" ON A CLEAN DRAFTING SLATE? "
or
"Heads-I-Win-Tails-You-Lose"

It is often quizzed: "What is the difference between a calamity and a disaster?" If the Direct Taxes Code were to be introduced in Parliament it would be a calamity and if the Code were to become an Act of Parliament it would be a disaster.

The Direct Taxes Code 2009 ('the Code' for short) is nothing short of an attempted tax racket by Government. It has been drafted reportedly by persons, who do not want to "improve" the system. Such a confession has been made by the framers of the DTC 2009 in the discussion paper itself.

Indeed, the authors of the Code suffer from a fatal arrogance, which asserts that whatever is technically possible is licit. Consequently, the authors of the Code have assumed that through the Code, with impunity, they could even nullify constitutional guarantees but with self-restraint, they have chosen not to do so. The readers are invited to refer to para 21.5 of the discussion paper, which reads:

> *"**The power of the High Court under Article 226** of the Constitution **and of the Supreme Court under Article 32** of the Constitution **is not affected**. **The power of the Supreme Court** to entertain a Special Leave Petition **under Article 136** of the Constitution **is also not affected**". (emphasis supplied)*

The above statement speaks volumes of the mind-set employed in drafting the Code. The authors of the Code are liable to be hauled up for contempt of the Supreme Court and the High Courts for assuming that the executive is supreme and has powers to initiate an amendment to the Constitution of India through this Direct Taxes Code, 2009.

Their motives are clearly spelt out that they do not want to improve upon the present Income Tax Act, 1961. In para 1.7 of the discussion paper it is stated, "*The Code is not an attempt to amend the Income Tax Act, 1961; **nor is it an attempt to "improve" upon the present Act**. In drafting the Code, the Central Board of Direct Taxes (the Board) has, to the extent possible, started on a clean drafting slate. Some assumptions which have held the ground for many years have been discarded". (emphasis supplied)*

When a team of draftsmen sets down to prepare a Code with the above said objectives, one cannot expect a tax Code by which taxes would be levied and collected like the honeybee collecting nectar from the flowers with out disturbing them. The Code is a brazen attempt in trampling upon set principles of the philosophy of taxation as laid down by Courts. That is why the output, based on a lackadaisical approach, suffers from "malapropisms, grammatical mistakes and conceptual idiosyncrasies, besides a very apparent blood thirsty approach to collect taxes arbitrarily even from genuine charitable trusts and religious trusts.

In the words of a great jurist, it is not permissible to enact a law which, in effect, spreads an all-inclusive net for the feet of every body, upon the chance that, while the innocent will surely be entangled in its meshes, some wrong-doers also may be caught.

Saint TIRUVALLUVAR said in his Tirukkural (558 verse)

"Inmayin innaadu udaimai muraicheyya

Mannavan kol keezhpadin"

As translated by Rajaji, this Kural means *"Under a ruler who does not follow the law, it is a greater misery to be possessed of wealth than to be poor*".

The Code is a typical example of doing away with the rule of law in the name of starting on a clean slate.

The Hon'ble Finance Minister, while presenting the Budget for 2009-10, said in his speech (vide para 36), " *It is time that we complete the process that was started in 1991 for building a trust based, simple, neutral, tax system with almost no exemptions and low rates designed to promote voluntary compliance…….. We need a tax system, which generates revenues on a sustained basis without use of coercive tax collection methods at the end of each year to meet targets. It is my intention to make a modest start in this direction in the current year and ensure that the process is completed in the next four years.* ***At the end of this process****, I hope the* ***Finance Minister can credibly say that our tax collectors are like honey bees collecting nectar from the flowers without disturbing them, but spreading their pollen so that all flowers can thrive and bear fruit****". (emphasis supplied)*

Even the above quoted laudable objectives of the Hon'ble Finance Minister have not been translated into the Code.

