PRESUMPTIVE TAXATION AND ITS LEGAL ASPECTS

Sudhanshu Munshi

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The wide latitude has been given by our Constitution to the Legislature in classification for taxation.It was quoted from the passage of Willis in East India Tobacco Co. v. A.P.[1] and was also endorsed by the Hon'ble Supreme Court in subsequent cases that:

> " A State does not have to tax every thing in order to tax something.It is allowed to pick and choose districts, objects, persons, methods and even rates for taxation if it does so reasonably....The (U.S.) Supreme Court has been practical and has permitted a very wide latitude in classification for taxation."

It is well settled law that the entries in the Lists in the Seventh Schedule to the Constitution should not be read in a narrow, pedantic or restricted sense and each and every subject mentioned in the entries should be read as including within its scope all subsidiary and ancilliary matters which can be fairly and reasonably comprehended under such entries.

The Income Tax Act is an enactment relating to entry 82 in List I of the Seventh Schedule to the Constitution, empowers Parliament to make a law in regard to tax on income,other than agricultural income.It may be noted that Constitution does not define the expression "income".The Income Tax Act, 1961 also does not provide exhaustive definition of the expression "income" which is inclusive one and expanding from time to time by various amending Acts.In Navinchandra Mafatlal v. CIT [2], Das J. observed:

1.(1963) 1 S.C.R. 404,409 (S.C.).

2.[1954] 26 ITR 758 (S.C.).

" What, then,is the ordinary.natural and grammatical meaning of the word `income'? According to the dictionary it means `a thing that comes in'.(See Oxford Dictionary,vol. V. page 162; Stroud, vol.II, pages 14-16). In the United States of America and in Australia both of which also are in English speaking countries, the word `income' is understood in a wide sense so as to include a capital gain. Reference may be made to Eisner v. Mecomber [1920] 252 U.S. 189; 64 L.Ed. 521, Merchans' Loan v. Stewart [1940] 311 US 60; 85 L.Ed. 40 and Resch v. Federal Commissioner of Taxation [1942] 66 CLR 198. In each of these cases very wide meaning was ascribed to the word `income' as its natural meaning."

In the above said case it was also observed that the word should be given its widest connotation in view of the fact that it occurs in a legislative head conferring legislative power. In Baldev Singh v. CIT [3] it was held that " Entries in the List are not powers but are only field of legislation and the widest import and significance must be given to the language used by Parliament in the various entries." In Bhagwan Dass Jain v. Union of India and others [4] it was held that `Even in its ordinary economic sense, the expression "income" includes not merely what is received or what comes in by exploiting the use of a property but also what one saves by using it oneself. That which can be converted into income can be reasonably regarded as giving rise to income'. It was also said in A. Sanyasi Rao and another v. Government of Andhra Pradesh and others [5] that the Income Tax Act no doubt defines the expression "income" in clause (24) of section 2, but that definition can not be read back into entry 82.

3.[1960] 40 ITR 605 (S.C.).

4.[1981] 128 ITR 315 (S.C.).

5.[1989] 178 ITR 31,45 (A.P.).

Even the said definition is an inclusive one and has been expanding from time to time. Several items have been brought within the definition from time to time by various amending Acts. The said definition cannot, therefore, be read as exhaustive of the meaning of the expression "income" occuring in entry 82 of List I in the Seventh Schedule. This, ofcourse, does not mean that an amount which can, by no stretch of imagination, be called "income" can be treated as "income" and taxed as such by Parliament. It must have some characteristics of income, as broadly understood. So long as the amount taxed as income can rationally be called income as generally understood, it is competent for Parliament to call it "income" and levy tax thereon. It is noted with approval in Bhagwan Dass Jain [6] case in Resch v. Federal Commissioner of Taxation [1942] 66 CLR 198 and the observation of Dixon J. of the High Court of Australia at page 224 as under:

> " The subject of income tax has not been regarded as income in the restricted sense which contrasts gains of the nature of income with capital gains, or actual receipts with increases of assets or wealth. The subject has rather been regarded as the substantial gains of persons or enterprises considered over intervals of time and ascertained or estimated by standards appearing sufficiently just, but nevertheless practical and sometimes concerned with avoidance or evasion more than with accuracy or precision of estimation. To include the annual value of the tax payers' residence owned by himself or used rent-free and to fix it a five percent of the capital value has not been considered to introduce a new subject (Hardings' case [1917] 23 CLR 119). To treat part of the undistributed profits earned during the

