TAXATION LAW

# UNIT – I
# General Concepts & Constitutional Basis of Taxation

Expanded Edition • 20+ Slides • For LLB / Judiciary / CA Foundation

LEARNING ROADMAP

# Full Coverage of UNIT-I

| | | |
|---|---|---|
| 1. Concept & Nature of Tax | 2. Characteristics of Tax | 3. Direct vs Indirect Taxes |
| 4. Tax Planning vs Avoidance vs Evasion | 5. McDowell & Anti-Avoidance | 6. Constitutional Power – Art. 265 |
| 7. Seventh Schedule Distribution | 8. Residuary Taxing Power | 9. Fundamental Rights & Taxation |
| 10. Commerce Clause (Arts 301-304) | 11. Inter-State Trade & Taxation | 12. Retrospective Taxation |
| 13. Immunity of Instrumentalities | 14. Delegation of Taxing Power | 15. Local Bodies Taxing Power |
| 16. Key Case Laws | 17. Exam Strategy | 18. Key Takeaways |

# Definition and Essential Nature

A tax is a compulsory exaction of money by a public authority for public purposes enforceable by law. It is not a payment for services rendered. The power to tax is an inherent attribute of sovereignty.

### Key Elements

- Compulsory contribution
- Imposed by State / public authority
- For public purposes
- Enforceable by law

### Not a Tax

- Fee (quid pro quo)
- Cess (specific purpose)
- Penalty / fine
- Compulsory deposit

02 • CHARACTERISTICS OF TAX

# What makes a levy a 'tax'

### Compulsory

Payment is not optional. Backed by coercive machinery of the State.

### Public Purpose

Raised for general public expenditure, not for private benefit of any person.

### No Quid Pro Quo

Taxpayer does not receive a direct measurable service in return.

### Legal Authority

Must be imposed by a valid law enacted by a competent legislature (Art. 265).

### Regularity

Usually periodic, though one-time levies can also be taxes if other conditions are met.

### Ability to Pay

Modern taxes often seek to align burden with the taxpayer's capacity (progressive taxation).

# Fundamental Classification

## Direct Tax

- Incidence and impact on same person
- Cannot be shifted easily
- Examples: Income Tax, Corporation Tax
- Progressive in design
- Based on ability to pay
- Taxpayer is conscious of burden
- High administrative cost of collection
- Elastic with income growth

## Indirect Tax

- Incidence on one, impact on another
- Can be shifted to consumer
- Examples: GST, Customs Duty
- Often proportional / regressive
- Burden hidden in price
- Broader base, easier collection
- Affects consumption patterns
- Major source of revenue for States

# Legitimate Minimisation of Tax

Tax planning is the arrangement of a person's financial affairs in such a way that he pays the minimum tax legally due. It is done within the four corners of the law and is encouraged by the tax system through incentives and deductions.

### Examples

Investing in 80C instruments, choosing between tax regimes, timing of capital gains, use of available exemptions.

### Legal Status

Fully legal and legitimate. Courts have recognised the right of a taxpayer to arrange affairs to reduce tax.

### Difference from Avoidance

Planning uses clear statutory incentives. Avoidance uses gaps or colourable devices.

### Exam Tip

Always state that tax planning is permissible and give 2–3 concrete examples.

# Colourable Devices & Judicial Approach

Tax avoidance is the art of dodging tax without actually breaking the law. It involves taking advantage of loopholes or using artificial arrangements whose only purpose is to reduce tax.

### McDowell & Co. (1985)

Supreme Court held that colourable devices and dubious methods of tax avoidance are not part of the law. Substance over form.

### Earlier View (IRC v. Duke of Westminster)

Every man is entitled to arrange his affairs so that tax is less. McDowell moved away from this extreme position.

### Later Refinement

Vodafone and other cases clarified that legitimate tax planning is allowed; only artificial and colourable devices are disregarded.

### GAAR

General Anti-Avoidance Rules now exist in the Income Tax Act to deal with impermissible avoidance arrangements.

# Illegal Suppression of Tax

### Meaning

Illegal means to escape tax – concealment of income, false statements, fake invoices, suppression of sales.

### Consequences

Heavy penalties under the Act + prosecution for wilful attempt to evade tax (criminal liability).

### Examples

Not disclosing cash income, claiming fake deductions, under-invoicing, benami transactions.

### Detection

Search & seizure, survey, information from third parties, data analytics by tax department.

### Difference from Avoidance

Evasion breaks the law.
Avoidance stays within the letter of the law but may be struck down if colourable.

### Exam Tip

Always give a clear three-way distinction: Planning (legal) – Avoidance (colourable) – Evasion (illegal).

07 • ARTICLE 265

# No Tax Without Authority of Law

Article 265: “No tax shall be levied or collected except by authority of law.” This is the fundamental constitutional safeguard against arbitrary taxation. Both levy and collection must be backed by a valid statute.

### Levy

The imposition of tax must be by a law made by a competent legislature.

### Collection

Even a validly levied tax cannot be collected except in the manner provided by law.

### Consequence of Violation

Tax collected without authority of law is illegal and is liable to be refunded.

### Scope

Applies to all taxes – Union, State and local. One of the most frequently cited articles in tax litigation.

08 • SEVENTH SCHEDULE

# Distribution of Taxing Powers

### Union List (List I)

Income tax (non-agricultural), customs, corporation tax, capital gains, residual taxes (Entry 97), service tax (earlier), CGST/IGST under Art. 246A.

### State List (List II)

Land revenue, agricultural income, taxes on lands & buildings, alcohol for human consumption, profession tax (subject to limit), SGST under Art. 246A.

