CONCLUSIONS AND SUGGESTIONS

In this final chapter, an attempt is made to have an overview of the disucssion made earlier and draw appropriate conclusions and offer suggestions.

5.1 INTRODUCTION

It is seem that taxing income has not provided the solution for generating required resources. The tax litigations are enormous. The tax evasion poses a constant problem for the revenue authorities. The tax base is very narrow. The exemptions and deductions under the tax laws have eroded the revenue potential of the tax mechanism. The tax-GDP ratio is poor. The tax rates have been varying from year to year from the peak to the bottom. There are innumerable amendments in the tax laws which are themselves very complicated. N. A. Palkhiwala observes as under :

"Two things strike the student of Indian Income-tax law with trepidation and amazement- the precipitate and the chronic tinkering with the law by the powers that be and the inexhaustible patience of the Indian public. the 1961 Act, which repealed the 1922 Act, was meant to put the Income-tax law on a stable basis. The first Law Commission spent many anxious months over the provisions of the new draft. The Select Committee considered the bill for weeks and parliament debated it for many a day. But

those who thought that the legislature's passion for mutability was satisfied, were rudely awakened. In point of Act, the present Act which came into force on 1st April, 1962, as amended and re-amended more often and more drastically during the first six years of its existence than the 1922 Act had been during the forty years that it had remained on the statute book. By 1968, the present Act underwent more than 250 insertions, 230 substitutions and 100 omissions. Upto 1976, the Act has suffered more than 560 insertions, 600 substitutions and 190 omissions. A list of the Acts which have wrought these staggering changes is given post.

Similar observation from the former Chief Justice of Calcutta High Court, who subsequently acted as the Chairman of the Income-Tax Investigation Commission, Mr. Justice Wanchoo, are also worth looking into :

"The chief difficulty about acquiring a true understnding of an Income-tax Act is that it is not grounded in any jural concept which is relatable to one's general sense of law, and consequently, in trying to unravel the meaning of a section or a sequence of sections, one does not get the usual

assistance of the logic of one's own mind concurrently accompanying the process. Most of the numerous grounds of liability to the tax are as artifical as the tax itself is. There is no conceptual basis underlying the provisions which impose it, but only a motive of searching for incomes that may be taxed and so, not unnaturally, there is no central discipline controlling the several provisions and holding them together. In the course of its search for taxable income and its endeavour to bring it under charge, an income tax Act both attaches itself to incomes commonly understood to be such and invents other varieties which no one would ordinarily regard as incomes. The conventional basis of the charge imposed by it is itself a bar to a ready understanding of its nature and extent, but the bar might not have been so difficult to surmount, if the provisions in which the income-tax statutes are generally expressed, were less complicated and disorderly than they usually are. As a matter of fact, the provisions laying the charge, those providing for its quantification by means of an assessment and those prescribing the procedures for the recovery of the

tax are equally wordy and confused and, not infrequently, the Annual Finance Act adds further complications. Even the British Act, which adopted a scheme of distributing the charging sections between five schedules according to the subject matter did not achieve any appreciable measure of success in simplification, because the schedules soon got out of control and in course of time, became submerged under rules. The provisions of an Income-tax Act are, therefore, not so much matters to be understood as rules to be learnt and remembered and carried as a load on the memory. I do not believe that anyone, even if he has spent a lifetime in dealing with an Income-tax Act, can truthfully say that he really knows it. Even the judgements of the Superior Courts in India as well as in England and America, bear marks of an uncertainty of grasp. Truly, can it be said of an Income-tax Act that is a taxing statute, not only in the sense that it imposes a tax, but also in the sense that it taxes one's powers of comprehension to the utmost.

To Income-tax Acts of shapeless structure, the Indian Income-tax Act, 1922, was no exception.

Indeed, after the extensive amendments of 1939 and the further amendments of individual sections subsequently made from time to time, it became a particularly deplorable specimen of bad draftsmanship, both as to the language of many of the sections and as to their location and arrangement. Unless one procceeded from the beginning of the Act right upto its end, one could not meet all the sections bearing on a particular topic, because they lay scattered all over the Act, some of them in the unlikeliest of places; and unless on hammered one's brain relentlessly and long, one could not hope to get at some meaning atleast of the tortuous sentences of inordinate length and of expressions, plainly inaccurate. That condition of the Act was certainly due in a large measure to the initial lack of logical arrangement of its sections, but its deficiencies were aggravated by a succession of piecemeal amendments, clumsily expressed and made without proper regard to thir effect on the rest of the Act. The growing habit of amending an Act, or even the constitution whenever an interpretation, unwelcome to the Executive, is judicially given or some impediment

to the exercise of executive power is discovered, had its share of effect on the Income-tax Act as well. It became a singularly confused mass of ill-expressed and mal-adjusted provisions. Still, it is pleasant to recall that Government themselves came to be conscious of the condition to which the Act had been brought and invited the Law Commission to revise its provisions, so as to make them more intelligible without, however, affecting the basic tax structure."

It is appropriate to open the discussion on the subject of 'amendments' with the quotation of an eminent tax expert, Mr.R.N.Ranka :

"There is no gainsaying that frequent amendments, substitutions, omissions and alterations have added fuel to the burning fire and made the task more painful. It is impossible for a tax expert, what to talk of a tax payer, to keep pace with frequent changes in tax laws. While giving opinion on even a minor point, a tax consultant has to look into the law relevant for the assessment year in issue.....The amendments are made without any concern for public hardship or public inconvenience. Frequent amendments may help the

revenue only for a short time but surely it is self-defeating in the long run; because too frequent amendments and confusion go hand-in-hand."

