CHAPTER I

HISTORICAL AND INTRODUCTORY

Income-tax in its modern form was introduced in India for the first time in 1860 to overcome the financial difficulties which followed the events of 1857. The period between 1860 and 1886 saw a series of experiments in the field of direct taxation, alternating between income-tax proper, and a licence tax on trades and professions, akin to the indigenous Mohturja and Veasabuddy. The final form of the tax was settled in 1886 in favour of the former, and the first systematic legislation on income-tax was enacted in the same year.

2. In the last 70 years or so, the structure of the tax has undergone a series of changes. While the principal factor responsible for changes has been the need for additional revenues, other factors such as changing economic conditions, judicial decisions, and the proposals made by a number of Enquiry Committees have also played their part in shaping the structure of income-tax. It may be added that, in the process of its assimilation to Indian conditions, the tax acquired distinctive characteristics as evidenced by the treatment of agricultural income and of the income of the Hindu undivided family, and by developments in the sphere of taxation of corporate income.

3. Today income-tax is a major source of revenue and one in which not only the Central Government but also the State Governments are vitally interested. Its importance is also likely to grow in future. We propose to give in this chapter a brief review of the historical development of its main features and its role as one of the principal sources of revenue. This, we think, will help to provide the necessary background for a proper appreciation of the main problems arising from the present working of the income-tax system.

4. The following are the main heads under which we propose to deal with the historical development of the various facets of income-tax legislation and administration:—

(1) the 'base', i.e., the net taxable income to which the charge is applied;

(2) the charge or the rate of income-tax;

(3) taxation of special entities, and corporations including insurance concerns;

(4) special aspects of the tax:
   (i) special forms of income taxation;
   (ii) division of proceeds of the tax between the Central Government and the State Governments;

(5) administrative problems including evasion and avoidance of the tax; and

(6) statistical trends.

317 MofP—1
5. The Income-tax Act, 1886, levied a tax on income accruing or arising to or received by a resident in India and income accruing to or received by a non-resident through an agent in India. The terms 'resident' and 'non-resident' were not defined in the law and were largely interpreted on the analogy of the decisions of the courts of law in the United Kingdom. The foreign income of a resident was brought to charge on the 'remittance' basis for the first time in 1922 in respect of income accruing and arising outside (British) India under the head 'business'. With effect from 1st April 1933, the basis was widened to apply to income from all sources. In 1939, as a result of the recommendations of the Income-tax Enquiry Committee, 1936, the entire income of a resident, whether accruing in (British) India or outside, became chargeable to tax. The remittance basis, therefore, faded into the background except for its applicability to persons 'resident but not ordinarily resident' and to a small portion of the foreign income of resident and ordinarily resident persons in some instances. The liability of non-residents to tax on income deemed to accrue or arise in India through business connection was amplified to cover income arising through certain other activities also. At the same time, resident, non-resident and not ordinarily resident persons were, for the first time, defined in the law on the analogy of the recommendations made by the United Kingdom Income-tax Codification Committee presented to the British Parliament in April 1936.

6. The following factors were responsible for the changes that were introduced, from time to time, in the law relating to the basis of liability to tax:—

(i) the desire to bring more income into the tax net with a view to increasing the yield;

(ii) considerations of equity as affecting different persons;

(iii) preferential treatment accorded to European business community and European civil servants; and

(iv) the existence within the country of different governmental units in the shape of the former Indian States.

7. The political changes in the last decade, the special problems facing capital-importing countries and the evolution of steeply progressive rate structures in almost all countries leading to demands for double income-tax avoidance or relief arrangements make it necessary that the main features of the present law relating to the basis of liability to income-tax should be reviewed. We have attempted this review, in broad terms, in Chapter II of the present Volume.

8. Certain types of income are either specifically saved from or are made chargeable to tax in the law itself. Agricultural income is an example of the former type and certain forms of distribution by companies, which the courts have declared to be of a capital nature, but which are made chargeable under the law, are examples of the latter type. In view of the difficulty of defining income precisely, the determination of what constitutes income is a rich field for controversy. We have discussed the subject at length in Chapter III of the present Volume.
9. The present treatment of income from agriculture is a unique feature of the Indian income-tax system. Agricultural income was subject to income-tax in the legislation introduced in 1860. Since 1886, however, successive Income-tax Acts have excluded agricultural income from their scope. The principal reason for making this distinction appears to have been the existence of a local rate or land revenue whose incidence was of comparable magnitude with, or higher than, that of the very low rates of income-tax levied in the beginning. A definition of agricultural income was inserted in the Act of 1886 which, except for minor changes, has remained substantially in the same form. The Government of India Act, 1935, made the taxation of agricultural income a provincial subject and this position has been maintained in the Constitution of India. Taxes on agricultural income are now levied in several Part A and Part B States. Although the absolute exemption of agricultural income from income taxation has been rescinded by the constitutional provisions referred to above, its exclusion from the total income detracts from the operation of the principle of ability to pay as applicable to different classes of income earners in the country. We have discussed the problems arising from this dichotomy in the chargeable income in Chapter V of Volume III relating to State Taxes.

10. A commonly accepted feature of income is that it should be received with some degree of regularity. An exception to this rule was, however, introduced in India as early as in 1918. Section 3 (2) (viii) of the income-tax Act of that year brought under charge receipts of a casual or non-recurring nature which arose from business or from the exercise of a profession, vocation or occupation or were by way of addition to the remuneration of an employee. Another important variation of the concept of regularity in this country was the taxation of capital gains arising between 1st April 1946 and 31st March 1948 on the consideration that such receipts increase ability to pay. The treatment of what have been termed as irregular incomes and lump sum receipts has been discussed by us in Chapter III.

11. As income-tax is a recurring annual impost, an assessee has to pay tax on the income relating to successive and definite periods, usually of twelve months each. The criteria laid down for determining these periods have changed from time to time. Under the Income-tax Act of 1886, salaries and interest on securities were to be assessed on the basis of the income of the year of assessment, while profits of companies and income from other sources were to be assessed on the income of the "previous year". Under the Act of 1918, the year of assessment became the basis in respect of all sources of income; a provisional assessment had first to be made on the income of the preceding year, and this was adjusted subsequently after the income of the year of assessment was finally ascertained. This system was given up in 1922, and the procedure was simplified by basing each year's assessment on the income of the "previous year". These provisions have continued to remain in force since then with some minor modifications, the most important change being that an assessee can choose different periods as his "previous year" for different sources of income.
12. From the very beginning, income-tax in India has been a charge on net income. No specific provision existed before 1918 for computing net income. The deductions were regulated on the basis of executive instructions. The following criterion laid down by the Bombay Government (when income-tax was administered by Provincial Governments) for computing net income is of interest:——

"(Net profits are) that portion of gross earnings in the year of assessment which remains at the disposal of the company after paying all charges necessarily incurred in effecting those earnings and in providing against destruction of capital from which those earnings are derived".⁴

13. A specific provision was inserted in the law in 1918 to regulate the admissibility of business deductions. After enumerating broad items of expenses, both as regards their nature and the extent to which they were admissible, the law prescribed a general test for the admissibility of other items. It was worded as "expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits".† This test continued until 1939 when it was replaced by the present clause (xv) of sub-section (2) of section 10 of the Income-tax Act practically in the same form as it exists today. A general test of this nature naturally furnishes a field for controversy and a number of suggestions regarding the admissibility of individual items have been made to us, which we discuss in Chapter IV of this Volume.

