ABSTRACT

This essay focuses on the conception of taxable income in India and argues that there is a disconnect between the policy of tax laws and their judicial interpretation. The author takes an inter-disciplinary approach to explain that the taxation laws in India are predominantly premised on the net accretion concept of taxable income whereas the Indian judiciary has consistently inclined towards the ‘source’ based definition of income. The paper further discusses the impact of each approach on the building of taxation jurisprudence in India. It concludes with the argument that the disengagement between the judiciary’s perception, the taxation policy and legislation has resulted in an incoherent understanding of the concept of ‘taxable income’ in India.
In 2009, the Government of India released the Direct Taxes Code Bill (later substituted by the Direct Taxes Code Bill, 2010). While the provisions of the new code attracted debate and scholarship from the legal community, the code's adoption of a "comprehensive conception" of income received little attention. This is surprising, given that the conception of income is the foundation of an income tax. However, a perusal of prior legal scholarship reveals ambiguity and scant deliberation surrounding the subject. Kanga, Palkhivala and Vyas' investigation of India's tax jurisprudence concluded that there is no logical explanation of "income" under India's income tax law. In his paper Income or Capital? in 1970, Bagchi concurred with this. A shortcoming of the existing tax scholarship is that it approaches the subject from either an exclusively legal or an exclusively policy-based perspective.
This paper adopts an interdisciplinary approach to achieve clarity about the concept of income under Indian income tax law. It considers in detail how each of the two prominent economic conceptions of income, source and net accretion, is articulated within India’s income tax law and jurisprudence. Consequently, it theorizes the following: India’s judicial conception of taxable income has been inspired by the source view of income. However, India’s tax policy and statutes have been in transition toward the net accretion view of taxable income. This paper attributes the incoherence in India’s conception of taxable income to the growing disconnect between the fiscal policy’s view and the judiciary’s view of taxable income.

II. Conceptions of Taxable Income

This section of the paper introduces the two prominent conceptions of “taxable income” that underlie fiscal systems: source and net accretion. It briefly discusses the characteristics of these two paradigms which are crucial to an analysis of India’s conception of taxable income.

A. Source Conception of Taxable Income

The source conception of income was a product of the British “political economy” in the eighteenth and nineteenth centuries. Britain was predominantly an agricultural society, and its view of income was inspired by the harvest cycle. K. Holmes explains it as follows:

“Income was viewed as a physical product; an annual harvest, or the cash into which the harvest could be converted. Income in this sense recurred regularly with the passage of seasons. Such income was related to the capital that produced it. The harvest arose out of farming, which took place on the land. Land on the other hand was a physical and continuing source of annual harvest. The harvest was separable from the source and was available for unconstrained disposal or consumption without impairing the underlying capital.”

From the harvest cycle emanated the perception of income as a flow from capital and land which produced the income stream, and signified capital in the

[Hereinafter, “K. Holmes”]

4 174, K. Holmes.

5 174, K. Holmes.
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physically. The gains on the disposal of land were not viewed as income. Some scholars attribute this to the infrequent changes of ownership in land, while others advocate alternative reasoning based on the political clout of landed interests. This distinction between income and capital was further grounded in the institution of trusts. Richardson comments:

"Income Tax was introduced in Britain in 1799 and was developed in the 19th century... At that time the United Kingdom had a developed agricultural economy and a developing industrial society... Ingrained in English legal thinking affecting both the political establishment and the judiciary was the use of trusts and the succession of property."

Landowners sought to bequeath their estate to their heirs, without giving the latter the power to dispose of the same.

"Thus, the estates were to be retained within a genealogical lineage where an estate was held in trust for each succeeding heir, who was entitled only to the income from the estate during his lifetime. An heir was not entitled to the capital of the estate, increases of which, during the heir's lifetime, were accumulated in the estate and passed on to successors. Consequently, a distinction arose between income, which could be consumed by the life tenant, and capital, which was to pass to remainder man."

The courts transposed this distinction in trust law into their understanding of income.

Finally, a word must be said about Britain's classical economists' approach to understanding income and the scheduler mechanism of taxation. Consider the following paragraph from S. Utz's Ability to Pay and notice the suggested nexus between scheduler taxation and the view that taxable income arises from the factors of production:

"Britain followed a scheduler system of taxation wherein the income tax laws relied on the device of requiring taxpayers to report income in accordance..."
with scheduled activities or from scheduled sources, which apparently made sense to the British, because British classical economists had so successfully sold their public on the inevitability of the macroeconomic model that distinguished land, capital and labour as ultimately distinct sources of new wealth."^{12}

Thus, British classical economists placed emphasis on functional rather than "personal" distribution.^{13}

This historical outline provides a contextual introduction to the characteristics of the source conception of income.^{14} The hallmark of the source conception of income is the distinction made between income and capital. This distinction is analogous to the distinction between the tree and its fruit.

The source is generally linked to capital, in its physical sense. The flows that capital produces are regarded as income and are subject to tax. Any accretion in capital value is not taxed.

B. Other Amplifications of the Concept of Income

As R.F. Plasschaert observes, the source conception was often seen in combination with other amplifications of the concept of income.^{15} The most important of these was periodicity, which envisaged income as a recurrent flow.^{16} Economists have expressed a distinction between regularity and recurrence.^{17} "Receipts may, and often do, fluctuate in an irregular pattern of recurrence."^{18} While regularity may suggest that a receipt may not fluctuate, recurrence merely demands the "possibility of future successive wealth."^{19}

Furthermore, the understanding of income as a flow led to the development of a legal concept divorced from the idea of economic gain.^{20} The simplest illustration

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12 S. Utz.
16 85, P. Wueller; See also 99, K. Holmes.
17 85, P. Wueller; See also 99, K. Holmes.
18 100, K. Holmes.
19 85, P. Wueller. Periodicity seems to be inspired by Britain’s harvest cycle and the life entitlement of the beneficiary of the trust.
20 379, K. Holmes.
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was the purchase of an annuity for a lump sum. The entire annual receipt was held taxable though a part of it represented recovery of the initial investment. As such, the fiscal system followed a “net income” concept. However, the idea of income as an inflow hindered the courts from noticing the corresponding diminution in the value of the asset that produced the inflow. K. Holmes referred to this phenomenon as the taxation of “illusory gains.”

Productivity was another test for qualification as income. The receipt should have arisen from an economic activity undertaken by the recipient of income. Noticeably, Britain’s scheduler approach to taxation bears semblance to the productivity criterion.

Further, the British courts saw only cash receipts or receipts convertible into cash as income, much like the harvest produce. K. Holmes notes that the courts’ view was often guided by an ordinary man’s perception of income.

This view of income was not limited to Britain. Literature suggests that it was adopted by many countries and economists of continental Europe. However, since India was a former colony of Britain, this paper draws on the British version of the source conception of income, including the already mentioned amplifications of this.

C. Net Accretion Conception of Taxable Income

Schanz, Haigs and Simons are recognized as the first proponents of the net accretion approach to income. These economists each had a background in fiscal policy; each was interested in developing a “fiscally useful concept of income” embedded in the ideals of equity or the “ability to pay” principle. Thus, the net accretion approach was a product of systemized study by economists. This is not to discount the plausible influence of the political and economic factors on their views of income. Whatever the primary influence, the essence of their perception of income was “ability to pay.”