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6.Bhagwan Dass Jain v. Unuion of India and others,Supra note 4.

current year as part of the assessable income of the shareholder imports no new subject (Cornell's case [1920] 29 CLR 39; Kellow-Falkiner Pty. Ltd. v. Federal Commissioner of Taxation [1928] 34 Aus.LR 276), nor does it substitute in the case of a foreign controlled business, for taxable income ordinarily calculated a percentage of gross receipts fixed by the discretionary judgement of the Commissioner (British) Imperial Oil cases [1925] 35 CLR 422; [1926] 38 CLR 153."

What can be converted into income also will come within the meaning of the word "income" in the entry. The entry 82 of the List I of the Seventh Schedule to the Constitution is wide enough to confer power to prevent evasion of income tax also. Resort to fiction is ofcourse permissible where it is necessary to deal with a device avoiding legitimate tax.[7] Irrespective of the actual receipt of an income or the factual situation in relation to the income, it will be competent for Parliament to make a fictional computation of the income and tax it as such.[8] In P.Kunhammed Haji case it was shown that there are business where accounts are hardly kept, the opportunities for manipulations are vast and wide. In such business as soon as income is amassed, the income earner vanish mysteriously. There are business where a common alibi could be easily employed or where any one could be an easily available name-lender. Such trades, therefore, rightly, needed stringent and corrective approaches and additional vigilant watch. According to Richard Musgrave, "A more realistic approach is needed, using presumptive taxation, applied outside and in lieu of the regular framework of income and sales taxation, as well as estimated tax basis applied within the context of regular tax system."

7.T.K.Aboobacker v.Union of India,[1989] 177 ITR 358 (Ker.).

8.P.Kunhammed Haji v. Union of India,[1989] 176 ITR 481 (Ker.).

It was observed in P.Kunhammed Kutty case and also from illuminating article of Dr. Amresh Bagchi [9]:

> " The theoreticians of fiscal administration have found in presumptive taxation much more than an effective check against evasion.It has the merit of promoting efficiency for the able enterpreneur. When there is a fixation of his income by statutary provision, anything he could make in excess of that norm, is a reward for his added activity. A dealer who falls short of the norm suffers the ill effects. The person who extends it,could get the advantage. Fiscal theorist opine that this tax-termed as a lumpsum tax-is the ideal form of taxation from the point of view of efficiency. China's recent economic reform, considered as successful by some, is cited by some academicians as illustrative of a classic example of the success of the concept underlying presumptive taxation."

According to Dr. Amresh Bagchi, presumptive taxation is not totally new either to the tax system in this country or other countries. Presumptive taxation has been in vogue in several countries as Takshiv in Israel and Fortait in France. Columbia has also introduced presumptive taxation on the basis of gross receipts and Turkey introduced a " Living Standard Assessment System" where living standard as indicators for presumptive taxation has been adopted in 1983. In India tax on presumption has been laid down in section 23, 44AC (Omitted), 44AD, 44AE, 44B, 44BB, 44BBA, 44C and 115K of the Income Tax Act,1961 and other Acts also. Tax Reform Committee[10] also recommended for adoption of such system and opined that:

9.The Economic Times,April 27,1988.

10.Tax Reforms Committee, Interim Report, New Delhi, 1991.

"....However, on balance, presumptive taxation should be easier to administer than our seeking to actual incomes. After all physical indicators should be more amenable to verification than references of income. Because mainly of its administrative merits, developing countries are falling back on the presumptive approach as the only practicable way of taxing small enterprises and the hard-to-tax groups effectively. Given the present structure of the economy and the limitations of the administration, the principle of presumptive taxation merits serious consideration in the Indian context too."

