2023:BHC-AS:35952-DB

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
CIVIL APPELLATE JURISDICTION

WRIT PETITION NO.3735 OF 2021

Serum Institute of India Private Limited,)
212/2, Off Soli Poonawalla Road,)
Hadapsar, Pune – 411 028) ….Petitioner

V/s.

1. Union of India, through the Secretary, Ministry of Finance, Government of India, North Block, Raisina Hill, New Delhi – 110 001)

2. Central Board of Direct Taxes, through its Chairman, 9th Floor, Lok Nayak Bhawan, Khan Market, New Delhi – 110 003)

3. The Commissioner of Income Tax, Circle – 6, Pune, PMT Building, Shankar Sheth Road, Pune – 411 037)

4. The Assistant Commissioner of Income Tax, Circle – 6, Pune, PMT Building, Shankar Sheth Road, Pune – 411 037) ….Respondents

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Mr. Arvind Datar, Senior Advocate a/w. Mr. Chinmoy Khadalkar, Ms. Salonee Paranjape and Mr. P.C. Tripathi i/b. Mr. Atul K. Jasani for petitioner.
Mr. Devang Vyas, ASG a/w. Mr. Suresh Kumar, Ms. Anusha P. Amin, Mr. Sheelang Shah, Ms. Vaibhavi Choudhary and Ms. Mohini Choughule for respondents.

CORAM : K. R. SHRIRAM &
DR. NEELA GOKHALE, JJ.
RESERVED ON : 6th NOVEMBER 2023
PRONOUNCED ON : 4th DECEMBER 2023

JUDGMENT (PER K.R. SHRIRAM, J.) :

1 Considering the reliefs sought in the petition, it was decided to hear the petition finally at the admission stage itself.

2 Therefore, rule. Rule made returnable forthwith.

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3 Petitioner is a biotechnology company manufacturing drugs and vaccines. Petitioner has a manufacturing plant at Hadapsar, Pune. Petitioner's units at Hadapsar area are eligible for deduction under Section 10AA of the Income Tax Act, 1961 (the Act). Petitioner also has commissioned another manufacturing facility in the Special Economic Zone (SEZ) located at Manjari, Pune, which commenced production during the Financial Year 2019-2020.

4 The Government of Maharashtra had, from time to time, issued several Industrial Policies and Schemes to promote industries in less developed areas of the State of Maharashtra. The present writ petition is concerned with one such scheme being, 'Package Scheme of Incentives, 2013', which came into effect from 1st April 2013 for a period of five years (hereinafter referred to as the said Scheme). The said Scheme provides for various incentives to major industries depending on the type of project and amount of investments they make. The benefits include stamp duty concessions, exemption from electricity duty and VAT/CST/SGST subsidy.

5 The said Scheme covered various eligible industrial units as specified from time to time which included biotechnology manufacturing units. Petitioner would fall in this category. The said Scheme covered various projects as defined in the Scheme including mega projects/ultra mega projects. These are industrial units satisfying the minimum threshold

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limits of fixed capital investments or direct employment prescribed in the said Scheme. Petitioner's project qualified as ultra mega project under the said Scheme. The qualifying criteria for ultra mega project states was either investment in eligible fixed assets of Rs.1500 Crores or direct employment of 3000 employees. The admissible period for investment under the said Scheme was from 1st April 2013 to 21st March 2020 and the operative period for the said Scheme is 30 years from the date of effect of the Entitlement Certificate. Petitioner's operative period is 1st January 2015 to 31st March 2045.

6 Petitioner states it being an eligible unit under the ultra mega project, made capital investment of more than Rs.1500 Crores. Petitioner made its application for being eligible under the said Scheme on 27th March 2018, i.e., after making an investment amounting to more than Rs.1500 Crores which has been approved by the State of Maharashtra on 12th October 2018 and further amended on 25th March 2019. In view of the approval, the State of Maharashtra has issued to petitioner eligibility certificate dated 25th January 2019 read with letter dated 17th December 2019. According to petitioner, in view of the above, petitioner is entitled to receive the following benefits under the said Scheme :

Benefit	Period
Electricity Duty (ED)	10 years from 1st April 2015 to 31st March 2025

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Stamp Duty	50% exemption from the payment of stamp duty on land acquired for the projects
VAT/CST	From 1st April 2015 to 30th June 2017
SGST	From 1st July 2017 to 31st March 2035
PF and ESIC	15 years - 1st April 2015 to March 2030

As per the approval letter, petitioner is entitled to total incentive/benefit of 75% of the eligible investment.

7 The Income Tax Act was amended in 2015 and sub-clause (xviii) to Section 2(24) of the Act was inserted by the Finance Act, 2015 with effect from 1st April 2016. The present petition is filed assailing the constitutional validity of sub-clause (xviii) to Section 2(24) of the Act (hereinafter referred to as impugned sub clause). Clause (24) to Section 2 defines the term "income. The relevant portion of sub-clause (xviii) is reproduced herein below :

2(24) – Income includes :

(xviii) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than, -

(a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43 or

(b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be.

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8 The effect of the impugned sub-clause is that subsidies, grants, cash incentives, duty drawback, waivers, concessions or reimbursements provided by the Central or State Governments either in cash or kind, will be included within the meaning of term "income" and consequently, will be taxable under the Act. The impugned sub-clause, however, excludes subsidies, grants or reimbursements which are taken into account to determine the actual cost of an asset in terms of Explanation 10 to clause (1) to Section 43. This reduces the actual cost and thereby reduces the quantum of depreciation. It is petitioner's case that waiver or concessions are not excluded under Section 43 of the Act, that are granted either by the Central Government or by the State Governments. Therefore, not only will the refund of sales tax, i.e., SGST, be liable to tax as income, but even the electricity duty exemption and the 50% exemption from payment of stamp duty are also to be treated as income.

9 According to petitioner, prior to insertion of the impugned sub-clause, subsidies, grants or incentives received by any person which were in the nature of "capital receipts" were excluded from the definition of "income" and consequently not taxable under the Act and that position has also been accepted by the Supreme Court in the following decisions :

(i) ***CIT V/s. Ponni Sugars and Chemicals Ltd.***[1]

(ii) ***Sahney Steel & Press Works Ltd. V/s. CIT***[2]

1. 306 ITR 392 (SC): (2008) 9 SCC 337
2. 228 ITR 253 (SC)

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(iii) ***CIT V/s. Chaphalkar Brothers***[3]

(iv) ***CIT V/s. Shree Balaji Alloys***[4]

It is petitioner's case that by insertion of the impugned sub-clause, all sorts of subsidies, whether capital or revenue in nature, have been brought within the ambit of term income and made taxable, even though capital subsidy has been held to be non-taxable by various Courts and the Hon'ble Supreme Court in a catena of decisions.

10 Petitioner is challenging the constitutional validity of the impugned sub-clause (xviii) of Section 2(24) of the Act whereby all incentives given in whichever form by the Government and with whatever purpose of objective are to be treated as income, irrespective of the fact as to whether or not the same is in the nature of capital assistance and or revenue assistance.

11 The following points are being contended by petitioner :

(a) The sub-clause also has unintended retrospective application since at the time of introduction of the Scheme by the State Government, the impugned sub- clause was not there in the Act and example has been given of company ABC which has availed benefits from 2012 to 2022;

(b) The impugned sub-clause seeks to tax a capital receipt as

3. 400 ITR 279 (SC)
4. 7 ITR-OL 50 (SC)

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"income" which is constitutionally impermissible. It obliterates the clear, well established and fundamental distinction between "income" and "capital receipts" disregarding the constitutional scheme that tax can be imposed only on "income'. Capital or revenue receipt has to be determined on the basis of a "purpose test". These subsidies are not taxable under the Act. The impugned sub-clause seeks to do away with the classification and the purpose test;

(c) The amendment does not create any distinction between taxability of a capital subsidy or revenue subsidy. Earlier it was held that the subsidy received on capital account is not income under Sections 4 and 5 of the Act or under Section 28 of the Act. However, by insertion of the impugned sub-clause, the said distinction is sought to be done away with. The amendment which removes the said distinction is contrary to the principles of "real income" theory which is one of the foundations for levy of income tax, and hence liable to be struck down as being unconstitutional and violative of fundamental rights;

(d) The State Government provides incentives, in order to promote industries and employment from its own coffers and the disbursal of the incentives and benefits is through funds of the State. For the Central Government to tax these incentives and benefits as income of recipient will be an indirect mechanism to tax the revenue of the State which is impermissible under the Constitution and violative of Article 289 of the

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Constitution;

(e) Impugned sub-clause is contrary to the scheme of the Income Tax Act, which is to levy tax on "income". The expression "income" defined under clause (24) of Section 2 of the Act read with Section 4 denotes that income is any monetary return coming in. In case of capital subsidy, there is no monetary return coming in. Only "real income" is taxable;

(f) The impugned sub-clause is in violation of Articles 12,14, 19, 246, 265 and 289 of the Constitution of India and is contrary to the provisions of Section 4 and 5 of the Income Tax Act, 1961.

(g) As the impugned sub-clause does not differentiate between a grant which is in the nature of "capital receipt" and "revenue account", such unintended retrospective applicability of the provision needs to be guarded as the same is unconstitutional/ invalid. Accrued rights cannot be taken away otherwise than by retrospective amendments.

12 Mr. Datar submitted :

(a) The subsidy, exemptions and waivers are incentives in order to attract industries to invest in the State of Maharashtra. These incentives encourage capital investments which will indirectly create jobs and nurture the economy. Though the true nature of such subsidy is to support or supplement the capital invested by the industries, therefore, a

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capital receipt, the same is now sought to be treated as “income” under the impugned sub-clause. Prior to the impugned sub-clause capital subsides were not taxable under the Act. The Hon'ble Supreme Court has laid down the “purpose test” to determine whether a subsidy is capital or revenue in nature, irrespective of when it is received. The test is that the character of the receipt in the hands of the assessee has to be determined with respect to the purpose for which the subsidy is given. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. As held in *Sahney Steel & Press Works Ltd.* (Supra) and *Ponni Sugars and Chemicals Ltd.* (Supra), the test laid down was the “purpose test”. The point of time at which the subsidy is paid is not relevant; the source of the subsidy is immaterial; the form of subsidy is equally immaterial. It is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. In the case at hand, the subsidy scheme was to enable petitioner to set up a new unit or expand the existing unit and, therefore, the receipt of the subsidy was on capital account;

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(b) The legislature has sought to artificially do away with the distinction between a revenue receipt and a capital receipt, without providing any legal or rationale for the same. If the object of the scheme is only one, i.e., to promote industrial development and generation of employment, which is the case under the said Scheme, the same can be only on capital account. Any benefit provided by the Governments to augment capital investment cannot by any means be treated as income. The impugned sub-clause seeks to obliterate the clear, well established and fundamental distinction between "income" and "capital receipts" disregarding the constitutional scheme that tax can be imposed only on income. In doing this, a "capital receipt" is being made liable to tax which is in gross violation of fundamental principles of taxation of income since "capital receipt" is really not in the nature of "income" to attract income tax. The impugned sub-clause thus, should be held unconstitutional, contrary to provisions of the Act and is liable to be struck down. In the alternative, the impugned sub-clause should be read down to the extent it purports to cover subsidies/grants/assistance received in "capital account" within the taxation ambit. The same should be read down in such a way that it would apply only to receipts on "revenue account" that are generally given to supplement the profits and not on "capital account". The impugned sub-clause is in violation of Articles 12, 14, 19, 246, 265 and 289 of the Constitution of India and lacks legislative competence. The Central

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Government has the power to impose taxes on income under Entry 82 of List I to Schedule VII. This power is restricted only to impose tax on "income". Although, the term "income" has not been defined under the Constitution of India, the same must be understood by its popular meaning and not to include every receipt. In the present case, what is received by petitioner in the form of subsidy, concessions or exemption is capital receipt and, therefore, cannot be brought to tax as income by amending the provisions of the Act. The impugned sub-clause seeks to expand the scope of "income" beyond the meaning which could be capable of being ascribed under Entry 82 of List 1 to Schedule VII. The definition of income under Section 2(24) is an inclusive one, its ambit, should be the same as that of the word income occurring under Entry 82 of List 1 to Schedule VII. Although, a legislative entry should be given widest possible meaning, but one should not deviate from its natural and grammatical meaning;

(c) The impugned sub-clause seeking to tax a capital receipt is in violation of Articles 246 and 265 read with Entry 82 to List 1 of Schedule VII. The Parliament cannot choose to tax as "income", an item which in no rational sense can be regarded as a citizen's income or even receipt. The Supreme Court has repeatedly held time and again that a capital receipt is not a taxable receipt, and consequently not an income, to introduce the impugned sub-clause in the teeth of the Supreme Court's decision is ultra vires the Constitution of India.

