

Income Tax – An overview of History, Constitution, treaty and scheme

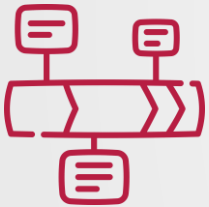
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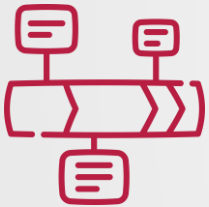


History of Income Tax



- The emergence of Income tax from the Napoleonic Wars in UK in 1798
- Post the War the tax was abolished, but it returned temporarily in 1803 with two additions:
 - Taxation at source
 - The division of income taxes into five ‘Schedules’ – A (income from land and buildings), B (farming profits), C (public annuities), D (self-employment and other items not covered by A, B, C or E) and E (salaries, annuities and pensions).

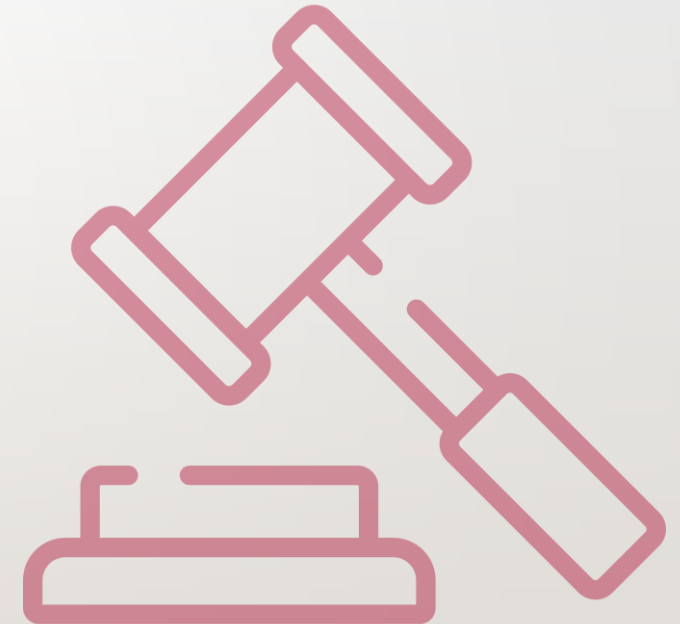
History of Income Tax



- Income Tax was a temporary tax which expired each year in April. The UK Parliament had to reapply it with the annual Finance Act
- The Provisional Collection of Taxes Act 1913 ensures that taxes can be demanded based on the Finance Bill, till the time the Act is enacted
- Similarity with Modern India
- The first Indian Income Tax was introduced in 1860 by Sir James Wilson to help recoup the losses sustained by the Raj from the Revolt of 1857
- This was followed with Acts of 1886, 1918, 1922, and finally 1961
- India too has enacted the Provisional Collection of Taxes Act 1913

History of Tax Treaty (1/2)

- Earliest Treaty was adopted by Prussia around the start of the Twentieth Century
- First Treaty was with Austria signed in 1899
- In 1920 League of Nations began to play a leadership role
- 1928 published the first internationally important Model Tax Conventions
- After World War I, Germany signed a treaty with Czechoslovakia in 1921 and with Austria in 1922
- The League of Nations began publication on tax treaties in 1923
- The OECD became the Organization for Economic Cooperation and Development



History of Tax Treaty (2/2)

- OECD first draft model treaty in 1963
- United Nations published a manual for the negotiations of bilateral tax treaties between Developed and Developing Countries in 1979
- In 1980 United Nations published a manual for the negotiations of Bilateral Tax Treaties between Developed and Developing Countries
- OECD made some amendments published in loose leaf form in 1990's
- UN Model Tax Convention 2001
- OECD started amending the publication every 2 to 3 years
- New UN Model on Tax Convention 2011
- OECD Model and Commentary 2017
- UN Model on Tax Convention 2017



Basic features of Tax

Why Tax?

Welfare functions of
the State

- 3 elements of a tax
- Tax Base
 - Rate of tax
 - Tax payer

Basic features of Tax

Evaluating the Tax Systems: Adam Smith in Wealth of Nations,1776)

