# Chapter 1

## Introduction and History of Tax System in India

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Chapter 1

Introduction and History of Tax System in India

1.0 Introduction:

The strength or weakness of an economy depends upon the system of taxation. If a correct system of taxation is applied, it leads to growth of the economy, stimulates the industrial activity and keeps the revenue consistent. Through efficient system of taxation an economy can be led to growth and the GDP increases faster. Taxes constitute an important and major source of revenue for the government. Tax is collected because the investment can be made for the developmental activities. The taxation policy of an economy can be considered as sound policy if it performs allocative, distributional and stabilization function in the economy\(^1\).

India has a three tier set up for taxation. It includes the union government, the state government and the urban/rural local bodies. As per the provisions made in the constitution of India, the power of collection of taxes is apportioned between the union government and the state government. The state government may delegate the further powers to the local authorities also. Various kinds of taxes are collected in India by the central and the state governments. The power to collect the tax on agriculture is vested with the state government. Indian tax system is most complicated tax system of the world. The tax system includes the collection of both the direct taxes and indirect taxes. Direct taxes are the taxes in which the impact and incidence are at the same point and these taxes create direct burden on the common man. These taxes cannot be shifted. These taxes include income tax, corporate tax, wealth tax, gift tax, etc. On the other hand, an indirect tax is one in which the impact and incidence are at the different points and such taxes can be shifted forward or backward. The burden of such tax indirectly falls on the consumers/customers. Important types of indirect taxes are sales tax, VAT, excise duty, custom duty, etc.

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The common public wants the government to raise the basic exemption limits and the corporate request the government to reduce the taxes. The government handles these requests based on the requirements of the economy.

Over the years, the government of India is on the wake of reformation of the tax system. This research work focuses on such tax reforms took place in India after 1991. The research work tries to analyse the effects of reforms on the Indian economy.

1.1 Tax – The Concept:

The concept of tax has been in the force in India since the ancient time. Manu, the ancient law giver, has laid down that the traders and artisans should pay one-fifth of their profits in gold and silver. The agriculturists had to pay one-sixth, one-eighth or one-tenth share depending upon their circumstances. The concept of tax is also found in Shrimad Bhagvat. Chanakya has also the mention of tax in his Artha Shashtra. Chanakya has referred tax as Kosh Moolo Dand. The tax system in ancient India was productive and the combination of direct tax and indirect tax was useful to maintain flexibility in the tax system.

The term Tax can be defined as follows:

According to Prof. Seligman, “A tax is compulsory contribution from the person to the government to defray the expense incurred in the common interest of all without reference to special benefits conferred”.

According to Bastable, “A tax is a compulsory contribution of wealth of a person, or body of persons for the services of public powers”.

According to Hector Deleon, “Taxation is the levying a tax, i.e. the process or means by which the sovereign, through its law making body, raises income to defray the necessary expenses of the government. It is merely a way of apportioning, the cost of government among those who in some measure are privilege to enjoy its benefits, therefore must bear its burden”.

According to Deviti DeMarco, “A tax is a share of the income of citizen which the state appropriate in order to procure for itself the means necessary for the production of general public service”.

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According to Hugh Dalton, “A tax is a compulsory charges imposed by a public authority irrespective of the exact amount of services rendered to the tax payer in return and not imposed as a penalty for legal offence”.

According to Jom Bouvier, “Tax is a pecuniary burden imposed for support of the government, the enforced proportional contribution of person and property of the government and for all public needs”.

The above definition of tax clarifies that the tax is a compulsory payment by an owner of income to the government without any reference to the specific benefits.

1.2 Characteristics of Tax:

A tax is imposed by the government. It has following important characteristics:

- **It is Compulsory:**

Since the tax is imposed by the government, it becomes compulsory to pay. The government levy taxes through the legislations and it becomes the duty of every citizen to pay the tax. If one refuses to pay the tax or creates an objection, it may lead to punishment. The element of compulsion in tax payment is found when one purchases some goods or services.

- **It is a Contribution:**

Tax is a contribution made by the contributor for the growth and development of the nation. The government provides some infrastructural facilities, defense, law and order, etc. In order to provide all these facilities, the government faces expenditure. The citizens make their contribution by paying the tax.

- **It is an Amount of Money:**

Tax is the payment by the citizens in the form of money. Tax is the payment from the income earned by the individual or corporate or it is the payment in the form of money paid at the time of buying or selling some product or service.

- **It is for Public Benefits:**

Tax is levied for the common good of the society without regard to specific benefits to the specific individual. The government uses the proceeds of tax for the benefits of
the citizens at the time of natural calamities like floods and famines or for the maintenance of law and order.

- **It Gives No Direct Benefit:**

The tax is compulsorily collected by the government on all the items purchased and sold by the citizens and all the income earned by the citizens. But the payment of tax does not give any direct benefit to the tax payer. Payment of other charges like bills, fines, prices, rent, etc. provide direct benefits to the payer, but the tax does not give any such direct benefit to the tax payer.

- **It is Paid out of Income or Wealth:**

The tax is the payment out of the income earned or the wealth generated by the individual. When the individual realizes the income, he has to pay the share of it to the government. Same way when an entity earns the profit, it needs to pay the tax out of it.

- **It is for the Economic Growth and Welfare:**

The government levies the tax for the purpose of providing the welfare facilities to the citizens of the country. The proceeds of tax are utilized for the investment in infrastructural facilities, industrial development, etc. Thus, the government utilizes the tax revenue for the economic growth.

1.3 **Cannons of Tax:**

Adam Smith, in his book titled “The Nature and Causes of the Wealth of the Nation”, has prescribed the cannons of taxes. These cannons provide the administrative framework for the taxation. However, the modern economists have added some new cannons to make the tax administration more effective in the modern times. The cannons of taxation are as follows:

- **Cannon of Equity:**

This cannon says that the tax collection should be based on the principle of social justice. There should equity in collecting the tax from the public. There should be horizontal as well as vertical equity. The horizontal equity says that the people with the equal ability to pay should be charged equal amount of tax. The vertical equity
says that the people with the greater ability to pay should be charged greater amount of tax. The existence of both horizontal and vertical equity makes the tax system fair.

- **Cannon of Certainty:**

This principle says that the rules related to tax should be certain. There should not be any ambiguity. The rules must specify when the tax is to be paid, how much tax is to be paid, how it is to be paid, etc. This certainty brings confidence in the tax payers mind and he feels that the tax is calculated correctly and he is not cheated.

