


The Course Traversed By Income Tax Law, Post Independence

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The first seeds of the modern-day system of direct taxation in India, as we know it, were sown by the British. Tax on income was introduced into India by Sir James Wilson and a separate Income Tax Act was passed in the year 1886. This was then replaced by an Act passed in 1918. The Income Tax Act that independent India inherited was the Indian Income-tax Act, 1922, which was an Act to consolidate and amend the law relating to Income Tax and Super Tax and it was only in the year 1962, 1st April, 1962 to be precise, that the Income-tax Act, 1961, came into force.

A great deal has been said in bits and pieces upon the evolution of the 1961 Act from luminaries such as N.A. Palkhivala, who controverially called it "a national disgrace". To quote: -

> *"Today the Income-Tax Act, 1961, is a national disgrace. There is no other instance in Indian Jurisprudence of an Act mutilated by more than 3000 amendments in less than thirty years, simple provisions like Sections 11 to 13 (which deal with exemption of the income of charitable Trusts) have suffered no less than fifty amendments.*
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> *The tragedy of India is the tragedy of waste of national time, energy and manpower. Tens of millions of men - hours, crammed with intelligence and knowledge - of tax gatherers, tax payers and tax advisors – are squandered every year in grappling with the torrential spate of mindless amendments. The feverish activity achieves no better than fever?"*

As tempting as it may be to subscribe to the same school of thought, if the Act is seen as an instrument of policy, more charitable words would perhaps be used. I certainly do not subscribe to the view that the Act is a "national disgrace", but perhaps one could understand the anguish behind those words. In a country where the legislature is regularly derided for being lax to amend and update legislations to better suit the needs of today, the Income-tax Act, 1961, perhaps due to its yearly amendments, has been successful in not only being a barometer of the fiscal priorities of those in power, but also the most agile instrument of policy. The study of income tax over the years is fascinating inasmuch as the insight it provides in jurisprudence as well as politics.

The maximum income tax rate for Individuals in the financial year 1947-48 was 'Five Annas in the rupee'. This changed to 'Four Annas in the rupee' in financial year 1955-56. The Second general election in India was held in February 1957. In the financial year 1958-59 the maximum income tax rate for Individuals was 25% which was reduced to 20% in 1964-65. It was in 1966 that Smt. Indira Gandhi came to power as the Prime Minister and the maximum tax rate for the financial year 1966-1967 sky-rocketed to 65%. In the year 1968-69 this rate further escalated to 75% 1969 being a year

which also witnessed Bank Nationalisation. The year 1971 witnessed the abolition of the privy purses through the twenty sixth amendment to the Constitution of India and the financial year 1971 -72 witnessed a maximum income tax rate for individuals reach 85% in line with the 'Garibi Hatao' slogan coined by Mrs. Gandhi in the 1971 election year. The financial year 1976-77 saw the rate reduce to 60% during the period of emergency and the term 'socialist' was introduced into the Preamble in the year 1976. The Janata 'coalition' come to power in power in March 1977, however the rate remained constant until the financial year 1984-85. The rate of for the year 1984-85 reduced to 55%.When further reduced to 50% in 1986-87. The stint of V.P. Singh as the Finance Minister also saw a "long term fiscal policy" being introduced and spoken about for the first time raising hopes of stability of rates over the long term. The rate remained at 50% until 1992. In 1991, in a historic decision, the Indian economy was opened up as a response to the payment crisis. The financial year 1992 saw the rate reduce to 40% which remained constant until the financial year 1995-96. The rate went back up to 50% in the financial year 1996-97 in the final days of the Narasimha Rao government, to be sharply slashed to 30% by the Vajpayee government. The base tax rate has remained constant ever since at 30%, though various governments have imposed 'surcharges' and 'cesses' as required.

