

BIBLIOGRAPHY

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Cooperatives under the Indian Income Tax Act

G. RAJASUNDARAM

THE cooperative sector has gradually gained an important place in the national economy of India. But the taxation of cooperative societies has, so far, received only scant attention. It is, therefore, worthwhile giving it a serious and systematic consideration.

A cooperative society is defined under the Income Tax Act as a cooperative society registered under the Cooperative Societies Act, 1912 (II of 1912) or under any other law for the registration of cooperative societies. It is not a separate taxable entity and is taxable as 'an association of persons'. This is so even if it is registered as a company.

Taxation of cooperative societies is covered partly by the general law and partly by the Income Tax Act. The general law plays, perhaps, a major part and defines what is taxable income in the hands of the cooperatives. The Income Tax Act simply exempts certain items of income from tax out of what is defined to be taxable by the general law. With regard to the cooperatives registered abroad the Income Tax Act plays still a minor role as the exemptions granted by the Act are not applicable to them.

One exception to the above rule is with regards insurance cooperative societies. From 1955, they have been brought to tax in the same way as profits of mutual and other insurance associations or companies by a specific provision of the Income Tax Act, because ".....there is really no substantial difference between the two and there is no justification for exempting one and taxing the other".¹ This article, therefore, deals in main, with the taxation of non-insurance cooperative societies.

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1. Finance Minister's speech, *Lok Sabha Debates*, 1955, Vol. 9, part II, Col. 5566.

THE GENERAL LAW

Under the general law, the surplus accruing to a mutual concern cannot be regarded as income for income-tax purposes. This is based on the principle that, when a mutual concern does business exclusively with its members, the concern as a whole or the members of such a concern cannot derive a profit from "dealing with themselves". Similarly, where the members of the concern receive back a part of their own contributions, either as patronage dividend or otherwise, the complete identity between the contributors and recipients negates the idea of any profit for "no man can make a profit out of himself". It has been held that even if a mutual concern is held to "to carry on a business or trade with its members" the surplus arising from such trade is not taxable income or profits.

The important test of mutuality was that there must be a complete identity between the contributors to the common fund and the persons who are entitled to participate in its surplus. "The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund: in other words, there must be complete identity between the contributors and the participators".²

The test of mutuality is not so simple as it sounds. Whether a transaction is mutual or non-mutual is one of the fact and there is no legal definition of mutuality. Each case should be decided on its own merits, bearing in mind all the circumstances of the particular case.

A cooperative society may be a mutual concern

2. Lord Macmillan in *Municipal Mutual Insurance Ltd., vs. H.M.S.*, 1932, 16 T.C. 430.

earning non-taxable surplus or a non-mutual concern earning taxable profits. The same cooperative society may carry on mutual activities resulting in a non-taxable surplus and also non-mutual activities resulting in taxable profits. Broadly, it may be said that the surplus arising out of dealings of a cooperative society with its members is not taxable in the hands of the society, provided the members who have dealings with it have (and they alone have) the right to participate in the above said surplus. This principle will, in general, benefit much the consumers' cooperative societies whose dealings are confined mostly to its members.

If a transaction is mutual, the entire surplus resulting from it is completely exempted from tax and not merely the patronage dividends paid to its members. It is not included even for total income purposes.

From the point of view of equity there seems to be little justification in exempting entire income arising out of mutual transactions. "Cooperative associations are organised for buying or selling or both. Even in the case of a cooperative consumers' store, the amount saved by the consumer is influenced not only by what the consumer originally pays the association but also by the amount the association has to pay its suppliers and its employees, by the amounts received from outside investment, and by the amount of its business with non-members. It is our unhesitating opinion that the association and its members, as a result of the trading venture which they undertake, do make a profit. The difficulty arises in determining to which of the two, the members or the association as such, this profit inures. In the hands of one or the other, it is assessable to tax. Thus, while originally "mutuality" may have had great potency in support of an argument that in fact no profits were made from the venture, it has lost much of its former vigour in those aspect of cooperative business which now confront us".³

In the U.K. and Sweden, the income of the cooperative societies is taxed in the same manner as any other commercial organisation. However, the amount of dividend and similar distribution made to customers is deductible from the total income if the distributions are allocated on the basis of the amount of the customers' transactions with the society. In Australia rebates or bonuses paid to

members, based on business done by them with the society and interest or dividend to members are deductible from its income, if, among other conditions, during the base year at least 90 per cent of its business was transacted with its members alone.