14. We may refer here briefly to the history of the law on depreciation in India as this item of admissible deduction is of special significance. There was no specific provision for deduction on account of depreciation in the Act of 1886. Depreciation was allowed under executive orders issued by the Government of India or by the Local Governments. The following are two specimen orders of this kind:——

(i) a deduction of five per cent. of the cost in respect of depreciation in the case of machinery. No separate charges for repairs and renewals of machinery were to be allowed;‡
(ii) a deduction of two and a half per cent. in respect of depreciation of buildings which housed heavy machinery instead of the actual cost of repairs and maintenance. The allowance was permissible in respect of the actual mill premises and not bungalows, chawls and other subsidiary premises. In the case of the latter class of buildings, the actual amount of expenditure on repairs, up to a maximum of ten per cent. of the annual rental valuation, was to be allowed.§

The orders issued by the Local Governments were by no means comprehensive or uniform. The Income-tax Act of 1918 for the first time took stock of this nebulous position and introduced in the

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⁴G.R.F.D. No. 1796 of 24th June 1886.
†Section 9(2)(ix) of the Indian Income-tax Act, 1918.
‡G. I. F. & C. No. 399 of 27th January 1887.
§G. I. No. 246-F of 18th January 1912.
statute itself provision for allowances for depreciation. Accordingly, section 9(2) (vi) of that Act provided for the depreciation allowance on the straight-line method. The rate of depreciation for any year was not to exceed a percentage of the original cost of the asset in question, which was to be fixed, subject to the approval of the Governor-General in Council, by the Local Governments for different assets having regard to the estimated life thereof. The cost of current repairs was separately allowable under section 9(2) (v) of the Income-tax Act, 1918.

15. The rates of depreciation were laid down statutorily for the first time by rules made under the Income-tax Act, 1922. They were revised in 1939 when the written down value method was substituted for the straight-line method of charging depreciation.

16. During the last decade or so, the law in respect of depreciation has been amplified from time to time taking into consideration the special problems facing business and industry. Special depreciation allowance was provided from 1940-41 for plant and machinery which were used for double and triple shifts. An initial allowance of 20 per cent. in respect of new plant and machinery installed after 31st March 1945, and an additional allowance equal to the normal allowance available for a period of five years in respect of new plant and machinery installed after 31st March 1948; were also introduced in order to encourage investment in fixed assets in the post-war period. The aggregate of all the allowances mentioned above was, however, not to exceed 100 per cent. of the original cost of the asset.

17. Representatives of the business community, who appeared before us, have questioned the validity of determining depreciation allowances on the basis of 'original cost', a subject which is now a matter of world-wide controversy round which a large mass of special literature has grown up. In Chapter V, we have discussed briefly the various aspects of this issue, more especially in relation to the practical necessities of the case as revealed by our survey of the finances of the public limited companies.

18. Closely allied to the subject of depreciation is the concept of depletion as applicable to wasting assets particularly to assets in the mineral industries. As mining is an important factor in industrial development, we have given special attention in Chapter VI of this Volume to the problems that have been raised before us by the various mining interests and the Ministry of Natural Resources and Scientific Research.

19. Before 1922, losses were not allowed as a set-off against income. The Income-tax Act, 1922, provided for the set-off of a loss from one source against income from other sources in the same year. The Income-tax (Amendment) Act, 1939, went a step further in this direction and permitted carry-forward of unabsorbed business losses for a period of six years. The carried forward loss, however, could be set off only against the profits of the same business. By an amendment made in 1953, a further restriction has been imposed to the effect that losses arising from transactions of a speculative nature can, even during the year of assessment, only be set-off against profits of the same business. Losses are an important factor for determining net income and we
have discussed in Chapter IV the many issues brought to our notice
in this connection.

20. Exemptions, credits and abatements are given to reduce tax
liability under special circumstances or for
special categories of assesses. They are of two-

types: (i) those that reduce the base of the tax to which the rate
is applied and (ii) those that have the effect of moderating the rate-
itself. We deal with the more important exemptions of category (i)
at this stage and those that figure at (ii) above will be discussed
in paragraphs 33—36.

21. Sub-section (3) of section 4 of the Income-tax Act details the
specific items of income that are to be excluded altogether from
'income'. The rest of the exemptions are interspersed all over the
Act or are provided for in notifications issued under section 60. The
power of granting exemptions by notification was taken away from
the executive in 1939 so that each exemption has now to be speci-
paratively approved by the Parliament. Exemptions take many forms
such as:

(a) income which is excluded from total income altogether,
\textit{e.g.}, income of certain public religious and charitable
institutions, agricultural income, yield of Post Office
cash certificates, the privy purses of the rulers of the
former Indian States;

(b) income excluded from total income for super-tax but
included for income-tax, \textit{e.g.}, the amount of income
which a partner of an unregistered firm or a member of
an association of persons is entitled to receive where the
unregistered firm or the association of persons has paid
super-tax;

(c) income included in total income but exempt both from
income-tax and super-tax, \textit{e.g.}, the business profits of
any co-operative society or the dividends or other pay-
ments received by members of such a society out of
such profits;

(d) income included in total income but exempt from income-
tax though not from super-tax, \textit{e.g.}, the amount of
income which a partner of an unregistered firm or a
member of an association of persons is entitled to
receive where the unregistered firm or association of
persons has paid income-tax but not super-tax;

(e) income included in total income and subject to income-
tax but not to super-tax, \textit{e.g.}, dividend income of
investment-trust companies.

22. We discuss below the evolution of the more important items
of exemptions which are at present included in the Indian Income-
tax:

(i) business income of co-operative societies;
(ii) income of certain public religious and charitable trusts;
(iii) income of local authorities;
(iv) certain exemptions on political grounds.
23. The exemption in favour of co-operative societies has been in existence since 1904, when the Co-operative Credit Societies Act was passed. At present, the business profits of co-operative societies are exempt from tax but are to be taken into account for determining the rate of income-tax on their other income. For super-tax the exclusion is complete. The rates of super-tax on co-operative societies are also substantially lower than those on personal incomes. At present, co-operative societies are charged super-tax at a flat rate of 25 annas in the rupee plus three pies surcharge, on that portion of their income which is in excess of Rs. 25,000. Dividends distributed by co-operative societies out of exempt profits are not taxable in the hands of their members, but are to be included for determining the rate of tax on their income. The grant of exemption appears to have been based partly on the principle of mutuality and partly on the policy of promoting thrift and self-help. Co-operative societies are likely to play a more active part than hitherto in promoting savings in rural areas. The Five Year Plan has also drawn attention to the various ways in which co-operative societies can be useful for promoting economic advancement in the rural sector, particularly in the sphere of agriculture and small-scale industries.

