

THE CONSTITUTIONAL AND LEGISLATIVE FRAMEWORK GOVERNING INCOME TAXATION IN INDIA

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ABSTRACT

This research explores the constitutional and legislative architecture that underpins income taxation in India, emphasizing the evolving dual tax regime introduced by recent Finance Acts. Grounded in the Indian Constitution—particularly Articles 14, 246, and 265—this framework delineates the division of taxing powers between the Union and State governments and affirms the principle that taxation must be backed by the authority of law. The study traces the historical evolution of India's income tax system, from ancient and colonial precedents to the transformative enactment of the Income Tax Act, 1961. Special attention is given to the legal basis, rationale, and implications of introducing Section 115BAC, which allows taxpayers to choose between the traditional exemption-based regime and a simplified concessional-rate regime. By analyzing judicial precedents, delegated legislation, and amendments from the Finance Acts of 2020 to 2025, the study highlights the government's intent to simplify compliance, broaden the tax base, and foster voluntary adherence, all while aligning with constitutional mandates. This work underscores the dynamic interplay between law, policy, and fiscal governance in shaping India's contemporary income tax regime.

INTRODUCTION



"The power of taxing people and their property is essential to the very existence of government."

- James Madison

(Source: - https://www.business-standard.com/india-news/income-tax-day-2024-date-history-significance-quotes-and-more-124072400291_1.html)

In exploring the intricate landscape of income taxation within the Indian context, it is imperative to delve into the foundational constitutional and legislative structure that governs this critical aspect of fiscal policy. The framework for income taxation in India is not merely a product of administrative convenience but is deeply rooted in the country's constitutional provisions, which delineate the authority and responsibilities of both the central and state governments in the realm of taxation.¹

The Indian Constitution, which came into effect on January 26, 1950, serves as the grundnorm that underpins all legal and legislative frameworks, including those pertaining to taxation. Notably, Article 246 of the Constitution empowers Parliament to make laws with respect to matters enumerated in the Union List, which includes income tax, while Article 247 grants the state legislatures the authority to levy taxes on income other than those expressly covered by the Union List or the Concurrent List. This bifurcation of powers establishes a dual system of

governance that defines the income tax landscape in India, allowing for both centralized and decentralized tax administration.

Moreover, the legislative framework for income taxation is primarily governed by the Income Tax Act of 1961, a comprehensive statute that has undergone numerous amendments to address evolving economic circumstances and societal needs.² This Act serves as the principal legislation for the assessment, collection, and administrative handling of income tax in the country. It encapsulates various provisions related to taxation, including the definitions of taxable income, permissible deductions, and tax rates applicable to different categories of taxpayers. Furthermore, the Act provides guidelines for tax assessment procedures, appeals, and penalties, thus creating a robust legal mechanism through which income tax is administered.

In addition to the Income Tax Act, other statutory regulations and directives issued by the Ministry of Finance, as well as the Central Board of Direct Taxes (CBDT), play a crucial role in shaping the practical implementation of income tax laws.³ These bodies are responsible for issuing circulars, notifications, and clarifications that facilitate the interpretation and application of the Income Tax Act, thereby ensuring compliance and resolving ambiguities that may arise in the administration of tax law.

Furthermore, the relationship between income taxation and various fundamental rights safeguarded by the Constitution cannot be overstated. The enforcement of tax laws must align with the principles of natural justice and procedural fairness, ensuring that taxpayers are afforded their rights as citizens. This imperative is crucial in maintaining public confidence in the tax system and ensuring that income tax administration remains transparent and equitable.

This chapter will comprehensively examine these elements, providing a detailed analysis of the constitutional mandates, legislative provisions, and regulatory frameworks that collectively form the

¹ Ministry of Finance, History of Income Tax in India.

² Income-tax Act, 1961, No. 43 of 1961 (India).

³ CBDT Circular No. 5/2020, dated Apr. 13, 2020.

bedrock of income taxation in India. In doing so, it will also explore the dynamic interplay between legal parameters and their practical implications in addressing the challenges faced by tax collectors and taxpayers alike in this complex fiscal landscape.

EVOLUTION OF INCOME TAX IN INDIA

The trajectory of the income tax system in India is a multifaceted narrative influenced by a confluence of historical, political, and economic transformations that have unfolded over the past 150 years. This system has migrated from its rudimentary colonial origins to its current intricate framework, reflecting the evolving imperatives of governance, economic progression, and public policy. An in-depth understanding of this evolution is vital for grasping the rationale underlying the dual tax regime that has been implemented in recent years.

The evolution of the Indian taxation system reflects a remarkable journey from its origins in ancient times to the complexities of the medieval period, with its development intricately linked to historical texts, societal norms, and the governance structures of various empires. In ancient India, particularly during the reign of the Mauryan Empire (approximately 322–185 BCE), taxation was not merely an obligation but a systematic approach integral to statecraft. Land revenue emerged as the predominant source of income for the state, complemented by various other levies on trade, professions, property ownership, and the exploitation of natural resources.

