CHAPTER VI

REBATES AND RELIEFS:
MITIGATION OF PROGRESSION
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Rebate, relief, exemption and deduction play an important role in taxation. Granting exemption to taxpayers results in reduction of effective progressive rates.¹ In India tax compliance by salaried class is higher when compared to non-salaried class for the past fifty years. Majority of the non-salaried class reveal their income only at low-income range.² Hence they are left with the only option of reducing rigors through rebate and relief available. Problems related to rebates, relief and certain exemptions are analysed in this chapter. Reliefs under section 89 are applicable only to salaried class to protect them from higher rates when salary is received in arrears or in advance. The problems confronted by salaried employees in the regard have also been discussed in this chapter.

When tax reform committee was appointed in 1977, the terms of reference required it to examine the scope of various exemptions. The committee explained the scope and role of exemptions in tax laws as follows:

The expression ‘exemption’ has a wide connotation and cannot be restricted to refer to only those items of income, which had been kept outside the field of taxation. In a wider sense all deduction, whether allowed in the process of computation of the gross total income or allowed in the process of determining the net taxable income or allowed as rebate are exemptions. They seek to modulate the structure to suit the needs of the times by providing differential tax treatment to various types of income consistent with the policies of the government. They provide the necessary incentives on a selective basis to certain types of desirable activities by inducing channelisation of savings of the community into selected sectors of investment. They facilitate achievement of certain basic social and economical objectives. Exemptions also

¹ Blum Walter J. and Kalven Harry J., The Uneasy Case For Progressive Taxation (1954), p.3.
² See Chapter III.
play the important role of alleviating hardship to certain categories of taxpayers. They provide mitigation of the high rates of taxation in appropriate cases, thus introducing an element of equity in taxation.\(^3\)

An element of complexity does get into tax laws when provisions are made to induct various exemptions, deductions and other reliefs.\(^4\) Tax rebates are incentives extended to individuals to enable a part of their earning to be saved. From time immemorial income tax rebate by way of reduction in the taxable income or tax payable had been granted to ensure that taxpayers do not resort to lavish and wasteful expenses.\(^5\) The same committee studied the question of erosion of progression when exemption and deduction were allowed for the investments made by high-income group, and opined:

We are afraid a total denial of the benefit of all incentives and exemption to such persons will set undesirable trends. In our anxiety to establish an egalitarian society, one cannot afford to forget that it is this group with larger income, which can substantially contribute to economic growth by way of larger savings and investments. In our view, to deny the benefit of exemptions might defeat the purpose of the incentives.\(^6\)

Consequent to liberalization and reforms in the economic field, many countries of the world stopped use of tax incentives as an instrument of promoting social and economic objectives. The Tax Reforms Committee appointed to suggest reforms to suit the new economic policy of the government had gone into the question of using rebates as an incentive for saving and observed that deductions often tend to confer unduly large tax benefit on taxpayers with higher incomes who were more resourceful and who could take full advantage of the tax concessions and would reduce the progressivity as well as horizontal equity of the tax system.\(^7\) The committee opined that concessions often failed to achieve the objectives underlying

\(^4\) Ibid at para 5.3.
\(^5\) Ibid.
\(^6\) Ibid. at para 5.6.
them. After taking into consideration the impact it might have on low-income group it came to the conclusion that it might not be possible to eliminate incentives for savings completely at one stroke for the reason that low income groups usually put their savings in provident fund, life insurance and UTI etc. and derive benefit from tax concession and also since they would not benefit as much from reduction in tax rates immediately.

The committee recommended that tax rebate allowed under section 88 for investment in provident fund, national saving certificate etc. should be permitted at the entry point restricted to investment up to maximum level of Rs 10,000/. It further recommended that concession should be restricted to contributions to provident fund, life insurance policies and repayment of loans taken for purchase or construction of residential house property. According to it the reduction in the total quantum of tax benefit attached to these schemes would merely reduce the undue privilege flowing to the relatively better off taxpayers who would be benefitting from rate reductions. It also recommended that the return of savings in certain forms should be wholly exempt from tax. (e.g. in the provident fund and bonus on life insurance policies as these were not easily withdrawable).

The Task Force was appointed after one decade reconsidered the issue of tax incentives on savings. The committee highlighted the abuse of tax incentives and difficulties of administrative complexities. It also took into consideration the cost effectiveness of such schemes. The influence of the report was reflected in the budget speech in 2002. Mr. Yashwant Sinha observed that ‘the cost of mobilizing

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8. Ibid.
9. Ibid at para 6.46.
10. Ibid.
11. Ibid at para. 5. 35 and 5. 36.
12. Task Force Report, (2002), p.124. Para. 5.30 reads thus: “A crucial question that bears on the decision to grant tax incentives should be their cost effectiveness. This implies that the mere identification of the existence of positive externalities associated with certain type of investment is not sufficient for justifying their use of such incentives in all instances. Rather, their use should be predicted on the belief that the benefits to the economy that can be expected from an increase in the incentive -favored activities would actually outweigh the total cost of the tax incentives granted.”

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small saving due to the tax rebate under section 88 has become exorbitantly high and uneconomic'.

Review of the committee reports and the budget speech indicate that softer tax approach to investments as tax incentives has undergone changes and yielded to the cost effectiveness of investment.

Being the most tax complying group salaried class make use of investment provisions to the maximum. Any attempt on the part of the Government to reduce the benefit is often met with stiff resistance from employees. Since most of the non-salaried either suppress their income or reveal it at bottom rates they do not pay much attention to tax rebates from investment on specified items. The average of investments made by employees (men)\textsuperscript{14} for four assessment years ending with 2001-02 are given in Table 1.