Convenience

Ease of
Compliance and
tax friendly
environment

Certainty

Literal
interpretation

Equity

Progressive tax

Economic Efficiency

Tax should be
transaction neutral
and not influence a
transaction in any
manner

Simplicity

Long term fiscal
policy

Levying Taxes – Constitutionality

- **Art.265** – *No tax shall be levied or collected except by authority of law* Division of taxing powers
 - Tax declared as *ultra vires* or unconstitutional by the Court whether paid under protest or not must be refunded: **S.T.O. v. Kahhaiya Lal Saraf** (AIR 1959 SC 135); D. D. Basu on Constitution of India
- **Union taxes** can be classified into 3 categories
 - **Art.268**: Levied by Union but collected by States
 - **Art.269**: Levied and collected by Union but wholly assigned to the States
 - **Art.270**: Levied and collected by Union and shared with the States
- **State taxes** – land revenue, agricultural income tax, excise duties on narcotics and alcohol, sales taxes (Art.286, entry 92A)

Levying Taxes – Constitutionality

- GST Framework: **Art 366 (12A)** - “goods and services tax” means any tax on **supply of goods, or services or both** except taxes on the supply of the alcoholic liquor for human consumption
 - **Article 246A:** (2) Parliament has **exclusive power** to make laws with respect to goods and services tax where the **supply of goods, or of services, or both** takes place in the course of **inter-State trade or commerce**
- Provisions for inter-state commerce [Part XIII of the Constitution]:
 - **Art.301:** Subject to Part XIII, trade, commerce and intercourse throughout the territory of India shall be **free**
 - Is Tax a restriction on trade? – The entry tax debate.
 - Jindal Stainless Steel v. Haryana (AIR 2016 SC 5617)

Constitutional Provisions for tax treaties (1/2)

Directive Principles of State Policy

Article 51: The State shall endeavour to— (c) foster respect for international law and treaty obligations in the dealings of organized peoples with one another

No tax can be imposed without authority of law

Article 265: No tax shall be levied or collected except by authority of law

Law in Article 265 means any act of competent legislature

Article 73: (1) Subject to the provisions of this Constitution, the executive power of the Union shall extend...(b) to the exercise of such rights, authority and jurisdiction as are exercisable by the Government of India by virtue of any treaty or agreement

Constitutional Provisions for tax treaties (2/2)

Legislation Giving Effect to International Agreements

Article 253: Notwithstanding anything in the foregoing provisions of this Chapter, Parliament has power to make any law for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body

Section 90 Income Tax Act

Section 90: (1) The Central Government may enter into an agreement with the Government of any country... (a) for the granting of relief... or (b) for the avoidance of double taxation... or (c) for exchange of information... or (d) for recovery of income-tax ... and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement

(2) Where the Central Government has entered into [such] an agreement... under sub-section (1)... then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee

Can a treaty have automatic effect in India?

- No
- India adopts the dualist approach where the Parliament must ratify an international agreement for it to have legal effect
- Article 253 of Constitution: Legislation for giving effect to international agreements
 - Notwithstanding anything in the foregoing provisions of this Chapter, Parliament has power to make any law for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body



Constitutionality of treaties

Maganbhai ishwarbhai Patel (1970) 3 SCC 400

- A treaty really concerns the political rather than the judicial wing of the State
- Can only be implement if all the 3 branches of government – the legislature, executive and the judiciary, possess the power to implement it
- If in convergence of the exercise of Executive power, rights of citizens or others are contracted or infringed or laws modified, the exercise of power must be supported by legislation; where there are no such restrictions, infringement of the rights or modification of the laws, the Executive is competent to exercise the power

Constitutionality of tax treaties

Azadi Bachao Andolan (252 ITR 471, Delhi high court)

Issue

- Whether Circular No. 789 dated 13.4.2000 with regard to the application of Indo-Mauritius Double Taxation Avoidance Convention issued by the CBDT is ultra vires of S.90 and S.119 of Income Tax Act, 1961?

Held

- Merely accepting the certificate of residence as substantial proof cannot be held conclusive
- The ITO, a quasi-judicial authority must after application of mind and looking at various facts come to the conclusion that the assessee is a resident of Mauritius. Such authority cannot be taken away by a circular
- Significant scope for Treaty Shopping, the intention of the legislature could not be double non-taxation

Azadi Bachao Andolan ((2004) 10 SCC 1, Supreme Court)

Issue

- Whether the decision of the Delhi High Court was bad in law

Held

- **Yes**
- Principles adopted in interpretation of Treaties are not the same as those in interpretation of Statutory Legislation
- Treaties are negotiated and entered into at a political level and have several considerations as their bases

Azadi Bachao Andolan ((2004) 10 SCC 1, Supreme Court)

- Circular briefly defines Article 4 of the Indo – Mauritius DTAC and states that FIIs and other investor funds incorporated in Mauritius are invariably residents of the country and thus liable for taxation in Mauritius
- SC states that Circular No. 789 does not interfere with S. 90 and S. 119 and is well within the ambit of the Indian Income Tax Act



Azadi Bachao Andolan ((2004) 10 SCC 1, Supreme Court)

- A State has the inherent power to enter into treaties with other States.
- Under Article 73, the Executive Power of the Union extends to all matters on which the Parliament can make laws.
- The executive is competent to represent India and enter into a binding Treaty with other States.
- However, the obligations under the treaty are not by itself binding on Indian nationals. This requirement is only applicable when the justiciable rights of citizens or others are affected.