The Arthashastra, authored by the ancient scholar Kautilya (also known as Chanakya), serves as a crucial document detailing the fiscal policies of that era. Kautilya emphasized the importance of revenue generation, articulating that “revenue is the backbone of administration.” His text categorizes a spectrum of taxes, which included customs duties imposed on goods entering or leaving trade routes, transaction levies on commercial exchanges, and production shares collected from agricultural outputs. Additionally, foundational texts such as the Manusmriti and the Yajnavalkya Smriti further elaborated on the principles of taxation by establishing guidelines that classified taxes based on various criteria, including profession, income levels, and societal roles.⁴

Transitioning into the medieval period, particularly under the Mughal Empire (1526–1857 CE), significant advancements in the structure and administration of taxation became evident. One of the pivotal figures during this time was Akbar's finance minister, Raja Todar Mal, who introduced the Dahsala system around the late 16th century. This innovative system categorized agricultural land based on its productivity and established a tax regime that was calculated on the basis of a 10-year average yield. This approach not only offered flexibility in payment methods for the agrarian population but also instituted a robust record-keeping mechanism that enhanced transparency and accountability within the tax administration. This made the

⁴ P.V. Kane, History of Dharmasāstra (Bhandarkar Oriental Research Institute, 1930).

Dahsala system one of the most efficient taxation frameworks in the pre-modern period, effectively balancing the needs of the treasury with the realities of agrarian life.⁵

The foundational principles established by these early taxation systems laid the groundwork for the future of India's taxation policies, promoting an understanding of structured and equitable tax collection. As these historical precedents demonstrate, the Indian taxation system has not only adapted to the changing socio-economic landscape but has also set the stage for the evolution of a more organized and equitable fiscal policy that continues to influence the current tax framework in India.

• COLONIAL ORIGINS: THE FOUNDATION OF INCOME TAX IN INDIA

The formal introduction of income taxation in India can be traced back to the year 1860. This pivotal moment was orchestrated by James Wilson, who held the position of Finance Member in the Viceroy's Executive Council at the time. The imposition of this tax was framed as a temporary measure aimed at alleviating the fiscal repercussions following the Revolt of 1857.⁶ The initial legal framework established in 1860 was elementary by today's standards, categorizing income into distinct classifications and imposing taxes accordingly. Despite its brief existence, the 1860 Income Tax Act marked the foundational principle that income could be subject to taxation based on its source, setting a precedent for subsequent legislative developments.

In 1886, the enactment of the Income Tax Act provided a more robust and systematic legal framework for income tax, further evolving the initial concepts introduced in 1860. This 1886 Act continued to classify income under various heads, a practice that remains a hallmark of the modern income tax system. Nevertheless, its reach was limited, predominantly covering urban incomes and commercial activities while providing minimal attention to rural and agricultural sectors, thereby reflecting the economic landscape of that era.⁷

A transformative legislative advancement occurred with the introduction of the Income Tax Act of 1918, which paved the way for the more consequential Income Tax Act of 1922.⁸ The 1922 legislation represented a substantial shift in tax policy; it centralized the responsibility for income tax collection and administration under the aegis of the central government, thereby enhancing governmental oversight. This Act established clearer guidelines for the assessment and appeals process, which significantly bolstered compliance and enforcement mechanisms. For nearly four decades, the 1922 Act served as the backbone of India's income tax administration, and it underwent numerous amendments designed to accommodate the evolving fiscal requirements of the country.

⁵ Irfan Habib, *The Agrarian System of Mughal India* (Oxford Univ. Press, 1999).

⁶ James Wilson's 1860 tax scheme, see Ministry of Finance archives, Govt. of India.

⁷ Income Tax Act, 1886 (India), repealed.

⁸ Income Tax Act, 1922, Acts of Parliament (India); see also Kanga & Palkhivala, *The Law and Practice of Income Tax*, 11th ed. (Arvind Datar ed., LexisNexis, 2022).

• POST-INDEPENDENCE TAX LAW REFORMS AND THE INCOME TAX ACT OF 1961

The end of colonial rule in 1947 heralded a new chapter for India as it embarked on the complex task of devising a taxation system that would cater to the unique needs of a sovereign and developing nation. In light of the inadequacies of the 1922 Act, which was increasingly viewed as antiquated, efforts to revolutionize the taxation landscape culminated in the establishment of the Income Tax Act of 1961.⁹ This comprehensive legislation was shaped by the contributions of the Law Commission, the Expert Committee on Taxation, and various policy think tanks dedicated to modernizing Indian tax law.

Enacted as a cohesive piece of legislation, the 1961 Act amalgamated various tax laws and judicial precedents into a singular framework that delineated the processes for the levying, assessing, collecting, and recovering of income tax. It introduced fundamental concepts such as ‘total income,’ ‘gross total income,’ and ‘residential status’ for taxpayers, while also institutionalizing mechanisms like tax deduction at source (TDS), advance tax, and provisions for penalties in cases of non-compliance. Since its introduction, this Act has remained the cornerstone of India’s income tax regime, subject to annual amendments through the Finance Acts to reflect contemporary economic realities.¹⁰

In the decades of the 1970s and 1980s, the complexities of the tax structure in India intensified, characterized by high tax rates and a proliferation of exemptions. Such an environment fostered a culture of tax evasion and aggressive tax planning strategies among taxpayers. Responding to these challenges, the Indian government established various committees, including the Wanchoo Committee in 1971 and the Choksi Committee in 1978, tasked with recommending comprehensive tax reforms. These committees emphasized the importance of broadening the tax base, rationalizing exemptions, and enhancing the enforcement of tax laws to curb evasion and ensure compliance.¹¹

