A Critical Analysis of Some Provisions of the Income Tax Act

A country's moral standards go down when laws are framed in such a way that honest men find it difficult to adhere to the laws. The article offers a critical analysis of some provisions of the Income Tax Act which seem illogical and call for Government's remedial intervention.

There are several instances under the Income Tax Act that belie any logic. For example, under the chapter dealing with 'collection and recovery of tax' referring to tax deduction at sources in Section 194C dealing with payments to contractors and sub-contractors, a proviso is added which reads as under:

"Provided that an individual or a Hindu Undivided Family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under Clause (a) or Clause (b) of Section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the amount of the subcontractor, shall be liable to deduct income tax under this Sub-Section."

Similar proviso is there in the following Sub-Sections:

1.	Payment of Commission or Brokerage	-	under Section 194H
2.	Payment of Rent	-	under Section 194I
3.	Payment of fees for professional or technical services	-	under Section 194J

The Finance Act (2002) by virtue of which this proviso was added in Memo explaining the provision reads as under:

"individuals and Hindu Undivided Families whose sales, turnover or gross receipts of the business or profession exceed Rupees Forty Lakhs or Rupees Ten Lakhs, as the case may be, are required to maintain books of account and other documents and get their accounts audited. Hence, the books of account and other documents are required to be maintained.

It is, therefore, proposed to amend the provisions of the above sections to provide that an individual or a Hindu Undivided Family, whose total sales, turnover or gross receipts from the business or profession carried on by him exceed the monetary limits specified under Clause (a) or Clause (b) of Section 44AB during the financial year immediately preceding the financial year in which the income is to be credited or paid, shall be liable to deduct income tax under the relevant provisions of the aforementioned Sections."

How can the law require an assessee to deduct tax from payment, which is income of the receiver merely because the payer has got gross receipts as per the limits laid down for tax audit?

What connection has the payers gross receipts have so far as the tax liability of the receiver is concerned? The reason given as quoted hereinabove is merely that the payer is required to maintain the books of account and other relevant documents and get the same audited, therefore, they are made liable to deduct tax.

Possibly it was thought that they will have the administrative set up, which can deal with the question of deduction of tax at source. Is this a valid logic?

Another such provision is Explanation 4 to Section 271, which reads as under: -

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"Explanation 4- For the purposes of Clause (d) of this Sub-Section, the expression 'the amount of tax sought to be evaded'-

> in any case where the amount of income in respect of which particulars have been concealed or inaccurate particulars have been furnished, has the effect of reducing the loss declared in the return or converting that loss into income, means the tax that would have been chargeable on the income in respect of which particulars have been concealed or inaccurate particulars have been furnished had such income been the total income;"

Here a provision is made so that even in case of loss return, if by virtue of additions the loss is converted into income or it is reduced, penalty can be levied related to the tax that would have been chargeable to tax on account of difference.

Thus, in effect, if the loss is reduced, the penalty will still be leviable based on tax on difference between amount of the loss as declared and assessed. For this also under the Finance Act (2002), in the Memo explaining the provisions it is simply mentioned as 'clarificatory amendment' in Section 271.

The clarification given says the amount of tax sought to be evaded would include the tax relatable to the reduction in the loss declared in the return or relatable to conversion of loss into income.

Does this also not sound illogical, when the question of penalty is to avoid tax, where is the avoidance of tax in case of loss return? The way the amendment goes, it shows that the Government wants to collect tax by any means.

The more glaring example of illogical provision is about the loss return, which under Section 139(3) is to be filed within the time allowed under Section 139 and there is no power to give time to file such return. The relevant provision reads as under:

"If any person who has sustained a loss in any previous year under the head 'Profits and Gains of Business or Profession' or under the head 'Capital Gains' and claims that the loss or any part thereof should be carried forward under Sub-Section (1) of Section 72, or Sub-Section (2) of Section 73, or Sub-Section (1) [or Sub-Section (3)] of Section 74 [or Sub-Section (3) of Section 74A], he may furnish within the time allowed under Sub-Section (1) a return of loss in the prescribed form and verified in the prescribed manner and containing such other particulars as may be prescribed and all the provisions of this Act shall apply as if it were a return under Sub-Section (1)."

