subsidiary (100% shares of one held by the parent company a by its
nominee) of such a company.

This definition has importance in the context of sec. 104
which imposes an additional tax in respect of the undistributed
profits of such companies.

4. Foreign company : A company which is neither an Indian
company nor has made the prescribed arrangements for the
declaration and payment of dividends within India is called a
foreign company.

5. Investment company : It is a company gross total income of
which consists mainly of income which is chargeable under the
heads 'Income from House Properly', Capital Gains, and 'Income
from the other Sources or income.

5. Trading Company : It means a company business of which
consists mainly in dealing in goods or merchandise manufactured,
produced or processed by someone else and income of which from
such business is not less than 51% of the gross total income.

The classification of companies is significant in view of the
differential treatment meted out to them in the context of rates
of tax.

7. Industrial company : It is a company carrying in
manufacturing, or processing of goods.

8. Consultancy service company :

The enumeration above is not exhaustive. Without having been
expressly defined certain other companies are merely referred to
viz. Banking company, dominion Government assessable as a
company, one man company, group companies Insurance companies,
Electricity supply company.
After dealing with the concept and classification of company it would be but proper to probe into theoretical foundations on which company taxation is based.

Theoretical foundations of company taxation:

There has never been uniformity of procedure of company taxation in the world. Varying practices prevailed in different countries yet, two distinct foundational premises could be discerned regulating their operation. These two foundational tenets or theories of company taxation are: 1) There are countries where the company acts merely as an agent for its shareholders; collecting tax from the latter on behalf of the state. This theory upholds the doctrine that company has no distinct existence apart from the members (Shareholders) whom it is composed of.

Secondly there are countries where a company is credited with a specific taxable capacity of its own and separate corporation tax, though some concession is granted to the shareholder who is also subjected to the personal income tax. Company was supposed to possess distinct taxable capacity on account of privileges it enjoys. Hence this theory may be called a privilege theory of distinct taxable capacity of company. A brief survey of earlier period of income taxation development in the world is attempted below:

Great Britain: In Great Britain, Companies were subjected to the standard rate of income tax. Such payment of income tax by the company used to be regarded as made on behalf of the shareholder, who is therefore exempted from the tax on his dividends. If the rate applicable to the shareholders total income were less than the standard rate at which the companies profits were taxed he would be refunded the excess amount of tax thus collected on his dividends. Thus in Britain companies were not endowed with any special taxable capacity but were merely regarded as agents for collecting at source the tax due from the shareholder. Before 1924 companies in Great Britain were subjected to a corporation profits tax. Which corresponded to super tax imposed on companies in India. The corporation tax was abolished in 1924.

South Africa: In the thirties similar practice was followed in South Africa. Dividends and debenture interest in respect whereof company paid nominal tax were exempt in the hands of shareholders.

U.S.A.: In the U.S.A. during this period companies were required to pay a corporation profits tax at a flat rate on their total profits. The rate used to be higher than the highest normal rate of income tax, but dividends were not taxed again in the hands of shareholders. But this did not mean that taxation of companies in U.S.A. was based on the premise of corporation merely being agent of shareholders. Because, shareholder, though exempt from income
tax on his dividends, could not claim any refund if the rate of tax applicable to his income was lower than that at which the company paid the tax. The exemption thus allowed in U.S.A. was only a political concession and the company was credited with a separate taxable capacity of its own.

Australia: In Australia, the company was taxed at a flat rate. The shareholder was not taxed on his dividends unless his personal rate exceeded that of the companies. In that case he was required to pay the excess to the state. The position corresponded in the main to that in the United States. While shareholders were called upon to pay the excess if their personal rates exceed over that of the company but the reverse was not true i.e. they were not entitled to claim refund if the reverse was the position. This clearly leads one to conclude that it was not the shareholder's ability to pay which governed the taxation of companies but that a separate taxable capacity on the part of the companies was regarded.

Canada: In Canada, companies were taxed on their total profits. While at the same time shareholders also taxed on their income from companies Canada was, thus the sole instance of a country which logically carried out the doctrine of the separate taxable capacity of companies.

Some European Countries: The privilege theory was followed in the continental Europe — especially in prewar, Germany. The company was taxed only on that portion of its profits which was in excess of a prescribed percentage viz. generally 4 to 5 percent of its paid up Capital. The dividends were also liable in the hands of the shareholder. In this way, double taxation was avoided to the extent of the amount exempted (4 or 5 percent) from the company tax. The tax obviously attempted to reach a peculiar taxable capacity of companies, which was measured by that part of their profits. Which exceeded the normal interest due to the shareholder.

A somewhat similar system was prevalent in Belgium. In Belgium double taxation to the time of 6% of the paid up capital was avoided.