• ECONOMIC LIBERALIZATION AND THE MODERNIZATION OF TAX POLICY (1991–2010)

The pivotal event of economic liberalization in 1991 catalyzed a transformative phase in India's tax policy, marking the transition from a predominantly socialist model to a more market-oriented economy. This shift necessitated significant tax reforms as an integral component of the broader economic restructuring agenda. The focus of tax policy evolved toward enhancing taxpayer compliance, reducing tax rates, minimizing the array of exemptions, and fostering greater transparency within the system. The implications of these reforms were profound, as they aimed to facilitate economic growth, attract foreign investment, and create a more equitable tax structure reflective of the aspirations of a rapidly evolving economy.

The Kelkar Committee Reports, which were deliberated upon over a period spanning from 2002 to 2004, provided a comprehensive series of recommendations aimed at overhauling and reforming the Indian

⁹ Law Commission of India, 2nd Report on Reform of Taxation Law (1958).

¹⁰ Income-tax Act, 1961, §§ 2(45), 192, 206C.

¹¹ Government of India, Wanchoo Committee Report (1971); Choksi Committee Report (1978).

taxation framework.¹² These reports underscored the pressing need for the simplification of tax laws, emphasizing that overly complicated regulations and excessive deductions hindered both compliance and revenue collection. Additionally, the committee advocated for the development and enhancement of taxpayer services, recognizing that better support structures would not only facilitate compliance but also engender a more cooperative relationship between the tax authorities and taxpayers.

Although the entirety of the committee's recommendations was not fully adopted, a significant portion laid a robust foundation for subsequent administrative and legislative improvements in the realm of taxation. This period was characterized not only by a commitment to reform but also by noteworthy advancements in technology, specifically in the realm of digital filing systems. During this time, the introduction of Personal Account Numbers (PAN) and Tax Deduction Account Numbers (TAN) was instrumental in streamlining the identification and processing of taxpayers. The digitization of assessment procedures also marked a pivotal transition towards modernity, enhancing efficiency within the tax administration.

Simultaneously, this era witnessed the incursion of global best practices into the domain of Indian tax policy, providing an impetus for a more cohesive and uniform indirect tax structure, as well as a framework for transparent taxation rates. Within this comprehensive policy landscape, the groundwork for a simplified and optional tax regime began to take shape, reflecting both domestic needs for reform and international trends advocating for efficiency and transparency in tax systems.

• **THE DUAL REGIME: INTRODUCTION AND POLICY RATIONALE (2019-PRESENT)**

The advent of an optional tax regime for taxpayers emerged as a strategic response to persistent demands for simplification in the taxation process, as well as the necessity to rectify tax distortions that stemmed from the multitude of deductions and exemptions proliferating within the existing framework. This dual regime model was officially introduced by the government through the Finance Act of 2020, which incorporated an additional provision

Section 115BAC into the Income Tax Act, 1961.¹³ This legislative amendment provided individual taxpayers and Hindu Undivided Families (HUFs) with the ability to choose between the traditional tax regime, which is characterized by elevated tax rates coupled with numerous exemptions, and a newly instituted regime that offers lower tax rates in exchange for the relinquishment of these exemptions.

The primary objective of this significant policy shift was to enhance the overall transparency of the tax system, thereby reducing the compliance burden on taxpayers and simplifying the process of tax calculations. Nevertheless, this reform also introduced an added layer of complexity to the decision-making process faced by taxpayers. Individuals were now tasked with the critical evaluation of which tax regime would yield the most favorable outcomes based on their specific income profiles and the nature of their eligibility for various deductions.

¹² Government of India, Kelkar Committee Report on Tax Reforms (2002).

¹³ Finance Act, 2020, No. 12 of 2020, § 60.

Furthermore, the Finance Act of 2023 brought additional refinement to this regulatory framework by establishing the new tax regime as the default system to be implemented from the Assessment Year 2024-25 onwards. Importantly, this act continues to afford taxpayers the option to select the older regime should they find it more advantageous.¹⁴ This pivotal development serves as a clear indicator of a definitive policy orientation towards tax simplification and resonates with broader global trends, including recommendations from various economic think tanks that advocate for a wider tax base alongside reduced tax rates. Overall, these initiatives reflect a progressive endeavor to align India's taxation system with international standards, thereby facilitating improved compliance, transparency, and economic efficiency.

PERTINENT CONSTITUTIONAL PROVISIONS

The taxation framework of India is fundamentally grounded in the Constitution of India, which serves as the supreme legal document governing the country's fiscal policies.¹⁵ It is through the constitutional provisions that the legitimacy and structural integrity of tax levies and collections are established, thereby providing a robust framework for both the Union and State governments. This legal foundation ensures that all fiscal powers exercised by these governing bodies are consistent with the fundamental principles of legality, fairness, and equity,¹⁶ which are crucial for a just tax system.

In particular, the dual income tax regime recently introduced in India reflects a significant development in the nation's fiscal policy landscape. This regime provides taxpayers with the opportunity to choose between two distinct taxation frameworks a traditional structure and a newer, arguably more simplified option. Such legislative innovation prompts an in-depth examination of the constitutional safeguards that are in place to uphold the rights of taxpayers and maintain the integrity of the tax system.

