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# **TAX EXEMPTION UNDER SECTION 10(26) AND 10(26AAA) OF THE INCOME TAX ACT 1961: A RELIC OF THE PAST**

**-Deepayan Dutta\***

The Exemption under Section 10(26) and 10(26AAA) of the Income Tax Act was introduced to safeguard tribal autonomy and provide fiscal exemptions. Such requirement was a necessity considering that the Scheduled Tribes were recognized as historically marginalized communities and deserved special protections and privileges for their welfare and development. However, in the present economic context, the exemption under 10(26) seems to be increasingly redundant. Consequently, re-evaluation of this provision can lead to a more efficient tax framework while ensuring genuine tribal welfare under evolving socio-economic dynamics.

## **INTRODUCTION**

The Sixth Schedule of the Indian Constitution contains provisions for the administration of tribal areas in the states of Assam, Meghalaya, Tripura and Mizoram in northeast India. It establishes autonomous councils that have legislative, judicial, executive and financial powers to independently govern these areas. These Autonomous Councils focus on protecting and preserving the tribal culture. The point behind Autonomous Councils is that their relationship to the land is the basis of tribal or indigenous identity.

In recognition of the special status accorded to the tribal areas under the Sixth Schedule, Section 10(26) and Section 10(26AAA) of the Income Tax Act, 1961 were introduced to provide tax exemption to members of Scheduled Tribes in the designated regions in Northeast India, Sikkim and Ladakh. To benefit from the exemptions under Section 10(26) and 10(26AAA), they should be members of scheduled tribes, as defined in Article 366(25) of the Constitution of India and must reside in areas classified as tribal regions as notified by the Central Government.

## **HISTORICAL BACKGROUND**

Section 10(26) and 10(26AAA) of the Income Tax Act, 1961, were introduced in recognition of the unique socio-economic challenges faced by the members of the scheduled tribes residing in these areas aimed at promoting the socio-economic development of tribal communities by allowing individuals in these groups to retain a larger portion of their income, thereby enhancing their financial stability and improving their overall welfare.

Section 10(26) stipulates that in computing the total income of an assessee, who is a member of a scheduled tribe as defined in clause (25) of article 366 of the Constitution, residing in any area specified in Part I or Part II of the Table appended to paragraph 20 of the Sixth Schedule to the Constitution or in the [States of Arunachal Pradesh, Manipur, Mizoram, Nagaland and Tripura] or in the areas covered by Notification<sup>i</sup>, any income which accrues or arises to him,— (1) any income, which accrues or arises to him from any source in the areas or the States mentioned in clause (26), should be excluded, and (2) income, arising by way of a dividend or interest on security, is also required to be excluded irrespective of the territory from which such accrual has taken place.

Section 10(26AAA) was introduced in the Income Tax Act by Finance Act 2008, with retrospective effect from tax year 1989-90, provides tax exemption to an individual being a “Sikkimese” in respect of any income which accrues or arises to him/her- (i) from any source in the State of Sikkim; or (ii) by way of dividend or interest on securities.

The rationale for introduction of Section 10(26) and 10(26AAA) was for the following reasons-

- a. Historical Marginalization- Scheduled Tribes (STs) in the specified areas have historically faced economic and social marginalization due to factors such as geographical isolation, lack of infrastructure and limited access to mainstream economic opportunities.
- b. Traditional occupations – Many STs rely on traditional occupations for their livelihoods. By exempting income from these activities, Section 10(26) and 10(26AAA) aims to encourage continuation of these occupations, thereby sustaining their economic base and heritage.
- c. Constitutional Mandate- The Constitution of India recognizes Scheduled Tribes as historically disadvantaged groups deserving of special protections and privileges to promote their welfare and development.

The object of differentiation in Section 10(26) and Section 10(26AAA) between income accruing or received from a source in the specified areas and the income accruing or received from a source outside such areas, is to benefit not only the members of the Scheduled Tribes residing in the specified areas but also to benefit economically such areas.

Article 342 of the Indian Constitution provides the framework for identifying Scheduled Tribes in India. It empowers the President to specify which tribes or tribal communities shall be recognized as Scheduled Tribes within a specific State or Union Territory, following consultation with the respective State Governor. The connection between Section 10(26) and 10(26AAA) and Article 342 hinges on the eligibility of Scheduled Tribe members. Article 342 enables the identification

and notification of tribes as Scheduled Tribes, which is critical for determining who can benefit from the tax exemptions offered in Section 10(26) and 10(26AAA).

## **CRITICAL ANALYSIS**

Section 10(26) and 10(26AAA) of the Income Tax Act provides exemption on tax from any income source in the specified areas of North Eastern Region, Ladakh and Sikkim or by way of dividend or interest on securities.

During the time of introduction of the provisions, the economic landscape of the specified areas of the Northeast Region, Ladakh and Sikkim was beset by numerous challenges, including lack of proper roads, transport facilities, and communication networks which hindered trade and access to markets, isolating rural communities and stunting economic growth. Additionally, the limited industrial base resulted in a heavy dependence on agriculture, which was not sufficient to provide stable employment or income, thereby exacerbating poverty levels within the state.

However, there has been a notable diversification in income sources for these communities over the years. As of 2024, there has been a significant transformation of the economic condition of the specified areas characterized by improved living standards, enhanced infrastructure and diversified industrial growth. For example, Meghalaya's economy is experiencing significant growth with the Gross State Domestic Product (GSDP) projected to reach ₹52,974 crore for the financial year 2024-25, reflecting a growth rate of 11.8% compared to the previous year.<sup>ii</sup> The booming economy of Meghalaya is supported by key sectors such as mining, agriculture, tourism, and information technology. As the socio-economic conditions of Scheduled Tribes continue to improve, many individuals are generating higher incomes, which may surpass the exemption limits provided by Section 10(26). Meghalaya falls under the specified areas laid down in the Sixth Schedule of the Constitution.