The direct tax structure in India reveals a characteristic frequent avalanche of amendments, insertions and deletions that have been made to the statute. Mr. N. A.Palkhivala rather eloquently describes the state-of-affairs as :

"(The provisions of) the Income-tax Act should provide enduring structure for levy and collections, while the changing rates would be prescribed by the Annual Finance Acts. But even the provisions of the Income-tax Act now-a-days are like a railway ticket-good only for one journey in time from 1st April of one year to 31st March of the next, and sometimes not even for the whole of that journey.

He also expresses that the Government does not give slightest thought to the public hardship or public inconvenience when making kaleidoscopic amendments to the Act. The people are expected to have respect for a law which has so little respect for their basic problems and difficulties. To continue Mr. Palkhivala in the same vein :

Small wonder that in all this welter of endless changes, the benighted taxpayer develops disrespect for the law, the variations in which cause him so much harassment and achieve so little public good. ....It is bad enough to make citizen tax gatherers for the Government on an annually varying commission and on other terms and conditions which are succinctly set out in more than 400 sections and nine schedules. But it is disastrous to make over those sections and schedules to the tender mercies of an administration which mistakes amendment for improvement and change for progress."

Mr.Palkhivala unleashes his vitriolic comment on the legislative activity associated with changes in laws in the following words :

"However, acute the recession, there is one activity which thrives and is in a state of perpetual boom-the law making industry. The obsessional attitude that churning out new laws is the hallmark of good Government is shared by the legislature and the rule-making authority alike. The Income-tax Rules were amended six times in 1959, five times in 1970, four times in 1971, four times in 1972, three times in 1973, six times in 1974 and

five times in 1975. These rules were again amended no less than four times between 1st January and 1st April 1976.

His comments on the resultant wastages ring so true against the backdrop of the reality :

Every year sees substantial alterations in or replacement of some of the various forms including the forms of return of income which are prescribed by the Income-tax rules. Various forms are changed overnight. Can this country, where crores of school children and adults have to go without writing paper, afford the luxury of throwing away millions of pages of printed forms, which are consigned to the scrap heap so nonchalantly ? ...Again, millions of manhours, crammed with intelligence and knowledge of tax gatherers, taxpayers and tax advisors-are utterly wasted every year in grapping with a torrential spate of amendments.....What we need more than anything elese by way of legal reform is an assurance of respite from the Niagara of rules, notifications, ordinances and Acts."

Frequent amendments in the statutes create fresh issues for litigations, confuse the administration as well as the taxpayer and bring uncertainty and instability in the tax laws. This has resulted because of the initial confusing tax structure, which has been in the name of simplification, become disfigured heavily. The solution to this issue relates to certain basic facts, viz. Firstly, unless we have a scientific and systematic legal framework, it would be difficult to have a stable tax structure; secondly, such initially stable tax structure can only be devised after taking into account various possible areas of the litigations arising out of the application of the tax laws; thirdly, such a stable tax structure can be framed after having a dilogue with the concerned people.

It is also possible to limit the scope of the amendments which have crippled the entire tax legislation today and made it very feeble in its effectiveness. The Government did appoint number of committees and commissions for reforming the tax structure. The recommendations of such commissions received partial justice from the Government. There

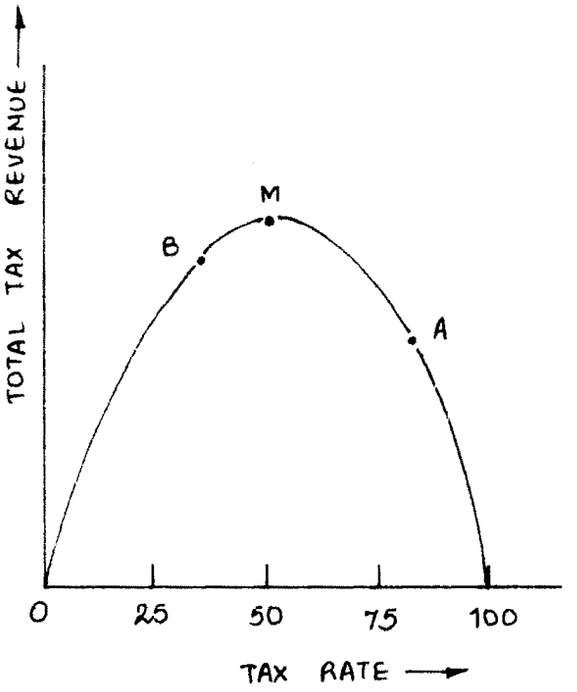
is no consistant and harmonious approach to the issue.

Since 1991 Government of India embarked upon an era of economic reforms.Accordingly during post 1991 budgets of the Union Government there are number of structural changes in the tax laws. The tax rates are reduced by almost all developed and developing economies to provide a boost to the economic growth. Tax slabs have been reduced, exemptions and deductions have been rationalised. Basic exemption has been enhanced. Due to all these policies affecting tax structure, it is presumed that lowering of tax rates would generate more revenues because there will be lesser tax evasion and a better tax compliance. The presumption is founded on the belief that, " high marginal tax rates on big incomes may seem fair but they waste economic resources and may not raise such money". [The Economist-London April, 1994 issue P.No.72]. However, it is seen that number of countries who lowered the tax rates have experienced that the reduction of tax rate may not nacessary increased the tax revenues. It is true that high marginal tax rates have disincentive effects, 'responsible for