- **Cannon of Convenience:**

This cannon says that there has to be convenience in making the payment of tax. The convenience in paying the tax helps create compliance. This principle helps in designing the tax collection system. An appropriate mechanism of tax collection is to be set, so that the tax payer can pay the tax easily.

- **Cannon of Economy:**

The cannon of economy talk about cost of tax collection. The principle of economy says that the administrative cost of collecting the tax should be the lowest. The economy in tax collection is beneficial to both the tax payer and the government.

- **Cannon of Simplicity:**

This cannon says that the procedure of calculation, collection and payment of tax should be as simple as possible. The tax laws and rules should be very simple so that the tax payer can understand them easily. Simplicity in tax system improves the compliance and reduces the errors.

- **Cannon of Transparency:**

This principle says that the system of taxation should be transparent. The tax payer should know mechanism of charging the tax, how, when and how much tax is imposed upon him. If the transparency is brought in the tax system, tax payers have the feeling of justice and fairness.
- **Cannon of Neutrality:**

This principle says that the system and rules related to taxation should not unduly encourage the tax payers to adopt some positive or negative behavior. The purpose of the tax system is to collect the revenue for the government and not to change the behavior of the public. The authorities should remain neutral at the time of defining the ability to pay of the tax payer.

- **Cannon of Predictability:**

This cannon says that the government should be able to determine how much the tax revenue is likely to be collected and when. There should be a degree of predictability about the revenue to be generated by the government from the tax, so that the government can plan the expenditures accordingly.

- **Cannon of Economic Growth:**

The tax system should support the economic growth of the country. It should not impede the growth and development of the country. The economic effect of tax system should be positive and there should remain the scope of growth and development of all the sectors of the economy.

- **Cannon of Co-ordination:**

This principle says that there should be co-ordination among all the authorities eligible to collect the tax. There should be co-ordination between the state government and the central government for the laws, rules and the system of tax collection.

**1.4 Objectives of Tax:**

After making the review of cannon of taxation, now the researcher has provided the understanding of the objectives of taxation. The basic objectives of taxation in any economy can be enumerated as follows:

- **Revenue Generation:**

The first and foremost objective of taxation is to generate revenue for managing the economy. As the size of economy grows, the amount of public expenditure also
grows. In order to meet the requirements for public expenditure, the government has to generate revenue. Tax is the major source of revenue for government.

- **Redistribution of Income and Wealth:**

There can be seen the inequality in the distribution of income and wealth. This inequality leads to many social evils. In order to reduce this inequality, the government charges the tax from the rich people and distributes the proceeds among the poor through social welfare schemes. In order to achieve this goal, the government imposes high rate of tax on luxury commodities, applies progressive tax system, and imposes tax exemption on basic goods.

- **Providing Social Welfare:**

Social welfare is the key indicator of the development of the society. The society needs the facilities of health and hygiene, education, protection, etc. The government is responsible to provide all these facilities to the people. The government levies tax from the people and spends this amount for these welfare facilities.

- **Reducing Social Evils:**

The consumption of drugs, alcohol, tobacco, etc. are the social evils. It is the responsibility of the government to fight with such social evils. The government imposes heavy tax on such commodities, so that the consumption of such commodities gets reduced.

- **Accelerating Economic Growth:**

An efficient tax system is required for the economic growth of the country. With the help of efficient tax system, the government mobilizes the resources from useless to useful areas of economy. Tax policy helps to increase the rate of capital formation and investment of this capital in the productive avenues.

- **Maintaining Economic Stability:**

Maintaining economic stability is an important objective of the tax policy. In the cases of inflation and recession, the government modifies the tax rates in such a way that the stability can be achieved. In the case of inflation, the rates of direct taxes are increased so as to reduce the purchasing power of the people and as a result the
inflation reduces. In the situation of recession, the rates of direct taxes are reduced to increase the purchasing power of the people and this result in the increase in demand and as a result the recession is controlled.

1.5 Classification of Tax:

In order to classify the taxes, there can be several view points for classification. In this research work, the researcher has classified the tax on the bases of who bears the ultimate burden of the tax. From this view point there are major two types of taxes: Direct Tax and Indirect Tax. The further classification of tax can be presented as follows:

**Figure 1.1**

**Figure Showing Classification of Taxes**

- **Direct Tax:**

  Direct taxes are also known as personal tax. In this tax, the impact and incidence are at the same point. These taxes cannot be shifted. Direct taxes are progressive in nature and they satisfy the principle of equity. Direct taxes do not affect the prices of commodity but they affect the purchasing power of the tax payer. Direct taxes are the taxes on the income and wealth of the people so personal income, corporate income, income from rent, income from interest, income from land, wealth, gifts, etc. are taxable. Direct taxes follow the principle of economy, convenience and certainty.
Following are the merits of direct taxes:

- Direct taxes are progressive in nature and as a result, they follow the principle of equity. The sacrifice depends upon the volume of income. The rate of tax increases as the income rises.
- The direct taxes are elastic because the government can generate more revenue in case of emergency.
- The direct taxes also follow the principle of certainty. There is certainty on both the side. There is certainty from the side of tax payer because there is certainty of amount of tax, rate, time and manner of payment of tax. There is certainty on the part of government about the proceeds from these taxes.
- The direct taxes are useful for reducing the inequalities in the society. The rich are charged higher tax and lower or no tax from the poor.
- Direct taxes are useful as an instrument of monetary policy. In the case of inflation, these taxes are increased and in case of recession, these taxes are reduced.

Following are the demerits of Direct Taxes:

- These taxes are the taxes on the honesty of the people. The people who are honest and disclose their correct income will have to pay the tax and those who hide their income are not liable to pay the tax.
- There are chances of evasion from these taxes when the people adopt falsification in accounts.
- These taxes are unpopular because a lump sum amount is charged from the people out of the whole income. It becomes painful for the people to give away such a big amount.
- Direct taxes provide little incentive to earn and save. As the person earns more income, he has to pay more tax. So the people are discouraged to earn more.
- Direct taxes are levied according to the ability to pay, but it is very difficult to measure the ability to pay of the people.

- **Indirect Taxes:**

Indirect taxes are also known as commodity tax. In this type of taxes, the impact and incidence are at the different points. These taxes can be shifted forward or backward.
These taxes affect the price of the commodity or services. These taxes are charged from the people whether they are rich or poor. These taxes can be differential in nature or can be charged on ad valorem basis.

