



## ABOUT THE BOOK

This book is the official proceedings of the One Day National Level Conference on “Future of Taxation: Empowering the Next Generation of Tax Professionals”, organized by the School of Commerce at Rathinam College of Arts and Science. It brings together research papers and expert insights on the evolving field of taxation, highlighting the growing role of technology, digital governance, AI, GST reforms, sustainability, and global tax policies. The volume serves as a valuable resource for students, academicians, professionals, and policymakers by addressing both challenges and emerging opportunities in modern tax practice. In short, the book connects academic knowledge with practical, real-world taxation in the digital era.

## ABOUT THE AUTHORS



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**FUTURE OF TAXATION : EMPOWERING THE NEXT GENERATION OF TAX PROFESSIONALS**

# Future of Taxation

*Empowering the Next Generation  
of Tax Professionals*

**Dr. T. M. Hemalatha  
Dr. G. Arut Geevitha  
Dr. B. Geethpriya**

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## CHAPTER 37

# **TAX EXEMPTIONS IN INDIA: A CRITICAL REVIEW OF REFORM IMPERATIVES AND EMERGING CHALLENGES**

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### **ABSTRACT**

This paper examines tax exemptions in India with particular emphasis on the need for reform and the challenges associated with their implementation. Tax exemptions constitute an important aspect of the Indian taxation system and warrant careful analysis, as they contribute to social welfare, promote economic development, and provide support to priority sectors such as education, agriculture, and charitable institutions. Nevertheless, the misuse of these exemptions has led to significant revenue leakage, increased tax avoidance, and disparities in tax treatment among taxpayers. The study explores the concept of tax exemptions in India by evaluating their socio-economic justification, identifying emerging issues, and underscoring the necessity for systematic reforms. By integrating legal provisions with practical experiences, the paper offers recommendations aimed at creating a fairer, more transparent, and efficient tax exemption framework that can better serve broader societal interests.

**Keywords:** Tax exemption, Tax reform, emerging challenges and reforms.

## **INTRODUCTION**

A tax exemption refers to a statutory provision that allows a reduction in taxable income as permitted by law. It functions as a legitimate deduction from income liable to tax, granted on the basis of specific qualifying conditions. In the Indian context, certain categories of income are exempt from taxation under the provisions of the Income Tax Act, 1961. Such incomes are commonly described as tax-free, as the Income Tax Department is not authorized to impose tax on them. Consequently, taxpayers can lower their overall tax burden by appropriately claiming these exemptions while filing their Income Tax Returns (ITRs). This paper highlights the framework and consequences of tax exemptions and calls for necessary reforms that are consistent with international best practices as well as domestic socio-economic needs.

## **INTERPREATION AND SIGNIFICANCE OF TAX EXEMPTION**

Tax exemption permits certain types of income to be disregarded for tax obligations in accordance with specific legal provisions in India. This can be observed in various laws, including the Income Tax Act of 1961, the Goods and Services Act, and other related legislation.

The aim of tax exemption are as follows –

- Foster economic growth and industrial advancement.
- Motivate investment in underdeveloped areas.
- Assist non-profit and faith-based organizations.
- Encourage growth in targeted sectors such as farming, education, and health services.
- Offer support to marginalized communities.

## **Legal Framework for Tax Exemptions**

Sir James Wilson played a pivotal role in the early development of taxation laws in India. Serving as the finance minister during the pre-independence period, he presented India's first Union Budget on April 7, 1860, and introduced the Indian Income Tax Act of 1860. This Act imposed taxes on tobacco duties, licenses, and personal income, and was primarily enacted to compensate for the financial strain experienced by the government after the Revolt of 1857.

Under the Indian Income Tax Act of 1860, income was classified into four main categories:

1. Income derived from landed property
2. Income from professions, trades, and employment
3. Income from securities
4. Income from salaries and pensions

The Indian Income Tax Act of 1860 laid the foundation for the country's income tax system. However, it underwent several modifications over time and was eventually replaced. In 1918, a revised Income Tax Act was enacted, which was later superseded by the Income Tax Act of 1922. The 1922 Act remained in force until the financial year 1961–62. Subsequently, the Ministry of Finance introduced the Income Tax Act of 1961, which came into effect on April 1, 1962, and extended its applicability across the entire country, including Jammu and Kashmir and Sikkim. Since its implementation, the Act has been amended on multiple occasions through provisions introduced in successive Union Budgets.