Japan: In Japan companies were not only subjected to ordinary income tax, but to an additional special income tax on that part of their profits which exceeded 10% of the average amount of their paid up Capital and reserves.

In nutshell, upto the 1930s barring the exception of Great Britain and South Africa the other countries seemed to regard companies not only as separate objects of taxation, but as having specific taxable capacity of their own. As a matter of concession, most of these countries (barring an exception of Canada) exempted the individual from paying the income tax on his corporate income; but was not allowed to claim any refund if his personal rate was less than the rate paid by the company. No
super tax was levied in any of the aforesaid countries instead the shareholders were taxed directly on their corporate income. This does not mean that the shareholders escaped super tax by allowing their corporate profits to lie undistributed with companies. Provision was made by most of these countries by which if a reasonable share of total profits was not distributed, the income tax officer could tax the shareholders on these profits as if they had been distributed to them in proportion to their holding of shares. Such provisions were found in Canada, Australia, South Africa, New Zealand and Great Britain.

**Criticism of the Privilege theory or distinct corporate taxable entity theory:**

It is claimed that companies enjoy certain privileges and it is therefore but apt that they be subjected to higher taxation. The answer largely depends upon the nature of the tax levied on a company. If it be levied on its paid-up capital or its total turnover or any such index of corporate life it would become a part of its expenses of production and a charge on its privileges. In such a case, the law should recognise the tax as a business deduction for income tax purposes.

If on the other hand, the company tax is of the nature of an income tax on corporate income, it is clear that the determining factor must be its incidence on persons. Though a company is regarded a distinct person it is only by fiction of law. Ultimately, corporate income belongs to and is received by persons who may or may not be liable to income tax. If the profits of companies are taxed, the real incidence of the tax is undoubtedly on those who receive corporate income. As has been said earlier a corporation has a distinct legal entity (distinct from its shareholders) only by fiction of law. Whatever legal life a corporation may have, it has no real life; a deduction from its income means a deduction from its shareholders’ income. Hence a necessary condition for taxing companies is the provision for the avoidance of double taxation. Double taxation is not avoided merely by exempting the shareholders corporate income from income tax. The incidence of company tax on the shareholders’ dividend income must not be in any way different from the incidence of income tax on his other income. The natural consequence of this theory is that there should be a provision for refund to the taxpayer if his personal rate is lower than the personal rate. Where company taxation is not accompanied by such a scheme, the incidence of taxation becomes unequal, corporate income being differentiated adversely as against other income; and as poor persons may have corporate income as well as rich persons, it may probably result in making the tax system regressive.

It would thus be clear, that from a theoretical point of view whatever the practice elsewhere corporation as such have no special taxable capacity. The individuals ability to pay on his corporate income is in no way different from that determined by his total income. Any levy of income tax unaccompanied by a
scheme of refunds thus differentiates against one particular part of the tax payers income, and indisputably conflicts with his ability to pay. England and S.Africa recognised the truth of these principles enunciated above by treating companies as agents. As regards those not recognising explicitly this principle, the very fact that they exempt dividends from a second levy of income tax shows that they do not completely believe in the theory on which company taxation is apparently based.

Taxation of companies in India:

The position in the 1930s

During the thirties Indian income-tax was imposed on the total corporate profits of companies at the maximum rate of 18 pies in the rupee. Companies were also subjected to super tax of one anna in the rupee on their profits in excess of Rs. 50000 were exempt from super tax.

Procedural steps of assessment resembled those for a normal individual assessee; the principal officer of the company was required to send in a signed return of income accrued during the previous year; he was also liable to be called upon to produce accounts and other relevant documents in support of the return. If he failed to submit a return or accounts when called upon to do so the company was deprived of the right of appeal.

So far as income tax was concerned, company was empowered to deduct tax at the maximum rate from its dividends before they were paid to the shareholders. The principal officer was required to issue along with the dividend warrant a statement specifying the amount deducted by way of income tax on the dividend and the rate at which it was deducted. Amounts of dividend received plus income tax deducted forms the income from the company if the recipient of the dividend and was taken into account in determining the rate of his tax. The person receiving dividend was however exempt from income tax on the dividend element of his income as it was already taxed at source. If the rate applicable to the total income was less than the maximum rate he could apply for the refund of the excess tax thus paid and the state was bound to give him relief. Thus it was clear that so far as payment of income tax was concerned, the company acted as agent for the shareholders. Tax, thus was not levied on companies as such but was only a convenient expedient for taxing the shareholders income. India thus treaded the path on British or South African line of theory of taxation during this period.