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(d) The impugned sub-clause is arbitrary and ultra vires to Article 14 of the Constitution. The impugned sub-clause without any basis and reasons overrules settled judicial precedents of the Supreme Court and various High Courts which have held that the capital subsidy is not income and cannot be subject matter of tax under the Act. To overrule these decisions by a Parliamentary exercise and without removing the basis of these decisions is arbitrary and in violation of Article 14 of the Constitution. The impugned sub-clause is manifestly arbitrary as it seeks to tax all subsidy without making any distinction between a revenue receipt or capital receipt. Imposing tax on subsidies, irrespective of whether such subsidy is received on revenue account or capital account results in violation of Article 14 of the Constitution. The impugned sub-clause makes no distinction between capital subsidy and revenue subsidy. The failure to make a proper classification is also violative of Article 14. The impugned sub-clause does not have any rationale nor provides any reasons as to why a capital subsidy is required to be taxed under the Act and thus arbitrary. In absence of any rationale and reasons, that the impugned sub-clause seeks to impose tax on capital subsidy, the same is liable to be struck down.

(e) The impugned sub-clause is violative of Article 19(1)(g) of the Constitution. The State Government on one hand is inviting and encouraging Petitioner to invest in its State by providing subsidies and incentives, on the other hand the Central Government seeks to tax the very

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same subsidy thereby affecting the right to carry on business. Thus, the impugned sub-clause is violative of Article 19(1)(g) of the Constitution as it places unreasonable hardship on Petitioner which has invested huge amounts of capital, and the same is sought to be taxed indirectly when it is received as a subsidy, despite being reward for investment by the State to augment and set up industry in a backward or designated region;

(f) It is the function and indeed the duty of every State Government to ensure not only economic development but also balanced development. The rights of a State to plan and lay down its own policy for economic development is plenary provided the subject matter is within List-II or within List-III of Schedule VII. Government grants are given under Article 282 to be utilized for public purpose. Thus, if the State of Maharashtra allocates Rs.10,000 Crores as capital subsidy in a fiscal year, it would be a classic case of manifest arbitrariness and palpable arbitrariness, if the Union of India takes away 35 to 40% of such subsidy as income tax. There is no explanation how it is in public interest to take away more than 1/3rd of the subsidy which is earmarked for industrial development by way of income tax, particularly to develop backward area and promote employment. There is nothing in the SOR, Memorandum of Finance Bill or even in the counter that has placed any material before this Court. In ***Saghir Ahmed V/s. State of Uttar Pradesh***[5], it was pointed out that the burden of

5. AIR 1954 SC 728,738

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proof is on the Union Government to justify law which prima facie involved Article 19(1)(g). The same principle applies to Article 14.

(g) The impugned sub-clause does not make any distinction between a capital receipt and a revenue receipt. The Supreme Court has, in the *Ponni Sugars and Chemicals Ltd.* (Supra), *Sahney Steel & Press Works Ltd.* (Supra), *Chaphalkar Brothers* (Supra) and ***CIT V/s. Shree Balaji Alloys***[6], held that the subsidies received from the Central or the State Government, whether capital or revenue receipt has to be determined on the basis of "purpose test". Therefore, if the object of the assistance under the Subsidy Scheme is to enable the assessee to set up a new unit or to expand the existing unit, then the receipt of the subsidy was on capital account. These subsidies are not taxable under the Act. However, the impugned sub-clause seeks to do away with the classification and the purpose test, and consequently, all subsidies are treated as income to be taxable under the Act. In absence of any specific head, the income is to fall under the residuary head "income from other sources". This classification, however, may not be correct as these subsidies, if assumed to be subsidies, will be treated as business income. Therefore, in absence of any corresponding amendment to Section 28 of the Act, subsidies received on capital account remains outside the scope of Section 28 and thereby not taxable under the Act.

6. 7 ITR-OL 50 (SC)

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In the event if the Court is not inclined to strike down the impugned clause in view of the grounds raised on the constitutional validity, the same should read down to the extent that the same is not applicable to capital receipts as per the tests laid down by the Supreme Court.

(h) The impugned sub-clause is contrary to the scheme of the Income Tax Act, which is to levy tax on “income”. The expression “income” defined under Section 2(24) of the Act read with Section 4, which is the charging section, denotes that income is any monetary return coming in. In case of capital subsidy, there is no monetary return coming in, the assessee who invests capital does not invest the same in return of subsidy, he invests to earn profit from running its business activity, which is income and not the subsidy. The subsidy is benefit provided by the Government, who could not invest capital or generate employment, but instead encourage private sectors to develop industry in specific areas by providing capital incentives to them, thereby reducing their capital cost. These incentives by any legal connotations do not come within the meaning of income. The impugned sub-clause is contrary to the well settled principles that under Act, only “real income” is taxable. The subsidy received in nature of waiver, concession or exemption cannot take character of income, thus not being exigible to income tax under the Act. The Supreme Court in ***Poona Electric***

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Supply Co. Ltd. V/s. CIT[7] has held that income tax is a tax on the real income, i.e., the profits arrived at on commercial principles subject to the provisions of the Act. In view of these observations of the Supreme Court, a subsidy is not real income and cannot be sought to be taxed under the Act. The assistance in nature of "waiver or concession or reimbursement" cannot be in the nature of income as there is no receipt in these cases. Such assistance is not an income under any of the five heads of income. Thus, such assistance is not an income, and merely by amending the definition or artificially expanding the definition of word "income", any receipt will not take the characteristics. The impugned sub-clause is only intended for those subsidies which are revenue receipts, and the manner in which such receipts are to be computed for the purpose of taxation under the Act. However, since the impugned sub-clause does not make any distinction between a capital receipt and revenue receipt, the same is contrary to the very purpose for which it has been introduced, therefore, is liable to be struck down;

(i) The importance of *Sahney Steel & Press Works Ltd.* (Supra) lies in the fact that it has discussed and analysed the entire case law and it has laid down the basic test to be applied in judging the character of a subsidy. That test is that the character of the receipt in the hands of the assessee has to be determined with respect to the purpose for which the

7. AIR 1966 SC 30

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subsidy is given. In such cases, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or expand the existing unit then the receipt of the subsidy was on capital account.

(j) The House of Lords in the case of ***Seaham Harbour Dock Co. V/s. Crook*** [8] held that the financial assistance given to the company for dock extension cannot be regarded as a trade receipt. The House of Lords found that the assistance had nothing to do with the trading of the company because the work undertaken was dock extension. The assistance in the form of a grant was made by the Government with the object that by its use men might be kept in employment and, therefore, its receipt was capital in nature. Even though the payment was equivalent to half the interest amount payable on the loan (interest subsidy), money received by the company was not in the course of trade but was of capital nature. The judgment of House of Lords shows that the source of payment or the form in which the subsidy is paid or the mechanism through which it is paid is immaterial and that what is relevant is the purpose for payment of

8. (1931) 16 TC 333 (HL)

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assistance. In the present case also the subsidy was for set up of new plants or expansion of the existing unit and hence, should be capital in nature. In *Ponni Sugars and Chemicals Ltd.* (Supra) also this position in law was reiterated that it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant. As held in ***CIT V/s. P.J. Chemicals Ltd.***[9] and ***Sadichha Chitra V/s. CIT***[10], if the assistance is given by the Government for completion of a project, then it must be of capital nature;

(k) It is open to the legislature within certain limits to amend the provisions of an Act retrospectively and to declare what the law shall be deemed to have been, but it is not open to the legislature to say that a judgment of a Court properly constituted and rendered in exercise of its powers in a matter brought before it shall be deemed to be ineffective and the interpretation of the law shall be otherwise than as declared by the Court. The definition of income under Section 2(24) has always been inclusive but was held to exclude subsidies which were capital receipts. The impugned amendment to include capital subsidies amounts to legislative overruling of several Supreme Court decisions which is impermissible as held in ***Madras Bar Association V/s. Union of India and Anr***[11]. Recently in

9. 1994 Supp (3) SCC 535
10. 189 ITR 774
11. (2022) 12 SCC 455

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NHPC Ltd. V/s. State of Himachal Pradesh[12] a Division Bench of the Supreme Court summarised the entire case law and held that legislative overruling is not permissible.

In ***Vodafone International Holdings BV V/s. Union of India***[13] it was held that rights of management or controlling interest are not separate assets; they are incidental to the holding of shares. Similarly, controlling interest in a company is not an identifiable or distinct capital asset. The basis of this judgment was removed by inserting Explanation I to Section 2(14), which reads as under :

> *[Explanation-1.]- For the removal of doubts, it is hereby clarified that "property" includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.*

Similarly, in the same Vodafone case, it was held that a share of a company incorporated outside India cannot be treated as an asset located in India even if the company's value is derived from underlying assets located in India. By another amendment, the basis of this decision was removed under Section 9(1)(i). Explanation 5 was added whereby such shares were deemed to be situated in India, i.e., foreign shares were deemed to be an asset in India. Explanation reads as under :

> *Explanation 5.-For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been*

12. 2023 SCC Online SC 1137
13. 341 ITR 1

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> *situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.*

Thus, it was mandatory for Parliament to have removed the basis of the Supreme Court rulings on subsidies by a suitable explanation such as :

> *Explanation For the removal of doubts: it is hereby clarified that the term "subsidy" will include and shall always been deemed to have included all kinds of subsidies, whether for setting up or establishing a business or for running a business, whether capital or revenue in nature, and irrespective of the purpose of the subsidy.*

13 Mr. Vyas, ASG submitted :

(a) The Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule to the Constitution of India. The authority of the legislature to tax income is derived from Entry 82 of List I, which empowers Parliament to enact laws taxing income other than agricultural income. Therefore, the Parliament has power to legislate tax on income and define what is income. It is settled law that the word "income" should be given its widest connotation in view of the fact that it occurs in a head conferring legislative power. The impugned sub-clause was inserted after due deliberation and it has been specified that income shall include assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement. After public consultations for Income Computation and Disclosure Standards (ICDS), the stakeholders suggested that in order to avoid any future

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controversy in this matter, there should be specific provision in the Act for treating these Government grants as income. The Accounting Standard Committee, which drafted the ICDS, suggested that the definition of income under clause (24) of Section 2 of the Act be amended so as to provide that the income shall include assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of Section 43 of the Act. Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement would support further income generation and since income is to be understood in the widest sense, these items have also been included in the scope of income. It is settled law that income is a word of elastic import;

(b) With regards to the challenge of constitutional validity of the impugned sub-clause, it is settled that the following parameters have to be followed by Writ Courts for examining the constitutional validity of any provision namely :

(i) Whether the law under challenge lacks legislative competence?