24. The exemption from taxation of income derived by religious and charitable trusts from property held under trust or under other legal obligation, and from voluntary contributions is among the oldest exemptions in the Indian tax system. The business income of such organisations is also exempt if certain conditions are fulfilled. As the law now stands, the benefit of exemption is subject to certain restrictions, the most important of which is that the income must be applied to religious or charitable objects relating to anything done in the taxable territories.

25. Various suggestions, which have been put forward before us for the modification of the exemptions in favour of these two types of organisations, will be dealt with in Chapter VIII.

26. Another exemption which deserves mention is that in favour of local authorities. The entire income of local authorities was being treated as exempt even from 1886, and the Income-tax Acts of 1918 and 1922 placed the exemption on a statutory footing. Pursuant to a recommendation of the Income-tax Enquiry Committee, 1936, the scope of the exemption was restricted by the Income-tax (Amendment) Act of 1939; as the law now stands, income arising to a local authority from business is liable to tax, except where the business consists of the supply of a service or commodity within its own jurisdictional area. On its taxable income, a local authority pays income-tax at a flat rate of four annas in the rupee plus five per cent. surcharge, and super-tax at two and a half annas in the rupee plus three pies surcharge without any exemption limits.

27. The rulers of the former Indian States enjoyed exemption under the Income-tax Act until 1953 from income-tax and super-tax on interest on Government securities held by them or on their behalf as their private property. But this exemption has now been discontinued. Article
291 (1) (b) of the Constitution of India has exempted the taxation of
the privy purse granted to ex-rulers of Indian States only where the
privy purse has been guaranteed or assured under an agreement
entered into before the commencement of the Constitution. This
exemption has since been incorporated in the Indian Income-tax Act.
As further instances of exemptions given on political considerations
may be mentioned the exemptions granted to diplomatic and consular
representatives and (in certain circumstances) to members of their
staff and to employees of international organisations.

28. We shall now refer to the evolution of the rate structure
applicable to personal incomes. Under the
Changes in personal
rate structure
Income-tax Act of 1886, income-tax was being
levied on income from four different ‘classes’ of
income and the concept of basing liability to tax on the total income
of a tax-payer was introduced only in 1918.

29. Graduation in the rates of income-tax which existed before
1916 was only nominal as a standard rate of five
Graduation
peeis on a rupee was applicable to all incomes
above Rs. 2,000. Graduation in the real sense of the term was
introduced in 1916, when eight different rates of tax were laid down
for incomes in different brackets.

30. Before 1939, income-tax was being levied at ‘step’ rates and
super-tax at ‘slab’ rates. A change-over for income-tax from the
‘step’ system to the ‘slab’ system was introduced in 1939, as a result
In both systems, progressively increasing rates of tax are laid down
for different income brackets. Under the ‘step’ system, all persons
in a particular income bracket bear the same effective rate on every
rupee of their income; under the ‘slab’ system, however, the taxes on
each slab are calculated separately and then added up.

31. Since 1939, further graduation for income-tax has been effect-
The ‘slabs’
ively by introducing a tax free slice of Rs. 1,500
followed by progressively increasing rates of
income-tax and super-tax on successive slabs of income. The slabs
for income-tax have remained the same ever since 1939 and the
changes have been confined to variations in the rates applicable to
the slabs. However, for super-tax purposes there have been changes
both in the number of slabs and the range of each slab, and the rates
of tax applicable to different slabs have also been varied.

32. The Indian tax system has always attempted to keep the
Exemption limits
income of tax on the lower income groups
at a relatively low level. Persons whose total
income was below Rs. 2,000 were exempt from taxation from 1922 to
1947 (except in certain years when ‘lower’ incomes, e.g., exceeding
Rs. 1,000 or Rs. 1,500 were subjected to tax). Since 1947, the
exemption limit has been gradually raised, and is now Rs. 4,200 for
individuals and twice this amount for Hindu undivided families
satisfying certain conditions.

33. Exemptions and abatements moderate, to some extent, the
Exemptions and
incidence of higher progressive rates for parti-
abatements
cular types of assesses and may also be used
in order to encourage any desirable social and
economic objectives with which the concession is linked. Life
insurance premia paid by an assesse on policies on his own life or on that of his wife, have been exempt in India since 1886; similar exemption has been available since 1918, to contributions to provident funds governed by the Provident Funds Act. The total amount enjoying exemption in respect of these items is subject to a maximum of one-sixth of the total income, a monetary limit of Rs. 6,000 (Rs. 12,000 for Hindu undivided families) being added in 1939. The exemption now takes the form of a rebate of income-tax (but not of super-tax) at the average rate of tax applicable to the total income of an assesse.

34. The introduction of the principle of differentiation between earned income and unearned income is another interesting development in the history of Indian income-tax. The differentiation was effected in two different ways. For income-tax purposes, the assesse was allowed to exclude from his income a fixed proportion subject to a maximum limit. This scheme was introduced in 1945 and has continued ever since with changes in the amount of exemption granted from time to time. For super-tax purposes, the method adopted was to levy tax on the earned income at lower rates than on unearned income. The latter differentiation was, however, short-lived, the rates of super-tax on earned as well as unearned incomes being uniform at present.

35. Another allowance, introduced in 1948, was an abatement in respect of voluntary donations to approved religious and charitable institutions. The abatement is at present at the average rate of income-tax and super-tax applicable to an assesse (but not exceeding a total of 8 annas in the rupee), and applies to donations of not less than Rs. 250 or not more than Rs. 1 lakh in a year, and not exceeding five per cent. of the assesse’s income.

36. The present structure does not take into account fully the personal circumstances of assessees. The role of family allowances, which is a feature of the income-tax structure of many countries, is sought to be filled in India by a tax-free slab available to all assessees. The slab is supposed to represent the minimum subsistence needs of an average family.

37. The exemption limits and rates of tax for Hindu undivided families, unregistered firms and other associations of persons were the same as for individuals from 1939-40 to 1948-49, the higher exemption limit for super-tax, which was previously available for a Hindu undivided family, having been given up during this period. Subsequently, however, they were given a higher exemption limit for income-tax, in partial implementation of a recommendation of the Income-tax Investigation Commission. Thus, for 1949-50 the exemption limit for a Hindu undivided family with two or more members was fixed at Rs. 5,000 as against Rs. 3,000 for individuals, and from 1950-51 the exemption limit for a Hindu undivided family has been twice that for individuals.

38. There have been some significant changes since 1928 in the rates of tax applicable to non-residents. Prior to that year, such rates depended only on the income of the non-resident which was liable to tax in India. The law was amended in 1928 so as to withhold the grant of refund on
company dividends and interest on securities from non-residents; this amendment was intended to bring the law into conformity with that prevailing in the U.K. An exception was, however, made in favour of non-residents who were British subjects or subjects of an Indian State; their personal rates of tax were to be calculated as if their income accruing in all countries arose in India and refund was to be allowed with reference to this rate. The principle underlying this differentiation was extended in 1939 to the taxation of all income of non-residents. Non-resident British subjects and subjects of Indian States were to be taxed at the rates applicable to their 'total world incomes', and other non-residents were to be charged to income-tax at the maximum rates and to super-tax at the rates appropriate to their total world income. After India became a Republic, the distinction between different classes of non-residents was abolished. An amendment inserted by the Finance Act of 1951 (which is still in force) provides that all non-residents are to be charged to income-tax at the maximum rate, and to super-tax on their total income at the rate applicable to the lowest slab for super-tax or at a rate appropriate to their total income, whichever is higher. The assessee is, however, given the option of being charged to tax on his total (Indian) income at the rate appropriate to his total world income. The option once exercised is binding on him for the future.