<table>
<thead>
<tr>
<th>Table - 1</th>
<th>Average investment made by salaried and non-salaried assessees (men) under section 88 for four assessment years ending 2001-02.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income range</td>
<td>No. of returns</td>
</tr>
<tr>
<td>0 - 40000</td>
<td>301394</td>
</tr>
<tr>
<td>40000-50000</td>
<td>131613</td>
</tr>
<tr>
<td>50000-60000</td>
<td>793078</td>
</tr>
<tr>
<td>60000-80000</td>
<td>1295295</td>
</tr>
<tr>
<td>80000-100000</td>
<td>774554</td>
</tr>
<tr>
<td>100000-150000</td>
<td>2127080</td>
</tr>
<tr>
<td>150000-200000</td>
<td>1392615</td>
</tr>
<tr>
<td>200000-300000</td>
<td>417261</td>
</tr>
<tr>
<td>300000-400000</td>
<td>135008</td>
</tr>
<tr>
<td>400000-500000</td>
<td>60669</td>
</tr>
<tr>
<td>500000-1000000</td>
<td>100336</td>
</tr>
<tr>
<td>Above 1000000</td>
<td>21046</td>
</tr>
</tbody>
</table>


\textsuperscript{13} Ibid.

\textsuperscript{14} Since the data regarding investment by women was inclusive of rebate under 88 C, exclusive data about investment was not available.
The data indicate certain behavioral patterns emerging in matters of revealing the income by the salaried and non-salaried assessees. The number of returns by non-salaried are maximum in the first four slabs as against the salaried class whose number of returns are maximum in middle slabs between Rs.60000/- and Rs.200000/-.

The investments made by salaried class outweigh that by non-salaried at all levels of income. The average investment of salaried at the income range between Rs.40000/- to Rs.100000/- are four digit figures whereas it is limited to three digit in case of non-salaried. Similarly salaried class in the income range between Rs.150000/- and 500000/- are making heavy investments in specified items.

Taking into consideration the high tax compliance ratio at the high income range and also the heavy investment made by the salaried class under section 88 it may be inferred that they are making use of investment under section 88 to reduce tax liability. Since most of the non-salaried reveal their income at low levels necessity of reducing liability does not arise for them. Hence it may be inferred that any reduction in rebate rates or other anomalies in these matters adversely affect the salaried class only.

Until 1990, deductions were granted to investment on specified items under section 80C. Deduction was allowed under the section at the rate of sixty per cent up to Rs.5,000/- and thereafter at the rate of forty per cent. Three slab rates for relief were first introduced in 1971. The slab rates were changed six times between 1974 and 1983 and the ceiling limit was also enhanced three times. Finance Act, 1983 also followed the three slab gradation based on the amount of investment on specified items.

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15 The table refers to investment by salaried and non-salaried men only because the data related to women are clubbed with rebate under 88C. Separate data of women regarding investment under section 88 and rebate under 88C are not made available by the income tax department.


18 Finance Act, 1983, old section 80C. Where the aggregate sum specified in sub-section (2) does not exceed Rs.6000/-, the whole of such amount should be deducted while computing total income. Where such amount exceeded Rs.6000/- but not exceed Rs.12000/- the deductible
The method of granting rebate as certain percentage of investment in specified items came into force only in 1990. From the assessment year 1990-91, section 88 provided for uniform tax rebate of 20% on savings made on various items such as insurance premium, provident fund, national saving certificate etc. The Finance Act, 2001 gave special rebate of thirty per cent to salaried group drawing salary less than rupees one lakh. The privilege was given to salaried class by subsequent finance Acts also.

The Finance Act, 2002 imposed restrictions, limits and conditions on rebate under section 88. The Act introduced three slab rates (30%, 20% and 15%) and denied the benefit of rebate to top income group. The impact of the amendment on individuals with taxable income between Rs.150,000/- and Rs.5,00,000/-, was that those who could earlier save upto Rs.16,000/- on taxes by making maximum possible investment of Rs.80,000/-, could save only up to Rs.15,000/- by an investment of Rs.1,00,000/-. The overall maximum limit for investment in various items mentioned in (1) to (17) of sub-section 2 of section 88 was raised to Rs.1,00,000/-. The sub-ceiling limit for investment in items (1) to (15) of sub-section (2) was Rs.70,000/-. This included installments paid towards purchase or construction of residential house and for tuition fee paid for education of the child.

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amount was Rs.6,000/- plus fifty per cent of the amount by which such amount exceeded Rs.6000/- and in cases where the aggregate exceeded Rs.12000/-, the deductible amount was Rs.9000/- plus forty per cent by which such aggregate exceeded Rs.12000/- an ceiling was Rs.40,000/-.

19 Section 87 was inserted by Finance Act, 1990, w.e.f. 1.4.1990.
20 Proviso to Section 88(1)(i).
21 Clause 35 of the Finance Bill 2002 proposed to reduce the rebate rate from 20% to 10% for individuals with taxable income between Rs.1,50,000/-, and Rs.5,00,000/-. It also proposed that those with taxable income above Rs.5 lakh should not be entitled to any rebate on their investment. Employees throughout India vehemently opposed the proposal and the government resolved the issue by enhancing the proposal in the bill from 10% to 15%.
22 Section 88(2)(xiv-b.)
Table - 2
Gradation of tax rebate at different income range