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(ii) Whether it violates any Article of Part III of the Constitution, particularly, Article 147?

(iii) Whether the prescribed criteria and classification resulting there from is discriminatory, arbitrary and has no nexus with the object of the Act?

(iv) Whether it is legislative exercise of power which is not in consonance with constitutional guarantees and does not provide adequate guidance to make the law just, fair and reasonable?

Provisions of sub-clause (xviii) to clause (24) of Section 2 of the Act thus have to be tested on the anvil of the above set of parameters as discussed below;

(c) Article 265 of the Constitution of India states that "No tax shall be levied or collected except by authority of law." Sub-clause (xviii) to clause (24) of Section 2 of the Act was introduced by the Finance Act, 2015 duly passed by the Parliament and is, therefore, not violative of Article 265 of the Constitution of India. Part III of the Constitution enumerates Fundamental Rights. Article 14 lists the Right to Equality and bars the State from creating unintelligible and irrational classifications. The impugned sub-clause only expanded the scope of income and all are treated on equal footing and unequals are not being treated as equals. The provisions are not discriminatory or arbitrary or violative of Article 14 of the Constitution. Constitution draws a distinction between taxation statute and other laws in

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a way that imposition of tax is not a ground for challenging it as a restriction on one's right to Freedom under Article 19(1) of the Constitution. The impugned sub-clause expanded the scope of income and the conditions laid down there are not in violation of Article 19 of the Constitution;

(d) The judicial precedents have set an extremely limited scope of interference and on all occasions of major challenges it has upheld legislative competence and expressed restraint when it comes to fiscal statues. The judiciary must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. The Court must always remember that legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract pro-positions and do not relate to abstract units and are not to be measured by abstract symmetry, that exact wisdom and nice adaption of remedy are not always possible and that judgment is largely a prophecy based on meagre and uninterpreted experience. As held in ***R. K. Garg V/s. Union of India and Ors.***[14], there is always a presumption in favour of the constitutionality of a statute and the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles. The Court also

14. (1981) 4 SCC 675

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held that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. There, may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid. The Court must while examining the constitutional validity of a legislation of this kind be resilient, not rigid, forward looking, not static, liberal and not verbal. The Court must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. It would be outside the province of the Court to consider if any particular immunity or exemption is necessary. The trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue;

(e) In ***Federation of Hotel and Restaurant V/s. Union of India***[15] the Court held that the subject of a tax is different from the measure of the levy. The measure of the tax is not determinative of its essential character or of the competence of the legislature. There has to be flexibility in the modes of effectuating a tax in view of innate complexities in the fiscal adjustment of diverse economic factors inherent in the formulation of a policy of taxation and the variety of policy options open to the State. As held in *Federation of Hotel and Restaurant* (Supra), though taxing laws are not outside Article 14, however, having regard to the wide variety of diverse

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15. (1989) 3 SCC 634

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economic criteria that go into the formulation of a fiscal policy legislature enjoys a wide latitude in the matter of selection of persons, subject matter, events, etc., for taxation. The tests of the vice of discrimination in a taxing law are less rigorous. If there is equality and uniformity, within each group, the law would not be discriminatory. Decisions of the judiciary on the matter have permitted the legislatures to exercise an extremely wide discretion in classifying items for tax purposes, so long as it refrains from clear and hostile discrimination against particular persons or classes;

(f) Every statute, including fiscal statutes, comes with a presumption of constitutionality unless proven otherwise. The onus falls on petitioner to demonstrate a clear transgression of constitutional principles. In the realm of fiscal laws, the presumption of constitutionality is particularly significant due to the complex nature of economic regulation. Since these laws are instrumental in the financial governance of the State and are often the outcome of detailed economic planning and consideration, Courts are inclined to approach them with deference. Unless a fiscal statute is manifestly arbitrary or discriminatory in its provisions or its operation, it is typically upheld. This allows for a broad range of discretion for the legislature in determining the classes of individuals or entities that are subject to or exempt from taxation, as long as there is a rational basis for such a classification. In the case of *R. K. Garg* (Supra) the

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views of Justice Frankfurter in the case of ***Morey V/s. Doud*** [16]was relied upon and the same is reproduced in paragraph 28 of ***State of Himachal Pradesh and Ors. V/s. Goel Bus Service Kullu***[17].

The Revenue Department's approach towards taxation of concessions or subsidies is nuanced and specific. The tax is levied on the concession amount or the subsidy received, not the total transaction value. This ensures that the taxation is limited to the extra benefit accrued due to the state's incentive schemes, thereby upholding the principles of fairness and equity in taxation. This methodology aligns with the canons of taxation which advocate for fairness, equity, and simplicity, ensuring that the tax burden is proportionate and not unduly onerous. Petitioner's claim of an indirect rollback of incentives is unfounded as the incentives remain intact. The only aspect subjected to taxation is the monetary benefit derived from the subsidy or concession, which is a fair and justifiable tax base;

(g) The Constitution safeguards the right to trade under Article 19(1)(g) but does not extend this protection to the right to profit. Petitioner's assertion that taxation of subsidies and concessions under the impugned sub-clause effectively nullifies the distinction between capital and revenue subsidies leading to the erosion of what they perceive as a benefit or savings cannot be entertained. They are not, however, intended to serve as permanent fixtures beyond the scope of taxation, especially when such

16. 354 US 457 (1957)
17. 2023 SCC Online 46

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benefits have fulfilled their economic purpose. The imposition of tax on these subsidies under the amended provision does not constitute an "taking away" of a benefit but rather represents a recalibration of fiscal advantages in line with broader economic and policy considerations. Profits, by their nature, are subject to fluctuations resulting from various factors, taxation being but one. It is the duty of the legislature to ensure that taxation policy reflects a balance between incentivizing economic activity and ensuring the equitable distribution of fiscal resources. Section 2(24)(xviii) is a manifestation of this balancing act, and its imposition is a reflection of a subsidy's life cycle coming to its fiscal fruition. Thus, petitioner's argument, is ostensibly rooted in concerns over profitability. However, this does not, in substance, provide a tenable basis to impugn the constitutional validity of the amended provision. Hence, petitioner's argument of eroded profitability due to taxation lacks constitutional merit. An extension of this logic could open floodgates of untenable demands from loss-incurring entities seeking tax exemptions to improve profitability. This could potentially create a taxing standard that is inconsistent and prone to manipulations.

Taxation is an economic reality that every business entity must contend with. As held in ***Nazeria Motor Service etc. V/s. State of Andhra Pradesh***[18], assumption that profits would be diminished or greatly reduced does not mean that there in any infringement of the fundamental rights

18. (1969) 2 SCC 576

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under Part III of the Constitution of India. As held in ***Malva Bus Services V/s. State of Punjab and Ors.***[19], the mere fact that a tax falls more heavily on certain goods or persons may not result in its invalidity.

As held in *Federation of Hotel and Restaurant* (Supra), mere excessiveness of a tax or even the circumstance that its imposition might tend towards diminution of the earnings or profits of the persons of incidence does not, per se, and without more, constitute violation of the rights under Part III – Constitution of India.

FINDINGS :

14 The petition challenges sub-clause (xviii) of Section 2(24) of the Act, which petitioner believes infringes various provisions of the Constitution of India and oversteps the legislative competence of the Parliament. It is petitioner's case that by amending Section 2(24)(xviii), the legislature has essentially overruled judicial precedents that distinguished capital receipts from revenue receipts, subsuming both under "income" and subjecting them to taxation, thereby overriding the established legal principles. Petitioner's argument regarding the violation of Article 14 stems from the assertion that the amendment to Section 2(24)(xviii) of the Act, which brings various subsidies under the ambit of taxable income, is discriminatory and arbitrary. Petitioner's argument is based on the premise that such savings are not a gain or profit that accrues to the business but

19. (1983) 3 SCC 237

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rather a reduction in expenditure. Petitioner's argument is that such amendment indiscriminately broadens the definition of income to include subsidies, without distinguishing between various types of subsidies and the purposes for which they are granted.

15 The facts, therefore, are very short. It is petitioner's case that it expanded its business unit in Hadapsar, Pune, in view of the said Scheme introduced by the Government of Maharashtra. The benefit that petitioner was to get by setting up this ultra mega project has been enumerated earlier. Can the Government of India by introducing the impugned sub-clause take away a part of the benefit that petitioner was getting from the State of Maharashtra?

Let us analyse the law as laid down in the judgments relied upon by both counsels.

16 In *Sahney Steel & Press Works Ltd.* (Supra), the Court held that what was relevant to decide the character of the incentive is the purpose test and not the mechanism of payment which is also the case of petitioner herein. As quoted in paragraph 14 of *Ponni Sugars and Chemicals Ltd.* (Supra), the importance of the judgment in *Sahney Steel* (Supra) lies in the fact that it has discussed and analysed the entire case law and it has laid down the basic test to be applied in judging the character of a subsidy. That test is that the character of the receipt in the hands of the assessee has

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to be determined with respect to the purpose for which the subsidy is given. In other words, in such cases, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant;

17 In *Ponni Sugars and Chemicals Ltd.* (Supra) also the Apex Court held that it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant. Keeping in mind the object behind the payment of the incentive subsidy, in that case the Court held that payment received by the assessee under the Scheme was not in the course of a trade but was of capital nature. In *Ponni Sugars and Chemicals Ltd.* (Supra), while answering whether the incentive subsidy received by the assessee was a capital receipt not includible in the total income, the Apex Court in paragraphs 13 to 17 held as under :

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13. In our view, the controversy in hand can be resolved if we apply the test laid down in the judgment of this Court in the case of Sahney Steel and Press Works Ltd. (supra). In that case, on behalf of the assessee, it was contended that the subsidy given was up to 10% of the capital investment calculated on the basis of the quantum of investment in capital and, therefore, receipt of such subsidy was on capital account and not on revenue account. It was also urged in that case that subsidy granted on the basis of refund of sales tax on raw materials, machinery and finished goods were also of capital nature as the object of granting refund of sales tax was that the assessee could set up new business or expand his existing business. The contention of the assessee in that case was dismissed by the Tribunal and, therefore, the assessee had come to this Court by way of a special leave petition. It was held by this Court on the facts of that case and on the basis of the analyses of the Scheme therein that the subsidy given was on revenue account because it was given by way of assistance in carrying on of trade or business. On the facts of that case, it was held that the subsidy given was to meet recurring expenses. It was not for acquiring the capital asset. It was not to meet part of the cost. It was not granted for production of or bringing into existence any new asset. The subsidies in that case were granted year after year only after setting up of the new industry and only after commencement of production and, therefore, such a subsidy could only be treated as assistance given for the purpose of carrying on the business of the assessee. Consequently, the contentions raised on behalf of the assessee on the facts of that case stood rejected and it was held that the subsidy received by Sahney Steel could not be regarded as anything but a revenue receipt. Accordingly the matter was decided against the assessee.