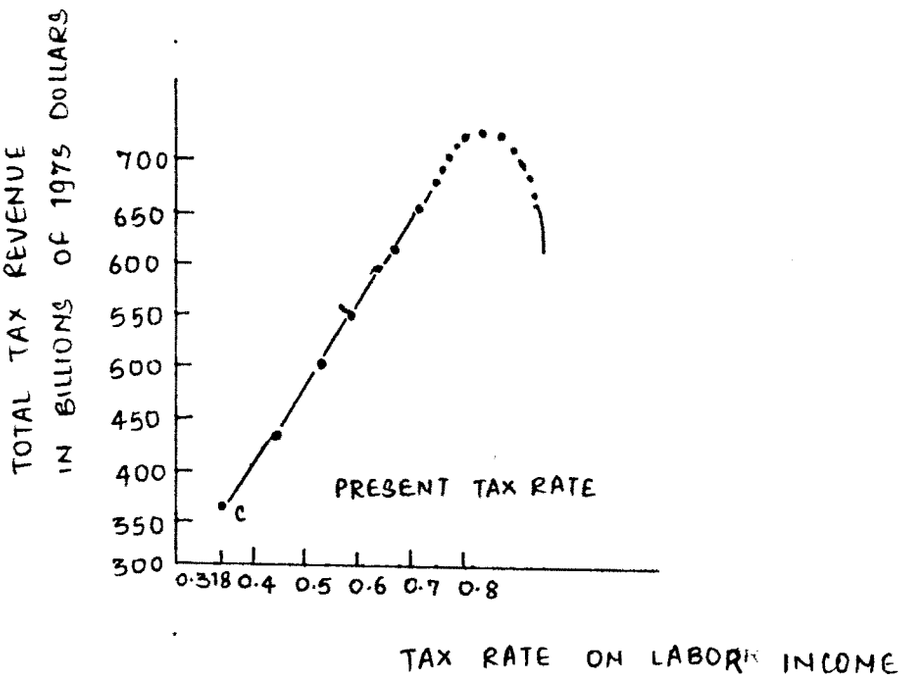
many of the nation's ills-low savings, recession, stagnant productivity, and high inflation' [Paul A Samuelson-Economics' Fourteenth Edition-P.No.330 The Publishers McGraw Hill Inc.]

A team of fiscal experts laid by Arthur Laffer empha-sised the importance of low marginal tax rates for good economic performance. The analytical tool introduced-Laffer Curve-shows that, at a zero tax rate there will be no revenue. When taxes reach 100 per cent, no one will work, so again there would be no revenues. The 'Laffer Curve' thus shows zero revenues at zero and 100 per cent tax rates. As tax rates rise from zero, total revenues rise. At some point people begin to work less, save less and divert their activity to the underground economy. The disincentive effect outways the revenue effect. As an illustration Paul Samuelson reproduces the Laffer Curve as under.

Evidence indicates that lowering tax rates would today lower revenues. The Laffer curve illustrates the relationship between tax revenues and tax rates. In the theor etical Laffer curve on the left, a tax rate of 50 per cent produces maximal revenues. By reducing tax rates from A to B revenues rise even as tax rates fall.



(a) THEORY



(b) REALITY

Careful empirical studies find a curve that its sharply to the right, with the U.S. Tax system approximately at point (as in (6) in this case, small movement in tax rates will have roughly proportional effects on revenues.(Source : Don Fullerton,"Relationship between Tax rates and Govt. Revenues", Journal of Public Economic (Oct.1982).

Thus we see that Laffer belives in low tax rates although in Indian context, though, taxes are reduced by the Government recently, the revenues have not pickedup.

(FINANCIAL EXPRESS BOMBAY WEDNESDAY MAY 18,1994) :

The Chairman of the Central Board of Direct Taxes (CBDT),Dr.N.R.Sivaswamy, has threatened that, the Government would "jack up" the tax rates mid year if the compliance was not encouraging following the reduction in corporate and income tax rates in the Budget.

Briefing newsman on the out-come of the three-day confernece of Chief Commissioners and Commissioners of Income Tax ,Dr.Sivaswamy said that the first instalment of advance tax has to be paid by June 15 and if the response was not upto the mark, the Government would be left with no option but to get back to high tax rates.

The ball, he said, was now in tax payer's court and it was for them to decide if they want low tax rates and better compliance or high tax rates coupled with increased deterrence and exemplary punishments.

He further said that the days of "soft tax administration were over and the tax evaders would be dealt with firmly.

On the controversial issue of deduction of tax at source with regard to services rendered by the companies, the CBDT chief said that the Government was thinking of requesting the Supreme Court to take up cases pending in various High Court.

Dr.Sivaswamy further said that 1994-95 has been declared as the "year of collection" and the Board was confident of achieving the revenue collection target of Rs. 23,405 crores through direct taxes.

Dr.Sivaswamy said a major recommendation at the just concluded three-day Income Tax Commissioner Conference here was to adopt a "new strategy" to increase number of tax assesses by 15 percent.

As of now there were about one crore tax assesses and in quantum term at least 15 lakhs assessees would be brought under tax net he added.

Mr.Sivaswamy said that the strategy this year would be to catch hold of high bracket perpetual tax offenders and award exemplary punishment rather than grouping them with large number of doubtful cases as in the past.

Such a step, he said, would ensure there was no withhunting and harassment of honest taxpayers.

One of the recommendations, Dr.Sivaswamy said, was that those tax assesses who declare more taxable income this year as compared to the previous year would be given assessment order without scrutiny.

The conference also suggested that, link between the assessees and a particular officer needed to be snapped, this would help the officials to be more objectives in their assessment.

Another recommendation, he said, was to set up of a research cell with regard to direct taxation. This would help the Board in formulating ways for broadening tax-base and increasing revenue.

He said less than three percent of Rs. 8,00,000 crores gross national product was collected by way of direct taxes. Even one percent of GNP was added this year, the Government would have additional revenue of Rs. 8,000 crores.