21 379, K. Holmes.
22 85, P. Wueller.
23 Tenant v. Smith, 1892 AC 150, 156 (House of Lords).
24 233, K. Holmes.
25 85, P. Wueller.
27 557-583, P. Wueller II.
28 557-583, P. Wueller II.
Schanz defined income as “net inflow of economic ability over a given period of time.”[29] However, he gave no indication as to the measure of the economic ability.[30]

Next, R.M. Haig conceptualized income as “the money value of the net accretion to one’s economic power between two points in time.”[31] According to him, the economic power of an individual was his power to satisfy his wants. He further defined income as “the increase or accretion to one’s power to satisfy his wants in a given period so far as that power consists of (a) money itself, or, (b) anything susceptible of valuation in terms of money.”[32]

Under R.M. Haig’s definition, income, in addition to cash receipts, would include the following. First, the receipt of any goods or services obtained in kind which can be valued in terms of money, and which would indeed satisfy wants. Second, accretion in the value of assets, whether realized or not. Like cash receipts, these accretions empower the individual to fulfill his wants. Third, the value of benefits obtained from non-market transactions, often referred to as imputed income. For instance, the benefit derived from living in one’s own house. This benefit represents the satisfaction of a want equivalent to that of a person who rents a house.[33]

This takes us to H.C. Simon’s definition of personal income. He viewed income as:

“The algebraic sum of (i) the market value of rights exercised in consumption and (ii) the change in the value of the store of other property rights between the beginning and the end of the period in question.”[34]

H.C. Simon’s conception is similar to that of R.M. Haig’s. Yet, while the latter measures the economic power at the stage of its accrual, the former measures the

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29 G.V. Schanz, Der Einkommensbergeiff und die Einkommensteuergesetze, FINanz ARCHiv 1-30 (1896) as translated in 85, P. Wueller.
30 233, K. Holmes.
32 R.M. Haig.
33 R.M. Haig.
34 R.M. Haig.
35 R.M. Haig.
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increase in a person’s economic power by looking at its disposition (at the stage of its exercise either for consumption or savings after such expenditure). For our purposes we shall follow R.M. Haig’s approach to measuring income.

It is noteworthy that a complete implementation of the net accretion conception is difficult to achieve. For instance, the United States would like to apply such principles but is prevented from doing so by administrative hurdles. Problems arise especially in the valuation of imputed income and accretions to the value of assets where such gains have not been realized. Consequently, imputed income remains untaxed and taxes on accretion to the value of assets are paid upon realization. Thus, the net accretion conception has practical drawbacks. Nonetheless, present-day literature regards it as the most suitable conception of income for the imposition of an income tax.

D. Divergence between Source and Net Accretion

This paper does not endeavor to reach a conclusion about which of the foregoing conceptions is superior from a tax policy perspective. Indeed, ample scholarship exists that evaluates the relative merits and drawbacks of these conceptions. Instead, this paper evaluates how the adoption of either conception bears on the law and its interpretation. This paper hypothesizes that the Indian fiscal system is in transition from the source conception to the net accretion conception. Therefore, it becomes important to gain an understanding of where these conceptions diverge. R.A. Musgrave’s elaboration on the net accretion approach assists in understanding this divergence:

“According to this definition (net accretion), income equals gain in net worth plus consumption during a given period. What matters is total income thus defined. No distinction is to be made between either sources or uses of income. Gains may be factor earnings (e.g., wages, interest, and rent) in the economist’s sense, or they may be mere transfers (e.g., gifts or gambling gains); they may be expected or unexpected, irregular or regular, accrued or realized, from business or accident, and so on and so forth. All that matters is that there exists a gain which gives rise to consumption or to increase in net worth. Similarly, it is left to the recipient whether he wishes to use his

37 233, K. Holmes.
39 Graetz.
40 Graetz.
41 174, K. Holmes. See also 557-583, P. Wueller II.
gain for one or another type of present consumption, or whether he wishes to postpone consumption and save.\textsuperscript{42}

These theoretical observations can be transposed to "actual receipts" that would be affected by this divergence.

First, receipts arising from transfers do not qualify as income under the source conception of income on account of the criteria of periodicity, productivity and the income-capital distinction. However, the gains embedded in these receipts are certainly income under the net accretion approach. Even an unrealized accretion to the value of assets is income under the latter approach.\textsuperscript{43}

Second, windfalls such as lottery, gambling winnings and life insurance receipts are not taxed under the source conception because they fail the periodicity and productivity criteria. Yet, under the net accretion conception they represent an economic gain and are therefore taxable.\textsuperscript{44}

Third, benefits that are not convertible into money, for instance, rent-free accommodation (that cannot be sublet) provided by an employer are not income under the British conception. However, under the net accretion approach, such a benefit satisfies want and is taxable if it can be valued in terms of money.\textsuperscript{45}

Fourth, benefits derived from non-market transactions (imputed income) are not income under the source view. This is because there is no receipt or an incoming; leaving aside their convertibility into money. On the other hand, the net accretion approach measures the increase in economic power with an increase in the satisfaction of wants. Therefore, as long as imputed income can be valued in terms of money, it is taxable.\textsuperscript{46}

Fifth, the conceptions diverge on annuity receipts. Under the source conception, income is perceived as a flow from a source as opposed to an economic gain. Despite the fact that a part of an annuity receipt is merely a return of the original investment, the entire annuity receipt is considered as income and is taxable. On the contrary, under net accretion, only the gain in excess of the amount invested is taxed from an annuity receipt.\textsuperscript{47}


\textsuperscript{43} 379, K. Holmes.

\textsuperscript{44} 164 and 166, K. Holmes.

\textsuperscript{45} 160, K. Holmes.

\textsuperscript{46} 158, K. Holmes.

\textsuperscript{47} 363, K. Holmes.
These five receipts are treated differently under the two conceptions of income. The differences in these conceptions may have a bearing on certain other receipts. However, we shall confine discussion to these five receipts and, in the following sections, analyze the bearing they have on Indian income tax law.

III. INDIA’S CONCEPTION OF TAXABLE INCOME

This section of the paper chronologically charts India’s changing conception of taxable income, within the framework of the two paradigms discussed in the previous part: source and net accretion. For several years, tax scholarship in India has critiqued the ambiguous conception of income underlying the Indian income tax system. Studying India’s conception within these paradigms helps to pinpoint the cause for this incoherence. To do so, the paper looks at India’s fiscal policy, legislation and judicial decisions.

A. Establishing India’s Conception of Income – Judiciary takes the lead

The Income Tax Act, 1922 [Hereinafter, “the Act”) was enacted during the British Rule in India. Consequently, there is a presumption that the Act adopted the British conception of income. To ascertain this, we peruse the relevant provisions.

The Act did not originally contain a definition of income. Unlike the British law, it followed a global system of income taxation. However, it contained a provision enumerating the “sources of income.” These sources resembled the schedules of the British income tax law and the four factors of production. The provision reads as follows.

“Save as otherwise provided by this Act, the following heads of income, profits and gains shall be chargeable to income tax in the manner hereinafter appearing namely:

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48 202, Kanga; 1781-1787, Bagchi.