"Malapropisms" in the Code – some illustrations:

Page Number	Section Number	*"Sic"* USAGES
B-17	1(3)	*Save as otherAwise provided in this Code*
B-26	29(1)	*A business shall be distinct and separate from another business if there is no interlacing, inter-dependence or unity* ***embarrassing*** *the two businesses. (emphasis supplied)*
B-112	175(4)	*Each member, or group of members, of the Hindu family, hitherto assessed as undivided, shall be jointly and* ***severely*** *liable for tax on the tax bases of any financial year or period, upto the date of partition, and shall be recovered from him, or them, accordingly. (emphasis supplied)*
B-116	184(4)	***The appeal filed by the Commissioner under section 183*** *shall be presented within three months from the end of the month in which the assessment order, to which the appeal relates, is passed*. (Section 183 provides for appeal to be filed by aggrieved assessee and the time limit is 30 days).

Grammatical Mistakes- some illustrations:

Page Number	Section Number	*"Sic"* USAGES
B-88	139(1)(a)	*any person to whom a* ***summon*** *under sub- section (1) of section 138..*
B-88	139(1)(b)	*any person to whom a* ***summon*** *or notice as aforesaid …….*

"***The most unkindest cut of all***" are the ARBITRARY PROVISIONS FOR TAXING CHARITABLE TRUSTS AND RELIGIOUS TRUSTS.

- *All religious trusts to pay tax at normal rates, if they are not registered with any law of the Central, State or Provincial Government for the regulation of religious endowments*. (VII Scheduled Serial No.38)

Comments:

- The constitutional guarantee given to charitable and religious trusts in terms of Articles 38 and 39 are clearly violated by the Code. Non-profit organizations have to be nurtured by the State because the State is not able to meet all the demands to secure a social order for the promotion of welfare of the people.

- All temples founded by individuals and not being registered with Hindu Religious & Charitable Endowment Board will be taxed at normal rates. (*For instance, in Hyderabad there is a temple of Lord Venkatachalapathi founded by an individual and popularly known as "VISA BALAJI". The HR & CE Board has been waging a battle to take over this temple. There are thousands of Hindu temples across the country, which are not registered with any Board. Consequently, this provision is going to increase litigation by astronomical proportions.)*
- For Jain religious trusts there is no regulatory body. Consequently, though these trusts are rendering yeomen service to the general public, they will be fully taxable on normal rates on their voluntary donations received.
- Similarly, there are a number of Muslim Religious Trusts, which are not registered in terms of the Wakf Act, 1995. All such trusts would become taxable under normal rates in terms of the Code.
- Similarly, a number of Christian Charitable Trusts, which are considered as Religious Trusts by the Code, would lose the benefit of tax exemption except in the States of Maharashtra, Gujarat and Orissa, where such religious trusts have to get registered with the Charity Commissioner.

- No donor to a religious trust gets any deduction, thanks to Section 72 of the Code.
- Thus, horizontal secular equity will be achieved by this Code, if it were to become law!!! Consequently, it will be a secular disaster for the Government.

- All trusts, termed as non-profit organizations, to pay 15% tax on their total income, despite the fact that they would be applying their income fully for the attainment of the declared objectives.
- Even these trusts would lose the benefit of concessional rate of tax, the moment they are deemed to have used or applied the funds or assets for the benefit of interested person (Section 92 of the Code).
- Shockingly, if any exempted income is earned by a charitable trust, it is deemed to be for the benefit of interested person and consequently, such trust loses even the little benefit available under the Code, besides being put through the rigmarole of the provisions of Section 86 to 96 (e.g. in the case of BITS PILANI, as per its published accounts, shares in public limited companies were transferred long back as part of endowment yielding dividend income to the University i.e., BITS PILANI. Consequent to Section 92(i) of the Code, the entire surplus of BITS PILANI will become taxable because the dividend income earned by it is tax free in terms of Section 9 r/w Clause 21 of the Sixth Schedule of the Code).
- Any charitable trust founded for the benefit of backward classes is not recognizable and consequently will be taxed at normal rates.
- No donor gets a deduction, if he donated to a trust for backward classes (as protected by Directive Principles of State Policy in the Constitution of India), thanks to Section 72.
- Indeed, any donor making a donation to any eligible fund listed in the Sixteenth Schedule to the Code is at the mercy of the Assessing Officer to get the deduction in terms of Section 72(1). The provisions of Section 72(3) of the Code empower the Assessing Officer to deny the deduction "*if any activity of the donee <u>is intended for any particular caste</u>". It is a strange condition, incapable of being complied with. How can a donor find out the intended use of donated amount for the benefit of any particular caste? That too, when the assessment is taken up much after the donation is given, how the Assessing Officer can glean the intention of the donee institution and deny the deduction?*
- The 1961 Act has properly recognized that all the receipts in a given year cannot be applied for attainment of charitable objects in the same year and accordingly laid down provisions to take care of such situations, without taxing the shortfall in the application of income. Whereas the Code has done away with this elementary principle and proposes to tax all the non-applied receipts to tax. It is against elementary common sense.
- *These provisions relating to Charitable and Religious Trusts are so much one-sided in favour of revenue, it is surprising to find these provisions printed on both sides of the Code.*