In the Budget Speech for 1992-93 (29th Feb.,92), the Finance Minister Dr. Manmohan Singh said that:

" In a country with a population of over 800 million, hardly 7 million persons pay income and corporate tax. It is therefore necessary to attract new tax payers into the tax net. With this end in view, I propose to introduce a presumptive tax system in respect of shop keepers and other retail traders with an annual turnover below Rs.5 lakhs. In order to enable them to avoid the difficulty of maintaining detailed account books, filing a complicated tax return and going through the normal assessment procedure, a simplified scheme has been worked out under which the tax payer will only give brief particulars of his turnover and pay just Rs.1400 as tax for that year.This should enable potential tax payers in this category to overcome their pshycological hesitation of getting into the tax system...."

It may be noted that the constitutional validity of the provisions of section 44AC and 206C of the Income Tax Act, 1961 is pending before the Supreme Court in India in Transfer Petition

No.42 of 1989: Bihar Excise Vendors & Association v. Union of India. However, constitutional validity of section 44AC and 206C has also been decided by the various High Courts of this country.

The relevant portion of above said section 44AC prior to its omission by the Finance Act, 1992 and section 206C(1) prior to its substitution by the Finance Act, 1992 of the Income Tax Act reads as below:

" Section 44AC.- Special provision for computing profits and gains from the business of trading in certain goods.- (1) Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of an assessee, being a person other than a public sector company (hereafter in this section referred to as "the buyer"), obtaining in any sale by way of auction, tender or any other mode, conducted by any other person or his agent (hereafter in this section referred to as the seller),-

(a) any goods in the nature of alcoholic liquor for human consumption (other than Indian made foreign liquor), a sum equal to forty percent. of the amount paid or payable by the buyer as the purchase price in respect of such goods shall be deemed to be the profits and gains of the buyer from the business of trading in such goods chargeable to tax under the head "profits and gains of business or profession.

Provided that nothing contained in this clause shall apply to buyer where the goods are not obtained by him by way of auction and where the sale price of such goods to be sold by the buyer is fixed by or under any State Act...

Explanation.- ....

(b)....

TABLE

S.No. (1)	Nature of goods (2)	Percentage (3)
(i)	Timber obtained under a lease.	Thirty-five percent.
(ii)	Timber obtained by any mode other than under a forest lease.	Fifteen percent.
(iii)	Any other forest produce not being timber	Thirty-five percent.

(2) For the removal of doubts, it is hereby declared that the provisions of sub-section (1) shall not apply to a buyer (other than a buyer who obtains any goods from any seller which is a public sector company), in the further sale of any goods, obtained under or in pursuance of the sale under sub-section (1).

(3) In a case where the business carried on by the assessee does not consist exclusively of trading in goods to which this section applies and where separate accounts are not maintained or are not available, the amount of expenses attributable to such other business shall be an amount which bears to the total expenses of the business carried on by the assessee the same proportion as the turnover of such other business bears to the total turnover of the business carried on by the assessee.

Explanation.- For the purposes of this section "seller" means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company, or firm, or co-operative society."

" 206C(1).- Every person, being a seller shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at time of receipt of such amount from the said buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, collect from the buyer of any goods of the nature specified in column (2) of the table below, a sum equal to the percentage specified in the corresponding entry in column (3) of the said table, of such amount as income tax on income comprised therein.

TABLE

S.No. (1)	Nature of goods (2)	Percentage (3)
(i)	Alcoholic liquor for human consumption (other than Indian-made foreign liquor).	Fifteen percent.
(ii)	Timber obtained under a forest lease.	Fifteen percent.
(iii)	Timber obtained by any mode other than under a forest lease.	Five percent.
(iv)	Any other forest produce not being timber.	Fifteen percent.

Provided that where the Assessing Officer, on an application made by the buyer, gives a certificate in the prescribed form that to the best of his belief any of the goods referred to in the aforesaid table are to be utilised for the purposes of manufacturing, processing or producing articles or things and not for trading purposes, the provisions of this sub-section shall not apply so long as the certificate is in force."

