P.A.C. NO. 67

# PUBLIC ACCOUNTS COMMITTEE
# (1977-78)

## (SIXTH LOK SABHA)

## TWENTY-EIGHTH REPORT

## IRREGULAR ALLOWANCE OF DISCOUNT TO A FOREIGN COMPANY

## MINISTRY OF FINANCE (DEPARTMENT OF REVENUE)

**[Paragraph 17 of the Report of the Comptroller and Auditor General of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II; Direct Taxes relating to Irregular Allowance of Discount to a Foreign Company.]**

*Presented in Lok Sabha on* 15 DEC 1977
*Laid in Rajya Sabha on* 15 DEC 1977


LOK SABHA SECRETARIAT
NEW DELHI

*November, 1977/Agrahayana, 1899(S)*
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| Page | Para | Line | For | Read |
|---|---|---|---|---|
| 3. | 1.8 | 5 | Lake | Lube |
| 3 | 1.10 | 8 | contracts | contract |
| 7 | 1.20 | 3 | Taku | Takru |
| 16 | 1.40 | 2 | After 'had', | insert 'not' |
| 18 | 1.44 | 6 | Delete 'and' | |
| 24 | 1.61 | 4 | rise | raise |
| 26 | 1.67 | 4 | After '1962', | put full stop. |
| 26 | 1.67 | 9 | accuring | accruing |
| 31 | 1.80 | Table | 61,12,492 | 61,42,492 |
| 32 | 1.84 | 2 | bases | basis |
| 32 | 1.86 | 5 | pro-rate | pro-rata |
| 36 | 1.99 | 7 | Delete comma | after 'completed' |
| 39 | 1.110 | 10 | our | out |
| 41 | 1.116 | 1 | desire | desired |
| 42 | 1.121 | 9 | on | own |
| 43 | 1.122 | 27 | realist | realise |
| 44 | 1.124 | 18 | Vic | Vice |
| 48 | 1.129 | 10 | After 'also', | insert 'be' |
| 48 | 1.129 | 30 | there | therefore |
| 49 | 1.131 | 3 | attribute | attributable |
| 50 | 1.134 | 4 | developed | devolved |
| 50 | 1.134 | 13 | no | on |
| 50 | 1.134 | 15 | dut | due |
| 51 | 1.137 | 8 | 37(i) | 37(1) |
| 51 | 1.137 | 10 | official | officials |
| 51 | 1.139 | 6 | Whil | While |
| 52 | 1.139 | 4 | related | belatedly |
| 69 | 1.134 | 8 | either | neither |
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# LIST OF MEMBERS OF PUBLIC ACCOUNTS COMMITTEE (1977-78)

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Shri C. M. Stephen

MEMBERS

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22. Shri Zawar Hussain

SECRETARIAT

Shri B. K. Mukherjee—*Joint Secretary.*

Shri Bipin Behari—*Senior Financial Committee Officer.*

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*Elected w.e.f. 23 November, 1977 *Vice* Sarvashree Shoe Narain and Jagdambi Prasad Yadav ceased to be a Members of the Committee on their appointment as Minister of State w.e.f. 14-8-77.

## INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Twenty-Eighth Report of the Public Accounts Committee (Sixth Lok Sabha) on Paragraph 17 of the Report of the Comptroller and Auditor General of India for the year 1973-74 Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, relating to Irregular Allowance of Discount to a Foreign Company.

2. The Report of the Comptroller and Auditor General of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes was laid on the Table of the House on 9 May, 1975. The Public Accounts Committee (1976-77) examined the paragraph 17 relating to Irregular Allowance of Discount to a Foreign Company at their sittings held on 16 November, 1976, but could not finalise the Report on account of dissolution of the Lok Sabha on 18 January, 1977. The Public Accounts Committee (1977-78) considered and finalised this Report at their sitting held on the 17 November, 1977. The Minutes of the sittings form Part II* of the Report.

3. A statement containing conclusions/recommendations of the Committee is appended to this Report (Appendix II). 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 Chairman and Members of the Public Accounts Committee (1976-77) in taking evidence and obtaining information on this Report.

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

6. The Committee would like to express their thanks to the Department of Revenue and Banking (now Department of Revenue), Ministry of Finance for their cooperation extended by them in giving information to the Committee.

C. M. STEPHEN,
*Chairman,*
*Public Accounts Committee.*

NEW DELHI;
*November* 28, 1977.
*Agrahayan* 7, 1899 (*S*).

* Not printed. One cyclostyled copy laid on the Table of the House and five Copies placed in Parliament Library.