Besides the following observations from Business Times dated May 11,1994 also speak of the other issues subsequent to lowering of tax base.

The Comptroller and Autitor General of India (CAG) has voiced serious concern over the rising pendency of tax assessments and amounting tax arrears which amounted to a massive Rs. 9,488.54 crores in 38.10 lakhs cases in 1992-93.

In his report on revenue receipts direct taxes for the year ended March 31, 1993, tabled in Parliament today, CAG said 3,364 cases alone amounted to arrears to the extent of Rs. 5767.04 crores. Each of these cases had arrears of more than Rs. 25 lakhs.

The arrears continue to mount, despite the action plan target for reducing them. During the course of test audit 13,916 audit observations involving under-assessment of tax of Rs. 3,490.62 crores were intimated to the department.

The existing tax structure based on taxation on income fails to provide equity. This observation can be proved from simple illustrations. The first deals with exclusion of agriculture income from taxation and second deals with the deductions from income from salary. The lack of equity in these areas is illustrated as under :

1 EXEMPTION OF AGRICULTURE INCOME

The existing base for taxation of income excludes from its scope tax on agriculture income- Indian agriculture contributes substantially to the national income and agricuture accounts for nearly 30% of the gross national product. Still this major area remains out of the tax net due to constitutional and political hurdes[3] . The exclusion of agriculture income provides anomalies and loopholes in the tax structure which becomes inequitable. All potential taxes are not fully collected and tax avoidance and tax evasion has already become Rampaul. Government appointed a high level committee headed by Raja Chelliah and broad thrust of the recommendations are :

1) To provide for moderate tax rates;

2) To broaden the base of taxation;

3) To simplify the tax structure so that complying with it will take less time;

4) To improve the tax administration so that There will be less harassment of the tax payers.

Agriculture income helps in broadening the tax base, to get additional tax revenues, to reduce the dependance on indirect taxes and to provide justice and equity to the entire tax system. Now-a-days agriculture conditions are better irrigation facilities, technology, new modern equipments, pesticides, insectisides etc. help to improve the agriculture income and because of this agriculture income can provide a wide base for taxation. More people can be brought under the tax system which in turn will help in getting additional revenues to the Government. Concessions and more reliefs are given to the rural rich and big farmers. This increased surplus in agriculture sector is not fully invested in productive activities. Part of this increased surplus is invested in unproductive purposes. It is therefore, desirable to mop up the

surplus by the Centre through taxation.

The share of indirect taxes in the total tax revenues in 1990-91 was 82 percent which gradually increased from 56% in 1950-51. That is why the Government of India is relying more and more on indirect taxes. If the Government taxes agriculture income there will be no need for depending more on indirect taxes i.e. customs and excise duties. This will prove to be anti inflationary. Rich people live in rural area and the potential for collecting revenue is therefore, very high. Hence, agriculture income should be taxed.

Various finance committees have recommended over the period of time. Direct Taxes Enquiry Committee, Chokshi Committee. Wanchoo Committee Kaldore Committee, Tyagi Committee etc. Taxation of agriculture income will help to improve the neutrality simplicity and equity of tax system. Without agriculture income tax there will be inequality between incidence of tax of agriculture income and non agriculture income.

<u>The following are the arguments against taxing agriculture income</u> :

Agricultural conditions are irregular, unexpected and depends upon vims of nature. The regularity of income which is the feature of other incomes is lacking in agriculture. Hence,

agriculture income should not be taxed.

Agriculture sector is neglected sector. The concessions given to the industrial sector are not given to the agriculture sector. Agriculturists work under very difficult conditions. Hence, agriculture income should not be taxed.

Political power is also another reason. Rich rural people are considered as vote banks and hence the politicians are scared of taxing them for the fear of loosing their votes.

Agriculturist occupy the land and cultivate more by compulsion than by choice. They cannot sell the land because there are no takers for land. Hence, agricultural income should not be taxed.

Method of acccunting adopted, valuation of stock irrigular agricultural conditions , illiteracy are otner factors. etc, These factors make calculation of agriculture income difficult. Hence taxation of agriculture income is not advisable. Agriculturists face unfavourable terms of trade much low prices, lack of bargaining power etc. They are exploited and hence, should not be taxed.

The implication of recommendations of the Chelliah Committee may be studied here before concluding whether agriculture income should be taxed or not :

1) Agriculturists whose income consist of only agricultural income need not pay income tax.
2) Agriculturists whose income from agriculture is below 25,000 and non agricultural income below taxable limit of Rs. 30,000 need not pay income tax.
3) Non-agriculturists having agricultural income more than 25,000 and non-agricultural income above table limit of Rs. 30,000 should pay tax.

To sum up in the wake of globalisation and liberalisation of the Indian economy tax should be broad including agriculture and industry without progressive taxation of agricultural income. There will be inequality between the incidence of tax on agriculture income and that on other incomes.

These arguments are not tenable, agriculture income should be taxed to broaden the tax base, get additional revenue, reduce the dependence on indirect taxes and provide justice and equity to entire tax system.

TAX ON SALARY INCOME-CASE OF SOCIAL INEQUITY

When we compare the provisions with the corresponding provisions relating to deductions from salary income the social injustice caused to the salary earners is clearly manifested. As may be seen, the only notweorthy deduction provided to salary earners (part from savings linked exemptions) is the standard deduction permissible under clause (i) of section 16 of the Act. It will be interesting to take a brief look at the historical background of this deduction. Initially in 1961, deductions with certain ceiling limits were allowed on account of payments towards (a) books etc (b) taxes on trade profession (c) maintenance and wear and tear of any vehicle used for the purpose of employment and (d) any other amount spent in the performance of employment.