## **Eligibility to Pay Income Tax in India**

According to the Indian Income Tax Department, individuals whose annual gross income exceeds ₹2.5 lakh are required to file Income Tax Returns. In the case of senior citizens, the basic exemption limit is ₹3 lakh per annum, while for super senior citizens, the threshold is increased to ₹5 lakh per annum.

Income tax liability in India is not limited to individuals alone; it also extends to companies, corporate entities, Hindu Undivided Families (HUFs), associations of persons (AOPs), bodies of individuals (BOIs), and local authorities. Furthermore, any taxpayer whose gross income exceeds ₹2.5 lakh in a financial year is mandatorily required to file an Income Tax Return annually, irrespective of the nature of income.

### ***Benefits of Tax Exemption***

- Tax exemptions result in numerous economic incentives, drawing in both domestic and foreign investments.
- social services including education, healthcare, housing, and public assistance. Different parts of the Income Tax Act, including Sections 11 and 12, state that income utilized for charitable and religious purposes is not subject to taxation. Additionally, donations made to registered organizations are also exempt from taxes.
- Support for Primary sector - Earnings from agricultural activities are completely exempt under section 10(1), providing relief to farmers and contributing to a rise in agricultural production.
- The reduction of tax burden for individuals, along with the exemptions and deductions offered from section 80C to section 80U, offers relief to the middle segment of society.

## **Emerging Challenges**

### **Perceived Inequity in the Tax System:**

Tax systems are often viewed as unfair due to the significant discretion involved in designing tax laws. Opinions differ widely on who should bear a higher tax burden and who should be granted exemptions. As a result, no single tax structure can satisfy all stakeholders, leading to persistent debates and grievances among taxpayers who feel disadvantaged by the existing system.

### **Tax Evasion and Avoidance:**

Many individuals actively seek methods to minimize or evade tax liabilities. With the assistance of skilled tax consultants, loopholes within tax regulations may be exploited to reduce tax payments. This tendency is more prevalent among high-income groups, who may even relocate their residence to countries with lower tax rates. Such practices shift the tax burden disproportionately onto honest taxpayers, creating public resentment and undermining the equity of the tax system.

### **Public Apathy toward Taxation:**

A major limitation of direct taxation is its inability to foster civic responsibility among individuals who fall outside the tax net. In India, a large segment of the population is exempt from income tax due to low-income levels. Those who directly pay taxes are more likely to question government spending, whereas non-taxpayers often remain indifferent to how public funds are utilized, weakening democratic accountability.

### **Opportunistic Political Behavior**

Political leaders often claim to act in accordance with public interest; however, their policy decisions may sometimes favor narrow interest

groups rather than the broader population. This selective approach can distort tax policies, including exemptions, thereby reducing their effectiveness in promoting inclusive economic welfare.

### **Inflationary Impact of Indirect Taxes:**

Indirect taxes tend to increase the prices of goods and services, making them inherently inflationary. When governments rely excessively on indirect taxation, it can contribute to sustained inflationary pressures, adversely affecting purchasing power, particularly among lower-income groups.

### **CASE LAWS**

#### **Commissioner Of Income-Tax vs Pulikkal Medical Foundation Pvt. Ltd. on 5 August, 1993**

K. Vinod Chandran, J.: The matter originates from an order of the Tribunal concerning the assessment year 1991-92. The Tribunal determined that the assessee qualifies for the exemption under Section 10(22A) of the Income Tax Act, 1961 [hereinafter referred to as "the Act"], citing the decision of a Division Bench of this Court in *C.I.T. v. Pulikkal Medical Foundation P. Ltd.* [(1994) 210 ITR 299 (Ker.)]. The legal questions presented for our review and determination are as follows:

1. "1. In light of the facts and circumstances of the case, is the Tribunal correct in both law and fact in concluding that the assessee is eligible for the exemption under Section 10(22A) of the Income Tax Act, 1961?
2. Considering the facts and circumstances of the case, and also in light of the High Court's finding in 210 ITR 299 at 312 that 'the assessee is operating the hospital on commercial lines'; and 'the assessee may engage in any activity for profit', is the Tribunal justified in affirming the CIT

(Appeals) order and granting the exemption under Section 10(22A) of the Income Tax Act, 1961?"