Following are the merits of Indirect Taxes:

- These taxes are useful for generating larger revenue for the government. The taxes are charged on the necessity as well as luxury goods.
- These taxes are included in the price of the goods and services, so there is less scope of evasion.
- It is very convenient to collect these taxes as these taxes are included in the price of the commodity or service.
- These taxes are economical from the view point of cost of collection as the collection cost is low.
- The coverage of these taxes is very large as almost all the commodities i.e. necessaries, luxuries, harmful ones, etc. are covered under the indirect taxes.

Demerits of Indirect Taxes are as follows:

- Indirect taxes sometimes become regressive. In some case, the government charges higher tax on necessary good and lower tax on luxurious goods.
- There is uncertainty about the proceeds from this tax. This tax is collected at the time of buying and selling the product and it is not certain when the people will spend their income.
- This tax discourages savings, since these taxes are included in the price; they increase the spending of the public.
- Since these taxes are included in the price, they encourage inflation.

1.6 Indian Tax System:

The Indian Tax System can be classified as direct taxes and indirect taxes. Various forms of direct taxes and indirect taxes are as discussed below:
- **Direct Taxes:**

  - **Income Tax:**

    Income tax is levied on the income of individuals, corporation and legal entities. Income tax in India is levied by the central government and it is controlled by the Central Board of Direct Taxes under the ministry of finance. Income tax is levied as per the Income Tax Act, 1961. Income earned in the financial year is subject to tax as per the rates prescribed for that financial year. Income tax is an annual tax on income.

    According to Section 14 of Income Tax Act, says that for the purpose of calculating the income of a person all the income such as salaries, house property, profits and gains, capital gains, and income from other sources are considered.

  - **Corporate Tax:**

    Company means any artificial legal entity, which has independent existence. The income of a company is calculated separately in the hands of the company. The amount of profit which is distributed as dividend among its shareholders is assessed in the hands of shareholders. Such distribution of dividend is not treated as expense but it is considered as an appropriation of profit. The tax levied from the company is based on the legal residence of the company. Companies of Indian origin are taxed in India, while the international companies are levied tax on the earnings from their operations in India. Various incomes such as royalty, interest, gains from sale of capital assets within India, dividend from Indian companies and fees for technical services are all considered as income Companies resident in India are taxed on the income earned from a business connection in India or from other sources. A company will be considered as resident in India if it is incorporated in India or if its control and management is situated entirely in India.

  - **Wealth Tax:**

    Wealth tax was introduced in India as per the Wealth Tax Act, 1957. It applies to all the citizens of the country. It is paid on the property ownership benefits. It has come into force since 1st April, 1957. The wealth tax is charged every year on every individual, HUF, and company at a rate of 1% of the total wealth if the amount of wealth increases beyond 15,000,00. Wealth Tax Act is important legislation in direct tax. Tax is to be paid year after year on the same property on the basis of its market
value. Till the person retains the ownership of the property, the tax has to be paid. Even if the property does not yield any return, the tax is required to be paid.

- **Gift Tax:**

A gift tax is a tax imposed upon the person giving value to another individual. It is defined as the tax imposed on the value of gift. So, it is a tax on monetary gift to other person. Gift Tax in India is regulated by the Gift Tax Act, 1958. As per this act, any gifts in excess of Rs. 25000 in the form of cash, cheques, drafts or in any other form received from the person who does not have any blood relations with the recipient were taxable. On 1st October, 1998, gift tax was abolished and all the gifts were free from tax. In 2004, the gift tax was revived and according to the new provisions, any gift exceeding the value of Rs. 50,000 is taxable.

- **Indirect Taxes:**
  - **Custom Duty:**

In India, the custom duty is managed by the Central Board of Excise and Custom under the ministry of finance. Custom Duty in India is managed according to Customs Act, 1962 and Customs and Tariff Act, 1975. Custom Duty is levied on all imports and exports. The custom duty is evaluated on the basis of value of transactions. It came into existence to check the illegal imports and exports. This is also aimed at protecting the domestic industries by charging the tax on imports.

- **Excise Duty:**

Excise duty in India is managed according to Central Excise Act, 1944 and Central Excise Tariff Act, 1985. Excise duty is levied on the production of goods. Here, the term production means bringing into existence a new article having distinct name, character, use and marketability and also includes packing, labeling, etc. There are different rates of excise duty such as 8%, 16%, etc. In some case, 2% education cess is also levied on the aggregate duty of excise. Excise duty is levied on the ad valorem basis and in some cases on the basis of maximum retail price. The liability to pay excise duty arises as soon as the good are manufactured. This tax is paid by the manufacturer, which is then transferred onto the buyer of the goods. The term “excisable goods” means the goods which are specified under the first and second schedule of the Central Excise Tariff Act, 1985. According to this act, the
manufacture includes any process, related or supplementary combinations which are specified under this act.

- **Sales Tax:**
  Sales tax is imposed by the government on the sale or purchase of the commodity within the country. There are two forms of sales tax, i.e. Central Sales Tax (CST) and State Sales Tax (SST). All the states in India follow their own sales tax act and charges tax accordingly. Apart from sales tax, the states may also charge work contract tax, turnover tax, purchaser tax, etc. Sales tax is a form of indirect tax where the burden of tax is borne by the purchaser of the commodity, but it is the duty of the seller to recover the tax from the purchaser. Generally, the sales tax is higher for luxurious goods and lower for necessities. Central Sales Tax is under the purview of central government. It is levied on the interstate transactions. However, from 1st April, 2005, the State Sales Tax is replaced with the Value Added Tax (VAT). VAT is a multi stage sales tax which is levied at every stage of value addition.

- **Service Tax:**
  Service Tax was introduced in India in 1994-95 by the than Finance minister Dr. Manmohan Singh. The person or firm who provides services is an assessee for the purpose of service tax. Service tax is levied on all services except for a negative service list.

1.7 **Taxes in Ancient India:**

Collection of tax from the public is the matter as old as the civilization. The references of tax can be found in the ancient literature also. The famous book ‘Ārthashashtra’ written by Kautilya gives clear references about the tax system that was prevailing in the ancient India. In the ancient India, taxes were collected both in cash and in kind. The forms of taxes in ancient India were like land tax, octroi, taxes on liquor, gambling houses and taxes on professionals. The great Sanskrit scholar Kalidas has recorded that “Just as the sun extracts water from the reservoirs and gives

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it back in the form of showers, so does the ruler extracts tax from his subjects and gives it back in the form of prosperity”³.

