P. A. C. No. 484

PUBLIC ACCOUNTS COMMITTEE (1975-76)

(FIFTH LOK SABHA)

HUNDRED AND EIGHTY-SEVENTH REPORT

CORPORATION TAX

DEPARTMENT OF REVENUE & INSURANCE

[Chapter II of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes]

LOK SABHA SECRETARIAT
NEW DELHI

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Page	Line	For	Read
(i)	21	15.3.75	12.3.75
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(iv)	12	Add 12th March after 25th January, 1975	
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168	7	came	come

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(1975-76)

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Shri H. G. Paranjpe—*Chief Financial Committee Officer.*

Shri N. Sunder Rajan—*Senior Financial Committee Officer.*

INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Hundred and Eighty-Seventh Report (Fifth Lok Sabha) on Chapter II of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes—Corporation Tax.

2. The Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil) was laid on the Table of the House on 8th May, 1974. The Public Accounts Committee (1974-75) examined the Audit Report relating to Corporation Tax at their sittings held on 25th January and 13th March, 1975. The Public Accounts Committee (1975-76) considered and finalised this Report at their sitting held on 12th December, 1975. Minutes of these sittings form Part II* of the Report.

3. A statement containing the summary of the main conclusions/recommendations of the Committee is appended to the Report. For facility of reference these have been printed in thick type in the body of the Report.

4. The Committee place on record their appreciation of the commendable work done by the Public Accounts Committee (1974-75) in taking evidence and obtaining information for this Report.

5. The Committee place on record their appreciation of the assistance rendered to them in the examination of the Audit Report by the Comptroller and Auditor General of India.

6. The Committee would also like to express their thanks to the officers of the Ministry of Finance for the cooperation extended by them in giving information to the Committee.

H. N. Mukerjee

(H. N. MUKERJEE,)
Chairman,
Public Accounts Committee.

NEW DELHI;
January 17, 1976
Pausa 27, 1897 (S).

*Not printed. (one cyclostyled copy laid on the Table of the House and five copies placed in Parliament Library).

CHAPTER I

MISTAKES INVOLVING CONSIDERABLE REVENUES

Audit paragraph

1.1. In computing the business income of a company for the assessment year 1968-69, the Department added back to the net profit a sum of Rs. 20,93,532 instead of Rs. 22,93,532 actually debited to the Profit and Loss Account in respect of "depreciation" resulting in under-assessment of income by Rs. 2,00,000. Further, an expenditure of Rs. 98,946 on "scientific research" debited to the Profit and Loss Account was not added back to the net profit. But an equal amount was allowed to be deducted from the net profit causing under-assessment of income by Rs. 98,946. The total under-assessment of income by Rs. 2.98,946 led to consequential tax undercharge of Rs. 1,64,420 for the assessment year 1968-69.

[Paragraph 13(a) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes]

1.2. The Committee were given to understand by Audit that the assessee in this case was a big biscuit manufacturing company with foreign collaboration and was assessed in a company circle. The assessment was filed on 26th September 1968 and was completed on 25th February 1972. In spite of the fact that the assessed income was Rs. 1.91 crores and the tax exceeded Rs. 2.5 lakhs, these mistakes had occurred. This was not the first instance of such costly mistakes on account of sheer negligence. Similar instances had been pointed out also in the Audit Reports for the years 1965 to 1972-73.

1.3. On the Committee enquiring whether it was not a fact that mistakes in the computation of income arising from negligence had been pointed out from year to year. The Ministry, in a note dated 26th March 1975, stated:

> "Mistakes in computation of income have been pointed out in Audit Reports of earlier years also. These mistakes arose mainly due to oversight or inadvertence."

1.4. A similar mistake of the nature pointed out in the Audit paragraph had also been reported in paragraph 46(b) of the Audit Report on Revenue Receipt 1970-71. The Public Accounts Committee (1972-73), in paragraphs 2.65 and 2.66 of their 87th Report (1972-73) had been observed as follows:

> "2.65. This is a case where the Income-tax Officer allowed depreciation on the township assets without first disallowing the depreciation already debited by the assessee in the profit and loss account. This accounted for excess allowance of depreciation of Rs. 2,82,346 resulting in short levy of tax of Rs. 1,55,287. The Committee had occasion to examine a similar case reported in the Audit Report, 1965. Despite issue of instructions in 1966 following the recommendation of the Committee contained in paragraph 1.26 of their 46th Report (1965-66), such a mistake has occurred again. The Committee would like to know whether the assessments in this case were checked by the Inspecting Assistant Commissioner/Internal Audit Party and if so, why the mistake was not detected."

> "2.66. The Committee learn that at the present there are no arrangements for checking up draft assessment orders before they are finalised and issued to the assessees. In view of the large number of mistakes in computation of assessable income that have been reported by Audit from year to year, the Committee desire that Government should consider the advisability of providing some kind of check of the draft assessment orders preferably a pre-check of Internal Audit in big cases."

1.5. The Department of Revenue & Insurance in their Action Taken Note dated 5th December 1973, contained in the 115th Report (Fifth Lok Sabha) of the Committee had stated:

> "The Ministry share the concern of the Committee for ensuring accuracy in the computation of income, especially in big cases. Instructions on the subject have been issued (No. 598 F. 236/254/72-A&PAC dated 25th August 1973). Having regard to the limited manpower resources presently available with the Department for assessment and Audit purposes, the Director O&M Services, who is currently engaged in a work study of the Departments audit organi-

sation is being asked to consider the feasibility of the Department's audit organisation suitably expanded, taking up pre-check of assessments in important cases. On receipt of his report further action will be considered, keeping in view also the effect of the above noted instructions and the Immediate Audit Scheme."

1.6. Referring to the Ministry's Action Taken Note on the recommendations of the Committee, the Committee desired to know the final action taken in this regard. The Department of Revenue & Insurance, in a note, stated:

"The matter has been examined in detail by the Director of O&M Services. He has reported that pre-assessment audit was not feasible. His report has been carefully considered and it has been decided by the Board that it was not practicable to carry out pre-check of assessments before their finalisation."

1.7. The Committee desired to know whether the effect of the instructions issued by the Central Board of Direct Taxes on 25th August 1973 had been assessed. The Committee also desired to know the action taken by the Ministry to provide safeguards against recurrence of such mistakes. The Department of Revenue & Insurance, in a note, stated:

"No review has been undertaken to assess the effect of Board's instruction No. 589 (F. No. 236|254|72-A&PAC) dated 25th August, 1973. Comprehensive instructions indicated in the last paragraph of the said instructions dated 25th August, 1973 have since been issued *vide* Directorate's circular F. No. Audit-9/73-74/DIT dated 11th March, 1974 by which the instructions contained in para 21 (XVII) of the Office Manual Volume II Section II have been completely revised and specified responsibility for checking of computation of income as well as calculation of tax has been fixed both for the Income-tax Officer and members of the ministerial staff."

1.8. The Committee were informed by the Department of Revenue and Insurance that the assessee company in this case was Britannia Biscuit Co. Ltd.

1.9. The Committee desired to know the circumstances in which the mistake had occurred in this case. The Committee also wanted to know how an amount of Rs. 22,93,532 could be transcribed as

Rs. 20,93,532 making for a round under-assessment of Rs. 2 lakhs. The Department of Revenue & Insurance, in a note, stated:

> "As per usual practice, the Income-tax Officer while framing the assessment order, added back depreciation as per assessee's claim for separate consideration. However, instead of adding back Rs. 22,93,532, he inadvertently added Rs. 20,93,532. This resulted in short computation of income by Rs. 2 lakhs."

1.10. The Committee enquired whether the fresh assessment had since been completed and, if so, whether the amount had since been collected. The Department, in a note, stated:

> "A fresh assessment has been completed on 2-9-1974 in which the mistakes noticed by Audit have been set right. The tax effect is the same as pointed out by Audit and it is fully covered by the advance tax paid by the assessee."

1.11. The Committee learnt from Audit that the assessee had appealed against the fresh assessment completed on 2nd September 1974. When asked whether the grounds of appeal were related to the present Audit objection, the Department, in a note, replied:

> "These grounds of appeal do not cover the audit objection. In fact, the mistakes were in favour of the assessee and there was no question of his agitating the same on the grounds of appeal.
>
> The assessee has filed an appeal against the fresh assessment dated 2-9-1974. It has not been objected to the setting right of the two mistakes discussed in the Audit paragraph."

1.12. The Committee enquired whether the case was looked into by the Internal Audit Party. In case this had not been done, the Committee desired to know the circumstances that led to this omission. The Department of Revenue & Insurance, in a note, stated:

> "The case was not checked by the Internal Audit Party. The Supervisor of the Internal Audit Party in his explanation has stated that he was busy checking the cases of other wards. His explanation has been found to be unsatisfactory. He has been warned and has since been replaced by an Inspector."

1.13. The Committee asked whether the Ministry had investigated the case with a view to ensuring that the mistake was bonafide. The Department, in a note, stated that the Commissioner had looked into the case and had reported that the mistakes were bonafide.

1.14. The Committee note that in computing the business income of Britannia Biscuit Co. Ltd. for the assessment year 1968-69, the Income-tax Officer had added back to the net profit a sum of Rs. 20,93,532 instead of Rs. 22,93,532 actually debited to the Profit and Loss Account in respect of 'depreciation', resulting in under-assessment of income by Rs. 2 lakhs and that the mistake has been attributed to inadvertence on the part of the Income-tax Officer. The Committee are disturbed to find that serious mistakes on account of negligence continue to recur every year. That this should be so despite repeated comments made in this regard in the earlier reports of the Public Accounts Committee and the assurances given by the Ministry of Finance that steps would be taken to avoid the recurrence of such mistakes, is regrettable. Such repetitive mistakes indicate that the instructions even of grave import, issued by the Central Board of Direct Taxes are not taken seriously enough by the assessing officers.

1.15. The Committee are concerned at no review having been undertaken by the Central Board of Direct Taxes regarding the effect of the Board's Instruction No. 589 dated the 25th August 1973. The Board's responsibility does not end with merely issuing instructions based on the recommendations of the Committee. There should be regular review of such instructions to ensure that they were being implemented in the field. The Committee desire that the Central Board of Direct Taxes should undertake such a review and take all necessary remedial measures.

1.16. In the instant case, the Committee have been informed that the return had been filed by Britannia Biscuit Co. Ltd. on 26th September 1968 and the assessment was completed only on 25th February 1972. It would, therefore, appear that after having kept the assessment pending for more than three years it was completed in haste without adequate scrutiny and only when the assessment was about to become time-barred. This indicates a kind of chaos in the system of work and a failure to realise the importance of accuracy and expedition in completing cases especially those with large revenue implication. The Committee desire that the existing methodology adopted by Income-tax officers for disposal of cases should be carefully examined and adequate measures taken to specify prio-

rities of work allocation and disposal. The Committee's earlier recommendation contained in paragraph 1.72 of their 119th Report (Fifth Lok Sabha) is relevant in this regard.

1.17. The Committee find that this case was not checked by the Internal Audit and the familiar plea of preoccupation with other cases has again been put forth by the Department. The Committee are unhappy that effective steps are yet to be taken by the Department to ensure that the computation of income and the assessment orders themselves are pre-checked, preferably by Internal Audit, particularly in large income cases of foreign companies and Indian monopoly houses, though an earlier recommendation of the Committee in this regard contained in paragraph 4.66 of their 87th Report (Fifth Lok Sabha) had been accepted in principle, by Government as early as December 1973. In view of the large number of mistakes in the computation of assessable income which have been brought to their notice year after year, the Committee strongly reiterate their earlier recommendation and would urge Government to act upon it without further loss of time.

.. Expenditure on scientific research ..

1.18. In respect of the expenditure of Rs. 98,946 on scientific research' debited to the Profit and Loss Account by the assessee company, the Committee desired to know the nature of the scientific research carried out by Britannia Biscuit Co. Ltd. The Member, Central Board of Direct Taxes stated:

> "The records do not indicate the nature of scientific research carried out by the company. In the assessment orders, there is no indication."

1.19. When asked what sort of research biscuit manufacturers were expected to conduct, the Officer on Special Duty, Directorate of Technical Development stated:

> "Their research centres round qualitative improvement of raw materials and standardisation of the finished products and also improvement of protein value of some of the biscuits."

The Department of Revenue & Insurance in a note furnished to the Committee stated in this regard:

> "The scientific research carried out by the assessee relates to development of low cost, high protein and vitaminised

biscuits with other nutrients; development of new packs for longer shelf life and experiments with raw materials for import substitutes.

The break-up of the expenditure of Rs. 98,946 incurred in the previous year of A. Y. 1968-69 is as below:

	Rs.
Salary of research and development personnel	67,784
Expenses such as cost of test tubes, flasks, chemicals, books etc.	23,962
Scholarship—Central Food Technological Research Institute, Mysore	7,200
TOTAL	98,946"

1.20. The Committee wanted to know whether such expenditure had been allowed in the past and if so, the amount of expenditure so claimed and allowed in respect of this company right from the year 1960-61 onwards. The Department, in a note, stated:

"Research and development expenses commenced from the assessment year 1968-69 only. Before that only expenditure allowed in this regard was a sum of Rs. 6,000/- in A.Y. 1967-68, being scholarship amount paid to Central Food Research Institute, Mysore. The figures of revenue expenditure claimed and allowed in respect of A.Y. 1968-69 and subsequent years are as below:

Assessment Year	Amount claimed	Amount allowed
	Rs.	Rs.
1968-69	98,946/-	98,946/-
1969-70	1,27,882/-	Assessment pending
1970-71	1,65,608/-	1,65,608/-
1971-72	1,28,928/-	Assessment pending
1972-73	1,52,986/-	3,600/-
1973-74	Assessment pending	"
1974-75	Do.	"

1.21. The Committee enquired whether this scientific research was conducted by any separate institution or by the assessee company

itself. The Chairman, Central Board of Direct Taxes stated during evidence:

> "There are two types of research. One is making a contribution to research institutions. The other is carrying out research by the assessee himself. The first is under section 35(1)(ii) and the second is under 35(1). I am afraid I am not in a position to say whether this was a contribution to a research institution or it was an expenditure incurred by the assessee himself in carrying out research relating to his business."

The Member, Central Board of Direct Taxes stated in this connection:

> "35(1) relates to scientific research relating to the business carried on by the tax-payer. 35(1)(ii) relates to any donation or contribution made to a scientific research institute whatever the nature of the scientific research and that is allowable deduction."

1.22. Section 35(1) of the Income-tax Act, dealing with expenditure on scientific research is reproduced below:

> "35(1) In respect of expenditure on scientific research, the following deductions shall be allowed:
>
> (i) any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business;
>
> (ii) any sum paid to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research:
>
> Provided that such association, university, college or institution is for the time being approved for the purposes of this clause by the prescribed authority."

1.23. The Department of Revenue & Insurance subsequently informed the Committee that the research was conducted by the company itself departmentally.

1.24. When asked whether the CSIR had approved of this institution for the purpose application of Section 35, the Officer on Special

Duty, Directorate of Technical Development replied:

> "Research is a continuous process. They have been working continuously on different types of raw materials. The question of approval by CSIR may not arise. I do not have any information whether any work have been entrusted to any of the national laboratories or linked up with CSIR."

The Department of Revenue & Insurance in a note, subsequently furnished to the Committee in this regard, stated that as the research was conducted by the company itself, the question of approval by CSIR did not arise.

1.25. The Committee asked whether this expenditure on research could be allowed as a deduction for income-tax purposes. The Officer on Special Duty, Directorate of Technical Development stated:

> "Unless we are able to gauge what exactly is the quantum of work that they have been doing, it would be difficult to say anything except saying that they are trying to improve the quality of biscuits nutritionally. Unless we are able to know what is the field in which they are engaged in research, it will be difficult to say."

The Director of Receipt Audit stated in this connection:

> "Expenditure actually incurred for scientific research related to business is allowable. Under Section 35(1)(ii) any sum paid to a scientific research association having as its object scientific research should be allowed provided it is recognised by the CSIR. I am an industrialist and I set up a scientific research organisation with a printed object. I go to CSIR and I say I am going to conduct this research, I get the permission. I prove that it is a scientific association, it is recognised and its object is scientific research. If I pay any sum to such association and it does not carry on any such research in fact, the ITO is obliged to do under 35(1)(ii). He is not obliged to find out whether the scientific research association is in fact undertaking this very thing. This is what has been happening in some cases. That is the real distinction between (i) and (ii). A tendency has developed in some big industrial houses to float scientific research associations, transfer money, because there is no ceiling on that. They transfer money

as much as they like and no research is conducted because there is no obligation to do so. This sort of loophole should be plugged. Our Comptroller and Auditor General wrote to the Ministry of Finance some years back about this lacuna and now this has assumed greater importance because in the Taxation Amendment Bill the concession will be Rs. 150 if he spends Rs. 100."

1.26. The Committee enquired whether any scrutiny had been made of this expenditure claimed by the assessee with a view to determining the genuineness of the claim. The Committee also wanted to know the section of the Income-tax Act under which this had been allowed and whether the Income-tax Officer had satisfied himself of the actual research carried out and the expenditure actually incurred on it. The Chairman, Central Board of Direct Taxes stated during evidence:

"I am not prepared to say that the ITO should not have applied his mind to see whether it was a genuine expenditure on research and development. The ITO should check whether this expenditure has actually been incurred on that object. I do not know whether the ITO applied his mind to the fact whether research had actually been carried out and what was the nature of the research."

In a subsequent note furnished to the Committee in this regard, the Department of Revenue & Insurance stated:

"As the blance-sheet and profit and loss account filed by the company were audited, no scrutiny of the expenditure claimed on account of scientific research appears to have been made by the Income-tax Officer.

The expenses were allowed u's 35 of the I. T. Act, 1961. The break-up of the expenditure in one assessment year *viz.* 1968-69 has already been furnished. The scholarship amount was allowed u's 35(i)(ii) and the balance amount u's 35(1)(i).

The Income-tax Officer does not appear to have made detailed enquiries as to what research was actually carried out."

1.27. The Committee asked whether the Board had issued any guidelines in this regard for the guidance of the assessing officers.

The Department, in a note, replied:

> "The Board have not issued any guidelines. Section 35(3) of the I.T. Act, 1961, specifically provides that, if any question arises under section 35 regarding the extent to which any activity constitutes scientific research or any asset is being used for scientific research, the Board shall refer the question to the prescribed authority whose decision shall be final. The prescribed authority as per Rule 6 of the I.T. Rules, 1962, for the case under consideration is the Council of Scientific and Industrial Research."

1.28. When asked whether the Income-tax Department could withdraw the concession if the claim was found to be malafide, the Chairman, Central Board of Direct Taxes stated:

> "There is no provision for this. After all the Income-tax Department cannot say. They are not in a position to say this."

1.29. In view of the tendency on the part of big industrial houses to float scientific research associations to avoid payment of tax, the Committee desired to know whether any survey in this regard had been conducted to determine how for this lacuna in the Act had assisted non-payment of taxes legitimately due. The witness stated:

> "The Department of Science and Technology has given the assurance. We told them about our apprehension. They told us they are setting up a group to oversee the functioning of these approved institutions.

1.30. The Committee desired to know whether, in case the group informed the Board that the assessee had not conducted any research, but had been claiming this concession, the Board would withdraw the concession. The witness stated:

> "As I said there were two types of research work done. One is carried out by the assessee himself. The other type relates to contribution to research institution carrying on the research. If they do not do it, they simply are grabbing money."

1.31. The Committee are distressed to find that an expenditure of Rs. 0.99 lakh on Scientific Research had been allowed by the income-tax Officer in this case without making precise enquiries as to what research was actually carried out and without ensuring whether it was a genuine expenditure on research and development

related to the business of Britannia Biscuit Company Ltd. The Committee have been informed in this connection that apart from the amount of Rs. 0.39 lakh allowed on this account for the assessment year 1968-69, further sums of Rs. 1.86 lakhs and Rs. 0.04 lakh have been allowed in respect of the assessment years 1970-71 and 1972-73 respectively. The assessments for the years 1969-70 and 1971-72 are stated to be pending and in respect of these two assessment years, Rs. 1.28 lakhs and Rs. 1.29 lakhs respectively have been claimed by the assessee company towards scientific research. The Committee desire that these claims should be carefully scrutinised by reopening the cases where necessary, in order to ensure that the permissible deductions from the taxable income are fully justified. In case it is found that there had been a misrepresentation of facts and that the deductions were incorrectly allowed, immediate action should be taken to subject the amounts to tax. The Committee would await a further report in this regard.

1.32. It is surprising that the Central Board of Direct Taxes have not considered it necessary to issue guidelines on what constitutes "expenditure on scientific research" for the guidance of the assessing officers. The Committee desire that this should be examined in depth and specific instructions issued immediately so that ambiguities could be avoided and uniformity in assessment ensured.

1.33. The Committee agree with the view of Audit that in Section 35(i) (ii) of the Income-tax Act, under which any sum paid to a scientific research association, having as its object scientific research, is allowed as a deduction provided the association is recognised by the CSIR, there is a lacuna which needs to be removed. It is not unlikely that ambiguity in the legal provision in this regard has led to a tendency on the part of some big Industrial houses to sponsor so-called scientific research associations with a view to claiming deductions from taxable income. The Committee, therefore, desire that the existing provisions should be reviewed and the loophole in the Act plugged forthwith. This tendency could, perhaps, also be countered by prescribing a ceiling on the sums payable to research associations for the purposes of computation of income-tax.

1.34. The Committee also note that the Department of Science and Technology propose to set up a group to oversee the functioning of research institutions approved by them, so as to ensure that such institutions actually utilise the contributions received by them for the purpose for which they are given. The Committee would like to know the action so far taken in pursuance of this objective. ...

Production of biscuits in excess of licensed capacity.

1.35. The Committee desired to know the registered licensed capacity for the plant of Britannia Biscuits Co. Ltd. installed in Madras and the actual production from 1965 to 1974. The Officer on Special Duty from the Directorate of Technical Development stated:

> "They have been granted a licence for the capacity of 1200 tons per annum in their Madras factory. The licence says it is only 1200 tons per annum. The application made by them was for 100 to 125 tons on a single shift basis. According to their application that comes to 1200 tons per annum. In 1972 their production actually was 8023 tons while in 1973 it was 8522 tons."

In a note subsequently furnished to the Committee in this regard, the Ministry of Industrial Development stated:

> "The figures of production of biscuits by M/s. Britannia Biscuits Company from 1965 to 1974 are given as under:

Year	Production in tonnes
1965	Did not commence production
1966	Do.
1967	2812 (Production commenced in March 1967)
1968	5278
1969	6369
1970	7763
1971	7123
1972	8023
1973	8522
1974	6694"

1.36. The Committee desired to know the number of shifts worked by the factory. The Member, Central Board of Direct Taxes stated:

> "As per the records they have claimed it on a single shift basis."

1.37. Since the company had exceeded the licensed capacity, the Committee desired to know the action taken by the Ministry of Industrial Development against the company for violating the provisions of the Licensing Act. The Officer on Special Duty, Directorate of Technical Development stated:

> "We took up the matter for taking suitable action. We are already discussing that with various departments. This question came up in Lok Sabha too sometime in 1974. They have exceeded their capacity. We asked the firm for the explanation as to how they were producing much more than their licensed capacity. They have made a representation to Government saying that they are producing short dough biscuits. According to them, by means of their own technology they have exceeded it and that they have not added any additional machinery. Within the production plant without recourse to additional machinery, they have said that they are producing their existing level."

1.38. When asked whether any action had been taken by the Ministry of Industrial Development to verify the statement made by the company, the witness stated:

> "We have not verified it."

The Ministry of Industrial Development in a note subsequently submitted to the Committee added that the matter was still under consideration.

1.39. The Committee desired to know the action taken by the Ministry of Industrial Development when this issue was highlighted on the floor of the House. The witness stated:

> "I think it was sometime in 1974 last year. Since then, we called for the explanation as to why they should not be prosecuted. We have taken up the matter with the Law Ministry."

The Ministry of Industrial Development in a note, further added:

> "The matter was referred to the Law Ministry on 31-8-1974. That Ministry raised certain points which are under examination."

1.40. In this context, the Committee pointed out that the company might have over-invoiced or under-invoiced its machinery while importing them and since the company was producing a lot more than their licensed capacity there was also a possibility that the actual production had not been faithfully reflected in the books

of accounts resulting in less collection of excise duties and avoidance of income-tax as well. The Committee, therefore, desired to know whether it was not considered necessary to have a physical check over the capacity of the machinery from the tax point of view. The Chairman, Central Board of Direct Taxes, stated that the Board would look into it. He added:

> "It will be a difficult task unless I have got some information. As a matter of fact this will be an argument in their favour. They will say that although our installed capacity or our licensed capacity is so much, in spite of that we are showing production of so much. We will certainly try to see that no leakage of revenue occurs in this regard. I was going to say that it is an excisable commodity."

1.41. The Committee desired to know the number of applications pending from companies managed entirely by Indian entrepreneurs in the South for the manufacture of biscuits. The Ministry of Industrial Development, in a note, stated:

> "Besides M/s. Britannia Biscuit Co., Messrs Auro-Food Private Ltd., P.O. Auroville, South Arcot Dt. are carried on the books of D.G.T.D. as manufacturers of biscuits. M/s. Century Mills, Madras which is a company managed by Indian entrepreneurs finance have also been sanctioned by the C. G. Committee on allocation of Rs. 18,81,535/- for import of an automatic biscuit making machinery. Besides this we have no other pending application from the companies managed entirely by Indian entrepreneurs finance in Tamil Nadu."

1.42. The Committee are surprised to learn that as against the licensed capacity of 1200 tonnes of biscuits per annum, the actual production of Britannia Biscuit Co. Ltd. has far exceeded the licensed capacity in all the years since the factory commenced production in 1967. During the period from 1968 to 1973, the production ranged from 5278 tonnes to 8528 tonnes. In 1973, the production had exceeded the license capacity by over 700 per cent. The Committee find it difficult to accept the explanation that this phenomenal increase in production had been achieved by the company by improved technology without providing any additional machinery. As the increase in production over the licensed capacity, prima facie, **appears to be abnormal and remains unexplained, the Committee are of the view that the possibility of the com-**

pany having resorted to manipulation of the Invoices to import additional machinery cannot be ruled out. The Committee desire that the said excess production should be thoroughly investigated into without losing further time and appropriate action taken without delay against the company if it is found to have violated the provisions of the Licensing Act.

1.43. What is more distressing is the fact that even though this question of the company producing biscuits far in excess of the licensed capacity had been raised in the Lok Sabha in 1974, no concrete action has so far been taken against the company. The Committee cannot understand why the Ministry of Industrial Development merely remained content with calling for the explanation of the company and referring the case to the Ministry of Law. Besides, though this case had been taken up with the Ministry of Law as early as August 1974, according to the information furnished to the Committee, it remains still under examination. The Committee deprecate such unconscionable delay in cases especially relating to monopoly concerns and big foreign business houses. The Committee desire that the reasons for the delay should be explained and responsibility fixed for appropriate action. The Committee would like to know the final decision since taken in this case.

1.44. The Committee would further urge that Department of Revenue & Insurance investigate immediately whether there has been any leakage of excise and customs revenues in respect of this company. The Committee would await a further report in this regard.

CHAPTER II

NON-OBSERVANCE OF THE PROVISIONS OF THE FINANCE ACTS

Audit paragraph

2.1. Under the Finance Acts 1964 to 1968, certain categories of companies, declaring or distributing dividends on equity shares in excess of specified percentage of their paid-up equity share capital as on the first day of the relevant previous year are to pay additional tax at prescribed rate on such excess dividends.

2.2. One such company which had paid-up equity share capital of Rs. 8 crores on the first day of the previous year relevant to the assessment year 1967-68 issued bonus shares of the value of Rs. 2 crores towards the end of the previous year. It distributed during the previous year, equity dividends amounting to Rs. 1.4 crores. The additional tax leviable on excess dividends was calculated by the Department with reference to the company's equity capital of Rs. 10 crores as at the end of the previous year instead of the capital of Rs. 8 crores as on the first day thereof. This resulted in short-levy of tax by Rs. 1.5 lakhs for the assessment year 1967-68. The same company declared/distributed equity dividends amounting to Rs. 1.75 crores during the previous year relevant to the assessment year 1968-69, for which additional tax of Rs. 5,62,500 was not levied by the Department.

2.3. Another company (a banking concern) declared and distributed dividends of Rs. 24,56,062 on its paid-up equity capital during the previous year relevant to the assessment year 1964-65. The Department, however, did not levy additional tax thereon. Further, though the company declared and distributed dividend of Rs. 53,20,000 on its paid-up equity capital during the previous year relevant to the assessment year 1967-68, the Department levied additional income-tax on Rs. 36,40,000. These errors caused tax under-charge of Rs. 3,10,205 for the assessment years 1964-65 and 1967-68.

2.4. In the cases referred to at 2.2 and 2.3 above, the Ministry have stated that the assessments in question have been rectified and the additional demands of Rs. 7,12,500 and Rs. 3,10,205 respectively raised. Report regarding collection of these demands is awaited.

[Paragraphs 14(a) (i) & (ii) of the Report of the Comptroller & Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

Background Information

2.5. With a view to ensuring that the savings generated in the corporate sector were increasingly utilised for industrial development and growth, the Finance Act, 1964 (*vide* paragraph D of Part II of the First Schedule to the Act) proposed the levy of an additional super tax on the amount of dividends declared or distributed on the equity capital during the previous year by companies of prescribed categories. The additional super tax leviable in such cases was intended to be a means of withdrawal of the rebate of super tax otherwise admissible to such companies. The rate of this withdrawal of rebate was 7.5 per cent of the entire amount of dividend on the share caiptal declared or distributed by the company during the previous year for the assessment year 1964-65.

2.6. This levy was continued for the assessment year 1965-66 also. From 1966-67, with the merger of super tax in corporation tax, the basis of this levy was slightly changed. From that year, an additional tax of 7.5 per cent is chargeable on so much of the total income of a company as does not exceed the relevant amount of distribution of dividends as defined in the Finance Act. The additional tax is chargeable only with reference to the amount by which such dividend exceeds 10 per cent of the paid-up equity capital of the company on the first day of the previous year. Equity dividends upto the first 10 per cent of such paid-up equity capital are excludible for the purpose of levy of additional tax in all cases. This scheme continued upto the assessment year 1968-69. As a measure of simplification and as a step towards improving the climate for equity investment, the levy of this additional tax was discontinued for the assessment year 1969-70.

2.7. The omission to levy additional tax at the rate of 7.5 per cent on equity dividend declared or distribution by the two assessees, has been pointed out in these paragraphs. The short-levy of tax in the two cases amounting to Rs. 7,12,500 and Rs. 3,10,205 respectively. The Committee learnt from Audit that both the assessees were assessed in company circles. The Public Accounts Committee had been informed earlier that Company Circles in the Income-tax Department were manned by senior and experienced officers.

2.8. The Committee were informed by Audit that such omissions had been noticed in test Audit in previous years also as would be

evident from the following data:

Audit Report	Para No.	Tax under-charg e
		Rs.
1969	56(d)	2,86,801
1970	54(b)	2,18,530
1969-70	40(c)	5,55,152
1970-71	50(c)	10,17,393
1971-72	16(i)(a) & (b)	1,84,785

2.9. In paragraph 1.8 of their 128th Report (Fifth Lok Sabha) the Committee had observed as under:

> "The Committee learn that the Ministry have ordered a review of the assessment of the companies for the assessment years 1964-65 to 1968-69 and that the results so far available indicate omissions to levy additional tax in 15 cases. It would have been more satisfactory had this review been conducted by the IAC (Audit). The Committee await the final outcome of the review which they trust would be followed up immediately by action to recover additional tax due to in respect of under-assessments that are detected."

In their Action Taken Note to the above recommendation, the Ministry have stated:

> "Final results of the review have been received. It has been reported that mistakes in four more cases have been detected in addition to the fifteen cases reported earlier. Necessary follow-up action for collecting the additional demand raised is being taken."

2.10. The Committee enquired whether the two cases referred to in the Audit paragraph were included in the 15 cases where omissions to levy additional tax had been detected as a result of the review conducted by the Ministry. They also wanted to know whether this review was conducted by IAC (Audit). The Member, Central Board of Direct Taxes stated during evidence:

> "These cases were detected before the review. These cases were detected on 19.5.1972 whereas the date of review is

13.9.1973. The review was to find out defects. These defects had already been detected. The review was to detect other cases where similar mistakes were committed. Here the mistakes were already exposed. These mistakes had been detected by Audit and we had the information already."

In a note furnished to the Committee in this connection, the Department of Revenue & Insurance added:

"The dates of audit of the two cases are as below:

Dunlop India Ltd.	— 19.5.1972
United Commercial Bank	— 14-12.1972

The review was ordered on 13.9.1973. Thus, the mistakes in these two cases were detected by Audit before the date of the review. The question of inclusion of these two cases in the review does not arise. The review was undertaken by the Income-tax Officers as the instructions dated 13-9-1973 did not specify that it should be done at the level of the IACs (Audit)."