The above system of taxing the cooperative societies can be supported from the point of view of both equity and administrative simplicity. While exempting from tax an approximate amount of profits representing 'retroactive price adjustment' or rebates or discounts, it taxes the profits attributable to business activities of the society. It relieves the Department as well as the assessors from the haphazard, arbitrary and burdensome job of deciding whether a particular item of income has arisen out of mutual or non-mutual transactions. It would, at the same time, check cooperative societies from converting 'non-mutual' into mutual transactions and thus from evasion of tax.

THE INCOME TAX ACT

Profits resulting from non-mutual transactions are taxable. The Income Tax Act, however, exempts from income-tax (and super tax) certain categories of income. But they are taken into account for total income purposes.

The exemption in favour of cooperative societies has been in existence from 1901, when the Cooperative Credit Societies Act was passed, in recognition of the fact that cooperative societies "encourage thrift, self help and cooperation among agriculturists, artisans and persons of small means". In the history of taxation of cooperative societies under the Income Tax Act since 1904, three distinct stages may be noted.

Before 1955, the exemption was granted by a Notification issued under Sec. 60 of the 1922 Act. The exemption was in respect of profits of a society (subject to minor exceptions) and dividends or other payments received by the members out of such profits. The term 'profits' referred to 'business profits' and the exemption did not extend to income from (i) interest on securities; (ii) dividend; and (iii) other sources.

In 1955, these concessions were enlarged on the recommendations of the Taxation Enquiry Commission and in view of the importance of planned cooperative development for the future welfare of the country. The main recommendations of the commission were : (i) The dividend received by a member from the cooperative society should be exempt from tax, irrespective of the income out of which it was paid; (ii) Interest and dividends of

3. Report of the Royal Commission on Cooperatives (Ottawa), 1945, pp. 32-33. Useful reference may be made to H.M. Graves' Viewpoints on Public Finance, p. 1431 "Several Views Concerning the Taxation of Cooperatives."

a cooperative society derived from its investments with any other cooperative society should be deemed to be non-taxable; (iii) Income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities should enjoy exemption from tax, considering the usefulness of the development of godowns etc. in our rural economy; and lastly (iv) income under the source interest on securities and income from property should be free from tax in the hands of all cooperative societies (including a cooperative society carrying on the business of banking but excluding housing societies, transport societies, insurance societies and urban consumers' societies) when the total income did not exceed Rs. 20,000.⁴

The recommendations of the Commission were carried out in *toto* in 1955. To put it in broad terms, the net effects of all these provisions were: (i) that income from business of all cooperative societies were completely free from tax; (ii) that income from 'other sources' were taxable in the hands of all cooperative societies; and (iii) that income from securities and property were taxable in the hands of housing societies, transport societies, insurance societies and urban consumers' societies irrespective of their total income and in the hands of all other cooperative societies only when their total income exceeded Rs. 20,000.