<table>
<thead>
<tr>
<th>Range of income</th>
<th>Tax liability</th>
<th>Amount invested Under Section 88</th>
<th>Percentage of allowable rebates</th>
<th>Amount of eligible tax rebate</th>
<th>Tax liability after rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>ii</td>
<td>iii</td>
<td>iv</td>
<td>v</td>
</tr>
<tr>
<td>1,00,000</td>
<td>9,000</td>
<td>30,000</td>
<td>30%</td>
<td>9,000</td>
<td>Nil</td>
</tr>
<tr>
<td>1,01,000</td>
<td>9200</td>
<td>30,000</td>
<td>20%</td>
<td>6,000</td>
<td>3200</td>
</tr>
<tr>
<td>1,50,000</td>
<td>19000</td>
<td>30,000</td>
<td>20%</td>
<td>6,000</td>
<td>13,000</td>
</tr>
<tr>
<td>1,51,000</td>
<td>19300</td>
<td>30,000</td>
<td>15%</td>
<td>4,500</td>
<td>14,800</td>
</tr>
<tr>
<td>5,00,000</td>
<td>1,24,000</td>
<td>30,000</td>
<td>15%</td>
<td>4,500</td>
<td>119500</td>
</tr>
<tr>
<td>5,01,000</td>
<td>1,24,300</td>
<td>30,000</td>
<td>0%</td>
<td>Nil</td>
<td>1,24,300</td>
</tr>
</tbody>
</table>


The progressive gradation of rebate is illustrated in Table 2. For the assessment year 2003, an individual drawing a salary of rupees one lakh and investing Rs.30000/- in specified securities was entitled to a rebate of 30% which reduced tax liability to nil.23 An increase of one thousand rupees at the margin enhanced the tax liability to Rs.3200/-. Similarly an individual having one lakh and fifty thousand rupees was entitled to twenty percent of the investment of Rs.30000/- and was eligible for a rebate of Rs.6000/-. An increase of one thousand rupees at this income level attracted an additional liability of one thousand eight hundred rupees since the investment rebate was reduced to 15%. An additional amount of one thousand rupees above five lakh was attracting a tax liability of Rs.48,00/-.

The analysis shows that gradation of 30% to 0% for allowing rebate was steep and sharp and exposed the salaried class to the marginal impact of progression. From the income revelation pattern it is most unlikely that non-salaried would reveal a few rupees at the marginal level to disentitle themselves from getting marginal relief of increased rebate. They would rather hide small amount and remain within the margin. The salaried are left with no such option. Salaried class constituted 24.72% of the total in the income range between Rs.150000/- and Rs.500000/- in 2001-02.24 They are eligible for a rebate rate of only 15% of the

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23 Proviso to section 88(1)(i).
24 Data compiled by the research wing of the Directorate of Income Tax.
invested amount. So far as the non-salaried are concerned only 10.16% come under this range of income. Analysis shows that owing to decline in rebate rate, the salaried class was in a more disadvantageous position and exposed to progressive rates than the non-salaried.

From the answers to the questionnaire, it was noted that few employees were exposed to the rigors of gradation of rebates due to small increase in gross salary. Five of them were selected for the study. Details of tax were collected from duplicate returns for the assessment year 2003-2004. The information collected is presented in the form of table 3 below.

Table - 3
Marginal impact due to gradation of rebate rates

<table>
<thead>
<tr>
<th>Salary</th>
<th>Tax on salary</th>
<th>Festival bonus</th>
<th>Salary including bonus</th>
<th>Tax liability</th>
<th>Amount of investment u/s. 88</th>
<th>Amount of eligible rebate on column iv</th>
<th>Amount after rebate on column iv</th>
<th>Tax after rebate on column iv</th>
<th>Additional liability of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>i</td>
<td>ii</td>
<td>iii</td>
<td>iv</td>
<td>v</td>
<td>vi</td>
<td>vii</td>
<td>viii</td>
<td>ix</td>
<td>x</td>
</tr>
<tr>
<td>99302</td>
<td>8860</td>
<td>1000</td>
<td>100302</td>
<td>9060</td>
<td>22314</td>
<td>6694</td>
<td>4463</td>
<td>2166</td>
<td>4597</td>
</tr>
<tr>
<td>99101</td>
<td>8820</td>
<td>1000</td>
<td>100101</td>
<td>9020</td>
<td>18600</td>
<td>5580</td>
<td>3720</td>
<td>3240</td>
<td>5300</td>
</tr>
<tr>
<td>99973</td>
<td>8995</td>
<td>1000</td>
<td>100973</td>
<td>9195</td>
<td>19713</td>
<td>5914</td>
<td>3943</td>
<td>3081</td>
<td>5252</td>
</tr>
<tr>
<td>149819</td>
<td>18964</td>
<td>1000</td>
<td>150819</td>
<td>19246</td>
<td>26018</td>
<td>5204</td>
<td>3903</td>
<td>13760</td>
<td>15343</td>
</tr>
<tr>
<td>149415</td>
<td>18883</td>
<td>1000</td>
<td>150415</td>
<td>19125</td>
<td>25812</td>
<td>5162</td>
<td>3872</td>
<td>13721</td>
<td>15253</td>
</tr>
</tbody>
</table>

Source: Computed from data collected from field study and based on tax rates of assessment year 2003-2004.

In the case of first three cases an addition of one thousand rupees pushed them to the next grade of one lakh consequently resulting in decreased rebate rebates (from 30% rebate rates to 20%). In the case of last two, the receipt of bonus pushed them to the next slab and the eligible tax rebate was reduced from 20% to 15%. Table reveals that tax liability in all the five cases increased by an amount more than the bonus.

