Note on Judicial Precedents where Constitutional Validity of provision in fiscal statutes is challenged and decided (especially under Income Tax Act, 1961)

By CA Kapil Goel can be contacted at 9910272806 (cakapilgoel@gmail.com)

Case Title/Citation	Constitutional Challenge & Principle Emerging/Applied
NTPC 192 ITR 187 Delhi High Court	**MAT U/s 115J on Book Profits** "This provision, namely, section 115J, was brought in the statute book in an effort to tax what is commonly known as "zero tax companies". These are companies which have, in fact, large profits in its books but, for the-purpose of the Income-tax Act, by virtue of various deductions which have been claimed, very little taxable income is disclosed. It is in an effort to bring such types of companies within the taxable net that section 115J was inserted by Parliament. We are unable to agree with learned counsel for the petitioner that this provision is violative of articles 14 and 19 of the Constitution". **Validity Upheld by DHC**
Exide Industries 292 ITR 470 Cal High Court	**Leave Encashment on Actual Payment basis – deduction in business profits (Section 43B)** "Leave encashment is neither statutory liability nor a contingent liability. It was a provision to be made for the entitlement of an employee achieved in a particular financial year. An employee earns certain amount by not taking leave which he or she is otherwise entitled to in that particular year. Hence, the employer is obliged to make appropriate provision for the said amount. Once the employee retires he or she has to be paid such sum on cumulative basis which the employee earns throughout his or her service career unless he or she avails of the leave earned by him or her. That, in our view, could not have any nexus with the original enactment. An employer is entitled to deduction for the expenditure he incurs for running his business which includes payment of salary and other perquisites to his employees. Hence, it is a trading liability. As such he is otherwise entitled to have deduction of such amount by showing the same as a provisional expenditure in his accounts. The Legislature by way of amendment restricts such deduction in the case of leave encashment unless it is actually paid in that particular financial year. The Legislature is free to do so after they disclose reasons

	for that and such reasons are not inconsistent with the main object of the enactment. We are deprived of such reasons for our perusal" **Held Unconstitutional**
A.B.Shanti 255 ITR 258 Supreme Court	***Section 269SS/Section 269T Excerpts:*** ***A Constitution Bench of this court in S. K. Dutta, ITO v. Lawrence Singh Ingty [1068] 68 ITR 272 held (page 275) :*** ***"It is not in dispute that taxation laws must also pass the test of article 14. That has been laid down by this court in Moopil Nair v. State of Kerala [1961] 3 SCR 77. But as observed by this court in East India Tobacco Co. v. State of Andhra Pradesh [1963] 1 SCR 404, 409 in deciding whether the taxation law is discriminatory or not it is necessary to bear in mind that the State has a wide discretion in selecting persons or objects it will tax, and that a statute is not oper. to attack on the ground that it taxes some persons or objects and not others ; it is only when within the range of its selection, the law operates unequally, and that cannot be justified on the basis of any valid classification, that it would be violative of article 14. It is well settled that a State does not have to tax everything 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 above dictum applies in full force as regards the present case. The object sought to be achieved was to eradicate the evil practice of making of false entries in the account books and later giving explanation for the same. To a great extent, the problem could be solved by the impugned provision.*** ***In Union of India v. A. Sanyasi Rao [1996] 219 ITR 330 (SC), sections 44AC and 206C of the Income-tax Act were challenged. It was held by this court (headnote) :*** ***"The heads of legislation in the lists should not be construed in a narrow and pedantic sense, but should be given a large and liberal interpretation. The word 'income' occurring in entry 82 in List I of the Seventh Schedule to the Constitution should be construed liberally and in a very wide manner and the power to legislate will take in all incidental and ancillary matters including the authorisation to make provision to prevent evasion of tax, in any suitable manner."*** ***When the principle in a statute is challenged on the ground of colourable legislation, what has to be proved to the satisfaction of the court is that though the Act! ostensibly is within the legislative competence of the Legislature in question, in substance and in reality, it covers a field which is outside its legislative competence (see Jaora Sugar Mills (P.) Ltd. v. State of M. P., AIR 1966 SC 416).*** The next contention urged by counsel for the appellant is that original