2.11. The Committee asked whether the assessments in the two cases were looked into by the Internal Audit Party and in case this had not been done, the Committee desired to know the reasons therefor. The Member, Central Board of Direct Taxes replied in the negative and added:

"The Revenue Audit detected these cases and thereafter we carried out a review. The explanation given was that there were a lot of time-barring cases which required complicated investigations and therefore the ITO had made a mistake. The Audit Party had not seen this and the Chief Auditor has explained that he was holding dual charge of Audit Range I and Audit Range II and due to heavy pressure of work, he could not take up a personal check of the cases. No further action has been considered necessary by the Commissioner. It has been accepted as satisfactory."

In a note subsequently furnished to the Committee in this connection, Department of Revenue & Insurance added:

"In the case of Dunlop India Ltd., the Internal Audit Party did not check the relevant assessments due to paucity of staff,

Additional units of Internal Audit Parties and posts of Income Tax Officers (Internal Audit) have since been sanctioned.

In the case of United Commerical Bank, the Internal Audit Party did not check the 1964-65 assessment. The assessment for the year 1967-68 was checked but the mistake discussed in the Audit paragraph was not pointed out. The concerned U.D.C. has been warned for this failure to check or detect the mistakes."

2.12. The Committee desired to know whether the assessee in the first case (Dunlop India Ltd.), commented upon by Audit, had failed any appeal against the assessment for 1967-68 as a result of which the total income had been reduced, and if so, whether the appeal related to the audit objection. The Member, Central Board of Direct Taxes, stated:

"That is correct. It was not as a result of audit objection at all; the audit objection has been accepted in toto."

The Department of Revenue & Insurance, in a note, further stated:

"The appeal in the case of Dunlop India Ltd. in which the incomes assessed in the original assessments have been reduced, related to the computation of income. The audit objection pertains to mistakes in computing excess dividend tax."

2.13. The Committee enquired into the grounds of appeal and the date on which the appeal had been filed. The Department of Revenue & Insurance, in a note, stated that the appeal was filed on 25th April, 1972 and furnished to the Committee a copy of the grounds of appeal before the Appellate Assistant Commissioner for the assessment year 1967-68.

2.14. The grounds of appeal were briefly as follows:

"1. The Income-tax Officer erred in not accepting the appellant's claim for deduction of the exchange loss referred to as such in his assessment order amounting to Rs. 41,32,157 in compiling the appellant's total income.

2. That the Income-tax Officer erred in not excluding from the total income of the appellant the sum of Rs. 1,76,957/- being appreciation in value in terms of rupees only when

compared to foreign exchange rates applicable to foreign currencies, since the appellant is not a dealer in foreign exchange and as such the gain, if any, was notional, casual and non-recurring."

2.15. The Committee learnt from Audit that the additional demands had been adjusted against refunds due. The Committee asked as to how these refunds had arisen in these cases. The Committee also wanted to know whether the Board had checked up that the claims for refund were proper and correctly allowed according to law and that it was not a mere device to satisfy both Audit and the assessee. The Member, Central Board of Direct Taxes stated:

"The Board do not check up individual assessments, but we have satisfied ourselves by making enquiries of the respective commissioners that the refunds have been granted on sound grounds."

The Department of Revenue & Insurance, in a note, added:

"Refunds have been issued by the Income-tax Officer as due in law as a consequence of appellate orders etc. To have further control, the Income-tax officers have been recently directed to get refunds over Rs. 1 lakh approved by the Inspecting Assistant Commissioner. In the case of Dunlop India Ltd. where net refund was more than Rs. 6 lakhs, it has again been checked. The Commissioner has reported that the amount of the refund is correct."

2.16. In respect of the case relating to Dunlop India Ltd., the Committee desired to know the amount paid to foreign shareholders and the amount paid to Indian shareholders out of the sum of Rs. 3.15 crores distributed as dividends during 1967-68 and 1968-69. The Committee also wanted to know the number of foreign shareholders who were assesseed to income-tax in India. The Member, Central Board of Direct Taxes stated:

"In 1967-68, the dividend distributed to resident shareholders is Rs. 82,24.869 whereas to non-resident shreholders is Rs. 92,75,131. Of the foreign shareholders, only one shareholder, it was the Dunlop Holding Company, was assessed to tax in India. For all company dividends tax is deducted at source."

The Department of Revenue & Insurance, in a note, further stated:

"The break-up of the dividend paid in the previous years of years 1967-68 and 1968-69 is as below:

Assessment Year	Dividend paid to resident shareholders	Dividend paid to foreign shareholders	Total
	Rs.	Rs.	Rs.
1966-67	65,77,790	74,22,210	1,40,00,000
1967-68	82,24,869	92,75,131	1,75,00,000
Total	1,48,02,659	1,66,97,341	3,15,00,000

There is only one foreign shareholders *viz.* Dunlop Holdings Ltd., U.K. with 51.24 per cent shares. The holding company is assessed to tax in India."

2.17. The Committee enquired into the total amount remitted by Dunlop India Ltd. as profits or know-how fees and other amounts paid to foreign concerns or parties during the period from 1965-66 to 1972-73. The Department of Revenue & Insurance, in a note, informed the Committee as follows:

"The information regarding remittances made by Dunlop India Ltd. out of India for technical know-how or on another accounts is as below:

Assessment Year	Technical know-how	Dividend	Buying commission
	£ (pounds)	(Rs. in lakhs)	£ (pounds)
1965-66	227772	45·39	..
1966-67	251176	49·96	..
1967-68	177071	55·80	..
1968-69	244740	67·70	..
1969-70	264513	67·70	321
1970-71	286214	67·70	743
1971-72	11561	77·37	2118
1972-73	*	77·37	15930

*In 1972-73, there was no remittance on account of technical know-how. However, the company claims to have remitted in 1972, a sum of Rs. 2,20,673 alleged to represent reimbursement of technical expenses incurred by the U.K. company during the year ended 31-12-1969. The Commissioner has stated that this claim will be considered by the Income-tax officers in the pending assessments of the two companies for 1973-74."

2.18. The Committee view with serious concern the two cases of failure to levy/incorrect levy of additional tax on dividends declared or distributed on equity shares in excess of the specified percentage of the paid-up equity share capital as on the first day of the relevant previous year, resulting in short levy of tax amounting to Rs. 10.23 lakhs. In the first case relating to a company under foreign control (Dunlop India Ltd.,) the Committee find that instead of levying the additional tax with reference to the paid-up equity capital of Rs. 8 crores as on the first day of the previous year relevant to the assessment year 1967-68, the tax had been computed after incorrectly taking into account the bonus shares valued at Rs. 2 crores issued towards the end of the previous year, thus resulting in a short levy of tax by Rs. 1.5 lakhs for the assessment year 1967-68. Again, in respect of the same company, no additional tax, which works out to Rs. 5.63 lakhs, had been levied on the equity dividends of Rs. 1.75 crores declared/distributed by the company during the previous year relevant to the assessment year 1968-69.

2.19. In the second case pointed out by Audit, which related to an Indian banking concern (United Commercial Bank Ltd.), the Committee find that the additional tax had not been levied on the dividends of Rs. 24.56 lakhs declared/distributed during the previous year relevant to the assessment year 1964-65 and had been incorrectly levied on the dividends declared distributed during the previous year relevant to the assessment year 1967-68. These mistakes had resulted in a short levy of Rs. 3.10 lakhs.

2.20. The Committee are informed that the lapses pointed out by Audit have been accepted by the Department and necessary rectifications carried out. While the Committee note that the Central Board of Direct Taxes took prompt action to rectify mistakes pointed out by the Central Receipt Audit, they cannot ignore the basic issues involved in such recurrent cases of under-assessment pointed out in test audit year after year. The Committee have been informed that both these cases were assessed in Company Circles which, admittedly, have fewer cases for disposal and are manned by experienced senior officers. Such an arrangement is apparently designed to ensure that large income cases of the type commented upon by Audit are thoroughly and properly scrutinised before the assessments are finalised. That mistakes of the nature pointed out by Audit should continue to recur, despite such an arrangement, would lead the Committee to infer that either the requisite competence is lacking in the officers posted to Company Circles or that such mistakes are deliberate and malafide. The Committee, therefore, desire that the circumstances leading to the under-assessments in these

two cases should be thoroughly investigated. The Committee are of the view that appropriate action is also called for against the officers, including those at the supervisory level, who have apparently been negligent in the discharge of their duties.

2.21. The Committee are also concerned to note that the relevant assessments relating to Dunlop India Ltd. had not been checked by Internal Audit, while in the case of United Commercial Bank Ltd. though the assessment for the year 1967-68 had been checked in Internal Audit, the patent short-levy of additional tax was not detected. What is more distressing is that this assessment relating to a banking concern, in the high income bracket, had been scrutinised only at the level of an Upper Division Clerk who has been warned for his failure to detect the mistake. In respect of the other three assessments, the explanation offered is one which has been too often placed before the Committee, namely, that the manpower resources of Internal Audit are inadequate. The Committee desire that the existing arrangements for Internal Audit should be reviewed and remedial steps taken forthwith. The Committee would also reiterate that all large income cases should invariably be checked at the level of the Inspecting Assistant Commissioner (Audit). The Committee are of the view that a pre-check of draft assessment orders by Internal Audit, recommended in paragraph 2.66 of their 87th Report (Fifth Lok Sabha) and reiterated in paragraph 1.17 of this Report would largely eliminate such unpardonable mistakes in assessment.

2.22. The Committee have been informed that Dunlop India Limited had gone in appeal in respect of computation of the company's income for the assessment year 1967-68, as a result of which the total taxable income had been reduced. It appears that one of the grounds of appeal related to the additions made on account of exchange fluctuations. The Committee understand that the question of assessability or non-assessability of profits accruing out of exchange transactions is not a simple issue and that in many cases, courts of law have upheld assessments of gains on exchange transactions. The Committee would, therefore, like to know whether Government have contested the order of the Appellate Assistant Commissioner in the present case.

2.23. Another feature which has come to the notice of the Committee in respect of Dunlop India Ltd. is that the company has been remitting large sums abroad every year on the plea of reimbursement of technical know-how fees. During the seven-year period from 1965-66 to 1971-72, the remittances made on this account to-

talled £ 1.46 millions. In addition, the company has also claimed to have remitted, in 1972, a sum of Rs. 2.21 lakhs alleged to represent reimbursement of technical expenses incurred by the U.K. company during the year ended 31st December, 1969 and this claim, according to the information furnished to the Committee by the Department of Revenue & Insurance, is to be considered by the Income-tax Officers in the pending assessments of the two companies, namely, Dunlop India Ltd. and Dunlop Holdings Ltd., U.K., for the year 1973-74. It would appear that the Indian subsidiary company has been allowed to remit large sums as payment of technical know-how fees to the foreign holding company. While the payments for technical know-how could, perhaps, be justified during the initial period of establishment of a company, the Committee are doubtful how far the technical know-how would be relevant in the case of a well-established company like Dunlop India Ltd. in an advanced stage of development.

2.24. The Committee would, therefore, like to be satisfied that the remittances made on account of technical know-how fees by Dunlop India Ltd. were, in fact, fully justified and genuine and have not served as an instrument of tax-avoidance. The Committee desire that the technical know-how agreement entered into by the company should be thoroughly examined by the Department of Revenue & Insurance with a view to determining its relevance to the Indian business of Dunlop India Ltd. and ensuring that it is not a mere cloak for tax-avoidance. In case it is found that the remittances on this account have been claimed and allowed wrongly, appropriate action should be taken.

2.25. The Committee are also of the view that it would be worthwhile for Government to undertake a detailed review of all such technical collaboration agreements entered into prior to 1965 by foreign enterprises operating in India and still in force, with a view to determining how far such agreements could be considered relevant to the Indian business of such enterprises concerned in the light of the developments and changes that they might have undergone since the agreements were first entered into. In case the review discloses that some of the collaboration agreements have outlived their purpose and serve only as instruments of tax-avoidance, immediate action to treat the payments of technical know-how fees in these cases as inadmissible expenditure and subject them to tax should be initiated, in addition to terminating the agreements, by invoking, if necessary, the power of eminent domain that a sovereign country enjoys. In all future technical collaboration agreements approved by the Government, it should also be ensured that a clause for a periodical review of the agreements from the point of view of

their relevance in the changed circumstances that may prevail is invariably incorporated. The Committee attach considerable importance to these recommendations and desire that they should be implemented expeditiously.

CHAPTER III

INCORRECT COMPUTATION OF BUSINESS INCOME OF COMPANIES

Audit paragraph

3.1. In the assessment of an Indian subsidiary of a foreign company, for the assessment year 1967-68 the Income-tax officer allowed a deduction on account of the subsidiary's share of holding company's expenses, by converting the dollar expenses for the whole of the calendar year 1966 at the post-devaluation rate instead of apportioning the expenses to pre-devaluation and post-deveIuation periods and then applying the exchange rate prevailing for the respective periods. This resulted in an excess allowance of expenses in the assessment of the Indian subsidiary amounting to Rs. 7,46,282 resulting in a short-levy of tax of Rs. 5,22,402 for the assessment year 1967-68.

3.2. The Ministry while not agreeing to the above have replied: "In the instance case the liability on account of over-head expenses incurred by Head Office crystalises yearly at the end of the accounting period and not on different dates during the accounting period and that deduction had, therefore, to be allowed for a sum calculated at the rates prevailing at the end of accounting period." However, it is understood that the adjustments (between a foreign company and its Indian branch) of the over-head expenses of the head office are settled periodically and not at the end of the accounting year.

[Paragraph 17(b) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II-Direct Taxes]

3.3. The Committee desired to know the name of the company referred to in the Audit Paragraph. The Committee also enquired whether the Indian enterprise was a branch of a multi-national corporation resident abroad or whether it was in itself a separate entity. A representative of the Department of Revenue & Insurance stated that the assessee company in this case was the IBM World Trade Corporation which was a multi-national corporation. He added:

> "It is incorporated in New York and the Indian Organisation is a Branch."

3.4. The Committee asked whether there was any application made for the recognition of this Branch of the multi-national corporation as a company for purposes of the Income-tax Act. The witness stated:

> "We have on our record a copy of the order passed by the Board declaring it to be a company for purposes of Income-tax Act."

The Department of Revenue & Insurance, in a note subsequently furnished to the Committee in this regard, added:

> "M/s. I.B.M. World Trading Corporation was declared to be a company for the purpose of the Indian Income-tax Act, 1922 vide order F. No. 60(18)-I.T./53 dated 8th May, 1953 passed by the Board in exercise of the powers conferred by sub-section (c) of Section 2 of the said Act. This order was cancelled and another order passed of even number dated 23rd May, 1953.
>
> Copies of the applications made by the assessee for being declared as a company are not readily available with the Board."

3.5. The Committee desired to know how often statements, debit notes etc. had been received by IBM World Trade Corporation from its Head Office and whether it was annual, half-yearly, quarterly, or monthly. The representative of the Department of Revenue & Insurance stated:

> "The debit note was received by the Indian Branch from the Head Office on 15th December for this year. Our information is that they have been received only once a year. I have got a copy of the debit note which I obtained from the Commissioner of Income-tax. This is for the whole year. My information is that there is one debit note."

The Department, in a note, stated in this connection:

> "The Commissioner of Income-tax has informed that the debit note for Head Office expenses for the assessment years 1965-66 to 1969-70 is affirmed by the company to have been received only once in December of the respective year by a single debit note."

3.6. The Committee enquired whether any investigation had been carried out to find out how often these debit notes had been received by the Indian unit. The Department of Revenue & Insurance, in a note, replied:

> "The Commissioner of Income-tax was asked to again verify whether debit for head office expenses for calendar year 1966 was received only once i.e. in December 1966 or whether the head office expenses were settled periodically. The practice obtaining for the preceding two years and the following two years was also asked to be verified.
>
> The Commissioner of Income-tax has reported that the company has affirmed that the debit notes for headquarters expenses were received only in December by a single debit note."

3.7. According to Audit, since devaluation was operative only from 6th June 1966, it was not correct to have allowed the head office expenses at the enhanced rate even in respect of the transactions relating to the pre-devaluation period. The Committee were also informed by Audit that the conversion ratio should have been adopted by splitting the expenses on a time-basis and that this principle had already been accepted by the Central Board of Direct Taxes in another case relating to Harrison and Crossfield (P) Limited. The Board had not, however, accepted the audit objection in this case on the ground that the liability on account of overhead expenses incurred by the Head Office crystallised only at the end of the accounting period and not on different dates. This stand taken by the Board is not acceptable to Audit, on account of the following reasons:

(i) The Central Board of Direct Taxes have themselves stated in the earlier case that 'the correct procedure would have been to allocate expenses on the basis of time', and

(ii) in this particular case there was no obligation on the part of the Indian Branch to pay the head office in terms of dollars. The Indian Branch accounts were maintained on a rupee basis and the net profit on the branch account should only be on rupee basis.

When asked by the Committee to state the correct position in this regard, the representative of the Department of Revenue & Insurance stated:

> "From the income-tax angle, the head office expenses are debitable to the profits of the Indian Branch. Now we have

ascertained in this case that the debit note for the head office expenses was sent by the head office to the branch in December 1966 and it was the date on which the entry was made in the account according to the prevalent rate of exchange that had to be used for converting the dollars into rupees. So, the whole amount of head office expenses relating to the whole of the calendar year 1966 both covering the pre-devaluation and post-devaluation period was converted at the higher rate of exchange which prevalid after the devaluation."

He added:

"There are two questions: one is the question of actual remittance and on that we do not have complete information. The second question is how it is treated for income-tax purposes. I have tried to answer the second point. As far as the Income-tax Department is concerned, whether a part of the taxable income should be allowed to be remitted in foreign exchange is a matter which does not fall within our purview."

The Governor, Reserve Bank of India, stated in this context:

"We can certainly talk on that matter. I mentioned that the practice is to remit it once a year. But it is certainly possible for us to check that when they obtain our approval. We can check up this for 1965-66 and see that in accordance with the normal practice whether they had remitted this much amount by the end of that year."

3.8. When the Committee pointed out that the correct procedure would appear to be to allocate the expenses on the basis of time, the representative of the Department of Revenue & Insurance stated:

"We considered the point and we are of the opinion that the correct position is that the expenses need not always be allocated to the pre-devaluation and the post-devaluation period and the crucial date is the date on which the debit is raised on that account."

3.9. The Committee desired to know the total expenditure incurred by the Indian unit and debited to the Profit and Loss Account during the last five years and the proportion of this expen-

diture which had been allocated, year-wise, to the head office under 'Head Office Expenses'. The witness stated:

> "The assessee has filed a composite trading-cum-profit and loss account. The total on the debit side is Rs. 6.40 crores in round figures. If from this, the cost of machines capitalised—that is an item in this—Rs. 1.11 crores is excluded, then the total debit comes to about Rs. 5.29 crores. Then there are certain items which cannot be regarded as expenditure. They should also be excluded. They are material consumed Rs. 1.77 crores; exchange loss Rs. 42 lakhs; provision for taxation Rs. 1.06 crores; development rebate reserves Rs. 16 lakhs. The head office expenses are Rs. 46,91,580. The other expenses debited to the profit and loss account is Rs. 1.73 crores. The percentage of Rs. 46.91 lakhs to Rs. 1.73 crores is 27.4 per cent."

The Department of Revenue & Insurance, in a note furnished in this connection to the Committee stated:

> "For the calendar year 1966 relevant for the assessment year 1967-68, the assessee had filed a composite trading-cum-profit and loss account. The total of the debit side is Rs. 6,40,63,432. This is inclusive of head office expenses of Rs. 46,91,580 which have been described in this composite statement as 'Share of New York administration and general expenses'.
>
> Particulars for other years are being obtained from the Commissioner of Income-tax."

3.10. While examining the head office expenses claimed by the National & Grindlays Bank Ltd. [*vide* 176th Report of the P.A.C. (Fifth Lok Sabha)], the Committee had been furnished by the Department of Revenue & Insurance with a copy of a Study Note on 'Head Office Expenses' prepared by the Department in August 1973, as a sequel to which instructions on scrutiny of claims towards Head Office Expenses were proposed to be issued for the guidance of assessing officers. According to this Note, the deduction claimed by IBM World Trade Corporation towards Head Office Expenses for the assessment year 1969-70 worked out to 78 per cent of the book profits prior to the charge of this payment. When the Committee

drew the attention of the witness to the facts disclosed in respect of IBM World Trade Corporation in this Study Note, he stated:

"This is a percentage of the head office expenses to the profit."

3.11. The Committee enquired whether IBM World Trade Corporation were allowed to remit 78 per cent of their profits as head office expenses. The Committee also wanted to know the control exercised by the Reserve Bank of India on the remittances made abroad by foreign companies. The Governor, Reserve Bank of India, stated in evidence:

> "In the case of non-banking companies, the practice has been to allow remittances once a year as claimed in their account subject to later checking with the Income-tax assessment."

3.12. When asked whether there was any ceiling on remittances of profits and head office expenses, the witness replied:

> "As far as I am aware, there is no ceiling."

He added:

> "In so far as the foreign companies other than the banking companies are concerned, we have been depending only on the tax assessment. Whatever is accepted as tax, we have accepted that because the real incidence is a tax matter. The head office expenses is out of the profit which they show and out of which they say that this portion should be treated as head office expenses. It is only if they make a profit in a year, including head office expenses, then the remittance would be allowed."

3.13. The Committee wanted to know whether any study had been conducted by the Reserve Bank of India of such foreign companies operating in India which claimed head office expenses and whether they were asked to furnish full details of these expenses. The Committee also desired to know the nature of vigilance and control exercised by the Reserve Bank in regard to foreign companies. The Reserve Bank of India, in a note, stated:

> "The Reserve Bank has been treating the amount claimed by the foreign company as Head Office expenses as actually a part of its remittable surplus, *i.e.* excess of income over expenditure during its accounting year, which the company considered to be non-taxable on the ground that it

represented expenses incurred by its Head Office which were directly attributable to the Indian operations. Accordingly, the Reserve Bank was not undertaking any scrutiny of the amount applied for by the foreign companies/banks towards remittance of Head Office expenses to their Head Offices abroad nor was the bank asking them to submit a break-up of the items composing Head Office expenses but allowing the remittance on a provisional basis subject to the acceptance by the income-tax authorities of the claim that the amount was non-taxable. For this purpose the Reserve Bank offices were required to call for the income-tax assessment order from the company/bank at the end of each year in order to verify whether the amount allowed to be remitted for the corresponding year was within the amount admitted by the income-tax authorities as deductible expenses for the purposes of tax. If the amount admitted was less than that allowed to be remitted, the company/bank was asked to repatriate the excess amount remitted abroad or to adjust it against the next remittance. For the year 1973 and onwards, the Reserve Bank has decided not to accept the claim on account of Head Office expenses without the production of evidence by the company/bank that its claim that a part of the surplus is non-taxable—as being Head Office expenses chargeable to the Indian operations—has been accepted by the income-tax authorities.

As regards the vigilance and control exercised by the Reserve Bank in regard to the foreign companies, it may be stated that all the exchange control rules and regulations as applicable to remittances from India apply equally to foreign companies as well as Indian companies and the foreign companies' applications for remittances are subjected to the same scrutiny as in the case of Indian companies. The powers for effecting remittances delegated to the authorised dealers in foreign exchange do not also discriminate between Indian and foreign companies and remittances falling within the scope of their delegated powers may be made by the authorised dealers, irrespective of whether the applicant is an Indian or a foreign company, subject to the fulfilment of such conditions as may be prescribed in each case.

The Reserve Bank has also been entrusted with certain new powers and responsibilities in relation to foreign

companies under the Foreign Exchange Regulation Act, 1973, which came into force on 1st January 1974. The major provisions of the Act applicable to foreign companies are sections 28, 29 and 31. In terms of section 28, companies (other than banking companies) which are not incorporated under any law in force in India or in which the non-resident interest is more than 40 per cent, or any branch of such a company shall not, except with the general or special permission of the Reserve Bank, (a) act, or accept appointment, as agent in India of any person or company, in the trading or comercial transactions of such persons or company for any direct or indirect consideration. The permission of the Reserve Bank is also required for the continuance of the arrangements described at clauses (a), (b) and (c) above, which were entered into by such companies prior to the 1st January, 1974. Under section 29 *ibid*, such companies (including any branch of such company) are required to obtain the permission of the Reserve Bank (1) to carry on in India any activity of a trading or commercial or industrial nature, as also for the continuance of their existing trade, commerce or industrial activities, (2) to establish in India a branch, office or other place of business for carrying on such activities, (3) to acquire either wholly or partly any undertaking in India of any person or company carrying on any trade, commerce or industry, (4) to purchase shares in India of Indian companies and (5) to continue to hold shares of Indian companies which were acquired before the commencement of the new Act, i.e., prior to 1st January 1974. In terms of section 31 of the Act, companies (other than banking companies) which are not incorporated under any law in force in India or in which the non-resident interest is more than 40 per cent shall not, except with the previous general or special permission of the Reserve Bank, acquire, hold, trensfer or dispose of in any manner any immovable property situated in India; this restriction does not, however, apply to the acquisition or transfer of any such immovable property by way of lease for a period not exceeding five years. These powers are intended to ensure that foreign companies are allowed to operate only in such fields as may be necessary for or conducive to rapid Indian economic development. The Ministry of Finance have published guidelines for administering the foreign investment pro-

visions (i.e. the provisions of section 29) of the Foreign Exchange Regulation Act, on 20th December 1973; these guidelines have been placed on the table of Parliament."

3.14. Another note furnished, at the instance of the Committee, by the Reserve Bank of India, indicating the statutory and administrative functions exercised by the Reserve Bank of India in regard to the remittances of foreign exchange from India by foreign enterprises operating in India to their holding companies or other foreign enterprises abroad, is reproduced below:

"All remittances of foreign exchange from India whether by foreign enterprises (including banks) or by persons other than foreign enterprises are governed by the provisions of Section 9 of the Foreign Exchange Regulation Act, 1973. This section prohibits the making of payments to persons resident outside India without the general or special exemption granted by the Reserve Bank of India. Section 8 of the Foreign Exchange Regulation Act governs the purchase, sale, lending, borrowing, etc. of foreign exchange by all persons resident in India including foreign enterprises but excluding all banks authorised to deal in foreign exchange. (Authorised dealers may undertake such transactions in foreign exchange as fall within the scope of the authoristion, either specific or general, granted by the Reserve Bank).

The Exchange Control Regulations governing the different kinds of remittances abroad have been laid down in the Exchange Control Manual and circulars issued by the Reserve Bank of India; the provisions of the Manual and the circulars constitute directions of a standing nature issued to authorised dealers under Section 20(3) of the Foreign Exchange Regulation Act, 1947 [corresponding to Section 73(3) of the new Act]. Copies of the Manual are available for sale to the public through authorised dealers.

Authorised dealers have been delegated powers to effect remittances abroad for various purposes without prior reference to the Reserve Bank of India provided the necessary conditions laid down in each case are fulfilled by the applicants and the necessary documentary evidence is verified by the authorised dealers before effecting remittances. In certain cases, monetary limits have also been laid down for remittances by authorised dealers

under their delegated authority. The delegated powers are spelt out in the Exchange Control Manual and in circulars issued from time to time by the Reserve Bank. Besides the powers to effect remittances on behalf of their constituents, authorised dealers may also make remittances in payment of bank charges, cost of cables and other sundry items of minor expenses incurred on their own behalf by their overseas branches/correspondents without the prior approval of the Reserve Bank.

Remittances in payment of imports constitute the bulk of the foreign exchange expenditure. Power has been delegated to authorised dealers in foreign exchange to allow remittances in payment for imports on the strength of 'exchange control copy' of import licences issued by the Import Trade Control authorities, up to the values indicated on the licences and subject to the conditions specified thereon. Remittances incidental to export and import trade on account of freight, insurance, commission to overseas agents, advertisements abroad, bank charges, etc. may be made in accordance with the regulations governing each kind of remittance as laid down in the different sections of the Exchange Control Manual.

Rules have also been laid down for remittances of the surplus freight and passage fare collections of foreign airlines and steamer companies operating in India. Yet another category is that of remittance of profits and dividends to the Head Offices or parent companies outside India of the branches or subsidiaries of foreign firms and companies, including banks, operating in India. These are allowed to be made to the extent that they represent current profits after deduction of the appropriate amount of tax as certified by auditors. Branches of foreign companies and banks also sometimes remit a part of their surplus which they claim as not being taxable as this represents expenses claimed by their Head Offices as allocable to the companies'/banks' Indian operations.

Remittances abroad of royalties, technical know-how fees and other payments arising out of collaboration arrangements entered into by firms/companies with non-resident parties are allowed by the Reserve Bank strictly in accordance with the terms of the collaboration agree-

ments provided these have been entered into with the prior approval of the appropriate department/Ministry of the Government of India. 'Technical know-how' fees will include all lump sum payments for supply of designs, formulae, layout and technical information, training of Indian technicians, revealing of process, provision of engineering services like erection of machinery, inspection, etc. 'Royalties' will include all recurring payments linked to output or sales, or for the use of patents, trade marks, etc. The remittance applications should be supported by a statement showing how the amount to be remitted has been arrived at, duly certified by the firm's/company's auditors and also tax clearance/no tax dues certificate from the Income-tax authorities. The policy followed for allowing remittances of royalties, technical know-how fees, etc. is the same whether the firm/company in India is a wholly Indian-owned firm/company or is a foreign company, provided the relative collaboration agreement has been entered into with the prior approval of Government. Apart from remittances under collaboration arrangements, the Bank also releases exchange towards payments to the overseas contractors for specific technical services rendered by them under specific contracts entered into by firms and companies with the prior approval of Government.

Transfers of sale proceeds of approved foreign investments in India are allowed by the Bank in consultation with Government unless the investments were originally approved on a non-repatriable basis.

Another important item for which exchange is released is travel abroad for various purposes such as business visits, medical treatment, higher studies/training, etc. The exchange is released on specific scales prescribed by Government in accordance with the guidelines laid down by them for different categories of foreign travel."

3.15. The Reserve Bank of India also furnished to the Committee a note indicating the procedure followed by the Reserve Bank for allowing remittances on account of 'Head Office Expenses by foreign companies operating in India' which is reproduced in Appendix-I.

3.16. The Committee desired to know whether any detailed statement of accounts had been furnished by the assessee company to

the Income-tax Officer in respect of the expenses stated to have been incurred by the Head Office of the company in New York to establish that these expenses had in fact been incurred by it on behalf of the Indian unit and whether the authenticity of the statement was duly certified. The Department of Revenue & Insurance, in a note submitted to the Committee, stated:

> "The assessee had filed a statement showing details of the head office expenses of Rs. 46,91,580 allocated to the Indian Branch. This statement (which is unsigned) was sent with company's letter dated 13-10-1970 (signed by S. Sundar Raman, Tax Specialist, IBM)."

3.17. The Committee called for details of the amount claimed by the assessee towards head office expenses and allowed by the Income-tax Officer and whether there was any scrutiny by the Income-tax Officer of the expenses before allowing the expenditure. The Department of Revenue & Insurance, in a note, stated:

> "The following are amounts claimed as head office expenses by the assessee and allowed by the I.T.O. for the assessment year 1967-68:
>
> Claimed : Rs. 46,91,580
>
> Allowed : Rs. 46,91,580
>
> The ITO had obtained a statement showing a break-up of the aforesaid expenses."

From notings made on this statement, it appears that the ITO had made some scrutiny of these details. He has left some notes regarding scrutiny of some items.

3.18. In respect of the amounts that were allowed as Heal Office expenses during the years 1968-69, 1969-70, 1970-71, 1971-72, 1972-73 and 1973-74, the Department of Revenue & Insurance, in a note, stated:

> "The particulars of the amounts claimed as head office expenses in the assessment years 1968-69 to 1970-71 are given below:
>
> Particulars in respect of the later three years are being obtained from the Commissioner of Income-tax.
>
> 1968-69—Rs. 45,94,697
>
> 1969-70—Rs. 50,24,305
>
> 1970-71—Rs. 56,75,993
>
> These are the amounts claimed by the assessee. The assessment orders do not show any dis-allowance."

During examination of the head office expenses claimed by another foreign banking company (National & Grindlays Bank Ltd.), the Committee had asked whether any machinery existed in the Income-tax Department for checking the expenditure in India as well as abroad. The Chairman, Central Board of Direct Taxes had then informed the Committee as follows:

> "We do not do any checking abroad at all. Checking is only here in India. We do not have any machinery abroad for checking expenditure there."