The Third and the final stage was reached in 1960. Before the Direct Taxes Administration Enquiry Committee it was complained that the exemptions granted to cooperative societies "... provided a wide loophole for avoidance of tax. Co-operative societies are now running transport services, controlling large industrial and commercial undertakings such as textiles, sugar etc. and their dealings are mostly with non-members. It was urged that exemption of such societies from payment of taxes was also inequitable in that they were comparatively better placed in the matters of financial strength and competitive power than other concerns having the same kind of business activity but which did not enjoy any exemption from taxation". The Committee was of the opinion that "The concession was necessary in the earlier stages of economic development, but...a stage has now been reached when the effect of the continuance of such a concession to industrial and transport cooperatives on the tax revenue of the country could not be ignored". Taking all the aspects of the matter into consideration it

recommended "...that it should be specifically provided for in the Section itself that the exemption would not be available to those cooperative societies whose total income exceeds Rs. 20,000. The limit of Rs. 20,000.....for the grant of the exemption is sufficiently high to cover almost all genuine co-operative societies".⁵

This view of an exemption limit is peculiar which should be verified in the light of reliable statistics. But neither a conclusive nor even inferential statistics as to the taxable income of various classes of cooperatives are available.

The recommendations of the Committee were brought into force by the Finance Act of 1960, with two major alteration and have been in force since than. Whereas the Committee recommended that no exemption should be granted where the total income of the society exceeded Rs. 20,000, the Finance Act, reducing this limit of Rs. 20,000 to Rs. 15,000, allowed it as a deduction irrespective of the total income of the society. Further, it exempted from tax the business income of cooperative societies connected with agriculture, rural credit and cottage industries. (Sec. 81 of the 1961 Act) The exemption of Rs. 20,000 in respect of the taxation of income from interest and property was kept unaltered. Furthermore, the Finance Act liberalised the tax-holiday available to a newly established industrial cooperative society by extending the time limit from 5 years to 7 years.

RATES OF TAXES

As already noted, for income-tax purposes a cooperative society was treated as an association of persons and taxed at progressive rates of income tax. Ever since 1939 and till 1965, the rates of super tax on cooperative societies had been substantially lower than those on individuals and companies and this lower rate too had been applied only when the income of the society exceeded Rs. 25,000. In 1965, the super tax was integrated with the income tax and no difference was made between earned and unearned income in the hands of a cooperative society. The rates of income-tax in force for the assessment year 1966-67 are :

On the first Rs. 5,000 of the total income	5 percent
On the next Rs. 5,000 of the total income	10 percent

4. *The Taxation Enquiry Commission's Report*, 1953-54, Vol. II, pp. 124-27.

5. *Direct Taxes Administration Enquiry Committee's Report*, 1959, pp. 181-83.

On the next Rs. 5,000 of the total income	15 percent
On the next Rs. 5,000 of the total income	20 percent
On the next Rs. 5,000 of the total income	25 percent
On the balance of the total income	41 percent

Provided that no income-tax is payable on a total income not exceeding Rs. 4,000.

Further, the cooperative society is liable for a surcharge at 6½ percent of the amount of the difference between the income tax computed in respect of its total income and the income tax computed in respect of a total income of Rs. 25,000 and for a special surcharge at 10 percent on the income tax and the above surcharge.

Table I compares the tax payable by cooperative societies having various grades of income with that payable by individuals. They are, of course, not strictly comparable. They will, however, suffice for our purpose.

TABLE I
INCOMETAX PAYABLE BY INDIVIDUAL AND COOPERATIVE SOCIETIES

Total Income	Tax payable in Rupees			
	Individual*		Co-operative Society†	
	1965-66	1966-67	1965-66	1966-67
3,000	NIL	NIL	NIL	NIL
5,000	35	11	NIL	NIL
10,000	533	561	NIL	NIL
15,000	1,285	1,386	NIL	NIL
20,000	2,085	2,266	619	688
25,000	3,221	3,516	1,485	1,650
50,000	13,285	14,586	10,145	11,272
80,000	27,785	30,536	22,288	24,765
1,00,000	39,160	43,049	30,649	34,045
5,00,000	2,89,816	3,18,771	2,02,310	2,24,789

*It is assumed that the individual is married and has more than one child and that his income is wholly earned business income.

†It is assumed that the income of the society consists of business income covered by the provision that no tax is payable upto Rs. 15,000. This Rs. 15,000 is taken into account for total income purposes.