	section 276DD is draconian in nature as penalty imposed for violation of section 269SS is imprisonment which may extend to two years and shall also be liable to fine equal to the amount of loan or deposit. This section was subsequently omitted and a new section 271D was enacted. The penalty of imprisonment was deleted in the new section. The new section 271D provides only for fine equal to the amount of loan or deposit taken or accepted. It is important to note that another provision, namely section 273B was also incorporated which provides that notwithstanding anything contained in the provisions of section 271D, no penalty shall be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provision if he proves that there was reasonable cause for such failure and if the assessee proves that there was reasonable cause for failure to take a loan otherwise than by account-payee cheque or account-payee demand draft, then the penalty may not be levied. Therefore, undue hardship is very much mitigated by the inclusion of section 273B in the Act. If there was a genuine and bona fide transaction and if for any reason the taxpayer could not get a loan or deposit by account-payee cheque or demand draft for some bona fide reasons, the authority vested with the power to impose penalty has got discretionary power **Validity Upheld by SC**
SC in Ashirwad Films **Struck Down Andhra Pradesh Higher entertainment Tax on Non Telgu Films** 2007 6 SCC 624	12. A taxing statute, however, enjoys a greater latitude. An inference in regard to contravention of Article 14 would, however, ordinarily be drawn if it seeks to impose on the same class of persons or occupations similarly situated or an instance of taxation which leads to inequality. The taxing event under the Andhra Pradesh State Entertainment Tax Act is on the entertainment of a person. Rate of Entertainment tax is determined on the basis of the amount collected from the visitor of a cinema theatre in terms of the entry fee charged from a viewer by the owner thereof. 14. *It has been accepted without dispute that taxation laws must also pass the test of Article 14 of the Constitution of India. It has been laid down in a large number of decision of this Court that a taxation statute for the reasons of functional expediency and even otherwise, can pick and choose to tax some. Importantly there is a rider operating on this wide power to tax and even discriminate in taxation: that the classification thus chosen must be reasonable.* **The extent of reasonability of any taxation statute lies in its efficiency to achieve the object sought to be achieved by the statute. Thus, the classification must bear a nexus with the object sought to be achieved** [See Moopil Nair v. State of Kerala AIR 1961 SC 552, East India Tobacco Co. v. State of Andhra Pradesh AIR 1962 SC 1733, V.

	Venugopala Ravi Varma Rajah v. Union of India and Anr. AIR 1969 SC 1094, Assistant Director of Inspection Investigation v. Kum. A.B. Shanthi AIR 2002 SC 2188, The Associated Cement Companies Ltd. v. Government of Andhra Pradesh and Anr. AIR2006SC928] 15. Objectives in a statute may have a wide range. But the entire matter should also be considered from a social angle. ***In any case, it cannot be the object of any statute to be socially divisive in which event it may fall foul of broad constitutional scheme enshrined under Articles 19, 21 as also the Preamble of the Constitution of India*** 16. In that behalf, it is important to read the object of a taxation statute on the touchstone of social values as mentioned in the Constitution. An adverse conclusion can be drawn if a particular statute goes against such values***. It is on thing to say that the taxation statute does not further social good, but quite another when it disturbs the social fabric. The court may take adverse note in respect to statutes falling in the latter category. We herein note two cases where an attempt has been made to raise this discussion to the pedestal of Directive Principles….*** **20. It is also required to be realized that imposition of reasonable tax is a facet of good governance.** **21. Another aspect of the matter cannot also be lost sight of. Taxing statute like penal statues should receive strict construction. It cannot be arbitrary. [See Bidhannagar (Salt Lake) Welfare Asson. V. Central Valuation Board & Ors., Civil Appeal No. 6345 of 2000 decided this date]** ***22. It may be true that the Court ordinarily is not concerned with the rate of tax unless the same is wholly arbitrary or confiscatory. However, it is well settled that generally speaking a tax imposed must be reasonable***
DHC in Madhushree Gupta and British Airways July 2009 Ruling ***Penalty Proceedings Initiation Without***	**Read Down to save it from Unconstitutionality** The presence of prima facie satisfaction for initiation of penalty proceedings was and remains a jurisdictional fact which cannot be wished away as the provision stands even today, i.e., post amendment. ***If an interpretation such as***

Satisfaction Section 271(1B) Finance Act 2008 WP(C) No. 5059 and 6272 of 2008	***the one proposed by the Revenue is accepted then, in our view, the impugned provision will fall foul of Article 14 of the Constitution as it will then be impregnated with the vice of arbitrariness*** 16. In our view the submission of the Revenue that the impugned provision deals with procedural aspect of the matter and hence cannot be challenged on the ground of retrospectivity is a surplusage. ***Suffice it to say that the legislature had plenary powers to enact a law both prospectively and retrospectively subject to certain constitutional limitations, as long its competency to do so is not under challenge and it is not unfair or unreasonable, i.e., falls foul Article 14 of the Constitution.*** …
Madras High Court in K.R.Palanisamy On Section 50C (deemed capital gains on stamp value) Constitutional Validity 306 ITR 61	**Point No.1: Whether the Central Legislature is competent to enact Section 50C of the Income-tax Act?** 17. Let us consider the legislative competence of the Parliament in inserting the provision Section 50C in the Income-tax Act. It is obvious from the reading of the above provision and rather it is not disputed that the same is inserted to prevent large scale undervaluation of the real value of the property in the sale deed so as to defraud revenue the Government legitimately entitled to by pumping in black money. The impugned provision has been incorporated to check such evasion of tax by undervaluing the real properties. Article 246 of the Constitution of India gives exclusive power to the Parliament to make law in respect of the matters enumerated in List I of VII Schedule (Union List). Entry 82 List I of VII Schedule empowers the Parliament to levy tax on income other than agricultural income. The legislative competence of the Parliament in enacting statute or inserting provision for arresting leakage of income has been considered by the Apex Court in several cases. The uniform opinion in all those cases is that the entries in the legislative list should be construed more liberally and in their widest amplitude and not in a narrow or restricted sense. Each general word should be held to extend to all ancillary or subsidiary matters which can fairly and reasonably be said to be comprehended by it.