14. The importance of the judgment of this Court in Sahney Steel case lies in the fact that it has discussed and analysed the entire case law and it has laid down the basic test to be applied in judging the character of a subsidy. That test is that the character of the receipt in the hands of the assessee has to be determined with respect to the purpose for which the subsidy is given. In other words, in such cases, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. The main eligibility condition in the scheme with which we are concerned in this case is that the incentive must be utilized for repayment of loans taken by the assessee to set up new units or for substantial expansion of existing units. On this aspect there is no dispute. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the

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<u>existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant.</u>

15. In the decision of House of Lords in the case of Seaham Harbour Dock Co. v. Crook (1931) 16 TC 333 the Harbour Dock Co. had applied for grants from the Unemployment Grants Committee from funds appropriated by Parliament. The said grants were paid as the work progressed the payments were made several times for some years. The Dock Co. had undertaken the work of extension of its docks. The extended dock was for relieving the unemployment. The main purpose was relief from unemployment. Therefore, the House of Lords held that the financial assistance given to the company for dock extension cannot be regarded as a trade receipt. It was found by the House of Lords that the assistance had nothing to do with the trading of the company because the work undertaken was dock extension. According to the House of Lords, the assistance in the form of a grant was made by the Government with the object that by its use men might be kept in employment and, therefore, its receipt was capital in nature. The importance of the judgment lies in the fact that the company had applied for financial assistance to the Unemployment Grants Committee. The Committee gave financial assistance from time to time as the work progressed and the payments were equivalent to half the interest for two years on approved expenditure met out of loans. <u>Even though the payment was equivalent to half the interest amount payable on the loan (interest subsidy) still the House of Lords held that money received by the company was not in the course of trade but was of capital nature. The judgment of House of Lords shows that the source of payment or the form in which the subsidy is paid or the mechanism through which it is paid is immaterial and that what is relevant is the purpose for payment of assistance. Ordinarily such payments would have been on revenue account but since the purpose of the payment was to curtail/obliterate unemployment and since the purpose was dock extension, the House of Lords held that the payment made was of capital nature.</u>

16. One more aspect needs to be mentioned. In Sahney Steel and Press Works Ltd. (supra) this Court found that the assessee was free to use the money in its business entirely as it liked. It was not obliged to spend the money for a particular purpose. In the case of Seaham Harbour Dock Co. (supra) assessee was obliged to spend the money for extension of its docks. This aspect is very important. In the present case also, receipt of the subsidy was capital in nature as the assessee was obliged to utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing

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business.

17. Applying the above tests to the facts of the present case and _keeping in mind the object behind the payment of the incentive subsidy_ *we are satisfied that such payment received by the assessee under the Scheme was not in the course of a trade but was of capital nature. Accordingly the first question is answered in favour of the assessee and against the Department.*

(emphasis supplied)

18 In *Sadichha Chitra* (Supra), the subsidies were granted as and when the film was being completed which resulted in creation of a capital asset. The Apex Court in *Sahney Steel & Press Works Ltd.* (Supra) confirmed the view taken in *Sadichha Chitra* (Supra) to be correct and in accordance with the principles laid down in *Seaham Harbour Dock Co.* case. In *Seaham Harbour Dock Co.* (Supra), the Dock Company had applied for and obtained grants from the Unemployment Grants Committee from funds appropriated by Parliament. The said grants were paid as the work progressed and were equivalent to half the interest on approved expenditure met out of loans. The payment were made several times a year for some years. The Dock company had undertaken an extension of its docks. The extended dock was also for relieving unemployment problem. Because the work undertaken was extension of the dock and the main purpose was relief of unemployment, the House of Lords held that the financial assistance given to the company for extension of the dock cannot be regarded as trade receipt. It was found that the assistance had nothing to do with trading of the company because the work undertaken was dock extension. Lord Buckmaster, in his judgment, wrote as under :

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Now I do not myself think that the matter can be put more succinctly than it was put by Mr. Hills when he said : "Was this a trade receipt?", and my answer is most unhesitatingly : No. It appears to me that it was nothing whatever of the kind. It was a grant which was made by a government department with the idea that by its use men might be kept in employment, and it was paid to and received by the Dock Company without any special allocation to any particular part of their property, either capital or revenue, and was simply to enable them to carry out the work upon which they were engaged, with the idea that by so doing people might be employed. I find myself quite unable to see that it was a trade receipt, or that it bore any resemblance to a trade receipt. It appears to me to have been simply a grant made by the Government for the purposes which I have mentioned, and in those circumstances cannot be included in revenue for the purposes of tax.

19 In ***Poona Electric Supply Co. Ltd. V/s. CIT***[20], relied upon by Mr.Datar, the Apex Court held as under :

Income tax is a tax on the real income, i.e., the profits arrived at on commercial principles subject to the provisions of the Income-tax Act. The real profit can be ascertained only by making the permissible deductions. There is a clear-cut distinction between deductions made for ascertaining the profits and distributions made out of profits. In a given case whether the outgoings fall in one or the other of the heads is a question of fact to be found on the relevant circumstances, having regard to business principles.

20 Similarly in ***Godhra Electricity Co. Ltd. V/s. CIT*** [21] relied upon by Mr. Datar, the Apex Court, in paragraph 13, held as under :

13. Under the Act income chargeable to tax is the income that is received or is deemed to be received in India in the previous year relevant to the year for which assessment is made or the income that accrues or arises or is deemed to accrue or arise in India during such year. The computation of such income is to be made in accordance with the method or accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements or it may be the mercantile system where entries are made on accrual basis, i.e., accrual of the right to receive payment and the accrual of the liability to disburse or pay. In CIT vs. Shoorji Vallabhdas & Co. (supra), it has been laid

20. (1965) 56 ITR (Sh. N.) 29
21. (1997) 225 ITR 746 (SC)

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> *Income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time all which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping an entry is made about a hypothetical income, which does not materialise.*

21 Before the amendment through the Finance Act, 2015, the Supreme Court applied the "purpose test" to determine whether a subsidy was a capital or revenue receipt. In the landmark cases of *Sahney Steel and Press Works Ltd.* (Supra) and *Ponni Sugars and Chemicals Ltd.* (Supra), the Court held that if the subsidy's purpose was to help the assessee run the business more profitably or meet daily business expenses, it was considered a revenue receipt (and thus taxable). Conversely, if the subsidy aimed at setting up a new unit or expanding an existing unit, it was deemed a capital receipt (and not taxable). The Finance Act, 2015, significantly altered the landscape by introducing sub-clause (xviii) to Section 2(24) of the Act. This amendment defined any assistance in the form of subsidy, grant, cash incentive, duty drawback, waiver, concession, or reimbursement provided by the Central or State Government as income, hence taxable, unless used to determine the actual cost of an asset. This amendment sought to end disputes by making all subsidies taxable unless they fell under an exclusion category;

22 There is very limited scope in challenge to constitutional

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validity. The fulcrum of the constitutional challenge is the question of legislative competence. Every legislation is an experiment in achieving certain desired ends and trial and error method is inherent in every such experiment. The law is very clear that the legislature should be allowed some play in the joints because it has to deal with complex problems which do not admit of solution through any doctrine or straight jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. Every legislation particularly in economic matters cannot provide for all possible situations or anticipate all possible abuses. As held in *R. K. Garg* (Supra), every legislation particularly in economic matters is essentially empiric and it is based on experimentation. There may be crudities, inequities and even possibilities of abuse but on that account alone it cannot be struck down as invalid. These can always be set right by the legislature by passing amendments. The Court must therefore adjudge the constitutionality of such legislation by the generality of its provisions. Laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. Moreover, there is always a presumption in favour of the constitutionality of a statute and the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles. The legislature

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understands and correctly appreciates the needs of its own people, its laws are directed to problems made manifest by experience and its discrimination are based on adequate grounds. In adjudging constitutionality the Court may take into consideration matters of common knowledge, matters of common report, the history of the times and may assume every state of facts which can be conceived existing at the time of legislation. The Court must while examining the constitutional validity of a legislation in economic matters "be resilient, not rigid, forward looking, not static, liberal, not verbal". It must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. It would be outside the province of the Court to consider if any particular immunity or exemption is necessary or not for the purpose of inducing disclosure of black money. The trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue and if it is found that any immunity or exemption granted under the Act is being utilised for tax evasion or avoidance not intended by the legislature, the Act can always be amended and the abuse terminated. Paragraphs 7, 8, 16 and 19 of *R. K. Garg* (Supra) read as under :

> *7. Now while considering the constitutional validity of a statute said to be violative of Article 14, it is necessary to bear in mind certain well established principles which have been evolved by the courts as rules of guidance in discharge of its constitutional function of judicial review. The first rule is that there is always a presumption in favour of the constitutionality of a statute and*

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the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles. This rule is based on the assumption, judicially recognised and accepted, that the legislature understands and correctly appreciates the needs of its own people, its laws are directed to problems made manifest by experience and its discrimination are based on adequate grounds. The presumption of constitutionality is indeed so strong that in order to sustain it, the court may take into consideration matters of common knowledge, matters of common report, the history of the times and may assume every state of facts which can be conceived existing at the time of legislation.

8. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J. that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrine or straight jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislature judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in Morey v. Dond 354 US 457 where Frankfurter, J. said in his inimitable style:

> *In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial difference 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 of 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.*

The court must always remember that "legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry" that exact wisdom and nice adoption of remedy are not always possible and that "judgment is largely a prophecy based on meagre and un-interpreted experience". Every legislation particularly in economic matters is essentially empiric

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and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There, may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid. The courts cannot, as pointed out by the United States Supreme Court in Secretary of Agriculture v. Central Reig Refining Company 94 Lawyers Edition 381 be converted into tribunals for relief from such crudities and inequities. There may even be possibilities of abuse, but that too cannot of itself be a ground for invalidating the legislation, because it is not possible for any legislature to anticipate as if by some divine prescience, distortions and abuses of its legislation which may be made by those subject to its provisions and to provide against such distortions and abuses. Indeed, howsoever great may be the care bestowed on its framing, it is difficult to conceive of a legislation which is not capable of being abused by perverted human ingenuity. The Court must therefore adjudge the constitutionality of such legislation by the generality of its provisions and not by its crudities or inequities or by the possibilities of abuse of any of its provisions. If any crudities, inequities or possibilities of abuse come to light, the legislature can always step in and enact suitable amendatory legislation. That is the essence of pragmatic approach which must guide and inspire the legislature in dealing with complex economic issues.