It may, during the following discussion, be kept in mind that the general rate of income tax on companies for the assessment year 1966-67 is 45 percent where the total income is Rs. 25,000 or less and 55 percent where it is more than Rs. 25,000.

Table I clearly shows how liberal the rates of tax

on the cooperative society are. The society is free from tax liability upto Rs. 15,000 (plus the specifically exempted items of income, if any). If, for example, the total income is Rs. 50,000, whereas an individual pays Rs. 14,586 as tax, the cooperative society pays Rs. 11,272 i.e., only 77.2 percent of the tax payable by an individual businessman. Even where the total income of the society is as high as Rs. 5,00,000, it pays only 70.5 per cent of the tax payable by an individual.

Another feature of the tax structure on the cooperative societies is that it is too complicated and it requires elaborate calculations. To arrive at the ultimate amount of tax by a society, say, having a total income of Rs. 30,000, one has to pass through not less than eight steps. They are:

- (1) Calculate tax on Rs. 30,000 at the prescribed rates;
- (2) Calculate tax on Rs. 25,000 at the prescribed rates;
- (3) Find out the difference between (1) and (2);
- (4) Calculate 6 per cent of (3);
- (5) Add (1) and (4);
- (6) Calculate the special surcharge on (5);
- (7) Calculate average rate i.e. divide (6) by Rs. 30,000;
- (8) Apply the average rate (7) to Rs. 30,000 minus Rs. 15,000 and the items of income specifically exempted from tax. The result is the tax payable by the cooperative society.

The rate structure on individuals is bound to be complicated to a certain extent because of various reasons, e.g. to adjust the ultimate tax burden of individuals to their varying economic conditions and to bring into practice 'the ability-to-pay principle' as far as possible. But there seems to be no valid reason for maintaining such a complex tax structure in respect of a cooperative society. Some of the points which suggest a flat rate of tax on a joint stock company, are equally applicable to a cooperative society. Most important of them are: it has its own entity apart from its members; the members enjoy, in general, limited liability; they have no right to claim the accumulated reserves of the society as their own; unlike a shareholder of a company, a member of a society can even withdraw the money represented by his share on notice; and what is more important, the total income of a society, without reference to its capital, does not indicate the tax paying capacity of either the society or its members.

In Sweden, the cooperative societies are taxed at a flat rate which is 20 per cent lower than the rate on companies. In Australia, the rates of tax on cooperatives are : 27.5 per cent on the first £5,000 and 37.5 per cent on amount in excess of £ 5,000. Following these examples we in India should simplify the scheme of taxing cooperative societies.

CONCLUSION

There is ample scope for improving the taxation of cooperative societies under the Indian Income Tax Act on the lines indicated. The concessions and exemptions granted to them seem to be liberal.

Adequate supervision is, therefore, necessary to ensure that no improper use is made of tax concessions. Any improper use of them would result not only in revenue loss to the Government but also in tax evasion and in severe discrimination against other classes of assesses.

It may incidentally be pointed out that if, instead of granting very liberal tax concessions, the same amount is given a subsidy or loans, there would be more incentive (and lesser manipulation of profits, where it is possible), and the success of a society can easily be assessed, comparing the net profits after tax of the society with that of any other form of business organisation.

TAXATION OF FIRMS

needs drastic change

G. RAJASUNDARAM

The author observes here that it is wholly unreasonable to compare the tax burden of a company with that of a firm for taxation purposes. He further suggests that the present system of rebates to partners be withdrawn after reducing the tax rates suitably.

FOR purposes of taxation, partnership firms are divided into two classes, namely, (1) registered firms and (2) unregistered firms. A registered firm means a firm registered under the Indian Income-tax Act and an unregistered firm means a firm which is not so registered.

In the case of a registered firm, tax is payable only by the partners on their share of income in the firm. In other words, a registered firm is not treated as a separate taxable entity and it is not required to pay tax as such. (From 1956 registered firm, however, is asked to pay some tax. This provision is discussed, in detail, later in this essay.)