## *REPORT*

## IRREGULAR ALLOWANCE OF DISCOUNT TO A FOREIGN COMPANY

*Audit Paragraph*

By an agreement entered into in August, 1961, between the Indian Refineries Limited and a foreign company having world-wide operations, the foreign company undertook to construct pipe-line and erect permanent pumping stations and terminals and also to supply materials to be employed in the work. The payment was to be made in rupees as well as in foreign currency; the latter, which was to cover the estimated cost of goods and services of non-Indian origin, was expressed in terms of U.S. dollars. According to the terms of agreement, 5 per cent of the foreign currency payment was to be made on the date of signature of each contract, another 3 per cent on the expiry of 12 months from the date of signature, and the balance in 20 equal half yearly instalments starting on the expiry of 2 years after the signature of the contract. The drafts which were to be drawn by the Indian Refineries Limited in U.S. dollars were to mature at intervals of six months, and thus, the first instalment being payable after 24 months, the last draft would mature after 138 months. The amounts represented by these drafts were to carry interest at six per cent per annum and separate drafts for interest were to be issued. The contract did not provide for any discount the party may voluntarily incur in encashing the dollar drafts earlier than when they were due.

1.2. In the balance sheets prepared for the Indian business, these drafts did not form part of the assets of the company's Indian business, but were transferred by the company to its head office. Similarly, the liabilities on account of foreign materials purchased by the head office abroad, formed part of head office account; the head office in turn having a running account with the Indian branch, which showed the net result at the end of the year after taking into account the debits on account of materials supplied and services rendered by head office and credits for remittances from India.

1.3. On 29th December, 1966 the foreign company had with it, in its head office account, the drafts issued by the Indian Refineries Limited of the aggregate face value of $1,79,66,255 falling due for payment in 1966—74. These drafts were discounted on that date with a bank in Geneva and after paying discount charges of $ 80,28,104 (Rs. 6.05 crores) ($ 77,37,881 on dollar drafts and $ 2,90,223 on lira drafts), the net

proceeds realised were $ 99,38,150. The discount charges amounting to Rs. 6.05 crores in terms of Indian currency were allowed as deduction in the assessment for the year 1967-68, treating it as expenditure incurred wholly and exclusively for the purpose of business. This was irregular for the following reasons:

(a) According to the contract, there is no provision permitting the party to discount the dollar drafts.

(b) The allowance was made on the basis of certificate dated 2nd August, 1971 from the company's auditor that the amount realised by the sale of dollar drafts was utilised to pay off the loans and other liabilities relating to the Indian business, even though according to the company itself, it was not able to correlate these dollars to their utilisation for paying liabilities of the Indian branch.

(c) Out of total cost of Rs. 21.45 crores incurred in Italy upto 31st December, 1965, the cost of capital assets came to Rs. 3.76 crores (i.e., nearly 18 per cent) and the entire amount of discount charges could not, therefore, be treated as revenue expenditure.

(d) In view of the fact that interest at six per cent per annum had already been paid to the company as consideration for deferment of the payment, further allowance of discount charges which was not provided for in the contract is unjustified.

1.4. Final reply from the Ministry is awaited (March, 1975).

[Paragraph 17 of the Report of the C&AG of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes]

### A. Award of Contracts

1.5. A general agreement was signed on 29 August, 1961 between the President of India and M/s. Ente Nazionale Idrocarburi (E.N.I.), a wholly Italian Government owned undertaking, with a view to establish and develop Indo-Italian cooperation in the petroleum sector. Under the above agreement, E.N.I. agreed to supply through the companies of the E.N.I. Group, plants, equipments and technical services for petroleum industries upto 95 billion Italian Liras and in any case, upto the maximum amount of 60 billion Italian Liras on account of goods, services etc. of Italian origins including those from other non-Indian sources.

1.6. In pursuance of the aforesaid General Agreement, SNAM entered into specific agreements for the contract work with the Oil and Natural

Gas Commission in 1961 and Indian Refineries Ltd. (New Indian Oil Corporation) in 1963. The specific agreements related to:

(a) Contract for the construction of Gauhati-Siliguri Project Pipeline;

(b) Contract for the construction of Haldia-Barauni-Kanpur Pipeline;

(c) Contract for the construction of Gujarat Pipeline System;

(d) Punjab Drilling Contract;

(e) Uttar Pradesh Drilling Contract.

1.7. The representative of the Department of Revenue and Banking has informed the Committee during evidence that work on these contracts was completed by the end of the calendar year 1967.

1.8. The following were the other contracts entered into by SNAM with the Ministry of Steel, Mines and Fuel between 1961 to 1963:

| | Amount in Lira |
|---|---|
| (i) Project Report on LPG distribution facilities . . | 1,80,00,000 |
| (ii) Project Report on Lake Oil Plant . . . . | 1,15,00,000 |
| (iii) Executive Project of oil product transmission scheme for pipeline from Barauni-Calcutta-Delhi . . | 51,20,00,000 |
| (iv) Executive project of oil product transmission scheme for specialised engineering services . . . . | 4,05,00,000 |
| | 58,20,00,000 |

1.9. Clause 6 of the General Agreement, relating to terms of payment for these contracts provided that all payments for the goods, services, etc. of Indian origin, and all other local expenditure, will be paid in cash in Indian currency by Government companies/agencies.