These constitutional safeguards are critical in ensuring that the choice offered to taxpayers does not compromise key principles such as the rule of law and equal protection under the law. They play a vital role in maintaining public trust in the government's fiscal operations and in ensuring that all citizens are treated equitably, irrespective of their socio-economic status. As such, understanding the interplay between constitutional provisions and taxation policies becomes paramount in analyzing how effectively India's taxation system can adapt to contemporary economic challenges while upholding the constitutional mandate. Thus, it is necessary for scholars and policymakers to rigorously assess the implications of such innovations within the framework of constitutional law to foster a taxation system that is both progressive and aligned with the nation's core values.¹⁷

¹⁴ OECD, Tax Policy Reforms 2023: OECD and Selected Partner Economies.

¹⁵ INDIA CONST. pmbi., arts. 246, 265.

¹⁶ Id. arts. 14, 19(1)(g), 265.

¹⁷ Income-tax Act, 1961, § 115BAC, inserted by Finance Act, 2020.

• ARTICLE 14: RIGHT TO EQUALITY

The significance of Article 14 of the Indian Constitution cannot be overstated, as it enshrines the principle that the State shall not deny any individual the equality that is guaranteed before the law or the equal protection of the laws. This principle is particularly pertinent in the realm of taxation, as Article 14 necessitates that any form of classification such as the distinctions drawn between the old and new tax regimes must not be arbitrary; rather, it must be grounded in an intelligible differentia that serves a legitimate purpose.

In the landmark case of **Khandige Sham Bhat v. Agricultural Income Tax Officer, AIR 1963 SC 591**,¹⁸ the Supreme Court upheld the constitutionality of treating different classes of taxpayers differently, emphasizing that reasonable classification based upon objective criteria is permissible within the broad ambit of Article 14.

Conversely, in **M.C.T. Muthiah v. CIT**,¹⁹ AIR 1956 SC 269, the Supreme Court found a provision unconstitutional due to its creation of unreasonable discrimination. This case underscored the necessity for tax laws to be just, fair, and non-arbitrary, thereby reiterating the importance of maintaining equal treatment within tax legislation.

• ARTICLE 265: NO TAX EXCEPT BY AUTHORITY OF LAW

Article 265 articulates a fundamental constitutional principle: “no tax shall be levied or collected except by authority of law.” This provision acts as a vital safeguard to ensure that all forms of taxation derive from an established legal framework. The introduction of the dual tax regime via the Finance Act must align with this pivotal article, thereby affirming its constitutional validity.

Case Law:

The ruling in **Chhotabhai Jethabhai Patel & Co. v. Union of India**,²⁰ AIR 1962 SC 1006, demonstrated that the Supreme Court acknowledged the legality of imposing retrospective taxation, provided that such taxation is appropriately legislated. This case emphasizes the necessity of a statutory foundation to underpin any tax collection efforts.

• ARTICLE 246 AND SCHEDULE VII: DISTRIBUTION OF LEGISLATIVE POWERS

Article 246, in conjunction with the Seventh Schedule of the Constitution, delineates the extent of legislative competence between the Union and State governments. Specifically, Entry 82 of the Union List empowers the Parliament to legislate regarding income tax, with the exception of agricultural income. This explicit provision offers the constitutional authority necessary to introduce and enforce both the traditional and contemporary tax regimes.

¹⁸ Khandige Sham Bhat v. Agrl. ITO, AIR 1963 SC 591.

¹⁹ M.C.T. Muthiah v. CIT, AIR 1956 SC 269.

²⁰ Chhotabhai Jethabhai Patel & Co. v. Union of India, AIR 1962 SC 1006.

• ARTICLE 270: DISTRIBUTION OF TAX REVENUES BETWEEN UNION AND STATES

Article 270 addresses the distribution mechanism for revenues generated by the Union, including income tax (excluding surcharges). This provision gains added significance within the context of the dual tax regime, as fluctuations in taxpayer preferences especially a tendency toward lower tax outflows can have far-reaching implications for the divisible pool of resources shared between the Union and the States.

Judicial Discussion:

While there has yet to be a landmark judgment directly interpreting Article 270, the Finance Commission Reports and the discussions surrounding relevant cases, such as **Union of India v. H.S. Dhillon, AIR 1972 SC 1061**,²¹ accentuate the critical importance of equitable distribution in fostering cooperative federalism within the Indian polity.

• ARTICLE 19(1)(G): FREEDOM OF OCCUPATION AND TRADE

Taxation policy must not impose unreasonable restrictions on an individual's freedom to engage in any profession, trade, or business. Overly burdensome or intricate tax compliance requirements can potentially be challenged as violations of this constitutional freedom.

Relevant Case:

In the case of **IndianExpress Newspapers v. Union of India, 1985 SCR (2) 287**,²² the Supreme Court underscored that tax regulations should not be so onerous that they infringe upon constitutional freedoms, thereby reinforcing the necessity for rational, proportionate tax structures that do not unduly impede the rights granted by Article 19(1)(g).