50 The scheduler income tax system is one where, “each of the various categories of income, or (partial) incomes...flowing to the same taxpayer, is subjected to a separate tax rate.” A global income tax is one where, “all incomes, from whatever source derived, accruing to the same taxpayer, are treated as a single mass of income and subjected to a single rate formula.” See 17, R.F. Plasschaert.

51 § 6, The Income Tax Act, 1922.

52 § 6 was initially interpreted in Probhat v. Emperor, AIR 1924 Cal 668 [Calcutta High Court] to be the charging section. Later, the Supreme Court departed from this position and held that the provision merely classified income.
(i) Salaries
(ii) Interest on Securities
(iii) Income from Property
(iv) Profits and gains of business, profession or vocation
(v) Income from other sources"

As such, there was no specific head for gains arising from the transfer of assets. Yet, that did not preclude taxing those gains under income from property, business, or employment or, in any case, under the head of income from other sources.

Thus, the Act followed a global method of taxation and made a provision that enumerated sources reminiscent of the British schedules.

Further, § 4 (3)(vii)\(^53\) of the Act excluded casual\(^54\) and non-recurring receipts\(^55\) not arising in the course of business or profession from total income. Similarly, § 4 (3)(v) excluded capital sums received in commutation of pension income or in payment of insurance policies.\(^56\) These exclusions could signify the use of a statute to relieve items that would otherwise be income. Alternatively, the provision could be a restatement of the "conception of taxable income," giving statutory effect to the criteria of periodicity, productivity and the income-capital distinction. Either way, § 4 had the effect of exempting gains arising from transfers and windfalls. These exclusions were characteristic of the source conception of income.

At one instance, the Act provided for the taxation of imputed income, where rental income was imputed to an owner occupying her building.\(^57\) Furthermore,

53 § 4 (3)(vii). The Income Tax Act, 1922: “Any receipts not being receipts arising from business or the exercise of profession, vocation or occupation, which are of a casual and non-recurring nature or are not by way of addition to the remuneration of an employee.”.

54 Casual has been defined by the courts to mean “subject to or produced by chance, accidental, fortuitous”. See Cossimbazar v. Commissioner of Income Tax, 1946 14 ITR 377 Cal, 395 [Calcutta High Court].

55 Some courts construed non-recurrence to imply the impossibility of recurrence. See In Re: Chunnilal Kalyandas, [1924] 1 ITC 419 (All) [Allahabad High Court]. Others interpreted the term to mean that there is no claim or right in the recipient to expect its recurrence. See Amrit Kunwar v. Commissioner of Income Tax, 1946 14 ITR 561, 591 [Allahabad High Court] [Hereinafter, “Amrit Kunwar”] as quoted in 446, Kanga.

56 § 4 (3)(v). The Income Tax Act, 1922: “Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber to any such provident fund.”

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in 1923, the Act was amended to tax rent-free accommodation provided by an employer to his employee, as the latter's salary income. This was despite the fact that the employee could not sublet the accommodation and convert the benefit into money. These provisions departed from the British conception of source.

Against this legislative backdrop, the Privy Council rendered a decision on the meaning of "income" in Shaw Wallace v. Union of India. The issue was whether receipts received in lieu of cessation of an agency could constitute income. The Court held that these receipts were not income and noted:

"Income... in this Act connotes a periodical monetary return 'coming in' with some sort of regularity, or expected regularity, from definite sources. The source is not one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall. Thus income has been likened pictorially to the fruit of a tree, or crop of a field. It is essentially the produce of something which is often loosely spoken of as 'capital'. But capital, though possible the source in the case of income from securities, is in most cases hardly more than an element in the process of production."

This decision was the beginning of the judicial conception of income. The Court did not cite any policy statement supporting its view. Further, the only statute quoted was § 6 of the Act. According to the Court, "it enumerated the sources from which taxable income could be derived under the Act." Inferably, the court was importing Britain's scheduler philosophy of income vide § 6 of the Act.

Furthermore, it clarified that receipts received in lieu of cessation of an agency had not arisen under the head of income from business. This was because "the head" contemplated the continuation of business. Since the receipt arose to substitute the source itself, it was not income. The Revenue argued for a broader conception of taxable income. It drew support from § 4 (3). As seen, the provision excluded casual and recurrent receipts and certain capital sums from the definition

59 Shaw Wallace.
60 Shaw Wallace.
61 Shaw Wallace.
62 Shaw Wallace.
63 Shaw Wallace.
64 Shaw Wallace.
of income. Revenue's proposition was that these items had to be specifically excluded because the Act envisaged them as income. The Court, however, attributed the enactment of the provision to the anxiety of the draftsman.

Furthermore, the Court denied the influence of the British conception of income and English judicial decisions. Yet, it recited the same. It introduced amplifications to the concept of income under the Act such as "coming in", monetary return (money or anything being capable of turned into money from its own nature), periodicity, productivity and the distinction between income and capital. From a practical standpoint, such a conception excluded windfalls, gains arising from transfers (capital receipts), benefits in kind that were not convertible into money, and imputed income from the scope of income.

A review of the Privy Council's decision in Gopal Saran Narain Singh v. Commissioner of Income Tax confirms the judiciary's adoption of the source conception of income. The facts of this case were as follows. A taxpayer transferred an estate worth Rs. 20,000,000 for a relatively small annuity of Rs. 2,40,000 for life. It was argued that the annuity in toto could not constitute his income as it provided no "profit" or "gain" to him. A part of the installments merely represented return of capital. The Privy Council, however, held that the entire annuity receipt was income in the hands of the taxpayer, "as the term income was not qualified by the notion of profits or gains. Anything which can properly be described as income..."

65 Shaw Wallace.
66 Shaw Wallace.
67 The Privy Council observed: "Again their Lordships would discard altogether the case law which has been so painfully evolved in the construction of the English income-tax statutes—both the cases upon which the High Court relied and the flood of other decisions which has been let loose in this Board. The Indian Act is not in pari materia; it is less elaborate in many ways, subject to fewer refinements, and in arrangement and language it differs greatly from the provisions with which the Courts in this country have had to deal. Under these conditions their Lordships think that little can be gained by attempting to reason from one to the other, at all events in the present case in which they think that the solution of the problem lies very near the surface of the Act, and depends mainly on general considerations." However, in later cases, the Supreme Court acknowledged the influence of the British legal interpretation of income.

68 The Court did not explain the taxation of owner-occupied houses provided for under the Income Tax Act, 1922.
69 The Court did not explain the provision in the Income Tax Act, 1922 for the taxation of rent free accommodation provided to the employee by the employer, even though the latter could not sublet and hence convert it into money.
70 Gopal Saran Narain Singh v. Commissioner of Income Tax, 3 ITR 237 (P.C.) [Privy Council]. [Hereinafter, "Gopal"]
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is taxable under the Act unless expressly exempted.” This case completed Shaw Wallace's articulation of the British conception of income. The judiciary perceived income as a "flow from a source" rather than an economic gain. This perception led to the taxation of "illusory gains," as in this case.

B. Statutory Definition of Income

In 1939, the Act was amended to insert an "inclusive" definition of income. The definition specifically included dividends and perquisites or profits received in lieu of salary as income. These inclusions were consistent with the judicial conception of income. The specific mention of dividends was to ensure the taxation of all distributions by corporations. Further, by the Finance Act, § 4 (3) (v), which excluded capital sums received in commutation of pension income or in payment of insurance policy, was deleted.