Now Section 80 reads as under: -

"Notwithstanding anything contained in this chapter, no loss which has not been determined in pursuance of a return filed [in accordance with the provisions of Sub-Section (3) of Section 139], shall be carried forward and set off under Sub-Section (1) of Section 72 or Sub-Section (2) of Section 73 or set off under Sub-Section (1) of Section 72 or Sub-Section (2) of Section 73 or set off under Sub-Section (1) of Section 72 or Sub Section (2) of section 73 or Sub-Section (1) [or Sub-section (3)] of Section 74 [or Sub-Section (3) of Section 74A]."

What can be the justification for disallowing carried forward of genuine loss (business or under the head Capital Gains) suffered by an assessee merely on the ground that the return was not filed within time allowed under Section 139? There can be cases of genuine hardship where on account of some serious illness or death or some sort of individual emergency, loss return could not be filed within the time allowed. How does this make a difference to a government, when it denies right to carry forward genuine business and capital losses if the return is filed two days later/after the due date? It is interesting to note that there was power to Income Tax Officer to grant time for filing Loss Return, but that was taken away by amending the law.

As the law stands, there is no power in anyone's hand to remedy the situation in such events. Can there by any valid reason for this?

Similar arguments can be advanced for the provision of long term and short term capital gains. A long term capital asset is defined as one which is not short term capital asset and a short term capital asset is defined as one that is held for not more than thirty six months.

Just imagine an asset held for three years will one day become long term and the one held for two years and 364 days will become short term resulting in two different consequences under the Act.

Recently the Finance Act (2005) has eliminated the deduction that was allowed to people having salary income as 'Standard Deduction' under Section 16 of the Income Tax Act, 1961. The idea originally indicated was that instead of expenditure on books, travelling for purpose of employment and other expenses incidental to employment, for which details have to be examined, the Standard Deduction was introduced. Now suddenly the said Standard Deduction is eliminated in the case of salaried people and the reason given is increase in the general exemption limit and substantial broadening of income slabs. Is it logical to ignore such expenditure incurred by the salaried people on such grounds?

Moreover, the benefit that is being referred to, if any, is available to all assessees having income under other heads also. So how can it be used as argument to eliminate Standard Deduction? Is it not a clear case of discrimination?

Another glaring example is the provision relating to Minimum Alternate Tax under Section 115J, 115JA etc. The law on the one hand gives incentives by allowing deductions in computing the total income and on the other hand levies tax based on book profits. The logic being that corporations are distributing income which is not charged to tax in the hands of company. The argument is that the number of zero tax companies or companies paying marginal tax is growing and the Department's studies show that in spite of such companies having earned substantial book profits and having paid handsome dividends, no tax has been paid by them to the exchequer. Does this sound logical? What is given by one hand is sought to be taken away by another. Then why give such large deductions? Is there any better way to make law more and more complicated?

Instances of this type of illogical provisions can be multiplied. The government, which is trying to redraft the entire Income Tax Act to make it more simple, should eliminate such illogical provisions from the Act. The basis of the Income Tax should be to tax the real income of a person, so that the person is induced to remain honest. Artificial and deeming provisions should as far as possible be avoided, which itself will make the law very simple. So also major portion of sections dealing with tax deducted at source, which involve colossal waste of paper and no corresponding benefit.

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Last but not the least is the need for a provision under which the officers are made accountable to the higher authorities and also empower the Appellate Authorities to impose fine or penalty when they find that unsustainable decisions have been taken by the lower uthorities. It is only then that the administration will also be more responsive and realistic in its approach for assessment. There are instances when Courts/ Tribunals have directed some compensation or penalty in the cases of the type mentioned hereinabove. ❐