In the Kautilya’s Arthashashtra, following references are available about the types of taxes collected in ancient India⁴.

- Customs duty (Sulka) which consists of import duty (Pravesya), Export duty (Nishramya) and Octroi and other gate tolls (Dwarabahiri Kadeya).
- Transaction tax (Vyaji) including manavyaji (transaction tax for crown goods).
- Share of production (Bhaga) including 1/6th share (Shadbhaga).
- Tax (Kara) in cash.
- Taxes in Kind (Pratikara) including labour (Vishti) supply of soldiers (Ayudhiya).
- Countervailing duties or taxes (Vaidharana).
- Road cess (Vartani).
- Monopoly tax (Parigha).
- Royalty (Prakriya).
- Taxes paid in kind by villages (Pindakara).
- Army maintenance tax (Senabhaktham).
- Surcharges (Parsvam).

During that time, two systems were prevailing for collection of taxes, i.e. Kara and Pratikara. Kara was tax to be paid in cash and Pratikara was tax to be paid in kind.

References to taxes in ancient India are also found in “Manusmriti”. Manu the ancient sage and law giver stated that king should levy taxes according to shastras. He advised that taxes should be related to income and should not be excessive. He laid down that traders and artisans should pay 1/5th of their profits in gold and silver, while the agriculturists were to pay 1/6th, 1/8th and 1/10th of their produce depending upon their circumstances. It shows that there was a well planned tax structure existing in ancient India.

India had a well developed tax system during Mauryan period. During that time, the basic tax was on land. This tax was referred to as ‘bhag’ which meant the share of crop raised in the land. The proportion of one sixth or one quarter was fixed at that time. The tax on cattle and live stock was also imposed before Muslim rule. During Mauryan rule, tax was levied on the particular class of people. Besides that the Mauryans had adopted the proportional system of income tax. The tax was levied on prostitutes, actors, dancers, musicians, jugglers, singers, players on musical instruments, buffoons, mimics, rope dancers, herald, etc.5

Sultan Allaudin Khilji introduced three taxes viz., Kharaj – tax on cultivation, Charai - tax on milch cattle, Ghari – tax on house. Firozeshah Tughluq stopped Ghari and Charai during his rule between 1351 and 1388. He introduced Jeziya on non-islamic tax. However, this tax was abolished by Akbar. During the Mughal period, the Zabt system of land revenue was prevalent. Direct taxes on certain professions and trade were sometimes imposed by the East India Company. These taxes were later discontinued due to poor administration. Again the tax on trade and profession was imposed in 1859 because of financial crisis.6

1.8 Taxes in Modern India:

- The Act of 18607:

The history says that the tax in its modern form was first introduced in India during the British rule. The income tax was introduced in India for the first time in 1860 in order to overcome the financial difficulties emerged in 1857. Thus we can say that the introduction of income tax was done in India by the British rule. During 1860 to 1986, the British government made various experiments on Indian tax structure. During this time, the government passed 23 Acts for the amendments of tax system. In the year 1860, the tax at the rate of 2% was levied from the income of Rs. 200 and Rs. 500 and 4% tax for the income above Rs. 500. The income below Rs. 200 was fully exempted and all the government property was also fully exempted.

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Exemptions were also granted for the cultivators of land, religious and charitable institutions. This Act of 1860 lapsed in 1865. This Act together with the local Acts remained in force till 1886. Ultimately the Act took the final form in favor of income tax since the experience, convinced the Government that income taxation had come to form a necessary compliment of its revenues and was the only means of compelling the official and professional classes to pay taxes that prospered most at that time. Therefore, a fresh legislation was undertaken in 1886 which was the first systematic legislation on income-tax.

- **The Act of 1886**:  
The Act of 1886 was an important land mark in the history of Indian Tax system. According to this act, the agricultural income was exempted from Income Tax and this act defined ‘agriculture income’ for the first time. Income was divided into four different heads viz., income from salaries and pension, profits of companies, interest on securities, and income from other sources such as income from house property. A flat tax of 2.6% was applied on the income above Rs. 2000. Interest on securities was also taxed with the same rate. An additional tax was introduced in 1917 in the name of ‘super tax’. Up to 1916, there was no penalty for failing to file the return, but in 1917, it was made compulsory to file the return for an assessee with the income over Rs. 2000. The Act of 1886 was in force for 32 years. In 1918 a new Act came into force with several amendments.

- **The Act of 1918**:  
In 1918, the act was passed to re-cast the act of 1886. The act defined the term ‘company’ and the term ‘previous year’. The Hindu Undivided Family was included under the term assessee. The act provided exemption from paying tax. Agricultural income was also exempted. Under this act, the income was classified under six heads, i.e. income from salaries, interest on securities, income derived from house property, income derived from business, income from professional earnings, and income derived from other sources. The rate of taxes varied from 4% to 12%.

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The Act of 1922:

Upon the recommendation of All India Income Tax committee appointed in 1921, the Act of 1918 was replaced by the Act of 1922. According to this act, the administration of tax was shifted from the hands of provincial government to the central government. In this act, the tax was applied to all the incomes except capital gains, casual income and income in kind not convertible in to cash. The levy of Super-tax was being incorporated in the provisions of this Act now which was being assessed as a separate-tax till then and the super-tax was defined as an additional duty of income tax. The assessable entities were “individual, Hindu Undivided family, company, firm and other association of individual”. This Act permitted an assessee to set off loss of profits or gains under one head of income against profit under any other head, both relating to the same assessment year. Further, this Act granted relief in respect of discontinuance of a business which had been assessed under the Act of 1918. The Act of 1922 was amended several times in order to remove the loopholes in the tax system. Various acts were passed such as the Act of 1939, the act of 1924, and so on. Thus the British government made various experiments on Indian tax system. The government appointed various committees and commissions for making the modifications in the tax system in India. But the government could not be successful in implementing an effective tax system in India. And kept on making amendments in Indian tax system.