1.10. For the goods, services, etc. supplied by the E.N.I. Companies, either on their own or in collaboration with other non-Indian companies, however, it was stipulated in the aforesaid clause that the payment would be made as under:

(i) five per cent at the date of signature of each contract;

(ii) three per cent twelve months after the date of signature;

(iii) the balance in twenty equal half-yearly instalments, starting from two years after the signature of each contracts; however, Government will have the faculty to pay only fifty per cent of the amount of the first four instalments, it being understood that the remaining fifty per cent of such instalments will be added proportionately to the other sixteen instalments.

1.11. In consideration for the aforesaid credit facility allowed, the Agreement provided for payment of interest to SNAM at 6 per cent per annum for the deferred payment, the interest being reckoned on the actual balance resulting, at the beginning of each semester, between the total value of the machinery, equipment, and technical services supplied, and the total payments already effected by Government and paid together with the half yearly instalments.

1.12. The payments in Italian currency on due dates were to be guaranteed by the State Bank of India.

1.13. Within the frame-work of the general agreement, the Indian Refineries Limited entered into a specific agreement with SNAM on 31st July, 1963 for the Haldia-Barauni-Kanpur Pipeline system mentioned at (b) in paragraph 1.6 ante. According to this specific agreement, the payment of the foreign exchange component was to be made in U.S. Dollars in the form of 20 drafts of subdivided amounts. Separate drafts were to be issued for principle and interest, the latter being computed upto the date of maturity of each dollar draft. The drafts for interest were to have the same dates of maturity as those for the principal amounts.

1.14. In the balance sheets prepared for the Indian business, drafts prepared by M/s SNAM and accepted by Indian Refinery Ltd. did not form part of the assets of the Company's Indian business, but were transferred by the Company to its head office at Milan. Similarly, the liabilities on account of foreign materials purchased by the head office abroad, formed part of head office account, the head office in turn having a running account with the Indian branch, which showed the net result at the end of the year after taking account the debits on account of materials supplied and services rendered by head office and credits for remittances from India.

1.15. Asked whether SNAM is a member of the International Chamber of Commerce, Paris, the Ministry of Petroleum intimated in a Note:

> "The position has been ascertained in consultation with the Federation of Indian Chambers of Commerce and Industry. It is understood that the firms Messrs SNAM Progetti and SNAM-Saipem are autonomous juricial entities as joint stock Companies, the majority capital being held by ENI. They are not formal members of CAMERA di COMMRCIO INTERNATIONALE Sezione ITALIANA and therefore do not figure as members of the International Chamber of Commerce."

1.16. The Committee desired to know if relevant contracts with SNAM were entered into on the basis of direct negotiations with the assessee company without inviting any tenders and if so the reasons therefor. In reply the Ministry of Petroleum explained in a Note:

"The Agreement (29 August, 1961) *inter-alia* contained the following provisions:—

4.1. 'The competitiveness of the prices quoted by ENI companies will have to be determined taking into consideration also all the other conditions of supply, including terms of payment.

4.2. In case the Government intend to determine the competitiveness of the prices by issuing international tenders, the following conditions will apply:

(1) Project reports and tender documents will be prepared, as hereinafter provided, by ENI Companies with the assistance of Government Companies/Agencies.

(2) The tenderers must be well-known parties of international repute to be determined by Government in consultation with ENI;'

Under the above provisions, it was open to IRL and ONGC to either advertise and invite global tenders or to negotiate with ENI. The process of advertisement would have been time consuming and it was not certain that even after advertising, any party would come forward with better terms than the one which SNAM could offer. It was further considered by ONGC that SNAM was the only Company that could be seriously considered for such contracts under the ENI credit. It was felt that no useful purpose would be served by inviting tenders for the purpose of comparison as the prospective tenderers would know that they were not likely to be successful in securing the contract. They would have, therefore, either not given tenders or given un-realistic quotations.

Moreover, M/s SNAM Saipem in collaboration with M/s Mannesmann of Germany had already constructed the Crude Oil Pipeline from Naharkatiya to Barauni and therefore, M/s SNAM Saipem were having necessary experience and knowledge of the terrain of the route besides possessing the necessary construction equipment in India which could be immediately switched over to the Gauhati-Siliguri Pipeline Project if the work was awarded to them. It was considered to be expeditious and economical if the work for the laying of the Pipeline was entrusted to UNI.

In the circumstances, the contracts were awarded to M/s SNAM. Their offers were thoroughly scrutinised and compared with other pipeline or drilling work awarded to them and/or to other parties. The terms obtained were considered reasonable and fair."