Legislative process of levying a tax

Money Bills

Article 110. (1) For the purposes of this Chapter, a Bill shall be deemed to be a Money Bill if it contains only provisions dealing with all or any of the following matters, namely

- a) The imposition...of any tax
- b) ...the borrowing of money or the giving of any guarantee by the Government of India, or ...with respect to any financial obligations...undertaken by the Government of India
- c) The custody of the Consolidated Fund
- d) The appropriation of moneys out of the Consolidated Fund
- e) The declaring of any expenditure to be expenditure charged on the Consolidated Fund of India...
- f) The receipt of money on account of the Consolidated Fund of India or the public account of India or the custody or issue of such money or the audit of the accounts of the Union or of a State; or
- g) Any matter incidental to any of the matters specified in sub-clauses (a) to (f)

Money Bills

- Money Bills in the Parliament:
- For all bills apart from Money Bills, both Houses of Parliament have equal say.
- But, Money Bills can only be introduced in the Lok Sabha
- Once passed in Lok Sabha, Rajya Sabha can merely recommend changes.
- These changes may or may not be adopted by the Lok Sabha. Rajya Sabha cannot debate the Bill for more than 14 days. Article 109(2):
 - *After a Money Bill has been passed by the House of the People it shall be transmitted to the Council of States for its recommendations and the Council of States shall within a period of fourteen days from the date of its receipt of the Bill return the Bill to the House of the People with its recommendations and the House of the People may thereupon either accept or reject all or any of the recommendations of the Council of States.*
- Speaker of the Lok Sabha classifies a Bill as Money Bill

Aadhar controversy: Puttaswamy v. UoI

(2019) 1 SCC 1

- Aadhar Bill was introduced as Money Bill. Only 7 of 59 sections referred to the Consolidated Fund of India
- Majority view: Sikri J: The Aadhar Bill had 'substantial nexus' with the 'appropriation of funds' and is 'directly connected' with Article 110 of the Constitution
- Concurring view: Bhushan J: The Aadhar Bill, particularly section 7, met the requirements of Article 110(c) and 110(e), dealing with the custody and expenditure charged on the Consolidated fund of India

Aadhar controversy: Puttaswamy v. UoI

(2019) 1 SCC 1

Judicial Review of Speaker's certificate:

- Overruled Saeed Siddiqui v. Uttar Pradesh and Yogendra Kumar v. Bihar; which stated that the decision of the Speaker is final and the courts cannot interfere.
 - Article 112 declares the decision of the Speaker as final.
- Per Majority: Judicial Review would be admissible in case the Speaker's certificate suffers from illegality.
- Per Bhushan J: [Finality of Speaker's certificate] does not apply in case of illegality of the decision. (para 892)
- Per Chandrachud J (dissenting): The principle which emerges from these decisions is that the decision of the Speaker is amenable to judicial review, if it suffers from illegality or from a violation of constitutional provisions.

Aadhar controversy: Puttaswamy v. UoI

(2019) 1 SCC 1

Concerns with the Majority view

- The 'substantial nexus' test has potential to open floodgates. Any mention of the Consolidated Fund of India does not warrant it be classified as a money bill.
- The decision renders the 'only' in the header to Article 110 otiose. The proposal was made to remove the 'only' in the Constituent Assembly Debates. This proposal was rejected, meaning there is a deliberate intention and meaning awarded to the term

Aadhar controversy: Puttaswamy v. UoI

(2019) 1 SCC 1

Minority view: Chandrachud J: Held the bill was not a Money Bill

- Chandrachud J traced the significance of a Two member house and the contributions of Rajya Sabha
- Section 7 of the Aadhar Act does not declare a charge on the Consolidated Fund of India and hence does not satisfy the provisions of 110
- In Pith and Substance, the Aadhar Act is not a money bill
- Referring to the Constituent Assembly debates on Money Bill and the legislative history of the Aadhar Bill itself, Chandrachud J held that this was not a Money Bill

