

Suggestions regarding report of expert group to simplify income-tax law – Chapters II & III – Basis of charge and income exempt from tax

[Published in 95 Taxman (Mag) p.45 (Part-2)]

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The Expert Group appointed by the Government to suggest changes in the Income-Tax Act, 1961, with a view to simplifying and rationalizing it and bringing it in tune with the new liberal economic environment, has submitted its Report containing a larger number of suggestions for re-writing the Income-Tax Act. In this article, the author discusses the suggestions contained in Chapters II and III of the Report pertaining to the “Basis of charge” and “Income exempt from tax” respectively. The author expresses reasoned disagreement with many of the suggestions of the Group and offers suitable modifications of his own which may be profitably looked into by the authorities before giving a final shape to the new Income-Tax Act – EDITOR

1. Introduction

An attempt has been made in this article to offer some suggestions in respect of Chapters II & III – (Basis of charge and income exempt from tax) of the Report of the Expert Group, to simplify income-tax law, which was constituted by the Government of India, vide their order dated August 6, 1996.

Drafting a statute is quite a difficult task whereas giving suggestions in respect thereof, for improvement, etc., is comparatively easier. Therefore, in all humility, the following suggestions regarding the aforesaid Chapters II & III are submitted for consideration by the appropriate forum, in the hope that the same may be found useful in the process of simplification of income-tax law.

2. Basis of charge of income-tax and definition of “income”

Section 4 of the Income-Tax Act, 1961 (the Act), is the basic charging section under which income-tax is chargeable on the total income of every person. The word “*income*” is defined under section 2(24) of the Act. As per section 14, all income, for the purpose of charge of income-tax and computation of total income, is classified under five heads of income. Then section 15 is the charging section in respect of “*Income from salaries*”, section 22 in respect of “*Income from house property*”, section 28 in respect of “*Profits and gains of business or profession*”, section 45 in respect of “*Capital gains*” and section 56 in respect of “*Income from other sources*”.

The definition of “*income*” in section 2(24) has been enlarged over a number of years in a haphazard manner. Similarly, sections 28 and 45, etc., have also suffered haphazard amendments. The whole approach in respect of these amendments has been a piecemeal one and not a holistic one. There has been no well-thought out, scientific or logical approach regarding the amendments of the definition of “*income*” under section 2(24) and the provisions of sections 15, 22, 28, 45 and 56.

Take for example the charge of income-tax in respect of income from “*salaries*”. Income from salaries is chargeable to tax under section 15; “*perquisites*” and “*profits in lieu of salary*”, etc., are included in the definition of “*salary*” under section 17(1). The value of any perquisite or profit in lieu of salary is also included in the definition of income under section 2(24)(iii) whereas “*salary*” is not so included.

Further, sub-clauses (iiia), (iiib), (v) and (iva) of section 2(24) relate to income from salaries. There seems to be no apparent logic behind the aforesaid manner of the drafting of these provisions.

Similarly, sub-clauses (v), (va), (vb), (vc), (vd) and (ve) relate to “*profits and gains*”, whereas “*profits and gains*” are already included in the definition of “*income*” under section 2(24)(i). Besides, the aforesaid sub-clauses of section 2(24) make references to the types of incomes included in “*profits and gains*” in section 28; whereas clauses (ia), (ib) and (ic) of section 56(1) make counter-references to the types of income included in sub-clauses (viii), (ix) and (x) of section 2(24), respectively.

In addition, “*profits and gains*”, “*capital gains*”, a major part of section 28 and dividend, etc., form part of the definition of “*income*” under section 2(24), whereas income from “*salaries*” and “*income from house property*” do not find place in the definition of “*income*”. The ultimate results is a total *hotch-potch*, so far as the definition of “*income*” under section 2(24) and the provisions of sections 15, 22, 28, 45 and 56 are concerned.

The Expert Group has not applied its mind to such an important aspect of the income-tax law, which has given rise to a lot of litigation. The aforesaid issue which is connected with the definition of “*income*”, and the provisions of sections 4, 5, 14, 15, 22, 28, 45 and 56; should have been addressed to, by the Expert Group in order to make them logical, comprehensive and harmonious.

A better course would be to include all possible items of “*income*” under sections 15, 22, 28, 45 and 56 in a comprehensive manner and then adopt the definition of “*income*”, accordingly.