The High Court of Kerala in P.Kunhammed Haji case[11] upheld the legislative competence of the Union to levy the tax on the commodities referred in sections 44AC and 206C and its constitutional validity, where it was said that if a presumptive tax is permissible exercise in the fiscal activity of a modern State, then the only further question to be probed into is whether those underlying assumptions are applicable to the three trading segments subjected to the special treatment under section 44AC and 206C of the Act and held that the exercise of presumptive taxation in relation to the liquor trade, timber and other forest produce are permissible constitutional operation. The validity of the tax as introduced by section 44AC could not then be doubted, disputed or denied by a court of law. In T.K.Aboobacker case,[12] the Kerala High Court upheld the legislative competency of the Union and held that the legislature was aware of the nature of the trade and the difficulty in assessing and collecting the tax, it will be competent to the legislature to device a fiction for treating a percetage of the purchase price paid by the assessee as income coming under the head "profits and gains".

11.P.Kunhammed Haji v. Union of India,Supra note 8.

12.T.K.Aboobacker v. Union of India,Supra note 7.

The Andhra Pradesh High Court in A.Sanyasi Rao case[13] has also upheld the legislative competency of the Parliament. However, in the above said case, it was held that the facts of this case fall squarely within the principle of the decision in Kunnathat Thathunni Moopil Nair v. State of Kerala[14] and that the imposition is likely to be characterized as disproportionate and thus offends article 14 of the Constitution and also unreasonable restriction under article 19(g) of the Constitution of India, but in view of overall object underlying the provisions and the language in sub-section (4) of section 206C, Hon'ble High Court read down the provision of section 44AC instead of striking down and held that section 44AC is merely an adjunct to and explanatory to the provisions of section 206C and thus a regular assessment of income of the assessee has to be made in accordance with section 28 to 43C of the Act. Meaning thereby, section 44AC does not dispense with sections 28 to 43C absolutely. The non-obstante clause in section 44AC(1) would be confined and limited to the purpose of sustaining the deductions provided for in section 206C. Collections will be made at the rates specified in section 206C and then a regular assessment will be made like in the case of any other assessee. In Sri Venkateswara Timber Depot v. Union of India[15] also legislative competence of Parliament and constitutional validity of sections 44AC and 206C was assailed where the Orissa High Court upheld the legislative competence of the Parliament for the enactment of section 44AC and 206C and also held said sections to be violative of article 14 and 19(g) of the Constitution but adopted the same view of Sanyasi Rao case and read down section 44AC accordingly. In Sat Pal and Co. v. Excise and Taxation Commissioner.[16], the Punjab and Haryana High Court fol-

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13.A.Sanyasi Rao v. Government of A.P.,Supra note 5.

14.[1961] AIR 1961 SC 552.

15.[1991] 189 ITR 741 (Orissa).

16.[1990] 185 ITR 375 (P. & H.).

lowed the decision of Sanyasi Rao case and upheld the legislative competence of Parliament and read down section 44AC as adjunct to section 28 to 43C and 206C. Similar question again arose before the Kerala High Court in K.M.Joseph Binoy (No.1) v. Union of India,[17] where Hon'ble High Court concurred with the judgement of the learned single judge where the decision of T.K.Aboobacker case[18] was followed and held "In view of the elaborate consideration of the matter in the judgement by Sukumaran J., reported in P. Kunhammed Kutty Haji's case [1989] 176 ITR 481 (Ker.) and upheld by a Bench of this Court in Aboobacker's case [1989] 177 ITR 358 and also the detailed decision by a Bench of the Andhra Pradesh High Court in A. Sanyasi Rao's case [1989] 178 ITR 31, we are of the view that there is no merit in the various pleas sought to be raised before us." Thus upheld the legislative competence and the constitutional validity of sections 44AC and 206C.

The vires of section 44AC and 206C was again questioned in Bhagwan Singh v. Union of India[19] but the same was not decided since the said question is pending before the Supreme Court of India. In Jaishree Traders v. Union of India [1993] 2 PLJR 80, the Patna High Court as quoted in Bhagwan Singh case held:

> " Sections 44AC and 206C were inserted in the Act by the Finance Act, 1988. Under section 44AC, the legislature has devised a notion of presumptive income, i.e., income deemed to accrue by conclusive presumption of law for determining the income tax liability of persons dealing in al

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17.[1992] 194 ITR 449 (Ker.).

18.T.K.Aboobacker v. Union of India,Supra note 7.