In this context, the representative of the Department of Revenue & Insurance had stated:

> "In the assessment of foreign companies, there are generally two methods which are adopted for determining their income which is taxable in India. Either we take their world profit and take a certain percentage of that as attributable to operations in India. We get their global balance sheet and profit and loss ascertained and we scrutinise them. We are not able to get the physical accounts from outside."

When asked whether there was any machinery in the Income-tax Department to probe into the details which were certified by the foreign auditors, the witness had replied:

> "We are handicapped in this regard. In most of the cases or in a large number of cases it will not be possible for us to get the foreign accounts from their foreign Head Offices."

3.19. The Committee desired to know the percentage of these amounts to the total expenditure incurred by the company in India. The Committee also wanted to know the total amount of money remitted by the Indian unit to its foreign head office during the years 1968-69 to 1973-74 and whether the clearance of the Income-tax Officer was taken before these remittances were allowed. The Department, in a note, stated:

> "As already mentioned, the assessee files a combined Trading-*cum*-Profit and Loss Account. Besides, particulars for the assessment years 1968-69 and later years are not readily available with the Board. The Commissioner of Income-tax has been requested to send the required information and this will be submitted as soon as received.
>
> As per information obtained from the Department of Economic Affairs, the amounts remitted by the Indian

unit to the foreign head office were as under:

Year	Amount (Rupees in lakhs)		
	Profits	H.O. Expenses	Others
1968-69	..	..	..
1969-70	..	..	..
1970-71	4·94	..	..
1971-72	..	..	..
1972 73	103·63	158·02	..

Particulars for the later years will have to be collected. The Commissioner of Income-tax has been requested to inform whether the clearance of the ITO was taken before the above remittances were allowed. The reply is awaited."

3.20. The Committee desired to know details of the remittances on account of profits and head office expenses allowed by the Reserve Bank of India in the case of the Indian unit of IBM World Trade Corporation for the last ten years *i.e.* from 1965-66 to 1974-75. The Reserve Bank of India, in a note, stated:

"The amounts of the portion of the surplus claimed as tax free as being attributable to Head Office expenses and allowed to be remitted to the U.S.A. by IBM World Trade Corporation for the years 1965 to 1974 are as under:

S. No.	Year to which the remittance relates	Amount of remittance approved U.S. $	Year during which the approval was granted	Remarks
1.	1965	605,487	1969	Amount admitted by the Income-tax authorities
2.	1966	618,534	1970	—do—
3.	1967	605,761	1971	—do—
4.	1968	660,224	1972	—do—
5.	1969	748,328	1972	—do—
6.	1970	767,968	1972	—do—
7.	1971	*	..	..
8.	1972	@	..	..
9.	1973	@	..	..
10.	1974	@	..	..

NOTES:—*The company claimed in November 1972 a remittance of U.S. $ 998,837 without deduction of tax as the amount was attributable to Head Office expenses for the year 1971. While the application was under consideration, in consultation with Government, the company advised that the allocation of Head Office expenses to India for 1971 (and also for the earlier years from 1965 to 1970) and for 1972 had been made incorrectly and that a fresh application for 1971 would be made for the correct amount. The revised application is awaited.

The company has not yet come up with any claim on account of Head Office expenses for the year 1972 and subsequent years.

In November 1974, the company, on its own, informed us that certain errors in the principle of allocating Headquarters Expense to India had been detected by its Head Office in New York and that the erroneous calculations had resulted in excess claim on account of Headquarters Expense for the years 1966 to 1970 as follows:

Year	Amount of excess claim on account of Headquarters Expense
	(U. S. Dollars)
1966	117,782
1967	146,719
1968	122,600
1969	44,084
1970	19,313
TOTAL	450,498

This amount would have formed part of the taxable surplus of the Company in India and would have been remittable as profit to its Head Office after payment of taxes. The company has calculated the amount of Indian Income taxes payable on the above surplus as being the equivalent of $ 333,922 which would represent the excess remittance overall. The company has stated that it is making a voluntary disclosure under Section 271 (4A) (ii) of the Income-tax Act, 1961 and submitting amended tax returns. The company has repatriated the amount of $ 338,922 from its Head Office on 20th December, 1974 and produced a bank certificate in support of the inward remittance. As the correct amount of tax payable on the additional taxable surplus of $ 450,498 is a matter for computation by the Income-tax authorities, the company has also undertaken to remit to India any further amount that may be round to be necessary, on being called upon to do so.

The amounts of profits (after allowing for Head Office expenses) allowed to be remitted by IBM World Trade Corporation for the years 1965 to 1974 are as under:

Year to which the profit/loss relates	Amount of profit (+)/loss (—) (in Rs.)	Amount allowed to be remitted (in Rs.)	Year in which approval was given
1965	—6,98,073		
1966	+4,54,094		(April 1971 revalidated in February, 1972)
1967	+34,01,307		
1968	+14,21,727	65,34,284(a)	
1969	+86,37,855		
1970	+81,72,956	1,04,06,029(b)	1972
1971	+1,15,45,264(c)	1,49,19,907(d)	1974
1972			
1973	(e)		
1974			

NOTES:—(a) The accumulated losses incurred by the company for the years 1961 to 1965 (inclusive) amounted to Rs. 41,15,079. The profits from 1966 onwards were used for absorbing these past losses. It was in 1968 that the net position resulted in a profit of Rs. 11,62,049 (profits for 1966, 1967 and 1968 aggregating Rs. 52.77,128 less aggregate losses of Rs. 41.15.079). This along with 1969 profits, together totalling Rs. 97,99,904, was allowed to be remitted after adjusting commission of Rs. 32,65,620 due from Head Office in New York for 1961 to 1969 on account of direct sales made in India by the Head Office (Rs. 97.99.904 less Rs. 32.65.620—Rs. 65,34,284—amount of net remittance).

(b) This was arrived at as follows:

	Profit for 1970	Rs. 81,72,956
Add	Excess provision for taxes written back to Profit and Loss Account	Rs. 25,71,000
		Rs. 107,43,056
Less	Commission due to branch from its Head Office	Rs. 3,37,027
		Rs. 104,06,029

(c) As per the Profit and Loss Account, there was an excess of expenditure over income amounting to Rs. 40.82,423. The profit of Rs. 115.46 lakhs was arrived at after capitalising an expenditure of Rs. 156.28 lakhs.

(d) This was arrived at as follows:

Operating profit for the year.	..	Rs. 1,15,45,624
Add Adjustment on account of tax credit certificates	..	Rs. 34,75,184
		Rs. 1,50,19,808
Less Profit on company's operations in Nepal	..	Rs. 99,901
		Rs. 1,49,19,907

(e) The company has not come up for remittance of profits for the years 1972 to 1974."

3.21. The Committee desired to know the number of foreign companies operating in India which had claimed head office expenses as having been incurred on behalf of the Indian Unit. The Committee also enquired whether a study was conducted of those foreign companies and whether these foreign companies had been asked to furnish complete accounts of the expenditure alleged to have been incurred on behalf of the Indian Units and whether these accounts of such expenditure had been subjected to scrutiny by the Income-tax Officer. The Department of Revenue and Insurance, in a note, stated:

"As there had been substantial increase in the remittances towards head office expenses during the years 1968-69 to 1970-71, the question of admissibility of head office expenses was taken up by the Foreign Tax Division for a study. Statements of remittances allowed by the Reserve Bank of India were sent to the ITOs and they were asked to furnish information in respect of—

(a) net profit and loss as per the profit and loss account;

(b) head office expenses claimed;

(c) the basis for such claim;

(d) evidence furnished in support of the claim;

(e) the amount disallowed; and

(f) the result of appeal, if any, filed by the tax-payer against such disallowance.

This data was collected in respect of 51 companies on the basis of the list of companies which were allowed remittances towards head office expenses during 1969, 1970 and 1971, supplied by E.A. Deptt. (Information in respect of all foreign companies operating in India which claimed head office expenses was not collected and is, hence, not readily available).

It was noticed that bulk of the remittances were by the branches of the foreign banks operating in India. Details in respect of head office expenses of all these banks were obtained from the Income-tax Officers.

Some cases have been taken for study in depth. It has also been decided, as an interim measure, that all applications for remittances of head office expenses exceeding Rs. 1 lakh will be referred by the Reserve Bank of India to the Department of Economic Affairs, who in its turn will refer the cases to the Central Board of Direct Taxes for clearance."

3.22. When asked whether any company had refused to furnish the necessary particulars in this regard, the Department of Revenue and Insurance, in a note, replied that no such cases of refusal had come to their notice.

3.23. The Committee enquired whether the Central Board of Direct Taxes had issued any instructions regarding allocation of this expenditure between the head office and the branch office in these cases. The Department of Revenue and Insurance, in a note, stated:

"The general criterion applied in determining admissibility of head office expenses is the one laid down under Section 37(1) of the Income-tax Act, 1961, viz., whether the expenditure is laid out or expended wholly and exclusively for the purpose of business and is not in the nature of capital expenditure. No special instructions have been issued so far. However, draft instructions which were prepared on the basis of the aforesaid study of this problem, were circulated to some senior Commissioners for their comments."

3.24. The Public Accounts Committee (1974-75) had also had occasion to examine, in some detail, the question of 'Head Office Expenses' claimed by foreign companies operating in India in connection with their examination of the Income-tax assessments relating to the National and Grindlays Bank Limited. The details of this

examination are contained in Chapter V of their 176th Report (Fifth Lok Sabha). During evidence tendered before the Committee in this connection, the Chairman, Central Board of Direct Taxes had informed the Committee as follows:

> "Quite sometime ago, we carried out some case studies to see what was actually happening and we discovered that each Income-tax Officer was using his own discretion and there was no uniform practice. We have got to see that a uniform practice is followed in determining the Head Office expenses of Indian Branches of foreign companies. After doing that case study we found that uniform practice was not being followed and some Income-tax Officers were not doing the job really properly.....As a result of case studies we came to the conclusion that full justice was not being done to the job by some Income-tax Officers. We thought that it would be better if we issue guidelines so that a uniform procedure is adopted and they are alert about the types of mistakes that are generally being noticed."

3.25. As regards the case studies conducted by the Department of Revenue and Insurance which had disclosed that the deductions claimed by various foreign companies towards 'Head Office expenses', worked out as a percentage to the book profits prior to the charge of these payments, covered a very wide spectrum ranging from 78 per cent and 70 per cent in the case of IBM World Trade Corporation (assessment year 1969-70) and Chartered Bank (assessment year 1970-71) to 4.6 per cent and 'nil' in the case of Ludlow Jute Co. Ltd. for the assessment years 1969-70 and 1970-71, the Chairman, Central Board of Direct Taxes had stated:

> "We are going into them. Instructions are being issued. We will be more vigilant in this regard. The position in re-regard to head office expenses varies from case to case and it is not possible to say that this much amount or this percentage of amount should be allowed in any particular case. One has to go into the facts of each case to see that expenses are wholly or exclusively incurred for the purpose of business of the assessee in India. Since we carried out the study, we propose to go into the facts to see as to why the percentages vary to such an extent in different

cases. After carrying out the study, we shall see whether any effort has been made by an assessee to inflate these funds. The information we have collected very recently and now we will carry out the study why there is such a wide margin of percentages by various companies."

3.26. In this context, the Public Accounts Committee (1974-75) had, *inter alia*, made the following recommendation in paragraph 9.13 of their 176th Report (Fifth Lok Sabha):

"What causes greater concern to the Committee is the absence of any uniform guidelines for the assessing officers on the treatment of Head Office Expenses of foreign companies for purposes of income-tax. The Committee have been informed that no definite guidelines have been laid down by the Board so far. Some case studies have, however, been conducted and guidelines have now been evolved which are under finalisation in consultation with a few Commissioners of Income-tax. Since this is a very important aspect which has been ignored so far, the Committee desire that the guidelines should be finalised without further loss of time and necessary instructions to the assessing officers issued which would assist them in their assessments."

In their Action Taken Note dated the 16th August, 1975 furnished to the Committee on the above recommendation, the Ministry of Finance (Department of Revenue and Insurance) had stated as follows:

"The matter is under consideration and a further communication will follow.*"

3.27. The Public Accounts Committee (1973-74), during their examination of the installation of computers on Indian Railways by the IBM World Trade Corporation, [discussed in their 127th Report (Fifth Lok Sabha)], had also been informed that the Department of Electronics had constituted an inter-Ministerial Working Group to examine the policies and procedures under which IBM World Trade Corporation operated in India. An interim report had been submitted by the Working Group on 31st July, 1974 after a preliminary analysis of various financial statements of IBM World Trade Corpo-

*The Committee were subsequently informed by the Department, in their note dated 3rd October, 1975, that necessary instructions (No. 846, F 491 S 74—FTD dated 16-1-75) had since been issued for the guidance of the assessing officers.

ration by the Cost Accounts Branch of the Ministry of Finance. This analysis had revealed that, on an overall basis, the return on the capital employed by the company amounted to 49 per cent, 58 per cent, 59 per cent, 74 per cent and 83 per cent respectively for the five years from 1968-1972.

3.28. This is yet another case relating to the assessment of a foreign company operating in India (IBM World Trade Corporation), which is a giant multi-national corporation, enjoying almost a virtual monopoly in computers and other data processing machines. The gist of the audit objection in this case is that instead of apportioning the deductions allowed on account of the head office expenses attributable to the operations of the Indian branch on a time-basis as and when the Indian branch became liable to bear the expenditure incurred on its behalf by the head office and then applying the exchange rate prevailing during the relevant periods, the Income-tax Officer had converted the dollar expenses for the whole of the calendar year 1966 at the post-devaluation rate. It has been pointed out by Audit that this failure to apportion the expenses to the pre-devaluation and post-devaluation periods had resulted in an excess allowance of expenses in the assessment of the Indian branch amounting to Rs. 7.46 lakhs and consequential short-levy of tax of Rs. 5.22 lakhs for the assessment year 1967-68.

3.29. The Committee note that the Audit objection has not been accepted by the Department of Revenue and Insurance mainly on the ground that in this case, the liability on account of expenses incurred by the head office of the Indian branch of IBM World Trade Corporation crystallised yearly at the end of the accounting period and not on different dates during the accounting period and, therefore, the deduction had to be allowed for a sum calculated at the exchange rates prevailing at the end of the accounting period. In support of this contention, the Department have stated that the company had 'affirmed' that the debits on account of head office expenses allocable to the Indian branch had been received only in December by a single debit note.

3.30. In the opinion of the Committee, this affirmation by the foreign company can at best be considered an after thought. No independent investigation appears to have been conducted in order to find out how often such debit notes had been received by the Indian unit of the company. Since the expenditure incurred by the head office was ascertainable, the logical and proper course in such a situation would be to value the liability of the Indian unit towards

head office expenses at various rates of exchange, on a time-basis, with reference to the periods when the liabilities actually arose. The Committee have also been informed by Audit in this connection that a similar objection relating to M/s. Harrison and Crossfield (P) Ltd. had been earlier accepted by the Ministry who had then conceded that the correct procedure would be to allocate the expenses on a time-basis and apply the conversion factor by splitting up such expenses into relevant periods. Under these circumstances, the Committee are unable to approve of the Ministry taking a different stand in the present case. The Committee desire that this case should be re-examined, in consultation with Audit and the outcome reported to them. Pending re-examination of the case, the assessment should be rectified as a measure of abundant caution, in the light of the Audit objection.

3.31. Apart from this instance of under-assessment, the broader issue of remittances made abroad by IBM World Trade Corporation year after year on account of head office expenses causes even greater concern to the Committee. The Committee find that in respect of the assessment years 1967-68, 1968-69, 1969-70 and 1970-71, the company had claimed Rs. 46.92 lakhs, Rs. 45.95 lakhs, Rs. 50.24 lakhs and Rs. 56.76 lakhs respectively towards head office expenses directly attributable to the company's Indian operations and that these claims had been admitted by the Income-tax Officers without any disallowance. Further, the remittances allowed by the Reserve Bank of India as head office expenses relating to the six year period from 1965 to 1970 total US dollars 40.06 lakhs and these claims are also stated to have been admitted by the Income-tax authorities. According to a study note prepared by the Department of Revenue and Insurance on 'Head Office Expenses', the deduction claimed by IBM World Trade Corporation on account of head office expenses for the assessment year 1969-70 worked out to 78 per cent of the book profits prior to the charge of these payments. If this is any indication of the quantum of remittances allowed in respect of this company, then it would follow that a major portion of the surplus earned by the company by its Indian operations has been allowed to be repatriated abroad tax-free. Such a situation has also been facilitated to a certain extent by the fact that no ceiling has been prescribed by Government on remittances towards head office expenses and whatever amount is admitted by the Income-tax authorities is allowed to be remitted abroad by the Reserve Bank of India.

3.32. It would appear that the claims preferred by the company have been readily accepted by the Income-Tax Officers without any

genuine scrutiny, and often the books of account of such multi-national corporations are not even called for and examined properly. The representative of the Department of Revenue and Insurance stated during evidence that 'in most of the cases or a large number of cases' it would not be possible for the Department to obtain the foreign accounts from the head offices of the companies for scrutiny. This is an impermissible situation, since our Income-tax Officers are driven to rely on the accounts certified by the company's own auditors or chartered accountants. This is a situation which needs to be rectified.

3.33. That the Income-tax Officers, however, had failed to make a proper assessment of amounts claimed by the company as head office expenses is also borne out by the company itself coming forward, in November 1974, with a voluntary disclosure under Section 271(4A)(ii) of the Income-tax Act, 1961, admitting an excess claim on account of head office expenses for the years 1966 to 1970 to the extent of US dollars 450 thousands and submitting amended tax returns. This is, indeed, a sad commentary on the functioning of our Income-tax Department.

3.34. In view of the far-reaching implications of the disclosure now made by IBM World Trade Corporation that 'certain errors in the principle of allocating Headquarters Expense to India had been detected by its head office in New York' and that 'the erroneous calculations had resulted in excess claim on account of Headquarter Expense' for the years 1966 to 1970, the Committee desire that all claims made by the company on this account relating to periods prior to 1966 and after 1970 should be subjected to a thorough scrutiny by the Investigation Cell set up by the Central Board of Direct Taxes to look into leading cases of tax evasion and malpractices. Besides, all the assessments of the company from 1960 to 1974 should also be strictly reviewed, with reference to the books of accounts of the company so as to establish the accuracy of the statements of receipts and expenditure and the genuineness of the allocation of expenditure between the Head Office of the company and the Indian unit and to ensure that no inadmissible expenditure is allowed to escape taxation and be repatriated abroad in foreign exchange. In case the review reveals that there has been a deliberate attempt by the company to evade taxes, stringent penal action under the law should be taken forthwith against the company, besides levying and collecting the tax on the income that has escaped assessment. The correctness of recognising this multi-national giant as a company under the Income-tax Act should also be looked into in detail. The Committee would

await a detailed report in regard to the action taken by Government on these recommendations.

3.35. The Committee also consider it rather significant that the application under Section 271(4A), admitting excess claims on account of head office expenses, had been made by the company after the Audit paragraph had appeared in the Report of the Comptroller and Auditor General of India and after the Committee had also probed into some of the Indian operations of IBM World Trade Corporation in their 127th Report (Fifth Lok Sabha) on the installation of IBM computers on Indian Railways, which was presented to the Lok Sabha in April, 1974. Besides, the affairs of the company have also been taken up for scrutiny by an inter-Ministerial Working Group constituted by the Department of Electronics. Under these circumstances, the Committee have grave doubts whether the disclosure made by the company only in November, 1974 could be treated as voluntary and not as one prompted by the fear of exposure. The Committee would, therefore, recommend that pending the completion of the comprehensive review suggested in paragraph 3.34 above, the application made under Section 271(4A) of the Income-tax Act should be kept pending so that the assessee company does not escape the consequences of penalty and prosecution proceedings for claiming excess expenditure in a manner which, prima facie, appears to be dubious and even deliberate.

3.36. Now that an inter-Ministerial Working Group has also been appointed to examine in detail the policies and procedures under which IBM World Trade Corporation operates in India, the Committee desire that the entire issue of head office expenses claimed by the company and the remittances made by it should be gone into by the Working Group with a view to quantifying, in concrete and specific terms, the extent to which the country's scarce foreign exchange resources have been frittered away and exposing all the devious methods employed by this multi-national corporation to the detriment of the country's wider national interest.

3.37. Another distressing feature which has come to the notice of the Committee during their examination is the virtually passive role played by the Reserve Bank of India in the matter of permitting remittances by foreign companies from India towards head office expenses. The Committee have been informed that the Reserve Bank does not undertake any scrutiny of the amounts applied for by foreign companies/banks towards remittances of head office expenses; nor does the bank call for a break-up of the items constituting the head office expenses. Prior to 1973, such remittances had been

allowed by the Reserve Bank on a provisional, on account basis, subject to the acceptance of the expenditure by the Income-tax authorities. From the year 1973 onwards, the Bank has, however, decided not to accept the claims on account of Head Office Expenses without the production of evidence by the foreign company/bank concerned that its claim that a part of the surplus is non-taxable—as being head office expenses chargeable to its Indian operations—has been accepted by the Income-tax authorities. Considering the fact that the scrutiny exercised in this regard by the Income-tax Officers appears to have been superficial and cursory, the Committee are doubtful how far the excessive reliance that is now being placed by the Reserve Bank on the Income-tax Department could be considered satisfactory. As the guardian of the country's scarce foreign exchange resources, the Committee feel that the Reserve Bank of India could and should play a more responsible and dynamic role in this regard. The Committee, therefore, desire that the adequacy of the existing procedures should be reviewed immediately and necessary measures taken to plug all loopholes in relation to operations by unscrupulous foreign investors.

The Committee would like Government to examine seriously how far remittances by foreign companies towards head office expenses should, if at all, be permitted, and the Reserve Bank should move positively in this matter and take appropriate action thereafter. In this context, the Committee consider it pertinent to draw the attention of Government to Article 2 of the UN Charter of Economic Rights and Duties adopted on 12th December, 1974 by the United Nations General Assembly, according to which each State has the right to regulate and exercise over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities and to regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies.

3.38. In paragraphs 9.13 and 9.14 of their 176th Report (Fifth Lok Sabha), the Committee had, inter alia, commented on the absence of any uniform guidelines for the assessing officers on the treatment of head office expenses for purposes of income-tax and had desired that guidelines in this regard, which were stated to be under finalisation on the basis of certain case studies and a study note prepared as early as August 1973, in consultation with a few Commissioners of Income-tax, should be finalised without further loss of time and necessary instructions issued to the assessing officers. The Committee have

been informed by the Department of Revenue and Insurance, in October 1975, that necessary guidelines in this regard had been issued only on 16 June, 1975. The Committee are perturbed over such egregious delay in taking a final decision on an issue which is vital both from the taxation and foreign exchange angles. The Committee would like very much to know the reasons for this delay and would reiterate their earlier recommendation that responsibility for it should be fixed for appropriate action. Now that the guidelines have at long last been issued, the Committee trust that real scrutiny of head office expenses by assessing officers would be facilitated and would produce the desired results. The adequacy of these guidelines should be reviewed later, on the basis of the experience gained in the field on their implementation, and such improvements, as are found necessary, effected. The Committee would keenly watch the effect of these guidelines on the assessing officers.

3.39. In view of the fact that there has been a substantial increase in the remittances made by foreign companies towards head office expenses during the years 1965—69, the Committee feel that it would be worthwhile for Government to review the veracity of the claims admitted during this period in respect of other foreign companies and banks as well. Since such a review is likely to yield rich dividends, the Committee desire that it should be undertaken forthwith, and would await a detailed report in this regard. It is, however, regrettable that the Central Board of Direct Taxes had not taken up so far a careful study of this problem with a view to ascertaining its magnitude and taking adequate steps to ensure proper tax compliance.

CHAPTER IV

DEPRECIATION AND DEVELOPMENT REBATE

Audit paragraph

4.1. A private limited company was manufacturing and selling nylon yarn. The nylon yarn was manufactured from 'caprolactum' which was imported from abroad. Till the assessment year 1969-70 the company claimed that manufacture of nylon yarn was petro-chemical industry and on that basis claimed development rebate at the higher rate of 35 per cent and also claimed tax-relief admissible for priority industries. These were allowed by the assessing officer for the assessment years 1967-68 to 1969-70.

4.2. In the assessment order for the assessment year 1970-71 the assessing officer, however, held that nylon yarn manufactured by the company, or caprolactum from which it was manufactured, could not be classified as petro-chemicals and as such it was not a priority industry eligible to get the benefits of higher development rebate or the relief aforesaid. These benefits and reliefs which were claimed by the company were accordingly correctly disallowed in the assessment year 1970-71. The irregular allowances for the earlier years resulted in wrong allowance of development rebate of Rs. 96,69,008 for these years and incorrect relief of Rs. 37,07,636 for the years 1967-68 and 1968-69. This resulted in short-charge of tax by Rs. 73,57,151 for the three assessment years.

4.3. This company filed its return of income for the assessment year 1968-69 on 22nd November, 1968, *i.e.*, late by 53 days for which it was liable to pay interest amounting to Rs. 1,55,192 under Section 139 of the Income-tax Act, 1961. The Department, however, levied interest of Rs. 1,04,874 only resulting in short-levy of interest of Rs. 50,318.

[Paragraph 18(a) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

4.4. Under the Income-tax Act, 1961, 'priority industry' which has been defined in the Act as one which carries on the business of generation or distribution of electricity or any other form of power

or of construction, manufacture or production of any one or more of the articles and things specified in the list in the Sixth Schedule, is entitled to the following concessions:

(a) a deduction @ 8 per cent of the profits and gains attributable to such industry under Section 80-E/I,

(b) development rebate at the higher rate of 35 per cent.

4.5. The Committee desired to know the nature of the business conducted by the assessee and the circumstances under which it was treated as a priority industry. The Committee also enquired whether it was not a fact that the assessee had manufactured nylon yarn from imported captrolactum and whether the manufacture of nylon yarn from imported caprolactum was a petro-chemical industry. The Member, Central Board of Direct Taxes stated:

"The assessee is J. K. Synthetics Ltd., dealing in nylon yarn. They were given the benefit of 80-E/I, as a priority industry for the years 1966-67, 1967-68 and 1968-69. The then ITO who made the original assessment consulted the Petroleum Research Institute, Dehra Dun and came to the conclusion that caprolactum and Nylon-6 which is made out of caprolactum is a petro-chemical and, therefore, it had to be given the benefits of a priority industry."

4.6. When the Committee asked whether the assessee company produced caprolactum, the witness replied:

"They did not produce caprolactum. It was an imported commodity. For 1970-71, the later Income-tax Officer went into the question *de-novo*. He held that the assessee was not eligible for this. We have taken necessary action to withdraw the relief already allowed and to carry out rectification in similar cases."

The Department of Revenue & Insurance, in a note furnished to the Committee in this regard, added:

"The assessee manufactures Nylon-6 yarn from captrolactum imported from abroad.

The 1967-68 to 1969-70 assessments were completed by the Income-tax Officer, Shri.. He allowed the assessee's claim that its undertaking was a priority industry for the purposes of higher development rebate under Section 33(1)

(a)(B) and deduction u/s 80-I of 8 per cent of the profits and gains admissible to a priority industry. Before making the assessments, he had made a reference to the Indian Institute of Petroleum, Dehra Dun to ascertain whether Nylon-6, manufactured from caprolactum was covered by the term 'petro-chemical' within the meaning of item 18 of the Sixth Schedule to the Income-tax Act. The Institute of Petroleum, gave its opinion, which according to Shri....was in favour of the assessee. He, therefore, accepted the assessee's claim.

The 1970-71 assessment was completed by another Income-tax Officer, Shri....who examined the claim afresh and held that manufacture of Nylon-6 from imported captrolactum was not a priority industry. Audit came on the scene after Shri....completed the assessment for A. Y. 1970-71. They observed that, as held in the assessment order for A. Y. 1970-71, the assessee's claim should also be disallowed in A. Ys. 1967-68 to 1969-70.

As already stated above, the assessee manufactures Nylon-6 yarn from imported caprolactum. Earlier, the question whether manufacture of nylon yarn from imported caprolactum was a priority industry was not free from doubt. The matter has since been examined thoroughly and detailed instructions have been issued in October, 1974 that an industry manufacturing Nylon-6 from imported caprolactum is not a priority industry."

4.7. The Committee desired to know whether the Central Board of Direct Taxes had, at any stage, advised the concerned Commissioner of Income-tax that the assessee company should be treated as a priority industry and in case such an advice was given, the basis therefor. They also enquired into the reasons for a subsequent rethinking on the subject. The Member, Central Board of Direct Taxes stated:

"The latter officer decided to disallow it and he wanted to consult the Commissioner. The Commissioner made a reference to us in December, 1972. It is a D.O. letter."

An extract from the letter read out by the witness is reproduced below:

"I am enclosing herewith a letter received by me from IAC, B Range, Kanpur along with a letter of the I.T.O. Special

Circle C Ward, Kanpur. The Managing Director of the assessee has also seen me in this connection.....I have also discussed the matter with the earlier I.T.O., Shri.... who had gone into this matter at some length last year and had contacted the Indian Institute of Petroleum, Dehra Dun, National Chemical Laboratory, Poona and the I.I.T., Kanpur. Shri....is also dealing with the case of Modipan Limited, in Central Circle III, Meerut, where manufacturing of Nylon-6 is similar. The point involved covers the interpretation of item 18 of the Sixth Schedule ....In my opinion the matter is not free from doubt. It appears that the Director of Indian Institute of Petroleum and Chemicals dictionary, have treated synthetic fibres or nylon-6 just as petro-chemical. However, the ITO in his report has mentioned certain other reasons to differ from the same."

4.8. As regards the decision of the Board on this reference, the witness stated:—

"The Board initially agreed with the view. The mater was discussed by the then Member with the Deputy Secretary of our Ministry. The final noting of the Deputy Secretary is:

'C.I.T. also informed that in the case of Nirlon Synthetic Fibre and Chemical Limited, assessed by the I.T.O., Commissioner's Circle II (6), Bombay, it was held that the Nirlon Yarn manufactured from caprolactum is a petro-chemical product entitled to relief under item 18. In the case of the J. K. Synthetics Ltd., also last year the assessee's point of view was accepted. Having regard to the point of the two technical institutes and to the interpretation that item 18 is to be bifurcated in two parts....'."

4.9. The Committee asked whether the intermediate products manufactured from imported basic products would come under item 18 of the Sixth Schedule and whether the concession under Section 80-E/I, could be extended to such intermediate products as Nylon-6. The Member, Central Board of Direct Taxes replied:

"Any intermediate product ought not to be treated as petro-chemicals."

When the Committee pointed out that, under these circumstances, the Commissioner of Income-tax should not have allowed the

concessions applicable to priority industries to J. K. Synthetics Ltd., the witness replied:

"That is our present view."

The Committee observed in this connection that this should have been the past view of the Board also, since it was obvious that the manufacture of intermediate products out of a basic petro-chemical could not be treated as a petro-chemical industry. The witness replied:

> "When the scientists expressed a view that Nylon-6 was also a petro-chemical, you would kindly appreciate our difficulty in not accepting it."

4.10. The Committee enquired whether the Ministry of Law had been consulted on this question and, if so, the advice given by that Ministry. The Department of Revenue and Insurance, in a note, stated:

> "The Law Ministry was consulted on 10th December, 1973. They advised that the question involved was largely of technical nature and it would be appropriate to consult the Chief Chemist, Central Revenue Control Laboratory, New Delhi."

As regards the advice given by the Chief Chemist, Central Revenues Control Laboratory, the Department stated:

> "The Chief Chemist was consulted on 11th December, 1973. He advised that Nylon-6 manufactured from captrolactum being a finished article, is not covered by the term petro-chemical referred to in Item 18 of the Sixth Schedule to the Income-tax Act."

4.11. The Committee desired to know whether other companies who were manufacturing Nylon Yarn from captrolactum had been allowed similar concessions. The Member, Central Board of Direct Taxes stated:

> "These are Century Enka, Garware Nylon, Shree Synthetics. We have no claims from them so far. Modipan preferred a claim, which has been disallowed. In the case of J. K. Synthetics it has been rejected for 1970-71. In this case this was allowed in the assessment orders pertaining to the years 1967-68, 1968-69 and 1969-70. In the case of

Nirlon Synthetics, it was originally allowed. Later we asked the Commissioner to take necessary measures to withdraw. The concessions have, therefore, been withdrawn."

He added:

"The Tribunal at Bombay has now allowed it and has considered it as a 'petro-chemical'. We are taking up the matter to the High Court."

The Department of Revenue and Insurance in a note subsequently furnished to the Committee in this regard, further stated:

"There were six other units manufacturing Nylon-6 yarn distributed in various Commissioners' charges. Out of these, two units have recently gone into production and the first assessment in these two cases will be for the year 1974-75 and 1975-76 respectively.

In other two cases the assessees did not claim that they were engaged in a priority industry.