Opinion was sought from salaried and non-salaried classes regarding gradation rates for rebate. The sample constituted hundred each. The responses were as follows. Majority of the salaried class considered the present system 'unfair'. In spite of repeated reminders most of the non-salaried group did not respond. Eighteen
of them expressed their opinion of reduction of rebate rate at the income range of 1.5 lakh as 'unfair'. It may be inferred from the responses that salaried class react to the changes in rebate rates more than the non-salaried. It is another indication that the tax pinch is more felt by the salaried class.

India is one of the few countries where dependent allowance is not permitted for computation of the tax liability. Parents incurring expenditure for education of children had to pay tax on such amounts though education is considered to be one of the basic amenities of life. The Kelkhar Committee highlighted the need to provide support for education under the tax law. The Government declared some relief regarding expenditure for education of children in the 2003 budget. Section 88 was amended to insert clause (xiv-b) to subsection (2) and it provided an exemption to any sum paid as 'tuition fee' whether at the time of admission or thereafter to any educational institution situated within India for the purpose of full-time education of two children of an assessee, as does not exceed an amount of twelve thousand rupees in respect of each child. In effect the maximum qualifying amount is twenty four thousand rupees.

In the answers to the questionnaire most of the salaried class has expressed their dissatisfaction over the clubbing of rebates for education under section 88. The responses made it clear that while certain problems were common to all employees some were not susceptible to such generalisation. Most of them were not able to get the intended relief because it was restricted to 'tuition fee' and not extended to other expenses relating to education. According to them cost of books and other incidental expenses overweight tuition fee. This problem arose from the wording of section 88(2)(xv-b). The employees were unanimous that clubbing of rebate for educational expenses along with other items of (1) to (15) of section 88(2) was singularly disadvantageous to them. Some of them had already made heavy investments in specified items (i) to (xv) of subsection (2) of section 88 as part of tax planning and

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26 Budget speech of 2003.
27 Third proviso to sub-section (5) of section 88.
exhausted the ceiling limit and hence could not accommodate the educational expenses incurred for children, for example, heavy investments in life insurance policies are recurring and inflexible expenses.

Another problem in the area was that of government employees of Kerala. Considerable number of them was not able to avail educational rebate owing to the governmental order compulsorily merging arrears of dearness allowance to the general provident fund account. From the study it is learnt that in the assessment year 2003-04 the State Government has made two orders\(^\text{28}\) compulsory crediting arrears of dearness allowance due from July 2000 onwards to the general provident fund account. The amounts credited to the general provident fund account as per the said orders varied approximately between Rs.20,000/- to Rs.34,000/- for the assessee selected for study. The regular subscription to general provident fund by the said category varied from forty thousand rupees to fifty seven thousand rupees. The amounts compulsorily credited to the general provident fund under the governmental orders along with regular subscriptions under items (i) to (xv) of section 88 exhausted the ceiling limit of Rs.70,000/- and deprived them the relief for educational expenses.

The impression one gets from the analysis is that deduction in respect of tuition fee under section 88 is disadvantageous to the employees when compared to others since employees are the main contributors of investment under section 88. It is more disadvantageous to the government employees since arrears of dearness allowance and pay are credited to general provident fund without giving option to the employees, as per government orders. Thus the intention of the Parliament to offer some relief to parents, who spend for education of their wards, was made infructuous.

Finance Act, 2005 brought in far-reaching changes to concessions for investments. It has dispensed with gradated rebate system under section 88.\(^9\) Hence the employees are no longer exposed to evils owing to gradation. The various items under old 88 are taken to newly inserted section 80C. The aggregate of investment in specified items under section 80C can be deducted from the total income subject to a maximum of one lakh rupees. Thus assessees in the 30% slab rate are benefited to a great extent. The item-wise sub-ceiling has also been dispensed by the new section 80C. Section 80CCE provides for clubbing of investments under section 80C, 80CCC and section 80CCD and the aggregate is subject to ceiling of one lakh rupees. Before amendment, assessees were getting additional rebate of ten thousand rupees under 80CCC and 80CCD.

Women employees were benefited to a great extent by the special rebate of five thousand rupees under section 88C.\(^9\) It was introduced as an incentive for women to work. In India since family is not the unit of assessment, the spouses are not in a disadvantaged position of clubbing their income and attracting more progressive rates. Section 88C is deleted by the Finance Act, 2005 and the concession is given in the form of special exemption of Rs.1,35,000/- instead of general exemption limit of Rs.1,00,000/-. This new arrangement has resulted in the reduction of benefit by an amount of Rs.1500/- for women in 30% brackets. Most of the women employees were unhappy over the withdrawal of rebate under section 88C. The present researcher has categorized the employees on the basis of marital status viz. single income and double income group. The data show that sixty percent of women employees selected for the study belonged to double income group. The rebate is an added boon to the double income group but erodes the principle of progression.

\(^9\) See Finance Act, 2005, section 29. It inserted subsection 9 which reads thus: "No deduction from the amount of income tax shall be allowed under this section to an assessee, being an individual or a Hindu undivided family for the assessment year beginning on 1\(^{st}\) day of April, 2006 and subsequent years."

\(^{10}\) Inserted by Act 10 of 2000.
Taking into consideration problems of senior citizens the Government has given them tax concession in the form of rebate under section 88B\(^3\). Finance Act, 2005 deleted the said provision and concession is awarded in the form of special higher non taxable limit of Rs.1,85,000/- for senior citizens. The concession is available to all individuals who are sixty-five years or above and residents in India. Since pensioners do not have provision for reimbursement of medical expenditure and in the absence of effective social security system special concession\(^3\) is a welcome relief.