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(16) xxxxxxxxxx. It must be remembered that every legislation is an experiment in achieving certain desired ends and trial and error method is inherent in every such experiment. Therefore, when experience shows that the legislation as framed has proved inadequate to achieve its purpose of mitigating an evil or there are cracks and loopholes in it which are being taken advantage of by the resourcefulness and ingenuity of those minded to benefit themselves at the cost of the State or the others, the legislature can and most certainly would intervene and change the law. But the law cannot be condemned as invalid on the ground that after a period of ten years it may lend itself to some possible abuse.

xxxxxxxxxxxxxx
(19) xxxxxxxxxx. It would be outside the province of the court to consider if any particular immunity or exemption is necessary or not for the purpose of inducing disclosure of black money. That would depend upon diverse fiscal and economic considerations based on practical necessity and administrative expediency and would also involve a certain amount of experimentation on which the Court would be least fitted to pronounce. The court would not have the necessary competence

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and expertise to adjudicate upon such an economic issue. The court cannot possibly assess or evaluate what would be the impact of a particular immunity or exemption and whether it would serve the purpose in view or not. There are so many imponderables that would enter into the determination that it would be wise for the court not to hazard an opinion where even economists may differ. The court must while examining the constitutional validity of a legislation of this kind, "be resilient, not rigid, forward looking, not static, liberal, not verbal" and the court must always bear in mind the constitutional proposition enunciated by the Supreme Court of the United States in Munn v. Illinois namely, "that courts do not substitute their social and economic beliefs for the judgment of legislative bodies". The court must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. The court should constantly remind itself of what the Supreme Court of the United States said in Metropolis Theater Co. v. City of Chicago :

The problems of government are practical ones and may justify, if they do not require, rough accommodations, illogical it may be, and unscientific. But even such criticism should not be hastily expressed. What is best is not always discernible, the wisdom of any choice may be disputed or condemned. Mere errors of government are not subject to our judicial review.

It is true that one or the other of the immunities or exemptions granted under the provisions of the Act may be taken advantage of by resourceful persons by adopting ingenious methods and devices with a view to avoiding or saving tax. But that cannot be helped because human ingenuity is so great when it comes to tax avoidance that it would be almost impossible to frame tax legislation which cannot be abused. Moreover, as already pointed out above, the trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue and if it is found that any immunity or exemption granted under the Act is being utilised for tax evasion or avoidance not intended by the legislature, the Act can always be amended and the abuse terminated. We are accordingly of of the view that none of the provisions of the Act is violative of Article 14 and its constitutional validity must be upheld.

(emphasis supplied)

23 In *Federation of Hotel and Restaurant* (Supra), the Apex Court held that the subject of a tax is different from the measure of the levy. The measure of the tax is not determinative of its essential character or of the

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competence of the legislature. There has to be flexibility in the modes of effectuating a tax in view of innate complexities in the fiscal adjustment of diverse economic factors inherent in the formulation of a policy of taxation and the variety of policy options open to the State. A fiscal statute or provision, like any other statute, must not transgress the fundamental rights enshrined in the Constitution. The doctrine of reasonableness and non-arbitrariness encapsulated under Article 14 of the Constitution becomes a touchstone for testing the validity of a fiscal statute. It is now well settled that taxing laws are not outside Article 14. However, having regard to the wide variety of diverse economic criteria that go into the formulation of a fiscal policy, legislature enjoys a wide latitude in the matter of selection of persons, subject matter, events, etc., for taxation. The tests of the vice of discrimination in a taxing law are, accordingly, less rigorous. In examining the allegations of a hostile, discriminatory treatment what is looked into is not its phraseology, but the real effect of its provisions. If there is equality and uniformity, within each group, the law would not be discriminatory. Decisions of the judiciary on the matter have permitted the legislatures to exercise an extremely wide discretion in classifying items for tax purposes, so long as it refrains from clear and hostile discrimination against particular persons or classes.

24 Therefore, though taxing laws are not outside Article 14, however, having regard to the wide variety of diverse economic criteria that

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go into the formulation of a fiscal policy, legislature enjoys a wide latitude in the matter of taxation. Legislative assumption cannot be condemned as irrational. Judicial veto is to be exercised only in cases that leave no room for reasonable doubt. Constitutionality is presumed. Every statute, including fiscal statutes, comes with a presumption of constitutionality unless proven otherwise. The onus falls on petitioner to demonstrate a clear transgression of constitutional principles. In the realm of fiscal laws, the presumption of constitutionality is particularly significant due to the complex nature of economic regulation. Since these laws are instrumental in the financial governance of the state and are often the outcome of detailed economic planning and consideration, courts are inclined to approach them with deference. Unless a fiscal statute is manifestly arbitrary or discriminatory in its provisions or its operation, it is typically upheld. This allows for a broad range of discretion for the legislature in determining the classes of individuals or entities that are subject to or exempt from taxation, as long as there is a rational basis for such a classification.

25 No precise or set formulae or doctrinaire tests or precise scientific principles of exclusion or inclusion are to be applied. The test could only be one of palpable arbitrariness applied in the context of the felt needs of the times and societal exigencies informed by experience. The Court has permitted the legislatures to exercise an extremely wide discretion in classifying items for tax purposes, so long as it refrains from

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clear and hostile discrimination against particular persons or classes. In examining the allegations of a hostile, discriminatory treatment what is looked into is not its phraseology, but the real effect of its provisions. One must look beyond the classification and to the purposes of the law. Classifications based on differences in the value of articles or the economic superiority of the persons of incidence are well recognised. A reasonable classification is one which includes all who are similarly situated and none who are not. Further, differentia must have a rational nexus with the object sought to be achieved by the law. A taxing statute is not, per se, a restriction of the freedom under Article 19(1)(g). The policy of a tax, in its effectuation, might, of course, bring in some hardship in some individual cases. But that is inevitable, so long as law represents a process of abstraction from the generality of cases and reflects the highest common factor. Then again, the mere excessiveness of a tax or even the circumstance that its imposition might tend towards the diminution of the earnings or profits of the persons of incidence does not, per se, and without more, constitute violation of the rights under Article 19(1)(g).

26 The Apex Court, in *Federation of Hotel and Restaurant* (Supra), in paragraphs 46 to 57, 62 and 77 held as under :

> *46. It is now well settled though taxing laws are not outside Article 14, however, having regard to the wide variety of diverse economic criteria that go into the formulation of a fiscal-policy legislature enjoys a wide latitude in the matter of selection of persons, subject-matter, events, etc., for taxation. The tests of the vice of discrimination in a taxing law are, accordingly, less*

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rigorous. In examining the allegations of a hostile, discriminatory treatment what is looked into is not its phraseology, but the real effect of its provisions. A legislature does not as an old saying goes, have to tax everything in order to be able to tax something. If there is equality and uniformity within each group, the law would not be discriminatory. Decisions of this Court on the matter have permitted the legislatures to exercise an extremely wide discretion in classifying items for tax purposes, so long as it refrains from clear and hostile discrimination against particular persons or classes.

47. But, with all this latitude certain irreducible desiderata of equality shall govern classifications for differential treatment in taxation laws as well. The classification must be rational and based on some qualities and characteristics which are to be found in all the persons grouped together and absent in the others left out of the class. But this alone is not sufficient. Differentia must have a rational nexus with the object sought to be achieved by the law. The State, in the exercise of its Governmental power, has, of necessity, to make laws operating differently in relation to different groups or class of persons to attain certain ends and must, therefore, possess the power to distinguish and classify persons or things. It is also recognised that no precise or set formulae or doctrinaire tests or precise scientific principles of exclusion or inclusion are to be applied. The test could only be one of palpable arbitrariness applied in the context of the felt needs of the times and societal exigencies informed by experience.

48. Classifications based on differences in the value of articles or the economic superiority of the persons of incidence are well recognised. A reasonable classification is one which includes all who are similarly situated and none who are not. In order to ascertain whether persons are similarly placed, one must look beyond the classification and to the purposes of the law.

49. In Jaipur Hosiery Mills Ltd. v. State of Rajasthan, a notification under the Rajasthan Sales-tax Act, 1950, exempting from tax the sale of garments which did not exceed Rs.4 per piece was assailed. This court found the classification permissible. It was held :

> *"..... it has to be borne in mind that in matters of taxation the Legislature possesses the large freedom in the matter of classification. Thus wide discretion can be exercised in selecting persons or objects which will be taxed and the statute is not open to attack on the mere ground that it takes some persons or objects and not others. It is only when within the range of its selection the law operates unequally and cannot be justified on the basis of a valid*

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classification that there would be a violation of Article 14."

50. In Hira Lal Rattan Lal v. State of UP this Court said :

> *" .... it is open to the legislature to define the nature of the goods, the sale or purchase of which should be brought to tax. Legislature was not incompetent to separate the processed or split pulses from the unsplit or unprocessed pulses and treat the two as separate and independent goods."*
>
> *"..... But the legislature has wide powers of classification in the case of taxing statutes."*
> *"..... The classification between the processed or split pulses and unprocessed or unsplit pulses is a reasonable classification. It is based on the use to which those goods can be put. Hence, in our opinion, the impugned classification is not violative of Article 14."*

51. In State of Gujarat v. Sri Ambika Mills Ltd., Mathew J. said :

> *"Statutes are directed to less than universal situations. Law reflects distinction that exist in fact or at least appear to exist in the judgment of legislators - those who have the responsibility for making law fit fact. Legislation is essentially empiric. It ad- dresses itself to the more or less crude outside world and not to the neat, logical models of the mind. Classification is inherent in legislation. To recognize marked differences that exist in fact is living law; to disregard practical differences and concentrate on some abstract identities is lifeless logic."*

and concluded

> *"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 of 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."*

52. In G.K. Krishnan v. Tamil Nadu, Mathew J. referred to the following observations of the Supreme Court of U.S.A. in San Antonio School District v. Rodrigues :

> *"Thus we stand on familiar ground when we continue to acknowledge that the Justices of this Court lack both the*

Gauri Gaekwad

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expertise and the familiarity with local problems so necessary to the making of wise decisions with respect to the raising and disposition of public revenues. Yet, we are urged to direct the States either to alter, drastically the present system or to throw out the property tax altogether in favour of some other form of taxation. No scheme of taxation, whether the tax is imposed on property, income, or purchases of goods and services, has yet been devised which is free of all discriminatory impact. In such a complex arena in which no perfect alternatives exist, the Court does well not to impose too rigorous a standard of scrutiny lest all local fiscal schemes become subjects of criticism under the Equal Protection Clause."

53. In I.T.O. v. N. Takim Roy Rymbai it was held :

"..... Given legislative competence, the legislature has ample freedom to select and classify persons, districts, goods, properties, incomes and objects which it would tax, and which it would not tax. So long as the classification made within this wide and flexible range by a taxing statute does not transgress the fundamental principles underlying the doctrine of equality, it is not vulnerable on the ground of discrimination merely because it taxes or exempts from tax some incomes or objects and not others. Nor the mere fact that tax falls more heavily on some in the same category, is by itself a ground to render the law invalid. It is only when within the range of its selection, the law operates unequally and cannot be justified on the basis of a valid classification, that there would be a violation of Article 14."