The above data is only indicative and meant to demonstrate that the Income-tax Act has quite closely reflected the philosophy of the government from time to time and has been used as an effective tool for fiscal as well as social policy. Taxation in a democratically elected government necessarily needs to reflect the will of the people which is dynamic and not static. In a welfare state taxation is an important tool for reducing disparities of income and wealth and in a socialist state it is an important tool for redistribution of wealth. The Income-tax Act, 1961, at best, can be accused of at times being over-enthusiastic resulting in being reined in by the Courts of law.

It is not just the rates of tax but also the authorities in the adjudication of tax disputes that have undergone a sea change since independence. The Appellate Authorities under the 1922 Act were the Appellate Assistant Commissioners and then the Income Tax Appellate Tribunal; there was also a revision to the Commissioner of Income Tax. The 1961 Act continued giving Appellate Assistant Commissioners jurisdiction over appeals up until 1989 when the same was vested with the Deputy Commissioner (Appeals) and Commissioner (Appeals). The Income Tax Appellate Tribunal had been introduced into the Indian Income-tax Act, 1922, on 25.01.1941 (as the notified date on which it came into force). The Tribunal has functioned without any fundamental changes ever since even with the introduction of the 1961 Act. The 1922 Act provided for a reference of a question of law for the advisory opinion of the High Court and was set in motion by a statement of the case to be made by the Tribunal to the High Courts. This procedure was continued in the 1961 Act with the modification that in certain cases, there can be a direct reference of a question of law to the Supreme Court. In 1998, the reference procedure was changed to an appeal to the High Court from the orders of the Tribunal, but only on "substantial questions of law", as in the case of second appeals under the Code of Civil Procedure. The merits of the change is debatable, but it has come to stay.

Even though the authorities under the Act have not since changed, the years 2019, 2020 and 2021 have seen drastic changes sought to be made in the justice delivery system as far as Income Tax Act is concerned. The Finance Act, 2019, paved the way for the 'E-Assessment Scheme, 2019' which was later in 2020 renamed as the 'Faceless Assessment Scheme'. The

change introduced by it in the procedure of assessment has been revolutionary and it purports to remove the then existing human interface in the assessment proceedings. Close on its heels, the 'Faceless Appeal Scheme, 2020' was introduced to remove the human interface in the first appeal before the Commissioner of Income-Tax (Appeals). The Finance Act, 2021, has amended the Income-tax Act, 1961, in preparation for a scheme to make the Tribunal faceless. Once notified, the making of Tribunals 'faceless' shall be one of the biggest changes made to the administration of justice in Income Tax matters. The constitutional validity of the Faceless Appeal Scheme has already been challenged in certain High Courts and a similar challenge to the implementation of 'Faceless Tribunal' as and when the rules are notified seems inevitable.

In a well-intentioned move to give an opportunity to "errant" assesses to come clean and "turn a new leaf", the Government appointed the Justice Wanchoo Committee to make recommendations, inter alia, in this regard and the result is the Income Tax Settlement Commission ('ITSC'). It was set up in 1976 and the first fifteen-twenty years or so saw the same functioning in the true spirit of settlement. It is not known what irked the Government when the ITSC was sought to be made dysfunctional in 2007 but it survived; there seems to have been a shift or change in its functioning since then, not the least due to the "tightening" of the language of the statutory provisions. From 1st February, 2021 the ITSC has been abolished and an "Interim Board" has been put in its place. It is generally believed that closing of the doors for "settlement" of the affairs of an "errant" tax payer, permanently, is not a well-considered move. The abolishing of the ITSC has been challenged and the constitutional validity of this retroactive discontinuance has also been challenged before different High Courts. Penalty proceedings have also been rendered faceless through the 'Faceless Penalty Scheme, 2021'. A dispute resolution committee has also been sought to be set up to give relief to small tax payers having a taxable income upto rupees 50,00,000/- and a disputed income upto Rs. 10,00,000/- with the powers to waive penalty and give immunity from prosecution to eligible taxpayers.