39. A number of representations have been made in regard to the rate structure, some in the direction of stiffening it, others in that of liberalising it. The considerations which arise relate not only to revenue, but also to social policy, and effect on savings and investment. We have already stated our general approach to this question in Volume I of our Report. Our detailed recommendations regarding the rate structure and the justification for them form the subject matter of Chapter IX of this Volume.

40. Companies have all along been treated as distinct taxable entities. In 1886, the net profits of a company were taxed at a flat rate. In 1916, an element of graduation was introduced by exempting from tax companies with an income of less than Rs. 1,000. Companies were made liable to super-tax, from 1917, on incomes exceeding Rs. 50,000. The amount paid or declared for payment by way of dividend was allowed to be deducted before super-tax was charged. The dividends were, however, assessed to super-tax in the hands of the shareholders. The taxation of undistributed profits to super-tax was considered by the Select Committee on the Super-tax Bill of 1917 “to operate harshly on those companies which had adopted the perfectly sound method of devoting a considerable portion of such undivided profits to creating a reserve fund....... We agree that there is a good deal to be said for this point of view, especially in India where commercial enterprises need careful nursing......”. The point was, however, not pressed as the Finance Member was willing to agree to an alternative provision allowing a deduction from taxable income of ten per cent. of the income chargeable under the Income-tax Act. This position was modified by the Super-tax Act, 1920, under which companies were to be charged to super-tax on both the distributed and undistributed profits at a flat rate of one anna in the rupee on that part of their income which was in excess of Rs. 50,000. Dividends were to be charged to super-tax in the hands of the shareholders.
41. The Income-tax Act of 1918 introduced a new provision for including dividends received by a shareholder in his total income for the purposes of determining the rate of tax on his other income; the dividends, however, continued to be exempt from tax in the shareholders' hands.

42. The Income-tax Act of 1922, which consolidated the law relating both to income-tax and super-tax, provided for credit to the shareholders for the income-tax (but not for the super-tax) paid by the company. The dividends were to be included in the shareholders' total income at a 'grossed' figure which included the proportionate income-tax paid thereon by the company and the shareholders were entitled to a refund on the gross dividend calculated at the difference between the company rate of tax and the personal rate of income-tax applicable to them.

43. In 1939, an important modification was introduced in the method of taxing companies in that the exemption of the first Rs. 50,000 of the income was given up and they were made liable to super-tax on every rupee of their income in the same way as for income-tax. In 1948, however, a principle of differentiation in favour of smaller companies by levying income-tax of only 24 annas in the rupee on Indian companies with total income not exceeding Rs. 25,000 as against five annas in the rupee on other companies was introduced. Since 1949 this differentiation has taken the shape of an additional rebate of one anna in super-tax to companies whose total income does not exceed Rs. 25,000.

44. The Income-tax (Amendment) Act, 1939, also introduced a modification in the method of taxing dividends in the assessment of shareholders. The gross dividends were made taxable in the hands of the shareholder at the rate applicable to his personal income. At the same time, he was allowed a credit in his assessment equal to the proportionate income-tax paid by the company on such dividends.

45. There was a continuous rise in the rates of income-tax and super-tax on companies until 1944-45. In 1944-45, Government felt that some relief was necessary in order to enable companies to build up larger resources for purposes of post-war rehabilitation and expansion of industry. The Finance Acts of 1944 and 1945 provided for a rebate of super-tax of one anna in the rupee on the total income of a company as diminished by dividends declared on equity shares. In 1946, the differentiation between distributed and undistributed profits took the shape of an additional super-tax on companies which distributed dividends exceeding both five per cent. of the capital of the company and 30 per cent. of the total income. This additional super-tax was at graded rates progressing from two annas to seven annas in the rupee. In 1948, this method, which operated in the form of a penalty for excessive dividends, was replaced by a rebate of income-tax at the rate of one anna in the rupee on the amount by which the disposable income of a company (i.e., its total income as reduced by seven annas in the rupee) exceeded the dividends declared. When profits which had been retained in one year and had attracted rebate were distributed in the subsequent year additional tax had to be paid on such distribution at a rate equal to the difference between five annas and the rebate already granted. This method still continues in operation. A number of questions, however, have been raised in regard to taxation of companies by witnesses who...
appeared before us. These and other relevant issues are dealt with by us in Chapter X of this Volume.

46. A feature of the taxation of companies is the set of provisions prescribing compulsory distribution of a specified proportion of the profits of the companies in which the public are not substantially interested. The amending legislation was first enacted in 1930 in view of a series of instances that came to the notice of the Government in which the distribution of profits was being withheld in order to escape liability to super-tax and the profits were being subsequently withdrawn as 'loans' etc., free of interest. The provisions followed closely the U.K. law on the subject. It was prescribed that if a company, which was under the control of not more than five members, had failed to distribute a reasonable proportion of its profits having regard to its existing and contingent business needs, the Income-tax Officer was authorised, with the previous approval of the Assistant Commissioner of Income-tax, to treat the company as if it were a partnership. The additional demand raised under this provision was, however, recoverable from the company and not from the shareholders. As the criterion of 'reasonable needs' was found to be difficult of application in practice, the provision was amended in 1939 on the recommendations of the Income-tax Enquiry Committee, 1936, so as to require companies in which the public was not substantially interested to distribute 60 per cent. of their profits less tax as dividends; the proportion could be raised to 100 per cent. in certain circumstances. If a company failed to distribute the necessary portion of its profits, the Income-tax Officer could make an order deeming the balance to have been distributed as dividends, and recover tax thereon at the rates appropriate to the personal incomes of the shareholders, either from the shareholders themselves, or, if this was not possible, from the company. The rationale and the working of this provision are a subject of sufficient importance to merit an exhaustive discussion of the various issues raised before us which we have attempted in Chapter XI of this Volume.

47. Before 1918, the income-tax law did not contain any special provisions for the determination of the profits of life insurance business. The procedure of calculating these profits on the basis of the annual average of the surplus disclosed by the actuarial valuation was evolved departmentally to suit the special features of insurance as a business. This practice was given statutory recognition under the Acts of 1918 and 1922, both of which empowered the rule-making authority to make rules laying down the method of determining the profits of insurance business. The rules, which were made, provided for the calculation of profits on the basis of the annual average of the valuation surplus, and for the refund of tax deducted in excess from interest on investments. The profits of mutual life insurance companies were treated as being exempt from taxation, on the basis of judicial decisions. The profits of other forms of insurance business were to be calculated on the basis of the company's accounts, and allowance was to be made for a reserve for unexpired risks and for additional reserves made by the company.

48. The method of assessing the profits of life insurance companies was completely revised by the Income-tax (Amendment) Act, 1939,
The present method will be discussed in Chapter VIII. In the same chapter we shall also discuss the case for lower rates of taxation for insurance companies as compared to other companies.