This provision underwent changes from time to time and finally by the Finance Act 1986, a flat deduction without any reference to the nature of the expenditure was introduced for the first time. This deduction, popularly known as the standard deduction, survives till today. Under the Finance Act 1993, the maximum amount permissible under this deduction is Rs. 15,000 (Rs. 18,000 in case of women assesses whose income does not exceed Rs. 75,000).

It will be seen from the background given above that, the standrd deduction as it stands today is intended to cover a very limited range of expenditure, leaving out many other costs incurred by an individual to earn his income, and is in no way on par with the permissible deduction in respect of the income from business or profession. From this angle, the present provision relating to deductions from salary income are unfair and unjust. They give inequitable treatment to the salary earners as against the business and professionals.

It is well accepted principle of direct taxation that deductions should be permitted for the costs incurred in earning the income. However, this principle has not been fully extended to the

salary earners. In the case of an individual, he has to keep himself alive and efficient to earn his income. Therefore just as deductions from business income are permitted for the costs incurred for the purpose of keeping the business going deductions must also be allowed for all costs incurred by an individual to keep himself alive and reasonably efficient.

It follows on this ground that such deductions must cover the expenditure incurred even on primary needs of an individual i.e. food clothes , shelter and health. These costs are analogous to the cost of business. There is, therefore, a strong case to substantially increase the amount of standard deduction on this ground alone.

Another ground for increasing the amount of standard deduction has been advocated by no less an authority than the Chelliah Committee. The committee while dealing with the exemption limit for individual taxation in its interim report has recognised inflation as a ground to make upward adjustments in the exemption limit. The same principle is equally applicable while fixing the amount of standard deduction. Further as against the

present static ceiling on such deduction, there is a need to increase the ceiling limit with every higher slab of income which principle has been well recognised for the purpose of fixing the tax rates.

The case of unfair treatment to the salary earners does not end here. It is reflected in the tax-rates too. It has been fully established that there is always a scope for tax evasion in case of income from business and profession. The disease of black economy has been clearly indentified only with this income. On the other hand, every single rupee of salary income comes into the tax-net and evasion of tax by salary earners is zero. But the Act treats both the classes on par while fixing the tax-rates.

This is highly unfair to the salary earners as they are definitely entitled to lower tax rates as compared with the rates applicable to the other individual assesses having income from business or profession.(e.g. business proprietors, contractors, legal and medical practitioners etc.). This shows that the entire structure lacks equity.

The tax is levied on total income as computed under different provisions of the Act. There are five heads of income and seperate deductions are provided under each head of income. In case of income from

Salary there are vary few deductions such as :

1) Standard deduction;

2) Deduction for entertainment allowance;

3) Deduction for professional taxes;

There are number of deductions for business income. A salary earner is deprived from other deductions. The financial express dated 23rd May 1994 throws light on the disparity and inequity as regards assessment of salary income.

Thus the Income Tax Act 1961 fails to provide a sound tax structure which is very necessary for a developing economy. The tax base being poor, the exclusion of agriculture income from taxation, presence of heavy tax evasion-all these issues have affected the revenue mobilisation in the country. In view of this the researcher belives that, there is a need to have a through examination of the existing structure. The tax system should be responsive to the needs of the economy and there should be automatic increase in tax revenues. Taxation plays a vital role in promoting the country's economic development. The existing tax base fails to provide this justice.

The researcher concludes this exercise with the observations quoted at P.No.81 in World Development Report 1991. Which highlight the significance of tax reforms.

TAX REFORMS

Taxes provide revenues to finance public spending and influence savings, investment allocations, and the structure of production. The level of revenue collection helps to determine whether a country can finance public sector capital formation, maintain its infrastructure, and provide for an adequate level of health and education services. In general, income taxes, taxes on foreign trade, and taxes on goods and services (sales and excise taxes) each account for about one-third of revenuues.Although tax patterns differ across countries, tax-to-GDP ratios in developing countries are in the 10-20percent range, about half of the levels of the industrial countries, whereas expenditure levels are in thee 20-30 percent range-much closer to the levels of industrial countries. Many tax systems in developing countriesdo a poor job of collecting revenue and introduce large distortions into the economy. Weak tax administration

leads to widespread tax evasion, which also fosters income inequality.

The objective of tax reforms is to raise revenue and reduce the costs of tax-induced distoritions. Recent reforms have emphasized revenue adequacy and compatibility between the tax system and administrative capacity. A main objective has been to broaden the tax base so that the tax structure can be simplified and the tax rates lowered thereby reducing tax-induced distortions and evasion.

This is what the object of a tax design should be for a growing economy.

However this is not accomplished. On the contrary the various complexities and confusions have destabilised the fiscal set up.

The issues pertaining to litigations under the direct tax laws have been highlighted in the succeding pages alongwith the issues that confused the concept of income have also been discussed hereafter.

The existing legislative prove under the direct tax laws are very complicated and it appears that they provide areas for litigatians. The observations in, " The Hindu" dated June 23rd 1994 support this view.

"Litigation in the Income-tax Department" observed the Union Finance Minister recently while addressing the conference of Commissioners of income-tax, 'had assued unduly large proportions. The collection was not commensurate with the litigation and paper work generated'. Speaaking later on the same theme the Chairman of the Central Board of Direct Taxes (CBDT) lamented that "Litigation was disproportionate to the tax actually generated...2.6 lakh cases were pending with the Tribunals, 35,000 references in High Courts and 3,500 appeals in the Supreme Court. In the U.S., in contrast, the annual income tax was one trillion dollars with cases pending in courts hardly in two digits." It is gratifying that the problem of exploding litigation has caught attention at the highest policy levels.