An unregistered firm, on the other hand, is treated as a separate taxable entity. It is taxed at the rates applicable to an unmarried individual without any regard to the number of partners and their personal income. The share of the partners in the income of the firm is exempted from tax in their hands but it is taken into account for total income purposes.

The benefit under the above scheme of taxation depends upon the level of income of the firm and the personal total income of the partners. If the level of income of the firm is low and the personal income of the partners is high, it would be beneficial to keep the firm unregistered. In other cases, registration of the firm would be profitable. But, now there exists a provision in the Income-tax Act to treat an unregistered firm as if it were registered if such a course is beneficial to the revenue.

An unregistered firm can, therefore, hardly benefit under the present scheme of firm taxation. It will be a loser and never be a gainer. In other words, every firm is compelled indirectly to register itself under the Income-tax Act.

The classification of firms into registered and un-

registered firms is peculiar to Indian law. This distinction can be supported neither on equity nor on economic expediency nor even on administrative considerations. After all, a firm is, legally as well as economically, an aggregate of persons called partners and it is only equitable to tax the income of the firm directly in the hands of partners. It cannot be assumed (as some do) that registration of firms is a concession.

It may, on economic and equity grounds, be maintained that the classification of tax-payers into individuals, firms, companies etc., is arbitrary and, therefore, a firm should be given an option to remain unregistered and to pay tax as an individual if it thinks it to be beneficial. But the discretion given to the I.T.O. to tax an unregistered firm as a registered firm invalidates the argument and clearly shows that it is not the real aim of the statute.

When the distinction between registered and unregistered firms was introduced, firms were taxed at the maximum rate and the partners were eligible for a refund. In order to relieve small firms from the trouble of paying tax and claiming refunds, they were allowed to remain unregistered and to pay tax at a lower rate as an individual. The official explanation for this special treatment of unregistered firms, therefore, was the desire not to put them to trouble of claiming refunds. But this explanation is no longer valid and the firms are no longer taxed at maximum rates. From 1939, profits of registered firms are made assessable directly in the hands of partners.

DISTINCTION JUSTIFIED

The Income Tax Enquiry Committee of 1939, justified the distinction on administrative considerations. It maintained that the registration of a firm enables the I.T.O. to have reliable evidences as to the existence of partnership and the manner in which the profits are divisible. In other words, it amounts to saying that the higher tax imposed on unregistered firm is a penalty

for not furnishing the particulars about the firm. But it overlooked the fact that even in the case of unregistered firms the I.T.O. has to ascertain on reliable evidences, the share of the partners in the income of the firm for assessing the personal income of the partners or for exercising the discretionary power given to him.

The reason put forth by the Committee does not seem to be good and no company is taxed as an individual if it fails to furnish the particulars about the shareholders, dividends declared etc. An equitable system for taxing firms may be summarised as under :

1. Every firm should be asked to furnish necessary and genuine particulars about the firm and the division of its profits.
2. A penalty should be imposed on firms not furnishing such particulars.
3. Income of the firm should be taxed directly in the hands of partners at the rates applicable to their personal income.

In short, all firms should be compelled to register themselves under the Income-tax Act. The suggestion, if carried out, would simplify the system of taxing firms and lessen the administrative burden. It would make the tax system more equitable and logical.

FIRM TAX

As already noted, in the year 1956 registered firms were, for the first time, asked to pay income-tax (but not super-tax) when the income exceeded Rs. 40,000 at slab rates varying from 5% to 9%. Section 182 of the Income-tax Act of 1961 makes it clear (i) that the total income of the registered firm has to be assessed and (ii) that the share of each partner in the income of the firm should be included in his personal income and assessed to tax.