• ARTICLE 279A: GST COUNCIL AND FISCAL FEDERALISM

Although it does not pertain directly to income tax, the establishment of the Goods and Services Tax (GST) Council under Article 279A exemplifies the dynamic nature of cooperative fiscal governance evolving in India. The objectives of the GST Council namely simplicity, compliance, and harmonization reflect the underlying principles analogous to those that underpin the dual income tax regime.

• ARTICLE 300A: RIGHT TO PROPERTY

Finally, Article 300A enshrines the protection of property rights within the constitutional framework, asserting that no individual shall be deprived of their property (including income) save through due process under the law. The constitutionality of the dual tax regime, founded as it is on legislative sanction, inherently respects and upholds this crucial constitutional guarantee.²³

²¹ Union of India v. H.S. Dhillon, AIR 1972 SC 1061

²² Indian Express Newspapers v. Union of India, (1985) 2 SCR 287.

²³ Id. art. 300A.

In summary, the Indian taxation system is not only a mechanism for revenue generation but also a complex interplay of legal principles and constitutional mandates designed to ensure fairness, equity, and accountability in the administration of tax laws. This chapter aims to elucidate these foundational principles and their implications for the ongoing evolution of taxation in India.

LEGAL BASIS FOR TAX REGIME STRUCTURING

The legal underpinnings that facilitate the structuring of multiple tax regimes in India—most notably the simultaneous existence of the traditional income tax regime alongside the newly implemented tax structure—are predominantly enshrined within the provisions of the Income-tax Act, 1961. This statutory framework is augmented by constitutional directives, the enactment of delegated legislation through annual Finance Acts,²⁴ and the acknowledged authority of the State to impose taxes as recognized by various judicial pronouncements. In this chapter, we shall delve into the statutory provisions that empower the legislature to establish parallel income tax systems and dissect the extent of such authority by referencing pertinent legislative instruments and legal interpretations.

• STATUTORY AUTHORITY UNDER THE INCOME-TAX ACT, 1961

The Income-tax Act, 1961 constitutes the primary legal framework governing the imposition, calculation, and collection of income tax in India. The latent power to devise multiple tax regimes is derived from this Act, which is subject to periodic amendments enacted through annual Finance Acts.

• FRAMEWORK OF THE INCOME-TAX ACT

Central to the Act's provisions is Section 4, which functions as the charging section that prescribes the conditions under which income tax may be levied. The section articulates:

"Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate, income-tax shall be charged in accordance with, and subject to the provisions of, this Act in respect of the total income of the previous year."

This pivotal provision indicates that the Act, while comprehensive in its procedural and definitional remit, delegates the authority to determine tax rates and exemptions to the Finance Act enacted annually by Parliament. Thus, it is within this statutory architecture that alternative and optional tax regimes have been conceived and introduced.

• ROLE OF THE FINANCE ACTS

The introduction of the new tax regime was formalized through the Finance Act, 2020, which incorporated Section 115BAC.²⁵ This section permits individuals and Hindu Undivided Families (HUFs) to elect to adopt concessional tax rates, provided they agree to relinquish certain exemptions and deductions. Moreover,

²⁴ Income-tax Act, 1961, § 4.

²⁵ Finance Act, 2020, No. 12 of 2020.

subsequent modifications incorporated in the Finance Act, 2023 rendered the new tax structure the default option, unless taxpayers expressly opted for the traditional regime. Such legislative developments highlight the ability of Parliament, via the Finance Act, to establish alternative taxation frameworks without necessitating amendments to the foundational structure of the Income-tax Act itself.

This practice is constitutionally valid, owing to Parliament's extensive legislative authority as delineated under Entry 82 of the Union List (List I of the Seventh Schedule) of the Constitution, which encompasses taxation on income, excluding agricultural income.

• LEGISLATIVE COMPETENCE AND CONSTITUTIONAL SUPPORT

The exclusive jurisdiction over income tax legislation is firmly located within the purview of the Union government as specified under Article 246 and Entry 82 of List I. The annual Finance Acts, which are deliberated and subsequently enacted by Parliament, possess the legal force of law in accordance with Article 265, which stipulates that no tax shall be imposed or collected except under the authority of law. Thus, the structuring of tax regimes through the medium of Finance Acts is not only statutorily permissible but also receives robust constitutional endorsement.

The landmark ruling in **K.C. Gajapati Narayan Deo v. State of Orissa (AIR 1953 SC 375)**²⁶ serves to underscore this legislative power, as the Supreme Court affirmed that "the legislative power includes the power to make laws prospectively as well as retrospectively." This judicial interpretation fortifies the premise that Parliament holds the capacity to inaugurate novel tax structures and schemes via Finance Acts, thereby enriching the dynamism of tax legislation.

• PRINCIPLE OF OPTION AND VOLUNTARINESS

A fundamental legal principle underlying the dual regime structure is the notion of "optionality." Section 115BAC of the Income-tax Act explicitly states that taxpayers retain the right to opt into the newly established tax regime. The legality of providing such an option is affirmed by the fact that both tax regimes operate within the regulatory confines of the same legislative Act, thus ensuring that they are neither inherently discriminatory nor arbitrary. The provision of a choice for taxpayers, contingent upon adherence to specified procedural criteria, aligns with the constitutional mandate encapsulated in Article 14, as interpreted in the landmark case of **Khandige Sham Bhat v. AITO (1963 AIR 591)**,²⁷ which emphasizes the principle of equality before the law.