The problem has been building for many years. Time was when reports of tax cases decided by the High Courts and the Supreme Court were carried by one volume of the Income Tax Reports(ITR) annually. Now, six such volumes are published each year and the reporting has been selective. And, what comes up before the higher courts is a small part of the litigation in which the department is engaged continually round the year.

The appeal syndrome :

Litigation starts when tax assessments are disputed at the level of the Assessing Officer and gets pushed up to higher and higher levels of the appellate hierarchy, with the buck stopping at the Apex court. The process of getting a final verdict often take not less than 20 to 25 years. And all the time, because of the growth in the number of tax-payers, and a steady stream of tax amendments, which generate problems of interpretation, litigation keeps ballooning. Involvement in this activity has become one of the major preoccupations of the Administration, sucking away its time and resources with results, such as they are, wholly incommensurate with the price paid. The beneficiaries of this scenario are by and large neither the taxpayers nor the State but the lawyers, accountants and others. If litigation collapses for the larger good they can well clamour for an Exit policy !

The effort to contain litigation can be two pronged: (a) to review all existing tax disputes pending at different levels and weed out what are clearly infructuous or are not worth pursuing on grounds of prudence and expediency and (b)to monitor the nature of disputes that arise at the first level and initiate action to limit the proliferation of avoidable disputes through policy directives for bringing about some kind of quality control in the making of assessments.

Sterile pursuits :

It would be in order to cite some instances of reported

cases which were patently not meant for the courts but had been pursued by the department to no intelligible purpose.

Dismissing the Revenue's appeal based on a decision of the Bombay High Court, given in 1981, the Supreme Court observed that "The circulars issued by the department are normally meant to be followed and accepted by the authorities. We do not find any justification for the officer not following the circulars nor was the department justified in pursuing the matter further in this Court (196 ITR 216)". After winning the case at the Bombay High Court, the taxpayer, caught in an alice-like situation, had to wait for over ten years to overcome the last ditch opposition of the tax addministration to the enforcement of its own instructions.

Pensioners of the United Nations arre tax-exempt by statute. Yet, a pensioner had to go all the way to the High Court to get the relief enjoined by the law (126 ITR 638) - (Karnataka High Court). Following this decision, the CBDT issued instructions in 1981 to its lower formtions to cease taxing income coming under this category. But this did not stop the same controversy erupting later in an identical case which the Madras High Court decided against the department recently, merely citing the CBDT circular (207 ITR 349).

In a recent case which received wide publicity involving a non-resident Indian, the department took an untenable position and the Court not only dismissed the Revenue's case but passed strictures and thought it fit to impose a stinging cost on the department.

Such cases keep coming up often. There is as much fish in the ocean as comes out of it. The astonishing aspect is that disputes with a patently zero-chance for the Revenue get cleared

for being pursued before the higher appellate authorities. Under the procedures, cases have to be thoroughly screened, at horizontal and vertical levels, reaching up to the CBDT, if the higher courts are involved for 'certification' as to suitability for further appeal, From the kind of cases cited, it would seem that such scrutiny is perhaps mechanical and ritualistic. Otherwise, how is one to explain the Administration contesting its own considered and publicly stated position, like the exemption available to U.N. pensioners ? 'Government's being the largest litigants' observed the Supreme court recently, "radical improvement is needed in the functioning of their machinery by reducing frivolous litigation...." This is particularly apposite in its application to the Income-tax Department.

The Public Accounts Committee had occasion to point out that the department lost its appeals more often than the tax-payer lost his. During 1977-78, 1978-79 and 1979-80, while the assessees succeeded before the Tribunal in 38 per cent, 52 per cent and 46 per cent of their cases, the department, succeeded to the extent of 20 per cent, 20 percent and 18 per cent of its cases (85th Report of the Public Account Committee - 7th Lok Sabha, p.10). Such figures for recent years are not among the readily accessible data, but there is no reason to believe that the department's record has got any better.

One interesting aspect of the decision making process in the department is that by the time the final verdict of the appellate authority arrives the persons principally responsible

for the decision making are invariably not on the scene because they have been shifted or have retired from the service. The long time lag in getting the appeal verdict sees to this. In any case, the practice of carrying out a post-mortem in matters of this sort, and fixing responsibility, is not known to exist. This may have some embarrassing overtone for those who set out to do this.

Special areas :

There are some special areas prone to avoidable litigation. The administration, in the process of implementing the excellent summary assessment scheme, has been needlessly finicky in the matter of carrying out what the statute authorises by way of "prima facie adjustments" to the declared income. Perhaps less than five per cent of the assessments suffer these controversial adiustments, but in terms of number, they can add up to serveral thousands.

If the Assessing Officer considers it necessary to make arguable changes to the eclared income, he can have resort to a mode of assessment specifically provided for this purpose - Sec.143(3) - but to do this under the guise of "prima facie adjustments" is to make a travesty of the law, and worse, of the CBDT's instructions. Such action has been successfully challenged before the courts and yet the syndrome is known to persist. If the Administration takes a lawful and pragmatic view in its approach to the summary assessment scheme, a sizable chunk of litigation can be done away with. on the contrary the

provision for an appeal against the summary assessment, put into the Finance Act, 1994, would seem to show that containing litigation is not yet on the agenda of the Administration.

Investment allowance for leasing companies :

There is a legal battle going on, involving a chain of cases, on the question of investment allowance to companies. The allowance was conceived with a view to giving a fillip to manufacturing industries in the larger public good, for accelerating to growth of the economy at a certain stage of its development. Now, the department is seeking to shut out leasing companies from the benefit of this concession, not because it is at variance with policy intents, but on a wholly technical ground resting on a narrow interpretation of an odd phrase or two occurring in a context unrelated to the policy.