Post the insertion of the statutory definition of income, the court broached the subject in Kamakshya Narain Singh v. Commissioner. This case is marked for its critique of the Shaw Wallace definition of income. The case revolved around the taxability of royalties arising from the leasing of coal mines. The taxpayer argued that coal on his land was capital, and the sums that he received from time to time for each ton raised and despatched was a capital receipt, being the price in exchange for a capital asset. Alternatively, he argued on grounds of equity, stating that coal was a wasting property and was gradually exhausted as each ton was

71 Gopal.
72 The law of statutory interpretation in India accords a special significance to an inclusive definition. In N.D.P. Namboodripad v. Union of India, AIR 2007 SC 1782 [Supreme Court of India] the Supreme Court noted “When the word ‘include’ is used in a definition clause, it is used as a word of enlargement that is to make the definition extensive and not restrictive”. Further, on several occasions, the Indian courts have commented on the ‘inclusive’ aspect of the definition as implying a broad statutory concept of income: “Income includes not only those things which this clause declares that it shall include, but such things as the word signifies according to its natural import....” See Commissioner of Income Tax v. Kiranbhai, 1999 235 ITR 635 Guj [Gujarat High Court].
73 § 4 (6C), The Income Tax Act, 1922 defined income as follows: “Income includes anything included in ‘dividend’ as defined in clause (6A) and anything which under Explanation 2 to subsection (1) of section 7 is a profit received in lieu of salary for purposes of that sub-section ...”
74 209, Kanga.
75 45, O.P. Chawla.
76 See § 4 (3) (v), The Income Tax Act, 1922.
raised and disposed off. In other words, as the taxpayer was experiencing a gain with the royalty receipts, he was simultaneously facing a decline in the value of the mine. And hence his gain was illusory. The Court, however, held the royalties to be taxable.

As regards the first argument, the Court rejected royalties as the purchase price paid for coal. The Court held that the royalties, in substance, were rent: the compensation which the occupier paid the landlord for the species of occupation which the contract between them allowed. The court classified the consideration received under the lease into three categories (1) the premium; (2) the minimum royalty; (3) the royalties per ton. The premium was held to be a capital receipt, received for parting with "the right to enjoy the benefits (a capital asset)." But the royalties were seen on a different footing. The minimum royalty was payable only if, in any year, the royalties on coal raised and despatched were less than the sum fixed as the minimum royalty. This, according to the Court, amounted to a species of annual guarantee: it did not correspond to any coal actually extracted and taken away; it was simply "income" flowing from the covenants in the lease. It would be payable if, in any year, the lessees took no coal at all, or if the coal was exhausted before the termination of the lease. On the other hand, the royalty payable on each ton of coal was a fluctuating amount and, as such, the Court faced a dilemma on account of the periodicity criterion laid down by the Privy Council in Shaw Wallace. Also, relying on Shaw Wallace's tree and fruit analogy, the taxpayer argued that in his case, "There was no fruit; that is to say, there was no increase, there was no sowing or reaping in the ordinary sense of the term; and there were no periodical harvests."

In this context, the Court critiqued the conception of income discussed in Shaw Wallace:

"Sir George Lowendes speaks of income being likened pictorially to the fruit of a tree or the crop of a field. But it is clear that such picturesque similes cannot be used to limit the true character of income....Income is not necessarily the recurrent return from a definite source, though it is generally of that character. Income again may consist of a series of separate receipts, as it generally does in the case of professional earnings."  

At first glance, it appears that the Court was departing from the Shaw Wallace definition of income. Scholarship interprets this decision as such. However, on a closer evaluation, the Court's decision in substance adheres to Shaw Wallace.

78 Kamakshya Narain Singh.
Consider the Court's purported rejection of the "periodicity" criterion and the preceding discussion where the Court classifies the lease consideration into three categories. The Court held that the guaranteed minimum royalties were income. Critical to the Court's reasoning was the fact that these guaranteed amounts clearly met the criteria of periodicity as they represented "regular" flows from a source (covenants of the lease). However, the Court perceived the fluctuation in the royalty payable per ton as a hindrance to the fulfilment of the periodicity criterion of Shaw Wallace. As discussed previously, periodicity demands recurrence of receipts or the possibility of future successive wealth. It does not impose the condition of regularity. Therefore, the royalty payable per ton met the periodicity criterion. The Court's observations could then have two plausible explanations. One, the Court misconceived periodicity to imply regularity. Two, Shaw Wallace envisaged periodic flows as both recurrent and regular receipts, and the Court limited periodicity to the mere "possibility of future successive flow".

Now, consider the Court's critique of Shaw Wallace's simile of the tree and its fruit. The Court's observations arose in the following context. The taxpayer contended that in a mining lease, there was no fruit; no reaping or sowing in the ordinary sense. Here, the taxpayer was referring to coal as the tangible capital asset or source, which he argued was the subject of sale with the royalties being consideration for the same. The Court characterized the transaction as one where the source was the right to enjoy the benefits of the lease and the royalty payments were its fruit. The premium paid for acquiring this right was held to be a capital receipt. Hence, the Court agreed to the simile of the tree and its fruit, conforming to the capital-income distinction.

In dealing with the taxpayer's second argument, the Court followed the source conception of income. It was argued that royalty payments did not represent a gain because they were accompanied by a simultaneous decline in the value of the mining lease. The Court briskly dismissed the argument and observed, "The fact that mines are wasting assets is irrelevant." A net accretion perspective of income would have appreciated the taxpayer's claim. Under the net accretion approach, the royalty receipts would remain taxable. However, the tax would be accompanied by a deduction for the economic decline in the value of the mine.

If the Court adhered to the Shaw Wallace view of income, how does one explain its formal critique of the same? Plausibly, the Court misinterpreted the proposition laid down in Shaw Wallace. Alternatively, the Court may have sought to retract the prescriptive formulation of income under Shaw Wallace because of the existence of the more inclusive definition of income in the statute. Judicial
propriety warrants that the courts follow legislation. However, the exercise of judicial self-restraint on one occasion does not mark a change in the judiciary’s perception of income. This is evident from subsequent cases, where the judiciary continued to follow the source view.

C. Introduction of the Capital Gains Tax

The most important digression from the source conception was the introduction of “capital gains tax” in 1948. The definition of income under the Act was amended to include capital gains and a new head of income was introduced in § 6 of the Act. Further, § 4 (3) (vii) which excluded casual and non-recurring receipts from income was amended to deny the benefit to capital gains.

Capital gains were defined to include gains arising from the sale or exchange of a “capital asset.” Further, capital asset was defined broadly to mean property of any kind (excluding stock in trade, personal effects and agricultural land).

From the set of capital receipts, a small subset arising from the sale or exchange of “capital asset” was made taxable. Other gains that represented accretions to capital remained non-taxable. Thus, the term “capital gains” came to signify “taxable gains” or “taxable capital receipts.” In addition, a lower rate of taxation was extended to the entire set of taxable gains.