In the history of income tax for the first time a relief in the form of rebate was offered to assesseses in the low-income slab without enhancing the nontaxable limit through the 2004-05 budget proposals. Section 88D initially did not provide for marginal relief. Tax experts highlighted the anomaly regarding denial of marginal relief, the same was rectified later, and the rebate was made available to income up to Rs.111250.\(^3\) The impact of rebate can be illustrated with the help of table 4.

<table>
<thead>
<tr>
<th>Total income (Rs.)</th>
<th>Assessment year 2004 - 2005 Tax Rs.</th>
<th>Cess Rs.</th>
<th>Total Rs.</th>
<th>Rebate under S. 88 D - Rs.</th>
<th>Tax liability Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>50,000</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>55,000</td>
<td>500</td>
<td>Nil</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>60,000</td>
<td>1,000</td>
<td>Nil</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>75,000</td>
<td>4,000</td>
<td>Nil</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>1,00,000</td>
<td>9,000</td>
<td>184</td>
<td>9,384</td>
<td>9,384</td>
<td>9,384</td>
</tr>
<tr>
<td>1010000</td>
<td>9,200</td>
<td>225</td>
<td>11475</td>
<td>11475</td>
<td>11475</td>
</tr>
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<td>111250</td>
<td>11250</td>
<td>225</td>
<td>11485</td>
<td>Nil</td>
<td>11485</td>
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<tr>
<td>111300</td>
<td>11260</td>
<td>225</td>
<td>11485</td>
<td>Nil</td>
<td>11485</td>
</tr>
</tbody>
</table>

Source: Computed reference to section 22 of Finance Act, 2004

It is evident from column (v) that tax liability suddenly shoots to an amount of Rs.11485/- by a mere increase of fifty rupees to gross income of Rs Rs 111250/-.

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\(^3\) Section 88B was inserted by the Finance Act 1992 which granted 100% rebate to a tax limit of Rs.10000. This limit was further enhanced to Rs.15000/- by the Finance Act, 2000.

\(^3\) Substituted by Finance Act, 2003.

\(^3\) Amendment to Finance (No.2)B-II, clause (4).
The gradation at this slab is very steep i.e. from zero to Rs.11485/-. Taking into consideration of the rate compliance history, non-salaried are likely to be benefited by the rebate. More than seventy three percent of non-salaried reveal their income below one lakh. Since the salaried cannot conceal income they are likely to be exposed to the marginal impact at the income range just above Rs.11250/-. The number of salaried class is more than 53% at the range of above one lakh. It may be inferred in the light of above circumstance that salaried are more likely to be affected by the sharp gradation of section 88 D than the non-salaried.

Another provision that grants relief exclusively to the salaried group from progressive rates is section 89. The section is intended to give relief when employees receive salary in arrears or in advance or payment in lieu of salary due to which the total income is assessed at a higher rate than that would have been assessed. Section 89 recognizes the fact that rate of tax should commensurate with the period of earning so far as possible and a taxpayer should be spared the pinching effect of the amount received in lump sum. The employees are allowed to spread the amount received in lump sum to back years in which it became due. The mode of granting relief is spelt out in Rule 21A (2) to 21A(5) would show that in all different kind of cases the exercise of giving relief is initiated by bringing to tax the whole of arrear amount in the assessment for the relevant assessment year to the year of receipt.

The computation of relief under section 89 is basically arithmetical. At first the rate of tax applicable to the total income including the arrears of payment in the year of receipt is ascertained and then the rate is found out by adding the arrears to the total amount. The employees have to submit true and authentic statement of the total income of the earlier years to which the arrear pertain. Usually assessees claiming relief under section 89 should produce Form No. 10E, TDS of relevant

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34 See chapter III.
36 Ibid.
previous years and detailed calculation statement for getting relief. The section is often called in application in the case of government employees owing to delayed clearance of arrears by government. Finances of state governments have been under continuous stress owing to slowdown in revenue receipts and increase in non development revenue expenditure. The escalation of borrowing requirements of state governments over the years has led to financial constrains forcing them to postpone the pay revision and declaration of dearness allowance of employees. The dearness allowance arrears are also compulsorily credited to the general provident fund account from time to time by successive governments.

In the answers to the questionnaire, thirty-four employees raised problems relating to spreading of relief under section 89. The aggrieved employees belonged to the State Government sector. The problem was analyzed by sample study. The sample consisted ten of such employees as follows: Six of them came under the jurisdiction of income tax circle, Calicut, and were drawing salary from district treasury, Kozhikode; two under the jurisdiction of Tirur income tax circle drawing salary from M.E.S College, Ponnani and the remaining two belonged to Palakkad circle drawing salary from district treasury, Palakkad. All of them received the arrears of salary pertaining to the assessment years 1996-97 to 1999-2000. The pay slips were issued to the employees in the assessment year 2000-01 and the entire arrears for the period from 1.1.1996 to 31.12.1999 was credited to the provident fund and the amount so credited was ‘locked in’ for a period of further four years as per the government orders. The present writer studied duplicate returns authenticated by income tax department, Form No. 10E, photostat copy of Form No. 16 and annexure-1 including detailed calculation statements filed by employees selected for study. All of them claimed rebate relief under section 89 by spreading arrears due for back years. The treasury refused the claims on the ground that benefit

\[37\] Sub-section (2B) of section 192.


Table - 5

Benefit of spreading of tax rebate under section. 89

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Source: Computed based on data collected from employees selected for study and the Finance Acts of relevant years.
in respect of contributions towards provident fund was not available for rebate under section 88 for any year other than the previous year in which the same was deducted and paid to the provident fund account. The details pertaining to the salary, arrears, and amount originally invested in general provident fund in the relevant years in which the arrears became due, arrears credited in the assessment year 2000-01 etc. are given in Table 5.