<u>Vertical equity violating principles of natural justice:</u>

- Application for rectification, under 1961 Act, if not disposed of within 6 months from the end of month of receiving such an application, is deemed to have been allowed. This position is turned upside down in Section 167(6) of the Code, which reads;

  "Any <u>application</u> received by an authority <u>for amendment of an order shall be decided within a period of six months</u> from the end of the month in which such application is

received by it, failing which an order shall be deemed to have been made rejecting such application". (emphasis supplied)

- **Consequently, inefficiency of the department perpetuates the tax liability and no remedy is available for the malady of the assessee.**
- In terms of Section 212(2), where an assessment is set aside or cancelled by an appellate authority and meanwhile tax was recovered from him, no refund of such tax will be issued to the assessee till a fresh assessment is made. **This agony of not getting the refund will be further exacerbated, in terms of Sections 192(5) and 193(4), if the assessee were to go on further appeal to the National Tax Tribunal or the Supreme Court, because tax on the originally assessed income will have to be paid before proceeding to file the appeals**.
- Thus, will the revenue achieve horizontal equity by these provisions?!!!
- During the assessment proceedings, under the 1961 Act an aggrieved assessee can approach the Joint Commissioner u/s 144A with an application to redress a grievance relating to an issue agitated by the Assessing Officer. **This remedy is completely removed in terms of Section 164 of the Code**.
- Similarly, in terms of Section 264 of the 1961 Act, a genuine claim, originally not made before an Assessing Officer for want of evidence or due to change of law subsequent to the assessment, could be raised in a revision petition before the Commissioner. **There is no corresponding provision in the Code**. **However, there is a long list of orders prejudicial to the interest of revenue provided (in Section 194 of the Code), which can be revised in favour of revenue by the Commissioner**.

Autocratic power to seize anything

- In the 1961 Act, during a search action u/s 132, seizure of stock- in-trade of jewellers is specifically prohibited by proviso to Section 132(1)(c)(iii). **Whereas stock-in-trade is also liable to be seized, in the case of jewellers in terms of Section 139(2)(f) of the Code**. This is again a typical instance of 'sentence-first- judgment-later'.
- As if the above provision is not adequate to kill the business morale of genuine jewellers, Section 143(6) of the Code provides for release of seized assets only against cash deposit of equal value. One has to wonder as to how anybody can remain in the business of jewellery after losing his stock-in-trade by way of seizure, and still find cash equivalent of the seized jewellery to get them released. A draconian law.
- Seized cash, whenever released, is payable with interest in terms of Section 132B(4) of 1961 Act. **Again, an instance of pseudo horizontal equity in the Code, which does not contain any such provision to pay interest on release of seized cash to the assessee**. In this regard, it is worthwhile to note that this provision in the Code is introduced to overcome many inconvenient decisions of High Courts and Supreme Court – particularly that of the Supreme Court in the case of DGIT vs Diamond Star Exports Ltd. (2008) 293 ITR 438 (Supreme Court) which obliged the Department to pay compensation with interest on illegal seizure of stock-in-trade of the jeweller.