3. The esteemed Senior Counsel for the Government of India (Taxes) cites *Aditanar Educational Institution v. Addl. C.I.T.* [(1997) 224 ITR 310 (SC)] to argue that the eligibility for the exemption under Section 10(22) of the Act can be evaluated by the Department each year when the assessment is presented to the Officer. Notable mention is made of the following statement:
4. We do not contest this principle; however, we note that the Assessing Officer did not perform such an assessment for the year 1991-92, which is the focus here. The order recorded as Annexure-A from the Assessing Officer merely indicates that although the High Court had acknowledged the claim in past years, the Department has pursued a Special Leave Petition with the Supreme Court. Thus, even the Assessing Officer operated under the presumption that if the Supreme Court ruled in favor of the Department, a denial of exemption could occur for the current year. We recognize the previously quoted principle wherein the Supreme Court stated that the exemption under Section 10(22) must be reviewed each year it is claimed, and approval of that exemption in a preceding year does not automatically benefit the assessee in the following years. Nonetheless, this issue does not emerge from the Tribunal's order since the Assessing Officer did not examine any factual considerations that would lead to a denial of the exemption for that specific year. Moreover, we find that the Hon'ble Supreme Court has upheld the High Court's ruling in *Pulikkal Medical Foundation P. Ltd.* in Civil Appeal No. 6098-99/1994, as per the order dated 25.02.1999.

5. Under these circumstances, the reference is concluded without addressing the legal question posed, as it does not pertain to the specific year in question.

## **Reforms and Schemes**

### **1. The New Tax System:**

The new tax regime offers reduced tax rates along with a defined basic exemption limit, giving taxpayers the option to choose between the traditional system with exemptions and the simplified system with lower rates. This approach aims to enhance transparency, simplify compliance, and reduce the overdependence on multiple exemptions.

### **2. Impartial Evaluation Mechanisms:**

The introduction of objective and impartial evaluation systems can significantly limit discretionary powers in granting exemptions. Such mechanisms help minimize misuse, improve accountability, and ensure that tax exemptions serve their intended economic and social objectives rather than being exploited for undue benefits.

## **ANALYSIS**

Tax exemptions in India are largely intended to promote social welfare and economic development; however, they have increasingly become contentious due to their unintended outcomes. Although exemptions can encourage investment and support philanthropic and developmental activities, they often disproportionately benefit high-income individuals and large corporate entities. This preferential treatment introduces bias into the tax structure and weakens its progressive character.

The misuse of exemptions by charitable institutions and similar organizations has emerged as a serious concern, as such benefits are sometimes influenced

by political considerations or driven by profit-oriented motives. Moreover, sector-specific exemptions tend to create artificial incentives, distorting market efficiency instead of fostering growth based on productivity and merit. While certain exemptions—particularly those related to agriculture and education—do contribute to public welfare, the overall system demands greater fairness, accountability, and transparency. Reducing the number of exemptions and rationalizing their application would improve efficiency and equity, better align with India’s broader tax objectives, and enhance the effectiveness of the taxation framework.

## **Conclusion**

Tax exemptions in India are not a recent development; they have long been an integral component of the country’s economic framework. However, political influence and preferential treatment of affluent groups have gradually diminished their effectiveness, making the system inequitable for a significant portion of society. The growing concerns related to revenue loss, inequality, systemic bias, and limited transparency highlight the urgent need for comprehensive reforms. By strengthening accountability mechanisms, ensuring greater transparency, and aligning tax exemptions with modern economic priorities, India can move toward a more fair, efficient, and inclusive tax system. Future tax policies should be evidence-based, principle-oriented, and firmly grounded in equity and fairness, thereby contributing to sustainable societal and economic development.

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