In summary, this chapter elucidates the intricate legal framework that supports the coexistence of multiple income tax regimes in India, highlighting the interplay between statutory provisions, legislative powers, and constitutional principles. This foundational understanding is essential for comprehensively grasping the dynamics of the Indian tax system and the implications of its ongoing evolution.

²⁶ K.C. Gajapati Narayan Deo v. State of Orissa, AIR 1953 SC 375.

²⁷ Khandige Sham Bhat, AIR 1963 SC 591.

The Supreme Court of India has consistently affirmed the principle that the State possesses the authority to implement differential tax treatments predicated upon reasonable classifications of taxpayers. This perspective allows for the establishment of a dual tax regime, which can effectively be interpreted as a systematic classification based on the differing financial preferences exhibited by taxpayers. Specifically, this classification differentiates between individuals who favor lower tax rates without accompanying deductions and those who opt for a tax structure that incorporates exemptions. Such a nuanced approach supports the notion that the tax system can be tailored to accommodate varying preferences, thereby promoting efficiency and equity within the tax framework.

• **BINDING NATURE AND DELEGATED LEGISLATION**

The Finance Acts, while enacted on an annual basis, wield significant statutory authority and are formulated as money bills, in accordance with the stipulations outlined in Article 110 of the Indian Constitution. When these Finance Acts are passed and formally enacted, they integrate into the overarching framework of the Income-tax Act, thus becoming part of the principal legislation governing income taxation in the country. The Central Board of Direct Taxes (CBDT) is empowered to formulate rules under this legislative framework, exemplified by provisions such as Rule 21AG, which pertains to the procedural mechanics surrounding taxpayer options to either opt into or out of the regime outlined in Section 115BAC.

These rules, established by the CBDT, possess a legally binding and enforceable character. The legitimacy of these rules is underscored by the ruling in *Gwalior Rayon Silk Manufacturing Co. Ltd. v. CST* (AIR 1992 SC 1782), wherein the Supreme Court articulated that regulations formulated under a delegated authority are imbued with the same legal force as the principal statute, contingent upon the stipulation that they do not contravene the foundational Act or any existing constitutional provisions. This reinforces the structure within which delegated legislation operates, ensuring that the rules prescribed serve to further clarify and implement the legislative intent of the broader taxation framework.

• **JUDICIAL VALIDATION OF TAX STRUCTURING**

Indian jurisprudence has consistently endorsed the prerogative of the State to devise tax schemes that afford taxpayers an array of choices. A landmark case in this domain is **Union of India v. Azadi Bachao Andolan (2004) 10 SCC 1**,²⁸ where the Supreme Court acknowledged the legitimacy of Double Tax Avoidance Agreements (DTAAs) that proffer favorable tax rates. In this judgment, the Court reaffirmed the principle that the legal choices presented to taxpayers within the bounds of the law do not constitute an abuse of the tax system per se. Such rulings signify a robust judicial endorsement of flexibility in tax structuring, emphasizing the importance of taxpayer autonomy within the confines of legal frameworks.

Drawing from this judicial precedent, the optional character of the newly implemented tax regime stands on a firm legal foundation, provided that the requisite standards of procedural and substantive fairness are

²⁸ *Union of India v. Bachao Andolan*, (2004) 10 SCC 1Azadi

upheld. This balance is essential; it underpins the legitimacy of tax structures that allow for individual discretion, thereby reflecting broader principles of equity and justice in the tax system.

AMENDMENTS INTRODUCING DUAL REGIMES: LEGISLATIVE EVOLUTION AND RATIONALE BEHIND OPTIONAL TAXATION

The introduction of a dual tax regime marks a significant transformation in the landscape of personal income tax policy in India. This paradigm shift was initiated with the Finance Act of 2020, subsequently refined through a series of Finance Acts leading up to 2025. The dual regime model permits individual taxpayers and Hindu Undivided Families (HUFs) the flexibility to select between the traditional exemption-based structure referred to as the old regime and a newer, concessional rate-based framework known as the new regime. Such a departure from the previously singular progressive system reflects a strategic intent to embrace a policy of voluntary simplification. The overarching objective of this dual taxation structure is to alleviate the compliance burdens faced by taxpayers while simultaneously ensuring revenue neutrality for the state.²⁹

• FINANCE ACT, 2020: INCEPTION OF THE NEW TAX REGIME (SECTION 115BAC)

The pivotal moment in this legislative evolution occurred with the enactment of the Finance Act, 2020, which introduced Section 115BAC into the Income-tax Act of 1961.³⁰ This provision became effective beginning with the Assessment Year 2021–22. The statute presented individual taxpayers and HUFs with the opportunity to opt for a set of concessional slab rates, contingent upon their agreement to forgo a majority of the exemptions and deductions that were historically available under the previous regime. Few key provisions are herein as follows:

1. The new tax regime introduced a streamlined structure of slab rates that span from 5% to 30%, effectively reshaping the taxation landscape for individual and HUF taxpayers.
2. It unambiguously disallowed commonly availed deductions, including those under Sections 80C, 80D, and 80E, as well as housing rent allowance (HRA) under Section 10(13A) and leave travel allowance (LTA) under Section 10(5).
3. The option to choose the new regime was established as voluntary, necessitating taxpayers to file Form 10-IE before the prescribed due date for submission of their tax returns.
4. For those taxpayers earning income from “Profits and Gains from Business or Profession,” the regime allowed for a one-time option to opt in, with a provision that enabled a one-time withdrawal as well.