54. In the present case, the bases of classification cannot be said to be arbitrary or unintelligible nor as being without a rational nexus with the object of the law. A hotel where a unit of residential accommodation is priced at over Rs.400 per day per individual is, in the legislative wisdom, considered a class apart by virtue of the economic superiority of those who might enjoy its custom, comforts and services. This legislative assumption cannot be condemned as irrational. It is equally well recognised that judicial veto is to be exercised only in cases that leave no room for reasonable doubt. Constitutionally is presumed. These words of James Bradley Thayer may be recalled :

"This rule recognizes that, having regard to the great, complex ever-unfolding exigencies of government, much which will seem unconstitutional to one man, or body of men, may reasonably not seem so to another; that the constitution often admits of different interpretations; that

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there is often a range of choice and judgment; that in such cases the constitution does not impose upon the legislature any one specific opinion, but leaves open this range of choice; and that whatever choice is rational is constitutional."

55. Thayer also referred to the words of a Chief Justice of Pennsylvania way back in 1811 which are also worth recalling :

"For weighty reasons, it has been assumed as a principle in constitutional construction by the Supreme Court of the United States, by this court, and every other court of reputation in the United States, that an Act of the legislature is not be declared void unless the violation of the constitutional is so manifest as to leave no room for reasonable doubt."

56. In Secretary of Agriculture v. Central Roig Refining Co., the Supreme Court of USA said :

"..... This court is not a tribunal for relief for crudities and inequities of complicated experimental economic legislation."

57. In Hoechst Pharmaceuticals Ltd. v. State of Bihar it was observed :

"..... <u>On questions of economic regulations and related matters, the court must defer to the legislative-judgment. When the power to tax exists, the extent of burden is a matter for the discretion of the law-makers. It is not the function of the Court to consider the propriety or justness of the tax or enter upon the reality of Legislative policy. If the evident intent and general operations of the tax legislation is to adjust the burden with a fair reasonable degree of equality, the constitutional requirement is satisfied</u> ....."

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62. <u>A taxing statute is not, per se, a restriction of the freedom under Article 19(1)(g). The policy of a tax, in its effectuation, might, of course, bring in some hardship in some individual cases. But that is inevitable, so long as law represents a process of abstraction from the generality of cases and reflects the highest common-factor. Every cause, it is said, has its martyrs. Then again, the mere excessiveness of a tax or even the circumstances that its imposition might tend towards the diminution of the earnings or profits of the persons of incidence does not, per se, and without more, constitute violation of the rights under Article 19(1)(g).</u> Fazal Ali J., though in a different

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con- text, in Sonia Bhatia v. State of U.P. & Ors., observed :

> *"..... The Act seems to implement one of the most important constitutional directives contained in Part IV of the Constitution of India. If in this process a few individuals suffer severe hardship that cannot be helped, for individual interests must yield to the larger interests of the community or the country as indeed every noble cause claims its martyr."*

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77. There is also no established legislative practice which would enable one to limit the concept of an expenditure tax in the manner suggested. So far as expenditure tax is concerned, the only legislation earlier in force was the 1957 Act which was in force for a period of eight years. Such short lived legislation can hardly furnish the foundation of an argument to limit the scope of legislative power to the manner in which it was exercised under that enactment. If, after withdrawing this legislation, Parliament considered that it was not worthwhile or possible to impose a tax on all expenditure and that it would be sufficient, expedient or necessary to impose such a levy only on lavish spending in certain directions, that cannot certainly be precluded on any theory of established legislative practice, as was done in State of Madras v. Gannon Dunkerley Co., in respect of sales tax. In that case the legislative trend prevalent over decades was relied upon in interpreting the expression "sale of goods" used in the Constitution. But there the Court was concerned with a legal term, "sale", which had acquired a definite connotation in law and in legislative instruments and that analogy cannot be availed of to interpret the scope of Entry 97. On the other hand, even a fairly long-established legislative practice under which income tax levy by the Centre was restricted to items of income stricto sensu (as contrasted with capital gains) was not considered sufficient to place that type of restriction on the interpretation of the expression "taxes on income" used in the Central Legislative List: vide, Navinchanda Mafat Lal v. CIT. Not only that, the validity of later definitions of "income" under the Income-tax Act which have a much wider ambit has been upheld as covered by the above legislative entry. See, in this context, the decisions in Naynit Lal v. AAC, Bhargava v. Union, and Bhagwandas v. Union. There is not even that much of legislative practice, so far as expenditure tax is concerned, which would justify our importing any limitation on the concept of a "tax on expenditure" under Entry 97 of List I. A perusal of the decision of this Court upholding the validity of the 1957 Act Azam Jha's case, does not also justify the reading in of any such limitation. The wider coverage of the tax made it easier for the Court to pin point its subject matter as "expenditure" and to treat it as a matter falling under the residuary entry, but it does

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> _not justify the inference sought to be drawn that a tax cannot be said to be a tax with reference to "expenditure" because it does not tax expenditure in general but confines itself to certain types or categories of expenditure. Once it is granted that the tax need not exhaust the entire universe of the subject-matter, the extent of the subject matter that should be covered or selected for imposing tax should be entirely left to Parliament. subject only to any criteria of discrimination or unreasonableness that may attract the provisions of Part III of the Constitution._
>
> (emphasis supplied)

27 The domain of economic and fiscal policy formulation is primarily vested in the legislature and the executive. The judiciary's role is limited to ensuring conformity with the Constitution without delving into the policy merits. Furthermore, this presumption ensures stability and predictability in fiscal policies, which are essential for economic growth and development. Overturning fiscal statutes could lead to economic chaos and undermine the authority of the legislative body. Therefore, Courts must balance the necessity to uphold constitutional mandates with the practical implications of interfering with legislative judgments in fiscal matters. 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 of 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.

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The Apex Court, in *State of Himachal Pradesh* (Supra) in paragraphs 27 to 30, held as under :

> *27. It is by now well settled that any tax legislation may not be easily interfered with. The Courts must show judicial restraint to interfere with tax legislation unless it is shown and proved that such taxing statute is manifestly unjust or glaringly unconstitutional. Taxing statutes cannot be placed or tested or viewed on the same principles as laws affecting civil rights such as freedom of speech, religion, etc. The test of taxing statutes would be viewed on more stringent tests and the law makers should be given greater latitude. It would be useful to refer to a couple of judgments on the above proposition.*
>
> *28. In the case of R.K. Garg etc. vs. Union of India and others, (1981) 4 SCC 675, the Constitution Bench was judging the constitutionality of economic legislation wherein challenge was to the validity of the provisions of Special Bearer Bonds (Immunities and Exemption Act, 1981) on the grounds of discrimination and violation of Article 14. P.N. Bhagwati J., speaking for himself, Chief Justice Chandrachud, A.C. Gupta, S. Murtaza Fazal Ali and A.N. Sen, J.J., observed in paragraph 7 regarding the presumption in favour of constitutionality of the statute and that the burden is on the person who attacks it, to establish that there has been clear transgression of the constitutional principles. In paragraph 8, it was laid down that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc. The views of Justice Frankfurter in the case of Morey vs. Doud, 354 US 457 was relied upon. The same is reproduced hereunder :*
>
> > *"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 of 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."*
>
> *29. In case of Bhavesh D. Parish and others vs. Union of India and another, (2000) 5 SCC 471, the challenge was to the validity of section 9 of Reserve Bank of India Act as amended by the Amendment Act 1997 on the ground that it was violative of Article 14 and Article 19(1)(g) of the Constitution. This Court dismissed the challenge to the said provision in paragraph 26 of*

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> *the report. It observed that matters of economic policy should be best left to the wisdom of the legislature. Further, it went on to state that in the context of a changed economic scenario the expertise of the people dealing with the subject should not be lightly interfered with. It was also observed that while dealing with economic legislation, this court would interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all.*
>
> *30. In the case of Indian Oil Corporation Limited vs. State of Bihar and another, (2018) 1 SCC 242, provisions of the Bihar Tax on Entry of Goods into Local Areas for Consumption, Use or Sale therein Act 1993, was under challenge. Justice Nariman speaking for the Bench observed in paragraph 25 that when it comes to taxing statute, the law laid down by this Court is clear that it can be said to be breach only when there is perversity or gross disparity resulting in clear and hostile discrimination without any rational justification for the same.*
>
> (emphasis supplied)

28 It was submitted on behalf of petitioner that the test of manifest arbitrariness was a ground to invalidate even the primary legislation and Mr. Datar relied upon ***Shayara Bano V/s. Union of India***[22] and ***In Re Natural Resources Allocation***[23]. According to petitioner, the impugned Section is liable to be struck down as manifestly arbitrary. There is nothing to indicate that there was anything arbitrary in introduction of the impugned sub-clause. We do not find that the sub-clause suffered from the vice of discrimination. All have been treated with equality and uniformity. There is no discrimination against any particular persons or classes.

29 As held by the Apex Court in ***Union of India V/s. Exide Industries Limited and Anr.***[24] relied upon by the ASG, the approach of the

22. 1981 (4) SCC 675
23. 1989 (3) SCC 634
24. 2020 (5) SCC 274

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Court in testing the constitutional validity of a provision is well settled and the fundamental concern of the Court is to inspect the existence of enacting power and once such power is found to be present, the next examination is to ascertain whether the enacted provision impinges upon any right enshrined in Part III of the Constitution. In the present case, the legislative power of the Parliament to enact sub-clause in the light of Article 245 of the Constitution is not doubted at all.