It is not just the policy and the legislative changes that have helped evolve tax jurisprudence. Justice O. Chinnappa Reddy, with whom the other four judges concurred, observed in the McDowell & Co. judgement that the Duke of Westminister doctrine, which looked benignly upon tax avoidance, was dead and gone even in the England, the country of its birth, and saw no justification for continuing the rule in India where "the time has come……..". The judgment was placed in perspective by Justice Ruma Pal and Justice Srikrishna in the case of Azadi Bachao Andolan and still recently in Vodafone by a Constitution Bench. It is a matter of comfort for the harassed assesses that the Tribunal and the Courts have time and again stepped in to make the operation of tax laws more equitable. Tax laws are subject to strict interpretation, however, the courts have often gone out of their way to use 'purposive interpretation' in order to make sure that a beneficial provision does not become a dead letter in law due to ambiguities. The judgements of the Courts on issues pertaining to the statutes of indirect taxation have also explained the interpretation to be placed on beneficial provisions. In *Collector of central Excise, Bombay-I & Onr. v. Parle Exports (1989) 1 SCC 345* it was held by a division bench of the Supreme Court that when two views of a notification are possible, it should be constructed in the favour of the subject and that while interpreting an exemption clause, liberal interpretation must be imparted to the language thereof, provided that no violence is done to the language employed by the statute. A three Judge bench of the Supreme Court in

the case of *Sun Export Corporation v. Collector of customs, Bombay & Ors. (1997) 6 SCC 546* had held that when two views are possible the one favourable to the Assessee in matters of taxation has to be preferred. However, a five judge constitution bench of Hon'ble Supreme Court in *Commissioner of Customs (Import) v. Dilip Kumar & Co. (2018) 9 SCC 1 (FB)* has held that every taxing statute at the threshold should be interpreted strictly, and in the case of ambiguity of charging provisions the benefit goes to the Assessee, in case of exemption provisions, the benefit must be strictly interpreted in favour of Revenue. It is moot that all these decisions are directly applicable to the interpretation of the Income-tax Act, 1961. The journey of Direct Tax jurisprudence has quite acutely been influenced by the jurisprudence relating to Indirect Taxation. It is notable that in the case of *Venakata Dilip Kumar v. CIT (2019) 419 ITR 298 (Mad)*, in a writ petition heard by a single judge, the Madras High Court, even after considering the Judgement of the Supreme Court in the case of *Commissioner of Customs (Import) v. Dilip Kumar & Co.* held that when the Assessee had satisfied the mandatory requirements under Section 54(1) of the Income-tax Act, 1961, to get deduction, his claim could not be rejected merely because of the technical defect of him not depositing the sum in the Capital gains account scheme as required by the statute.

The Jurisprudence with respect to penalty has similarly seen its fair share of changes with respect to the basic question as to what is the nature of the penalty imposed by the Income Tax Act, 1961. The Supreme Court in the case of *CIT v. Messrs. Khoday Eswarsa & Sons 1971 (3) SCC 555*, relying upon the Judgement in *CIT, West Bengal v. Anwar Ali (1970) 76 ITR 696 (SC)* held with respect to the 1922 Act that before levying penalty, the department should have cogent material or evidence from which it could be inferred that the Assessee had consciously concealed particulars of income or had deliberately furnished inaccurate particulars of income. This Judgements found resonance even decades later in the case of *Dilip N. Shroff v. JCIT (2007) 6 SCC 329* where the Supreme Court held that before a penalty can be imposed, the entirety of the circumstances must reasonably point to the conclusion that the disputed amount represented income and that the Assessee had consciously concealed the particulars of his income or furnished inaccurate particulars thereof. However, in the case of *UOI v. Dharmendra Textile Processors & Ors. (2008) 13 SCC 369*, a three Judge bench of the Supreme Court, while dealing with an issue regarding the Central Excise Act, 1994, referred to Dilip Shroff and stated that penalty under Section 271(1)(c) was a civil liability and that willful concealment is not an essential ingredient for attracting civil liability as in the case of prosecutions. Subsequently, the Supreme Court in the case of *CIT v. Reliance Petroproducts P. Ltd. (2010) 11 SCC 762*, further explained that the Judgement of Dharmendra Textiles had overruled the judgement of Dilip shroff only to the extent that the latter had upheld the relevance of mens rea to the penalty proceedings. It went on to hold that there must be 'concealment' or 'furnishing of inaccurate particulars of income' and that merely making a claim that is not sustainable by law shall not by itself amount to furnishing of inaccurate particulars regarding the income of the Assessee. The new section 270A coins novel expressions such as "under reporting" and "misreporting", but I believe that the substance of the matter has not undergone any change; and it is quite unlikely – at least I would like to believe so – that the Tribunal and the courts will change the discourse relating to penal provisions and succumb to the attempts made by the revenue to merely make penalty an automatic adjunct to the tax and thus a source of revenue.