49. An Excess Profits Duty was levied for the first time in 1919, and was in force only for one year. This form of income-taxation was, however, exploited more fully during the second World War. The Excess Profits Tax, which was introduced in 1940, applied to profits earned during the period from 1st September 1939 to 31st March 1946 by all businesses and professions, except (a) life insurance business, (b) professions where the earning of profits depended mainly on personal qualifications, (c) profits assessable only on the remittance basis and, (d) profits arising in Indian States after 31st March 1942. For each accounting year falling within the above years, a 'standard profit' had to be calculated. For the profits of the period between 1st September 1939 and 31st March 1941, excess profits tax was levied at the rate of 50 per cent. on the excess over the standard profits while a rate of 66 2/3 per cent. was applied on such excess during the period 1st April 1941 to 31st March 1946. If the profits of the accounting year were less than the standard profits, the consequential 'deficiency' of profits could be carried backwards or forwards. The excess profits tax was to be deducted in computing the assessee's income liable to income-tax and super-tax.

50. A deposit scheme was introduced in 1942 and was made compulsory from 1st January 1943 onwards. In addition to the excess profits tax payable by them, the assessees had to deposit an additional amount equal to certain prescribed percentages of the excess profits tax. These deposits were repayable after the termination of the War and one-tenth of the excess profits tax was also to be refunded to the assessees.

51. The excess profits tax charged and collections made during each of the years from 1940-41 to 1950-51 are shown in the following table:

<table>
<thead>
<tr>
<th>Year ending</th>
<th>Excess Profits Tax charged during the year (Figures are in lakhs of Rupees)</th>
<th>Collections made during the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-3-1941</td>
<td>56</td>
<td>54</td>
</tr>
<tr>
<td>31-3-1942</td>
<td>9,22</td>
<td>7,85</td>
</tr>
<tr>
<td>31-3-1943</td>
<td>26,21</td>
<td>30,78</td>
</tr>
<tr>
<td>31-3-1944</td>
<td>68,07</td>
<td>65,30</td>
</tr>
<tr>
<td>31-3-1945</td>
<td>1,14,00</td>
<td>1,02,15</td>
</tr>
<tr>
<td>31-3-1946</td>
<td>1,01,34</td>
<td>88,31</td>
</tr>
<tr>
<td>31-3-1947</td>
<td>94,48</td>
<td>75,76</td>
</tr>
<tr>
<td>31-3-1948</td>
<td>37,09</td>
<td>21,49</td>
</tr>
<tr>
<td>31-3-1949</td>
<td>35,39</td>
<td>28,49</td>
</tr>
<tr>
<td>31-3-1950</td>
<td>13,22</td>
<td>7,54</td>
</tr>
<tr>
<td>31-3-1951</td>
<td>13,27</td>
<td>8,12</td>
</tr>
</tbody>
</table>
The tax was abolished in 1946 and there has been no attempt since then to revive it.

52. With the discontinuance of the Excess Profits Tax in 1946, however, a ‘Business Profits Tax’ calculated in a simpler manner than the excess profits tax was levied on profits earned by businesses from 1st April 1946 to 31st March 1949. This tax was imposed as an anti-inflationary measure. The types of business and profits subject to this tax were the same as for the excess profits tax, only the excess of the profits over a standard figure called the ‘abatement’ being chargeable to the tax. The abatement for companies was six per cent. of the working capital subject to a minimum of Rs. 1 lakh per annum up to 31st March 1947 and Rs. 2 lakhs per annum subsequently. For other assesses, the abatement was Rs. 1 lakh per annum up to 31st March 1947 and Rs. 2 lakhs per annum subsequently. The tax was levied at the rate of 16½ per cent. of the amount of excess profits over the abatement up to 31st March 1947 and ten per cent. thereafter. The business profits tax, like the excess profits tax, was an admissible deduction for determining an assesse’s income chargeable to income-tax and super-tax. This tax was abolished in 1949 and there has been no proposal to revive it since then.

Our views regarding the future use of special business taxes of the type mentioned above are contained in Chapter VIII of Volume I of the Report.

53. Income-tax is one of the most elastic sources of revenue, and although the administration and collection of the tax is now Central, a part of the proceeds go into a divisible pool and are made available to State Governments. Accordingly, the tax plays an important role not only in the finances of the Central Government but also of the State Governments.

54. Before 1919, income-tax was a ‘divided head’ of revenue, but the proportion of the various divided heads of revenue which was retained by the Central Government varied from province to province. A complete separation between Central and provincial finances followed the Montague-Chelmsford Reforms; income-tax then became a part of the revenues of the Central Government. Even at that stage, however, a beginning was made, through Devolution Rules 14 and 15, in the direction of assigning a portion of income-tax to the provinces. Each province was to receive three pies in the rupee of the amount by which the assessed income of any year exceeded that of the year 1920-21; some ad hoc adjustments were made on account of the fact that certain large industrial units had their manufacturing organisations in a province different from the province in which they were assessed.

55. This scheme of allocation continued until after the Government of India Act, 1935 came into operation. The Taxation Enquiry

*A higher abatement was admissible in some cases, as follows :

To firms with three working partners . . . . Rs. 1½ lakhs.
To firms with four or more working partners and to a Hindu undivided family . . . . . . . . . . . . . . . Rs. 2 lakhs.
Committee of 1924-25 had expressed the view that, if any division of taxes was to be made between the Centre and the provinces, the choice of income-tax as the main balancing factor was inevitable.

56. The Government of India Act, 1935, provided for assignment to provinces of a part of the net proceeds of central taxes on income after excluding therefrom the proceeds of corporation tax, income-tax and super-tax from Chief Commissioners' provinces and on federal emoluments, and after deducting the cost of collection; a surcharge could, however, be imposed wholly for federal purposes. The proportion of the total yield of income-tax to be assigned to the provinces was fixed at 50 per cent. on the recommendation of Sir Otto Niemeyer; the share of each province being calculated in an ad hoc manner on a variety of considerations. The percentages so fixed were given statutory recognition through an Order-in-Council, and distribution on this basis continued to be operative till 15th August 1947. As a consequence of Partition, the award of Sir Otto Niemeyer was reviewed by Shri C. D. Deshmukh and the revised percentages became effective from 1st April 1950.

57. The Constitution of India has, in Article 270, prescribed the procedure to be followed regarding the division of the revenue from taxes on income between the Central Government and the State Governments. Corporation tax is, however, excluded in terms of the Constitution from the definition of taxes on income and is therefore not divisible. The proportion of revenue to be assigned to the State Governments, and the allocation of this amount among them is to be decided on the recommendations of a Finance Commission to be appointed once in five years. The first Finance Commission so set up reported in December 1952. The Commission had to consider various conflicting suggestions regarding the criteria to be adopted for allocation such as the collection of income-tax in each State, or the collection adjusted with reference to the residence of the individuals paying tax or the origin of the income, the population of each State, the per capita income in each State, and the needs of each State for finances. The recommendations made by the Commission were based on the formula of distributing twenty per cent. of the States' share of the divisible pool according to collections in each State, and 80 per cent. according to population. These recommendations were given effect to by an Order of the President and 55 per cent. of the net divisible pool, is distributable among States in the proportions specified in the Order with effect from 1952-53.