Income Tax Act

Scheme of the Income Tax Act

- It is a Charge on Income of Persons as defined under the Act
- Income (Section 2(24)) under 5 heads (Section 14) charged on a Person (Section 2(31))
- A person is taxed as per his or her residence (Section 6) and the source of income
- Income may be deemed to be sourced in India (Section 9). A non resident may be deemed to be resident (Section 6(1A))
- The income from the 5 heads constitutes total income (Chapter IV). The income may be set off (Chapter VI) or deducted (Chapter VIA) or granted rebate (Chapter VIII)
- Assessment (Chapter XIV), Collection (Chapter XVII), Refund (Chapter XIX) follow with the Income Tax Authorities (Chapter XIII) and in Appeals (Chapter XX)

Assessment

- Section 140A - Self Assessment
- Section 143 – Assessment
 - 143 (1)- Summary Assessment → without calling the assessee. (1-year time limit)
 - 143 (3) - Regular Assessment → limited scrutiny or complete scrutiny
 - » Finance Act 2018: Plans to make completely have faceless assessments
- Section 144 – Best judgement assessment. From Finance Act 2020, 144 assessment are covered under e-assessment. Implementation by 1.4.2022
- Section 147 – Re-Assessment if AO has ‘reason to believe’ that income has escaped assessment
- Section 153A: Assessment in case of search or requisition
- Section 153C: Based on income under assessment of one person, assessment of income of another person

Assessment versus reference to DRP

- Fresh provisions for applicability of Section 144C: Now any non-resident is covered that is not a company, or any foreign company
- *Vijay Televisions v. DRP* (Mad HC; TS-469-HC-2018(MAD)-TP): Where there is an omission to follow mandatory procedure, such omission cannot be termed as a mere procedural irregularity and it cannot be cured.
 - The Delhi High Court in *ESPN Star Sports Mauritius v. UoI* [2016] 388 ITR 383, the Andhra Pradesh High Court in *Zuari Cement Ltd. v. ACIT* case (WP(C) No.5557/2012) as well as the Bombay High Court in *International Air Transport Association v. Dy. CIT* [2016] 241 Taxman 249; came to the same conclusion.
- The process before DRP is a continuation of Assessment Proceedings – *Vodafone India Services Pvt. Ltd.* (Bom HC; 361 ITR 531).
- Regular Assessment under 143(2):
 - Notice under 143(2) must be given within 6 months.
 - *ACIT v. Hotel Blue Moon: Kapadia and Dattu JJ* (SC; 321 ITR 362): If for any reason the return filed by the assessee is repudiated, the AO must have necessarily issued a notice

Special Assessment provisions – Search

- Post a Search, an Appraisal Report created under section 132
 - Inventory of documents and books of accounts are compiled
- AO under section 153A must issue a notice for re-assessment of previous 6 assessment years based on the findings from the search
 - Notice can be issued for periods beyond 6 years upto 10 years if
 - » Income escaped is more than 50 lakh rupees in one year in the four years beyond the 6th year. It forms a part of an asset and relates to that particular year
- Assessment under 153A can be made only against a person on whom search is initiated under section 132 – Jindal Stainless v. ACIT, (2009) 122 TTJ 902 (Del HC)

Anti-Avoidance provisions – GAAR

- Section 96 (1) of the ITA proposes a two-pronged requirement for an agreement to be impermissible:
 1. The "main purpose or one of the main purposes" of the arrangement must be to obtain a tax benefit (the "main purposes" test); and
 2. The arrangement must fulfil one or more of the four conditions specified in clauses (a) to (d) (the "tainted elements" test)
- The onus to establish both prongs of the test in Section 96 shall lie on the Revenue.
- Concerns with GAAR:
 - Uncertainty?
 - Purposive Interpretation of Tax Statutes?
 - Unfettered Discretion to Commissioners?
 - Chilling Effect?

Anti-Avoidance provisions – SAAR

Examples of SAAR

Areas covered	Section under the Act
Deeming certain payments by closely held companies by way of loans and advances to specified shareholders/other specified entities as dividends	2(22)(e)
Provision targeting transfer of income without transfer of assets	60
Provision in respect of revocable transfer of assets	61
Provisions relating to clubbing of income which prevent shifting of income from one person to another for tax reasons	64
Provisions targeting avoidance of income tax by transactions resulting in transfer of income of non-residents	93
Provisions targeting avoidance of tax by certain transactions in securities, such as dividend stripping	94

Chapter XXC – Transactions dealing with immovable property

- Keeping in mind the stakes in transactions involving immovable property and identifying it as a potential leakage of income, the government introduced Chapter XXC
- Chapter XXC was the successor to Chapter XXA
- The Chapter provides for the purchase of immovable property by the Central Government
 - A transfer of immovable property, if situated in a notified city or and
 - If consideration noted under the contract for such transaction exceeded the prescribed limit
 - The Central government could intervene to purchase the immovable property

Thank you