Analysis of data shows that amount credited to the general provident fund is fairly good amount. The amount together with the regular subscription can not be accommodated within the ceiling limit under section 88 for the assessment year 2000-2001. It shows that they have exhausted the ceiling limit under section 88. Column (15) indicates the total amount of arrears eligible for spreading. From column (16) it is evident that employees are eligible for an amount varying between Rs.10200/- to Rs.26980/- if spreading of rebate was permitted.

The legal position in this regard was analyzed. The question whether the amount of arrears compulsorily credited to the provident fund as per government orders can also be spread over, so that ceiling on tax rebate would not come in the way if it is taken as deposit in the year in which it is due to the provident fund account, came for consideration before the Madras Income Tax Appellate Tribunal in R.J.Basu v. Second I.T.O.\(^\text{40}\) It was decided that fiction enabling spread over under section 89 would have to be carried to its logical extent, so that if income could be spread over, there was no reason at all why the deposits in provident fund account should also not to taken as spread over on the same basis, so as to qualify for rebate in the years in which it could be deemed to have been deposited.\(^\text{41}\) It was held that since the additional salary is considered to be part of total income of the previous

\(^{40}\) (1991) 94 C.T.R. (ITAT) (Mad.) 296. Assessee, a bank officer received arrears of pay Rs.76,560/- in 1983 for the period 1973 to 1978. The bank had deducted at source tax on additional provident fund contribution compulsorily credited on the revision of pay. The assessee claimed relief under section 89(1) and for revising computation by taking into account the additional deduction available under section 80C in respect of subscription to the provident fund out of arrears. ITO had computed the relief merely adding the additional salary for the respective assessment years. This was confirmed in appeal.

\(^{41}\) Ibid at 297.
year, the total income has to be recomputed by taking into account the additional
deduction available under section 80C, in respect of compulsory subscription to the
provident fund deducted out of the arrears.42

Identical issue came before the Karnataka High court in Karnataka Food and
Civil Supplies Corporation Ltd v. State of Karnataka.43 The Court decided that the
employees were eligible for spreading arrears credited to the general provident fund
for claiming rebate relief.

The question of spreading, arrears of pay credited to general provident fund
for claiming rebate relief came before the Income Tax appellate Tribunal (Cochin)
in I.T.O., Palghat v. Smt. Mercy C.I.44 The assessee received arrears of salary for the
period 1988-89 to 1993-94, a portion of which was credited as per government order.
She claimed relief under section 89(1) and rebate under section 80C/88 for earlier
years. The assessing officer negatived the claim of rebate for earlier years. The
first appellate authority allowed the claim of the assessee, which was confirmed by the
Tribunal an appeal on the reasoning that sub rule (d) required that tax should be
calculated on the total income of each of the previous years as increased by the
relevant additional salary. ‘Total salary’ is defined in section 2 (45) to mean the total
amount of income as computed in accordance with the provisions of the Act. The
Tribunal was of the view that additional salary was considered to be part of the total
income of the previous years and the total income had to be recomputed.45 It was
held that addition actually resulted in a compulsory deduction as well as
enhancement of the deduction under section 16. Cochin Tribunal was in agreement
with the Madras Tribunal decision and held that tax was to be calculated after
making the addition to the total income, the exercise could not be completed without

42 Ibid at 298.
44 I.T.A. No.108 Cochin/1996. Before Sri. K.P.T. Thangal and Sri M. M Cherian. The order was
passed on 26.10.1999 (unreported case).
making the consequential change which resulted in additional deduction under sections 16 and 80C.46

In spite of the favourable decisions, the employees still face problems relating to spreading of arrears credited to general provident fund. Out of ten employees under study six had claimed refund of tax due to the denial of spreading. It came out in the interview that the income tax officer was not convinced of the claim at the first hearing and the cases were posted for further hearing. The judgment of income tax tribunal, Cochin was produced and income tax officer passed a favourable order. The rest of them did not claim refund of the amounts while filing returns. Though the decision of the income tax officer was made known the rest could not prefer claims since time for claiming refund had already elapsed.

It is observed during the field study that the disbursing officers take different stands regarding the eligibility of spreading of rebates. There is no uniformity in the treatment on arrears of pay credited to general provident fund. The present writer had discussions with the departmental authorities regarding the issue. The outcome of the discussion was that some of the assessing officers find it difficult to allow the spreading of rebate because the Income Tax Act and the Rule are silent about this and Form No. 10E does not provide for that type of contingency. Apart from this the officials were confused and hold the view that in the absence of formal circular issued by the Central Board of Direct Taxes they are not in a position to allow such claims.

The employees are left to seek judicial remedy individually leading to multiplicity of litigation in the area. The Central Board of Direct Taxes can solve the problem by issuing a circular incorporating the interpretation laid down by the High Court so that officers may take a consistent stand to the relief of employees. The lethargy of employees unions is also noticeable in this area.

46 Ibid.
Another allied problem, which has caused hardship, is reduction of disposable income. The arrears so credited were locked in for periods of two to four years. The employees were also prevented from paying the huge tax due, out of the arrears. The governmental instruction to the treasuries was to clear arrear bill only if the employee credits the entire arrear amount into his general provident fund account. Thus employees were forced to raise money to pay tax causing unnecessary hardship. The Kerala High Court delivered several judgments directing the Government to pay 25% pay revision arrears (30% in one case) deposited in the provident account to meet tax liability. Though the Government had preferred appeal, against those judgments it had been disposed of in favour of the employees. Subsequently Government passed orders complying with the court orders.\(^{47}\) The Government allowed only payment of 25% of arrear towards payment of tax and it was insufficient to meet the tax liability since most of the employees were in 30% income tax bracket and were liable to pay surcharge. The arrears are near to the regular income and consequently the tax liability is enhanced to two to three times reducing disposable regular income to the extent of 30% to 50% (Table 5). Married single earners are hardly hit by the orders. The judicial intervention does not seem to be an absolute solution. The Government while making such orders should foresee the evil impact on employees and should make it clear that arrear minus the tax due on it alone need be credited.