58. We have given these details in order to underline the importance of income-tax from the point of view of both the Central Government and the State Governments. State Governments have thus specific interest in the working of the income-tax system. Their full co-operation is needed, especially in regard to the collection of arrears, which work is entrusted to the State administrative machinery.

59. We have so far discussed the growth of the various concepts which have been built into our income-tax system and have gone to mould the rate structure. We shall now briefly review the growth of the administrative machinery employed for assessing and collecting the tax. In the earlier days, the assessment and collection of
income-tax formed only one of the multifarious duties of the land revenue departments in the provinces. The need for specialised personnel for this work was realised only when its contribution to revenue became substantial; and a Central Department meant exclusively for income-tax administration was created in 1922. Since then, the administrative framework of the income-tax system has not undergone any substantial alteration. The present structure of the Income-tax Department consists of a Central Board of Revenue at the top, with Commissioners of Income-tax posted on a regional basis who are in turn assisted by Inspecting Assistant Commissioners of Income-tax. Assessment is made by an Income-tax Officer whose work is supervised by the Inspecting Assistant Commissioner and the Commissioner of Income-tax. The appeals from his orders are heard, in the first instance, by an Appellate Assistant Commissioner who, though he is under the administrative control of the Central Board of Revenue, is ensured under the Act independence in regard to his appellate functions.

60. The procedure for the reporting of income by assesses has undergone a process of gradual evolution. The Income-tax Act of 1886 laid an obligation only on companies to file every year statements of their net income and it was entirely within the discretion of the Collector to devise means for finding out other persons likely to have taxable income and to adopt the appropriate method of determining their income. The Act of 1918 prescribed a more elaborate form of return to be filled in by companies, and required the Collector to send notices calling for a return of income to other assesses believed to have incomes of over Rs. 2,000 per annum. Since 1939, a statutory obligation has been laid on assesses having taxable income to file voluntary returns of their income although individual notices still continue to be sent.

61. The methods of determining a person's income and the tax payable by him have gradually become more and more elaborate. Under the Act of 1886, the procedure for assessment was summary, and the Collector could intimate the amount of income and tax determined by him to the assessee either through a list published in his office or through an individual notice; normally, individual notices had to be sent to assesses whose income was over Rs. 2,000 per annum, but the Collector had considerable discretion in the matter.

62. Companies and other persons could also enter into an agreement with the Collector for composition of the tax for a number of years at an agreed annual amount.

63. The Act of 1918 required the Collector, when he was not satisfied that an assessee's return was correct and complete, to give him an opportunity to produce his accounts and evidence. With increasing rates of tax and with successive changes in the law, an elaborate procedure for scrutiny of the evidence has been evolved so as to provide adequate safeguards both for revenue and for the assessee.

64. The power to reopen assessments, where income chargeable had escaped assessment or been under-assessed, was first conferred
on the revenue authorities in 1918. Such re-assessments were to be made within a period of one year following the normal year of assessment. Since 1939, this period has been extended to eight years in cases of deliberate concealment and to four years in other cases.

65. Assessees, who were aggrieved by the assessment made on them, had the right, under the Act of 1886, to appeal to the Collector in certain cases and to the Divisional Commissioner in other cases. The Act of 1918 provided for all appeals to be filed direct before the Commissioner of Income-tax. Discretionary power was also given to the Chief Revenue Authority, on its own initiative or on application by the assessee, to refer to the High Court any points of law other than those arising from penalty or prosecution proceedings.

66. In the new administrative machinery set up in 1922, assessments were to be made by the Income-tax Officer, and appeals lay to the Assistant Commissioner (except where the assessee had defaulted in filing a return or in producing his accounts). A second appeal lay to the Commissioner, and the Commissioner could refer points of law to the High Court, at his own instance or on the application of the assessee. If the Commissioner declined to state a case to the High Court (which he could do only if he considered that no point of law was involved), the assessee could approach the High Court for a *mandamus* requiring the Commissioner to state a case. In 1926, a further right of appeal to the Privy Council was given, in order to resolve the situation which had been created by conflicting decisions given by different High Courts on the same point.

67. The machinery for appeals was completely changed in 1939, as a result of the recommendations of the Income-tax Enquiry Committee, 1936. A separate cadre of Appellate Assistant Commissioners of Income-tax was created, whose function was exclusively to deal with appeals against orders passed by Income-tax Officers. The function of hearing second appeals was transferred from the Commissioner of Income-tax to a new authority established in 1941. The decisions of this authority, the Income-tax Appellate Tribunal, are final on questions of fact: on questions of law, it may make a reference to the High Court, on application either by the Commissioner of Income-tax or the assessee. The Commissioner of Income-tax continues to have the power of reviewing the decisions of the lower authorities. It will be seen, therefore, that with the growing complexity of income-tax assessments and the vast increase in the amounts involved, increasing facilities are being provided to the assessee to have his point of view adequately taken care of. Several suggestions, however, have been made before us for improvement in this regard; and we discuss them in detail in Chapter XIII of this Volume.

68. The principle of deduction of tax at the source (from salaries and interest on securities) has been adopted in the Indian system from the very beginning. The Income-tax Act of 1886 made the paying officer responsible for deduction from the salaries of Government servants and of employees of local authorities. Other employees were under an obligation to pay the tax in instalments as and when the salary was paid but the Collector could enter into an agreement with an
employer for the deduction of the tax and its payment into the
treasury, in which case the employer was entitled to payment of a
commission. Where there was no such agreement, the tax found due
on assessment was to be paid within the time specified by the Collec­
tor, and arrears of tax could be recovered as if they were arrears of
land revenue. The Income-tax Act of 1922 extended to all employers
the obligation to deduct tax at the source on salaries. Although
assessments were now made by a department of the Central Govern­
ment, the machinery of the provincial revenue departments continued
to be used for recovering arrears of tax from defaulters. Where­
defaults occurred, the Income-tax Officer could issue a certificate to
the Collector, and the Collector could then proceed to recover the
amount covered by the certificate as if it were an arrear of land
revenue. The system of collection and recovery has remained sub­
stantially the same as described above.

69. An important development has been the introduction of a
scheme of payment of tax in advance, something
in the nature of ‘pay-as-you-earn’. An assessee
is required under the scheme to pay the estimate­
ed tax on the income of each year in advance, in
three or four instalments. The amount of advance tax to be paid
is determined by the Income-tax Officer on the basis of the last
completed assessment but the assessee can submit his own estimate;
subject to a penalty if his estimate falls short of the actual tax by
a margin of over twenty per cent. When a return of income filed
by an assessee shows that he will have to pay some more tax in
addition to the advance tax already paid by him, the Income-tax
Officer has been given the power, since 1948, of making a provisional
assessment on the basis of the return, and of collecting the tax found
due. Another improvement which was effected in the process of
recovery was the conferment of power on the Income-tax Officer to
issue a garnishee order to any person from whom money may be­
due to an assessee to pay over the amount towards arrears of tax
due from the assessee. Despite all these measures, the fact still
remains that there is a large volume of arrears awaiting recovery.
We deal with this problem of arrears in detail in Chapter XIII of
this Volume.