- In terms of Section 141 of the Code, only books of account or documents seized shall be handed over by the authorised officer to the Assessing Officer within 60 days or within extended period as approved by the Commissioner/CCIT. Whereas in terms of Section 143(3) of the Code, if the assessee desires to get the seized assets released, an application should be made within 30 days from the end of the month in which the assets were seized; that too, after explaining to the satisfaction of the Assessing Officer about the nature and source of the asset. This condition is impossible to comply with. On the one hand the Assessing Officer would say that he has not received the seized books of account and documents and consequently he can never get satisfied by the explanation of the assessee. Further, seizures may take place on different dates and the limitation would count from each such date of seizure, which is again an impossible task for the assessee to follow up. In other words, once assets are seized the assessee/victims have no chance of getting the same released within a reasonable time, even where fully explained assets are seized.

WELL SETTLED NORMS THROWN OUT TO OVER COME "INCONVENIENT" JUDGE MADE LAWS:

- Under the guise of simplification many an inconvenient decision of the Apex Court and the High Courts have been thrown out of the window. This step is commented upon in the discussion paper (Vide Para 1.7 at Page A-8), **"Some assumptions which have held the ground for many years have been discarded."** This attempt is nothing short of throwing the baby with the bathtub. Admittedly, these principles got settled almost 70 years back and they have been holding the ground for all these years. There is no valid reason to discard them.
- Indeed, law is not made on assumptions. It is not mathematics. Whenever anybody assumes a thing, he makes an "ass" of "u" and "me", my administrative law lecturer used to say in the Madras Law College. Law is based on reason. **Chief Justice Oliver Wendell Holmes said, "The life of the law has not been logic: it has been reason."**
- Income Tax Law has always been on reason. When first time it was introduced in UK, it was meant to cover the expenses incurred in the Napoleanic War. Reasons have changed but tax has remained. Whereas this Code is based on assumptions sourced on logic. Hence, it is built on fallacies. **The basic fallacies of conceptual idiosyncrasies are listed here under**:

a. **Financial Year**: Both tax payers and tax gatherers and the professionals involved have got clear cut comprehension of the concepts of "previous year and Assessment Year". This is sought to be substituted by one term "Financial Year". But if one goes through the provisions of the Code in Charging Section 2 (2) and 2(7) and Section 204 and Section 285(94) and (109), the so-called simplification is riddled with confusion well confounded. It is a typical case of obfuscation.

b. **EET**: This is a borrowed concept from the Western countries because our draftsmen are incapable of thinking themselves. This concept of Exempt-Exempt-Tax is relevant in those States where there is social security system. In India, we do not have social security system: but we want to follow this "cut-and-paste" culture even in drafting our tax code, by following their system only half way through.

c. **<u>How to prevent Foreign Direct Investments and Collaborations?</u>**: Two sections in the Code will achieve this purpose. So far, Supreme Court has upheld that whenever there is a conflict between a Double Taxation Avoidance Agreement and the domestic law, the law that is favourable to the assessee would prevail. This concept has been built into the 1961 Act in Section 90(2). **This is sought to be reversed by Section 258(8) of the Code which reads:**

> ***"For the purposes of determining the relationship between a provision of a treaty and this code, -***
>
> ***a) neither the treaty nor the Code shall have a preferential status by reason of its being a treaty or law: and***
>
> ***b) <u>the provision which is later in time shall prevail.</u>"***

d. This provision will force the entire set of countries, which have entered into DTAAs with India, up in arms because the Code is later in point of time and it shall prevail as against the treaties. **More so in the context of Section 5(5) according to which, an income of a non-resident is deemed to accrue in India, even if such income is not paid in India, on services rendered outside India and the income has otherwise not accrued in India.** *This is globalization of the jurisdiction of the Code beyond the taxable territories of India.*

e. These two provisions will ensure that all the foreign investments in any field of activity would be withdrawn forthwith. Further, no collaboration worth its salt will be forthcoming because the rate of tax for fees for technical services and for royalties would be governed by the Code. **Still worse, presently any purchase of plant and machinery by FOB Contract outside Port India would not be chargeable to tax in India because no income accrues on such purchase of plant and machinery due to the seller not having any Permanent Establishment in India. By virtue of Section 5(5) such contracts would be subject to tax because income is deemed to accrue in India, though in fact and in law it has not accrued.**