From the answerers to questionnaire to pensioners the present writer could locate certain problems faced by them. Tax treatment of gratuity depends on the nature of employment. Amount received by government employees as death or retirement gratuity is wholly exempt.\(^{48}\) For employees covered under Payment of Gratuity Act, 1972, gratuity is exempted to the extent of the least of the (i) fifteen days salary or (ii) Rs.350000/-\(^{49}\). Pension is taxable but it is fully exempt in the case of government employees.\(^{50}\) The exemption is limited to the extent of one half of the

\(^{48}\) Income Tax Act 1961, Section 10(10)(i).
\(^{49}\) Ibid. section 10(10)(ii).
\(^{50}\) Ibid. section 10(10A)(i).
commuted value of such pension in the case of nongovernmental employees.\textsuperscript{51} Leave salary payments, in respect of the period of earned leave, received at the time of retirement is fully exempt for government employees.\textsuperscript{52} The exemption is limited to ten months for nongovernmental employees.\textsuperscript{53} Any amount received by an employee under voluntary retirement scheme is exempted to the extent of rupees five lakhs.\textsuperscript{54} Any payment from a provident fund to which Provident Act, 1925 applies qualifies for exemption.\textsuperscript{55} The accumulated balance due to and payable to an employee participating in a recognized provident fund is exempted to the extent permissible in Rule 8 of part A of the Fourth schedule.\textsuperscript{56} Certain payments from superannuation funds are also exempt subject to certain conditions.\textsuperscript{57}

It was learnt from their responses that retired personnel had problems connected with the terminal payments under the voluntary benefit scheme, which exposed them to the high progressive rates. Hence some were selected for the interview. From the interview with retirees under voluntary retirement scheme, most of them from banks, it is learnt that certain problems are unique for them. The banks pay compensation in installments to suit their convenience. The complaint is that assessment officers restricted the exemption only to first installment. Another grievance raised was that relief under section 89(1) was also denied to them. Some of them have received a lump sum on account of wage revision during the year though retirement was two years ago. Since the exemption under section 10(10C) was exhausted, their claims to relief under section 89(1) were denied. The retirees expressed their concern that neither their former employers nor the unions to which they belong nor the government which supported the scheme have come forward to help them. According to them owing to the harsh stand taken by department their tax burden had gone up.

\textsuperscript{51} Ibid. section 10(10A)(ii)(b).
\textsuperscript{52} Ibid. section 10(10AA)(i).
\textsuperscript{53} Ibid. section 10(10AA)(ii).
\textsuperscript{54} Ibid. section 10(10C).
\textsuperscript{55} Income Tax Act, 1961, section 10(11).
\textsuperscript{56} Ibid. section 10(12).
\textsuperscript{57} Ibid. section 10(13).
A number of public sector companies have formulated voluntary retirement scheme for their employees as part of staff strength reduction and structured the financial package. The components of the package under the voluntary retirement scheme included payments of *ex gratia*, gratuity, pension, leave encashment, and in some cases travel and transportation reimbursement. Since the definition of ‘salary’ include ‘profit in lieu of salary,’ the amount of compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or modification of the terms and conditions relating there to was taxable unless expressly exempted. With a view to extending relief to such employees the Finance Act, 1987 introduced a new clause (10C) in section 10 which provided for exemption in respect of payment received by them at the time of their voluntary retirement in accordance with any scheme which the Central Government may approve having regard to the economic viability of the public sector company and other relevant circumstances.

In *Sasikant Laxman v. Union of India* the constitutional validity of the newly introduced section 10(10C) was challenged by a private sector employee as conferring exemption only to employees of public sector. The Supreme Court upheld the validity of the said provision. Guidelines were framed in Rule 2BA of Income Tax Rules, 1962 for the purpose of finding out employees eligible for exemption under the section. The exemption of amount received under voluntary retirement scheme has been extended to employees of the Central Government, state governments and employees of notified institutions having importance throughout India or any state. The amount is calculated on the basis of three month’s salary for each completed years of service. The last salary drawn is the basis of computation of the amount. Where the amount receivable exceeds five lakh rupees, the amount representing the excess limit is taxable. If all conditions under section 10(10C) read

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58 Section 17(1).
59 Section 17 (3).
61 Notification No.SO.863(E), dated, November 12, 1993.
with Rule 2AB are satisfied, the employer need not deduct tax at source on benefits of the voluntary retirement scheme. The same circular clarified that exemption under section 10(10C) is in addition to the exemption to other terminal benefits.

The Calcutta High Court in *SAILDSP Voluntary Retirement Employees Association 1998 v. Union of India* pointed out that the character of the payment did not change merely because it was stretched. Even though there is no legal impediment in allowing the benefit under section 10(10C) in cases where the voluntary retirement scheme payments are made in installments, hardship to the retirees was caused owing to a particular line interpretation of the second proviso to section 10(10C) taken by the assessment officials. In such cases the retirees were made liable to pay tax in more than one assessment year on account of staggering of payment in installments instead of one lump sum. This resulted in a ‘bracket creep’ and attracted more progressive tax rate.