19.[1994] 209 ITR 824 (Patna).

coholic liquor and timber. Under section 206C, a provision was made for collection of income tax at source by the seller of the said commodities from the buyers with reference to the presumptive income postulated under section 44AC. The said provision was challenged in this Court and in the Supreme Court on various constitutional backgrounds.

Keeping in view the wide ranging litigation on the afore said issue the Supreme Court directed that the High Courts will not consider the constitutional validity of the said provision and the matter will be finally determined by the apex court but till then for interim orders, the dealers may approach the respective High Courts. The question of validity of the said provision is still pending consideration before the Supreme Court. In the meantime, by the Finance Act, 1992, section 44AC has been deleted from the statute book and section 206C has been substituted, makingit self-contained. The effect of this amendment is that the concept of presumptive income for the purpose of computing income-tax has been given a go-by. Now section 206C as it stands is merely a mode of collecting income-tax at source, which is subject to final determination of income of the payee and the amounts collected are subject to adjustment and refund on final assessment of income-tax under the provisions of the Act."

It will be worthwhile to mention here that in Union of India v. A.Sanyasi Rao[20] it was noted by the Hon,ble Supreme Court that the Union of India have filed S.L.P.(C) Nos.3944-4087 of 1992 and I.A.No.1-74 of 1992 in S.L.P.(C) of 1992 against the judgements

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20.[1993] 202 ITR 584 (S.C.).

of the Orissa[21] and Punjab and Haryana[22] High Courts following the decision of the Andhra Pradesh High Court in A.Sanyasi Rao v.Government of A.P.[23] Since the matters are pending before the Supreme Court and were not listed, Hon'ble Supreme Court took the matter on the board.

It may also be noted that section 44AC has been omitted from the statute book by the Finance Act, 1992 (18 of 1992), s.21, with effect from April 1, 1993 and section 206C(1) has been substituted by the Finance Act, 1992, which came into force with effect from April 1, 1992.

Relevant portion of the existing section 206C, after the substitution of sub-section (1) and insertion of Explanation by the Finance Act, 1992 (18 of 1992), s.79(a) & (b) respectively, is reproduced here as follows:

S.206C. Profits and Gains from the business of trading in alcoholic liquor, forest produce, etc.

> (1) Every person, being a seller shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of the receipt of such amount from the said buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, collect from the buyer of any goods of the nature specified in column (2) of the Table below, a sum equal to the percentage specified in the corresponding entry in column (3) of the said Table, of such amount as income tax.

21.Sri Venkateswar Timber Depot v. Union of India, Supra note 14.
22.Sat pal and Co. v. Excise and Taxation Commissioner, Supra note 15.
23.See Supra note 5.

TABLE

S.No. (1)	Nature of goods (2)	Percentage (3)
(i)	Alcoholic liquor for human consumption (other than Indian-made foreign liquor).	Fifteen percent.
(ii)	Timber obtained under a forest lease.	Fifteen percent.
(iii)	Timber obtained by any mode other than under a forest lease.	Five percent.
(iv)	Any other forest produce not being timber.	Fifteen percent.

Provided that where the Assessing Officer, on an application made by the buyer, gives a certificate in the prescribed form that to the best of his belief any of the goods referred to in the aforesaid Table are to be utilised for the purposes of manufacturing, processing or producing articles or things and not for trading purposes, the provisions of this sub-section shall not apply so long as the certificate is in force.

Explanation.- For the purposes of this section,-

(a) " buyer" means a person who obtains in any sale, by way of auction, tender or any other mode, goods of the nature specified in the Table in sub-section (1) of the right to receive any such goods but does not include,-

(i) a public sector company,

(ii) buyer in the further sale of such goods obtained in pursuance of such sale, or

(iii) a buyer where the goods are not obtained by him by way of auction and where the sale price of such goods to be sold by the buyer is fixed by or under any State Act;

(b) " seller" means the Central Government, a State Government or any local authority or corporation or authority established by or under a Central, State or Provincial Act, or any company or firm or co-operative society.