In the fifth case, the claim for priority industry was allowed for and from A. Y. 1964-65. The Income-tax Officer had not allowed the claim at this stage. However, the assessee made an application for rectification u/s 154 on the basis of a certificate issued by the Indian Institute of Petroleum to the effect that manufacture of Nylon-6 is covered under item No. 18 of the Fifth and Sixth Schedules. However, before action could be taken by the Income-tax Officer on the assessee's application u|s 154, the Appellate Assistant Commissioner before whom an appeal was pending allowed the claim of the assessee as a priority industry on the basis of the same certificate from the Indian Institute of Petroleum filed before him.

In the sixth case the company manufactures Nylon-6. It made a claim for the first time in assessment year 1970-71 to be treated as a priority industry which was rejected by the Income-tax Officer. The ITO rejected the claim on the basis that the assessee did not adduce evidence to the effect that manufacture of Nylon-6 is a petro-chemical industry.

Detailed instructions have since been issued in December, 1973 that manufacture of Nylon-6 from caprolactum is not a petro-chemical. The field officers are expected to follow these instructions and apply them at all stages of assessment, appellate and other ancillary proceedings."

4.12. The Committee desired to know whether J.K. Synthetics Ltd., had filed any appeal in this case or any other case before the Appellate Assistant Commissioner and, if so, how the appeal had been disposed of. In a note furnished to the Committee, the Department of Revenue and Insurance stated:

"M/s. J. K. Synthetics had filed an appeal before the AAC against the assessment order for the assessment year 1970-71 and against the appellate order for the assessment year 1969-70 and order u/s 263 of the Additional CIT for the assessment year 1968-69 before the Income-tax Appellate Tribunal. All these appeals were pending in October 1974. The assessment for the assessment year 1970-71 was made by Shri....ITO. The appeal for the assessment year 1969-70 was decided by Shri ....AAC and the order u|s 263 for the assessment year 1968-69 was passed by Shri...., the then Additional CIT.

The appeal against the assessment order for the assessment year 1970-71 was disposed of by Shri....AAC on 31st October, 1974. The appeals against the appellate order for the assessment year 1969-70 and the order of the Additional CIT u/s 263 for the assessment year 1968-69 have not yet been disposed off by the Income Tax Appellate Tribunal."

4.13. As regards the effect of the decision of the Appellate Assistant Commissioner on Government revenue, enquired into by the Committee, the Department of Revenue and Insurance stated:

"As a result of this order (dated 31st October, 1974 for the assessment year 1970-71), there has been reduction in tax of Rs. 1,00,34,965. While the AAC has upheld the ITO's stand with regard to manufacture of Nylon Yarn-6 being not a priority industry and the assessee, therefore, being not entitled to higher development rebate and relief u|s 80-I, he has allowed substantial relief on other points. Both the assessee and the department have filed appeals before the I.T.A.T. against the AAC's order."

4.14. As regards the second point raised in the Audit paragraph relating to the incorrect levy of interest, under Section 139, for the late filing of the return for the assessment year 1968-69, the Committee were informed by Audit that while the objection had been accepted by the Ministry, the short-levy had, however, been worked out as Rs. 47,415 only on the ground that the interest was chargeable upto 21st November, 1968 (52 days) only. The Committee were also informed that as the return was filed on 21st November 1968, the assessee was liable to pay interest upto that date as interest was chargeable for each day of delay in filing of the return after 30th September, 1968 to the date of filing of the return *i.e.* 22nd September 1968 in this case.

4.15. The Committee desired to know whether the amount of interest had been correctly calculated upto the date of filing of the return and the additional demand collected from the assessee. The Department of Revenue and Insurance, in a note, stated:

> "The audit objection regarding the short-levy of interest of Rs. 50,318 u/s 139 for assessment year 1968-69 is acceptable. Earlier, an additional demand of Rs. 47,415 which represented interest upto the day preceding the date of filing of the return was raised. There was some doubt whether the date on which return was filed was to be excluded or not for the purposes of calculating the interest The Law Ministry have been consulted. They have advised that interest should also be levied for the day on which the return was filed. A further additional demand of Rs. 2903 (50,318—47,415) has been raised. Bulk of the total additional demand amounting to Rs. 47,415 has been collected."

4.16. The Committee asked whether these assessments had been checked by the Internal Audit. The Department of Revenue and Insurance, in a note, stated:

> "None of the three assessments were checked by Internal Audit Party. CIT has reported that the IAP Inspector forgot to check this case. The Commissioner has held that the Inspector did not take his duties seriously. He has been warned to be careful and avoid such lapses in future.
>
> This case was also liable to be checked personally by the Chief Auditor. However, it was not checked. The Chief Auditor has explained that he was looking after both internal and revenue audit and could not check

the case due to pressure of work. His explanation has been considered as plausible, but he has been advised to be careful in future."

4.17. The Committee enquired whether these assessments had been seen by the Inspecting Assistant Commissioner or the Commissioner of Income-tax. The Department stated in a note that the information was being gathered.

4.18. The Committee desired to know the present position of reassessment and recovery of tax in the cases relating to this company. The Department of Revenue and Insurance, in a note stated:

"The present position of reassessment and recovery of tax is as below:

Assessment year 1967-68.

Remedial action u/s 263 was taken on 29-12-1973. Assessee filed a writ petition. Allahabad High Court has Allowed the Writ petition on 7-5-1974, that ITO's order, in the circumstances of the case, had merged with the order of the AAC which was passed earlier to the order u/s 263. The Allahabad High Court has differed from the recent decision of the Gujarat High Court in the case of K. N. Patel (I.T. Journal—Vol. 22—4 p. 249). CIT has requested Departmental Counsel to file an appeal to the Supreme Court. The additional demand has been reduced to nil as a result of the High Court's decision.

Assessment year 1968-69.

An order u/s 263 was passed on 22-3-1974. The assessee has filed an appeal to the Tribunal, which is pending. The assessee has applied for stay of recovery. The company has been asked to furnish security for payment of the demand.

Assessment year 1969-70.

The original assessment has been set aside by the AAC. Fresh assessment is pending."

4.19. The Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts,

Volume I, Indirect Taxes had also contained a paragraph relating to the grant of a large refund of Central Excise duty amounting to Rs. 1.37 crores, on revision, to J. K. Synthetics Ltd., (paragraph 34 of the Report). The Committee desired to know whether the Central Board of Direct Taxes was aware of this fact and, if so, the action taken by the Board. The Department of Revenue and Insurance, in a note, stated:

> "The Board are aware that the assessee has received large refund of Central Excise. As per Audit para No. 34 of C&AG's Report for 1972-73 for Central Excise, the refund for the period 1st January, 1970 to 16th June, 1972 is Rs. 1.37 crores. The Commissioner has been instructed on 7th May, 1974 to look into this aspect and verify that refunds have been fully accounted for in the books and the income-tax returns."

4.30. The Chairman, Public Accounts Committee (1974-75) had received a representation on 16th December 1974, alleging certain improprieties committed by the Commissioner of Income-tax to favour J.K. Synthetics Ltd. The representation had, *inter alia*, alleged that the Income-tax Officer who had reopened this case and the Appellate Assistant Commissioner had been transferred. The Committee enquired into the factual position in this regard and the circumstances under which these transfers had been effected. In a note furnished to the Committee, the Department of Revenue & Insurance stated:

> "The Income-tax Officer who made the assessment for the year 1970-71 on 24th January, 1973 was Shri....He was appointed as ITO in Special Circle, C Ward on 25th August, 1972 on his transfer from Calcutta. He made a representation to CBDT on 15th August, 1973 for his transfer to Calcutta. He met the Chairman but his representation was rejected by the Board on 10th September, 1973. He applied for Earned Leave for 31 days from 3rd September, 1973 to 4th October, 1973 on grounds of illness of his wife but was allowed leave from 10th September, 1973 to 29th September, 1973. He again applied for extension of leave from 29th September, 1973. The charge was held during leave period from 10th September, 1973 onwards by Shri...., one of the seniormost ITOs of Kanpur Charge, who has now

been promoted as AAC and who was also at that time holding charge of Special Circle, A & B Wards.

Mr.....came back from leave on 23rd October, 1973 and applied again for extension of leave up to 9th November 1973 on account of mental disturbance. He explained that he was mentally upset due to non-acceptance of his application for transfer to Calcutta by the Board and would like to take further leave. In these circumstances, Shri....who was already holding this charge from 10th September 1973 in the absence of Shri....was asked to hold the charge in a substantive capacity and on return from leave, Mr....took over as ITO, Special Circle, A Ward, which was a comparatively lighter charge although it also had important cases like Swadeshi Cotton Mills Ltd., Muir Mills Ltd. and Bagla Group. Shri....held this charge till October, 1974 when he was promoted as AAC. The transfer of Shri....was, therefore, in the interest of work and in order that a senior ITO should hold continuous charge to dispose of all the time-barring cases in the charge.

Mr....did not reopen the case for 1970-71. The case was pending with him and was disposed of in the normal manner. After completing the assessment for 1970-71, he left a note that action under Section 263 would be taken for the earlier years with regard to the allowance of higher development rebate and relief u|s 80-I.

Till 26th November 1972, the AAC in this case was Shri ....On his being appointed as IAC in place of Shri....who was transferred to Ahmedabad, Shri....took over as AAC incharge of the case. Shri....continued till May 1973 when he was appointed as IAC, D Range in place of Shri....On his transfer here by Board's Orders F. No. 15/5/73-Ad. VI (Vol. III) dated 26th May 1973, Shri....took over as AAC, Special Range and had jurisdiction over this case. Mr.... continued here till his transfer to Lucknow as IAC under Board's Orders F.No. 15|5|73-Ad. VI (Vol. V) dated 19th October, 1973. The transfer was in no way connected with the proceedings in the case of J. K. Synthetics Ltd.

The AAC Shri....had heard the appeal for the year 1970-71 but could not proceed further as there was a writ filed by the assessee and the High Court passed an order staying the

proceedings. The writ was decided by the High Court on 6th October, 1974. The case was then heard and decided by the successor AAC Shri..... by his order dated 31st October, 1974 in which he has confirmed the ITO's stand about the assessee's being engaged as 'priority industry'. The Department's case thus has been upheld even by the successor AAC and the transfer of either the ITO or the AAC has not affected in any way the judgement of the successor AAC who has decided this particular point in favour of Revenue and an appeal is now pending with the Tribunal. The Department of course also has gone in appeal to the Tribunal on certain other issues involved."

4.21. Another representation dated 12th September, 1974 had also been received by the Chairman which referred to various alleged corrupt practices by the Commissioner of Income-tax. The Committee enquired into some of these allegations and the Chairman, Central Board of Direct Taxes stated in this connection in evidence:

"I wish to make a respectful submission in this regard and that is that a series of allegations have been made against this particular officer. Anonymous complaints have been received. Some complaints through Members of Parliament have also been received. These complaints are being investigated both by the CBI as well as the Department concerned. In the first instance, I think, we should leave this matter to the investigating agency."

4.22. The Committee view with concern the irregular extension of the benefits admissible to priority industries, under Section 80-E/1 of the Income-tax Act, and of higher development rebate permissible to the petrochemical industry, to a company (J. K. Synthetics Ltd.), controlled by a monopoly house, manufacturing nylon yarn, which is only a product derived from the petrochemical base, caprolactum. This has resulted in a short-levy of tax amounting to Rs. 73.57 lakhs for the three assessment years 1967-68 to 1969-70. In addition, an interest of only Rs. 1.05 lakhs had been levied, under Section 139 of the Income-tax Act, for the belated filing of the return of income for the assessment year 1968-69, as against Rs. 1.55 lakhs actually leviable.

4.23. The Committee find that a strange procedure appears to have been adopted in this case by the Income-tax Officer who made the original assessments for the years 1967-68 to 1969-70 by asking the Indian Institute of Petroleum, Dehradun, for a technical opinion on the subject when it would have been more appropriate to refer the

case, if there was any doubt, to the Chief Chemist, Central Revenues Control Laboratory, New Delhi. In fact, when the Chief Chemist was consulted subsequently, in December 1973, he had categorically opined that Nylon-6, manufactured from caprolac.um, being a finished article, was not covered by the term 'petrochemical' referred to in item 18 of the Sixth Schedule to the Income-tax Act. Expert opinion apart, it is evident, from the purely common sense point of view, that the manufacture of intermediate or finished products from a basic petrochemical, especially when the raw material base itself is manufactured elsewhere or is imported, cannot be deemed to be a petrochemical industry qualifying for the benefits of priority industries. If one were to apply logically the standard adopted in this case by the Income-tax Officer initially then almost every article or product manufactured out of petrochemicals should be subject to concessional rates of tax, which would be clearly against the letter and spirit of the concession given by the Parliament.

4.24. What is even more strange about the manner in which this case has been handled is that the Central Board of Direct Taxes should have also initially agreed with the assessment of J. K. Synthetics Ltd. as a priority industry. This was done on a reference made in this regard by the Commissioner of Income-tax, in December 1972, after another Income-tax Officer had correctly decided to disallow the claim of the company for the assessment year 1970-71. Though the reasons for the unusual enthusiasm shown in this case by the Commissioner of Income-tax are not entirely clear, having regard to certain serious allegations against the Commissioner of Income-tax that have been brought to the notice of the Committee and the influence known to be wielded by the monopoly group controlling the company, the Committee cannot help feeling that unseen forces have, perhaps, been at play in shaping the course of the case. The Committee would, therefore, like to be satisfied that no 'malafides' are involved and desire that a thorough probe should be conducted into the handling of the case at various stages and the conduct of the officials responsible for the mis-classification of the company as a priority industry and the consequential under-assessment of tax as well as the short-levy of interest for the belated filing of the return for the assessment year 1968-69. The results of the probe, which needs to be completed expeditiously, should also be intimated to the Committee early.

4.25. One redeeming feature of the case is that the mistake has now been set right, though belatedly, and detailed instructions have been issued in October 1974 that an industry manufacturing Nylon-6

from imported caprolactum is not a priority industry. The Committee also note that necessary steps have been taken to withdraw the relief already allowed and to carry out rectification in similar cases. The collection of the additional tax due in this case has, however, been thwarted by the assessee approaching the Income-tax Appellate Tribunal and Courts of Law. The Committee have been informed that the Appellate Tribunal has considered Nylon-6, manufactured out of caprolactum to be a 'petrochemical'. A writ petition filed by the assessee in the Allahabad High Court against the remedial action, under Section 263, by the Department for the assessment year 1967-68 has been allowed on the ground that the Income-tax Officer's Order, in the circumstances of the case, had merged with the order of the Appellate Assistant Commissioner which was passed earlier to the order under Section 263. The Committee learn that as a result of the High Court's decision, the additional demand has been reduced to nil and that Government propose to file an appeal in the Supreme Court. The Department also proposes to test the decision of the Income-tax Appellate Tribunal in the High Court. The Committe would urge Government to take all possible steps to expedite the appeal proceedings.

4.26. In this context, the Committee would once again draw the attention of Government to an earlier recommendation of theirs contained in paragraph 2.30 of their 128th Report (Fifth Lok Sabha), wherein the Committee, commenting on the tendency on the part of some assessees to frustrate the rectification of even patent mistakes by seeking legal remedies on mere technical grounds, had suggested that Government should examine whether any amendment to the Act was necessary to ensure that the rectification of patent mistakes was not frustrated by assessees on such technical grounds. The Committee had then been informed by the Department of Revenue & Insurance that a similar recommendation of the Direct Taxes Enquiry Committee (Wanchoo Committee), that revenue matters, in respect of which adequate remedies are provided in the respective statutes themselves, should be excluded from the purview of Article 226 of the Constitution, was being examined by Government. The Committee would like to be informed of the final decision, if any, in this regard. In case a decision is yet to be taken on this recommendation, the Committee desire that this should be processed on a priority basis and the necessary amendment made, as this would greatly facilitate the collection of revenue.

4.27. As regards the short-levy of interest for the belated filling of the return of income for the assessment year 1968-69, the Committee

have been informed that additional demands totalling Rs. 50,318 have now been raised and that bulk of the additional demand has also been collected. The Committee desire that early steps should be taken to recover the balance also.

4.28. It is also extremely distressing that none of the three assessments relating to this company had been checked by Internal Audit, despite the fact that the assessments related to a large income monopoly group. The familiar but entirely specious excuse that the assessments could not be checked by the Inspector concerned on account of forgetfulness and by the Chief Auditor on account of 'pressure of work', has once again been trotted out. The Committee gravely disapprove of such apathy on the part of the Department in regard to the important aspect of internal checking.

4.29. The Committee had also had occasion to examine separately the grant of a large refund of Central Excise duty amounting to Rs. 1.37 crores, on revision, to J.K. Synthetics Ltd. The Committee have been informed by the Central Board of Direct Taxes that the Commissioner of Income-tax had been instructed, on 7th May 1974, to look into this matter and verify that the refund had been fully accounted for in the books and the returns of income. A long time has passed since then, and the Committee would like to be apprised immediately of the results of the verification.

4.30. Incidentally, the Committee have received a representation alleging various corrupt practices on the part of the Commissioner of Income-tax concerned. The Committee have learnt from the Chairman, Central Board of Direct Taxes, in this connection that a series of allegations had been made against this particular officer and that these complaints were being investigated both by the CBI as well as the Department. While the Committee, naturally, would not express any opinion at this stage, they would, in view of the gravity of the charge and the status of the official, urge Government to complete the investigations without delay and take all appropriate action.

4.31. It has been alleged that the transfers of the Income-tax Officer who had reopened the case of J.K. Synthetics Ltd., and of the Appellate Assistant Commissioner, who had upheld the contention of the Income-tax Officer were mala fide. The Committee have carefully considered the factual position in this regard with the assistance of the Department of Revenue & Insurance. The Committee feel that they should, in general terms, impress upon Government the imperative need of ensuring that the assessing officers of a sensitive

area like the Income Tax Department have the confidence that conscientious and capable work would receive recognition and approbation merited by it and that deflection from the path of duty would not be countenanced. This is a principle of conduct which the top echelons of the Department should keep constantly in mind.

Audit paragraph.

4.32. A non-resident company carrying on its business in India, with its assets situated in India, filed its accounts in sterling pounds showing also the corresponding rupee figures. The depreciation schedule of fixed assets furnished by the company was all along kept in sterling. While the company actually reduced the sterling value of the fixed assets in its books of accounts to give effect to devaluation of the 'Rupee' on 6th June 1966 and of the 'Pound sterling' on 18th November 1967, similar reduction in their written down value in sterling in the depreciation schedule for income-tax purposes was not done. The assessing officer did not notice this omission and allowed depreciation to the extent of Rs. 2.19 crores leading to an underassessment of tax of Rs. 1,53,31,000 (approximately) for these three years. There was corresponding excess payment of interest of Rs. 48,56,849 for the three assessment years.

4.33. The Ministry have accepted (February 1974) the above position and intimated that a further report regarding rectification of the assessments and collection of demand will follow.

[Paragraph 18(c) of the Report of the Comptroller and Auditor General of India for the year 1972-73]

4.34. Section 32(1) of the Income-tax Act, 1961 provides for deduction on account of depreciation allowance on assets in the computation of income of an assessee engaged in any business and profession. Rule 5 of the Income-tax Rules, 1962 framed thereunder provides that depreciation should be calculated at a fixed percentage of the actual cost of the asset to the assessee or its written down value.

4.35. Though under the provisions of Income-tax Act, 1961 no obligation is cast to maintain books of account in Indian currency, but, when it comes to computation of income under the Income-tax Act, the provisions of the Income-tax Act and Rules are to be strictly adhered to. Under the Income-tax Rules, the form of return of Income has been statutorily prescribed. In the return of income, the profit or loss as per Profits and Loss Account alongwith additions and substractions is to be shown in terms of rupees. Similarly, the depre-

ciation and development rebate are also to be shown in terms of rupees in the Annexure provided. The resultant income under various heads is to be shown in terms of rupees in Part I of the Return of Income as specifically required.

4.36. The Committee were informed by Audit that the case reported in the Audit paragraph related to a non-resident company—Calcutta Electric Supply Corporation Ltd.—carrying on its business in India and having its assets situated in India.

4.37. The Committee desired to know the circumstances in which the mistake in this case was committed. The Department of Revenue and Insurance, in a note submitted to the Committee, stated:

> "The assessee company had along with its return of income submitted the depreciation schedules in Pound sterling. While preparing the depreciation schedules for income-tax purposes, the company did not start with the original rupee value of the assets for working out the written down value.
>
> The Income-tax Officer also did not notice this omission and did not prepare a depreciation schedule in terms of rupees showing the rupee cost of the assets, the written down value and admissible depreciation in rupees. Following the past practice, depreciation was computed with reference to the written down value in pound sterling. This resulted in excess depreciation being allowed for the assessment years under reference."

4.38. The Committee asked whether the Ministry had investigated into the case to ensure that the mistake was bonafide and whether there was any vigilence angle involved. The representative of the Department of Revenue and Insurance stated:

> "We called for the explanation of the ITOs who committed this mistake and then also asked the Commissioner to examine the bonafides."

The Department of Revenue and Insurance, in a not, further stated:

> "C.I.T., West Bengal—I was directed to look into this aspect of the case. He has reported that no *mala fides* can be attributed to the Income-tax Officers concerned."

4.39. When the Committee enquired whether the mistake was attributable to any new provisions having been made in the Act or the rules which were uintelligible to the assessing officers, the Department of Revenue and Insurance, in a note, replied:

> 'The mistake was in the computation of admissible depreciation allowance. It was not due to any new provisions having been made in the Act or the Rules."

4.40. The Committee were informed by Audit that the Central Board of Direct Taxes had issued instructions in November, 1972 for the avoidance of mistakes arising from the devaluation of the rupee. The Committee, therefore, enquired how the mistake had occurred in spite of these instructions. The Department of Revenue and Insurance, in a note, stated:

> "The assessments in this case for the three years under objection were completed on 15-10-1971, 21-12-1971 and 28-12-1972 while the Board's instructions referred to were issued later, *i.e.*, in November 1972."

4.41. The Committee drew attention to their recommendation contained in their earlier 117th Report (Fourth Lok Sabha) that in the course of the check of assessments by Inspecting Assistant Commissioners, the allowances made in the assessments on account of depreciation and development rebate should receive special attention and enquired whether these cases were checked by the Inspecting Assistant Commissioner or the Commissioner of Income Tax. The representative of the Department of Revenue and Insurance stated:

> "In this case the depreciation does not seem to have been checked."

In a note subsequently furnished to the Committee, the Department of Revenue and Insurance added:

> "The computation of depreciation was not checked in this case by the Inspecting Assistant Commissioner concerned. The Commissioner of Income-tax, West Bengal-I has reported that during the relevant period, the I.A.C. was holding additional charge of I.A.C. Establishment and due to heavy workload it was not possible for him to check depreciation."

4.42. The Public Accounts Committee (1973-74) had been informed by the Department of Revenue and Insurance that instructions

had been issued, in 1965, by the Central Board of Direct Taxes that all company assessments should be checked cent-per-cent by the Internal Audit. The Committee learnt from Audit that, despite these instructions, the assessments for all the three years in this case were not checked by Internal Audit. The Committee enquired into the reasons therefor, especially when the case related to a non-resident company whose income was in crores. The representative of the Department of Revenue and Insurance stated:

> "In Calcutta, the work relating to the checking of depreciation was allotted to a special ITO for this purpose. It was not done by the ordinary members of the Internal Audit Party staff."

He added:

> "In this case the assessment was reported to the Internal Audit Party, but could not be checked by them."

The Department, in a note, added:

> "The assessments were reported to the IAP but were not checked. Commissioner of Income-tax, West Bengal-I has reported that depreciation was required to be checked by an ITO who was especially assigned this task. As it was not possible for him to check all cases, he was picking up some files and checking them.
>
> It is correct that every company assessment is to be checked by the Internal Audit. The Board have since June 1972 introduced a system of *immediate Audit* and all company assessments are required to be checked within one month of the completion of the assessments."

4.43. To a question whether the Special I.T.O. was technically qualified so that he could understand the depreciation of a particular machine, the witness replied:

> "This does not require as far as I can see, any technical expertise because it has to be calculated according to the rates laid down in the rules, but this officer, I am told, is not an engineer."

4.44 When the Committee pointed out that but for the detection of this mistake by Revenue Audit, the exchequer would have lost

about Rs. 2 crores, the Chairman, Central Board of Direct Taxes stated:

> "We are extremely grateful to the Revenue Audit for having brought this case to our notice. Whatever revenue we are going to get out of this case, is entirely attributable to Revenue Audit. I am prepared to admit this because this was a clear case of what you may call negligence or oversight at all levels, Income-tax Officers and the Audit party."

4.45. The Committee enquired whether it was a fact that the subordinate staff of the Internal Audit Organisation were psychologically reluctant to find fault with the assessing Income-tax Officers, Assistant Commissioners and Commissioners under whom they might have to function at a future date. The witness stated:

> "I do not think this is the correct position. My experience as a Commissioner of Income-tax was that they were over-enthusiastic. They were trying to find fault where no fault lay."

4.46. The Committee desired to know when the company had submitted its returns of income. The representative of the Department of Revenue and Insurance stated:

> "The returns were filed on 28th December, that is, two months late for all the three years. No penal action was taken."

The Chairman, Central Board of Direct Taxes, added:

> "The penalty for late submission of return is 2 per cent of the tax payable for every month of default."

4.47. When the Committee asked the reasons for not taking penal action against the assessee, the Department of Revenue and Insurance, in a note, stated:

> "The Commissioner of Income-tax, West Bengal has reported that the assessee was allowed extension of time for three months by the Income-tax Officer. Besides, the advance tax paid in respect of the assessment years 1968-69 and 1969-70 exceeded the tax on the income eventually assessed in pursuance of orders under Section 263 of the Income-tax Act. Since the assessee company had generally been extending its co-operation in the past, the Income-tax Officer

would not have been justified in starting penalty proceedings for late filing of returns. The assessee is a Sterling Company and had its accounts audited in India as well as in United Kingdom. It had to wait for its U.K. Auditor's report before filing its return of income and was thus prevented by sufficient cause from filing its return in time."

4.48. To a question relating to the completion of the assessments, the representative of the Department of Revenue and Insurance replied:

"The return was filed on 28th December, 1967 and for 1967-68, the assessment was made in October, 1971."

4.49. When the Committee enquired into the reasons for the delay of about four years in completing the assessments of a giant non-resident company like the Calcutta Electricity Corporation, the Chairman, Central Board of Direct Taxes replied:

"The position is that the workload is such that despite giving heavy disposals, we are still carrying a very heavy backlog."

4.50. The Committee pointed out that the Department should have a system of disposals on a selective basis and desired to know whether instead of prescribing a specified number of cases as the target for each Income-tax Officer, it would not be better to fix the target with reference to the amount of revenue involved. The witness replied:

"This is very much in my mind and I propose to deal with this case in this manner. It is really a matter of regret that such large cases of income should not be disposed of by an Assistant Commissioner. We are very much conscious of this deficiency. We will try to see there is concentration on large income group cases by experienced officers. In certain cases, cases will be given to Assistant Commissioners also. We will see that the number of cases given is not large so that they are able to bring assessments uptodate."

4.51. The Committee asked whether it would not be better to entrust cases where the income was above Rs. 5 lakhs, to the Assistant Commissioners instead of to the Income-tax Officers. The witness replied:

"I would beg this limit to be left to me because I have got to assess the number of cases that would be involved in this and the manpower position. As a matter of fact since the time I gave this assurance to you, I have been thinking in my mind as to what should be the limit above which I should transfer cases to the Assistant Commissioners of Income-tax."

4.52. The Committee learnt from Audit that the Ministry had intimated in their letter dated 19th September, 1974 that remedial action under Section 263 had been initiated in this case and that instructions [No. 697(F. No. 2281|18|74-ITAII) dated 31-5-1974] had also been issued to all the Commissioners of Income-tax to instruct all the Income-tax Officers to maintain depreciation schedules in rupees and to see that all the assessees conformed to the requirements of the Income-tax Rules, as prescribed in the form of return of income. A review of old cases had also been ordered with instructions to submit a report on the results of the review to the Central Board of Direct Taxes by 10th July, 1974 positively.

4.53. The Committee asked whether the Ministry had received the reports on the review of past cases ordered in the Board's Instruction No. 697 dated 31st May, 1974 and, if so, they desired to know the number of cases in which this mistake had been detected and the tax effect. The Department of Revenue and Insurance, in a note, stated :

"The review has been completed and no other case except that of Calcutta Electric Supply Corporation has been reported."

4.54. The Committee enquired whether the re-assessments had since been completed. The representative of the Department of Revenue and Insurance stated :

"The re-assessments were made on 26th July, 1974. The demands raised after the Audit had pointed out the mistake are :

Assessment year	1967-68	..	Rs. 79,18,305
-do-	1968-69	..	Rs. 39,10,784
-do-	1969-70	..	Rs. 35,42,182

thus making a total of Rs. 1,53,71,271. In addition, there is an interest which was allowed at the time of original

assessment, amounting to Rs. 53.13 lakhs for all these three years."

4.55. When the Committee asked whether the additional demands raised had since been collected, the witness stated:

"Not yet. The collection has been stayed till the appeal against the Commissioner's order is decided."

4.56. The Committee wanted to know the steps that had been taken by the Department to expedite the appeal and to vacate the injunction. The Chairman, Central Board of Direct Taxes stated:

"There is no injunction in this order."

The Commissioner of Income-tax, West Bengal-I, aded:

"The case happens to fall in my charge. The assessments were set aside by the Commissioner of Income-tax under Section 263 of the Income-tax Act. The Income-tax Officer was directed to re-do the assessment. In one of the assessments, the additions have not been confined to taking back the excessive depreciation that was allowed; several other additions have been made. Substantial additions have been made. The assessee wanted the collections to be stayed till the disposal of its appeal to the Tribunal against the Additional Commissioner's order. Since the amount involved was very large and since there is a convention in all such cases of staying tax till first appeal and where there is a disputed question of law, the assessee contends in this case that it is entitled to calculate depreciation in sterling value and that the other additions that have been made by the I.T. Department are not correct. We requested the Tribunal to complete the hearing of the assessee's appeal as early as possible. We expect that by the end of June it will be disposed of."

4.57. To a question whether any security for the additional demand had been obtained from the company, the witness replied:

"So far as the Calcutta Electric Supply Corporation Limited is concerned, it had never defaulted. We have been able to collect all our demands."

He added :

> "The assessment orders weere passed in July 1974 and the Tribunal should be able to dispose of the appeal in another two months."

4.58. The Committee desired to know the reasons for the Stay. The witness stated during evidence :

> "Once a view has been taken, even if it is a wrong view, the Department cannot resile so easily. If time has been given, we are committed to it as a Department."

The Chairman, Central Board of Direct Taxes, stated:

> "If this amount had not been allowed earlier and disallowed later, there would have been absolutely no case for the stay of the demand. Here also if the Department took a very stern and rigid view of the matter, then the recovery can be pressed."

4.59. Since it had been stated earlier by the Commissioner of Income-tax, West Bengal-I that there was a convention, in all such cases, of staying the collection of tax till the finalisation of the first appeal, the Committee desired to know whether it was a written convention or a normal procedure. The Commissioner of Income-Tax stated:

> "In this particular case, the order in question *i.e.* the order under Section 263, was passed by the Commissioner of Income-tax. If it had been passed by the I.T.O., we might not have stayed it at all. Since what is disputed is the Commissioner's order, an appeal lies only to the Tribunal. We thought we should wait till the appeal was disposed of. If we want we can even now enforce the collection."

4.60. When the Committee enquired whether there were any arrears of tax due from the company on the original assessments, the representative of the Department of Revenue and Insurance replied in the negative. The Chairman, Central Board of Direct Taxes, added:

> "There was no self assessment tax due because they have paid more advance tax than the demand which was raised on them."

The Department of Revenue and Insurance, in a note furnished in this connection, further added:

"Assessment Year	Income returned	Income originally assessed	Income as per fresh assesssment.
	Rs.	Rs.	Rs.
1967-68 . .	3,68,03,280	3,59,88,509	4,79,09,920
1968-69 . .	3,69,25,320	3,39,16,054	3,94,11,570
1969-70 . .	1,78,02,660	1,88,19,035	2,37,89,860

The taxes levied for these years in the original assessments [under Section 143(3)] were fully paid by assessee."

4.61. Subsequently, the Central Board of Direct Taxes, in their D.O. letter dated 14th February 1975, informed the Committee as follows:

'You will recall that during the sitting of the PAC on 25-1-1975 the question of recovery of the tax arising out of the Audit Objection was raised by the Chairman of the PAC. On behalf of the Ministry it was mentioned that the disputed demand was kept in abeyance till the disposal of the first appeal, as it was the usual Departmental practice to do so. However, the Commissioner of Income-tax, West Bengal, who was also present, agreed to consider revocation of stay and enforcement of recovery of arrears. The Commissioner of Income-tax on careful examination of the entire issue has reported that the Income-tax Appellate Tribunal having agreed to hear the company's appeal on the 17th, 18th or 19th February 1975, further action had better be kept pending till the appeal order. In the circumstances the Commissioner feels that it may not be appropriate to revoke the stay, especially in view of the fact that the appeals are likely to be heard in a few days time. A copy of D.O. letter CESC1/74-75 dated 10-2-1975 from the Commissioner of Income-tax is enclosed herewith for perusal.