1.17. The contracts entered into with SNAM neither contained any provision for the prices being tested by issuing international tenders nor a provision to the effect that the contractors would have the option to adjust

their prices to the level of the best bidders. In this connection, Ministry of Petroleum have stated that:

> "In the case of IRL, the prices offered by SNAM for Gauhati-Siliguri Pipeline were tested with those of Messrs Mannesmann Saipem given by them for the pipeline of Oil India Ltd., which were based on global tenders. The prices of HBK pipeline were compared with those quoted for Gauhati-Siliguri and the pipeline of Oil India Ltd. As regards ONGC contracts, the prices quoted by SNAM were tested with those offered by two French contractors for structural drilling works in the Jaisalmer Area under the French Credit. Further comparison was also made with the rates quoted by SNAM for two contracts in other countries *viz.* Argentine and Egypt. The prices quoted by SNAM were found to be reasonable."

1.18 As regards the award of contract by the Indian Refineries Ltd. (now Indian Oil Corporation) to SNAM-SAIPEM for construction of Gauhati-Siliguri Pipeline, the Committee on Public Undertakings (1972-73) had in paragraph 2.42 of their 66th Report (Fifth Lok Sabha) observed that:

> "The Committee are also not able to appreciate why Indian Refineries Ltd/Government did not call for global tenders for execution of the Project specially when the ENI credit which was ultimately availed of for the project contained a specific provision to the effect that IRL could "advertise and invite global tenders". While the Committee appreciate that SNAM-SAIPEM had the experience and knowledge of terrain, it would not have been unreasonable to expect that SNAM-SAIPEM would have offered even more competitive rates to gain the new contract in the face of keen competition by firms of national and international standing who were openly evincing keen interest in the work. The Committee need hardly point out that ENI group of companies had already their machinery, equipment and men in the country for execution of the Naharkatiya-Barauni crude pipeline and it was obviously in their interest to gain another pipeline contract. The Committee are of the view that had gloal tenders been invited nothing would have been lost, while there is every reason to believe that IRL would have considerably gained by inducing the firms to give most competitive offers in respect of cost and accommodation for foreign exchange component of the project."

1.19. About award of contract by the Indian Refineries Ltd. to SNAM-SAIPEM for construction of Haldia-Barauni-Kanpur Pipeline, the Commit-

tee on Public Undertakings had in paragraph 3.77 of their aforesaid Report recommended *inter alia* that:

> "The Committee would like Government to fully investigate the circumstances under which IRI and Government allowed themselves to be persuaded to hand over the construction contract to SNAM-SAIPEM exclusively without putting it to sure and practical test of global tenders."

1.20. By their Resolution No. 28(1)/70-OR, dated 22 August, 1970, the Government of India, Ministry of Petroleum & Chemicals, appointed a oneman Commission, headed by Justice J.N. Taku, for inquiring into, and submitting a report on the terms of reference. The terms of reference as enlarged on 25 October 1971 included, among others, the following matters as well:

> "(g) to investigate the circumstances under which IRL/Government awarded the construction contracts for Gauhati-Siliguri and Haldia-Barauni-Kanpur Pipelines to SNAM-SAIPEM on negotiated basis without calling for global tenders.
>
> (h) whether the SNAM-SAIPEM was shown undue favour by officials of Indian Refineries Ltd. of Indian Oil Corporation or the Government, in connection with the award of the aforesaid contracts and in connection with the execution of the Gauhati-Siliguri and Haldia-Barauni-Kanpur Pipeline Projects under the aforesaid contracts."

1.21. On 1 November, 1970, the Ministry of Petroleum and Chemicals and Mines and Metals (Department of Petroleum) furnished a reply intimating that this matter had been referred by Government to the Pipeline Inquiry Commission *vide* term (g) of the terms of reference. Commenting upon this, the Committee on Public Undertakings in their 33rd Action Taken Report (Fifth Lok Sabha) (1972-73) had observed that:

> "While noting the reply of Government the Committee feel that it would have been better if the Commission had also been specifically asked to fix responsibility for this lapse of not calling for global tenders."

1.22. At pages 285 and 319 of their Report (August 1975), the pipelines Inquiry Commission have concluded that:

> "— that the awarding of the construction contracts for the Gauhati-Siliguri and the Haldia-Barauni-Kanpur pipelines on negotiated basis, without calling for global tenders, was a policy decision, of the Government with which the officers of Messrs Indian Refineries Limited/Government of India had nothing to do;

— that under the Government of India-ENI Agreement the Government of India had the option to test the competitiveness of Messrs SNAM-SAIPEM's offer for both those pipelines, either on negotiated basis or by inviting global tenders, and hence they did not do anything contrary to the terms of the said Agreement if, having regard to all the facts and circumstances of the case, they decided to avail themselves of the first alternative. However, so far as Messrs SNAM-SAIPEM were concerned, they were, as stated in the preceding paragraph, always ready to have their offer tested by global tenders;