In view of the above said decision of various courts and the wide latitude given to the legislature in the matter of classification in taxation, the matters to be considered is: Whether the remedy sought through presumptive taxation is proportional to the evil, reasonable and such remedy does not assume the character of a confiscatory measure. In this regard Hon'ble Supreme Court in V. Venugopala Ravi Varma Rajah v. Union of India[24] observed that:

" Tax laws are aimed at dealing with complex problems of infinite variety necessiating adjustment of several disparate elements. The Courts accordingly admit, subject to adherence to the fundamental principles of the doctrine of equality, a larger play to legislative discretion in the matter of classification. The power to classify may be exercised so as to adjust the system of taxation in all proper and reasonable ways;the legislature may select persons,properti- es, trans

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24.[1969] 74 ITR 49.

actions and objects, and apply different methods even rates for tax, if the legislature does so reasonably. Protection of the equality clause does not predicate a mathematically precise or logically complete or symmetrical classification: it is not a condition of the guarantee of equal protection that all transactions, properties, objects or persons of the same genus must be affected by it or none at all.If the classification is rational, the legislature is free to choose objects of taxation, impose different rates, exempt classes of property from taxation, subject different classes of property to tax in different ways and adopt different modes of assessment."

Moreover vires of section in regard to tax on presumption may be vouchsafed by providing rebuttal provision in the section where onus of proof lies on the tax-payer where the actual income is less than the income computed on the presumptive basis. Tax Reform Committee[25] in this regard also opined that " In order that the presumptive income approach suggested above for small enterprise does not come under any legal attack, it would be necessary to make the presumptions rebuttable but only on presentation of well documented accounts and records." The Andhra Pradesh High Court in Sanyasi Rao case[26] also sustained deductions under section 44AC for the purpose of section 206C of the Income Tax Act while reading down section 44AC to make it consistent with the requirements of Articles 14 and 19(g) of the Constitution of India and thus treated it as adjunct to and explanatory to section 206C. The opportunity of rebuttal by the tax

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25.Tax Reforms Committee, Interim Report, Supra note 10.

26.A.Sanyasi Rao v. Government of A.P.,Supra note 5.

payer could always be read in the section itself, as the Hon'ble Supreme Court in C.B.Gautam v. Union of India[27] read such rebuttal in section 269UD of Chapter XX-C of the Income Tax Act, 1961 or explicitly such rebuttal provision may be inserted to satisfy the principles of natural justice.

27.[1993] 199 ITR 530.

JUDICIAL POSITION IN REGARDS TO SECTION 44AC & 206C OF THE INCOME TAX ACT,1961

SR. No.	NAME OF THE CASE	HIGH COURT	SUPREME COURT	LEGISLATIVE COMPETENCE	CONSTITUTIONAL VALIDITY
1	P.Kunhammed Haji v. Union of India,[1989] 176 ITR 481(Ker.)	Kerala		Upheld	Upheld.
2	T.K.Aboobacker v. Union of India,[1989] 177 ITR 358(Ker.)	Kerala		Upheld	Not in issue.
3	A.Sanyasi Rao v. Government of Andhra Pradesh, [1989] 178 ITR 31 (A.P.)	Andhra Pradesh		Upheld	Upheld after reading down the provisions of section 44AC and sustaining deductions under section 44AC for the purpose of section 206C.
4	Satpal & Co. v. Excise & Taxation Commissioner, [1990] 185 ITR 375 (P.H.)	Punjab & Haryana		Upheld	Views as adopted in Sanyasi Rao case.
5	Sri Venkateswara Timber Depot v. Union of India, [1991] 189 ITR 741 (Orissa)	Orissa		Upheld	Views as adopted in Sanyasi Rao case.
6	K.M.Joseph Binoy (No.1) v. Union of India, [1992] 194 ITR 449 (Ker.)	Kerala		Upheld	Upheld.
7	Union of India v. A. Sanyasi Rao, [1993] 202 ITR 584 (S.C.)		Supreme Court	S.L.Ps not listed though pending before the Supreme Court were taken on the board.	S.L.Ps not listed though pending before the Supreme Court were taken on the board.
8	Bhagwan Singh v.Union of India, [1994] 209 ITR 824 (Patna)	Patna		Not decided since pend-pend before the Supreme Court.	Not decided since pending before the Supreme Court.