On behalf of the Ministry, I hasten to assure you that all possible steps will be taken to expedite the hearing

of the appeal and recover the arrears due, as expeditiously as possible. I shall also let you know the further developments in this case shortly."

4.62. The D.O. letter No. CESC-1/74-75 dated 10th February, 1975 from the Commissioner of Income-tax, West Bengal-I, referred to above, is reproduced below:

"The amount of tax outstanding against the Calcutta Electric Supply Corporation Ltd., at present is Rs. 1,74,95,796 after adjustment of refund to the extent of about Rs. 29.5 lakhs. The entire demand relates to 1967-68, 1968-69 and 1969-70 assessments reopened u|s 263 of the Income-tax Act. The bulk of the demand has resulted from the reduction in depreciation effected by computing depreciation with reference to the cost of the company's assets in rupees and withdrawing the excessive allowance of which the company had wrongly availed by computing the depreciation in sterling even after the devaluation of the sterling and the rupee. Part of the demand also covers additions other than disallowance of excessive depreciation claim made by the assessee company. The Tribunal have agreed to hear the relevant appeals against the orders passed by the Additional Commissioner of Income-tax u|s 263 on the 17th, 18th or 19th February. The assessee company, whom I asked to pay up the entire demand after my return from Delhi last month, expressed inability to do so on the ground of lack of funds and also its dispute of the additions in the assessments made in pursuance of the Additional Commissioner's orders u|s 263. The company agreed, however, to arrange for the necessary funds to meet all the demands other than those relating to disputed disallowance like provision for gratuity, after the disposal of its appeal by the Tribunal. In the circumstances, it is doubtful whether, at this stage, I can cancel the order I have passed permitting stay of the disputed demand till the disposal of the Tribunal appeal. There is a risk of the company's going to the High Court and getting an injunction, if I do so. I shall let you know the position as soon as the Tribunal's decision on the pending appeals is known. I shall request the Tribunal to let us have their orders immediately after the hearing, in view of the large amount of demand that is locked up in the appeal.

Incidentally the company has been representing that a substantial amount of refund—about Rs. 20 lakhs—pertaining to the assessments for 1962-63 to 1966-67 has not been issued to it and that it has also not passed so far for the refund because of its own dues to the Department. I have instructed the Income-tax Officer to calculate the refund due to the company immediately and adjust it against the outstanding demand."

4.63. In their subsequent letter dated the 6th March, 1975 the Department of Revenue and Insurance informed the Committee as follows :

"Out of the outstanding demands, Rs. 80.07 lakhs have since been collected as under :

(1) Adjustment of refund for assessment year 1970-71	Rs. 25·16 lakhs.
(2) Adjustment of refund for assessment year 1971-72	Rs. 32·04 lakhs
(3) Received by cheque on 5-3-1975 . .	Rs. 22·87 lakhs.
	Rs. 80·07 lakhs.

Steps are being taken to collect the balance."

4.64. When asked to indicate the latest position in this regard at a subsequent sitting of the Committee held on 15th March, 1975, the Commissioner of Income-tax, West Bengal-1 stated:

"The total demand raised in the three assessments namely 1967-68, 1968-69 and 1969-70, aggregated to Rs. 2,05,12,199. We have so far collected during the last two months Rs. 1,05,53,717, by adjustments of refunds and also by cash realisation. This leaves us with the balance of Rs. 99,58,482. In regard to this I would like to make two submissions. We have made protective assessments and realised taxes to the extent of about Rs. 29 lakhs under this assessment. This amount of Rs. 29 lakhs relates to interest. It relates to interest which accrued to the assessee by reason of excess payment of advance taxes in these three years. So when we have reopened these assessments for enhancing the income originally assessed, the question of advance

interest does not arise. The assessee should refund interest amount of about Rs. 50 lakhs received by it. Meanwhile pending decision in the appeals against the reopened assessments, we were not in a position to modify the returns filed by the assessee itself. We made the assessment accordingly on the basis of the returns and also recovered the taxes relating to the interest. We have thus about Rs. 29 lakhs relating to protective assessments which is not due to us. We cannot have it both ways. We cannot say that the old assessments are untenable and at the same time, keep with us what is not due to us. The tax due namely Rs. 99 lakhs include about Rs. 29 lakhs which we are holding in trust or custody till the matter is settled in the court. This will leave with a demand of only about Rs. 70 lakhs. They were disputing the liability on certain legal grounds. We have disallowed certain reserves. There are two judgements of the Kerala High Court and the Bombay High Court in favour of the Electric Supply Undertaking, Out of Rs. 2.05 crores, we have already collected about Rs. 1.05 crores. The balance that remains is Rs. 99 lakhs and out of Rs. 99 lakhs about Rs. 29 lakhs are with us. We are holding the amount under some other head. It leaves Rs. 70 lakhs to be collected. The Tribunal has already heard the appeal. The hearing took place in the middle of the last month. We expect the orders to be issued in a few days."

4.65. The Committee desired to know the advance tax paid by the assessee company for the assessment year 1967-68. The witness stated:

"In 1967-68, the advance tax demand amounting to Rs. 3,16,20,061 was fully paid. Adjustments and refund of advance tax etc. were Rs. 57,26,654. They paid on 5th March, 1975 Rs. 10,62,236. The assessment for the year 1967-68 was made on Rs. 4,79,00,000 and odd. The tax demanded was Rs. 3,32,60,000 and odd. The tax paid amounted to Rs. 2 crores 22 lakhs."

4.66. The Committee asked when the original assessment was completed. The witness stated:

"The first assessment for 1967-68 was made on the 15th October, 1971, that for 1968-69 on the 21st December, 1971 and the assessment for 1969-70 on the 28th February, 1972. All the three reassessments were made on the same day *viz.* 26th

July 1974. As far the additional demand raised in these assessment the position was as follows:

1967-68	Rs.	1,09,84,989
1968-69	Rs.	51,36,525
1969-70	Rs.	43,90,865
	Rs.	2,05,12,199

The tax that remains outstanding out of the above is about Rs. 99,58,482 consisting of the following:

1967-68	Rs.	42,02,159
1968-69	Rs.	22,69,556
1969-70	Rs.	34,86,767
	Rs.	99,58,482

About Rs. 30 lakhs has been collected by adjustment of interest payable to the assessee under Section 214 against demands raised through protective assessments in the year 1972-73. The balance that is strictly realisable from the assessee is, therefore, about Rs. 69 lakhs."

4.67. The Committee enquired whether the Central Board of Direct Taxes did not have full powers to issue instructions to the Income-tax authorities to enforce recovery of taxes due. The Chairman, Central Board of Direct Taxes stated:

"The Board does not come into the picture in regard to realisation. The Board does not enforce statutorily any demand raised under the Income-tax Act. The Board has no statutory authority to enforce recovery. We are barred from issuing instructions."

When asked as to what was the function of the Board if they could not expedite or enforce collections, the witness stated:

"The Section reads like this:

'The Board may from time to time issue such orders and instructions and directions to other income-tax authorities as it may deem fit for the proper administration of the Act and such authorities and all other persons employed in the execution of this Act shall observe and follow

such orders, instructions or directions of the Board provided that no such orders, instructions or directions shall be issued, (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a proper manner or so as to interfere with the discretion of the Assistant Appellate Commissioner in the exercise of the appellate functions.'

We do issue instructions to the Commissioners of Income-tax in an executive manner. But here also all that we could do and did was to request the Commissioner of Income-tax for the recovery. Watching and enforcing collection in general is a different thing. But in the matter of assessments the Board cannot direct; we can only ask the Commissioner to get the recovery effected. We ask the officers in the field to make the maximum collection out of the arrears and then we go about it. These are general instructions which we are entitled to give."

4.68. The Committee desired to know the reasons for the delay in rectifying the mistake pointed out by Audit in April, 1973. The Department of Revenue and Insurance, in a note, stated:

"A proposal to invite proceedings under Section 263 of the Income-tax Act was sent by the Income-tax Officer in May 1973 soon after the receipt of the half margin memo from Revenue Audit. The Additional C.I.T. passed an order under section 263 on 25th September, 1973 setting aside the assessment. The fresh assessment was completed on 26th July, 1974 after giving the assessee sufficient opportunity of being heard.

The fresh assessments could not be completed earlier for the following reasons:

(1) The assessee took considerable time to compile depreciation schedules for three years on the lines suggested by Audit.

(2) The assessee made several fresh claims in each year aggregating Rs. 25 to 30 lakhs.

(3) The case has been heard on nine different dates after giving the time required by the assessee to collect materials in support of its claims.

(4) The assessee furnished the actual valuation report in support of claims for gratuity provision only on 15th July, 1974."

4.69. Pointing out that the proposal for initiating proceedings under Section 263 of the Income-tax Act had been mooted by the Income-tax Officer in May, 1973 on receipt of the half margin memo from Audit and that order under Section 263 had, however, been passed by the Additional C.I.T. only on 25th September, 1973, *i.e.*, after 4 months, the Committee wanted to know the reasons for this delay. In a note submitted to the Committee, the Department of Revenue and Insurance stated:

"The request for revision of the assessments for 1967-68 to 1970-71 under Section 263 was made by the Income-tax Officer on 28th May, 1973. The proposal was forwarded by the Inspecting Assistant Commissioner to the Additional Commissioner of Income-tax on 4-6-1973. The Additional Commissioner wanted clarification about appeals, if any, pending before the Appellate Assistant Commissioner on 25th June, 1973. The clarification was furnished by the Income-tax Officer on 6th July, 1973. The Additional Commissioner took some time to study the case papers. The case was fixed for statutory hearing on 17th September, 1973. The relevant assessments were set aside and the Income-tax Officer was directed to make fresh assessments after properly scrutinising the assessee's depreciation claim, among other things, by the Additional Commissioner's order dated 25th September, 1973. The Additional Commissioner concerned was burdened with large number of applications under Sections 263 and 264 and he was charged in addition with the responsibility for scrutinising the orders of Appellate Assistant Commissioners and filing Departmental appeals to the Tribunal where necessary. He had also to attend to all reference applications under Section 256(1) and 256(2) besides Supreme Court appeals. The time gap between the submission of the proposal to the Additional Commissioner and the passing of orders by him does not appear to be unduly long or unusual in these circumstances."

4.70. Since it had been stated during evidence that the orders of the Appellate Tribunal on the appeal filed by Calcutta Electric Supply Corporation Ltd. were expected 'in a few days', the Committee, on 29th March, 1975, addressed the Department of Revenue and Insurance to indicate the final orders of the Tribunal, if passed, in this

regard. In a note, the Department informed the Committee as follows:

> "The Income-tax Appellate Tribunal have not yet passed orders on the appeal of the Calcutta Electric Supply Corporation."

4.71. The Committee desired to know (i) when the hearing in this case had been completed (ii) the reasons for the delay in passing orders and (iii) how much more time was likely to be taken by the Tribunal to pass orders. In their d.o. letter F. No. 236/330/73-A&PAC II dated 18th April 1975, the Department of Revenue and Insurance informed the Committee as follows:

> "On contacting the Commissioner of Income-tax, West Bengal I am given to understand that till today the Tribunal has not passed orders on the Corporation's appeal. The hearing was concluded on 17th February, 1975. The reasons for the delay and how much more time is likely to be taken by the Tribunal is not known to us."

4.72. The Chairman, Public Accounts Committee addresed the Finance Minister in this regard on the 19th April 1975, bringing the facts of the case to his notice and requesting him to look into the case personally and ensure that the Tribunal passed their orders on the appeal immediately. A copy of this letter is reproduced in Appendix-II.

4.73. On the 2nd May 1975, the Department of Revenue and Insurance, in their d.o. letter F. No. 236/330/73-A&PAC.II informed the Committee as follows:

> "In continuation of my above letter I wish to inform you that the Commissioner of Income-tax, Calcutta has reported by telex that the Tribunal have passed orders on the 30th April, 1975 dismissing the appeals of the Calcutta Electric Supply Corporation against the orders passed by the Additional Commissioner of Income-tax under Section 263 of the Income-tax Act, 1961.
>
> The Commissioner of Income-tax is being directed to expedite the collection of the demand outstanding, if any."

The Finance Minister also confirmed this position, in his letter dated 7th May, 1975, which is reproduced in Appendix III.

Deposits received from subscribers

4.74. The Committee desired to know the quantum of deposits made by the subscribers to Calcutta Electric Supply Corporation Ltd. and the interest paid by the Corporation to them on these deposits. The Committee also enquired whether it was a fact that the company was investing these deposits in its own business and paying a much lower rate of interest to its consumers. The Commissioner of Income-tax, West Bengal-1 stated:

> "So far as consumers' deposits are concerned, there are two aspects. So far as income-tax is concerned, they borrow at higher rates. They will make substantial profits. There is no question about it."

4.75. When the Committee pointed out that it was understood that the company practically paid no interest and made considerable profits by reinvesting the subscribers' deposits for which the company did not have to offer any security, the witness replied:

> "There you are right. They have appropriated it towards their profit. They have taken it from the consumers' deposit account to the general reserves. It ranges from one or two lakhs of rupees to Rs. 87,000. We have the figures for the last eight years. We have assessed this particular amount in 1972-73 when it came to our notice."

He added:

> "Their contention is that the deposits are of a capital nature and that the consumers are entitled to go to them and ask for refund when they no longer need the power supply."

4.76. The Committee enquired whether this did not amount to concealment of income. The witness replied:

> "I would not call it a deliberate concealment. It is avoidance in a sense. We are reopening the earlier assessments. We are issuing straight away a penalty notice for 1972-73."

He added:

> "We have taxed them for 1972-73 and for the earlier years also we will simultaneously bring the transferred deposits within the tax net and start penalty proceedings. But penalty depends on how far we are able to convince the appellate authorities. So far as we are concerned, we shall take the view that concealment is effectively established."

4.77. The Ministry of Irrigation and Power, in a note furnished to the Committee in this connection added:

"The information in regard to the quantum of deposits made by the consumers of the Calcutta Electric Supply Corporation and the interest accrued or paid by the Corporation on these deposits as shown in the audited accounts of the Corporation for the last 5 years is as under:

Year	Consumers' security deposits	Interest accrued or paid thereon
	(Rupees in lakhs)	
1969-70	367·93	9·93
1970-71 . . .	389·35	10·88
1971-72	411·76	12·62
1972-73	443·70	14·25
1973-74	476·75	15·57"

Payment of rebate to consumers

4.78. Referring to the provision in the Electricity Act, according to which profits made in excess of the permitted limit have to be given back to the consumers in the shape of a rebate, the Committee enquired whether Calcutta Electric Supply Corporation was covered by this provision and whether it had distributed the excess profits to its consumers in the form of rebate. The Department of Revenue and Insurance, in a note, replied:

"The Commissioner of Income-tax, West Bengal-I has reported that the assessee company has pointed out that the company had not made excess profits and as such was not required to give rebate to the consumers in the form of lower charges. It has been explained that its profits for the financial years 1968-69 to 1973-74 fell below the standard rate to which it was entitled as an Electric Supply Undertaking under the 6th Schedule of Electricity

(Supply) Act, 1948. In this regard, the assessee company has furnished the following particulars:

(Rupees in lakhs)

Financial Year	Reasonable Return	Profit excluding withdrawals from contingency reserve	Shortfall
1968-69 . .	205·10	161·76	43·34
1969-70 . .	211·34	141·71	70·13
1970-71 . .	213·17	105·71	107·46
1971-72 . .	219·13	138·87	80·26
1972-73 . .	228·93	102·66	126·27
1973-74 . .	222·36	2·05	220·31''

The Ministry of Irrigation and Power, in a note furnished to the Committee in this regard, stated as follows:

"Sub-paragraph II(1) of the Sixth Schedule of the Electricity (Supply) Act, 1948, provides as under:

'If the clear profit of a licensee in any year of account is in excess of the amount of reasonable return, one-third of such excess, not exceeding five per cent of the amount of reasonable return, shall be at the disposal of the undertaking. Of the balance of the excess, one-half shall be appropriated to a reserve which shall be called the Tariffs and Dividends Control Reserve and the remaining half shall either be distributed in the form of a proportional rebate on the amount collected from the sale of electricity and meter rentals or carried forward in the accounts of the licensee for distribution to the consumers in future, in such manner as the State Government may direct'.

It may thus be seen that authority for issuing direction to the Licensee Company in the matter of distribution of excess profit is vested in the State Government. Disputes, if any, in this regard between the State Government and

the Corporation are to be referred to the Central Electricity Authority constituted under Section 3 of the Electricity (Supply) Act, 1948 in terms of paragraph XVI of the Sixth Schedule to that Act. So far, no such dispute has been referred for arbitration either by State Government or the Company to the Central Electricity Authority.

Year-wise details of the 'clear profit' and the 'reasonable return' as defined in the Sixth Schedule to the Electricity (Supply) Act, 1948 and applicable to the Calcutta Electricity Corporation as shown in the audited accounts of the Corporation are indicated in the table given below:

Sl. No.	Year	Reasonable* Return	Clear Profit*
		(Rupees in lakhs)	
1.	1969-70	222·45	141·71
2.	1970-71	223·77	140·71
3.	1971-72	219·13	138·87
4.	1972-73	228·94	157·66
5.	1973-74	222·35	107·04

*As defined in the Sixth Schedule to the Electricity (Supply) Act, 1948.

It would be seen from the above table that during the years 1970-71 to 1973-74 the clear profit did not exceed the reasonable return permitted under the Electricity (Supply) Act, 1948.

However, as per the audited accounts of the Corporation the amounts indicated below has been shown under consumers rebate Reserve for the various years:

Year	Amount Rs.
1	2
31st March, 1952	Nil.
31st March, 1953	7,49,557
31st March, 1954	7,49,557
31st March, 1955	7,49,557
31st March, 1956	7,49,557

1	2
31st March, 1957	24,55,970
31st March, 1958	24,55,970
31st March, 1959	24,55,970
31st March, 1960	71,14 633
31st March, 1961 . . .	71,14 633
31st March, 1962	41,79,696
31st March, 1963	31,10,252
31st March, 1964	31,10,252
31st March, 1965	36,61,159
31st March, 1966	36,61,159
31st March, 1967	47,10,603
31st March, 1968	76,45,598
31st March, 1969	71,14 685
31st March, 1970	71,14,685
31st March, 1971 . .	71,14,685
31st March, 1972	71,14,685
31st March, 1973	71,14,635
31st March, 1974 . . .	71,14,685

As mentioned earlier under the provisions of the Act, the State Government is to prescribe the manner in which the Consumer's Rebate Reserve is to be distributed."

4.79. This case is one more instance of a non-resident, foreign company (Calcutta Electric Supply Corporation Ltd.), with a returned income of over Rs. 9 crores for the three assessment years 1967-68, 1968-69 and 1969-70, benefiting substantially from negligence and oversight, at all levels of the Income Tax Department, in the computation of the depreciation allowance admissible to it. The Committee have been informed that the company had all along submitted its depreciation schedules in Pound sterling along with its returns of income. While preparing the schedules for Income-tax purposes, the company did not, however, start with the original rupee value of

its assets for working out their written-down value. Surprisingly, the different Income-tax Officers who assessed the company to tax did not also notice this anomaly and prepare a depreciation schedule showing the cost of the assets, their written-down value and the admissible depreciation in terms of rupees. Instead, in accordance with the past practice in this regard, they computed the depreciation with reference to the written down value in Pound sterling, even after the devaluation of the Rupee in June 1966. This resulted in excess depreciation being allowed to the company, for the three assessment years, leading to an under-assessment of tax of Rs. 1.53 crores and corresponding excess payment of interest, amounting to Rs. 48.57 lakhs, on the advance tax paid by the company. This simple but costly mistake could have been avoided with a little more vigilance and care. The Committee find that the assessment for 1967-68 had been completed only on 1st October, 1971, even though the return of income had been filed on 29th December, 1967. Similarly, the assessments for 1968-69 and 1969-70 were completed on 21st December, 1971 and 28th February, 1972 respectively. It is evident that proper attention had not been paid to the timely assessment of a large income company. The Committee take a very serious view of this egregious and expensive lapse.

4.80. The Committee find it even more disturbing that these assessments were checked neither by the Inspecting Assistant Commissioner concerned nor by Internal Audit. It has been stated by the Department of Revenue & Insurance that during the relevant period, the Inspecting Assistant Commissioner was holding additional charge of establishment and that due to 'heavy work-load', it was not possible for him to check the depreciation allowed in this case. Further, even though instructions had been issued by the Central Board of Direct Taxes, as early as 1965, that all company assessments should be checked cent-per-cent by Internal Audit and depreciation was also required to be checked by an Income-tax Officer specially entrusted with the task, the assessments for all the three years, though reported to the Internal Audit Part, could not be checked. The Committee learn from the Department that as it was not possible for the Special Income-tax Officer to check all cases, he was picking up some files, apparently at random, and checking them. The Committee would very much like to know the basis on which cases were selected for scrutiny by the officer, for it is incomprehensible how a case in which the depreciation allowance amounted to as high a sum as Rs. 2.19 crores could have escaped his notice.

4.81. In cases with large revenue implications, such as the one under examination, the Committee cannot countenance what appears

to be a casual approach on the part of the officials concerned. Neither can the Committee accept the plea of 'pressure of work' or 'overwork'. A system which allows for such explanations itself stands condemned. As has been pointed out by the Committee, in paragraph 3.63 of their 128th Report (Fifth Lok Sabha), it is upto Government to see that proper arrangements are made to ensure effective compliance with their instructions and to carefully assess the work-load, keeping in view the quality aspect, so as to provide adequate staff commensurate with the work-load involved. Having due regard to the revenue involved in the present case, the Committee must recommend a close investigation into the circumstances leading to the deplorable failure, at all levels of the Department, to detact the mistake pointed out by Audit, and also fixation of responsibility for appropriate disciplinary action.

4.82. The Chairman of the Central Board of Direct Taxes has been good enough to admit before the Committee that whatever revenue Government would get out of this case is entirely attributable to Revenue Audit. However, Government should not merely rest content with acknowledgement of error and paying a graceful tribute to Audit for having done its duty. What is required, when such dereliction is brought to light through test check by Audit, is a more positive approach, a determined gearing up of the entire machinery for genuine scrutiny of all such cases, and purposeful investigation with a view not only to rectification of errors but also to forestalling them. The Committee are unhappy that the steps so far taken by the Ministry of Finance and the Central Board of Direct Taxes to ensure effective compliance with their own instructions and those issued at the instance of the Committee in the past, particularly those relating to the computation of depreciation and development rebate, leave much to be desired.

4.83. In this context, the Committee recall their oft-repeated concern over the large number of cases of under-assessment of tax on account of incorrect allowance of depreciation, commented upon in successive Audit Reports and Reports of the Committee year after year. It is disturbing that despite the Committee having made a number of suggestions in this regard, many of which had also been accepted by Government for implementation, there appears to be no perceptible improvement in the situation. The Committee have attempted a review, in some detail, of the implementation by Government of the recommendations made by the Committee during the past decade relating, among other things, to depreciation and development rebate in their 186th Report (Fifth Lok Sabha). The Committee are confident that if the measures suggested by them in this

Report are implemented by Government, they would bring about significant improvement in the work of the Income-tax Department.

4.84. Another unhappy feature of the case under scrutiny is that the collection of the additional tax due from Calcutta Electric Supply Corporation should have been kept in abeyance by the Commissioner of Income-tax till the disposal of the first appeal filed by the company before the Income-tax Appellate Tribunal. The Committee are distressed that an extra-legal concession, and that too without obtaining any security for the additional demand, should have been extended to a defaulting but powerful and long entrenched foreign company on the basis of what has been described as 'the usual departmental practice'. The Chairman of the Central Board of Direct Taxes as well as the Commissioner of Income-tax, West Bengal-I, have admitted, before the Committee that if the Department wanted to and did take 'a very stern and rigid view of the matter', the recovery could be pressed and enforced. The Committee desire that principled action, even on occasion, 'very stern and rigid', should be taken, which, it is feared, did not happen in this case. It would be of interest to know in how many cases a similar concession had been extended, if only as a matter of convention, by the Income-tax Department to the multitude of small assessees.

4.85. Besides, though the Commissioner of Income-tax had agreed, during evidence, to consider revocation of the stay and enforcement of recovery of the arrears, it required some positive intervention by the Committee to ensure that a considerable demand was realised partly by cash and partly by adjustment of refunds due for the assessment years 1970-71 and 1971-72. It appears however, that an amount of Rs. 70 lakhs was still to be recovered from the company as on 15th March, 1975. Now that the appeals of Calcutta Electric Supply Corporation against the orders of the Additional Commissioner of Income-tax, under Section 263 of the Income-tax Act have been dismissed by the Appellate Tribunal, the Committee desire that the balance of tax due should also be recovered forthwith, in case this has not already been done.

4.86. The unduly long time taken by the Income Tax Appellate Tribunal in passing final orders also causes concern to the Committee. Even though the hearing in this case had concluded on 17th February, 1975, the Tribunal took over two months to pass orders. Here again, the Committee had to enter in to protracted correspondence with Government to ensure that he orders were announced expeditiously. The facts of the case had also to be brought to the notice of

the Finance Minister himself before the orders were finally announced on 30th April, 1975. It is strange that the Tribunal should have taken so much time, after the conclusion of the hearings, to give its verdict even in important cases involving large revenues, when the very objective of setting up such Tribunals was to reduce the time spent in litigation in courts of law and to expedite decisions in revenue matters. The Committee would like Government to consider the feasibility of prescribing a suitable time-limit for the Appellate Tribunal to pass final orders after the conclusion of the hearing.

4.87. Yet another important issue arising out of the examination by the Committee is the appropriation by the company of the deposits made by the consumers towards the profits of the company and their transfer to its general reserves. Since this is tantamount to tax-avoidance, as the Commissioner of Income-tax himself conceded, the Committee take a very serious view of this default. The Committee learn that the transferred deposits have been taxed for the assessment year 1972-73 and penalty proceedings initiated. The assessments for the earlier years are also being reopened simultaneously with penalty proceedings. The Department has taken the stand that in this case concealment has been effectively established. Since what rightly belongs to the consumers and was held in trust by the company has been utilised by it for its own gains without any corresponding benefit to the consumers, the Committee insist that this should be looked into from the tax angle on a top-priority basis, under the direct supervision of the Commissioner and the Central Board of Direct Taxes, and stringent action, under the law, taken. In the present climate, when concerted drive is already under way to combat tax evasion, this should not be too difficult a task.

4.88. The practice of receiving deposits from consumers is also prevalent in other public utility organisations. Since it is likely that such deposits might have also been appropriated by such organisations towards their own profits and transferred to their general reserves, the Committee desire that a review of all such cases should also be undertaken from the tax angle and necessary rectificatory action taken. The Central Board of Direct Taxes should issue general instructions in this regard for the guidance of the asssessing officers in the light of the facts disclosed in the present case.

CHAPTER V

AVOIDABLE OR INCORRECT PAYMENT OF INTEREST BY GOVERNMENT

5.1. The Board issued instructions in April 1966 directing the Income-tax Officers to complete regular assessments as soon as possible after receipt of the returns so that excess of advance-tax paid could either be adjusted against the demand or refunded to the assessee. In 1968, the Act has been amended so as to provide for provisional assessment for grant of refund of advance-tax paid in excess. The purpose of the instruction and the amendment is to avoid situations where Government may have to pay interest to the assessee.

5.2. A company submitted its income returns for the assessment years 1967-68 and 1968-69 on 15th November, 1967 and 26th September, 1968 respectively, showing Rs. 1,74,24,840 and Rs. 42,04,722 as incomes for the respective previous years. The company had paid advance-tax of Rs. 2,12,08,655 and Rs. 80,00,000 in respect of these assessment years and the advance-tax so paid exceeded the taxes payable on the basis of the incomes returned. The first hearing for the assessment year 1967-68 was taken up on 24th January, 1972 and that for the assessment year 1968-69 on 2nd February, 1972, i.e. after a period of about 4 years from the dates of submission of the returns. On completion of regular assessments, interest of Rs. 18,74,837 and Rs. 21,55,053 was paid on account of excess payment of advance-tax. Had regular/provisional assessment for refund of excess payment of advance-tax been made by the Department promptly after receipt of the returns, payment of interest on the excess advance-tax paid could have been avoided.

5.3. The Ministry in their reply (February 1974) have accepted the omission so far as it relates to the assessment year 1968-69 and for the assessment year 1967-68, they have stated that as Section 141-A relating to the provisional assessment was introduced with effect from 1-4-1968 only it was not applicable for the assessment year 1967-68. However, under the Board's instructions in 1966, regular assessment itself should have been completed expeditiously.

[Paragraph 22(a) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

5.4. Under Section 141-A of the Income-tax Act 1961, as applicable from 1-4-1968, in a case, where a return of income has been filed under Section 139 of the Act and the assessee claims that the amount of tax paid in advance exceeds the tax payable on the basis of the return and if in the opinion of the Income-tax Officer, the regular assessment of the assessee is likely to be delayed, the Income-tax Officer may proceed to make, in a summary manner, a provisional assessment of the sum refundable to the assessee, on the basis of such return of income and the documents accompanying the return. The objective sought to be achieved thereby is to reduce or save a part of the interest which becomes otherwise payable under Section 214 on completion of regular assessment at a distant date.

5.5. Prior to the assessment year 1968-69, the Central Board of Direct Taxes in their instruction F. No. 12/91/65-IT(B) dated 16-4-1966 directed the Income Tax Officers to complete the regular assessment as soon as possible after the receipt of the return so that the excess of advance tax paid could either be adjusted against demand or refunded to the assessee. Although Section 141-A was introduced with effect from 1-4-1968 (assessment year 1968-69), being a procedural section, it is applicable to cases where returns are filed after 1-4-1968 as well as to those where returns were filed before 1-4-1968, but where no proceedings were started before that date by way of provisional or regular assessments. Further, under Section 141-A, as amended by the Taxation Laws (A) Act, 1970, the Income-tax Officer is bound to make a provisional assessment where the tax paid by way of tax deducted at source and by way of advance tax, is more than the tax payable on the basis of the return and where the Income-tax Officer does not make an assessment under Section 143 within six months from the date of receipt of the return. This being a procedural amendment was applicable to all the cases pending as on 1-4-1971.

5.6. The Committee were informed by Audit that the assessments commented upon in the Audit paragraph related to Indian Iron & Steel Co. Ltd.

5.7. Pointing out that even though the assessee company had filed its returns of income for the assessment year 1967-68 on 15th November 1967, the first hearing was held only on 24th January 1972, the Committee desired to know the circumstances under which the first hearing of the case was held after 4 years from the date of submission of the return and the assesments had been kept pending for so long and the reasons for the Income Tax Officer not following the

provisions of Section 141-A of the Income-tax Act and the Board's instructions dated 16th April, 1966. The Department of Revenue & Insurance, in a note, stated:

> "The Ministry is of the view that in so far as the question of making provisional assessments under Section 141-A is concerned, there has been no lapse. In terms of the provisions of Section 141-A, provisional assessment for refund under this Section can be made in law in a case where the assessee has made a claim that the advance tax paid by him or the tax deducted at source in his case exceeds the tax payable on the basis of the return of income filed by him and the statement of accounts, documents etc. accompanying it. No such claim was made by the assessee in the present case.
>
> The Ministry, however, agreed that there has been an inordinate delay in the taking up and finalisation of the regular assessments. The Commissioner of Income-tax has reported that the assessments were delayed on account of heavy pendency of workload and frequent changes of ITOs due to, among others, promotions as Assistant Commissioners."

5.8. The Committee learnt from Audit that the regular assessments for the assessment years 1967-68 and 1968-69 were completed only in February 1972. As this was an instance where the assessments in respect of a large income group had been completed only towards the close of the limitation period, the Committee desired to know whether the Board had enquired into the reasons for the delay in making the assessments. The Department of Revenue & Insurance, in a note, stated:

> "The Board has enquired into the reasons for the delay in the making of these assessments. The reasons for the delay as reported by the Commissioner of Income-tax are as stated above. However, the Board is not satisfied and has instituted disciplinary proceedings against the officer responsible for the delay."

5.9. To another question whether the Department had fixed responsibility for such a heavy loss of revenue, the Department of Revenue & Insurance, in a note, replied in the affirmative and added that regular disciplinary proceedings had been instituted against the officer concerned.