f. **<u>Autonomy of the Board Lost</u>:** Under the Code, the CBDT is proposed to be reconstituted with a view to apparently streamlining the functioning and management of the Board. Actually the Central Government- that means the Revenue Secretary will have a strangle hold over the entire Income Tax Department. **In particular Section 127 of the Code betrays the underlying motives in drafting the Code. According to this provision, the Board shall be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time. If practicable, the Board shall be given an opportunity of being heard before such direction is given. The decision of the Central Government whether a question is one of policy or not shall be final.**

g. The provisions of Section 127 of the Code bring out clearly the methods of obfuscation of the bureaucracy and to explain this one should refer to the following piece from "Yes Minister" – an instance of questioning of the Secretary to the Government by the PAC:

> *"Mrs. Betty Oldham: Look, Sir Humphrey. Whatever we ask the Minister, he says is an administrative question for you. And whatever we ask you, you say*

is a policy question for the Minister. How do you suggest we find out what's going on?

Sir Humphrey Appleby: Yes, I do think there is a real dilemma here, in that while it has been Government policy to regard policy as the responsibility of Ministers and administration as the responsibility of officials, questions of administrative policy can cause confusion between the administration of policy and the policy of administration, especially when responsibility for the administration of the policy of administration conflicts or overlaps with responsibility for the policy of the administration of policy.

Mrs. Betty Oldham: That's a load of meaningless drivel, isn't it?

Sir Humphrey Appleby: It is not for me to comment on Government policy. You must ask the Minister".

h. That is why they want to have the Head Office of the Board at New Delhi. If RBI Headquarters can be located at Mumbai, the Financial Capital of the country, it is axiomatic to have the CBDT, as an autonomous body, headquartered at Mumbai. Indeed, in the 1961 Act the role of the Central Government is very limited to removing difficulties in the administration of the Act and in redressal of grievances. Whereas in the Code, "Big Brother" would be controlling, God only knows, in whose interest. Thus, in terms of Chapter X of the Code the tax administration will be marked by "*petrification of discretion and paralysis of the will to do justice"*.

i. **How to decimate corporate growth?**: In the 1961 Act, this concept of charging minimum tax on Corporates was originally introduced in terms of Section 80VVA, which did not involve interpretation of any other law other than the Income Tax Law. Then came the provisions of 115J onwards involving the interpretation of both Company Law and Income Tax Law. Now, the Code introduces a concept of 'not minimum alternate tax' but 'maximum alternate tax', which is based on taxing the net worth. **It is elementary to understand that net worth of any Company increases only on the basis of taxed income. That is, after paying both corporate tax and dividend distribution tax, besides other taxes. Only when a company is efficiently managed there can be increase in the net worth. Such increased net worth will get completely eroded, if the company were to pay tax on accumulated net worth in terms of Section 2(3) read with Paragraph A of Second Schedule.**

- **Method of accounting:**

The provisions of Section 85 of the Code are self-contradictory. Sub Section (1) prescribes the choice of the method of accounting as cash or mercantile for the heads of income "income from business" and "income from other sources". Here the ghostwriters of the Code forgot that the head of income prescribed in Section 14 of the Code is captioned as "income from residuary sources" and continue to use the old caption as per 1961 Act. The continuity ends there. Then

start all the fallacies. In particular the following two instances set back the settled law by a couple of decades.

a) Value of sale of goods taken as per the method of accounting regularly employed shall be enhanced (euphemistically termed "adjusted") by the amount of any tax duty etc. leviable on the sale of the goods. **This is a provision heavily weighted against the assessees. On the one hand, no deduction would be available without actual payment of such tax, duty etc., and on the contrary, sale value shall be increased by such tax leviable on the sale of goods**. *That means income will be grossed up but expenses allowed only on payment. This kind of 'mixed system of accounting' is proscribed even by Courts due to lack of matching principle. One more instance of bye passing the rule of law.*

b) "Sticky Loan interest" has been a contentious issue which got settled by a series of judgments of the Apex Court and introduction of Section 43D in the 1961 Act. Such interest income shall accrue in accordance with RBI guidelines or NHB guidelines. This settled position is unsettled by sub-section (5) of Section 85, which does not recognise RBI guidelines and consequently throws open the Pandora's Box of litigation for all the public financial institutions and public companies in the financial sector.