The legislative purpose of section 10(10C) can be gathered from the budget speech while introducing the section. The Finance Minister has proposed a relief to the employees opting for voluntary retirement scheme by exempting voluntary retirement scheme payments up to Rs.5,00,000/- even when received in installments. The Finance Act, 2003 amended section 10(10C) by substituting the words ‘any amount received or receivable by an employee’ by the words ‘any amount received or receivable by the employee of’, and ‘at the time of his voluntary retirement’, was substituted ‘on his voluntary retirement,’ making legislative intention clear, i.e. to exempt voluntary retirement scheme payments paid in installments subject to the limit of five lakh rupees as fixed by the section. The Central Board of Direct Taxes has clarified that any payment received or receivable (even if received in installments) by an employee of certain institutions at the time of voluntary retirement or termination of service, in accordance with the scheme or schemes of voluntary retirement or in the case of public sector company, a scheme

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64 Budget Speech by the Finance Minister 2003
of voluntary separation, is exempted from income tax to the extent that such amount
does not exceed five lakh rupees. It is clear that the right to payments though
received in installments had arisen on the date of retirement, and no restriction on
the ground of installment is possible. Unfortunately the wording of the proviso
continues and is capable of being misunderstood. Hence legislative intervention is
necessary to reshape the proviso to section 10(10C) to make intention clear.

Section 89 gives relief to employees when salary is received in arrears or
advance. The section is clearly worded as to give relief for payments in the nature of
'profit in lieu of salary' also since it is included in the definition under section17 (3).
Rule 21A further clarifies the matter. Sub-rule 4(b) of Rule 21A specifically
provides for spread over in three years of compensation payable on termination of
service after minimum service of three years and has laid down the manner in which
the average rate is to be calculated. Section 89 was already in force when section10
(10C) was inserted to provide additional benefits to retirees under voluntary
retirement scheme. The Board's Circular further clarified that exemption under
section10 (10C) was in addition to exemption for other terminal benefits. In I.T.O. v.
Dilip Shriodkar it was held that exemption allowed under section 10(10C) did not
exclude; relief under section 89(1). But In spite of these the department continues to
misinterpret section 89 relying on the second proviso to section 10(10C) to deny
relief under it. It is a salutary rule of statutory interpretation that when the language
of a section is plain and easily understood it should be assigned the ordinary
meaning and nothing should be read into the provision of a fiscal statute for finding
out the meaning it intended. The interpretation of section 89 by the department is
not in conformity with this fundamental rule.

The denial of the relief has pushed the retirees to higher slabs and payment
of tax at more progressive rates. These hardships could have been avoided by the

65 Circular No.9/2003 dated 18 November,2003
67 (2004) 137 Taxman 59 (ITAT), (Patna).
timely intervention by the C.B.DT through circulars and through legislative intervention by amending and curing the mischief in the second proviso of section10 (10C). The proviso may be redrafted as 'provided further that where exemption has been allowed to an employee under this clause once, no exemption there under shall be allowed to him thereafter.'

For the purpose of evaluating the vertical equity of tax exemption of voluntary retirement scheme payments the tax impact on the employer companies was also studied. The banks were permitted to defray the entire components of the voluntary retirement scheme package to be treated as deferred revenue over a period of five years.\textsuperscript{69} The Finance Act, 2001 inserted section 35DDA in to the Act for amortization of expenditure incurred under voluntary retirement scheme and an employer was permitted to deduct one fifth of the amount so paid in computing the profits and gains of the previous year and the balance was to be deducted in equal installments for each of the four immediately succeeding previous years. Catena of court decisions favouring the employer companies exists.

The Madras High Court in \textit{C.I.T. v. Simpson Co. Ltd.}\textsuperscript{70} held that payment made for the purpose of retrenchment of workers was for the purpose of reducing the staff and wage bill. The expenditure incurred in that regard was for the purpose of business and also with a view to maintaining good relationship with labour and had to be considered as having been laid out wholly and exclusively for business purposes of the assessee.\textsuperscript{71} The Calcutta High Court in \textit{C.I.T v. Machinery Manufacturing Co. Ltd.}\textsuperscript{72} held that the payment of compensation to induce workmen to retire prematurely was an item of expenditure incurred by assessee company on the ground of commercial expediency in order to facilitate carrying on of business, and was revenue expenditure and allowable deduction.\textsuperscript{73}

\textsuperscript{69} Circular BP.BC.73\textbackslash{}21.04.018 dated January 30,2001
\textsuperscript{70} (1998) 230 I.T.R. 794 (Mad.).
\textsuperscript{71} \textit{Ibid} at 797.
\textsuperscript{72} (1992) 198 I.T.R. 559 (Cal.).
\textsuperscript{73} \textit{Ibid} at 562.
The impression one gets from the analysis is that tax deductibility of voluntary retirement scheme payments made by employer companies are well protected by the timely intervention of the board and legislature, while the problems of the employees remained unsolved for several years resulting in violation of vertical equity of taxation.

The private sector employees expressed their dissatisfaction during the interview over the tax exemption given to certain categories of employees under the voluntary retirement scheme. They contended that in the era of globalization there was no job security and they had to pull on the rest of their life with the terminal benefits. The privilege under section 10 (10C) is limited to the retirees of public sector, government sector, quasi government sector and other specified sectors under the section. The fact remains that the tax burden is more on the retirees from private sector and from the equitable point of view infringes horizontal equity.

The overall impression from the analysis is that gradation in allowing rebates, the compulsory crediting of arrears of pay to the general provident fund by respective governments without permitting employees the relief of spreading of investments and the anomalies in tax treatment of terminal payments expose the employees to steep progressive rates and put them in a more disadvantageous position.