The Explanatory Memorandum accompanying the Finance Bill of 2020 articulated the government's intention behind the introduction of the new regime as a measure to “simplify” the tax structure, thereby

²⁹ Ministry of Finance, Explanatory Memorandum to the Finance Bill, 2020.

³⁰ Income-tax Act, 1961, § 115BAC (inserted by Finance Act, 2020).

aiming to reduce the level of litigation that often accompanies tax matters. Furthermore, it sought to enhance transparency in the taxation process and eradicate the distortions that had arisen due to speculative tax planning predicated upon numerous exemptions.

• FINANCE ACTS OF 2021 AND 2022: PROCEDURAL REFINEMENT AND OPERATIONALIZATION

Subsequent Finance Acts during the years 2021 and 2022 did not undertake substantial modifications to Section 115BAC.³¹ Instead, these legislative amendments were focused on addressing procedural and administrative gaps that had emerged during the early implementation phases of the new tax regime. Here are the few developments:

1. The Income-tax Rules of 1962 were amended to incorporate Rule 21AG, which delineated the procedures for filing Form 10-IE, now necessary for opting into the newly established taxation framework.
2. The Central Board of Direct Taxes (CBDT) disseminated clarifications via Circular No. 4/2020 to provide guidance to employers concerning the computation of Tax Deducted at Source (TDS) under Section 192 within the context of the new tax regime.
3. Importantly, no new deductions were permitted under the new structure, thereby preserving the integrity of the exemption-free framework established in the previous Act.

These legislative amendments were strategically aimed at enhancing compliance by integrating the new tax regime into the broader return-filing and TDS architecture. However, complexities surrounding the deadlines for filing tax returns and transitioning between tax regimes cultivated an environment of confusion among the taxpayer community, necessitating ongoing clarification and guidance.³²

• FINANCE ACT, 2023: MAKING THE NEW REGIME THE DEFAULT

A significant policy development was witnessed with the Finance Act of 2023, which introduced Section 115BAC(1A), thereby establishing the new tax regime as the default option for individual and HUF taxpayers commencing from the Assessment Year 2024–25 onward. Here are the few notable changes:³³

1. Under the revised provisions, taxpayers are now automatically assessed under the new regime unless they actively opt out by submitting Form 10-IE.
2. The standard deduction of ₹50,000 under Section 16(ia) was extended to encompass the new tax regime, thus providing some relief to taxpayers within this framework.

³¹ Id.

³² Explanatory Memorandum to Finance Bill, 2020.

³³ Finance Act, 2023, No. 8 of 2023, § 45.

3. Furthermore, the rebate limit under Section 87A was increased to ₹7 lakh for taxpayers opting for the new regime, enhancing the attractiveness of this structure for lower-income groups.
4. The introduction of marginal relief provisions aimed to prevent undue tax increases for those whose income exceeds the 7 lakh threshold, thereby introducing a degree of equity in the taxation process.

Through this analysis, we can observe the evolution of tax policy in India, characterized by a trend towards simplification, compliance facilitation, and an attempt to balance taxpayer burden with government revenue needs. The journey from the inception of the dual tax regime in 2020 to its current execution in 2023 highlights the legislative responsiveness to both taxpayer concerns and overarching economic goals.

The transition to establishing the new taxation regime as the default standard was articulated during the Budget Speech of 2023. This strategic shift has been conceptualized as a proactive measure aimed at "encouraging compliance." The overarching objective is to foster a simplified and uniformly applicable tax structure that inherently minimizes the necessity for taxpayers to seek external assistance for tax planning. By streamlining the tax framework, the government seeks to enhance compliance rates and reduce the administrative burdens on both taxpayers and tax authorities.

• **FINANCE ACT, 2024: A FRAMEWORK FOR RATIONALIZATION AND TAXPAYER RELIEF**

The enactment of the Finance Act, 2024 introduced a suite of amendments designed to fine-tune the dual tax regime and rectify some of the notable imbalances that came to light during the initial years of its implementation.³⁴ The adjustments made are significant, as they reflect a responsiveness to the evolving needs of taxpayers and the complexities of tax administration. Few of the key features of the act are as follows:

1. A pivotal amendment reinstates the indexation benefit for immovable property acquired before July 23, 2024, thereby providing a level of relief to taxpayers even under the new regime. This change is crucial as it seeks to mitigate the effects of inflation on capital gains, thereby enhancing fairness in tax liabilities related to property transactions.
2. In a bid to streamline the taxation framework, the Finance Act has also withdrawn the foreign exchange fluctuation benefit on capital gains for non-residents. This modification aligns the treatment of capital gains for non-residents with that of resident taxpayers, ensuring a more equitable approach within the dual regime.
3. Furthermore, the Act has provided much-needed clarity on the conditions for opting into the new regime and the timelines for switching between regimes. These updates will facilitate better guidance for taxpayers navigating their options, thus encouraging more informed decision-making.