While introducing the capital gains tax, the Finance Minister noted in his budget speech:

“My next proposal is a tax on capital gains. Honourable members must be well aware of the extent to which large capital gains have been made in recent years and are still being made owing to prevailing conditions. These profits are, as the law stands, outside the scope of the Income Tax Act. I feel very strongly that this lacuna in our legislation should be filled. There is stronger

79 See The Indian Income Tax (Amendment) Act, 1941.
80 See The Indian Income Tax (Amendment) Act, 1941.
81 See The Indian Income Tax (Amendment) Act, 1941.
85 Gains arising from the transfer of an asset that formed the inventory of a business, for instant receipts arising from sale of land in a real estate business, were taxable even under the source conception of income. This is because the land in this context did not represent the source but a trading asset. The receipts arising therefrom were categorized as revenue receipts, and land as a trading asset.
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justification for taxing these profits than there is for taxing ordinary income since they represent what is properly unearned increment. The U.S.A. taxes such profits."^{86}

The introduction of capital gains tax was justified on grounds of equity. For India's fiscal policy, the inclusion of capital gains in "taxable income" signified the beginning of a changed perception of income—accretions to capital enhance the ability to pay and should be taxed as income. A tax on capital gains diverged from the income-capital distinction, periodicity and productivity. India's fiscal policy took its first step toward the net accretion conception of income.

Because income had acquired a meaning under the source conception, the constitutionality of the capital gains tax was challenged before the Supreme Court.\(^7\) It was argued that the Constitution empowered the Central Government to impose "taxes on income" and income did not embrace capital gains either according to its "natural import"\(^8\) or common usage or according to judicial interpretation of relevant legislation in England or India. Further, it was contended that a clear line of demarcation had always been observed by English lawyers and English jurists between income and capital, that the English legislative practice had always recognised this difference and that as the word had come to acquire a certain meaning and a certain connotation by reason of such legislative practice in England, the British Parliament which enacted the Government of India Act, 1935 must be regarded as having understood and used the word "income" in the Constitution in that sense.

Observations made by the Court in response to these arguments assist our cause. First, the Court confirmed that the basis of the Privy Council's decision in Shaw Wallace had been inspired by the scheduler philosophy. It observed:

"The truth of the matter is that while Income-tax legislation adopts an inclusive definition of the word 'income' the scheme of such legislation is to bring to charge only such income as falls under certain specified heads (e.g., the 5 Schedules of the English Act of 1918 and our section 6 read with the following sections) and as arises or accrues or is received or is deemed to arise or accrue or to be received as mentioned in the statute. The Courts

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86 Finance Minister's Budget Speech, (1947) 15 ITR (St.) 10.
87 Navincha Mafatla v. Commissioner of Income Tax, (1954) 26 ITR 758 (SC) [Supreme Court of India]. [Hereinafter, "Navincha Mafatla"]
88 Income in its natural import signified income as was understood in the source conception of income.
have striven to ascertain the meaning of the word “income” in the context of this scheme.”

Indeed, the courts were following the source conception of income to interpret income under the income tax law.

Second, the Court sanctified the capital gains tax by drawing a distinction between the meaning of income under the Act and the Constitution:

“There is no reason to suppose that the interpretation placed by the Courts on the word in question was intended to be exhaustive of the connotation of the word “income” outside the particular statute. If we hold, as we are asked to do, that the meaning of the word “income” has become rigidly crystallised by reason of the judicial interpretation of that word appearing in the Income-tax Act then logically no enlargement of the scope of the Income-tax Act, by amendment or otherwise, will be permissible in future. A conclusion so extravagant and astounding can scarcely be contemplated or countenanced.”

In effect, the Court concluded that the source view was limited to understanding income under the Act. As regards the Constitution, income was to be interpreted according to its meaning in English, “coming in,” whereby any receipt could be made chargeable to tax. Two points should be noted here. First, the Court respects the source conception of income, holding it valid under the Act. Second, by drawing a distinction between income under the Act and under the Constitution, it assures policymakers the freedom to tamper with the source view of income. To rephrase, source conception was followed in interpreting income under the Act. However, if the legislature wished to tax receipts outside the source view vide a specific enactment, the courts would respect it.

Consequently, there emerged the practice of addressing items specifically included in income by the legislature, in deviation from the source view, as “artificial income” (a term that commonly appears in the income tax commentaries of Kanga, Palkhivala and Vyas).

D. Judiciary’s inconsistent application of the Shaw Wallace Conception

In 1952, the Supreme Court rendered its next noted decision on the meaning of income in *Raghuvanshi Mills v. Commissioner of Income Tax*. The case entailed

89 Again, income in its natural import signified income as was understood in the source conception of income.

90 *Raghuvanshi Mills v. Commissioner of Income Tax*, (1952) 22 ITR 484 (SC) [Supreme Court of India]. [Hereinafter, “Raghuvanshi Mills”]
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the question of the taxability of insurance proceeds received for the loss of profits occasioned by the destruction of the taxpayer's factory in a fire. The insurance proceeds were received pursuant to a policy taken specifically to cover the loss in profits.

The Court attached significance to the fact that the insurance proceeds were received in lieu of profits. These profits, if earned, would have been operating revenue and taxable income. On the other hand, had the insurance compensated for the loss of the factory (a capital asset), the proceeds would have been non-taxable as they were capital receipts. The Court thus followed the income-capital distinction.

In addition, it was argued by the taxpayer that the insurance proceeds would not qualify as income because they did not recur. Nor did they directly arise from an economic activity.

The court responded by referring to § 4 (3) (vii) of the Act, which excluded casual and non-recurring receipts from the tax net, provided these receipts did not arise from business or the exercise of a profession or vocation. It then held that the insurance receipt was inseparably connected with the ownership and conduct of the business, and arose from it.

§ 4 (3) (vii), however, was an exclusion. It did not render casual and non-recurring receipts arising in the course of an economic activity, or insurance receipts, expressly taxable. These receipts would remain non-taxable if they did not qualify under the general conception of income. The taxpayer proposed the definition in Shaw Wallace as the general conception of income: "income comes in with some sort of regularity or expected regularity from definite sources."

Confronted with a situation where a strict reading of Shaw Wallace would prevent the taxation of these insurance receipts as income, the Court observed:

"It is true the Judicial Committee attempted a narrower definition in Commissioner of Income-tax v. Shaw Wallace & Co., by limiting income to "a periodical monetary return 'coming in' with some sort of regularity, or expected regularity, from definite sources" but, in our opinion, those remarks must be read with reference to the particular facts of that case......we do not

91 Raghuvanshi Mills.
92 Raghuvanshi Mills.
93 Raghuvanshi Mills.
94 Shaw Wallace.
think their Lordships had in mind a case of this nature when they decided Shaw Wallace & Company's case."

The following proposes two plausible explanations for the court to have read down Shaw Wallace.

First, consistent with its approach in Kamakshya Narain Singh, the Supreme Court attempted to seek a more flexible definition of income than that given in Shaw Wallace, such that it would yield to the legislative mandate where required. The statute itself exempted receipts that did not meet the productivity and periodicity criteria. The Shaw Wallace definition of income simply overlay these limitations and rendered them meaningless. To give effect to the statute, the Court would have to read down the Shaw Wallace definition of income.

Second, independent of the statute, the Court perceived these insurance receipts as income. The Court observed:

"The assessee is a business company. Its aim is to make profits and to insure against loss. In the ordinary way it does this by buying raw materials, manufacturing goods out of them and selling them so that on balance there is a profit or gain to itself. But it also has other ways of acquiring gain, as do all prudent businesses, namely by insuring against loss of profits."