At present, the provisions of various aforesaid sections are quite mixed up, unwieldy and incomprehensible. In order to make the aforesaid provisions simple, the same are required to be arranged and drafted in a simple, harmonious and easy to understand, manner.

3. Removal of concept of assessment year.

The Expert Group has recommended that after the incorporation of the concept of financial year as the uniform previous year for all taxpayers, there would be no need of retaining the concept of assessment year. But one may have reservations about the aforesaid recommendation.

First of all, a person who can understand the concept of financial year as the “*income year*”, can also understand the concept of assessment year. Besides, the income of a particular income year or financial year is taxable in the next following year which we presently call assessment year. The return of income is also to be filed in the next following financial year, *i.e.* the relevant assessment year. Therefore, it would be more advantageous to retain the concepts of both the financial year and the assessment year.

In addition, the expression “*assessment year*” has been used at a large number of places in the Act. Most of the time-limits are fixed with reference to the end of the assessment year.

Removal of the concept of “*assessment year*” will, therefore, necessitate avoidable amendments at numerous places in the Act without serving any purpose. It would be nothing but a change for the sake of change. I would, therefore, suggest that the concept of “*assessment year*” should be retained along with the concept of “*financial year*”.

4. Receipt of income in India which does not accrue or arise in India – Section 5(2)

The provisions under section 5(2)(a) to tax “*income*” on receipt basis, though the same does not accrue or arise in India, are rather archaic. It may be recalled here that as per the provisions of section 5(2)(a), total income of a person who is “*non-resident*” includes all income from whatever source derived, which is received or deemed to be received in India by or on behalf of such person.

The aforesaid provision is the main reason why persons of Indian origin receive money abroad in the first instance and thereafter they remit it to India. Take the cases of persons serving on “*Indian ships*” on high seas. Such persons become non-residents. Their salaries are payable abroad in foreign exchange, only to avoid tax on receipt basis. It is rather ironical that if a person receives his salary in a foreign bank or on board a ship and thereafter remits the same to India, then it is not taxable in India. However, if the same salary is paid in the bank account of a non-resident Indian or

to his relatives in India, the same is exigible to Indian income-tax. The aforesaid provisions are illogical, leading to sizeable leakage of foreign exchange out of India.

The Expert Group does not appear to have addressed the aforesaid issue. It may be emphasized here that valuable foreign exchange is kept abroad just because of the aforesaid unreasonable tax provisions. Furthermore, receipt of “*income*” should never be the basis of charge of income-tax in an economy which is starving for foreign exchange. It is, therefore, suggested that the aforesaid provisions should be suitably amended.

It may also be stated here that the Assessing Officers in most of the places use the artificial concept of post office serving as an agent of the non-resident and where regular remittances are sent through the same bank, for the inference of an implied request for such remittance through the bank, inferring the local bank to be its agent and then proceed to tax income embedded in such payments on receipt basis, even where the receipt is for services rendered abroad or sales made as between principals. Such a course of action on the part of Assessing Officers has been sanctified vide the Board’s Circular No. 302 dated May 2, 1981 for gift-tax purposes. This artificiality should certainly be removed if the tax laws are to be made simpler.

5. Amendment of status – “*Resident but not ordinarily Resident*” – Under section 6(6)

The Expert Group has recommended reduction of the period for the residential status of “*resident but not ordinarily resident*” from the present 9 years to 5 years if a person has been “*non-resident*” for two consecutive years. The aforesaid recommendation is nothing but an exercise in tinkering with the provisions of the Act. There is nothing sacrosanct about the period of five years against the present period of nine years.

If the Expert Group is so much concerned about the loss of revenue on this account, then the simpler course would be to scrap the concept of status of “*resident but not ordinarily resident*” altogether. No useful purpose would be served by making the aforesaid change when the present provisions have been working satisfactorily for so long.

6. Income exempt from tax – Under section 10

Section 10, over a period of time, has become highly unwieldy and cumbersome. Various kinds of exemptions have been incorporated in section 10 in an unscientific and haphazard manner.

Some exemptions under section 10 relate to various heads of income, namely, “*Income from salaries*”, “*Income from other sources*”, etc. There are certain exemptions which cannot be classified on the basis of the criterion of division amongst the five heads of income.

Exemptions under section 10 are so numerous and also so clumsily worded that an attempt to get at a certain kind of exemption, is nothing but an exercise in groping in the dark and deep sea in search of a tiny nugget.