5.10. The Committee desired to know whether these cases had been seen by the Internal Audit and if so, whether they had raised any objection and in case the assessments had not been checked by the Internal Audit Party, the reasons therefor. The Department of Revenue & Insurance, in a note, stated:

> "These assessments were not seen by the Internal Audit before these were scrutinised by Revenue Audit. The reason was that Internal Audit was preoccupied with checking cases of other Wards. In any case, the audit objection pertains to the delay in the making of regular assessment and this objection would not have been avoided even if these assessments had been checked by the Internal Audit before these were scrutinised by Revenue Audit."

5.11. Since the case pertained to a large income group, the Committee enquired whether these assessments had been seen by the Inspecting Assistant Commissioner or Commissioner of Income-tax. The Department of Revenue & Insurance, in a note submitted to the Committee, stated that these assessments were not seen by the Inspecting Assistant Commissioner or by the Commissioner of Income Tax before these were looked into by Revenue Audit.

5.12. A number of instances of delays in completing assessment had also come to the notice of the Committee earlier and the attention of the Government had been repeatedly drawn by the Committee to the tendency on the part of Income-tax Officers to rush through assessment work in the last month of the financial year or postpone them till they are about to become time-barred. For instance, in paragraph 1.9 of the 17th Report (Fourth Lok Sabha), the Committee had observed as follows:

> "The Committee would like to draw special attention to the fact that the total value of assessments completed in the last month (March) of the financial year 1965-66 represened approximately 29 per cent of the total value of assessments completed further, nearly 40 per cent of the value of assessments in the last month were completed in the last seven days of March each year. This is clearly indicative of the fact that the department is not planning its work properly and that a large number of cases are rushed through in the last month and indeed in the very last week of the financial year. The Committee would like Government to take effective measures to ensure that ITOs plan their programme in such a way that assess-

ment of cases involving large incomes is not crowded into the last month and the last week of the year."

Again in paragraph 1.32 of their 117th Report (Fourth Lok Sabha), the Committee had observed:

> "While under assessments have been caused by a multiplicity of reasons, an important contributory factory, in the opinion of the Committee, has been the tendency on the part of many ITOs to delay and rush through assessments at the close of the financial year. During the course of discussions on individual Audit paragraphs, the Committee noticed that quite a number of cases in which mistakes or irregularities occurred had been rushed through in the months of February, March. The representative of the Board also conceded that the Income-tax Department tended to work at a 'snails pace' in the initial months of the financial year. The Committee have already drawn attention to this matter in their previous Reports and would like Government to take effective steps to curb this tendency so that work is evenly spaced out over the year."

In paragraph 2.50 of the 51st Report (Fifth Lok Sabha), the Committee had pointed out as follows:

> "The rush of assessments in March 1967 was partly responsible for this failure. The Commitee wish to reiterate their often repeated suggestion that assessments in high income brackets should as far as possible be completed earlier in the year."

Yet another recommendation in paragraph 1.72 of the 119th Report (Fifth Lok Sabha) reads as follows:

> "The Committee have received an impression that the ITOs act with alacrity where they want to and other cases are put off till these are about to become time-barred. The figures reported in paragraph 7(iv) of the Report of the C&AG (1971-72) speak elequently of the utter lack of planning. The number of assessments completed during 1970-71 and 1971-72 was as low as 59,688 and 57,408 respectively in April and 55,078 and 55,737 respectively in May and it started rising gradually thereafter. The number of assessments completed in the month of March during these years was 5.37 lakhs and 4.94 lakhs respectively. That the performance is so poor in the beginning of

a year despite the carry-over of the pending assessments to the extent of over 12 lakhs in number shows that some thing is seriously wrong somewhere. The Committee would like to be informed of concrete measures taken to improve the rate of disposal of cases in the beginning of the financial year and to eliminate the undue rush towards the end of the financial year."

5.13. To a question whether the interest of Rs. 40.30 lakhs paid to the assessee had been duly assessed to tax, the Department of Revenue & Insurance, in a note, replied that the interest was chargeable to tax in the assessment for the year 1972-73 and that it had been assessed to tax in that year.

5.14. Pointing out that the company had filed its return for 1967-68 on 15th November 1967, the Committee enquired whether any penal interest was levied for the late filing of the return. The Department of Revenue & Insurance, in a note, stated:

"No penal interest has been levied because—

(a) in terms of the provisions of clauses (ii) and (iii) of the Proviso under Section 139(1) as it stood at the relevant time, penal interest would have been chargeable only if the return had been filed after first of January 1968. The return having been filed before the said date, no penal interest was chargeable in law for the delay in the filing of the return.

(b) The assessment had resulted in a refund. Even if the assessee were liable to penal interest for late filing of return, the amount of the penal interest leviable would have been nil.

In this connection, the Committee were informed by Audit that under clauses (ii) and (iii) of the Proviso to Section 139 (1), as it stood at the relevant time (Assessment year 1967-68), the date for the filing of the return could be extended upto 31st December, 1967, without charging interest, only on an application made in this regard by the assessee. In the present case, the return had been filed on 15th November, 1967 and no penal interest would have been leviable only if the assessee had applied for the extension of time for filling the return and the Income Tax Officer had allowed it. However, since the assessment had resulted in

a refind and no tax was determined to be payable, no penal interest could be charged."

5.15. The Committee deplore the inordinate delay of about four years that had occurred in the finalisation of assessments of a company (Indian Iron & Steel Co. Ltd.) in the large-income bracket, as a result of which Government had to pay a large sum of Rs. 40.30 lakhs as interest to the assessee under Section 214 of the Income-tax Act. The Committee find that even though the assessee company had filed its returns of income for the assessment years 1967-68, and 1968-69 on 15th November 1967 and 26th September 1968 respectively, disclosing incomes of Rs. 1.74 crores and Rs. 0.42 crore, the assessments were completed by the Income-tax Officer only in February 1972, and that even the first hearing for the assessment year 1967-68 was taken up as late as 24th January 1972 and that for the assessment year 1968-69 on 2nd February 1972. As the amounts of advance tax of Rs. 2.12 crores paid for the assessment year 1967-68 and Rs. 0.80 crore for the assessment year 1968-69 for exceeded the tax payable on the basis of the respective returns of income, the Committee are of the view that the Income-tax Officer should have safeguarded the financial interests of Government by completing the regular assessments as soon as possible after the receipt of the returns so that the advance tax paid in excess could have been refunded to the assessee, in terms of the Board's instructions dated 16th April 1966. That the Income-tax Officer did not do so would indicate that the Officer concerned had negligent in the discharge of his duties.

5.16. The Committee learn that disciplinary proceedings have been initiated against the Officer responsible for the delay in the present case. The Committee desire that these proceedings should be completed quickly and the final action taken against the officer intimated to them.

5.17. The Committee note the view taken by the Department of Revenue & Insurance that there had been no lapse in this case in so far as the question of making provisional assessments under Section 141A was concerned. The Committee have been informed in this connection that provisional assessment under this Section could be made in law only in a case where the assessee had made a claim that the advance tax paid by him or the tax deducted at source in his case exceeded the tax payable on the basis of the return of income filed by him and the statement of accounts, documents, etc. accompanying it, and that since no such claim had been made by the assessee in the present case, it would not be covered by the provisions of Section

141A. However, with a view to ensuring that adequate steps are taken to prevent avoidable payment of interest by Government in such cases, the Committee would suggest that Government should examine the feasibility of making provisional assessments by Income-tax Officers obligtatory in cases in which the advance tax paid exceeds the income returned substantially.

5.18. The delay in finalising the assessments in this case had also not been noticed by the concerned Inspecting Assistant Commissioner or the Commissioner as the case never came into their orbit. All large income cases, however, are expected to be reviewed by the supervisory officials. The only inference the Committee can thus draw from the failure of the Inspecting Officers is that the middle management in the Income-tax Department is somewhat lax. The Committee fear that if this continues, the maladies of the Department would persist. It is, therefore, urged that the Central Board of Direct Taxes should review seriously the duties and responsibilities at present entrusted to the Inspecting Assistant Commissioners and the effectiveness of the supervision exercised by them, with a view to evolving suitable remedial measures.

5.19. The Central Board of Direct Taxes should also devise immediately a fool-proof system for a regular and more efficient monitoring of the progress of assessments relating to large income cases and tighten the inspection machinery. The Directorate of Inspection and the Board have an inescapable obligation in this regard. In this context, the Committee reiterate their earlier recommendations in regard to the persistent tendency on the part of Income-tax Officers to complete assessments only towards the close of the limitation period. Apart from the loss that may arise on payment of interest in cases like the one discussed in the preceding paragraphs, the Committee fear that by so rushing through assessments, there is the greater risk of the returns not being scrutinised properly and consequential loss of revenue through inadequate examination.

CHAPTER VI

SURTAX

Audit paragraph.

6.1. In the Income-tax assessment of a company for the assessment years 1966-67, 1970-71, 1971-72 and 1972-73, Rs. 5,25,582, Rs. 11,79,990 Rs. 1,61,47,836 and Rs. 1,26,93,891 were allowed as deductions from the respective total income, with consequent relief in the tax chargeable on the income in those assessment years. But the capital computed under the Sur-tax Act for the aforesaid assessment years was not reduced proportionately. This resulted in excess computation of capital by Rs. 10,66,33,049 with consequent short-levy of sur-tax by Rs. 26,88,138 for the assessment years 1966-67, 1970-71, 1971-72 and 1972-73.

6.2. The Ministry have relied (January 1974) that the assessments in question are being rectified for the assessment years 1970-71 to 1972-73 and that no action is possible for the assessment year 1966-67 as the same has already become time-barred. Further report from the Ministry is awaited (March 1974).

[Paragraph 27(a) (i) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes].

Background Information

6.3. Under the Companies (Profits) Sur-tax Act, 1964, Sur-tax is leviable on the amount by which the chargeable profits exceed the amount of statutory deduction. The statutory deduction [Section 2(8)] is an amount equal to 10 per cent of the capital of the company computed in the manner laid down in the Second Schedule to the Sur-tax Act or an amount of Rs. 2 lakhs, whichever is greater.

6.4. Rule 4 of the Second Schedule to the Companies (Profits) Sur-tax Act, 1964 lays down:

> "Where a part of the income, profits and gains of a company is not includible in the total income as computed under

the Income-tax Act, its capital shall be the sum ascertained in accordance with rules 1, 2 and 3, diminished by an amount which bears to that sum the same proportion as the amount of the aforesaid income, profits and gains bears to the total amount of income, profits and gains."

6.5. Under this rule, where an item of income earned by a company is not includible in its total income for purposes of levy of income-tax, the capital of that company for the purposes of the Sur-tax Act should be reduced proportionately, the proportion being what the non-includible amount of income bears to the total income. The underlying idea of this rule is that the entire capital of a company would have been utilised for earning full income. If a portion of the income is excluded from levy of tax, as a corollary, proportionate capital should also be excluded while calculating the amount of standard deduction.

6.6. In the Sur-tax assessments of a company (Union Carbide India Ltd.) for four years (1966-67 and 1970-71 to 1972-73), the assessing officer correctly excluded the deductions admissible under Sections 80E/I (Profits of Priority Industries), 80J (Profits of New Industrial undertakings) and 80 MM (Exempt Royalty) of the Income-tax Act from chargeable profits. But the amount of the capital was not propertionately reduced as required under Rule 4 of the Second Schedule to the Companies (Profits) Sur-tax Act, 1964. This, according to the Audit paragraph, led to an excess statutory deduction under Section 2(8) of the Sur-tax Act and consequent under-charge of Sur-tax of Rs. 26,88,138 for these four years.

6.7. The Committee desired to know whether remedial action had been taken for the assessment years 1970-71 to 1972-73 and if so, the additional demand raised and recovered. The Department of Revenue & Insurance, in a note submitted to the Committee, stated:

"The dates of completion of remedial action and the figures of additional demand raised year-wise are as below:

Assessment Year	Date	Amount
		Rs.
1970-71 . . .	22-1-1974	6,31,351
1971-72 . . .	18-5-1974	16,21,206
1972-73 . . .	18-5-1974	13,09,521
		35,62,078

The difference between the above amount of additional demand raised by the Income-tax Officer and the additional demand of Rs. 26,10,050 worked out by Audit for the above three years is on account of rectification of items other than those covered by the Audit paragraph.

Out of the additional demand raised by the Income-tax Officer, the only demand outstanding is Rs. 13,09,521 relating to Assessment Year 1972-73. This demand has been stayed pending the Tribunal's decision on the assessee's appeal against the remedial order u/s 16."

6.8. The Committee asked when the assessment for the assessment year 1966-67 was completed. The Department of Revenue & Insurance, in a note, stated:

"The first sur-tax assessment for Assessment Year 1966-67 was completed on 8-9-1969. Re-assessment u/s 8(a) of the Sur-tax Act has been completed on 10-9-1974."

6.9. To a question as to when the Audit memo was issued in this case, the Department of Revenue & Insurance replied that it was issued on 13th March 1973. The Committee desire to know the period upto which remedial action under Section 13 of the Sur-tax Act was permissible. The Department of Revenue & Insurance, in a note, stated:

"For Sur-tax Assessment Year 1966-67, remedial action under Section 13 was permissible upto 7-9-1973."

6.10. When asked as to why remedial action under Section 13 could not be taken in time in respect of assessment year 1966-67 to safeguard against the loss of revenues, the Department of Revenue & Insurance, in a note, stated:

"Action u/s 8(a) of the Sur-tax Act has been taken in time and the reassessment has been completed on 10-9-1974 raising a demand of Rs. 78,071 which is practically the same as the additional demand of Rs. 78,088 worked out by Audit. The question of any loss of revenue does not arise."

6.11. The Committee enquired whether these cases had been checked by the Internal Audit Party. In case this had not been

done, the Committee desired to know the reasons for the ommission. The Department of Revenue & Insurance, in a note, stated:

> "The sur-tax assessments were not checked by the Internal Audit Party. The Superviser of the IAP has been warned to be careful in ascertaining the cases he was required to check and check them in time.
>
> At the relevant time, the Chief Auditors were also required to personally check these assessments. They could not check them due to pressure of work. Their explanation has been accepted by the Commissioner.
>
> Inspectors have since been posted in the IAPs in place of Supervisors. New posts of Income-tax Officers (Internal Audit) have also been sanctioned to personally check important cases."

6.12. The Committee are concerned to note that while correctly excluding the deductions admissible under Section 80E/I, 80J and 80MM of the Income-tax Act from chargeable profits, the Assessing Officer had failed, in this case relating to a foreign company (Union Carbide India Ltd.) to reduce proportionally the amount of the capital as required under Rule 4 of the second Schedule of the Company (Profits) Sur-tax Act 1964, which led to an excess statutory deduction under Section 2(8) of the Act and consequent under-charge of sur-tax of Rs. 26.88 lakhs for the assessment years 1966-67, 1970-71, 1971-72 and 1972-73. That such a mistake should have occurred despite the clear and unambiguous rules framed in this regard would indicate that the assessing officer had not exercised care in finalising the assessments. The Committee would like the circumstances leading to this mistake to be gone into and appropriate action taken thereafter.

6.13. The Committee understand that remedial action, under Section 13, has been taken in respect of the assessments relating to the years 1970-71, 1971-72 and 1972-73 and necessary additional demands raised. For the assessment year 1966-67, while no remedial action under Section 13 was possible, on account of the assessment having become timebarred, action under Section 8(a) of the Act has, however, been taken in time and an additional demand of Rs. 78,071 raised.

6.14. The Committee find that the Audit Memo in this case had been issued on 13th March 1973 and remedial action under Section 13 of the Act in respect of the assessment year 1966-67 was permissible up to 7th September 1973. If the Department had, therefore, taken

prompt action on receipt of the Audit query, the rectification for the assessment year 1966-67 could also have been made under Section 13 before the assessment became time-barred. The Committee take a serious view of the delay in initiating action on Audit objections, and desire that responsibility for the failure should be fixed and the action taken intimated early to the Committee. A suitable time-limit for initiating rectificatory action in such cases should also be prescribed, in consultation with the Comptroller and Auditor General of India.

6.15. The Committee also view seriously the lapse on the part of the Internal Audit in not checking the assessments. Even though the Chief Auditors themselves were required to personally check these assessments, they had not done so and the failure on their part has been, as usual, attributed to 'pressure of work'. The Committee regret to observe that the same familiar excuse is offered by the Department time and again, which is only indicative of a definite weakness in the existing machinery for internal audit. The Committee need hardly emphasise the importance of a sound and efficient internal audit organisation and desire that the adequacy of the existing arrangements for internal audit should be reviewed in detail and necessary remedial steps taken.

6.16. In this connection, the Committee find that in all such cases where serious lapses have been found, Government merely rest content with obtaining an explanation from the concerned officials and issuing a warning. This ritual, in the opinion of the Committee will neither help the Administration nor the exchequer. The Committee are of the view that a more positive and dynamic procedure has to be evolved in this regard so that punishments are graded according to the magnitude and seriousness of the lapse committed by the officials and the positive action taken even in two or three cases acts as a deterrent to others. The Committee are also of the view that where there has been a failure or lapse in the discharge of responsibility by an officer at any level, he should be proceeded against rather than some petty officials working under him.

6.17. The Committee would also like to be informed of the final decision of the Income-tax Appellate Tribunal on the assessee's appeal against the additional demand of Rs. 13.10 lakhs relating to the assessment year 1972-73.

Audit paragraph.

6.18. When a portion of the general reserve is utilised for issuing bonus shares, the increase in the paid-up share capital is preceded by

an equivalent reduction in the reserves. In other words, the capitalisation of the general reserve means only a mutually compensating readjustment as between two elements both forming part of the capital of the company and does not result in any increase in the capital of the company for the purpose of sur-tax assessment.

6.19. In a case, a company issued bonus shares of Rs. 2.50 crores during the previous year relevant to the assessment year 1967-68 by utilising a part (Rs. 1,50,68,493) of the accumulation of its general reserve. While computing the statutory deduction allowable in the sur-tax assessment of the company for 1967-68, a sum of Rs. 1,50,68,493 was, however, added to the capital of the company as on the first day of the previous year. This resulted in excess computation of the amount of statutory deduction by Rs. 15,06,849 and consequent short-levy of sur-tax of Rs. 5,27,397

[Paragraph 27(d) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II—Direct Taxes]

Background Information

6.20. Under the Companies (Profits) Sur-tax Act, 1964, Sur-tax is leviable on the amount by which the chargeable profits of a company exceed the amount of statutory deduction. The statutory deduction [Section 2(8)] is an amount equal to 10 per cent of the capital of the company computed in the manner laid down in the Second Schedule to the Sur-tax Act or an amount of Rs. 2 lakhs whichever is greater The capital for this purpose is computed in accordance with the Rules in the Second Schedule to the Act. According to Rule 1, the capital of a company shall, include, as on the first day of the previous year relevant to the assessment year, its paid-up share capital, certain reserves, debentures and long term borrowings Rule 3 of the Second Schedule, however, provides:

> "Where after the first day of the previous year relevant to the assessment year, the capital of a company as computed in accordance with the foregoing rules of this schedule is increased by any amount during that previous year on account of increase of paid-up share capital or issue of debentures and borrowing of any moneys referred to in clause (v) of Rule (1) and is reduced by any amount on account of reduction of paid-up share capital or redemption of any debentures or repayment of any moneys, such capital shall be increased or reduced, as the case may be, by a sum which bears to that amount the same propor-

tion as the number of days of the previous year during which the increase or the reduction remained effective bears to the total number of days in that previous year."

6.21. The Committee learnt from Audit that the case commented upon in the Audit paragraph related to Gwalior Rayon Silk Manufacturing (Wvg.) Co. Ltd., a company belonging to a monopoly group.

6.22. The Committee desired to know the circumstances in which the mistake had occurred in this case. The Department of Revenue and Insurance, in a note submitted to the Committee, stated:

"The company's previous year for A.Y. 1967-68 ended on 31st March, 1967. On 2nd August, 1966, the company issued bonus shares of Rs. 2,50,00,000 by capitalising a similar sum from its general reserve. While computing the capital for the purposes of sur-tax, the Income-tax Officer increased the capital by Rs. 1,50,68,493 calculated on proportionate basis *i.e.* with reference to the number of days of the previous year during which, the increase remained effective. The Income-tax Officer's action was erroneous.

The general reserve was already a part of the capital on the first day of the previous year. When bonus shares were issued and part of the reserve was capitalised, the paid-up capital increased and the reserve was reduced by the same amount. The increase under one head was wholly set off by the reduction under another head. There was no increase in the aggregate capital, as computed under Rule 1 of the Second Schedule to the Sur-tax Act. There was no case for any proportionate enhancement of the capital under Rule 3 of the Second Schedule. This aspect was missed by Income-tax Officer which gave rise to the error."

6.23. The Committee learnt from Audit that while most of the assessments of the monopoly group, to which the assessee company in this case belonged were centralised in Central Circles or Special Circles in Calcutta and Bombay and that, in fact, some of the cases of this group were dealt with by a Special Cell in Delhi, this particular company had been assessed at Indore. The Committee, therefore, desired to know the reasons therefor and the number of Sur-tax cases dealt with by the Income-tax Officer, Indore. The Department of Revenue and Insurance, in a note, stated:

"This company of the Birla Group is assessed by the Income-tax Officer, 'A' Ward, Indore. The Income-tax Officer, Indore has 10 sur-tax cases."

6.24. When the Committee enquired whether the Commissioner of Income-tax or the Inspecting Assistant Commissioner or the Director of Inspection had ever looked into the assessment of this case, the Department replied that the case was seen neither by the Commissioner nor the Inspecting Assistant Commissioner before the date of audit.

6.25. The Committee learnt from Audit that even though the objection had been accepted by the Ministry, the Department of Revenue and Insurance had intimated that rectificatory action in this case had been stayed by the Madhya Pradesh High Court. The Committee desired to know the grounds on which the writ had been filed by the company. The Department of Revenue and Inurance, in a note submitted to the Committee in this regard, stated:

> "The Income-tax Officer issued notice u/s 13 of the Sur-tax Act, on 30th August, 1972. After some hearings and correspondence, he again wrote a letter to the company on 5th June, 1974 and fixed 18th June, 1974 for the hearing. The company filed a writ petition on 17th June, 1974 in the High Court of Madhya Pradesh. The High Court has issued in interim order staying further proceedings of rectification. The assessee has challenged the issue of notice u/s 13. It has claimed that there is no apparent mistake and hence Section 13 cannot be resorted to."

6.26. The Committee, in paragraph 2.30 of their 128th Report (Fifth Lok Sabha) had, *inter alia*, suggested that Government should examine whether any amendment to the Act was necessary to ensure that rectification of patent mistakes was not frustrated by assessees seeking legal remedies on mere technical grounds. The Direct Taxes Enquiry Committee (Wanchoo Committee), in para 4.49 of their Report, had also recommended that revenue matters, in respect of which adequate remedies were provided in the respective statutes, should be excluded from the purview of Article 226 of the Constitution.

6.27. In their Action Taken Note dated 3rd December, 1974 on this recommendation, the Department of Revenue and Insurance stated:

> "The power of High Courts to issue writs emanates from Article 226 of the Constitution. The constitutional rights of a tax payer ot move the High Court to issue directions,

orders or writs against the purported exercise of the power of rectification of mistakes by any Income-tax authority under Section 154 of the Income-tax Act, 1961 cannot, therefore, be taken away except by an amendment of the Constitution. It will be relevant in this connection to mention that the Direct Taxes Enuiry Committee (Wanchoo Committee) in paragraph 4.49 of their Final Report, had recommended that revenue matters, in respect of which adequate remedies are provided in respective statutes themselves, should be excluded from the purview of article 226 of the Constitution. This recommendation is being examined and the decision taken by Government in this regard would be intimated to the Committee in due course."

6.28. The Committee asked whether the Department of Revenue and Insurance had conducted any review of other assessments to spot similar mistakes. The Department, in a note, replied:

"A general review was ordered on 22nd May, 1974 asking the field officers to re-check the completed assessments. Mistakes have been noticed in 10 cases involving a tax effect of Rs. 1.70 lakhs."

6.29 The Committee were given to understand by Audit that though this case had also been checked by the Internal Audit Party, the mistake had not been pointed out by them.

6.30. The Committee take a serious view of the mistake that had occurred in this case relating to a company Gwalior Rayon Silk Manufacturing (Wvg.) Co. Ltd., again linked with a monopoly group, in computing the capital of the company, under Rule 3 of the Second Schedule of the Companies (Profits) Sur-tax Act, 1964. The incorrect augmentation of the capital proportionally, after taking into account the bonus shares worth Rs. 2.50 crores issued by the company by utilising a part of the accumulation in its general reserve, had resulted in an excess statutory deduction of Rs. 15.07 lakhs under Section 2(8) of the Act and consequent short levy of tax of Rs 5.27 lakhs. The circumstances in which a mistake like this had been committed by the Income-tax Officer has not been satisfactorily explained by the Department. Besides, the attempt at extenuation by reference to an unfortunate misreading of the Second Schedule can only be considered as very special pleading and by no means convincing. The Committee cannot but take a grave view of lapses involving large losses to the revenue. The circumstanes leading to this mistake require to be investigated with a view at least to ensuring that no mala fide intentions were involved.

6.31. It is also surprising that neither the Inspecting Assistant Commissioner nor the Commissioner had looked into this case, even though the charge in which the case had been assessed does not appear to have more than a few large income cases of this type. The Committee would like Government to find out whether the supervisory officials had inspected the ward in which the case was assessed at any time after the assessment had been made and, if so, how this particular case had escaped their notice. In case there has been any remissness on their part in this regard, appropriate action should be initiated.

6.32. The Committee note that the rectificatory proceedings under Section 13 of the Act has been stayed by the Madhya Pradesh High Court on a writ petition filed by the assessee, challenging the issue of notice under Section 13. This is one more instance where the rectification of even patent mistakes has been frustrated by the assessee seeking a legal remedy. In this connection, the Committee would invite the attention of Government to an earlier recommendation of theirs contained in paragraph 2.30 of their 128th Report (Fifth Lok Sabha) and reiterated in paragraph 4.26 of this Report on the question of amending Article 226 of the Constitution in so far as it relates to revenue matters, in respect of which adequate remedies are provided in the respective statutes themselves.

6.33. The Committee find that Gwalior Rayon Silk Manufacturing (Wvg.) Co. Ltd. is being assessed at Indore even though most of the assessments relating to the Birla Group of companies are centralised in Central Circles or Special Circles in Bombay and Calcutta and a special cell has also been set up in Delhi to deal with the income-tax cases of this group. The response of the Ministry of Finance to an enquiry by the Committee into the reasons for this arrangement is a surprising silence. The Committee are of the view that the Income-tax cases of this company should also be transferred to the special cell at Delhi so that all ramifications which this particular unit of the Birla Group may have with the other units of the group could be unravelled and properly looked into.

6.34. Another intriguing point emerging out of this case relates to the extension of the capital plus reserves base for the purpose of lowering the sur-tax liability. The Committee have came across a number of instances in the earlier Audit Reports where the profits of a particular year are first credited to the General Reserves and appropriations made thereafter for declaring dividends. Since such a transfer of the profits to the General Reserve may only be accrued to lower the sur-tax liability, by claiming higher exemptions on an

artificially enhanced capital base, the Committee would like to know whether Government have contemplated or conducted any study of the sur-tax assessments of companies which might have adopted such a method of tax-avoidance. In case such a study has not so far been undertaken, the Committee would recommend that this should be initiated forthwith and the outcome of the study intimated as early as possible. Government should also examine whether any amendment to the existing Act and Rules is necessary to prevent such an abuse.

CHAPTER VII

GENERAL OBSERVATIONS

7.1. The cases discussed herein reveal certain grave deficiencies in the functioning of the Income Tax Department, particularly in the areas of company taxation. They involve assessments where the returned income often runs into crores of rupees. Only a test check by Statutory Audit of the assessments in nine cases of foreign and Indian companies, belonging to multi-national corporations or monopoly groups, has disclosed non-levy/under-assessment of tax and excess payment of interest, adding up to the staggering figure of Rs. 3.66 crores. Obviously there is something very wrong with the administration of company taxation at various levels. The Committee feel considerable disquiet over the mistakes and omissions discussed at some length in this Report These defaults have become almost repetitive in character, in spite of many recommendations made by the Committee in this regard in the past and the mass of detailed instructions issued from time to time by the Central Board of Direct Taxes.

7.2. The errors and omissions in the assessment of large-income cases which have come to the notice of the Committee are broadly attributable to one or the other of the following factors:

(i) sheer negligence or laxity on the part of assessing officers;

(ii) inadequate and improper planning of work by the assessing officers and non-allocation of proper priorities for the timely completion of large-income cases, resulting in hasty assessments and disposals without adequate scrutiny towards the end of the limitation period;

(iii) complacency on the part of the Ministry of Finance and the Central Board of Direct Taxes towards issuing guidelines in respect of assessment of important items of expenditure such as 'Head Office Expenses' of foreign companies operating in India and 'expenditure on scientific research' which often serve as facades to facilitate tax-avoidance;

(iv) inadequacy of internal control and supervision, particularly at the middle management level; and

(v) ineffectiveness of internal Audit.

In the preceding chapters, the Committee have tried not only to trace the reasons for such default but also to suggest remedial measures. The Committee trust that at least in the context of the present National Emergency, Government will take more serious notice of their observations and recommendations and display a less inhibited approach in implementing them.

7.3. The Committee would, in particular, like to draw Government's immediate attention to the deficiencies in internal control and supervision in the Income-tax Department, especially at the middle management level of Inspecting Assistant Commissioners, which have been brought into sharp focus in the cases discussed in this Report. It is distressing to observe these middle-level officers often rather remiss in the discharge of the duties entrusted to them. The Committee emphasise that these officers have precise and purposeful role which they are enjoined to perform but with disappointing results so far.

7.4. Another reason for the recurrent mistakes in assessment, particularly in large income cases is that, in the absence of any categorisation of different types of cases and disposals on a selective basis, even assessments with large revenue implications are left in the hands of Income-tax Officers with comparatively less experience. In the circumstances, Government should seriously consider the desirability of entrusting the assessment of such cases directly to the Inspecting Assistant Commissioners of Income-tax. The Chairman Central Board of Direct Taxes has himself admitted, during evidence, that Government is 'very much conscious of this deficiency' and has assured the Committee that he would try to ensure concentration on large-income group cases by experienced officers and to transfer certain cases to the Assistant Commissioners also. The Committee have examined the subject of supervision and internal control and the question of entrusting direct assessment work to the Inspecting Assistant Commissioners at considerable length in their 186th Report (Fifth Lok Sabha) and have made specific suggestions and recommendations which, it is urged, should be dealt with on a priority basis and implemented forthwith.

7.5. The Committee have not been able to examine some of the paragraphs relating to Corporation Tax included in Chapter II of the Report of the Comptroller and Auditor General for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes on account of paucity of time. The Committee expect however, that the Department of Revenue and Insurance and the Central Board of Direct Taxes will take necessary remedial action in these cases, in consultation with Statutory Audit.

H. N. Mukerjee

(H. N. MUKERJEE)

Chairman,
Public Accounts Committee.

NEW DELHI;
December 12th, 1975
Agrahayana 21, 1897 (Saka)

APPENDIX I

(*Vide* paragraph 3.15)

Note indicating the procedure followed by the Reserve Bank of India for allowing remittances on account of 'Head Office Expenses' by foreign companies operating in India.

It would be useful to state briefly how and to what extent the Reserve Bank comes into the picture as regards Head Office expenses of branches of foreign companies. Under the current regulations, such a branch is permitted to remit its entire surplus after deducting the appropriate amount of tax. The tax is determined by the income-tax authorities taking into account the expenses incurred by the company from the total income. The expenses may be incurred in India, or abroad in the form of Head Office expenses (that are rightly allocable to Indian operations). Both types of expenses are subject to scrutiny by the income-tax authorities. If no Head Office expenses are claimd the entire surplus arising in India (excess of income over expenditure in India) less adequate provision for tax (at the prescribed rate on the whole surplus) would be remittable as profit. The effect of indicating a separate amount out of the Indian surplus, as being Head Office expenses and to ask that it be allowed to be remitted is to break up the surplus into two parts, one which is admittedly taxable as profit and another which the branch claims is not taxable as it is an expense. When the Reserve Bank allows remittance of "Head Office expenses" (as claimed by the foreign company or bank), it is in effect allowing—on a provisional basis only—the remittance of a part of the surplus (i.e., income less the expenses in India) on which the company claims that it does not have to pay any tax. This is a question to be determined by the tax authorities and the remittance of a part of the surplus—claimed as Head Office expenses—without deduction of tax, is always provisional and subject to the determination of the tax authorities.