The Act of 1939:

The Act of 1939 was an amendment act based on the recommendations of Income Tax Committee called Aiyer’s Committee Report, 1936. The committee was formulated to investigate on all aspects of income tax such as incidence and efficiency of tax administration in India. The committee made substantial changes in the Act of 1922 and entered a new era of taxation in India. The act brought in to charge foreign income of ‘resident’ in British India. A new class of assessee called ‘resident but not ordinarily resident’ was brought between ‘resident’ and ‘non-resident’.

A number of different types of receipts were included in ‘income’ which were not otherwise taxable. ‘Salary’ which was taxable on ‘receipt’ basis was to be taxed on ‘due’ basis according to this Act. It granted to a business, for the first time, relief by way of carry forward of loss for a period of six years. ‘Slab system’ was introduced in 1939 for income-tax also and since then it is an integral part of the Indian income-tax system. ‘Slab system’ is no doubt, better than ‘step system’. Under the step system’, a single average rate is charged on each taxpayer’s entire (total) income, increasing with the size of that income, whereas under the ‘slab system’, the income of an individual is divided into slabs in order to charge the tax. The tax system is progressive in Indian. Under step system, when the total income just exceeds one of the levels at which the rate increases, the whole income, not merely that excess, will be taxed at a higher rate. For example, the income is Rs. 10,000 and it is being taxed at 5 percent. This Act also introduced many provisions to check tax avoidance.

- Income Tax during 1939 and 1961:

The reforms in the tax structure brought in 1939 did not prove to be effective as they could not bring any benefit to the British Rule. The Act of 1922 was amended as many as twenty nine times during 1939 and 1956. Each amendment was important. The scheme of payment of tax in advance was introduced in 1944 and the difference between ‘earned’ and ‘unearned’ income was created in 1945. The scheme of provisional assessment was introduced in 1948. Capital gains tax was introduced for the first time in 1946, but the concept of capital gain was amended several times.

In April 1953, the Government appointed another Commission, known as the Taxation Enquiry Commission under the chairmanship of Dr. John Mathai. This commission was entrusted with the wider responsibility than those assigned to the committee of 1935 and commission of 1947.

The main task entrusted to this commission was to examine the tax system in relation to the incidence of the tax system regarding the distribution of the burden of taxation and inequalities of income and wealth, the suitability of the tax system with reference to the development program of the country, the effects of income taxation on capital formation and development of productive enterprise, and the use of taxation in dealing with inflationary and deflationary situations. The Finance Act of 1955
incorporated many changes recommended by this Commission and this was the beginning when the recommendations of the commission were given the effect from time to time.

In January, 1956, Mr. Nicholas Kaldor was invited to investigate the Indian tax system in the light of revenue requirement for the second five year plan. The report submitted by him was focused on personal and business taxation. His report was exhaustive and he suggested several changes in the tax system. As a result, several taxation acts were passed viz., Wealth Tax Act, 1957, Expenditure Act, 1957 and Gift Tax Act, 1958. Income tax on ‘capital gains’ was also revived. In 1956, the Income Tax Act was referred to Law Commission in order to reform the tax structure in the light of logic and intelligibility of the tax without affecting the basic structure. The Law Commission submitted the report on 26th September, 1958 but in the meantime Direct Tax Enquiry Committee was formed under the chairmanship of Shri Mahavir Tyagi. The committee focused on minimization of inconvenience to the assessee and reduction in the tax evasion. The committee submitted its report on 30th November, 1959. The recommendations were incorporated in the Income Tax Act, 1961.

- **Income Tax Act, 1961:**

On the basis of recommendations from Shri Mahavir Tyagi committee, Income Tax Bill, 1961 was presented in the Lok Sabha on 24th April, 1961. After passing through both the Hoses of parliament, the Bill was approved by the president on 13th September, 1961 and the act came into force on 1st April, 1962. The present law of income tax is governed by the Income Tax Act, 1961, which has 298 sections and 4 schedules and is applicable to whole of India including the state of Jammu and Kashmir.

The search for an effective tax system answering the developing needs of the nation has led to the appointment of various committees and commissions which have led to many changes in the Act, 1961. Changes have been brought in by almost every Finance Act, Amending Acts and Ordinances. About 70 laws have been passed between 1962 and 1989 to amend the Income-tax Act, 1961. Some amendments were made according to the recommendations of the committee such as, (i) Bhootalingham’s Report on Rationalisation and Simplification of Tax Structure

The Tax Reforms Committee was also appointed in 1991 under the Chairmanship of Shri Raja J. Chelliah which submitted its Final Report Part-I in Aug, 1992, and final Report Part- II in January 1993. Some of the recommendations of the Tax Reforms committee have already been implemented in subsequent budgets. This Committee is basically concerned with the question of administrative reforms with respect to both direct and indirect taxes. The Committee also presents detailed and specific recommendations for important changes in India’s tax structure. The essence of these changes is to lower nominal rates and to broaden tax-base. This Committee is also in favour of progressive income taxes. Therefore, even the Income-tax Act of 1961, which was then considered to be very comprehensive, had to be amended from time to time. The 1961, Act has enlarged the number of categories of assessable entities to seven as against six of the 1922 Act, including ‘every artificial juridical person’, who has not been included in the six categories, i.e. residuary class 3. A scheme of self-assessment was introduced which, in course of time, displaced the scheme of provisional assessment. Provisions regarding advance tax, interest and penalty were
made more rigorous. Regarding reopening of back assessment for escaped income, the Act retained the limit of eight years where the assessee has failed to make a return or failed to disclose all material facts. The procedures for assessment were completely recast in April 1989, i.e., assessment year 1989-90.

1.9 Important Events in the History of Income Tax in India\textsuperscript{12, 13, 14}:

Table – 1.1

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<tr>
<th>Year</th>
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| 1939 | - Appellate functions separated from inspecting functions  
- A class of officers known as AACs came into existence  
- Jurisdiction of Commissioners of Income tax extended to certain classes of cases and a central charge was created at Bombay |
| 1940 | - Directorate of Inspection (Income-tax) came into being  
- Excess Profits Tax introduced w.e.f. 1-9-1939 |
| 1941 | - Income-tax Appellate Tribunal came into existence  
- Central charge created at Calcutta |
| 1943 | - Special Investigation Branches set up |
| 1946 | - A few officers of Class-I directly recruited  
- Demonetisation of high denomination notes made  
- Excess Profits Tax Act repealed |
| 1947 | - Business Profits Tax enacted (for the period 1-4-1946 to 31-3-1949) |
| 1951 | - Report of Income-tax Investigation Commission known as Vardhachari Commission received  
- Voluntary Disclosure Scheme introduced |
| 1952 | - Directorate of Inspection (Investigation) set up  
- Inspector of Income-tax declared as an I.T. authority |