— that offer of Messrs SNAM-SAIPEM for the Haldia-Barauni-Kanpur pipeline was subjected to a detailed examination, first by the staff of Messrs Indian Refineries Limited and then by their Manager, Messrs Bechtal Corporation, and found to be competitive;

— that as Messrs SNAM-SAIPEM'S offers for both the Gauhati-Siliguri and the Haldia-Barauni-Kanpur pipelines were compared with the quotation, which was accepted by Messrs Oil India Limited for their crude oil pipeline on the basis of global tenders only three years back, and were found to compare very favourably with the quotation, which was accepted by Messrs Oil India Ltd.; the putting of Messrs SNAM SAIPEM's offers to global tenders in the case of Gauhati-Siliguri pipeline and also the Haldia-Barauni-Kanpur pipeline, would have been, at best, a futile and time consuming exercise;

— that there has been no negligence or carelessness or *mala fide* motive on the part of any of the officers of Government/Messrs Indian Refineries Limited in awarding the construction contracts for those two pipelines to Messrs SNAM SAIPEM on negotiated basis without calling for global tenders;

— that apart from the "undue favour" which Messrs Indian Refineries Limited/Messrs Indian Oil Corporation showed to Messrs SNAM Progetti under item 11, *supra* they did not show any other favour to Messrs SNAM-SAIPEM/Messrs SNAM Progetti in the award, or in connection with the execution, of the Gauhati-Siliguri and the Haldia-Barauni-Kanpur Pipeline contracts;

— that the said 'undue favour' took place unwittingly on account of the failure on the part of Shri P. R. Nayak and Shri M. Gopal Menon to study the offer for the preparation of the Project Report and the Project Report with the care and attention

that they deserved, as also their obstinacy to stick to the original alignment of the pipeline through the Raniganj coalfield area come what may."

1.23. The Report of the Pipelines Inquiry Commission was submitted to Government in August, 1975. Asked what action Government had taken on the findings of the Commission, the Ministry of Petroleum have in a note dated 19 May, 1977 intimated that:

"The findings contained in the Report of the Pipelines Enquiry Commission are under examination of the Government and a statement will be furnished as the action is completed."

1.24. The Committee wanted to know why a provision was made in the contract entered into between Indian Refineries Ltd. and SNAM for making part payment in US Dollars instead of Italian currency. In a note the Ministry of Finance (Department of Economic Affairs) have explained *inter alia* that:

"(i) The main Agreement of August, 1961 between the Government of India with ENI was in the nature of a supplier's credit. It visualised payment only in Italian currency.

(ii) However, all the Agreements entered into by the ONGC or the IOC (Refinery Division) provided for the issue of Dollar Drafts payable in Italian currency. In each Agreement, the total value of supplies was expressed in two parts—one part payable in rupees for services in India and the other part expressed in US Dollar on account of supplies etc. arising abroad.

(iii) Prior to rupee devaluation, *i.e.*, 6-6-1966, the Department of Economic Affairs as also the Reserve Bank of India for exchange control purposes had a broad policy concerning payments to non-residents.

(iv) As the regulations then stood, the methods of payment permitted for remittances from India to foreign countries took into account the broad currency areas then in force. For the Convertible Account Countries which include Italy and the countries of Italian monetary area the prescribed methods of payment were as follows:

(a) Payment of rupees to the account of a resident of the country concerned or of any country in the "Convertible Account" Group.

(b) Payment in sterling or a sterling Area Currency for credit to an external or "Non-resident Account" in the UK or any other sterling Area Country.

(c) Payment in the currency of the country concerned or in the currency of any territory in the sub-group.

(v) Taking into account the permissible methods of payment under the Exchange Control Regulations then in force if any request arose seeking remittance to an Italian party, permission would have been given for payment either in Italian currency or in US Dollar. During those years, particularly residents in West European Countries preferred payment in Dollar, and this was being readily agreed to.

(vi) To fall in line with the main Agreement, the State Bank of India was issuing Dollar drafts payable in Italian currency.

(vii) According to information furnished by the Oil and Natural Gas Commission to the Ministry of Finance, the original provision of payment in Italian Lira in Italy was changed to payment abroad in US Dollar in the Punjab Drilling Contract at the instance of the Reserve Bank of India.

(viii) Likewise, the Indian Oil Corporation has also clarified that the Contract as such provided for payment in US Dollar and in Indian rupees. The US Dollar was made payable in Italian Lira using the average rate then in force in Milan Stock Exchange at the due date of payment of each draft. This section was amended on 2nd April 64 to the effect that payments of the drafts shall be made in US Dollar abroad. In both the cases, the modification made was to eliminate reference to Italian currency. The reason for this was that since Italy was (and is) in the Convertible Account Group, purely in terms of foreign exchange it would be immaterial whether the payment is made in Italian currency or in US Dollar. Purely for administrative purposes and also for general acceptability, it provided for smooth working by making direct Dollar payments to the accounts of residents in Italy.