2. The position of a foreign company with a branch in India is in this way quite different from that of an *Indian company*, with or without foreign financial collaboration. If such an Indian company seeks to make a remittance abroad, on account of fee, royalty, dividend, expenses or any other reason, the authority and justification for such a remittance is scrutinised by the Reserve Bank of India in the normal way. But when a foreign company seeks to remit a part of

its own surplus, without deduction of the tax element, on the ground that it is Head Office expenses and therefore not subject to tax, the Reserve Bank of India has been treating this naturally as a tax matter and allowing only a provisional remittance (the basis for final check being the total remittance on account of a particular financial year cannot exceed the total profit less total tax, as decided by the tax authorities, after determining any issues arising as regards any expenses in India or Head Office expenses).

3. It would be open to the company not to ask for a separate remittance on account of share of Head Office expenses but still to claim it as an expense for tax assessment purposes. (Some foreign banks, viz., the Dutch Bank and Bank of Tokyo do in fact adopt this latter procedure.) The effect will be the same. An example would make this clear. Let us assume that the total surplus of a branch before meeting Head Office expenses is Rs. 130 lakhs and that out of this it asks for remittance of Head Office expenses of Rs. 30 lakhs and of a profit of Rs. 100 lakhs less taxes and let us take the rate of tax as 73.5 per cent. The branch will then remit Rs. 100—Rs. 73.5 lakhs, i.e., Rs. 26.5 lakhs as net profit and Rs. 30 lakhs as share of Head Office expenses. Total remittance would be Rs. 56.5 lakhs. The branch may, however, not ask for a separate remittance on account of Head Office expenses but claim that the current provision for taxes is Rs. 73.5 lakhs and the balance i.e. Rs. 56.5 lakhs (Rs. 130 lakhs less Rs. 73.5 lakhs) is remittable as profit subject to production in due course of the assessment order of the tax authorities, establishing the correctness of the amount retained for tax payment and the amount remitted, as "on account remittance". It is only if the branch is asked to justify the tax provision made that it may go on to explain that out of the total surplus of Rs. 130 lakhs Rs. 30 lakhs is non-taxable being expenses of the Head Office correctly allocable to the operations in India and the rest is subject to tax at the normal rates. If this is accepted by the tax authorities, the total remittance would be the same whether the remittance of share of Head Office expenses is claimed separately or as part of profit. If any part of the Head Office expenses is disallowed by Reserve Bank of India or Income-tax authorities, there will be an increase in the amount of remittable profit with a proportionate increase in tax liability. Thus, the total amount of remittance is dependent entirely on how the tax authorities deal with the claim on account of share of Head Office expenses. The effect of a particular sum determined as Head Office expenses is only on the tax payable in India—and the consequential effect on the profit after tax that is remittable.

4. This is the rationale for the Reserve Bank allowing remittances of Head Office expenses subject to the production of evidence that the amount has been accepted for assessment purposes by tax authorities. Since the details of the amount claimed are to be scrutinised

by the Income-tax authorities, the Reserve Bank does not itself undertake such scrutiny.

5. The question of Head Office expenses arises in the case of branches* of foreign companies. Essentially, this is because the branches belong to the same organisation and the allocation of Head Office expenses to the branches is somewhat akin to allocation of overheads to different limbs/activities of an organisation. The Head Office may incur two different kinds of expenditure. Firstly, it spends money on its own running which includes the general control over and supervision of branches; secondly, it may spend money on behalf of a particular branch which is *ab initio* charge on the latter. Expenses of the latter type are payments made to third parties which the branch has to reimburse to the Head Office. Allocation of expenses of the first type is justifiable on the ground that part of the expenses of the bank—in undertaking the activities of the (Indian) branches which result in the profit in India—are incurred in the Head Office. The Head Office is in overall control and exercises supervision. It may be doing part of the work of "operations", i.e., scrutinising and sanctioning certain loans and advances of value above a minimum or of special complexity. It may be giving advice/guidance etc. It may also undertake (by deputing personnel from the Head Office outside India), inspections of the branches with a view to ensuring that they function efficiently. The Head Office also recruits and trains some persons who are deputed to India. In other words, the Head Office contributes directly and indirectly to the activities and the business of the branch and it would not be unreasonable to debit a part of these overheads to each branch. It may be mentioned that some Indian banks (e.g. Bank of India, Bank of Baroda and Indian Overseas Bank) having branches abroad also repatriate amounts to India on account of Head Office expenses which are accepted as tax deductable expenses by the tax authorities of the respective countries.

6. There is no set formula for arriving at the quantum of Head Office expenses to be borne by each branch and the allocation is bound to be on broad lines, on one set or another of acceptable principles. The allocation, as between each country, of the Head Office expenses may be in proportion to the activities in each such country—which may be measured (1) by the cost of running (i.e. establishment expenses of) all the branches in each particular country (the

*In addition to branches, a few wholly-owned subsidiaries of foreign companies have been allowed to remit Head Office expenses in the past. The number of such companies is small—only five in all. The question whether such remittance of Head Office expenses by subsidiaries as a separate item of expenditure should continue to be permitted is under consideration.

method followed by National and Grindlays Bank), or (2) according to the gross income of the branches situated in each country (the method apparently followed by the majority of foreign banks) or (3) on the basis of the working funds employed in each country (which is the method adopted by British Bank of the Middle East). All these methods are in vogue. Any reasonable formula which is applied uniformly to branches in all parts of the world has been found acceptable by the tax authorities in the past, this does not seem open to objection.

7. As already stated, the Reserve Bank permits the remittance of a part of the surplus as Head Office expenses not subject to tax, on production of evidence that the claim of non-taxability has been accepted by the Income-tax authorities. Since tax assessments involve considerable delay, the Reserve Bank accepts (or rather, was accepting until recently, as explained below) in lieu of a copy of the assessment or a certificate from the tax authorities, an auditors' certificate to the effect that the amount claimed as Head Office expenses and therefore non-taxable has been calculated on the basis of a formula accepted by the Income-tax authorities and that amounts similarly calculated for earlier years have been allowed as expenses for the purpose of tax. This is subject to the undertaking that the tax assessment will be produced in due course. At the end of each year, the offices of the Exchange Control Department have to call for tax assessments from the companies and check whether the remittances allowed in the relevant years were within the amounts accepted by the Income tax Department as an expense deductible from the income to arrive at the net taxable profit. If excess remittance was made, the excess is asked to be repatriated or adjusted against the next remittance. However, because of the long delay in assessments, there is a corresponding delay in the adjustment of such excesses. The question was, therefore, reviewed early in 1973 and it was decided that commencing from 1973 the claim that a part of the surplus is non-taxable, as being attributable to Head Office expenses, would be accepted only on production of evidence that such claim has been accepted by Income-tax authorities.

No applications fro mforeign banks/or companies for remittance of Head Office expenses for the year 1973 and onwards have been allowed by the Reserve Bank so far.

8. The above recital indicates why the Reserve Bank has been relying on the income-tax authorities for determining the admissibility of foreign companies' claims for exemption from tax on the part of their surplus attributable to Head Office expenses. The

matter has now been considered further. Although the question of Head Office remittances is primarily one of income-tax to be determined by tax authorities, it has, naturally, foreign exchange implications also, and the Reserve Bank may be in a position to make a contribution useful to tax authorities in considering the question especially as regards the banking industry. It is, therefore, proposed, as was stated during the oral evidence before the Public Accounts Committee, that the Reserve Bank should associate itself with the Central Board of Direct Taxes in the latter's study in depth of the question of norms and guidelines to be adopted for allowing branches of foreign companies, especially banks, to claim tax exemptions in respect of Head Office expenses.

APPENDIX II

(*Vide* paragraph 4.72)

JYOTIRMOY BOSU
CHAIRMAN
PUBLIC ACCOUNTS COMMITTEE

Most Immediate
By Special Messenger

19th April, 1975

Dear Shri Subramaniam,

I would like to bring to your notice the following:—

In paragraph 18(c) of the Report of the Comptroller and Auditor General of India for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, the Audit has pointed out that in the case of Calcutta Electric Supply Corporation Limited, (a non-resident company), the Income-tax Officer allowed depreciation on the written down sterling value of the assets and this resulted in excess allowance of depreciation of Rs. 2,19,01,491 (Rs. 2.19 crores) leading to under-assessment of tax of Rs. 1.53 crores for the assessment years 1967-68 to 1969-70. This also resulted in excess payment of interest of Rs. 48.57 lakhs for the above three years. Total under-charge of tax for these three years amounted to Rs. 2.02 crores. Remedial action under Section 263 of the Income Tax Act has also been initiated as intimated by the Ministry in their letter dated 19th September, 1974. It is learnt that the Corporation went in appeal against the orders of the Additional Commissioner under Section 263 to the Income-tax Appellate Tribunal.

During the examination of the case by the Public Accounts Committee at their sitting held on 25th January, 1975, the Committee were informed that the Central Board of Direct Taxes had requested the Tribunal to complete the hearing of the Corporation's appeal as early as possible. At the instance of the Committee, the Ministry of Finance in their D.O. letter dated 18th April, 1975 have stated that the hearing was concluded on 17th February, 1975 and that the Tribunal has not passed order till today on the Corporation's appeal. The Ministry have added that the reasons for the delay and how much more time is likely to be taken by the Tribunal are not known to them.

The amount involved in this particular case is very heavy and the delay in passing the final orders by the Income-tax Appellate Tribunal, is causing financial loss to the Government. The Committee feel that any delay in the finalisation of appellate orders is not in the interest of the revenue of the Government. A number of other instances have also come to the notice of the Committee in which remedy of patent mistakes are frustrated by assessees seeking legal remedies on more technical grounds.

I would request you kindly to look into the matter personally and ensure that the Income-tax Appellate Tribunal pass their orders on the appeal of the Calcutta Electric Supply Corporation immediately.

Yours sincerely,

Sd/-

(JYOTIRMOY BOSU)

Shri C. Subramaniam,
Minister of Finance,
New Delhi.

APPENDIX III

(*Vide paragraph* 4.73)

(COPY)

D.O. No. 236/330/73-A&PAC II/Vol. II/474/FM/-VIP(I)

FINANCE MINISTER

INDIA.

New Delhi—110001
May 7, 1975.

Dear Professor Mukerjee,

Please refer to Shri Jyotirmoy Bosu's D.O. dated 19th April, 1975 on the pendency of appeals in the case of Calcutta Electric Supply Corporation Ltd. before the Income-tax Appellate Tribunal, Calcutta Bench.

2. I am given to understand that the Income-tax Appellate Tribunal, Calcutta Bench, have passed orders on 30-4-1975 dismissing the appeals of the Calcutta Electric Supply Corporation against the orders passed by the Additional Commissioner of Income-tax under Section 263 of the Income-tax Act. The Senior Financial Committee Officer, Lok Sabha Secretariat has been informed of this development on the 2nd May, 1975, as soon as information was available about the disposal of the appeal.

With regards,

Yours Sincerely,

Sd/- C. SUBRAMANIAM.

Professor Hiren Mukerjee,

Chairman,

Public Accounts Committee,

51, Parliament House,

New Delhi.

APPENDIX IV

Summary of main conclusions/recommendations

S. No.	Para No.	Ministry/Department concerned	Conclusions/Recommendations
1	2	3	4
1	1.14	Finance (Rev. & Ins.)	The Committee note that in computing the business income of Britannia Biscuit Co. Ltd. for the assessment year 1968-69, the Income-tax Officer had added back to the net profit a sum of Rs. 20,93,532 instead of Rs. 22,93,532 actually debited to the Profit and Loss Account in respect of 'depreciation', resulting in under-assessment of income by Rs. 2 lakhs and that the mistake has been attributed to inadvertence on the part of the Income-tax Officer. The Committee are disturbed to find that serious mistakes on account of negligence continue to recur every year. That this should be so despite repeated comments made in this regard in the earlier reports of the Public Accounts Committee and the assurances given by the Ministry of Finance that steps would be taken to avoid the recurrence of such mistakes, is regrettable. Such repetitive mistakes indicate that the instructions even of grave import, issued by the Central Board of Direct Taxes are not taken seriously enough by the assessing officers.

2	1.15	-do-	The Committee are concerned that no review having been undertaken by the Central Board of Direct Taxes regarding the effect of the Board's Instruction No. 589, dated the 25th August, 1973. The Board's responsibility does not end with merely issuing instructions based on the recommendations of the Committee. There should be regular review of such instructions to ensure that they were being implemented in the field. The Committee desire that the Central Board of Direct Taxes should undertake such a review and take all necessary remedial measures.
3	1.16	-do-	In the instant case, the Committee have been informed that the return had been filed by Britannia Biscuit Co. Ltd. on 26th September, 1968 and the assessment was completed only on 25th February, 1972. It would, therefore, appear that after having kept the assessment pending for more than three years it was completed in haste without adequate scrutiny and only when the assessment was about to become time-barred. This indicates a kind of chaos in the system of work and a failure to realise the importance of accuracy and expedition in completing cases, especially those with large revenue implication. The Committee desire that the existing methodology adopted by Income-tax officers for disposal of cases should be carefully examined and adequate measures taken to specify priorities of work allocation and disposal. The Committee's earlier recommendation contained in paragraph 1.72 of their 119th Report (Fifth Lok Sabha) is relevant in this regard.

1	2	3	4
4	1.17	Finance (Rev. & Ins.)	The Committee find that this case was not checked by the Internal Audit and the familiar plea of preoccupation with other cases has again been put forth by the Department. The Committee are unhappy that effective steps are yet to be taken by the Department to ensure that the computation of income and the assessment orders themselves are pre-checked, preferably by Internal Audit, particularly in large income cases of foreign companies and Indian monopoly houses, though an earlier recommendation of the Committee in this regard contained in paragraph 2.66 of their 87th Report (Fifth Lok Sabha) had been accepted, in principle, by Government as early as December, 1973. In view of the large number of mistakes in the computation of assessable income which have been brought to their notice year after year, the Committee strongly reiterate their earlier recommendation and would urge Government to act upon it without further loss of time.
5	1.31	-do-	The Committee are distressed to find that an expenditure of Rs. 0.99 lakh on Scientific Research had been allowed by the Income-tax Officer in this case without making precise enquiries as to what research was actually carried out and without ensuring whether it was a genuine expenditure on research and development related to the business of Britannia Biscuit Company Ltd. The Committee have been informed in this connection that apart from the amount of Rs. 0.59 lakh allowed on this account for the assessment year

			1968-69, further sums of Rs. 1.86 lakhs and Rs. 0.04 lakhs have been allowed in respect of the assessment years 1970-71 and 1972-73 respectively. The assessments for the years 1969-70 and 1971-72 are stated to be pending and in respect of these two assessment years, Rs. 1.28 lakhs and Rs. 1.29 lakhs respectively have been claimed by the assessee company towards scientific research. The Committee desire that these claims should be carefully scrutinised by reopening the cases where necessary, in order to ensure that the permissible deductions from the taxable income are fully justified. In case it is found that there had been a misrepresentation of facts and that the deductions were incorrectly allowed, immediate action should be taken to subject the amounts to tax. The Committee would await a further report in this regard.
6	1.32	-do-	It is surprising that the Central Board of Direct Taxes have not considered it necessary to issue guidelines on what constitutes expenditure on scientific research for the guidance of the assessing officers. The Committee desire that this should be examined in depth and specific instructions issued immediately so that ambiguities could be avoided and uniformity in assessment ensured.
7	1.33	-do-	The Committee agree with the view of Audit that in Section 35(i) (ii) of the Income-tax Act, under which any sum paid to a scientific research association, having as its object scientific research, is allowed as a deduction provided the association is recognised by the SCIR, there is a lacuna which needs to be removed. It is not unlikely that ambiguity in the legal provision in this regard has led

1	2	3	4
			to a tendency on the part of some big industrial houses to sponsor so-called scientific research associations with a view to claiming deductions from taxable income. The Committee, therefore, desire that the existing provisions should be reviewed and the loophole in the Act plugged forthwith. This tendency could, perhaps, also be countered by prescribed a ceiling on the sums payable to research associations for the purposes of computation of income-tax.
8	1.34	Department of Science & Technology	The Committee also note that the Department of Science and Technology propose to set up a group to oversee the functioning of research institutions approved by them, so as to ensure that such institutions actually utilise the contributions received by them for the purpose for which they are given. The Committee would like to know the action so far taken in pursuance of this objective.
9	1.42	Finance (Rev. & Ins.)	The Committee are surprised to learn that as against the licensed capacity of 1200 tonnes of biscuits per annum. the actual production of Britannia Biscuit Co. Ltd. has far exceeded the licensed capacity in all the years since the factory commenced production in 1967. During the period from 1968 to 1973, the production ranged from 5278 tonnes to 8528 tonnes. In 1973, the production had exceeded the licensed capacity by over 700 per cent. The Committee find it difficult to accept the explanation that this phenomenal increase in production had been achieved by the company by improved

			technology without providing any additional machinery. As the increase in production over the licensed capacity, *prima facie*, appears to be abnormal and remains unexplained, the Committee are of the view that the possibility of the company having resorted to manipulation of the invoices to import additional machinery cannot be ruled out. The Committee desire that the said excess production should be thoroughly investigated into without losing further time and appropriate action taken without delay against the company if it is found to have violated the provisions of the Licensing Act.
10	1.3	Industrial Development	What is more distressing is the fact that even though this question of the company producing biscuits far in excess of the licensed capacity had been raised in the Lok Sabha in 1974, no concrete action has so far been taken against the company. The Committee cannot understand why the Ministry of Industrial Development merely remained content with calling for the explanation of the company and referring the case to the Ministry of Law. Besides, though this case had been taken up with the Ministry of Law as early as August 1974, according to the information furnished to the Committee, it remains still under examination. The Committee deprecate such unconscionable delay in cases especially relating to monopoly concerns and big foreign business houses. The Committee desire that the reasons for the delay should be explained and responsibility fixed for appropriate action. The Committee would like to know the final decision since taken in this case.

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11	1.44	Finance (Rev. & Ins.)	The Committee would further urge that Department of Revenue & Insurance investigate immediately whether there has been any leakage of excise and customs revenues in respect of this company. The Committee would await a further report in this regard.
12	2.18	-do-	The Committee view with serious concern the two cases of failure to levy/incorrect levy of additional tax on dividents declared or distributed on equity shares in excess of the specified percentage of the paid-up equity share capital as on the first day of the relevant previous year, resulting in short levy of tax amounting to Rs. 10.23 lakhs. In the first case relating to a company under foreign control (Dunlop India Ltd.), the Committee find that instead of levying the additional tax with reference to the paid-up equity capital of Rs. 8 crores as on the first day of the previous year relevant to the assessment year 1967-68, the tax had been computed after incorrectly taking into account the bonus shares valued at Rs. 2 crores issued towards the end of the previous year, thus resulting in a short levy of tax by Rs. 1.5 lakhs for the assessment year 1967-68. Again, in respect of the same company, no additional tax, which works out to Rs. 5.63 lakhs, had been levied on the equity dividends of Rs. 1.75 crores declared/distributed by the company during the previous year relevant to the assessment year 1968-69.

13	2.19	Finance (Rev. & Ins.)	In the second case pointed out by Audit, which related to an Indian Banking concern (United Commercial Bank Ltd.), the Committee find that the additional tax had not been levied on the dividends of Rs. 24.56 lakhs declared/distributed during the previous year relevant to the assessment year 1964-65 and had been incorrectly levied on the dividends declared/distributed during the previous year relevant to the assessment year 1967-68. These mistakes had resulted in a short levy of Rs. 3.10 lakhs.
14	2.20	-do-	The Committee are informed that the lapses pointed out by Audit have been accepted by the Department and necessary rectifications carried out. While the Committee note that the Central Board of Direct Taxes took prompt action to rectify mistakes pointed out by the Central Receipt Audit, they cannot ignore the basic issues involved in such recurrent cases of under-assessment pointed out in test audit year after year. The Committee have been informed that both these cases were assessed in Company Circles which, admittedly, have fewer cases for disposal and are manned by experienced senior officers. Such an arrangement is apparently designed to ensure that large income cases of the type commented upon by Audit are thoroughly and properly scrutinised before the assessments are finalised. That mistakes of the nature pointed out by Audit should continue to recur, despite such an arrangement, would lead the Committee to infer that either the requisite competence is lacking in the officers posted to Company Circles or that such mistakes are deliberate and *malafide*. The Committee, therefore, desire that the

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			circumstances leading to the under-assessments in these two cases should be thoroughly investigated. The Committee are of the view that appropriate action is also called for against the officers, including those at the supervisory level, who have apparently been negligent in the discharge of their duties.
15	2.21	Finance (Rev. & Ins.)	The Committee are also concerned to note that the relevant assessments relating to Dunlop India Ltd. had not been checked by Internal Audit, while in the case of United Commercial Bank Ltd. though the assessment for the year 1967-68 had been checked in Internal Audit the patent short-levy of additional tax was not detected. What is more distressing is that this assessment relating to a banking concern, in the high income bracket, had been scrutinised only at the level of an Upper Division Clerk who has been warned for his failure to detect the mistake. In respect of the other three assessments, the explanation offered is one which has been too often placed before the Committee, namely, that the manpower resources of Internal Audit are inadequate. The Committee desire that the existing arrangements for Internal Audit should be reviewed and remedial steps taken forthwith. The Committee would also reiterate that all large income cases should invariably be checked at the level of the Inspecting Assistant Commissioner (Audit). The Committee are of the view that a pre-check of draft assessment

			orders by Internal Audit, recommended in paragraph 2.66 of their 87th Report (Fifth Lok Sabha) and reiterated in paragraph 1.17 of this Report would largly eliminate such unpardonable mistakes in assessment.
16	2.22	Finance (Rev. & Ins.)	The Committee have been informed that Dunlop India Limited had gone in appeal in respect of computation of the company's income for the assessment year 1967-68, as a result of which the total taxable income had been reduced. It appears that one of the grounds of appeal related to the additions made on account of exchange fluctuations. The Committee understand that the question of assessability or non-assessability of profits accruing out of exchange transactions is not a simple issue and that in many cases, courts of law have upheld assessments of gains on exchange transactions. The Committee would, therefore, like to know whether Government have contested the order of the Appellate Assistant Commissioner in the present case.
17	2.23	-do-	Another feature which has come to the notice of the Committee in respect of Dunlop India Ltd. is that the company has been remitting large sums abroad every year on the plea of reimbursement of technical know-how fees. During the seven-year period from 1965-66 to 1971-72, the remittances made on this account totalled £ 1.46 millions. In addition, the company has also claimed to have remitted, in 1972, a sum of Rs. 2.21 lakhs alleged to represent reimbursement of technical expenses incurred by the U.K. company during the year ended 31st December, 1969 and this claim,

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			according to the information furnished to the Committee by the Department of Revenue & Insurance, is to be considered by the Income-tax Officers in the pending assessments of the two companies. namely, Dunlop India Ltd. and Dunlop Holdings Ltd., U.K., for the year 1973-74. It would appear that the Indian subsidiary company has been allowed to remit large sums as payment of technical know-how fees to the foreign holding company. While the payments for technical know-how could, perhaps, be justified during the initial period of establishment of a company, the Committee are doubtful how far the technical know-how would be relevant in the case of a well-established company like Dunlop India Ltd. in an advanced stage of development.
18	2.24	Finance (Rev. & Ins.)	The Committee would, therefore, like to be satisfied that the remittances made on account of technical know-how fees by Dunlop India Ltd. were, in fact, fully justified and genuine and have not served as an instrument of tax-avoidance. The Committee desire that the technical know-how agreement entered into by the company should be thoroughly examined by the Department of Revenue & Insurance with a view to determining its relevance to the Indian business of Dunlop India Ltd. and ensuring that it is not a mere cloak for tax-avoidance. In case it is found that the remittances on this account have been claimed and allowed wrongly, appropriate action should be taken.

19	2.25	Finance(Rev. & Ins.)	The Committee are also of the view that it would be worthwhile for Government to undertake a detailed review of all such technical collaboration agreements entered into prior to 1965 by foreign enterprises operating in India and still in force, with a view to determining how far such agreements could be considered relevant to the Indian business of such enterprises concerned in the light of the development and changes that they might have undergone since the agreements were first entered into. In case the review discloses that some of the collaboration agreements have a outlived their purpose and serve only as instruments of tax-avoidance, immediate action to treat the payments of technical know-how fees in these cases as inadmissible expenditure and subject them to tax should be initiated, in addition to terminating the agreements, by invoking, if necessary, the power of eminent domain that a sovereign country enjoys. In all future technical collaboration agreements approved by the Government, it should also be ensured that a clause for a periodical review of the agreements from the point of view of their relevance in the changed circumstances that may prevail is invariably incorporated. The Committee attach considerable importance to these recommendations and desire that they should be implemented expeditiously.

1	2	3	4
20	3·28	Finance (Rev. & Ins.)	This is yet another case relating to the assessment of a foreign company operating in India (IBM World Trade Corporation), which is a giant multi-national corporation, enjoying almost a virtual monopoly in computers and other data processing machines. The gist of the audit objection in this case is that instead of apportioning the deductions allowed on account of the head office expenses attributable to the operations of the Indian branch on a time-basis as and when the Indian branch became liable to bear the expenditure incurred on its behalf by the head office and then applying the exchange rate prevailing during the relevant periods, the Income-tax Officer had converted the dollar expenses for the whole of the calendar year 1966 at the post-devaluation rate. It has been pointed out by Audit that this failure to apportion the expenses to the pre-devaluation and post-devaluation periods had resulted in an excess allowance of expenses in the assessment of the Indian branch amounting to Rs. 7.46 lakhs and consequential short-levy of tax of Rs. 5.22 lakhs for the assessment year 1967-68.
21	3·29	Do.	The Committee note that the Audit objection has not been accepted by the Department of Revenue & Insurance mainly on the ground that in this case, the liability on account of expenses incurred by the head office of the Indian branch of IBM World Trade

Corporation crystallised yearly at the end of the accounting period and not on different dates during the accounting period and, therefore, the deduction had to be allowed for a sum calculated at the exchange rates prevailing at the end of the accounting period. In support of this contention, the Department have stated that the company had 'affirmed' that the debits on account of head office expenses allocable to the Indian branch had been received only in December by a single debit note.

22	3·3	Do.	In the opinion of the Committee, this affirmation by the foreign company can at best be considered an after thought. No independent investigation appears to have been conducted in order to find out how often such debit notes had been received by the Indian unit of the company. Since the expenditure incurred by the head office was ascertainable, the logical and proper course in such a situation would be to value the liability of the Indian unit towards head office expenses at various rates of exchange, on a time-basis, with reference to the periods when the liabilities actually arose. The Committee have also been informed by Audit in this connection that a similar objection relating to M/s. Harrison & Crossfield (P) Ltd. had been earlier accepted by the Ministry who had then conceded that the correct procedure would be to allocate the expenses on a time-basis and apply the conversion factor by splitting up such expenses into relevant periods. Under these circumstances, the Committee are unable to approve of the Ministry taking a different

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			stand in the present case. The Committee desire that this case should be re-examined, in consultation with Audit and the outcome reported to them. Pending re-examination of the case, the assessment should be rectified as a measure of abundant caution, in the light of the Audit objection.
24	3.31	Finance (Rev. & Ins.)	Apart from this instance of under-assessment, the broader issue of remittances made abroad by IBM World Trade Corporation year after year on account of head office expenses causes even greater concern to the Committee. The Committee find that in respect of the assessment years 1967-68, 1968-69, 1969-70 and 1970-71, the company had claimed Rs. 46.92 lakhs, Rs. 45.95 lakhs, Rs. 50.24 lakhs and Rs. 56.76 lakhs respectively towards head office expenses directly attributable to the company's Indian operations and that these claims had been admitted by the Income-tax Officers without any disallowance. Further, the remittances allowed by the Reserve Bank of India as head office expenses relating to the six-year period from 1965 to 1970 total US dollars 40.06 lakhs and these claims are also stated to have been admitted by the Income-tax authorities. According to a study note prepared by the Department of Revenue & Insurance on 'Head Office Expenses', the deduction claimed by

			IBM World Trade Corporation on account of head office expenses for the assessment year 1969-70 worked out to 78 per cent of the book profits prior to the charge of these payments. If this is any indication of the quantum of remittances allowed in respect of this company, then it would follow that a major portion of the surplus earned by the company by its Indian operations has been allowed to be repatriated abroad tax-free. Such a situation has also been facilitated to a certain extent by the fact that no ceiling has been prescribed by Government on remittances towards head office expenses and whatever amount is admitted by the Income tax authorities is allowed to be remitted abroad by the Reserve Bank of India.
25	3·32	Do.	It would appear that the claims preferred by the company have been readily accepted by the Income Tax Officers without any genuine scrutiny, and often the books of account of such multinational corporations are not even called for and examined properly. The representative of the Department of Revenue & Insurance stated during evidence that 'in most of the cases or a large number of cases' it would not be possible for the Department to obtain the foreign accounts from the head offices of the companies for scrutiny. This is an impermissible situation, since our Income-tax Officers are driven to rely on the accounts certified by the company's own auditors or chartered accountants. This is a situation which needs to be rectified.

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26	3.33	Finance (Rev. & Ins.)	That the Income-tax Officers, however, had failed to make a proper assessment of amounts claimed by the company as head office expenses is also borne out by the company itself coming forward, in November, 1974, with a voluntary disclosure under Section 271(4A)(ii) of the Income-tax Act, 1961, admitting an excess claim on account of head office expenses for the years 1966 to 1970 to the extent of US dollars 450 thousands and submitting amended tax returns. This is, indeed, a sad commentary on the functioning of our Income-tax Department.
27	3.34	Do.	In view of the far-reaching implications of the disclosure now made by IBM World Trade Corporation that 'certain errors in the principle of allocating Headquarters Expense to India had been detected by its head office in New York' and that 'the erroneous calculations had resulted in excess claim on account of Headquarter Expense' for the years 1966 to 1970, the Committee desire that all claims made by the company on this account relating to periods prior to 1966 and after 1970 should be subjected to a thorough scrutiny by the Investigation Cell set up by the Central Board of Direct Taxes to look into leading cases of tax evasion and malpractices. Besides, all the assessments of the company from 1960 to 1974 should also be strictly reviewed, with reference to the

books of accounts of the company so as to establish the accuracy of the statements of receipts and expenditure and the genuineness of the allocation of expenditure between the Head Office of the company and the Indian unit and to ensure that no inadmissible expenditure is allowed to escape taxation and be repatriated abroad in foreign exchange. In case the review reveals that there has been a deliberate attempt by the company to evade taxes, stringent penal action under the law should be taken forthwith against the company, besides levying and collecting the tax on the income that has escaped assessment. The correctness of recognising this multinational giant as a company under the Income-tax Act should also be looked into in detail. The Committee would await a detailed report in regard to the action taken by Government on these recommendations.

28	3·35	Do.	The Committee also consider it rather significant that the application under Section 271(4A), admitting excess claims on account of head office expenses, had been made by the company after the Audit paragraph had appeared in the Report of the Comptroller and Auditor General of India and after the Committee had also probed into some of the Indian operations of IBM World Trade Corporation in their 127th Report (Fifth Lok Sabha) on the installation of IBM computers on Indian Railways, which was presented to the Lok Sabha in April, 1974. Besides, the affairs of the company have

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			also been taken up for scrutiny by an inter-Ministerial Working Group constituted by the Department of Electronics. Under these circumstances, the Committee have grave doubts whether the disclosure made by the company only in November, 1974 could be treated as voluntary and not as one prompted by the fear of exposure. The Committee would, therefore, recommend that pending the completion of the comprehensive review suggested in paragraph 3.34 above, the application made under Section 271(4A) of the Income-tax Act should be kept pending so that the assessee company does not escape the consequences of penalty and prosecution proceedings for claiming excess expenditure in a manner which, *prima facie*, appears to be dubious and even deliberate.
29	3·36	Finance (Rev. & Ins.)	Now that an inter-Ministerial Working Group has also been appointed to examine in detail the policies and procedures under which IBM World Trade Corporation operates in India, the Committee desire that the entire issue of head office expenses claimed by the company and the remittances made by it should be gone into by the Working Group with a view to quantifying, in concrete and specific terms, the extent to which the country's scarce foreign exchange resources have been frittered away and exposing all the devious methods employed by this multi-national corporation to the detriment of the country's wider national interest.