The payment of super tax by companies stood on entirely different footing. The flat rate of one anna per rupee was levied on company as such, and was assessed on its total profits. It was not allowed as a business deduction. The shareholders were not exempt from super tax on the dividend received, and at the same time they were not allowed to claim any refunds for the super tax paid by the company. In fact these dividends were subject to
double taxation, once to the flat rate of the company super tax and a second time to the graduated rate of personal super tax.

There was another case of double taxation. Certain companies held shares in other companies; the latter companies were taxed on their income and the shareholding companies were again subjected to super tax on the income which they received from the taxed companies. In this way the holding companies were required to pay double super tax on their corporate income.

Thus there were double standards of company taxation in India during this period. Companies were subject to the maximum rate of income tax along with a flat rate of super tax on their total income. When paying income tax companies acted as agents to their shareholders. When paying super tax they were supposed to act for themselves.

So far as company income taxation was concerned it was clear that this income taxation was based on the theory of 'company acting as agent to their shareholders' and it was in true with the ability principle hence there is no criticism to offer against income taxation of companies in India.

Super tax on Companies: A criticism.

In the first place super tax constituted a clear form of double taxation of the tax payers income in so far as it consisted of distributed corporate profits; and in the absence of refund it violated the doctrine of ability to pay.

Secondly, it made the tax system unequal and interfered with the proper progression of the tax. In this way also it was opposed to the doctrine of ability to pay.

Thirdly, while the super tax on companies was itself not justifiable its injustice was aggravated by the meaningless exemption of companies with incomes below Rs. 50000. The exemption was made on a false conception of the company as a real person.

Fourthly, imposition of super tax on holding companies as well as their subsidiaries was another instance of double taxation which was far from justified.

Fifthly, while the poorer shareholders suffered double taxation the richer shareholders escaped the personal super tax on part of their corporate profits by allowing them to remain undistributed and by capitalising them in course of time.

On all these counts in the thirties the company taxation was far from justified. On these counts Prof. Kaldor was constrained to condemn company taxation in India as 'mess of things'.

This schemata of company income taxation lasted upto 1959 and
super tax upto 1965 when finally there was complete integration of super tax with income tax.

Upto late sixties the income tax paid by a company was considered to have been paid on behalf of the shareholders. The net tax payable by a shareholder used to be arrived at by deducting from the calculated tax an amount equal to the income tax deemed to have been paid on his behalf by the corporation; and it was refunded to him, if his total income was below the exemption limit. Thus the income tax paid by the company on the distributed part of its income was ultimately grossed with the income of the shareholders to whom it was either refunded or finally adjusted against tax payable by them on their personal incomes. Besides the company had to bear itself the income tax in the undistributed part of its income.

Ostensibly the above arrangement was complicated and unscientific. The Government therefore, changed this system in 1960. The changed system envisaged a complete delinking of the tax liability of the shareholder from that tax borne by the company. Thus the legal fiction of deeming income tax paid by corporations on their distributed profits as having been paid on behalf of their shareholders was done away with since 1960. In this new scheme the shareholder was no longer to receive credit for a portion of the tax paid by the company. Thus from 1960-61 the incidence of both income and super taxes on corporate income was put wholly on the corporations.

One can thus sum up that theoretically henceforth there was a complete shift of company taxation from the former theory (of company functioning as agent to shareholder) to the latter (privilege theory or separate entity theory).

Like corporation tax proper the income tax on corporate income was levied at a flat rate on the income of corporations. Upto 31st March, 1957 the flat rate of income tax on corporations was always equal to the maximum marginal rate of income tax (not super tax) applicable to personal incomes. In 1957-58, however the flat rate income tax on corporations was fixed at 30% as against the maximum marginal rate of 25% applicable to personal incomes.

In order to encourage the ploughing back of profits in corporations, a rebate was allowed in the case of income tax in respect of undistributed profits of companies (other than 23 A companies). In 1956-57 the rebate was abolished. Distribution of excessive dividends was sought to be discouraged through differential rates of corporation tax.


T.E.C. put forth following recommendations pertaining to company taxation :-
i> The granting of a development rebate of 25% in a few selected industries of national importance. Since this pertained directly to investment it was a sound recommendation.

ii> Granting a rebate on undistributed profits. This was considered unnecessary and unscientific and hence it was abolished in 1956.

iii> Granting additional depreciation allowance on new investments. and

iv> Granting exemption from taxation of new industrial concerns upto a specific length of time it was considered uncalled for and unnecessary. It was more or less a superfluous exemption in the presence of other simultaneous rebates and allowances.

These recommendations were accepted and afterwards implemented by the G.O.I. Some of these concessions were abolished.