	The expression "income" as defined in the Income-tax Act under Section 2(24) cannot be read back into Entry 82 of List 1 of the VII Schedule to the Constitution. 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" occurring in Entry 82 of List I of the VII Schedule. The said Entry should be widely and liberally construed so as to enable a Legislature to provide by law for the prevention of evasion of Income Tax. Tax could be evaded by breaking the law or could be avoided in terms of the law. When there is a factual avoidance of tax in terms of law, the Legislature steps into amend the income tax law to catch such an income within the net of taxation. (See Punjab Distilling Industries Vs. C.I.T., AIR 1965 SC 1862, (Constitution Bench), Balaji Vs. C.I.T., AIR 1962 SC 123 (Constitution Bench), Bhagavandoss Jain VS. Union of India, AIR 1981 SC 908 = (1981) 128 ITR 315, Asst. Director of Inspector, Investigation Vs. A.BShanthi, AIR 2002 SC 2188 and Union of India Vs. A.Sanyasi Rao, AIR 1996 SC 1219 = 219 ITR 330). (bold supplied) **Point No.4: Whether it is necessary to read down section 50C:** 40. It is contended that the provision cannot even be read down as the same is beyond the legislative competence and violative of Articles 14 and 265 of the Constitution of India. Much reliance has been made to the decision of the Supreme Court in the case of DELHI TRANSPORT CORPORATION VS. D.T.C.MAZDOOR CONGRESS, AIR 1991 SC 101. Here again, we are not able to accept the contention of the learned counsel for the petitioner. While answering the contention of the petitioner that the impugned provision is arbitrary in nature, which gives unguided power to levy tax on a fictitious consideration, a detailed discussion has been made as to how provisions under the Stamp Act and the Income-tax Act have given opportunity to the assessees as well to dislodge the value assessed or adopted by the authorities under the Stamp Act with necessary material on record and negatived the contention. ***In K.P.VARGHESE VS. INCOME-TAX OFFICER, (1981) 131 ITR 597 and C.B.GAUTAM VS. UNION OF INDIA, (1993) 1 SCC 78, as there was no provision giving opportunity to the assessees, to rebut the***

	presumption made under the then existing provision Section 50(2) of the Income-tax Act, it was directed to be read down by giving an opportunity to the assessees and also casting upon the burden of proof of under valuation. However, as discussed in point No.2, sufficient ***opportunity has been given to the assessee to rebut the presumption as to the full market value of the capital asset arrived at by the authorities under the Stamp Act and further on point No.1, as we concluded that the provision is constitutionally valid and not hit by legislative incompetence, the contention as to reading down of the provision has to be rejected and there is no such necessity as well. As the provision impugned is held to be valid, Varghese case and Gautam's case are not applicable***
Section 40(a)(ia) Income Tax Act	**Constitutional Validity Since upheld in** a) All High Court 216 CTR 83 Dey's Medical b) P&H High Court in Rajesh Kumar 178 Taxman 481 Applied: ***"…In State of West Bengal v. Kesoram Industries Ltd. AIR 2005 SC 1646, reiterating the earlier view, the Hon'ble Supreme Court quoted with approval following passage:-*** ***"32. . . . . In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The Legislature after all has the affirmative responsibility. The Courts have only the power to destroy not to reconstruct. When these are added to the complexity or economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the Judges have been overruled by events, self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability . . ." (p. 1674)…*** ***…7. It cannot be disputed that Legislature, in exercise of its taxing power, not only can provide for levying tax, it can also provide for penal action for enforcing the charge, if there is any evasion of tax or statutory liability. In R.S. Joshi v. Ajit Mills Ltd. AIR 1977 SC 2279, a Bench of seven Judges of the Hon'ble Supreme Court approved the observations in earlier judgment in R. Abdul Quader and Co. v. STO AIR 1964 SC 922:-*** ***". . . . All powers necessary for levy and collection of the tax concerned and for seeing that the tax is not evaded are comprised within the ambit of the legislative entry as ancillary or incidental. . . ." (p. 924)"***