As it happens, the Karnataka High Court has now ruled that leasing companies are entitled in law to the benefit (199 ITR 409). It would be proper and expedient if the CBDT, following this ruling, and more importantly, the policy aspect, extends the concession to all similarly placed companies. Pending litigation in a number of cases can be terminated forthwith. The burden of stricking with the controversy for another 10 to 15 years can be taken off at one stroke. This, of course, would mean giving up some revenue but the cost and uncertainties of persisting with the controversy should go into the reckoning.

Again, on the question of depreciation on transport vehicles acquired through hire-purchase an audit-generated controversy

is still holding ground. Here again it is a question of semantics. The CBDT gave the benefit of the concession to the user of the vehicle in an ancient decision taken as early as 1943, before the advent of audit. But the CBDT has not been able to come to terms with audit on this issue and is holding out heroically, thereby stemming a tide of litigation.

Audit exercises spawning disputes :

Ever since audit by the Comptroller and Auditor General (CAG) started, completed assessments have been getting unsettled to bring them in line with the Audit viewpoint. There can be no complaint if patent errors or lapses are the causes of these proceedings. These often are, but there is a category of audit criticism generated by Audit's interpretations of the tax law. These carry no special stamp of authority with the courts; they also get thrown out as not sustainable. The Supreme Court ruled quite a long time ago (Indian and Eastern Newspaper Society, 119 ITR 996) that the CAG's audit parties have no locus standi to hand down interpretations of the law, and make these the foundation for reckoning loss of revenue, but the practice, on all accounts, is known to continue.

The surprising aspect of the scenario is that the CBDT, even though it may not agree with the interpretations, makes it mandatory that tax assessments should be brought in line with the interpretations. In a surtax case 11 High Courts threw out the Audit's view but that did not deter the department from going to the Supreme Court which also failed to oblige (187 ITR

108). The burden of coping with these procedures, involving additional tax levies, falls on the tax payer who has no alternative but to seek remedies through litigation.

The Chelliah Committee had occasion to comment on the extent to which the tax department's performance had been inhibited by fear of Audit and the recourse to a play-safe approach loaded against the taxpayer.

The present Adminisration is heir to a historical legacy but the Supreme Court's decision cited above shows a way, for sorting out any jurisdictional encroachment. Back-seat driving may have its plus points but it is as well one also takes note of its limitations.

Preventive steps :

The department could consider putting in place a system for carrying out a meticulous scrutiny of the orders of the appellate authority at the first level (the Deputy Commissioner or the Commissioner, as the case may be) to identify the nature of the controversies generated and how far these are avoidable, because of infirmities in the assessment process, and to take appropriate remedial action.

The screening should be carried out by an authority at a sufficiently high level. Functional distribution of work, at the level of the Commissioner can be extended to take care of these needs which are acquiring focus.

The Finance Minister was hopeful of realising additional revenue during this year through streamlining the administration.

This is the year of administrative reforms, says the Chairman of the CBDT. It is not too soon for the Administration to get out of the cobwebs of sterile litigation and use the time and resources towards more positive pursuits.

Dr. Chelliya Chief fiscal advisor and Ministe of State ministri of finance govt. of India in speech on" Agenda for comprehensive tax setarms" delivered at the Indian economic confenence in 1994 observe as under,

Among many factors, two mahor developments have contributed to the motive and impetus for tax reform. The first is the realisation by policy makers and even tax administrators that the economic effects of taxation had to be given weighty consideration, as otherwise resource allocation gets distorted and economic growth adversely affected. The economic effects of the tax structure become all the more important in a competitive world. The second development contributing to the demand for tax reforms is the dawning of awareness, on the part of economists and tax designers, that the administrative implications and the possible behavioural response of tax administrators had to be kept in view while designing and recommending a particular tax structure. A theroretically perfect tax structure would be of no avail if it cannot be administered effectively or would induce the administrators to act contrary to the intentions of the tax designers. Much of the guest for simplicity in tax structure can be traced to this important consideration.

Along with simplicity, another desirable feature has been emphasised in the recent literature on tax reform, namely, the virtue of horizontal equity, meaning equal treatment of equals. This emphasis on equal treatment can be said to have arisen from the dissatisfaction over the serious violations of the rule of horizontal equity which had crept into the tax systems designed mainly to achieve vertical equity, in the sense of attempting to get the rich to pay a substantially large share of taxation. The consensus now seems to favour a tax system which would be fairly simple as well as transperent, would substantially satisfy the rule of equal treatment of equals and would have a moderate degree of progression. A high degree of progression is being ruled out partly because it tends to weaken economic incentives or cause distortions, but more because the inherent deficiencies of a real-world in come tax get accentuated by a high degree of progression.

He further observes,

As for the income tax, I have argued for a broad base covering as many constituents of income as is practically possible. As pointed out already, if the income tax is to achieve its purpose and if some degree of progression is to be introduced in the structure, it is essential that income must be defined adequately so that what is taken as income for tax purposes reflects "ability to pay". Only with the proper definition one can try to enforce the rule that equals must be treated equally. Much inequity under the income tax system had arisen, and even now arises, from the defective definition of income. There are deficiencies arising not merely from the inherent difficulties

in reaching all types of income but also from concesion and loopholes. Surprisingly, this aspect has not received pointed attention in general or even in academic discussions. What should be taken as a satisfactory and fair definition of income is rarely discussed in memoranda submitted by trade and industry associations as well as by taxpayers' associations. Economists in general in India, until recently, were stresing the progressive aspect of income tax because of the desire to tax the rich fairly heavily. They were, in other words, putting emphasis on vertical equity and arguing for highly progressive income tax. On the other hand, business and industry have been stressing the desirability of having only a moderately progressive income tax so that economic incentives may not be adversely affected. At the same time they have been pressing for various concessions. Whether one advocates moderate progression or steep progression, it is obvious that if equals are not treated equally, it would imply that progression cannot be achieved in a fair manner because many unequals will be treated equally. In fact the more defective the definition of income the more inequitable will be any degree of progression that is introduced in a scheme of income taxation. High progression in taxation loses its meaning if horizontal equity is violated.