Now to the next step of examination, i.e., whether the said clause contravenes any right enshrined in Part III of the Constitution, either in its form, substance or effect. It is no more res integra that the examination of the Court begins with a presumption in favour of constitutionality. This presumption is not just borne out of judicial discipline and prudence, but also out of the basic scheme of the Constitution wherein the power to legislate is the exclusive domain of the legislature/Parliament. This power is clothed with power to decide when to legislate, what to legislate and how much to legislate. Thus, to decide the timing, content and extent of legislation is a function primarily entrusted to the legislature and in exercise of judicial review, the Court starts with a basic presumption in favour of the proper exercise of such power. The process of testing validity is not to sneak into the prudence or proprieties of the legislature in enacting the impugned provision. Nor, is it to examine the culpable conduct of the legislature as an appellate authority. The only examination of the Court is

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restricted to the finding of a constitutional infirmity in the provision, as is placed before the Court. In the absence of any finding of any constitutional infirmity in a provision, the Court is not empowered to invalidate a provision. The raison d'être behind this self-imposed restriction is because of the fundamental reason that different organs of the State do not scrutinise each other's wisdom in the exercise of their duties. The time-tested principle of checks and balances does not empower the Court to question the motives or wisdom of the legislature, except in circumstances when the same is demonstrated from the enacted law. The approach of constitutional Courts ought to be different while dealing with fiscal statutes. It is trite that the legislature is the best forum to weigh different problems in the fiscal domain and form policies to address the same including to create a new liability, exempt an existing liability, create a deduction or subject an existing deduction to new regulatory measures. In the very nature of taxing statutes, the legislature holds the power to frame laws to plug in specific leakages. "Such laws are always pin-pointed in nature and are only meant to target a specific avenue of taxability depending upon the experiences of tax evasion and tax avoidance at the ground level". The general principles of exclusion and inclusion does not apply to taxing statutes with the same vigour unless the law reeks of constitutional infirmities. No doubt, fiscal statutes must comply with the tenets of the Constitution. However, a larger discretion is given to the legislature in

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statutes than in other spheres. Paragraphs 15 to 17, 36, 37 and 44 of *Exide Industries Limited and Anr.* (Supra) read as under :

> *15. The approach of the Court in testing the constitutional validity of a provision is well settled and the fundamental concern of the Court is to inspect the existence of enacting power and once such power is found to be present, the next examination is to ascertain whether the enacted provision impinges upon any right enshrined in Part III of the Constitution. Broadly speaking, the process of examining validity of a duly enacted provision, as envisaged under Article 13 of the Constitution, is premised on these two steps. No doubt, the second test of infringement of Part III is a deeper test undertaken in light of settled constitutional principles. In State of Madhya Pradesh vs. Rakesh Kohli & Anr., this Court observed thus :*
>
> > *"17. This Court has repeatedly stated that legislative enactment can be struck down by Court only on two grounds, namely (i) that the appropriate legislature does not have competence to make the law, and (ii) that it does not take away or abridge any of the fundamental rights enumerated in Part III of the Constitution or any other constitutional provisions....".*
>
> *The above exposition has been quoted by this Court with approval in a catena of other cases including Bhanumati & Ors. vs. State of Uttar Pradesh & Ors., State of Andhra Pradesh & Ors. vs. Mcdowell & Co. & Ors. and Kuldip Nayar & Ors. vs. Union of India & Ors., to state a few.*
>
> *16. In furtherance of the twofold approach stated above, the Court, in Rakesh Kohli (supra) also called for a prudent approach to the following principles while examining the validity of statutes on taxability :*
>
> > *"32. While dealing with constitutional validity of a taxation law enacted by Parliament or State Legislature, the court must have regard to the following principles :*
> >
> > *(i) there is always presumption in favour of constitutionality of a law made by Parliament or a State Legislature,*
> >
> > *(ii) no enactment can be struck down by just saying that it is arbitrary or unreasonable or irrational but some constitutional infirmity has to be found,*
> >
> > *(iii) the court is not concerned with the wisdom or*

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unwisdom, the justice or injustice of the law as Parliament and State Legislatures are supposed to be alive to the needs of the people whom they represent and they are the best judge of the 5 (2010) 12 SCC 1 6 (1996) 3 SCC 709 7 (2006) 7 SCC 1 community by whose suffrage they come into existence,

(iv) hardship is not relevant in pronouncing on the constitutional validity of a fiscal statute or economic law, and

(v) in the field of taxation, the legislature enjoys greater latitude for classification….."

17. In the present case, the legislative power of the Parliament to enact clause (f) in the light of Article 245 is not doubted at all. That brings us to the next step of examination i.e. whether the said clause contravenes any right enshrined in Part III of the Constitution, either in its form, substance or effect. It is no more res integra that the examination of the Court begins with a presumption in favour of constitutionality. This presumption is not just borne out of judicial discipline and prudence, but also out of the basic scheme of the Constitution wherein the power to legislate is the exclusive domain of the Legislature/ Parliament. This power is clothed with power to decide when to legislate, what to legislate and how much to legislate. Thus, to decide the timing, content and extent of legislation is a function primarily entrusted to the legislature and in exercise of judicial review, the Court starts with a basic presumption in favour of the proper exercise of such power.

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36. The process of testing validity is not to sneak into the prudence or proprieties of the legislature in enacting the impugned provision. Nor, is it to examine the culpable conduct of the legislature as an appellate authority over the legislature. The only examination of the Court is restricted to the finding of a constitutional infirmity in the provision, as is placed before the Court. Thus, the nondisclosure of objects and reasons per se would not impinge upon the constitutionality of a provision unless the provision is ambiguous and the possible interpretation violate Part III of the Constitution. In the absence of any finding of any constitutional infirmity in a provision, the Court is not empowered to invalidate a provision.

37. To hold a provision as violative of the Constitution on account of failure of the legislature to state the objects and reasons would amount to an indirect scrutiny of the motives of the legislature behind the enactment. Such a course of action, in

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our view, is unwarranted. The raison d'etre behind this self imposed restriction is because of the fundamental reason that different organs of the State do not scrutinise each other's wisdom in the exercise of their duties. In other words, the time tested principle of checks and balances does not empower the Court to question the motives or wisdom of the legislature, except in circumstances when the same is demonstrated from the enacted law.

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44. Before stepping into the next ground, we are inclined to observe that the approach of constitutional courts ought to be different while dealing with fiscal statutes. It is trite that the legislature is the best forum to weigh different problems in the fiscal domain and form policies to address the same including to create a new liability, exempt an existing liability, create a deduction or subject an existing deduction to new regulatory measures. In the very nature of taxing statutes, legislature holds the power to frame laws to plug in specific leakages. Such laws are always pinpointed in nature and are only meant to target a specific avenue of taxability depending upon the experiences of tax evasion and tax avoidance at the ground level. The general principles of exclusion and inclusion do not apply to taxing statutes with the same vigour unless the law reeks of constitutional infirmities. No doubt, fiscal statutes must comply with the tenets of Article 14. However, a larger discretion is given to the legislature in taxing statutes than in other spheres. In Anant Mills Co. Ltd. vs. State of Gujarat & Ors. 16, this Court noted thus :

> *"25. ...But, in the application of the principles, the courts, in view of the inherent complexity of fiscal adjustment of diverse elements, permit a larger discretion to the legislature in the matter of classification so long as it adheres to the fundamental principles underlying the said doctrine. The power of the Legislature to classify is of wide range and flexibility so that it can adjust its system of taxation in all proper and reasonable ways..."*

Viewed thus, the reason weighed with the Division Bench of the High Court in the impugned judgment is untenable.

(emphasis supplied)

30 In ***Malwa Bus Service (Private) Limited and Ors. V/s. State of Punjab and Ors.***[25], the Court held in paragraph 21 as under :

25. (1983) 3 SCC 237

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> *21. xxxxxxxxxxxxxx even a fiscal legislation is subject to Article 14 of the Constitution. But it is well settled that a legislature in order to tax some need not tax all. It can adopt a reasonable classification of persons and things in imposing tax liabilities. A law of taxation cannot be termed as being discriminatory because different rates of taxation are prescribed in respect of different items provided it is impossible to hold that the said items belong to distinct and separate groups and that there is a reasonable nexus between the classification and the object to be achieved by the imposition of different rates of taxation. The mere fact that a tax falls more heavily on certain goods or persons may not result in its invalidity. xxxxxxxxxxxxx*

(emphasis supplied)

31 The Constitution safeguards the right to trade under Article 19(1)(g) but does not extend this protection to the right to profit. Petitioners have stated that there is no pleaded case of hardship but are only aggrieved by the impugned amendment order which destroys the distinction between capital and revenue subsidies. In addressing the contention raised by petitioner, it is imperative to decipher the essence of the argument concerning the taxation of subsidies and concessions under Section 2(24)(xviii) of the Act. Petitioner assert that such taxation effectively nullifies the distinction between capital and revenue subsidies, leading to the erosion of what they perceive as a benefit or savings. However, this line of reasoning appears to combine the concept of fiscal incentive with absolute fiscal immunity. Subsidies and concessions are inherently designed to stimulate certain economic activities or to steer the economy in a desired direction. They are not, however, intended to serve as permanent fixtures beyond the scope of taxation, especially when such benefits have fulfilled their economic purpose. The imposition of tax on

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these subsidies under the amended provision does not constitute “taking away” of a benefit but rather represents a recalibration of fiscal advantages in line with broader economic and policy considerations. Profits, by their nature, are subject to fluctuations resulting from various factors, taxation being but one. It is the duty of the legislature to ensure that taxation policy reflects a balance between incentivizing economic activity and ensuring the equitable distribution of fiscal resources. Section 2(24)(xviii) of the Act is an example of this balancing act, and its imposition is a reflection of a subsidy's life cycle coming to its fiscal fruition. Petitioner's argument, is ostensibly rooted in concerns over profitability. This does not, in substance, however, provide a tenable basis to impugn the constitutional validity of the amended provision. Hence, petitioner’s argument of eroded profitability due to taxation lacks constitutional merit. An extension of this logic could open floodgates of untenable demands from loss-incurring entities seeking tax exemptions to improve profitability. This could potentially create a taxing standard that is inconsistent and prone to manipulations;

In *Nazeria Motor Service etc.* (Supra), the Apex Court held that even on the assumption that the profits would be diminished or greatly reduced, it cannot be held that there is any infringement of Article 19(1)(g) under Part III of the Constitution of India. Paragraphs 7 and 8 of the said judgment read as under :

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7. It has not been contended on behalf of the State that the impugned Validating Act imposes a tax which is by way of a regulatory or compensatory measure. It has, therefore, to be seen whether the restrictions imposed are reasonable and in public interest within the meaning of Article 304(b). Before the High Court an attempt was made on behalf of the appellants to show that by raising the rate of tax the burden had been increased to such an extent that the business of the appellants had been virtually annihilated. According to some of the affidavits filed on behalf of the writ petitioners, profits derived in recent years did not exceed an average of Rs.2,000/- per stage carriage even without the additional burden which had been imposed and the transporters would suffer heavy losses if the tax as increased by the impugned legislation were to be realized. The High Court referred to the computation of the income by the Income tax department of some of the transporters in whose assessments the income in regard to each bus had been calculated at a figure of Rs.7,000/- annually, which showed that the profits were much higher than Rs.2,000/-. It was not disputed before the High Court that the transporters had been permitted to enhance the fares. If the fares could be enhanced it was obvious that the burden would not fail on the transporters. It was urged that owing to competition from the railways and from operators whose vehicles had been registered in the Madras State and who could charge lower rates the appellants were not in a position to collect extra fares which they had been permitted to do. This argument also cannot hold and was rightly repelled by the High Court on the ground that if the operators were not prepared to charge higher rates as a matter of policy or for the purpose of business competition that could not impinge on the reasonableness of the restriction. Apart from a faint attempt to repeat some of the arguments which were addressed before the High Court on this point nothing new has been brought to our notice which would justify the view that the tax which has been imposed exceeds the limits of permissible reasonableness. As regards public interest we are unable to find nor has any attempt been made to satisfy us that the provisions of the impugned Validating Act with regard to imposition of tax are not in public interest.