(ix) In retrospect, it is true that there was a protection since the drafts were issued in US Dollar. However, it would be necessary to emphasise the fact that prior to rupee devaluation, we did not have an awareness of the problem arising out of variations in exchange rate, and did not have a conscious policy of overcoming any assurance for exchange protection.

(x) Further, this was a period when there was a regime of fixed exchange rates, and the currency variations were within the narrow limits specified by the IMF Articles of Agreement."

## B. Issue of Post-Dated Drafts

1.25. In this case, though Clause 6 of the Agreement had provided that 92 per cent of the payment could be made in 20 equal half yearly instalments starting on the expiry of 2 years after the signature of the contract with additional facility to pay only 50 per cent of the amount of the first four instalments, the remaining 50 per cent of such instalments being added proportionately to the other 16 instalments, the Indian Refineries Ltd. issued post-dated drafts to the foreign company for instalments due in 1966 to 1974. The aggregate value of these drafts was $ 1,79,66,255.

1.26. The Committee desired to know if repayment of loan in 20 half yearly instalments provided for in clause 6 of the General Agreement was the same as repayment by the immediate issue of 20 drafts payable half yearly one after the other and if not what was the difference between the two modes of payment. In reply, the Department have explained in a note that:

"From the view point of the borrower, there is no difference between repayment of his loan liability in periodical instalments of specified amounts, on the one hand, and repayment in the form of concurrent issue of bills of exchange for the same amounts maturing for the payment on the same dates. on the other. However, from the view point of the lender, there is a material distinction between the two forms of repayment. This is because under the scheme of payment by instalments due on specified dates, he has to wait till the specified date for receiving the payment due to him, but if he receives payment in the form of a bill of exchange, he can negotiate the bill of exchange before the date of its maturity and realise its present worth. It may be mentioned here that the dollar drafts received by SNAM under the relevant contracts were negotiable bills of exchange."

1.27. Replying to the question whether it was financially prudent to give to the foreign company post-dated drafts, the representative of the Ministry of Finance has said:

"It depends on what was negotiated. Quite often, when deferred payment arrangements are entered into, the party which agrees to such arrangements can insist on being provided certain documents which could ensure that the payments would be made on due dates, and it is not unusual for advance promissory notes or other such documents being passed."

1.28. Supplementing the above reply of the representative of the Ministry of Finance, the Finance Secretary has added:

"We have to keep the emotions apart if we want to get the best term possible."

1.29. The representative of the Reserve Bank of India has further clarified the reply as follows:

"Although drafts were given post-dated, no payment from India in foreign exchange was remitted before the due date. Payments were made on the due date as per the contract executed and handed over to them.***** They got these drafts and in their hands they are negotiable instruments and they were able to have them discounted and get advances that they required."

1.30. The Committee enquired if the facility of giving post-dated drafts was ever extended by Government to any other foreign company operating in India and if not, how was grant of this facility to SNAM justified. In reply, the Ministry of Finance have stated in a note:

"During recent years, the Government of India has not entered into any Agreement involving suppliers' credit. Currently, any credit or loan is between the Government of India and the foreign Government concerned and the loan proceeds are credited to the Government account. Any licensing on remittance towards knowhow, supply of document, machinery, etc. is settled directly by remittances in cash by the concerned organisation. Under these circumstances, the question of issuing advance draft does not arise. It is still the Practice, however, that the Government of India issues Promissory Notes honouring to repay the outstanding loans. These Notes are issued to the lending Governments and are not negotiable. The question of discounting such Promissory Notes would not arise."

### C. Discounting of Dollar Drafts

1.31. As stated in the Audit paragraph, on 29 December 1966, M/s. SNAM had with them, in their Head Office Account, dollar drafts of the aggregate value of 1,79,66,225 dollars falling due for payment in 1966—1974. These drafts were discounted on that date with a bank in Geneva (Banque of Commerce Et De Placenents Bale SA). After paying discount charges of $80,28,104 (Rs. 6.05 crores) the net proceeds realised were $ 99,38,150. Details are given below:

(In US Dollars)

| | | Discount paid | Net proceeds |
|---|---|---|---|
| US $ Drafts . . | 1,72,20,572 | 77,37,881 | 94,82,690 |
| Lira Drafts . . . | 7,45,683 | 2,90,223 | 4,55,460 |
| | 1,79,66,255 | 80,28,104 | 99,38,150 |

1.32. As regards the reasons due to which the assessee Company was compelled to resort to pemature selling of dollar drafts received by it from India, the Department of Revenue & Banking have informed the Committee in a note that:

"(i) World balance sheets of E. N. I. and SNAM for the calendar years 1963 to 1966 were filed to show that SNAM's own capital available for employment in its business projects was virtually nil, with the result that whole of the investment of SNAM in its different projects, including the business in India, was financed through outside borrowings.