\textsuperscript{12} https://blog.bankbazaar.com/5-latest-tax-reforms-of-2015/  
\textsuperscript{13} http://www.business-standard.com/budget/article/top-5-tax-reforms-india-inc-seeks-from-budget-2016-116022200293_1.html  
\textsuperscript{14} https://turbotax.intuit.com/tax-tips/irs-tax-return/2017-tax-reform-legislation-what-you-should-know/L96aFuPhc
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<th>Year</th>
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| 1953 | - Estate Duty Act, 1953 came into existence w.e.f. 15-10-1953  
- Act XXV of 1953 gave effect to the recommendations of Commission appointed under Taxation of Income (Investigation Commission) Act, 1947 |
| 1954 | - Internal Audit Scheme in the Income-tax Department introduced  
- Taxation Enquiry Commission known as John Mathai Commission set up |
| 1957 | - The Wealth tax Act, 1957 introduced w.e.f. 1-4-1957  
- I.R.S. (DT) Staff College started functioning at Nagpur and much later four R.T.Is. stationed at Bombay, Calcutta, Bangalore and Lucknow opened |
| 1958 | - The Gift-tax Act, 1958 introduced w.e.f. 1-4-1958  
- Report of Law Commission received |
| 1959 | - Direct Taxes Administration Enquiry Committee submitted its report |
| 1960 | - Directorate of Inspection (Research, Statistics & Publications) was set up  
- Two grades of Inspectors - selection and ordinary grades - merged into one single grade |
| 1961 | - Direct Taxes Advisory Committee set up - Direct Taxes Administrative Enquiry Committee  
- Income-tax Act, 1961 came into existence w.e.f. 1-4-1962  
- Revenue Audit introduced for the first time in the Department  
- New system for evaluation of work done by Income-tax Officers introduced |
| 1963 | - Central Board of Revenue bifurcated and a separate Board for Direct Taxes known as Central Board of Direct Taxes (CBDT) constituted under the Central Board of Revenue Act, 1963 |
| 1964 | - For the first time an officer from the department became Chairman of the CBDT w.e.f. 1-1-1964  
- The Companies (Profits) Sur-tax Act, 1964 was introduced |
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<tr>
<td>1964</td>
<td>- Annuity Deposit Scheme, 1964 introduced</td>
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<tr>
<td>1965</td>
<td>- Voluntary Disclosure Scheme came into operation</td>
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</tbody>
</table>
| 1966 | - Functional Scheme introduced  
- Special Recovery Unit created  
- Intelligence Wing created and placed under the charge of Directorate of Inspection (Investigation) |
| 1968 | - Valuation Cell came into existence in the Income tax Department  
- Report of rationalisation and simplification of tax structure (Bhoothalingam Committee) received  
- Administrative Reforms Commission set up |
| 1969 | - Direct Recruitment to Class II Income-tax Officers made  
- The post of IAC (Audit) created in the Income-tax Department |
| 1970 | - The posts of Addl. Commissioner of Income-tax created and abolished after one year  
- Recovery functions which were hitherto performed by Income-tax Officers, given to Tax Recovery Officers. Prior to that State Government officials exercised the functions of a Tax Recovery Officer |
| 1971 | - A new cadre of posts known as Tax Recovery Commissioners introduced w.e.f. 1.1.1972  
- Report of Direct Taxes Enquiry Committee received  
- Summary Assessment Scheme introduced w.e.f. 1-4-1971 |
| 1972 | - A Special Cell within the Directorate of Inspection (Investigation) created to oversee the cases of big industrial houses  
- A new cadre of posts known as IAC(Acq.) created and IAC appointed as Competent Authority with the insertion of new Chapter XXA in the Income Tax Act, 1961 on the acquisition of immovable properties in certain cases of transfer to counter evasion of tax  
- Directorate of Organisation & Management Services (Income-tax) created  
- The post of I.T.O. (Internal Audit) created |
<table>
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| 1974 | - Bradma Scheme in the Income-tax Department introduced  
       - System of Permanent Account Number introduced  
       - Valuation Officers given statutory powers under the Income-tax Act, 1961 and Wealth-tax Act, 1957 |
| 1975 | - Compulsory Deposit Scheme (Income-tax Payers) Act, 1974 introduced  
       - Action Plan for the Income-tax Officers introduced for the first time  
       - Concept of M.B.O introduced |
       - Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 introduced w.e.f. 25-1-1976  
       - A new scheme for departmentalization of accounts introduced  
       - Chokshi Committee submitted its interim report |
| 1977 | - A new cadre of posts known as IAC (Assessment) created |
| 1978 | - Appellate functions given to a new cadre of Commissioners known as Commissioner (Appeals)  
       - Directorate of Inspection (Recovery) set up  
       - A new directorate known as Directorate of Inspection (Vigilance) came into existence by bifurcating the functions of Directorate of Inspection (Investigation)  
       - Chokshi Committee submitted its final report |
<p>| 1979 | - A new directorate designated as Directorate of Inspection (Publication &amp; Public Relations) created out of the Directorate of Inspection (RS&amp;P) |
| 1981 | - Economic Administrative Reforms Commission set up |</p>
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|      | - Three new Directorates viz. Directorate of Inspection (Intelligence), Directorate of Inspection (Survey) and Directorate of Inspection (Systems) created  
- Within the Directorate of Inspection (Income Tax and Audit), a separate Director of Inspection (Audit) appointed  
- Directorate of Inspection (RS&P) re-organized and Directorate of Inspection (P&PR) re-designated as Directorate of Inspection (Printing & Publications)  
- I.R.S.(DT) Staff College, Nagpur, re-designated as National Academy of Direct Taxes  
- Special Bearer Bonds (Immunities & Exemptions) Act promulgated  
- Director General (Special Investigation) and Director General (Investigation) appointed to control the functioning of various Directorates under the control of Central Board of Direct Taxes  
- Five posts of Chief Commissioner (Administration) created  
- A few posts of Commissioner of Income-tax were earmarked as Commissioner of Income-tax (Inv.) and Commissioner of Income-tax (Recovery) |
| 1982 | - Special Cell within the Directorate of Inspection (Investigation) converted into a separate Directorate and re-designated as Directorate of Inspection (Special Investigation)  
- DIT (Systems) appointed in the Directorate of Income-tax (Organization and Management Services) to coordinate efforts in introducing electronic data processing in the IT Deptt. A microprocessor based EDP system along with data entry system was installed heralding the era of computerization  
- Levy of Hotel Receipts Tax discontinued  
- Regional Training Institute at Nagpur started functioning under the control of the National Academy of Direct Taxes |
<p>| 1983 | - The vigilance set up re-organized and the strength of Dy. Director (Vigilance) and Asstt. Director (Vigilance) augmented |</p>