Super tax after Independence:

Super tax on corporate income is the real corporation tax in the true sense of the term. It was levied at a flat rate. This tax had been subject to two rebates. The rebates were based on two principles of differentiation. The first was a tax concession in favour of smaller companies and the second was a differentiation between Indian and non Indian companies. The dividends declared by non Indian companies received by a foreigner could not be taxed in India. Therefore a loss arose to Government of India in respect of super tax or such dividends. To make up this loss a small additional tax was levied on non Indian companies. This additional tax was levied though a rebate on corporation tax to Indian companies.

In the Finance Act, 1956, another principle of differentiation was introduced. This was with the object of taxing dividends issued in excess of certain prescribed minimum and the issue of bonus shares. The Act levied a higher rate of super tax for all companies; and suitable rebates were allowed with a provision that no excess dividends were to be declared or no bonus shares were to be issued. This differentiation was introduced in the place of rebate in respect of undistributed profits from income tax.

In 1957 another new principle was introduced viz. a concessional rate of corporation tax was applied to income received as dividends from Indian subsidiary. This had two objects in view viz. i> To compensate foreign companies for the increase in the basic rates of corporation tax (if they had invested in Indian subsidiaries) and to encourage Indian companies to make investments in other Indian companies.

The excess dividends tax was levied with a view to
encouraging corporate savings, and the tax on bonus shares to preventing companies from issuing bonus shares just to increase their paid up capital to avoid excess dividends tax.

For checking the accumulation of undistributed profits with a view to avoiding high personal taxation; the Govt. applies a penal tax thus. The minimum percentage of available profits, (after taxes) which an industrial company should distribute in order to avoid penal tax was 45% for non industrial companies and investment companies were required to distribute 60 & 100 percent respectively. The penal tax was 37.5% for noninvestment companies, and 50% for investment companies. In 1960-61, the percentage of distributed profits- in order to avoid penal tax for 23A companies - was raised from 45 to 50 and that for non industrial companies from 60 to 65.

The above brief narrative at once brings out the intrinsic contradictions of the then company super taxation. On the one hand a penal tax was levied on distributed profits in the shape of excess dividends tax or bonus issue tax and on the other a penal tax was also levied on undistributed profits. Fortunately the mistake was rectified and the excess dividends tax had been abolished. Subsequently in 1965 with complete integration of S.T. with I.T. these anamolies pertaining to S.T. ipso facto came to an end.

Present position:

At present for income tax purposes companies are classified into various classes viz. Domestic company & Foreign company, Public sector company, Investment co, Trading company, company in which public are substantially interested. Various rates are charged for different companies. While calculating business profits general principles of deduction are followed. Inadmissibles are added back to the profit shown by P & L account of the company. After making necessary adjustments profit from business is arrived at. Taking head wise income gross total income of the company is found out and deducting straightway deductions total income of the company is found out. Applying pertinent rates of I.T income tax payable is found out on which surcharge at stipulated rate is calculated thereon and income tax liability of the company is found out. The dividends are addible to the personal income of the shareholder. No relief in the form of refund is allowed to the shareholders. Thus the company is treated as a tax entity in itself and not an agent to shareholders.

Shareholder in his individual assessment is allowed deductions from his gross total income the amounts whereof have been varying from maximum Rs.3000 to 7000 and for U.T.I. dividend Rs. 3000 and Rs. 3000 for dividend on equity shares of Indian company. In the budget of 1992 straightaway deduction u/s 80L had been done away with but it has been restored to the extent of Rs. 7000.
Thus the dividend income is taxable at the hands of the shareholder without any consideration of the differentials of marginal rates applicable to the individual shareholder and the company. A limited relief u/s 80 L. is granted to him with the differentials of situation of his. Hence it could be said in conclusion that the theoretical pedestal of the present company taxation resembles that of Japan in the thirties.

About the incidence on company it was stated that double taxation occurred at two levels viz. individual and corporate level. In pre 1961 period it is discussed at length. Straightaway deduction is allowed to company from 1st April 1965. This deduction underwent changes since then to date. Upto 1990 one domestic company for dividend from another domestic company was eligible for deduction upto 60% of intercorporate dividends. From 1 April 1991 i.e. for A.Y. 1991 it is 60% for financial institutions and 100% for other companies if the receiving company distributes dividend of the whole amount of intercorporate dividend. Thus this amended provision ensured the object that dividend income be taxed only where it finally rests and double taxation is mitigated.

While concluding this chapter a reference to recommendations of Chelliah Committee is inevitable. It may be pointed out that the committee after a detailed investigation into Indian tax structure and system preferred to maintain status quo as far as the anatomy of company assessee is concerned. The committee however, after studying tax rates of various countries concludes that tax rates in India are on the higher side and recommends lowering down of the company tax rates.
CHAPTER 4 : ASSESSEE DIMENSIONS

Chapter References & Notes.


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