70. Evasion and avoidance of income-tax are as old as the tax itself.
Numerous amendments have had to be made to
the Income-tax law since 1886 for closing loop­
holes which gave room for leakage of revenue as
and when they were discovered. The history of legislation regarding
the taxation of a firm, the evolution of the concept of receipts which
are ‘deemed’ as income, the invalidation for the purposes of income­
tax law of acts that are otherwise legal, and the regulation of distribu­
tion of profits by companies in which the public are not substantially
interested—these are only a few instances which illustrate the
vigilance with which the law has had to protect revenue against those
who use their skill to outwit its intentions.

71. The Income-tax Investigation Commission submitted in 1948
a report on the adequacy of income-tax law from the point of view
of preventing evasion and avoidance. Some of its recommendations
were incorporated in the law by the Income-tax (Amendment) Act,
1953, while others still remain to be implemented. In Chapter XII,
of this Volume, we have reviewed some of the more important of
its recommendations as well as some other points that emerged
during the course of our discussions and have recorded our recom-
mendations in respect of them.

72. We may notice one more feature of the income-tax system,
viz., inclusion of incentives for capital formation and economic development. This is a recent
feature. Thus, a rebate of one anna in the rupee is given on all undistributed profits of companies. A new section, 15C, has been introduced in 1949 under which new industrial undertakings which were not formed by the splitting up or reconstruction of an existing business, and which began to manufacture articles on or after 1st April 1948 are exempt from tax, for the first five years after the commencement of the manufacturing operations, on that part of their profits which is not in excess of six per cent. of the capital employed. The concession was originally available to undertakings which employed at least 50 persons, but from 1st April 1952, it has been made applicable to undertakings which have ten or more workers in a manufacturing process carried on with the aid of power, and twenty or more workers, without the aid of power. The exemption from corporation tax to dividends received by a company on shares held by it in another company is an incentive to investment included in the present law. Such an exemption in respect of Investment Trust Companies fulfilling certain conditions is as old as 1933; a new provision was introduced in 1953 whereby a similar concession has been extended to companies which hold shares in an Indian company which is wholly or mainly engaged in any one of the ten industries specified in the section subject to the necessary conditions being fulfilled.

73. Having surveyed briefly developments in the law and practice of income-tax in India, we now proceed to give a brief review of the operation of the tax in terms of income assessed, the number and distribution of assessees, and the amount of revenue collected. The statistical material that we have utilised is not, however, satisfactory for a historical and comparative analysis. The separation of Burma, the partition of the country in 1947 and the financial integration of Part B States are some of the factors affecting the utility of the statistical material. In addition, we may draw attention to the fact that income-tax statistics are compiled on the basis of the number of assessments completed and the demand raised. As arrears of assessment and collection are included in the statistics, they vitiate comparative analysis.

74. Net collection from income-tax rose from Rs. 1.37 crores in 1886-87 to Rs. 191.3 crores in 1944-45—a significant increase judged by any standard. The net collection remained between Rs. 2 crores and Rs. 3 crores until 1915. With the introduction of graduation and the concept of total income and of super-tax between 1916—18 the net collection rose to Rs. 22 crores in 1919-20. The figure continued to range during 1930 to 1939 between Rs. 15 and 18 crores. After the comprehensive amendments in the law in 1939 and the introduction of slab rates, the net collection rose to Rs. 26 crores in 1940-41. Thereafter, the net collection rose rapidly as a result of the operation of various
factors such as the expansion of money incomes during the War, the levy of the surcharge, which was ultimately amalgamated with the normal rates, at progressively increasing rates, and the levy of the Excess Profits Tax. The peak figure for net collection was Rs. 191 crores in 1944-45. The Excess Profits Tax was abolished with effect from 1st April 1946 but the disposal of arrears continued to yield substantial revenue in the next three or four years. Net collections stood at Rs. 163 crores in 1953-54. Annual figures for the period 1948-49 to 1953-54 are given below:

Table 2.—Net collections of income-tax and super-tax from 1948-49 to 1953-54

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (in crores of Rupees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948-49</td>
<td></td>
</tr>
<tr>
<td>1949-50</td>
<td>160</td>
</tr>
<tr>
<td>1950-51</td>
<td>173</td>
</tr>
<tr>
<td>1951-52</td>
<td>183</td>
</tr>
<tr>
<td>1952-53</td>
<td>185</td>
</tr>
<tr>
<td>1953-54</td>
<td>163</td>
</tr>
</tbody>
</table>

Broadly speaking, the present level of net yield is attributable to (i) the enlargement of the basis of liability brought about as a result of the 1939 legislation, (ii) the introduction of slab rates in that year, (iii) the steep rise in the rates during the Second World War and (iv) the increase in taxable income due partly to economic development but more particularly to the inflationary conditions of the economy during and since the War. The increase in the yield is thus also reflected in the number of assessees and the volume of taxable income, but the proportions of increase among different income groups, sources of income and industrial groups show considerable variations.

75. The number of assessees in 1904-05 was 2,43,000, when the exemption limit was Rs. 1,000; after the exemption limit was raised to Rs. 2,000, the number registered was 2,73,311 in 1922-23; and it was 2,65,940 in 1938-39 on the eve of the Second World War, with the exemption limit continuing at Rs. 2,000. The increase in the tempo of War activities was reflected in 1940-41 when the number of assessees rose to 3,68,532. It was 4,47,494 in 1940-47 immediately before the Partition of the country. There has been a considerable increase in the number of assessees since partition, which may partly be attributable to the inclusion of new assessees from Part B States since 1950-51 and partly to the new assessees that have been discovered as a result of the external survey referred to in paragraphs 7—9 of Chapter XII of this Volume.

76. The following table shows the number of assessees on the Index Register of the Income-tax Department as on 1st April for
each year since 1948-49 by income groups and separately for salary earners:—

Table 3.—The number of assesses since 1948-49 according to income groups

<table>
<thead>
<tr>
<th>Year</th>
<th>More than Rs. 25,000</th>
<th>Between Rs. 10,000 and Rs. 25,000</th>
<th>Between Rs. 5,000 and Rs. 10,000</th>
<th>Less than Rs. 5,000</th>
<th>Salaried assesses, cases involving loss etc.</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>1948-49</td>
<td>36,598</td>
<td>59,352</td>
<td>92,130</td>
<td>1,42,769</td>
<td>1,50,996</td>
<td>5,21,845*</td>
</tr>
<tr>
<td>1949-50</td>
<td>39,242</td>
<td>61,090</td>
<td>87,832</td>
<td>1,42,500</td>
<td>2,15,852</td>
<td>5,46,516*</td>
</tr>
<tr>
<td>1950-51</td>
<td>43,830</td>
<td>75,526</td>
<td>1,17,063</td>
<td>1,61,555</td>
<td>3,06,257</td>
<td>7,04,231*</td>
</tr>
<tr>
<td>1951-52</td>
<td>45,761</td>
<td>81,229</td>
<td>1,31,312</td>
<td>1,55,717</td>
<td>3,82,297</td>
<td>7,96,316</td>
</tr>
<tr>
<td>1952-53</td>
<td>51,795</td>
<td>96,173</td>
<td>1,46,635</td>
<td>1,61,030</td>
<td>4,44,773</td>
<td>9,00,406</td>
</tr>
</tbody>
</table>

% Increase between 1948-49 and 1952-53: 40 39 59 13 133 42

*Contains assessments re-opened under section 34 for which no separate record was kept before 1951-52.