In this respect one may offer certain suggestions. As far as possible, the exemptions under section 10 should be divided amongst the five heads of income and they should be incorporated in the Act, along with the respective heads of income, for ready and easy reference. Some of the exemptions may be shifted to other places depending upon their nature. Here, one may cite an example of the recommendation of the Expert Group itself. The Expert Group has recommended that clauses (21), (22), (22A), (23), (23B) and (23C), etc., may be deleted from section 10 and the same may be incorporated in the Chapter dealing with charitable trusts, etc., one may also cite another example in respect of exemptions / deductions available in respect of capital gains. Such exemptions / deductions are already there in the Chapter dealing with “*capital gains*” in the form of sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H of the Act.

Both logic and simplicity demand that as far as possible all the provisions relating to various exemptions under section 10 should be properly classified and then incorporated in the relevant Chapters dealing with taxable income under the various heads of income, *viz*; –

- (i) Salaries,
- (ii) Income from house property,
- (iii) Profits and gains of business and profession,
- (iv) Capital gains, and
- (v) Income from other sources

Some of the provisions may be shifted to other relevant Chapters and the remaining provisions may be continued under section 10 itself. Such a course of action will make the income-tax law more handy, simple and purposeful.

7. Casual and non-recurring receipts – Section 10(3)

Instead of being used as a provision-for exempting certain receipts up to a certain limit, this provision is often being used or misused as a “*charging section*”, as every receipt in excess of Rs.5,000, is being brought to tax by the Assessing Officers. In view of the aforesaid reason, this provision has generated lot of avoidable litigation.

Instead of providing some relief, this provision has become an instrument of harassment to the taxpayers.

Section 10(3) seeks to exempt a part of receipt which is of a casual and non-recurring nature and which is otherwise of income nature and, therefore, taxable. Unfortunately, the Assessing Officers are bringing to tax all kinds of receipts in excess of Rs.5,000, under the cover of the provisions of section 10(3).

It is, therefore, suggested that the authorities may seriously address themselves to the issue in order to make the relevant provisions more clear and simple. One suggestion is to replace the word “*receipts*” by the phrase “*receipts which are of income nature*”.

8. Charitable and religious trusts – Section 11

Some of the suggestions in respect of the Report of the Expert Group relating to charitable and religious trusts, are discussed below :

(a) Application of income :

The Expert Group has recommended that the trust must spend at least 60 per cent of its income during the financial year and can accumulate the balance. It has further recommended that in case of a trust set up after the date of commencement of the new law, the requirement of spending 60 per cent of the income during the year would not be applicable and the trust will be free to accumulate up to 100 per cent of its income during the first 5 years of its existence.

One may have strong reservations in respect of the first recommendation of the Group. In the first place why tinker with the present provisions wherein 75 per cent of the income has to be spent during the year and the 25 per cent thereof can be accumulated? The aforesaid change as suggested by the Expert Group does not serve any useful purpose. It will be nothing but making a change for the sake of change.

(b) Provision regarding accumulation of income – Under section 11(2) :

The Expert Group has recommended the deletions of the provisions of section 11(2) of the Act under which a trust can accumulate its income for a maximum period of ten years in order to build up its corpus by making an application to the Assessing Officer in Form No.10.

The present provisions of section 11(2) should be continued because most of the new trusts may not have sufficient income in the first five years of their existence and if the trust does not have enough income, then what will it accumulate? Thus, it can be seen that most of the new trusts will have to face very big problems if the provisions of section 11(2) are scrapped as it will be impossible for them to build up a reasonable amount of corpus in order to run the day-to-day activities of the trust.

The recommendation regarding 100 per cent accumulation of income during the first 5 years of the existence of the trust need not be disturbed.

- (c) Provisions regarding application of part of income in the next following financial year at the option of the assessee :

It is not clear from the recommendations of the Expert Group whether the provisions under *Explanation (2)(ii)(b)* to section 11(1), under which a trust could opt for spending a part of its income in the next following year, would be continued or not.

It is suggested that the aforesaid provisions must be continued as there may be cases where a very major part of income of a trust is received at the fag end of the financial year and in such a situation, it would be impossible for the trust to spend any part of such income during the financial year concerned. In such a situation, the income may be spent in the next financial year.

- (d) Mode of investment – Section 11(5) :

The Expert Group has recommended, *inter alia*, omission of any “*mode of investment which may be prescribed*” from section 11(5).

These provisions should not be deleted so as to maintain some kind of flexibility in respect of the modes of investment, keeping in view the fast changing economic scenario.

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