The Court's view was that a receipt arising in the ordinary course of an economic activity fulfilled the productivity criteria. The non-recurrence of the receipt was inconsequential. However, the decision did not rid the judicial conception of income of the periodicity criteria. A more appropriate presentation of the holding is, "Gains arising from isolated transactions are not income unless they are part of a pattern of transactions undertaken in the carrying on of a trade or business."

The dicta of the case gave rise to several decisions that were inconsistent with the Shaw Wallace conception, but only with regard to periodicity and productivity. The income-capital distinction, the hallmark of the source conception, was always strictly observed. In addition, income was still viewed as an inflow in the form of money or benefits convertible into money.

Consider the following illustrations. The Bombay High Court adjudged the issue of whether monthly alimony received under a court decree was income.

95 Raghuvanshi Mills.
96 Raghuvanshi Mills.
97 164, K. Holmes.
98 Maheshwaridevi v. Commissioner of Income Tax, 1984 147 ITR 258 Bom [Bombay High Court]. [Hereinafter, "Maheshwaridevi"]
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Although these receipts were recurrent, they did not arise from any economic activity. Nor did these receipts represent windfalls. The Court regarded the right to receive alimony as a capital asset and a source. This case is cited as an example where periodic flows from an enforceable obligation were regarded as income, and where the criterion of productivity was rendered inconsequential. On the other hand, a voluntary gift was regarded as a casual payment even if it was repeated and took the form of a regular annual allowance. According to the Court, the gift represented a windfall.

On another occasion, the Supreme Court remarked that winnings from horse-racing would be taxable under the Act, but for the exception made for casual and non-recurrent receipts. It rendered both periodicity and productivity inconsequential to the meaning of income. Furthermore, in due course, the legislature deleted the provision excluding casual and non-recurring receipts. Despite the deletion, Courts have held personal gifts to be non-taxable under the general conception of income. Similarly, the gains embodied in the life insurance receipt were held to be non-taxable. A capital receipt (not being a capital gain) remained untaxed on account of the income-capital distinction.

E. Fiscal Policy's Evolving View of Income

The Finance Act, 1955 brought several changes to the definition of income which deviated from the source conception of income. Again, these legislative changes signified the changing perspective of the policymaker.

A number of "artificial incomes" were made taxable. First, capital receipts compensating for the loss of certain sources of income were included in the definition of income. The compensation for loss of office as a managing agent or

99 Maheshwaridevi.
100 574, Amrit Kunwar.
102 The provision was deleted vide The Finance Act, 2003.
104 Commissioner of Income Tax v. B.K. Roy, 248 ITR 245 (SC) [Supreme Court of India].
cessation of agency was made taxable as business income. Compensation received for loss of employment became taxable as salaries. These receipts had been held to be non-taxable by the Courts, pursuant to the income-capital distinction. Second, several benefits enjoyed by employees and directors of corporations were made taxable as income, despite the fact that some of these benefits were not capable of being converted into money.

As noted previously, the 1948 capital gains tax covered gains from transfers arising vide a sale or an exchange. This tax was withdrawn in 1949, ostensibly because of its adverse effect on investment, the resultant hindrance to the free movement of securities in the capital market and the small yield. None of the given reasons had a bearing on the conception of income. In 1956, the capital gains tax was reintroduced. Once more, the Finance Minister justified the inclusion of capital gains within income on account of the ability to pay. He noted:

"Capital gains are an important factor in aggravating economic inequalities and there is no justification for regarding capital gains as a species of income not liable to tax."  

This time the scope of the tax was widened. Earlier gains arising from the sale or exchange of capital assets were made taxable. The provision now taxed gains arising from the sale, exchange, transfer or relinquishment of a capital asset. Thus, the Act enlarged the subset of taxable gains realized from certain dispositions of assets. From the policymaker’s perspective, the move marked a further dilution of the source conception of income.

F. Adoption of the Income Tax Act, 1961

Act of 1922 was replaced by the Act of 1961, which is the law currently in force in India. The new Act did not mark a change in India’s philosophy on income tax. The provisions discussed hitherto were retained in the new Act.

105 O.P. Chawla states, “The general principle accepted in the Indian Income Tax Law until 1955 had been that compensation for wrongful repudiation of a service agreement, or for loss of office or employment or cessation of business was a capital receipt, though the payment might be entirely voluntary and the recipient might have no legal right to any compensation at all”. See 1972, O.P. Chawla. See also Explanation 2, § 7(I), The Income Tax Act, 1922 and §10 (5A), The Income Tax Act, 1922.

106 See 1972, O.P. Chawla. See also Explanation 2, § 7(I), The Income Tax Act, 1922 and §10 (5A), The Income Tax Act, 1922.

107 § 2 (6C), The Income Tax Act, 1922.


110 39-47, O.P. Chawla.
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The 1961 Act extended the policymakers’ resolve to tax gains arising from every kind of disposition of property. Capital gains were re-defined as gains arising from the “transfer” of a capital asset. In addition to a sale or an exchange, the term “transfer” was defined to include artificial categories such as relinquishment, the extinguishment of any rights, and the conversion of an asset into stock in trade. This, coupled with a broad definition of capital asset as property of any kind, ensured that almost no gains arising from the disposition of property would go tax-free. This new definition of transfer practically diluted the income-capital distinction. Situations arose where Courts expressed doubts regarding the taxability of certain gains that the formal letter of the law did not capture clearly. For instance, the Courts stood divided on whether insurance proceeds received for a capital asset lost in fire, arose vide a transfer as formally defined. On such occasions, the legislature would promptly insert a statutory provision to confirm the taxability of the impugned gain. Thus, whilst the income-capital distinction remained ingrained in the minds of the judiciary and in scholarship, policy steadily moved toward its abolition.

111 § 45, The Income Tax Act, 1961 states that “any profits or gains arising from the transfer of a capital asset effected in the previous year shall... be chargeable to income-tax under the head “Capital gains”, and shall be deemed to be the income of the previous year in which the transfer took place.”

112 § 2(47), The Income Tax Act, 1961 defined ‘transfer’ as follows:

“transfer”, in relation to a capital asset, includes,—

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in- trade of a business carried on by him, such conversion or treatment; or

(v) the maturity or redemption of a zero coupon bond; or

(vi) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or

(vii) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, a”


114 Vania Silk Mills v. Commissioner of Income Tax, 191 ITR 647 (SC) [Supreme Court of India]; Commissioner of Income Tax v. Grace Collis, 248 ITR 323 (SC) [Supreme Court of India].

115 § 45 (1A) was inserted by The Finance Act, 1999, which provided that where any person receives insurance money on account of damage or destruction of a capital asset due to the circumstances specified therein, the same shall be taxable in the year of receipt.
Next, the Finance Act, 1964 further eroded the judiciary’s understanding of income as a receipt necessarily convertible into cash. In the past, the legislature had targeted benefits received by employees. This taxable treatment was now extended to non-monetary benefits arising in the course of business or profession. Further, in 1972, windfall gains in the form of winnings from lotteries and games were included in the definition of income. The Central Board of Direct Taxes explained in the provision, “the exemption from tax of such receipts is not in keeping with the principle of taxing equally persons with equal capacity to pay.” Indeed, the explanation conformed to the net accretion view of income.