77. The largest increase in numbers has been taken place among salaried assesses in spite of the rise in the exemption limit from Rs. 3,000 in 1948-49 to Rs. 3,600 in 1951-52.

78. The total income assessed was Rs. 33 crores for assesses with income above Rs. 2,000 in 1886-87, Rs. 53 crores in 1903-04; Rs. 236 crores in 1922-23 after the concept of 'total income' and graduation had found a place in the system, and it had dropped to Rs. 174 crores in 1937-38, owing to the 'depression' of the 'thirties. It rose to Rs. 215 crores in 1940-41, to Rs. 406 crores in 1943-44 and Rs. 463 crores in 1946-47, i.e., immediately before Partition. The table below shows the variations in the post-partition period:—

Table 4.—Incomes subjected to income-tax from 1948-49 to 1952-53

(In crores of Rupees)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Income*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948-49</td>
<td>571</td>
</tr>
<tr>
<td>1949-50</td>
<td>387</td>
</tr>
<tr>
<td>1950-51</td>
<td>575</td>
</tr>
<tr>
<td>1951-52</td>
<td>783</td>
</tr>
<tr>
<td>1952-53</td>
<td>710</td>
</tr>
</tbody>
</table>

*After deduction of earned income relief, where due.
A portion of the increase from 1950-51 is attributable to the inclusion of figures relating to Part B States.

79. The total assessed income is distributed among companies and assessees other than companies as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>1940-41</th>
<th>1952-53</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies</td>
<td>47.39</td>
<td>200.34</td>
</tr>
<tr>
<td>Other than companies</td>
<td>167.54</td>
<td>510.68</td>
</tr>
</tbody>
</table>

The total assessed income of companies increased by 325 per cent. since 1940-41 while the increase for assessees other than companies in the corresponding period was 200 per cent. The income earned by companies in 1952-53 was roughly of the order of 30 per cent. of the total income earned by all assessees put together, which shows the importance of the company form of organisation among the income earners in India.

80. The comparative figures of total assessed income for assessees other than companies with income from 'business and professions' and companies are shown in the table below:

<table>
<thead>
<tr>
<th>Category</th>
<th>1940-41</th>
<th>1952-53</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business and professions</td>
<td>57.60</td>
<td>215.78</td>
</tr>
<tr>
<td>Companies†</td>
<td>47.39</td>
<td>200.34</td>
</tr>
</tbody>
</table>

† Includes income from sources other than business also.

The income from business and professions is practically of the same order as that of the income of the companies.

81. Among the companies, those with an income above Rs. 2 lakhs accounted for Rs. 174 crores of the total assessed income out of Rs. 200 crores in the year 1952-53; i.e., about 87 per cent. of the total income from companies as against the corresponding figure for 1940-41 which was 82 per cent. Among non-company assessees, the distribution of total assessed income shows that the larger proportion accrues to assessees with an income of Rs. 25,000 and under. They accounted for Rs. 338 crores out of a total assessed income of Rs. 510 crores in 1952-53, i.e., nearly 66 per cent. of the total income relating to that category; the corresponding figure for 1940-41 was nearly 80 per cent. The share of persons with incomes below Rs. 25,000 in the total assessed income has gone down in 1952-53 as compared to 1940-41.
82. The position regarding the distribution of total income according to various sources of income is as follows:

**Table 5.—Distribution of income assessed according to sources of income**

(In crores of Rupees)

<table>
<thead>
<tr>
<th>Sources</th>
<th>Total assessed income in</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1940-41</td>
</tr>
<tr>
<td>Salaries</td>
<td>65.20</td>
</tr>
<tr>
<td>Interest on securities</td>
<td>6.59</td>
</tr>
<tr>
<td>Property</td>
<td>13.51</td>
</tr>
<tr>
<td>Business including companies</td>
<td>104.99</td>
</tr>
<tr>
<td>Other sources*</td>
<td>24.46</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>214.75</strong></td>
</tr>
</tbody>
</table>

* 'Other sources' include dividends.

83. The income assessed under the head 'salaries' has shown an increase of nearly 150 per cent. over the 1940-41 level; the income from interest on securities has increased by 260 per cent.; that from 'property' by 150 per cent.; that from business by 300 per cent. and from other sources, which include dividends, by 280 per cent.

84. The distribution of total assessed income according to different types of industries is of some interest. The industries have been classified into nine groups for purposes of income-tax statistics and some of them consist of heterogeneous elements but the comparative analysis is useful for understanding the relative importance of different industries:

**Table 6.—Distribution of income assessed according to industries**

(In crores of Rupees)

<table>
<thead>
<tr>
<th>Categories of industries</th>
<th>Total taxable income in</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1941-42</td>
</tr>
<tr>
<td>Mines, quarries, etc.</td>
<td>7.46</td>
</tr>
<tr>
<td>Textile manufacture</td>
<td>7.59</td>
</tr>
<tr>
<td>Manufacture of metal and metal goods</td>
<td>11.43</td>
</tr>
<tr>
<td>Food manufacture etc.</td>
<td>7.27</td>
</tr>
<tr>
<td>Manufacture of chemicals, leather goods etc.</td>
<td>4.05</td>
</tr>
<tr>
<td>Building and miscellaneous manufacturing trade</td>
<td>4.53</td>
</tr>
<tr>
<td>Distribution and communications</td>
<td>47.78</td>
</tr>
<tr>
<td>Finance</td>
<td>14.61</td>
</tr>
<tr>
<td>Professions, i.e., doctors, lawyers, etc.</td>
<td>12.44</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>117.14</strong></td>
</tr>
</tbody>
</table>
Expansion of income has taken place almost in every trade but it is most marked under the classifications ‘distribution and communications’. The former includes, among others, wholesale and retail merchants in almost every line, managing agents, road and air transport business.

The broad picture that emerges from study of figures relating to the distribution of the total assessed income among the various sectors of the economy is:

(i) that the company form of organisation is gaining importance as a major income-earning activity;

(ii) that proprietary business is and continues to be an important factor in the economy;

(iii) that in the business sector, trading concerns predominate, thus underlining the fact that we have still a long way to go in productive and industrial development; and

(iv) that the share in the total assessed income of persons with incomes above Rs. 50,000 a year has increased, and of persons with incomes below Rs. 25,000 has declined since 1940-41. The significance of money incomes in real terms, however, has altered greatly since that year.

In the succeeding chapters in this Volume, we proceed to discuss the income-tax system in detail, examine the various suggestions made for its improvement, and put forward our recommendations with a view to rationalising the system and enabling it to play a more adequate and efficient role in both the fiscal system and the economy of the country.