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<tr>
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<td>- Computerized systems for processing challans and PAN designed and developed</td>
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<tr>
<td>1984</td>
<td>- Taxation Laws(Amendment) Act 1984 passed to streamline procedures in the interest of better work management; avoid inconvenience to tax payers; reduce litigation; remove anomalies and rationalise some provisions</td>
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</tbody>
</table>
| 1985 | - Post of Director General (Investigation) created for more effective checking of tax evasion  
|      | - E.D.(Amendment) Act 1985 discontinues levy of estate duty on deaths occurring on or after 16.03.1985  
|      | - Compulsory Deposit Scheme (Income Tax Payers) Act 1974 discontinued w.e.f. 1.4.1985  
|      | - Interest Tax Act, 1974 discontinued w.e.f. 31.3.1985  
|      | - A new "Reward Scheme" for motivating officers introduced w.e.f. 1.4.1985 |
|      | - Established Settlement Commission  
|      | - Introduced Block assets concept for depreciation  
|      | - Four offices of Appropriate Authority for acquiring property in which unaccounted money is invested set up in metropolitan cities |
| 1987 | - Government's approval obtained to set up three new benches of Settlement Commission  
|      | - L.K. Jha Committee set up for simplification and rationalisation of tax laws  
|      | - Office of Directorate General (Tax Exemption) set up at Calcutta  
|      | - The Direct Tax Law(Amendment) Act 1987 introduced uniform previous year and redesignated the following authorities  
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<th>Year</th>
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| 1988 | **Income tax Officer**  
- Expenditure Tax Act 1987 brought into force  
- Benami Transactions Prohibition Act 1988 introduced  
- The Government announced a "Time Window Scheme" which allowed tax payers 50% rebate of interest u/s 220(2) if they pay the tax and balance interest. The scheme was in operation between 1.7.88 to 30.9.88  
- CIT (Central) placed under the control and supervision of Director General (Investigation)  
- Government decided that cadre control for Group 'C' and 'D' posts would be with Chief Commissioner and with CBDT for Group 'A' and 'B' posts  
- Extension of Direct Tax Law to the State of Sikkim by a notification of the President of India dated 7.11.1988 |
| 1989 |  
- Creation of an attached office of DGIT(Management Systems) to supervise Directorate of I. Tax(Research, Statistics, Publication & Public Relations) and Directorate of I. Tax (Organization and Management Services) from Sept. 1989 |
| 1990 |  
- Gift tax Bill introduced on 31.5.1990  
- Creation of 65 posts of Dy. Commissioner of I. Tax by upgradation of equal number of posts of Asstt. Commissioner of I. Tax |
| 1991 |  
- Interest Tax Act, 1974 revived  
- Directorate of I. Tax(Systems) started reporting directly to Board |
| 1992 |  
- Rs. 1400 Presumptive Taxation scheme introduced as a measure to widen tax base  
- The post of Director General of Income-tax (Management Systems) was abolished |
| 1993 |  
- 40 additional posts of Commissioner of Income-tax (Appeals) created  
- Authority for Advance Rulings set up  
- A comprehensive phased cadre review for Group B, C and D |
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| 1994 | - 2068 additional posts in Group B, C and D sanctioned  
      - New PAN introduced  
      - Regional Computer Centers (RCCs) were set up in Chennai, Delhi and Mumbai |
| 1995 | - New procedure for search assessment introduced  
      - 50 years of training commemorated and "Seminar Twenty Five" introduced by National Academy of Direct Taxes |
| 1996 | - 77 posts of Commissioners of Income-tax created  
      - Infrastructure for operational needs strengthened  
      - Study report on 4th cadre review of Group 'A' officers (IRS) of the Department prepared by Directorate of Income Tax (Organization and Management Services) |
| 1997 | - Rates of Income-tax reduced significantly  
      - Legal measures to widen tax base on certain economic indicators introduced in selected cities  
      - Presumptive tax scheme discontinued  
      - Voluntary Disclosure Scheme 1997 introduced  
      - Minimum Alternate Tax introduced  
      - National Computer Centre (NCC) was set up in Delhi |
| 1998 | - Sec. 260A introduced enabling direct appeals to High Court  
      - 1/6 Scheme & penalty for non-filing of return introduced to widen tax base  
      - Gift-tax abolished for gifts made after 1.10.1998  
      - Kar Vivad Samadhan Scheme 1998 introduced  
      - Silver Jubilee of Regional Training Institutes celebrated  
      - Designation of Asstt. Commissioner (Senior Time Scale) changed to Dy. Commissioner and that of Dy. Commissioner (Junior Administrative Grade) to Joint Commissioner |
| 1999 | - Furnishing details of bank account and credit cards in the prescribed form made mandatory for refund purpose  
      - Prima-facie adjustments to return done away with; |
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<tr>
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<td>acknowledgments to serve as intimations</td>
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<td>- Samman Scheme introduced in 1999 to honor deserving taxpayers</td>
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<td>2000</td>
<td>- The process of implementation of restructuring of the Department commenced to increase efficiency and to deal with increased workload</td>
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<td>- Total sanctioned work force reduced from 61,031 to 58,315</td>
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<td>- Certain rationalization measures at structural levels introduced</td>
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<td>- Interest-tax Act terminated with effect from 1-4-2000</td>
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<td>2001</td>
<td>- The restructuring of the Department resulted in reducing the stagnation at all levels and large number of personnel were promoted in various grades</td>
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<td>- Jurisdiction pattern was revamped</td>
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<td>- New posts were created at the level of DGIT/DIT in the areas of Research, International Taxation and Infrastructure</td>
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<td>2002</td>
<td>- Computerized processing of returns all over the country introduced</td>
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<td></td>
<td>- Kelkar Committee Report, inter alia, recommended:- i. Outsourcing of non-core functions of the department ii. Reduction in exemptions, deductions, reliefs, rebates etc.</td>
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<td></td>
<td>- The National Website of the Income Tax Department (<a href="http://www.incometaxindia.gov.in">www.incometaxindia.gov.in</a>) was launched to provide a vital interface between the Department and taxpayers</td>