(ii) It was stated that when the contracts in India were taken up, funds had to be raised from various lending agencies to finance the projects in view of the loan agreement between the E. N. I. and India. It was pointed out with reference to SNAM's world balance sheets aforesaid that there had been a steady increase in the amount of loans and credits secured by SNAM from different parties, as huge funds were required to carry out the Indian projects.

(iii) The assessee company produced an article published in the "Economist" and also Annual Reports of the Bank of Italy to show that during 1963 and 1965, Italy was engulfed by economic and financial crises because of rise in wage costs, poor harvest, higher prices for imported raw materials, etc. It was stated that, in these circumstances, SNAM found that its requirement of funds was larger than what was available, particularly due to the long-term credits agreed to be given by ENI to India. The assessee company was, therefore compelled to sell its bills receivable, including the dollar drafts received from India. Since 1964, the company was making efforts for realising the dollar drafts and after protracted negotitations for over two years, it was able to secure a favourable rate of discounting charges and the actual discounting was done by it in December 1966."

1.33. Expressing the view that sale of Dollar Drafts amounted to a breach of contract, the Income Tax Officer in his letter dated 25 July, 1972 addressed to the Commissioner of Income Tax, New Delhi had, *inter alia* stated:

"Under the contract, the assessee company acquired only a right to receive the payment on specified dates and the dollar-drafts represent that right only. These are not ordinary drafts or hundies which are encashable on sight or after a period of 3 months or 6 months. Such drafts have a ready market for trans-

fer by discounting. But the dollar-drafts under consideration has no marketability except under computation. Moreover there is no provision in the contract authorising sale of these drafts nor there is any stipulation prohibiting the same. A perusal of the contract clearly indicates that the company agreed to accept the payments in instalments and to cover the instalments, stipulation was made to accept dollar-drafts duly guaranteed by the State Bank of India which were payable on further dates. Therefore the intention was clear that these drafts were not intended for sale. Moreover, these drafts containing agreement of payment between two parties are not a marketable commodity. Therefore the sale of drafts amounts to a breach of contract."

1.34. The Committee enquired whether in the absence of any stipulation in the contract entered into with SNAM, it was open to SNAM to resort to premature realisation of dollar-drafts. In reply, the Department of Revenue and Banking have opined that:

"As the said contracts do not contain any stipulation, express or implied, restraining SNAM from premature realisation of the dollar drafts, it was open to SNAM to realise the said drafts."

**D. Relationship of txpenditure incurred on discounting of Dollar Drafts with Indian Business**

1.35. Section 37(i) of the Income Tax Act, 1961 stipulates:

Any expenditure [not being expenditure of the nature described in Sections 30 to 36 (and section 80 VV) and not being in the nature of capital expenditure or personal expenses of the assessee], laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

1.36. In a note furnished to the Committee the Department of Revenue and Banking have stated that the admissibility of discounting charges for computation of income is governed by the following legal position:

"Expenditure incurred on the discounting of bills of exchange received during the course of carrying on a business is allowable as deduction in computing the profits of the business u/s 28 of the Income-tax Act on the basis of the general principle that where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains, it ought to be allowed, provided there is no prohibition against such an allowance *vide* Usher Wiltshre Breawery Ltd. Bruce-CTC 399, 429 (H.L.). In particular, such expenditure is

allowable u|s 37(1) of the I.T. Act, if it is found to be revenue expenditure incurred wholly and exclusively for the purposes of the business. The question whether a transaction has the effect of diminishing the assessee's taxable income, whether it was a prudent or wise transaction and whether it was necessary for the assessee to enter into that transaction, are irrelevant in determining whether the expenditure relating to that transaction is allowable as a deduction or not [vide the principles enunciated by the Supreme Court in the case of Eastern Investment Ltd. Vs. CIT (20 ITR. 1)]."

1.37. According to the legal position described above, SNAM had not only to establish that the expenditure was not in the nature of capital expenditure or personal expenses of the assessee but also to prove that it had been laid out or expended wholly and exclusively for the purposes of the Indian business.

1.38. The Department of Revenue and Banking have intimated that in their detailed note dated 30 August, 1971, the assessee Company had, apart from explaining the circumstances due to which it was compelled to discount the dollar drafts, claimed that discount charges related wholly and exclusively to their Indian business. The following evidence was produced by them before the Department in support of their claim:

"(a) It was stated that the whole of the amount realised by SNAM by discounting its dollar drafts was utilised for the payment of liabilities relating to its Indian business. SNAM filed certificates to this effect from its auditors and from the Vice President of SOFID, the financing company of the E.N.I. group. (Certificate dated 2-8-71 from its Auditors and certificate dated 3-8-71 from the Vice President of SOFID). In this connection, the Charter of Incorporation of E.N.I. (of which SNAM is a wholly owned subsidiary) was produced to show that the E.N.I. group of companies are owned by the Government of Italy and that its accounts are audited by a Board of Auditors presided over by the Accountant General of Italy (equivalent to the C.& A.G. of India).