Under the Indian income tax horizontal equity has been seriously violated. The violation has taken place through

(a) many concessions and deductions introduced with the intention of promoting one objective or another, (b) exemption of income from some sources e.g. agriculture; (c) decision to exclude many prequisities, (d) treating certain items of income such as capital gains more leniently under the mistaken notion that capital gains do not represent income; and (e) the application of a progressive rate schedule on an eroded base.

5.5 SUGGESTIONS

On the basis of various issues discussed in the earlier chapters more particularly the theoretical discussions regarding sound tax structure, the discussion concerning the weaknesses in the existing tax base, the relative merits and demerits of the tax base, the need for mobilising resources by widening the tax base, the researcher desires to offer the following suggestions with a view to attain the objectives of tax policies in a growing economy. The suggestions are as under :

1 Kaldor visualised the expenditure tax as a supplement to the income tax India and Shrilanka accepted his suggestions. In United Kingdom also the lavish standards of living by rich people impressed Kaldor as a social evil that should be combated by taxation.

The expenditure tax was subsequently given up and at present the same is levied on expenditure incurred in hotels. There is very insignificant application of the existing expenditure tax as it fails to cover other ostentatious expenditure. It is, therefore, suggested that the scope and applicability of

the existing expenditure tax should be further broadened.

2 The main important issue involved in Indian Direct Tax structure concerns with the existing narrow tax base as less than 1 percent of the population is covered under tax net. The tax base cannot be widened by using income as a base for taxation. The term income is subject to wide ambiguities. It should be precise. The Government should appoint a Committee consisting of fiscal experts with view to examine the possibility of introducing all together expenditure as a tax base. There may be number of legal and accounting difficulties in switching over from income to expenditure as a tax base but because income as a tax base has failed under Indian conditions to provide resource generating tool, the alternative possibility should be exhaustively examined. This is an experiment in which fullfledged (and not complementry) expenditure tax should be introduced.

3 Government of India recently lowered the tax rates under an apprehension that the reduction in tax rate may yield more revenues. However, it has been observed that, this is not true. Variation in tax rates may influence a fraction

of people in the society. The major issue therefore, should be to bring more people in the tax net. Government has tried various discloser schemes, schemes for presumptive taxation, efforts for counteracting tax evasion still the outcome of all these is not encouraging. Therefore, if the tax base is altered from income to expenditure and the tax is levied on expenditure incurred by an assessee beyond particular limit, there is every possibility that this would provide wider coverage of new assessees. In this situation the tax rates can be lowered and with the addition of new assessees more revenues may be generated. Lower tax rates would encourage economic activity and may curb tax evasion.

The case for expenditure tax is strong in case of Indian situation, because under the existing tax laws agricultural income is altogether exempt because of the constitutional difficulties. The introduction of expenditure tax would not suffer from constitutional hardships.

4 The tax-GDP ratio needs an urgent improvement. The revenues from direct taxes are on a decline and heavy reliance is placed on indirect taxes.

It is suggested that, there is a need to improve this situation.

The tax reform is a continuing process all over the world. The authors Barlett and Steel in their recent publicatios, "America : Who really pays the taxes" observe that, the American Federal Tax system conspires with the moneyed interests against the poor and middle class to create," two seperate and distinct tax systems One for the rich and powerful-call it the previliged Person's tax laws- another For You And Everyone Else- call it the Common Persons Tax Law."

The authors further observed that the tax system is a mess. In fact it has become a kind of masterpiece of inefficiency and perverse incentives- a scheme for redistributing income from poor to the wealthy. They further observe that, "A person who sends the cheque to the Government is not necessarily the one who bears the burden of the tax." IN case of corporations, "The taxes are paid either by shareholders customers or employees" and the top marginal tax rates are offset by loopholes,"The lessening of tax progressivity in recent decades helped shink the middle class."

In India also there is a need to ponder over the above observations seriously and sincerely.

In a country where Gross Domestic Savings and Gross Domestic Capital Formation are the indicators causing concern for the economic growth, the tax policies ought to be adopted in such a manner that the required growth rate is attained effectively. The tax on income, it has been argued, stifles the initiative to save whereas theoretically it is observed that the expenditure tax encourages the savings. The Gross Domestic Savings in India are Rs. 28,785 (1980-81) Rs.1,25,957 (1990-91), Rs. 1,45,132 (1991-92) Rs. 1,59,984 (1992-93) (in Crores) and the percentage thereof works out to 21.2%, 23.7%, 23.8% and 22.8% which means that there is a decline in the rate of savings. Similarly the rate of capital formation is for the above years 22.8, 27.1, 24.8 and 25.0 respectively. If this is compared with other asian economies - not to talk of other advanced countries - it can be inferred that there is need to encourage savings and investment. Most of the countries are embarking upon supply side economics which has become a post - Reagen - Thatcher order from 1979 to 1990. Basically the new economic doctorines keeps its thrust on tax acts where by savings and investments are encouraged. The tax on expenditure supports this philosophy.