</tr>
<tr>
<td>2003</td>
<td>- The National Website of the Department (<a href="http://www.incometaxindia.gov.in">www.incometaxindia.gov.in</a>) won the Silver Medal in the category of the ‘Government Websites’ under the National e-Governance Awards</td>
</tr>
<tr>
<td>2004</td>
<td>- As a measure of widening of tax base, the concept of AIR (Annual Information Return) was introduced</td>
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<td>- Fringe Benefit Tax (FBT) was introduced as a major step towards widening of tax base and bolstering of the Direct Tax Collection</td>
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<td>- Securities Transaction Tax (STT) was introduced</td>
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| 2005 | - Tonnage Tax was introduced for the Shipping Companies  
- Banking Cash Transaction Tax (BCTT) was introduced w.e.f. 01-06-2005 |
| 2006 | - A project for enabling electronic filing (e-filing) of Income Tax Returns was launched  
- Tax Return Preparer Scheme (TRPS) was launched to assist individuals and HUF taxpayers to file their Return of Income  
- The institution of Income Tax Ombudsman set up in 12 cities throughout the country to look into tax related grievances of the common public |
| 2007 | - The Refund Banker Scheme was launched in Delhi and Patna charges  
- Sevottam Scheme was launched to standardize service delivery to the taxpayers  
- The first citizen-friendly single window Aayakar Seva Kendra (ASK) was setup, for centralized receipt and registration of specified categories of documents, including income tax returns  
- The Income Tax Department became the biggest revenue mobilizer for the Government in 2007-08, with its share increasing from 34.76% in 1997-98 to 52.75% in 2007-08  
- All India Tax Network (TAXNET) was setup connecting more than 700 offices in more than 500 cities. Consolidation of 36 (RCC) independent regional databases into a single centralized database (PDC or Primary Data Centre) was carried out  
- Integrated Taxpayer Data Management System (ITDMS) for drawing of 360° taxpayer profile was launched |
| 2008 | - Cyber Forensic Labs were setup to identify relevant digital data during search and survey operations, recover hidden or password protected or deleted data and store retrieved data in a manner so that it could be used as evidence in judicial proceedings  
- Electronic filing of Income Tax Returns Project was awarded Silver Award in the category "Outstanding Performance in
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<tr>
<td>2009</td>
<td>Centralized Processing Centre was setup in Bangalore for bulk processing of e-filed and paper returns. The Centre operates without any interface with taxpayers in a jurisdiction – free manner</td>
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<td>2010</td>
<td>- Integrated Tax Payer Data Management System (ITDMS) was conferred the Prime Minister's Award for 'Excellence in Governance and Administration'</td>
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<td>- CPC Bangalore awarded the Gold Award for 'Excellence in Government Process Re-engineering' under the National e-Governance Awards for the year 2010-2011</td>
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<td>- To simplify the 50 years old Income-tax Act, 1961, 'The Direct Taxes Code Bill, 2010' was introduced in the Parliament</td>
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<td>2011</td>
<td>- Foreign Tax Division of CBDT was strengthened to effectively handle the increase in tax information exchange and transfer pricing issues</td>
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<td>- Various IT initiatives were taken for efficient tax administration. These include e-filing and e-payment of taxes, adoption of 'Sevottam' concept by CBEC and CBDT, web based facility for tax payers to track the resolution of refunds and credit for pre-paid taxes and augmentation of processing capacity</td>
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<td>- A new simplified form 'Sugam' was introduced to reduce the compliance burden of small tax payers falling within presumptive taxation</td>
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<td>2012</td>
<td>- Senior Citizens (not having any income from business/profession), were exempted from payment of advance tax</td>
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<td>- TRACES (TDS Reconciliation, Accounting and Correction Enabling System) launched to serve an integrated one-stop platform for the stakeholders to facilitate the services related to TDS operations</td>
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| **2013** | - The Government approved the Cadre restructuring of the Department for the creation of 20,751 additional posts and for carrying out various measures to increase the effectiveness of the Department  
- Briefly, the salient features of the approved restructuring are as under:  
- Number of assessment units (AUs) increased by 1080 from 3420 to 4500, for strengthening the tax-administration, Each Range to have one more Assessing Officer, Increase in the number of Administrative CsIT deployed on assessment related functions to increase from 228 to 250, 114 Special Ranges to be created, with adequate supporting manpower, Creation of reserves numbering 620 created in the IRS cadre, Bifurcation of the posts of the CITs in the HAG and SAG scales, on functional basis, Up gradation of all existing 116 posts of CCsIT in HAG+ and Apex scales along with an increase of their number by 1 post, Strengthening of the training set-up with creation of three more RTIs, Strengthening the Appellate/Advocacy Structure by increasing the number of CIT Appeals and providing them supporting manpower. Advocacy structure in the ITAT to be strengthened, |
| **2014** | - New National Website of the Income Tax Department www.incometaxindia.gov.in launched with enhanced new features and content  
- SIT to investigate Black Money in Swiss Bank Accounts formed  
- Tax Administrative Reforms Commission (TARC) headed by Dr. Parthasarathi Shome submitted its report of reviewing the applicability of tax policies and tax laws in the context of global best practices and recommending measures for reforms required in tax administration to enhance its effectiveness and efficiency |
| **2015** | - Revised Income Tax Return Forms  
- increased the Service Tax rate from 12.36% (including education cess) to 14% |
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|      | - Birth of Sevottam, the Tax Grievance Resolution System  
|      | - Tax Incentives of E-payments  
|      | - Passing of the Black Money Bill |
| 2016 | - Scrap Minimum Alternate Tax (MAT)  
|      | - Replace DDT with compulsory Dividend Withholding Tax  
|      | - Restore Capital Gains Tax Treatment for buy-back of shares  
|      | - Retro Tax  
|      | - Clarify tax sops to SEZs |
| 2017 | - Lower Tax Rates and Changed Income Ranges  
|      | - Alternative Minimum Tax Exemptions Increased  
|      | - Increased standard deduction  
|      | - Increased Child Tax Credit  
|      | - Personal and dependent exemptions |