30	3.37	Do.	Another distressing feature which has come to the notice of the Committee during their examination is the virtually passive role played by the Reserve Bank of India in the matter of permitting remittances by foreign companies from India towards head office expenses. The Committee have been informed that the Reserve Bank does not undertake any scrutiny of the amounts applied for by foreign companies/banks towards remittances of head office expenses; nor does the bank call for a break-up of the items constituting the head office expenses. Prior to 1973, such remittances had been allowed by the Reserve Bank on a provisional, on-account basis, subject to the acceptance of the expenditure by the Income-tax authorities. From the year 1973 onwards, the Bank has, however, decided not to accept the claims on account of Head Office Expenses without the production of evidence by the foreign company/ bank concerned that its claim that a part of the surplus is non-taxable—as being head office expenses chargeable to its Indian operations—has been accepted by the Income-tax authorities. Considering the fact that the scrutiny exercised in this regard by the Income-tax Officers appears to have been superficial and cursory, the Committee are doubtful how for the excessive reliance that is now being placed by the Reserve Bank on the Income-tax Department could be considered satisfactory. As the guardian of the country's scarce foreign exchange resources, the Committee feel that the Reserve Bank of India could and should play a more responsible and dynamic role in this regard. The Committee, therefore, desire

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		that the adequacy of the existing procedures should be reviewed immediately and necessary measures taken to plug all loopholes in relation to operations by unscrupulous foreign investors. The Committee would like Government to examine seriously how far remittances by foreign companies towards head office expenses should if at all, be permitted, and the Reserve Bank should move positively in this matter and take appropriate action thereafter. In this context, the Committee consider it pertinent to draw the attention of Government to Article 2 of the UN Charter of Economic Rights and Duties adopted on 12th December, 1974 by the United Nations General Assembly, according to which each State has the right to regulate and exercise over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities and to regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies.
31	3·38 Finance (Rev. & Ins.)	In paragraphs 9.13 and 9.14 of their 176th Report (Fifth Lok Sabha), the Committee had, *inter-alia* commented on the absence of any uniform guidelines for the assessing officers on the treatment of head office expenses for purposes of income-tax and had desired

			that guidelines in this regard, which were stated to be under finalisation on the basis of certain case studies and a study note prepared as early as August, 1973, in consultation with a few Commissioners of Income-tax, should be finalised without further loss of time and necessary instructions issued to the assessing officers. The Committee have been informed by the Department of Revenue & Insurance, in October, 1975, that necessary guidelines in this regard had been issued only on 16 June, 1975. The Committee are perturbed over such egregious delay in taking a final decision on an issue which is vital both from the taxation and foreign exchange angles. The Committee would like very much to know the reasons for this delay and would reiterate their earlier recommendation that responsibility for it should be fixed for appropriate action. Now that the guidelines have at long last been issued, the Committee trust that real scrutiny of head office expenses by assessing officers would be facilitated and would produce the desired results. The adequacy of these guidelines should be reviewed later, on the basis of the experience gained in the field on their implementation, and such improvements, as are found necessary, effected. The Committee would keenly watch the effect of these guidelines on the assessing officers.
32	3.39	Do.	In view of the fact that there has been a substantial increase in the remittances made by foreign companies towards head office expenses during the years 1965—69, the Committee feel that it would

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			be worthwhile for Government to review the veracity of the claims admitted during this period in respect of other foreign companies and banks as well. Since such a review is likely to yield rich dividends, the Committee desire that it should, be undertaken forthwith, and would await a detailed report in this regard. It is, however, regrettable that the Central Board of Direct Taxes had not taken up so far a careful study of this problem with a view to ascertaining its magnitude and taking adequate steps to ensure proper tax compliance.
33	4·22	Finance (Rev. & Ins.)	The Committee view with concern the irregular extension of the benefits admissible to priority industries, under Section 80-E/I of the Income-tax Act, and of higher development rebate permissible to the petrochemical industry, to a company (J. K. Synthetics Ltd.), controlled by a monopoly house, manufacturing nylon yarn, which is only a product derived from the petrochemical base, caprolactum. This has resulted in a short-levy of tax amounting to Rs. 73.57 lakhs for the three assessment years 1967-68 to 1969-70. In addition, an interest of only Rs. 1.05 lakhs had been levied, under Section 139 of the Income-tax Act, for the belated filing of the return of income for the assessment year 1968-69, as against Rs. 1.55 lakhs actually leviable.

34	4·23	Do.	The Committee find that a strange procedure appears to have been adopted in this case by the Income-tax Officer who made the original assessments for the years 1967-68 to 1969-70 by asking the Indian Institute of Petroleum, Dehradun, for a technical opinion on the subject when it would have been more appropriate to refer the case, if there was any doubt, to the Chief Chemist, Central Revenues Control Laboratory, New Delhi. In fact, when the Chief Chemist was consulted, subsequently, in December, 1973, he had categorically opined that Nylon-6, manufactured from caprolactum, being a finished article, was not covered by the term 'petrochemical' referred to in item 18 of the Sixth Schedule to the Income-tax Act. Expert opinion apart, it is evident, from the purely commonsense point of view, that the manufacture of intermediate or finished products from a basic petrochemical, especially when the raw material base itself is manufactured elsewhere or is imported, cannot be deemed to be a petrochemical industry qualifying for the benefits of priority industries. If one were to apply logically the standard adopted in this case by the Income-tax Officer initially, then almost every article or product manufactured out of petrochemicals should be subject to concessional rates of tax, which would be clearly against the letter and spirit of the concession given by the Parliament.
35	4·24	Do.	What is even more strange about the manner in which this case has been handled is that the Central Board of Direct Taxes

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			should have also initially agreed with the assessment of J. K. Synthetics Ltd. as a priority industry. This was done on a reference made in this regard by the Commissioner of Income-tax, in December 1972, after another Income-tax Officer had correctly decided to disallow the claim of the company for the assessment year 1970-71. Though the reasons for the unusual enthusiasm shown in this case by the Commissioner of Income-tax are not entirely clear, having regard to certain serious allegations against the Commissioner of Income-tax that have been brought to the notice of the Committee and the influence known to be wielded by the monopoly group controlling the company, the Committee cannot held feeling that unseen forces have, perhaps, been at play in shaping the course of the case. The Committee would, therefore, like to be satisfied that no 'malafides' are involved and desire that a thorough probe should be conducted into the handling of the case at various stages and the conduct of the officials responsible for the misclassification of the company as a priority industry and the consequential under-assessment of tax as well as the short-levy of interest for the belated filling of the return for the assessment year 1968-69. The results of the probe, which needs to be completed expeditiously, should also be intimated to the Committee early.
36	4·25	Finance (Rev. & Ins.)	One redeeming feature of the case is that the mistake has now been set right, though belatedly, and detailed instructions have

			been issued in October, 1974 that an industry manufacturing Nylon-6 from imported caprolactum is not a priority industry. The Committee also note that necessary steps have been taken to withdraw the relief already allowed and to carry out rectification in similar cases. The collection of the additional tax due in this case has, however, been thwarted by the assessee approaching the Income-tax Appellate Tribunal and Courts of Law. The Committee have been informed that the Appellate Tribunal has considered Nylon-6, manufactured out of caprolactum to be a 'petrochemical'. A writ petition filed by the assessee in the Allahabad High Court against the remedial action, under Section 263, by the Department for assessment year 1967-68 has been allowed on the ground that the Income-tax Officer's Order, in the circumstances of the case, had merged with the order of the Appellate Assistant Commissioner which was passed earlier to the order under Section 263. The Committee learn that as a result of the High Court's decision, the additional demand has been reduced to nil and that Government propose to file an appeal in the Supreme Court. The Department also proposes to test the decision of the Income-tax Appellate Tribunal in the High Court. The Committee would urge Government to take all possible steps to expedite the appeal procedings.
37	4·26	Do.	In this context, the Committee would once again draw the attention of Government to an earlier recommendation of theirs contained in paragraph 2.30 of their 128th Report (Fifth Lok Sabha), wherein the Committee, commenting on the tendency on

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			the part of some assessees to frustrate the rectification of even patent mistakes by seeking legal remedies on mere technical grounds, had suggested that Government should examine whether any amendment to the Act was necessary to ensure that the rectifications of patent mistakes was not frustrated by assessees on such technical grounds. The Committee had then been informed by the Department of Revenue & Insurance that a similar recommendation of the Direct Taxes Enquiry Committee (Wanchoo Committee), that revenue matters, in respect of which adequate remedies are provided in the respective statutes themselves, should be excluded from the purview of Article 226 of the Constitution, was being examined by Government. The Committee would like to be informed of the final decision, if any, in this regard. In case a decision is yet to be taken on this recommendation, the Committee desire that this should be processed on a priority basis and the necessary amendment made, as this would greatly facilitate the collection of revenue.
38	4·27	Finance (Rev. & Ins).	As regards the short-levy of interest for the belated filing of the return of income for the assessment year 1968-69, the Committee have been informed that additional demands totalling Rs. 50,318 have now been raised and that bulk of the additional demand has also been collected. The Committee desire that early steps should be taken to recover the balance also.

3	·28	Do.	It is also extremely distressing that none of the three assessments relating to this company had been checked by Interral Audit, despite the fact that the assessments related to a large income monopoly group. The familar but entirely specious excuse that the assessments could not be checked by the Inspector concerned on account of forgetfulness and by the Chief Auditor on account of 'pressure of work', has once again been trotted out. The Committee gravely disapprove of such apathy on the part of the Department in regard to the important aspect of internal checking.
40	4·29	Do.	The Committee had also had occasion to examine separately the grant of a large refund of Central Excise duty amounting to Rs. 1.37 crores, on revision, to J.K. Synthetics Ltd. The Committee have been informed by the Central Board of Direct Taxes that the Commissioner of Income-tax had been instructed, on 7th May 1974, to look into this matter and verify that the refund had been fully accounted for in the books and the returns of income. A long time has passed since then, and the Committee would like to be apprised immediately of the results of the verification.
41	4·31	Do.	Incidentally, the Committee have received a representation alleging various corrupt practices on the part of the Commissioner of Income-tax concerned. The Committee have learnt from the Chairman, Central Board of Direct Taxes, in this connection that a series of allegations had been made against this particular officer and that these complaints were being investigated both by the CBI as well as the Department. While the Committee, naturally, would not express

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			any opinion at this stage, they would, in view of the gravity of the charge and the status of the official, urge Government to complete the investigations without delay and take all appropriate action.
42	4·31	Finance (Rev. & Ins.)	It has been alleged that the transfers of the Income-tax Officer who had reopened the case of J.K. Synthetics Ltd., and of the Appellate Assistant Commissioner, who had upheld the contention of the Income-tax Officer were mala fide. The Committee have carefully considered the factual position in this regard with the assistance of the Department of Revenue & Insurance. The Committee feel that they should, in general terms, impress upon Government the imperative need of ensuring that the assessing officers of a sensitive area like the Income Tax Department have the confidence that conscientious and capable work would receive recognition and approbation merited by it and that deflection from the path of duty would not be countenanced. This is a principle of conduct which the top echelons of the Department should keep constantly in mind.
43	4·79	Do	This case is one more instance of a non-resident, foreign company (Calcutta Electric Supply Corporation Ltd.), with a returned income of over Rs. 9 crores for the Three assessment years 1967-68, 1968-69 and 1969-70, benefiting substantially from negligence and oversight, at all levels of the Income Tax Department, in the computation of the depreciation allowance admissible to it. The

Committee have been informed that the company had all along submitted its depreciation schedules in Pound sterling along with its returns of income. While preparing the schedules for Income-tax purposes, the company did not, however, start with the original rupee value of its assets for working out their written-down value. Surprisingly, the different Income-tax Officers who assessed the company to tax did not also notice this anomaly and prepare a depreciation schedule showing the cost of the assets, their written-down value and the admissible depreciation in terms of rupees. Instead, in accordance with the past practice in this regard, they computed the depreciation with reference to the written down value in Pound Sterling, even after the devaluation of the Rupee in June 1966. This resulted in excess depreciation being allowed to the company, for the three assessment years, leading to an under-assessment of tax of Rs. 1.53 crores and corresponding excess payment of interest, amounting to Rs. 48.57 lakhs, on the advance tax paid by the company. This simple but costly mistake could have been avoided with a little more vigilance and care. The Committee find that the assessment for 1967-68 had been completed only on 1st October 1971, even though the return of income had been filed on 29th December 1967. Similarly, the assessments for 1968-69 and 1969-70 were completed on 21st December 1971 and 28th February 1972 respectively. It is evident that proper attention had not been paid to the timely assessment of a large income company. The Committee take a very serious view of this egregious and expensive lapse.

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44	4·80	Finance (Rev. & Ins.)	The Committee find it even more disturbing that these assessments were checked neither by the Inspecting Assistant Commissioner concerned nor by Internal Audit. It has been stated by the Department of Revenue and Insurance that during the relevant period, the Inspecting Assistant Commissioner was holding additional charge of establishment and that due to 'heavy work', it was not possible for him to check the depreciation allowed in this case. Further, even though instructions had been issued by the Central Board of Direct Taxes, as early as 1965, that all company assessments should be checked cent-per-cent by Internal Audit and depreciation was also required to be checked by an Income-tax Officer specially entrusted with the task, the assessments for all the three years, though reported to the Internal Audit Party, could not be checked. The Committee learn from the Department that as it was not possible for the Special Income-tax Officer to check all cases, he was picking up some files, apparently at random, and checking them. The Committee would very much like to know the basis on which cases were selected for scrutiny by the officer, for it is incomprehensible how a case in which the depreciation allowance amounted to as high a sum as Rs. 2.19 crores could have escaped his notice.
45	4·81	Do.	In cases with large revenue implications, such as the one under examination, the Committee cannot countenance what appears to be a casual approach on the part of the officials con-

cerned. Neither can the Committee accept the plea of 'pressure of work' or 'over-work'. A system which allows for such explanations itself stands condemned. As has been pointed out by the Committee, in paragraph 3.63 of their 128th Report (Fifth Lok Sabha), it is upto Government to see that proper arrangements are made to ensure effective compliance with their instructions and to carefully assess the work-load, keeping in view the quality aspect, so as to provide adequate staff commensurate with the work-load involved. Having due regard to the revenue involved in the present case, the Committee must recommend a close investigation into the circumstances leading to the deplorable failure, at all levels of the Department, to detect the mistake, pointed out by Audit, and also fixation of responsibility for appropriate disciplinary action.

46 4·82 Do.

The Chairman of the Central Board of Direct Taxes has been good enough to admit before the Committee that whatever revenue Government would get out of this case is entirely attributable to Revenue Audit. However, Government should not merely rest content with acknowledgement of error and paying a graceful tribute to Audit for having done its duty. What is required, when such dereliction is brought to light through test check by Audit, is a more positive approach, a determined gearing up of the entire machinery for genuine scrutiny of all such cases, and purposeful investigation with a view not only to rectification of errors but also to forestalling them. The Committee are, unhappy that the steps

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			so far taken by the Ministry of Finance and the Central Board of Direct Taxes to ensure effective compliance with their own instructions and those issued at the instance of the Committee in the past, particularly those relating to the computation of depreciation and development rebate, leave much to be desired.
47	4·83	Finance (Rev. & Ins.)	In this context, the Committee recall their oft-repeated concern over the large number of cases of under-assessment of tax on account of incorrect allowance of depreciation, commented upon in successive Audit Reports and Reports of the Committee year after year. It is disturbing that despite the Committee having made a number of suggestions in this regard, many of which had also been accepted by Government for implementation, there appears to be no perceptible improvement in the situation. The Committee have attempted a review, in some detail, of the implementation by Government of recommendations made by the Committee during the past decade relating, among other things, to depreciation and development rebate in their 186th Report (Fifth Lok Sabha). The Committee are confident that if the measures suggested by them in this Report are implemented by Government, they would bring about significant improvement in the work of the Income-tax Department.
48	4·84	Do.	Another unhappy feature of the case under scrutiny is that the collection of the additional tax due from Calcutta Electric

Supply Corporation should have been kept in abeyance by the Commissioner of Income-tax till the disposal of the first appeal filed by the company before the Income-tax Appellate Tribunal. The Committee are distressed that an extra-legal concession, and that too without obtaining any security for the additional demand, should have been extended to a defaulting but powerful and long entrenched foreign company on the basis of what has been described as 'the usual departmental practice'. The Chairman of the Central Board of Direct Taxes as well as the Commissioner of Income-tax West Bengal-1, have admitted, before the Committee that if the Department wanted to and did take 'a very stern and rigid view of the matter', the recovery could be pressed and enforced. The Committee desire that principled action, even on occasion 'very stern and rigid', should be taken, which, it is feared, did not happen in this case. It would be of interest to know in how many cases a similar concession had been extended, if only as a matter of convention, by the Income-tax Department to the multitude of small assessees.

49	4·85	Do.	Besides, though the Commissioner of Income-tax had agreed, during evidence, to consider revocation of the stay and enforcement of recovery of the arrears, it required some positive intervention by the Committee to ensure that a considerable demand was realised, partly by cash and partly by adjustment of refunds due for the assessment years 1970-71 and 1971-72. It appears, however, that an amount of Rs. 70 lakhs was still to be recovered from the

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			company as on 15th March 1975. Now that the appeals of Calcutta Electric Supply Corporation against the orders of the Additional Commissioner of Income-tax, under Section 263 of the Income-tax Act have been dismissed by the Appellate Tribunal, the Committee desire that the balance of tax due should also be recovered forthwith, in case this has not already been done.
50	4.86	Ministry of Finance (Rev. & Ins.)	The unduly long time taken by the Income Tax Appellate Tribunal in passing final orders also causes concern to the Committee. Even though the hearing in this case had concluded on 17 February 1975, the Tribunal took over two months to pass orders. Here again, the Committee had to enter into protracted correspondence with Government to ensure that the orders were announced expeditiously. The facts of the case had also to be brought to the notice of the Finance Minister himself before the orders were finally announced on 30th April 1975. It is strange that the Tribunal should have taken so much time, after the conclusion of the hearings, to give its verdict even in important cases involving large revenues, when the very objective of setting up such Tribunals was to reduce the time spent in litigation in courts of law and to expedite decisions in revenue matters. The Committee would like Government to consider the feasibility of prescribing a suitable time-limit for the Appellate Tribunal to pass final orders after the conclusion of the hearing.

51	4.87	Do.	Yet another important issue arising out of the examination by the Committee is the appropriation by the company of the deposits made by the consumers towards the profits of the company and their transfer to its general reserves. Since this is tantamount to tax-avoidance, as the Commissioner of Income-tax himself conceded, the Committee take a very serious view of this default. The Committee learn that the transferred deposits have been taxed for the assessment year 1972-73 and penalty proceedings initiated. The assessments for the earlier years are also being reopened simultaneously with penalty proceedings. The Department has taken the stand that in this case concealment has been effectively established. Since what rightly belongs to the consumers and was held in trust by the company has been utilised by it for its own gains without any corresponding benefit to the consumers, the Committee insist that this should be looked into from the tax angle on a top-priority basis, under the direct supervision of the Commissioner and the Central Board of Direct Taxes, and stringent action, under the law, taken. In the present climate when concerted drive is already under way to combat tax evasion, this should not be too difficult a task.
52	4.88	Do.	The practice of receiving deposits from consumers is also prevalent in other public utility organisations. Since it is likely that such deposits might have also been appropriated by such organisations towards their own profits and transferred to their general reserves, the Committee desire that a review of all such cases should also be

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			undertaken from the tax angle and necessary rectificatory action taken. The Central Board of Direct Taxes should issue general instructions in this regard for the guidance of the assessing officers in the light of the facts disclosed in the present case.
53	5·15	Ministry of Finance (Rev. & Ins.)	The Committee deplore the inordinate delay of about four years that had occurred in the finalisation of assessments of a company (Indian Iron & Steel Co. Ltd.) in the large-income bracket, as a result of which Government had to pay a large sum of Rs. 40.30 lakhs as interest to the assessee under Section 214 of the Income-tax Act. The Committee find that even though the assessee company had filed its returns of income for the assessment years 1967-68 and 1968-69 on 15th November 1967 and 26th September 1968 respectively, disclosing incomes of Rs. 1.74 crores and Rs. 0.42 crore, the assessments were completed by the Income-tax Officer only in February 1972, and that even the first hearing for the assessment year 1967-68 was taken up as late as 24th January 1972 and that for the assessment year 1968-69 on 2nd February 1972. As the amounts of advance tax of Rs. 2.12 crores paid for the assessment year 1967-68 and Rs. 0.80 crore for the assessment year 1968-69 far exceeded the tax payable on the basis of the respective returns of income, the Committee are of the view that the Income-tax Officer should have safeguarded the financial interests of Government by completing the regular assessments as soon as possible after the receipt of the returns so that the advance tax paid

			in excess could have been refunded to the assessee, in terms of the Board's instructions dated 16th April 1966. That the Income-tax Officer did not do so would indicate that the Officer concerned had been negligent in the discharge of his duties.
54	5·16	Do.	The Committee learn that disciplinary proceedings have been initiated against the Officer responsible for the delay in the present case. The Committee desire that these proceedings should be completed quickly and the final action taken against the officer intimated to them.
55	5·17	Do.	The Committee note the view taken by the Department of Revenue & Insurance that there had been no lapse in this case in so far as the question of making provisional assessments under Section 141A was concerned. The Committee have been informed in this connection that provisional assessment under this Section could be made in law only in a case where the assessee had made a claim that the advance tax paid by him or the tax deducted at source in his case exceeded the tax payable on the basis of the return of income filed by him and the statement of accounts, documents, etc. accompanying it, and that since no such claim had been made by the assessee in the present case, it would not be covered by the provisions of Section 141A. However, with a view to ensuring that adequate steps are taken to prevent avoidable payment of interest by Government in such cases, the Committee would suggest that Government should examine the feasibility of making provisional assessments by Income-tax Officers obligatory in cases in which the advance tax paid exceeds the income returned substantially.

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56	5·18	Finance (Rev. & Ins.)	The delay in finalising the assessments in this case had also not been noticed by the concerned Inspecting Assistant Commissioner or the Commissioner as the case never came into their orbit. All large income cases, however, are expected to be reviewed by the supervisory officials. The only inference the Committee can thus draw from the failure of the Inspecting Officers is that the middle management in the Income-tax Department is somewhat lax. The Committee fear that if this continues, the maladies of the Department would persist. It is, therefore, urged that the Central Board of Direct Taxes should review seriously the duties and responsibilities at present entrusted to the Inspecting Assistant Commissioners and the effectiveness of the supervision exercised by them with a view to evolving suitable remedial measures.
57	5·19	Do.	The Central Board of Direct Taxes should also devise immediately a fool-proof system for a regular and more efficient monitoring of the progress of assessments relating to large income cases and tighten the inspection machinery. The Directorate of Inspection and the Board have an inescapable obligation in this regard. In this context, the Committee reiterate their earlier recommendations in regard to the persistent tendency on the part of Income-tax Officers to complete assessments only towards the close of the limitation period. Apart from the loss that may arise on payment of interest in cases like the one discussed in the preceding paragraphs, the Committee fear that

			by so rushing through assessments, there is the greater risk of the returns not being scrutinised properly and consequential loss of revenue through inadequate examination.
58	6·12	Do.	The Committee are concerned to note that while correctly excluding the deductions admissible under Sections 80E/I, 80J and 80MM of the Income-tax Act from chargeable profits, the Assessing Officer had failed, in this case relating to a foreign company (Union Carbide India Ltd.), to reduce proportionally the amount of the capital as required under Rule 4 of the Second Schedule of the Company (Profits) Sur-tax Act 1964, which led to an excess statutory deduction under Section 2(8) of the Act and consequent under charge of sur-tax of Rs. 26.88 lakhs for the assessment years 1966-67, 1970-71, 1971-72 and 1972-73. That such a mistake should have occurred despite the clear and unambiguous rules framed in this regard would indicate that the assessing officer had not exercised care in finalising the assessments. The Committee would like the circumstances leading to this mistake to be gone into and appropriate action taken thereafter.
59	6·13	Do.	The Committee understand that remedial action, under Section 13, has been taken in respect of the assessments relating to the years 1970-71, 1971-72 and 1972-73 and necessary additional demands raised. For the assessment year 1966-67, while no remedial action under Section 13 was possible, on account of the assessment having become time-barred, action under Section 8(a) of the Act has, however, been taken in time and an additional demand of Rs. 78,071 raised.

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60	6·14	Finance (Rev. & Ins.)	The Committee find that the Audit Memo in this case had been issued on 13th March 1973, and remedial action under Section 13 of the Act in respect of the assessment year 1966-67 was permissible up to 7th September 1973. If the Department had, therefore, taken prompt action on receipt of the Audit query, the rectification for the assessment year 1966-67 could also have been made under Section 13 before the assessment became time-barred. The Committee take a serious view of the delay in initiating action on Audit objections, and desire that responsibility for the failure should be fixed and the action taken intimated early to the Committee. A suitable time-limit for initiating rectificatory action in such cases should also be prescribed, in consultation with the Comptroller and Auditor General of India.
61	6·15	Do.	The Committee also view seriously the lapse on the part of the Internal Audit in not checking the assessments. Even though the Chief Auditors themselves were required to personally check these assessments, they had not done so and the failure on their part has been, as usual, attributed to 'pressure of work'. The Committee regret to observe that the same familiar excuse is offered by the Department time and again, which is only indicative of a definite weakness in the existing machinery for internal audit. The Committee need hardly emphasise the importance of a sound and efficient

			internal audit organisation and desire that the adequacy of the existing arrangements for internal audit should be reviewed in detail and necessary remedial steps taken.
62	6·16	Do.	In this connection, the Committee, find that in all such cases where serious lapses have been found, Government merely rest content with obtaining an explanation from the concerned officials and issuing a warning. This ritual, in the opinion of the Committee, will neither help the Administration nor the exchequer. The Committee are of the view that a more positive and dynamic procedure has to be evolved in this regard so that punishments are granted according to the magnitude and seriousness of the lapse committed by the officials and positive action taken even in two or three cases acts as a deterrent to others. The Committee are also of the view that where there has been a failure or lapse in the discharge of responsibility by an officer at any level, he should be proceeded against rather than some petty officials working under him.
63	6·1	Do.	The Committee would also like to be informed of the final decision of the Income-tax Appellate Tribunal on the assessee's appeal against the additional demand of Rs. 13.10 lakhs relating to the assessment year 1972-73.
64	6·30	Do.	The Committee take a serious view of the mistake that had occurred in this case relating to a company, Gwalior Rayon Silk Manufacturing (Wvg.) Company Limited, again linked with a monopoly group, in computing the capital of the company, under Rule 3

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			of the Second Schedule of the Companies (Profits) Sur-tax Act, 1964. The incorrect augmentation of the capital proportionally, after taking into account the bonus shares worth Rs. 2.50 crores issued by the company by utilising a part of the accumulation in its general reserve, had resulted in an excess statutory deduction of Rs. 15.07 lakhs under Section 2(8) of the Act and consequent short-levy of tax of Rs. 5.27 lakhs. The circumstances in which a mistake like this had been committed by the Income-tax Officer has not been satisfactorily explained by the Department. Besides, the attempt at extenuation by reference to an unfortunate misreading of the Second Schedule can only be considered as very special pleading and by no means convincing. The Committee cannot but take a grave view of lapses involving large losses to the revenue. The circumstances leading to this mistake require to be investigated with a view at least to ensuring that no malafide intentions were involved.
65	6·31	Finance (Rev. & Ins.)	It is also surprising that neither the Inspecting Assistant Commissioner nor the Commissioner had looked into this case, even though the charge in which the case had been assessed does not appear to have more than a few large income cases of this type. The Committee would like Government to find out whether the supervisory officials had inspected the ward in which the case was assessed at any time after the assessment had been made and, if so, how this

			particular case had escaped their notice. In case there has been any remissness on their part in this regard, appropriate action should be initiated.
66	6·32	Do.	The Committee note that the rectificatory proceedings under Section 13 of the Act has been stayed by the Madhya Pradesh High Court on a writ petition filed by the assessed, challenging the issue of notice under Section 13. This is one more instance where the rectification of even patent mistakes has been frustrated by the assessee seeking a legal remedy. In this connection, the Committee would invite the attention of Government to an earlier recommendation of theirs contained in paragraph 2.30 of their 128th Report (Fifth Lok Sabha) and reiterated in paragraph 4.26 of this Report on the question of amending article 226 of the Constitution in so far as it relates to revenue matters, in respect of which adequate remedies are provided in the respective statutes themselves.
67	6·33	Do.	The Committee find that Gwalior Rayon Silk Manufacturing (Wvg.) Company Limited is being assessed at Indore even though most of the assessments relating to the Birla Group of companies are centralised in Central Circles or Special Circles in Bombay and Calcutta and a special cell has also been set up in Delhi to deal with the income-tax cases of this group. The response of the Ministry of Finance to an enquiry by the Committee into the reasons for this arrangement is a surprising silence. The Committee are of the view that the Income-tax cases of this company should also be transferred

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			to the special cell at Delhi so that all ramifications which this particular unit of the Birla Group may have with the other units of the group could be unravelled and properly looked into.
68	6·34	Finance (Rev. & Ins.)	Another intriguing point emerging out of this case relates to the extension of the capital plus reserve base for the purpose of lowering the sur-tax liability. The Committee have came across a number of instances in the earlier Audit Reports where the profits of a particular year are first credited to the General Reserve and appropriations made thereafter for declaring dividends. Since such a transfer of the profits to the General Reserve may only be a ruse to lower the sur-tax liability, by claiming higher exemptions on an artificially enhanced capital base, the Committee would like to know whether Government have contemplated or conducted any study of the sur-tax assessments of companies which might have adopted such a method of tax-avoidance. In case such a study has not so far been undertaken, the Committee would recommend that this should be initiated forthwith and the outcome of the study intimated as early as possible. Government should also examine whether any amendment to the existing Act and Rules is necessary to prevent such an abuse.
69	7·1	Do.	The case discussed herein reveal certain grave deficiencies in the functioning of the Income Tax Department, particularly in the arena of company taxation. They involve assessments where the returned

income often runs into crores of rupees. Only a test check by Statutory Audit of the assessments in nine cases of foreign and Indian companies, belonging to multi-national corporations or monopoly groups, has disclosed non-levy/under-assessment of tax and excess payment of interest, adding up to the staggering figure of Rs. 3.66 crores. Obviously there is something very wrong with the administration of company taxation at various levels. The Committee feel considerable dis-quiet over the mistakes and omissions discussed at some length in this Report. These defaults have become almost repetitive in character, in spite of many recommendations made by the Committee in this regard in the past and the mass of detailed instructions issued from time to time by the Central Board of Direct Taxes. As observed in paragraph 9.17 of their 176th Report (Fifth Lok Sabha), the Committee are constrained to the view that while the Income-tax Department does not hesitate to harass small-income assessees, such ardour seems to be lacking where large-income assessees are concerned.

70 7.2 Do.

The errors and omissions in the assessment of large-income cases which have come to the notice of the Committee are broadly attributable to one or the other of the following factors:

(i) sheer negligence or laxity on the part of assessing officers;

(ii) inadequate and improper planning of work by the assessing officers an non-allocation of proper priorities for the timely completion of large-income cases, resulting in hasty

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			assessments and disposals without adequate scrutiny towards the end of the limitation period; (iii) complacency on the part of the Ministry of Finance and the Central Board of Direct Taxes towards issuing guidelines in respect of assessment of important items of expenditure such as 'Head Office Expenses' of foreign companies operating in India and 'expenditure on scientific research' which often serve as facades to facilitate tax-avoidance; (iv) inadequacy of internal control and supervision, particularly at the middle management level; and (v) ineffectiveness of internal audit. In the preceding chapters, the Committee have tried not only to trace the reasons for such default but also to suggest remedial measures. The Committee trust that at least in the context of the present National Emergency, Government will take more serious notice of their observations and recommendations and display a less inhibited approach in implementing them.
71	7·3	Finance (Rev. & Ins.)	The Committee would, in particular, like to draw Government's immediate attention to the deficiencies in internal control and supervision in the Income-tax Department, especially at the middle

			management level of Inspecting Assistant Commissioners, which have been brought into sharp focus in the cases discussed in this Report. It is distressing to observe these middle-level officers often rather remiss in the discharge of the duties entrusted to them. The Committee emphasise that these officers have precise and purposeful role which they are enjoined to perform but with disappointing results so far.
72	7·4	Do.	Another reason for the recurrent mistakes in assessment, particularly in large income cases is that, in the absence of any categorisation of different types of cases and disposals on a selective basis, even assessments with large revenue implications are left in the hands of Income-tax Officers with comparatively less experience. In the circumstances, Government should seriously consider the desirability of entrusting the assessment of such cases directly to the Inpecting Assistant Commissioners of Income-tax. The Chairman, Central Board of Direct Taxes has himself admitted, during evidence, that Government is 'very much conscious of this deficiency' and has assured the Committee that he would try to ensure concentration on large-income group cases by experienced officers and to transfer certain cases to the Assistant Commissioners also. The Committee have examined the subject of supervision and internal control and the question of entrusting direct assessment work to the Inspecting Assistant Commissioners at considerable length in their 186th Report (Fifth Lok Sabha) and have made specific suggestions and recommendations which, it is urged, should be dealt with on a priority basis and implemented forthwith.

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73	7·5	Finance (Rev. & Ins.)	The Committee have not been able to examine some of the paragraphs relating to Corporation Tax included in Chapter II of the Report of the Comptroller and Auditor General for the year 1972-73, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes on account of paucity of time. The Committee expect, however, that the Department of Revenue & Insurance and the Central Board of Direct Taxes will take necessary remedial action in these cases, in consultation with Statutory Audit.

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