- Restriction on the maintainability of appeals before NTT and Supreme Court:

- Only when the disputed tax is paid by the assessee appeals would be maintainable before the National Tax Tribunal or the Supreme Court in terms of Sections 192(5) and 193(4).
- These provisions are imported from the statutes on Indirect Taxes. This is on a fallacious reason. When it comes to indirect taxes, the manufacturers/sellers etc., having collected the taxes already from the consumers, are not entitled to retain the same, while disputing the liability before the higher appellate forums. But, in the matter of income-tax this reason is totally unwarranted and inapplicable. Firstly, the issue before the Courts is regarding the question of taxability of any income or allowance of a deduction. The assessee has not collected any tax from others on account of such claim for exemption or deduction. One more instance of draconian provision in the Code.
- Mockery of the Hierarchical System:

a) In terms of Section 194 of the Code the Commissioner of Income Tax is vested with powers to revise orders prejudicial to the interest of revenue. No appeal has been provided against such orders of the Commissioner. But, after the Assessing Officer gives effect to such revision order, appeal lies to the CIT (Appeals) and in such appeal, the issues decided by the Commissioner in the revision order can be challenged. By this provision an

appellate jurisdiction is given to the CIT (Appeals) over orders passed by his counter part of the same rank.

b) A new concept of "Dispute Resolution Panel" is introduced in the Code (vide Section 284(88) and Section 165 and Section 162). Surprisingly, the jurisdiction of this Dispute Resolution Panel is restricted to variation of only Rs. 25 lakh between the returned income and the assessable income. *If the variation is more than that amount, then direct appeal lies to the CIT (Appeals). When the limit is not exceeded and one goes through the medium of Dispute Resolution Panel, then the appeal lies to the ITAT. Further, how this collegium of three Commissioners is going to function will be known only after the prescriptions are published.*

- A separate analysis of the provisions relating "Recovery", "Penalties" and prosecution would further highlight the draconian nature of the Code.

In sum the above analysis clearly demonstrates that the Code suffers from:

i) Absolute uncertainty;
ii) Complexity which verges upon incomprehensibility;
iii) Excessive and cumulative burdens which make dishonesty immeasurably more rewarding than integrity and hard work;
iv) Injustices inherent in fatuous laws and arbitrary provisions which stem from individual whims and are not based on any discernible principle of legislation or taxation;
v) An administration, not accountable to anybody for its inefficiencies, which shifts the burden on the honest taxpayer;
vi) This Code will only benefit none except the legal and accountancy professions.

- Chief Justice Oliver Wendell Holmes said, "When I pay taxes I buy civilization". In the words of Justice Sabayasachi Mukharji, the then Chief Justice of India, "One would wish that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers very often, in a country of shortages, with ostentatious consumption, and deprivation for the large masses, ask is, does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in government spending are avoided or eschewed, no amount of moral sermons would change people's attitude to tax avoidance".

- In this context, what is civilization is succinctly spelt out by the great jurist Nani A Palkhivala in his "India's Priceless Heritage" (at page 47):

"In these days of spiritual illiteracy and poverty of the spirit, when people find that wealth can only multiply itself and attain nothing, when people have to deceive their souls with counterfeits after having killed the poetry of life, it is necessary to remind ourselves that civilization is an act of the spirit. Material progress is not to be mistaken for inner progress. When technology outstrips moral development, the prospect is not that of a millennium but of extinction. Our ancient heritage is a potent antidote to the current tendency to standardize souls and seek salvation in herds".

- In conclusion one would recall the verse from "Saint Tiruvalluvar", under the chapter "Oppression and Misrule". (552nd verse)

"*Velodu ninraan idu enradu polum*
Kolodu ninraan iravu".

Freely translated it means that an arbitrary tax is an equivalent of a loot extracted by a dacoit.

It is prayed that the powers that be can be persuaded to not presenting this draconian Code in the Parliament.

Hyderabad
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