G. Judiciary’s Affirmative Departure from the Source Conception

In 1981 and 1993, the Supreme Court rendered decisions that marked an affirmative departure from the judicial conception of income adopted so far. The first of these cases was Bhagwandas Jain v. Union of India, where the constitutionality of tax imposed on imputed rent was under challenge. This was reminiscent of Navinchandra Mafatlal’s case (previously discussed), which challenged the constitutionality of the capital gains tax. In the instant case, the taxpayer argued that he was not deriving any monetary benefit by residing in his own house and, therefore, no tax could be levied on the grounds that he was deriving income from that house. The argument was supported by the proposition that income meant the realization of a monetary benefit and that, in the absence of any such realization, the inclusion of any amount by way of notional income was impermissible. The Court justified the tax on the reasoning that imputed rent had been taxed as income since the inception of the Act in 1922. Thus, when the British Parliament enacted the Government of India Act, 1935 (which forms the basis of the Indian Constitution), it must have perceived income as including imputed rent. The Court also relied on the rationale of its earlier decision in Navinchandra Mafatlal.

The observation relevant to our purpose is as follows:

“Even in its ordinary economic sense, the expression ‘income’ includes not merely what is received or what comes in by exploiting the use of a property but also what one saves by using it oneself. That which can be converted into

119 Bhagwandas Jain v. Union of India, (1981) 128 ITR 315 (SC) [Supreme Court of India]. [Hereinafter, “Bhagwandas Jain”]
120 Navinchandra Mafatlal.
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Income can be reasonably regarded as giving rise to income. The tax levied under Act is on the income (though computed in an artificial way) from house property in the above sense and not on house property.”121

This was the first time that the Supreme Court considered the meaning of income in the “economic sense.” Recall Simon’s definition of income under the net accretion perspective, i.e., as the sum of an individual’s saving and consumption. Furthermore, the Court did not let the existing conception of income as an ‘incoming’ hinder its decision. Unfortunately, this observation was not the mainstay of the Court’s decision, and was subsequently viewed in the context of imputed rent alone.

The second decision was rendered in Commissioner of Income Tax v. G.R. Karthikeyan.122 The statute rendered winnings from “lotteries, card games and crossword puzzles and other games” specifically taxable under the Act.123 The issue in this case was regarding the taxability of winnings from a car race. The taxpayer argued that a car race did not fall within the purview of “other games” and hence, the resultant winnings were non-taxable under the specific clause. Note that §10 (3),124 which exempted casual and recurring receipts from tax, had been amended to provide for an exemption limit. The winnings in this case fell outside that exemption limit.

The Court held that winnings from a car race were income irrespective of whether they qualified under the specific clause as “winnings from other games.” It reasoned that the definition of income under the Act was inclusive. Consequently, the meaning of income under the Act should be synonymous with its meaning under the Constitution of India.

The Court was here referring to the case of Navinchandra Mafatlal, which had drawn a distinction between the meaning of income under the Act and the Constitution.125 As regards the Act, income could be interpreted within the boundaries of the source conception. But, under the Constitution, income was to be understood in the broadest sense, according to its ordinary meaning in English, as anything that comes in or rather any profit or gain.

121 Bhagwandas Jain.
124 The provision was amended vide The Finance Act, 1986 – 1987. A ceiling of Rs. 2500/- was introduced for exemption.
125 Navinchandra Mafatlal.
In G.R. Karthikeyan, the Supreme Court abolished this distinction. Further, the Court held that the casual nature of the receipts would have no bearing on its decision. According to the Court, the very fact that casual receipts were expressly exempted under the statute signified that they otherwise would have been income. Thus, the Court disregarded the criteria of periodicity and productivity.

Unlike the previous case of Bhagwan Das, the Supreme Court in Karthikeyan did not show a leaning toward an economic view of income. In fact, it proposed that the judiciary have no view of income, source or otherwise. In essence, it contemplated any profit or gain as income under the income tax statute unless it was specifically exempted.

Despite these decisions, the source view of income persisted in subsequent case law and tax scholarship.

H. From source to net accretion

From a pragmatic perspective, the last phase of legislative changes to the definition of income brought India's conception of income to the net accretion end of the spectrum.

In 2002, the definition of income was amended to include compensation paid for restraint on trading or on the exercise of profession. This provision was introduced to cover cases where such compensation did not fall within the purview of capital gains.

Furthermore, in 2003, § 10 (3), which had exempted casual and non-recurring receipts from the levy of income tax, was deleted from the Act. This provision had already been diluted to a considerable extent. First, capital gains had been removed from its scope and, subsequently, so were winnings from lotteries. In due course, a ceiling for exemption under this clause was introduced for all casual and non-recurring receipts. The Department of Revenue circular explaining the omission specified that the purpose of the omission was to bring these receipts in the tax net. More importantly, the reason cited was the rationalization of the definition of income.

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126 G.R. Karthikeyan.
127 G.R. Karthikeyan.
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Finally, in 2006, any gift of money exceeding Rs. 50,000 was rendered taxable under the Act. However, broad exceptions were created under this rule to exclude gifts received from relatives and on the occurrence of certain events. In 2009, the provision was extended to tax gifts received in kind.

Currently, the following receipts remain non-taxable under the new Act of 1961: personal gifts, life insurance receipts and the residue of any capital receipts not falling within the purview of capital gains or any other specific provision. In addition, the problem of taxation of illusory gains (as in the case of annuities) still persists under the Act. While fiscal policy moved toward the net accretion conception, it failed to address this issue.

IV. Taxable Income under the Direct Taxes Code Bill, 2009

In 2009, the Government released the new Direct Taxes Code, accompanied by a discussion paper which explained the underlying fiscal policy. As regards the conception of income, the discussion paper stated the following:

“If equitable taxation should be in accordance with the capacity to pay of the taxing unit, and if income is to be taken as a measure of the capacity to pay, it must be so defined for tax purposes as to reflect adequately the potential economic welfare of the individual concerned i.e., the capacity has to spend during a year without affecting his net worth at the beginning of the year. This means that definition must be comprehensive enough to include all accruals to spending power. The conventional definition of income does not do so. Ideally, we need a comprehensive definition of ‘income’ for tax purposes. Such a definition of income, would include apart from gifts received,

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133 Relative was defined to include:
    “(a) spouse of the Individual;
    (b) brother or sister of the individual;
    (c) brother or sister of the spouse of the individual;
    (d) brother or sister of the either of the parents of the individual;
    (e) any lineal ascendant or descendant of the individual;
    (f) any lineal ascendant or descendant of the spouse of the individual;
    (g) spouse of the person referred to in clause (ii) to (vi)”.
134 On the occasion of marriage of the individual; or under a will or by way of inheritance; or in contemplation of death of the payer.

71
(a) All earnings including labour, investment and business income net of cost of earning and depreciation

(b) Net accrued capital gains i.e. net increases in capital assets owned

(c) Value of services or utility of non-business assets owned;

(d) Imputed value of the services rendered by the members of the family

(e) Windfall gains

(f) Casual receipts

The conceptual basis of the definition of income is clear: the definition equates income to change in net worth. However, in practice it is not possible to measure satisfactorily all the elements included.