The Finance (No. 2) Act, 1962, revised the structure of tax on registered firms by reducing the limit for exemption from Rs. 40,000 to Rs. 25,000 and the rates of tax. It also made distinction between firms having four and more partners and imposed higher rates of tax on firms with five or more partners. The Finance Act 1964, however, abolished the distinction and prescribed the following rates of income-tax :

- | | | |
|----------------------------------------------------------------|-----|-----|
| (1) On the first Rs. 25,000 of the total income | ... | Nil |
| (2) On the next Rs. 25,000 of the total income or part thereof | ... | 6% |
| (3) On the next Rs. 50,000 of the total income or part thereof | ... | 8% |
| (4) On the balance of the total income | ... | 12% |

Further, registered firms were required to pay a surcharge of 20%. The professional firms were, however, subjected to surcharge of only 10%, if the income from profession formed not less than 51% of their total income. The same rates of income-tax and surcharge have been continuing. For the assessment year 1966/67, however, a special surcharge for the purpose of the Union is imposed at 10% of the aggregate amount of income-tax and surcharge.

The partners are allowed, in their personal assessment, some relief under section 86(iv) in respect of the tax paid by the firm. Under this, each partner is entitled to a rebate of tax at his personal rate on his proportionate share of the income-tax paid by the firm. Before 1965, though the rebate of income tax was allowed on his entire share of income-tax paid by the firm, the rebate of super tax was allowed only in respect of the share of tax paid by the firm on income other than its business income.

EFFECTIVE TAX BURDEN

It may be of interest to note the effective tax burden on the share income of a partner. Because of the peculiar system of allowing rebate, the effective tax burden decreases with the increase in the total income of the partners and *vice versa*. In other words, the effective burden of tax on the firms is higher in the case of poor partners than in the case of rich partners. As we know, equity, on the other hand, favours a reverse treatment.

Let us consider whether there is any equitable case for taxing firms as such. The firm tax is often justified comparing the tax burden on a registered firm with that of an unregistered firm or of a company, in particular a private company or a closely held company, familiarly known as "company in which the public are not substantially interested".

As already noted, it is wrong to compare the taxation of an unregistered firm and that of a registered firm. The distinction between registered and unregistered firms is purely a creation of law and that too, is based on unsound and inequitable grounds.

Introducing the tax on firms in 1956, the then Finance Minister explained that the tax on registered firms was imposed to neutralise, to some extent, the advantages of a registered firm as against a company. The scheme of allowing rebates to the partners and also the difference made in 1962 between firms in terms of number of partners go to confirm this explanation.

The following Table, when viewed with the available statistics as to the total income of registered firms assessed in recent years, supports the above explanation :

For the Asst. Year 1966/67.
Amount in Rs.

Total Tax Burden on Shareholders and Partners—a Comparison

Name of the Co. or the firm	Income of the Co. or the firm	Personal income of the shareholder or the partner	SHARE HOLDER					PARTNER				
			Share income	Total income 3+4	Tax by the Co. (share)	Tax by the shareholder	Total tax 6+7	Income from the firm	Total income 3+9	Tax by the firm -rebate (share)	Tax by the partner	Total tax 11+12
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
A ¹	50,000	Nil	2,400	2,400	6,000	Nil	6,000	10,000	10,000	394	561	955
		10,000	2,400	12,400	6,000	957	6,957	10,000	20,000	348	2,442	2,790
		25,000	2,400	27,400	6,000	4,866	10,866	10,000	35,000	295	8,897	9,192
		50,000	2,400	52,400	6,000	18,651	24,651	10,000	60,000	239	23,826	24,065
B ²	1,00,000	10,000	4,800	14,800	12,000	1,353	13,353	20,000	30,000	1,422	6,138	7,560
		25,000	4,800	29,800	12,000	6,038	18,038	20,000	45,000	992	14,256	15,248
		50,000	4,800	54,800	12,000	20,077	32,077	20,000	70,000	804	31,251	32,055
C ²	2,50,000	10,000	12,000	22,000	30,000	2,845	32,845	50,000	60,000	3,740	23,826	27,566
		25,000	12,000	37,000	30,000	10,118	40,118	50,000	75,000	3,440	33,413	36,853
		50,000	12,000	62,000	30,000	25,311	55,311	50,000	1,00,000	2,936	52,667	55,603