³⁴ PwC India, Indian Union Budget 2024-25: Highlights & Updates (2024)

The budgetary discourse for 2024³⁵ underscored the imperative of fairness and equity, particularly concerning the treatment of capital gains. It suggested that the dual regime's adaptability to practical tax planning challenges is crucial for maintaining the overarching aim of simplification while enhancing compliance. This nuanced approach demonstrates an understanding of the complexities involved in taxation and the need to create a system that is both fair and practical for all taxpayers.

• **FINANCE ACT, 2025: ENSURING EVALUATIVE CONTINUITY AND OFFERING TARGETED RELIEF**

In the context of the Finance Act, 2025, while a comprehensive restructuring of the provisions under Section 115BAC was not undertaken, it signifies a critical phase of policy stabilization characterized by minor yet impactful changes that emerged directly from taxpayer feedback and the evolving economic landscape. Few noteworthy amendments in the Finance Act, 2025 are as follows:

1. **Introduction of a Presumptive Tax Regime for Non-Residents:** One of the most significant amendments introduced is the presumptive tax regime specifically aimed at non-resident tech service providers operating within the electronics sector. This initiative, which establishes a flat tax rate of 25%, aims to attract foreign investors and aligns with contemporary economic trends, thereby promoting growth in this sector.
2. **Retention of Rebate under Section 87A:** The Act has retained the rebate provisions under Section 87A, reflecting sensitivity to the financial realities faced by lower-income taxpayers. Moreover, discussions regarding a potential income-linked exemption floor for senior citizens and pensioners have commenced, illustrating a commitment to enhancing social equity within the tax framework.
3. **Clarification of Deductions for Employer Contributions to NPS:** Additionally, the Finance Act has clarified the treatment of employer contributions to the National Pension Scheme (NPS) as well as deductions available under Section 80CCD(2) within the new tax regime. This transparency is vital for encouraging retirement savings among taxpayers.

The amendments articulated in the 2025 Act represent a calibration strategy rather than a transformative overhaul of the existing legislative framework. This indicates a strong signal that the new tax regime is not merely a temporary adjustment but is poised to replace the older regime permanently, underlining the government's commitment to ensuring a streamlined and straightforward taxation process.³⁶

• **LEGISLATIVE RATIONALE: UNRAVELING POLICY JUSTIFICATIONS FOR THE DUAL REGIME MODEL**

The dual tax regime is fundamentally grounded in a multiplicity of public policy objectives that collectively aim to enhance the effectiveness and fairness of the taxation process:

³⁵ Budget Summary 2024–25, Ministry of Finance.

³⁶ Finance Act, 2025, Notes on Clauses.

- I. A core objective is the reduction of taxpayer dependency on tax consultants, which consequently alleviates the burden of extensive documentation typically required in complex tax regimes.
- II. The regime fosters voluntary compliance by promoting self-assessment and encouraging accurate reporting of income, thereby enhancing the integrity of the tax system.
- III. The structure aims to achieve revenue neutrality, wherein the imposition of lower tax rates is balanced by the elimination of various deductions, thereby maintaining the overall revenue collection levels for the government.
- IV. By allowing taxpayers sufficient time to adapt to a regime devoid of deductions, the dual framework maintains taxpayer autonomy while supporting a transition that is both manageable and sustainable.
- V. The design of the dual regime facilitates enhanced administrative efficiency, enabling automated processing of tax returns and expediting assessments through standardization of tax procedures.

These justifications resonate with India's broader strategic movement towards a governance model characterized by minimal intervention and maximum efficiency in the financial sector, heralding a future of technology-driven public administration.

The legislative evolution from the Finance Act of 2020 through to that of 2025 illustrates a systematic and thoughtful transition in India's approach to income tax policy. The initially optional tax regime is progressively being redefined as the primary framework for future personal taxation, reflecting a deliberate intent to stabilize and streamline tax administration. While the successive Finance Acts have enhanced the existing framework through improved rebate provisions, expanded deductions (within defined limits), and an overall simplification of tax defaults, it is crucial that ongoing efforts ensure clarity in both administration and interpretation. This will ultimately optimize the intended benefits of the reforms proposed. The trajectory of Section 115BAC is emblematic of both legal and fiscal innovation, bearing significant implications for the future landscape of taxation in India.³⁷

CONCLUSION

The constitutional and legislative framework governing income taxation in India has undergone significant transformation to accommodate changing economic realities and policy priorities. Anchored in the provisions of the Constitution and implemented through the Income-tax Act, 1961, the system reflects a blend of legal robustness and administrative flexibility. The introduction of the dual tax regime, starting with the Finance Act of 2020 and refined in subsequent Finance Acts, represents a pivotal shift toward tax simplification, transparency, and efficiency. These changes aim to reduce taxpayer dependency on consultants, promote self-assessment, and ensure revenue neutrality through the withdrawal of exemptions in exchange for lower rates. The optional nature of the new regime, backed by judicial and constitutional

³⁷ Government of India, Vision for Viksit Bharat 2047, NITI Aayog.

validation, respects taxpayer autonomy while advancing administrative ease. Moving forward, the government's steady shift toward institutionalizing the new regime as the default standard signals a long-term vision for a streamlined, technology-driven tax environment aligned with India's economic goals and constitutional values.

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