The discussion paper identified these elements as: imputed income (value of services or utility of non-business assets and the imputed value of services rendered by members of the family), unrealized accretions in the value of assets, and economic depreciation and taxation of shareholders on the undistributed profits of the company. Finally, it concluded:

"In line with the principles and problems discussed, the Code seeks to adopt, to the extent possible, a comprehensive definition of income. Therefore, income for the purposes of the code will, in general, include all accruals and receipts of revenue and capital nature unless otherwise specified."

For the first time, India's conception of income was clearly stated in its fiscal policy. Furthermore, this was accompanied by the explicit adoption of the net accretion view of income. This marked a major change in India's income tax law. Yet, it drew little attention in scholarly circles. This was because not much had changed on the surface of the new code. Recall that policy had been continually moving toward the net accretion view of income. Consequently, the Act had been amended several times to reflect this evolving view of income. Most receipts that were not income under the source view but qualified as such under net accretion had been made taxable under the 1961 Act. As such, from a practitioner's perspective, there would be little practical significance to the explicit adoption of the net accretion approach.


137 Discussion Paper.

138 Discussion Paper.

139 With the exception of gifts, life insurance receipts and capital receipts.
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However, the explicit adoption of a comprehensive conception of income under the Direct Taxes Code Bill would synchronize the judiciary’s and the policymaker’s views of income. In addition, there are a few notable changes from the 1961 Act. First, all receipts that enhance a person’s ability to pay, such as life insurance receipts, are now recognized as income. Exemptions, if any, have been made on the considerations of positive externalities, encouraging human development and reducing risk, equity, and reducing compliance and administrative burden. Second, illusory gains should not be taxable under the proposed Direct Taxes Code Bill. As discussed, under the source conception, income was perceived as a flow rather than an economic gain, leading the judiciary to tax the inflow without considering the corresponding diminution in the value of assets such as annuities. In contrast, net accretion taxes the economic gain alone as income. As such, the Direct Tax Code contains no provision to guide the computation of a taxable annuity.

Finally, under the 1922 and 1961 Acts, the legislature had made inroads into the income-capital distinction by taxing accretions to property on their realization as capital gains. Thus, “capital gains” became synonymous with “taxable accretions” or “taxable capital receipts.” However, under the new code, as is the case in the United States, all accruals and receipts, whether revenue or capital in nature, are regarded as income, in consonance with the net accretion view. The United States’ Internal Revenue Code taxes all accretions to property on their realization (arising from the sale or disposition of property). However, from these economic gains, it creates a subset called capital gains. The object behind creating this subset is to tax certain gains at a preferential rate, namely the gains realized from the transfer of investment assets. Several policy objectives such as the promotion of savings are cited to justify such a preferential rate. Thus, two concepts emerged under the U.S. law: ordinary gains and capital gains (a subset of ordinary gains that are taxed at preferential rates). As Graetz notes, “capital gain is a creature of the tax law, without a direct analogue in either economics or accounting.” The explicit adoption of the net accretion approach makes India’s taxation of accretions to property comparable to that of the United States. The Direct Taxes Code, 2010 draws a distinction between business capital assets and

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140 § 56, The Direct Tax Code, 2010. Although a deduction is provided for these amounts if certain condition are met.

141 Graetz.

142 Graetz.

143 Graetz.

144 § 248 (42), The Direct Tax Code, 2010 defines a “business capital asset” as: 73
investment capital assets. The gains arising from the former are taxed under the head of ‘income from business’ and are subjected to ordinary rates of tax (ordinary gains). Gains arising from the transfer of investment assets are called capital gains. Interestingly, India seeks to tax capital gains at ordinary rates. Consequently, the question arises as to why the Direct Taxes Code Bill creates these two sets of gains – ordinary gains and capital gains. Plausibly, this distinction has been introduced for the purposes of computation and to grant certain capital gains the benefit of indexation and roll-over benefit.

V. CONCLUSION

India’s judicial conception of taxable income has been inspired by the source view of income. The judiciary began with a strict adoption of the source conception of income. However, over the years, it attempted to recede from this. Plausibly, this was a consequence of the introduction of an inclusive definition of income, followed by legislative amendments that departed from the source view. The Courts sought a neutral stance and took the aid of a formalist interpretation of income. Yet, in cases involving interpretation, the Courts resorted to the source conception. Moreover, the Courts were flexible with regard to the criteria of periodicity and productivity. However, the income-capital distinction remained entrenched in the judicial mind.

On the other hand, India’s tax policy and statutes have been in transition to the net accretion view of taxable income. Noticeably, India’s fiscal policy embraced the net accretion view in a piecemeal fashion. This piecemeal approach in fact subserved the idea of source conception as the norm. The fact that every departure from the source view required a special enactment confirmed the applicability of the source view of income. Further, the legislature abstained from enacting a

(a) any capital asset self-generated in the course of business;
(b) any intangible capital asset in the nature of;
   (i) goodwill of a business;
   (ii) a trade mark or brand name associated with the business;
   (iii) a right to manufacture or produce any article or thing;
   (iv) right to carry on any business;
   (v) tenancy right in respect of premises occupied by the assessee and used by him for the purposes of his business, or
   (vi) licence, right or permit (by whatever name called) acquired in connection with, or in the course of, any business;
(c) any tangible capital asset in the nature of a building, machinery, plant or furniture, or
(d) any other capital asset connected with or used for the purposes of any business of the assessee.

§ 245 (151), The Direct Tax Code, 2010 defines ‘investment asset’ as any capital asset, which is not a business capital asset.
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sweeping amendment that would define income from the net accretion perspective. Nor did it issue a policy statement confirming its commitment to the net accretion perspective of income. Inferably, this was because India's fiscal policy itself was only in transition from the source view.

Consequently, this paper attributes the incoherence in India's concept of taxable income to the growing disconnect between the fiscal policy's view of income and the judiciary's view of income. The following are some closing thoughts on attributing responsibility for this incoherence.

One view is that economic policy must be clearly reflected in legislation. The Courts may only interpret the law as it exists. Given the transitioning fiscal policy and the vague definition of income, the judiciary had little choice but to seek support from precedent.

An alternative view could argue on the impossibility of defining a concept such as income in the law. Income tax law does not exist in a vacuum. Its object is the implementation of a fiscal system. Consider the following passage:

"the legal concept of income is not something that can ultimately be defined by law because it is not something that exists either as a physical fact or as an abstract thought ... [O]ne cannot identify the borders of the concept because, at its borders, income is a fiction, invented for the purposes of income tax legislation, that does not have independent existence in the world physical fact or abstract thought." 146

Consequently, the judiciary must keep pace with fiscal policy and further the economic conception of income. Consider R.M. Haig's comments on this subject in the context of the U.S. Supreme Court's decision in Eisner v. Macomber147:

"if the legal concept established by court interpretation...departs in any fundamental fashion from the economic concept, injustices may arise of such magnitude as to necessitate an abandonment of the income tax..." 148


147 Eisner v. Macomber, 252 U.S. 189 (1920) [Supreme Court of the United States]. The case centred on the issue of the taxability of stock dividends. The Supreme Court declared that realization was essential to the concept of income. Haig advocated the net accretion perspective of income and viewed realization as an unnecessary qualification to the concept of income.

148 15, R.M. Haig.