### Concurrent / Shared

GST is a special concurrent power under Art. 246A. Both Centre and States tax the same supply (intra-State).

### Residuary Power

Art. 248 + Entry 97 List I – any tax not mentioned in List II or III belongs to the Union.

# Constitutional Limits on Taxing Power

### Article 14

Taxing statutes must not be discriminatory. Classification must be reasonable and have a nexus with the object.

### Article 19

Reasonable restrictions on freedom of trade/business are permissible. Confiscatory taxes can be challenged.

### Article 21

In extreme cases, a tax that is so harsh as to deprive a person of livelihood may attract Art. 21 scrutiny.

### Article 301

Freedom of trade and commerce – a tax that directly and immediately restricts free flow of trade can be struck down.

### Compensatory Tax Doctrine

Earlier used to save certain taxes. Later diluted. GST has changed the landscape.

### Exam Point

A taxing statute enjoys a presumption of constitutionality, but is not immune from FR challenge.

# Articles 301–304

Article 301 declares that trade, commerce and intercourse throughout the territory of India shall be free. This freedom is subject to the restrictions in Arts. 302–305. Taxation that directly impedes the free flow of trade can violate Art. 301.

### Art. 302

Parliament may impose restrictions on trade in the public interest.

### Art. 303

No preference or discrimination between States by Parliament or State legislatures (limited exceptions).

### Art. 304

States may impose reasonable restrictions and non-discriminatory taxes on goods from other States with Presidential sanction in certain cases.

### Atiabari Tea Co.

Landmark case – tax can amount to a restriction if it directly and immediately restricts the free flow of trade.

# Power and Limits

### Power Exists

Legislature can make tax laws retrospective. Courts have upheld this power subject to limits.

### Limits

Cannot be so unreasonable as to violate Art. 14. Cannot take away vested rights arbitrarily.

### Vodafone Controversy

Retrospective amendment to tax overseas share transfers created huge uncertainty and international criticism.

### Policy Lesson

Retrospective taxation undermines certainty and investor confidence. Used sparingly in modern practice.

### Judicial Approach

Courts examine whether the retrospective law is clarificatory or seeks to impose a new burden unfairly.

### Exam Tip

State the power + the constitutional limits + one example (Vodafone or any other).

# Inter-Governmental Tax Immunity

The doctrine of immunity of instrumentalities suggests that one government should not tax the instrumentalities of another. In India the doctrine has limited application and is largely regulated by specific constitutional provisions.

### Art. 285

Property of the Union is exempt from State taxation unless Parliament provides otherwise.

### Art. 289

Property and income of a State are exempt from Union taxation (with exceptions for commercial activities).

### Practical Scope

The immunity is not absolute. Commercial activities of government may still be taxable.

### Exam Point

Mention Arts. 285 & 289 and state that the doctrine is not as absolute as in some other federations.

# Legislature vs Executive

### Essential Function

The power to levy tax is an essential legislative function. The legislature cannot completely abdicate it.

### Permissible Delegation

Legislature can delegate the power to fix rates within limits, to grant exemptions, or to frame rules for collection.

### Limits

Policy and guidelines must be laid down by the legislature. Excessive delegation is unconstitutional.

### Local Bodies

Municipalities and Panchayats can levy taxes only when authorised by State law. Their power is purely delegated.

### Case Law

Courts examine whether the parent Act provides adequate guidance and whether the delegate has stayed within limits.

### Exam Tip

Distinguish original taxing power (Union/State) from delegated power (executive / local bodies).

# Must-Remember Decisions

| | |
|---|---|
| **McDowell & Co. (1985)** | Colourable devices of tax avoidance are not permissible. Substance over form. |
| **Atiabari Tea Co.** | Tax can violate Art. 301 if it directly and immediately restricts free flow of trade. |
| **Express Hotels** | Discussed compensatory tax theory in the context of entry tax / luxury tax. |
| **Jindal Stainless (2016)** | Re-examined entry tax and compensatory tax doctrine; significant for inter-State trade. |
| **Vodafone International** | Highlighted issues of retrospective taxation and tax certainty. |
| **Kunnathat Thatehunni** | Classic case on the distinction between tax and fee. |

# How to Score in UNIT-I

1. **Start with Definition**
   Always begin with a clear one-line definition of tax or the concept asked.

2. **Constitutional Anchor**
   Quote Art. 265, relevant List entry, or Art. 301 as applicable.

3. **Distinctions**
   Direct/Indirect, Tax/Fee, Planning/Avoidance/Evasion – tables score high.

4. **Case Names**
   McDowell, Atiabari, Vodafone – even one line holding is enough.

5. **Current Context**
   Mention GST as the major redesign of indirect tax and co-operative federalism.

KEY TAKEAWAYS

# UNIT-I at a Glance

**01** **Tax = Compulsory + Public Purpose + No Quid Pro Quo**

Art. 265 is the constitutional foundation.

**02** **Direct vs Indirect**

Incidence & impact same vs shifted. GST is the major indirect tax.

**03** **Planning – Avoidance – Evasion**

Legal – Colourable – Illegal. McDowell is the leading case on avoidance.

**04** **Seventh Schedule + Art. 246A**

Distribution of taxing power. GST is dual and concurrent.

**05** **Commerce Clause**

Art. 301 can limit taxing power if trade is directly impeded.

**06** **Delegation & Immunity**

Essential legislative function cannot be abdicated. Arts. 285 & 289 regulate inter-governmental immunity.

# End of UNIT – I

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