Much water has flowed under the bridge as far as the debate between tax planning and tax evasion is concerned. The sanction to arrange

affairs in a manner so as to reduce the impact of taxation in a legitimate way as per the framework of law always had judicial sanction even when the 1922 act was in operation. The Supreme Court in the case of *Jiyajeerao Cotton Mills Ltd. v. CIT (1958) 34 ITR 888 (SC)* held that every person is entitled to arrange his affairs as to avoid taxation but the arrangement must be real and genuine and not sham or make believe. In *Mc Dowell & Co. Ltd. v. CTO (1985) 154 ITR 148 (SC)* a constitutional bench of the Supreme Court re-iterated the said principles and further stated that tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be a part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. Justice Reddy observed, *"In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax, and whether the transaction is such that the judicial process may accord its approval to it".* The McDowell Judgement was subsequently used by the department to probe transactions in a broad manner and allege commercial transactions to be colourable devices. In *UOI v. Azadi bachao Andolan (2004) 10 SCC 1*, the department sought to argue that the McDowell judgement had changed the concept of fiscal jurisprudence in this country and any tax planning which is intended to and results in tax avoidance of tax must be struck down by the Court. However, in Azadi Bachao Andolan, the Court observed that the majority opinion was not congruous with the 'extreme' view taken by Cinnappa Reddy J. The Judges observed that "The judgment of the Privy Council in *Bank of Chettinad (1940) 8 ITR 522 (PC)*, wholeheartedly approving the dicta in the passage from the opinion of Lord Russell in Westminster 1936 AC 1 was the law in this country when the Constitution came into force. This was the law in force then, which continued by reason of Article 372. Unless abrogated by an Act of Parliament, or by a clear pronouncement of this Court, we think that this legal principle would continue to hold good. Having anxiously scanned *McDowell (1985) 3 SCC 230* we find no reference therein to having dissented from or overruled the decision of the Privy Council in Bank of *Chettinad (1940) 8 ITR 522 (PC)*. If any, the principle appears to have been reiterated with approval by the Constitutional Bench of this Court in *Mathuram (1999) 8 SCC 667*. We are, therefore, unable to accept the contention of the respondents that there has been a very drastic change in the fiscal jurisprudence in India, as would entail a departure. In our judgment, from *Westminster to Bank of Chettinad to Mathuram* despite the hiccups of McDowell, the law has remained the same."Subsequently, the Supreme Court in *Vodafone International Holdings BV v. UOI & Ors. (2012) 6 SCC 613*, when asked to reconsider the Judgement in Azadi Bachao Andolan, has reaffirmed that it is not conflicting in nature with Mc Dowell in so far as treaty shopping and / or tax avoidance is concerned, stating that the Judgement of Reddy J. spoke with the need to depart with the Westminster principle only in the context of colourable and artificial devices.

It is impossible to capsulise the evolution of income tax law since independence where there are constraints of space! All that can be done – and I do not at all claim to have attempted anything more – is to just show the contours of the subject and the manner in which a miniscule part of them have evolved over a period of 75 years. I cannot pretend to have done justice to the subject.

Jai Hind!!!

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