1. Calculations are made only in respect of four partners or shareholders.

2. " " " " " " three " "

Notes to The Table:

- (i) The company (Private) or the firm has 5 equal shareholders or partners.
- (ii) It is assumed that the company pays 60% as tax and out of what remains 60% is declared as dividend.
- (iii) In calculating personal tax, deduction is made for Annuity Deposit.
- (iv) Income of the firm or the company is derived from business.
- (v) Income in the hands of shareholders or partners is treated as unearned income.

The Table compares the total tax burden of a shareholder (i.e., tax paid by the company on his share income *plus* tax paid by him on his personal income) with the total tax burden of a partner (i.e., tax paid by the firm on his share income *minus* rebate allowed *plus* tax paid by him on his personal income). It may be clear from the table that, even if we take into account the tax on firms, the total amount of tax payable by the partners is lesser than that payable by the shareholders, provided that in either case the personal income does not exceed Rs. 25,000 and if it exceeds Rs. 25,000, the total income of the concern is about Rs. 1,00,000. In other words, this Table presents a case for taxation of firms so far as the personal income of partners is low and the total income of the firm is not very high. And the income-tax statistics show that almost all registered firms assessed in recent years were small in size, that is, out of the total number of registered firms assessed in recent years, not less than 95% of the firms had the total income of Rs. 2,00,000 or less. Statistics as to the total income of partners are not available. But this may not alter or affect much the above conclusion.

TAXATION OF COMPANIES AND FIRMS

Thus, there is justification for the taxation of firms when it is compared with that of companies and their shareholders. But the question is: Is it reasonable to compare firms and companies for tax purposes?

A comparison of the taxation of a large public company i.e., a widely held company, with that of a firm would result but in confusion. The peculiar and special characteristics of a widely held company justify a special treatment. Such a company is not only a legal entity but also an economic and a social entity. As a natural consequence of incorporation and the transferability of shares, it enjoys stability and perpetual succession. The shareholders' liability is limited and the ownership is often separated from control of the management of the affairs of the company. A firm, on the other hand, has no such characteristics.

A big firm, no doubt, often resembles a small private company from the view point of economics. But on this basis, one cannot justify the tax on firms. Because the taxation of a private company as any other large public company, itself is justified not on equity grounds but mainly on administrative considerations. Under the present steeply progressive rates of taxes on individuals, economic expediency also favours such a treatment of a private company. Principles of equity, on the other hand, not only strongly oppose such a treatment but also strongly recommend 'the partnership method' for taxing them. In other words, enquiry requires that the profits of a private or a closely held company should be taxed as partnerships. In this connection, it may be pointed out that in the U.S.A., the Income-tax Act authorises corporations having no more than 10 shareholders to elect the partnership basis of income taxation if all shareholders wish. The privilege includes the right to pass through operating losses to the shareholders.

It is, therefore, wholly unreasonable to compare the tax burden of a private company or of a closely-held public company with that of a firm and to impose tax on this basis. A particular view of equity requires that every endeavour should be made to relate the incidence of taxation to the total income of the persons to whom the income actually belongs. For tax purposes, any comparison should, therefore, be made between individual and not between a firm and a company.

In conclusion, it may be said that even if the tax on firms is not abolished considering the revenue needs of the Government (effective tax collection from registered firms may vary from 3 to 4 crores) the present scheme which allows rebates to partners may be withdrawn, no doubt, after reducing suitably the rates of tax. It involves undue administrative burden. Because of this scheme effective firm-tax, no doubt, decreases with the decrease in the difference between tax liabilities of the shareholder and the partner. But in no case the decrease in tax is proportional and it can never equalise the tax burden of a shareholder and that of a partner.