8. This is sufficient to dispose of the challenge under Article 19(1)(g), as well. We may in this connection refer briefly to the conclusion of the High Court which was reached on a consideration of the affidavits filed before it. It has been found that there is no material which would warrant the conclusion that the increase in the surcharge of the fares and freight contemplated by the impugned Validating Act would constitute an impediment to the trade. The utmost that could be said was that it would result in the diminution of profits. Even on the assumption that the profits would be diminished or greatly

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> *reduced it cannot be held that there is any infringement of Article 19(1)(g).*
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> (emphasis supplied)

32 Taxation is an economic reality that every business entity must contend with. The interplay between taxation and profitability is a complex one, subject to numerous variables beyond merely the taxation of subsidies. The mere fact that a tax falls more heavily on certain goods or persons may not result in its invalidity. The policy of a tax, in its effectuation, might, of course, bring in some hardship in some individual cases. But that is inevitable, so long as law represents a process of abstraction from the generality of cases and reflects the highest common factor. Every cause, it is said, has its martyrs. Then again, the mere excessiveness of a tax or even the circumstance that its imposition might tend towards diminution of the earnings or profits of the persons of incidence, like in the case at hand – savings get reduced resulting in lower profitability, does not, per se, and without more, constitute violation of the rights under Part III of Constitution of India.

33 The chronology of events is pivotal in assessing the merits of petitioner's arguments against the constitutional validity of Section 2(24)(xviii) of the Act. When petitioner applied for the subsidy, the amendment to the Act specifically the inclusion of sub-clause (xviii) to Section 2(24), had been in effect for more than two years. This timeline is not merely incidental but is of substantive significance for several reasons. Firstly,

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petitioner, being engaged in business activities, is presumed to have conducted due diligence and engaged in careful planning, which would undoubtedly include an assessment of tax implications on all fiscal benefits, including subsidies. The amendment was public knowledge, and the implications of the inclusion of subsidies within the ambit of taxable income were clear and unambiguous. Therefore, petitioner, at the time of application, was having full knowledge or ought to have had full knowledge of the tax treatment of such subsidies post-amendment. Secondly, the act of applying for a subsidy after the amendment came into force indicates an acceptance of the prevailing tax regime. It is reasonable to infer that by choosing to partake in the subsidy scheme, petitioner implicitly acknowledged and consented to the accompanying tax obligations as legislated by the amendment. Thirdly and furthermore, it is a well-settled principle that ignorance of the law is no excuse. Petitioner cannot claim ignorance of the amendment or its implications. The legislative change was not done surreptitiously but was the result of a transparent legal process, providing ample opportunity for all stakeholders to acquaint themselves with the new provisions.

34 As regards Mr. Datar's submissions that the parliament to remove the basis of the Hon'ble Supreme Court rulings on subsidies should have done it by a suitable explanation and not by the impugned sub clause, it is settled law as held in ***Hindustan Gum and Chemicals Ltd. vs. State of***

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Haryana and Ors.[26] that it is permissible for a competent Legislature to overcome the effect of a decision of a Court setting aside imposition of tax by passing a suitable legislation, by amending the relevant provisions of the statute concerned with retrospective effect, thus taking away the basis on which the decision of the Court had been rendered and by enacting an appropriate provision validating the levy and collection of tax made before the decision in question was rendered.

35 As stated earlier, it should be left to the wisdom of the Legislature to decide whether there should be an amendment or explanation.

36 We are unable to find or even assume that what the legislature has done for inserting the impugned sub-clause is irrational. There is no room for any doubt. There is nothing to even question the constitutionality and in our view petitioner has not been able to demonstrate a clear transgression of constitutional principles. The nature of economic regulation is complex. The fiscal laws are instrumental in the financial governance of the state and are outcome of detailed economic planning and consideration.

37 Undoubtedly, the power to tax exists and the extent of burden is a matter for the discretion for the law makers. It is not the function of the court to consider the propriety or justness of the tax or enter upon the

26. (1985) 4 SCC 124

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reality of legislative policy. If the evident intent and general operations of the tax legislation is to adjust the burden with a fair reasonable degree of equality, the constitutional requirement is satisfied.

38 The policy of tax in its effectuation, might, of course, bring in some hardship in some individual cases. That is, inevitable. Every cause, it is said, has its martyrs. Mere excessiveness of a tax or even the circumstances that its imposition might tend towards the diminution of the earnings or profits of petitioner, per se and cannot constitute violation of constitutional rights. If in the process a few individuals suffer severe hardship that cannot be helped, for individual interests must yield to the larger interests of the community or the country as indeed every noble cause claims its martyr.

39 As submitted correctly by the ASG, the judicial invalidation of this provision would precipitate not merely a legal conundrum but a fiscal catastrophe with far-reaching consequences. A retrospective annulment of this provision would cause a state of chaotic disarray. Individuals and entities that have availed of subsidies and concessions and complied with the tax obligations thereof stand to face an untenable situation. They have acted in good faith under the existing legislative policy, and to dismantle this retrospectively would be to penalize compliance and create an environment of uncertainty and unpredictability in tax matters. Moreover, such a judicial step would likely instigate a flood of claims and litigations for refund of taxes paid under the provision, straining the administrative

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machinery and judicial resources. This would not only disrupt the revenue stream but also place an undue burden on the exchequer. Hence we are not inclined to strike down Section 2(24)(xviii).

40 In ***Bhagwan Dass Jain V/s. Union of India and Ors.***[27], relied upon by ASG, the short question that arose for consideration was whether it was open to the Revenue to include in the income of the assessee any amount calculated in accordance with Section 23(2) of the Act in respect of a house in the occupation of the assessee for the purposes of his own residence. The assessee contended that inclusion of any amount under Section 23(2) of the Act in his income was unconstitutional as there could be no income at all in such a case accruing to him in the true sense of that term. The liability that was sought to be imposed under the Act in respect of his residential house was, therefore, in its pith and substance a tax on building falling under Entry 49 of List II of the Seventh Schedule to the Constitution and hence, Parliament could not impose the said liability under a law made in exercise of its legislative power under Entry 82 of List I of the Seventh Schedule to the Constitution which authorised it only to levy taxes on income other than agricultural income. The argument made by the assessee was that as assessee is not deriving any monetary benefit by residing in his own house, no tax can be levied on him on the ground that he is deriving income from that house. It was contended that the word

27. (1981) 2 SCC 135

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"income" only means realisation of monetary benefit and that in the absence of any such realisation by the assessee, the inclusion of any amount by way of notional income under Section 23(2) of the Act in the chargeable income was impermissible as it was outside the scope of Entry 82 of List I of the Seventh Schedule to the Constitution. The court held, words in the Constitution conferring legislative power should receive a liberal construction and should be interpreted in their widest amplitude. The word "income" in Entry 82 is capable of a wider meaning than what was given to it in the Indian Income Tax Act, 1922 or the English Act of 1918 and includes all items which were taxable under the contemporaneous law relating to tax on incomes which was in force at the time when the Constitution was enacted. The Court held that even in its ordinary economic sense, the expression "income" include 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 income can be reasonably regarded as giving rise to income. Paragraphs 5, 6, 13 and 14 of the said judgment read as under :

> *5. Entry 82 of List I of the Seventh Schedule to the Constitution empowers Parliament to levy 'taxes on income other than agricultural income'. Now it is well-settled that the entries in the list in the Seventh Schedule to the Constitution should not be read in a narrow or restricted sense and each and every subject mentioned in the entries should be read as including within its scope all ancillary and subsidiary matters which can fairly and reasonably be comprehended in it. Words in the Constitution conferring legislative power should receive a liberal construction and should be interpreted in their widest amplitude.*

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6. The expression 'income' according to Oxford Dictionary means 'a thing that comes in'. Income may also be defined as the gain derived from land, capital or labour or any two or more of them.

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13. There is one other circumstance which persuades us to take the view that computation of income for purposes of levy of income tax in accordance with section 23(2) of the Act is justifiable under Entry 82 of List I of the Seventh Schedule to the Constitution. It is to be borne in mind that the Government of India Act, 1935 was enacted when the Indian Income-tax Act, 1922 was in force. Section 9 of the Indian Income-tax Act, 1922 provided for levy of income tax on the basis of the bona fide annual value of the property even when it was in the occupation of the assessee for the purposes of his own residence. While enacting entry 54 of list I of the Seventh Schedule to the Government of India Act, 1935, the British Parliament must have had in its view the Indian Income-tax Act, 1922 which was probably the only law relating to tax on incomes in force in British India then. Similarly the Constituent Assembly while enacting Entry 82 of List I of the Seventh Schedule to the Constitution must have understood that the word 'income' used in that Entry would in any event include within its scope all items which came within the definition of income and were subjected to charge in the Indian Income-tax Act, 1922 which was in force at the time the Constitution was adopted. That the Constitution makers had the Indian Income- tax Act, 1922 in their view is borne out from Article 270(1) of the Constitution which provides for collection of taxes on income by the Government of India and distribution thereof between the Union and the States, Article 366(1) which defines 'agricultural income' as agricultural income as defined for the purposes of the enactments relating to Indian Income-tax and Article 366(29) which defines 'tax on income' as including a tax in the nature of an excess profits tax. In the circumstances it would not be wrong to construe the word 'income' in Entry 82 as including all items which were taxable under the contemporaneous law relating to tax on incomes which was in force at the time when the Constitution was enacted when as observed by this Court in the case of Navinchandra Mafatlal (supra) the word 'income' in Entry 82 is capable of a wider meaning than what was given to it in the Indian Income-tax Act, 1922 or the English Act of 1918.

14. 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 income can be reasonably regarded as giving rise to income. The tax levied

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> *under the Act is on the income (though computed in an artificial way) from house property in the above sense and not on house property.* *Entry 49 of List II of the Seventh Schedule to the Constitution is not, therefore, attracted. The levy in question squarely falls under Entry 82 of List I of the Seventh Schedule to the Constitution.*

(emphasis supplied)

41 Matters of economic policy should be best left to the wisdom of the legislature. In the context of a changed economic scenario the expertise of the people dealing with the subject should not be lightly interfered with. While dealing with economic legislation, this court would interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all. The case of petitioner certainly does not fall within this exception. We also do not find that by inserting the impugned sub clause there is any perversity or gross disparity resulting in clear or hostile discrimination.

42 As noted earlier it is trite that the legislature is the best forum to weigh different problems in the fiscal domain and form policies to address the same including to create a new liability, exempt an existing liability, create a deduction or subject an existing deduction to new regulatory measures. In the very nature of taxing statutes, legislature holds the power to frame laws to plug in specific leakages.

The mere fact that the institution of tax by virtue of the impugned sub clause falls more heavily on petitioner cannot result in its invalidity.

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43 In light of the above, in our view, the amendment to Section 2(24) by the insertion of sub-cause (xviii) of the Finance Act, 2015, is a perfect example of a legislative endeavour to align the definition of "income" with the evolving economic landscapes and judicial precedent of it being an inclusive and elastic term. The submissions of petitioner though appear to be of fiscal concern were, in our view, more an argument of diminished profits and a narrow interpretation of income which the Apex Court has time and again expanded. The submissions of petitioner fall short of appreciating the overarching legislative intent to foster a comprehensive and equitable taxation regime. The amendment to Section 2(24) by insertion of the impugned sub-clause that includes various subsidies and concessions only indicates the well established jurisprudential path ensuring that the income tax laws remain attuned to the economic realities and continue to serve as a vital cog in the nation's fiscal machinery. As submitted by ASG, it is the duty of the legislature to ensure that taxation policy reflects a balance between incentivizing economic activity and ensuring the equitable distribution of fiscal resources.

44 In our view, there is no merit in the petition. Petition dismissed.

(DR. NEELA GOKHALE, J.) **(K. R. SHRIRAM, J.)**

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