The word 'residing' also cannot be given a restricted interpretation confining the benefit of exemption only to the local members of the Scheduled Tribes. The Hon'ble Gauhati High Court has been unable to hold that the word 'residing' connotes permanent residence relatable to the concept of 'domicile'. The benefit of exemption is given to the members of the Scheduled Tribe for economic advancement of the tribal areas vis-a-vis financial benefit to the individuals.<sup>iii</sup>

With evolving employment landscapes, many individuals from scheduled tribes now work in sectors that extend beyond designated tribal areas, such as urban employment in industries and service sectors. This transition could lead to reduced applicability of Section 10(26) and 10(26AAA) since many of these jobs do not fall under the exemption criteria of income being

sourced from tribal areas. The changing dynamics of employment threaten the continued relevance of the existing tax exemption.

Section 10(26) and 10(26AAA) is constitutionally valid and though it has been established that the classification therein for the purpose of exemption from tax between income from a specified area and income from outside that specified area is not discriminatory and does not offend Article 14 of the Constitution.<sup>iv</sup>, but with rising economic development, tribal members might find themselves earning from sources that do not qualify for the exemption, thereby diminishing the significance of the exemption provided under Section 10(26) and 10(26AAA) in contributing to their financial well-being.

## **NEED FOR REASSESSMENT**

The socio-economic landscape for Scheduled Tribes has changed dramatically over the years. Recent observations also highlight instances of misuse within the claim process for Section 10(26) and Section 10(26AAA) exemptions as well. Such exploitation undermines the integrity of the provision and denies rightful beneficiaries the advantages intended by the law.

All that a nontribal assessee in India need do would be to enter into a sham partnership with a member of the Scheduled Tribe residing in the specified area and ostensibly give him under the partnership a substantial share of the profits of the business while in reality, pay the tribal only a nominal amount. Moreover, but for the condition provided in sub-clause (a), the exemption granted under section 10(26) is likely to operate unequally and cause inequality of treatment between individuals similarly situated.<sup>v</sup>

Recently, the Investigation Wing of Income Tax Department, NER carried out searches on certain businessmen in Meghalaya, found to be involved in running a web of petrol pumps managed and controlled as benami properties. These persons were depriving the State Government of legitimate revenue by suppressing sales and non-deposit of local taxes collected, while also indulging in massive evasion of income tax by misusing exemption under Section 10(26) of the Income Tax Act, 1961 meant for tribal persons.<sup>vi</sup>

According to the Revenue Authorities, People belonging to the tribal community were found owning property in Guwahati, Agartala, Imphal, Delhi etc and receiving rent but did not file their tax returns. Several people from the ST community have been keeping fixed deposits in banks in Guwahati and Delhi, on which they had been earning interest but were not filing returns. It has also been observed that no tax was deducted on a salary of even non-tribal person posted in tribal areas. Hotel chains, owned by partnership firms, neither were filing returns nor paying taxes. The

law is being misused because there is a wrong perception among the tribals that they are exempted from income tax. The tribals are not exempted from penal consequences of repayment of cash loans taken of over Rs 20,000. The penal consequences on cash payment of more than Rs 2 lakh for any purpose of investment, including land or vehicle, are also not exempted. Cash payments of more than Rs 10,000 are also not exempted.<sup>vii</sup>

Given these evolving circumstances, there is an urgent need to re-evaluate Section 10(26) and 10(26AAA), to align it with the current realities faced by the Scheduled Tribes. The focus may shift from location-based tax exemptions to broader income-based tax relief measures that consider the variety of income sources now available to these communities. Such reforms would better support their integration into the broader economic framework and provide encouragement for continued development.

## CONCLUDING REMARKS

In conclusion, Section 10(26) and 10(26AAA) is becoming increasingly redundant as economic conditions, income sources, and employment trends evolve. The changing economic fabric of society necessitates a reassessment of this provision, as it struggles to meet the tax-related needs of contemporary tribal populations. Adjusting this provision in favour of a more inclusive tax framework may better serve the interests of Scheduled Tribes moving forward.

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<sup>i</sup> Notification No. TAD/R/35/50/109, dated the 23rd February, 1951, issued by the Governor of Assam under the proviso to sub-paragraph (3) of the said paragraph 20 [as it stood immediately before the commencement of the North-Eastern Areas (Reorganisation) Act, 1971 (81 of 1971)] [or in the Ladakh region of the State of Jammu and Kashmir]

<sup>ii</sup> Press Trust of India (Shillong) (2024, February 17) Meghalaya needs to sustain 11.5% GSDP growth to become \$10 bn economy: CM  
[https://www.business-standard.com/economy/news/meghalaya-needs-to-sustain-11-5-gsdp-growth-to-become-10-bn-economy-cm-124021700640\\_1.html](https://www.business-standard.com/economy/news/meghalaya-needs-to-sustain-11-5-gsdp-growth-to-become-10-bn-economy-cm-124021700640_1.html)

<sup>iii</sup> Dipti Doley Basumatary v. Union of India, (2007) 290 ITR 498

<sup>iv</sup> ITO v. R. Takin Roy Rymbai, (1976) 1 SCC 916

<sup>v</sup> *Ibid*

<sup>vi</sup> <https://pib.gov.in/PressReleasePage.aspx?PRID=1581756>

<sup>vii</sup> Shailesh Yadav (ANI) (2018, December 18) Tribals misusing IT Law? ANI  
[https://www.business-standard.com/article/news-ani/tribals-misusing-it-law-118122900444\\_1.html](https://www.business-standard.com/article/news-ani/tribals-misusing-it-law-118122900444_1.html)