(b) A copy of a debit note was filed to show that the discounting charges in question were debited by SNAM H.O. to the account of its Indian branch.

(c) A statement from the Swiss Bank which discounted SNAM's dollar drafts (Banque De Commerce Et De Placements, Bale

S.A.) was filed showing the computation of the discounting charges and the net proceeds of the dollar drafts.

In view of the foregoing evidence, it was considered that the charges paid by SNAM on discounting its dollar drafts in December, 1966, were allowable as a revenue expenditure u/s 37(1) of the I.T. Act.

1.39. Explaining the extent to which the evidence given by the assessee was subjected to scrutiny by the Department, it was stated that:

"The evidence produced by SNAM in support of its contention that the proceeds of the discounted dollar drafts were utilised for meeting the loan liabilities relating to its Indian business was also cross-checked with reference to SNAM's world balance-sheets and other relevant statements of accounts relating to its Indian business. Thus, in regard to the point that SNAM's Indian business was being financed by moneys borrowed by it abroad, it was seen from its world balance-sheets as on 31-12-1965 that as against its capital and reserves of 36,649 million Liras, the book value of its fixed assets amounted to 240,121 million Liras and share-holdings in other companies to 28,794 million Liras. The said balance-sheet also show that as on 31-12-1965. SNAM current liabilities stood at 105,330 million Liras and its liabilities in respect of medium and long-term loans and the finances provided by the E.N.I. at 108,363 million Liras. This clearly shows that SNAM's business projects, including its contracts in India, were being financed from borrowed moneys. In regard to the point that the proceeds of the dollar drafts were utilised by SNAM for meeting the loan liabilities relating to its Indian business, it was seen that while in respect of calendar years 1965 and 1966 the financing charges or interest on borrowed moneys debited by SNAM H.O. to its Indian branch, through its head office account, amounted to Rs. 64.16 lakhs and Rs. 61.42 lakhs, respectively, no debit on account of financing charges or interest was passed in the account of the Indian branch of SNAM in respect of the calendar year 1967. These facts corroborated SNAM contention that the proceeds of the dollar drafts discounted by it in December, 1966 were utilised for meeting the loan liabilities relating to its Indian business."

1.40. The Committee wanted to know if it was a fact that the assessee company had been able to correlate the sale proceeds of these drafts with the utilisation for the Indian business or even with the payment of liability

of the Indian business and if not on what basis were the discounting charges allowed as an item of deduction for computation of income. In reply, the Department of Revenue and Banking have stated that:

> "The assessee company stated in response to queries that because it maintained consolidated accounts for its world business, it would not be possible for it after the lapse of several years to relate every single dollar receipt on account of discounting of drafts to a dollar standing as a liability in its account. It stated that if the question was asked in 1967, it might have been less difficult to attempt such co-relation by reference to the original data in form of punch cards, which form the basis of compilation of SNAM accounts which are maintained on a mechanised or computerised system."

1.41. Asked about the comparative position of Bills receivable and loan liabilities of the Company for the accounting years 1963 to 1966 as they appeared in the world balance-sheets. The Department have furnished the following figures:

(In Million Liras)

| Last date of a/c year | Bills receivable | Loan liabilities |
|---|---|---|
| 31-12-1963 . . . . . . | 13050 | 96,486 |
| 31-12-1964 . . . . . | 17368 | 105,459 |
| 31-12-1965 . . . . . | 29889 | 108,363 |
| 31-12-1966 . . . . . | 19315 | 106,581 |

1.42. After discounting the dollar drafts on 19-12-1966, SNAM S.P.A. realised $ 99,38,150 which, when converted into Lira at the rate of $ 1=625 Lira, comes to 6211 million Liras. Comparison of loan liabilities as on 31-12-1965 and 31-12-1966 however shows that the liabilities were reduced to the tune of 1782 million Liras only. During the same period, the bills receivable dropped from 29,889 million Liras on 31-12-1965 to 19,315 million Liras on 31-12-1966, recording a shortfall of 10574 million Liras.

1.43. The Committee desired to know that if, as certified by the Company's Auditors, the amount realised by SNAM S.P.A. by discounting its dollar drafts was utilised in full for the payment of liabilities relating to its Indian business, how was it that loan liabilities as they appeared in the world balance-sheets did not reflect in full the effect of that utilisation. In reply, the Department have explained:

> "Comparison of figures of liabilities as they stood on 31-12-1965 with that of 31-12-1966 cannot provide a reasonable basis for

disproving the statement of the Auditors of SNAM as well as that of the Vice President of SOFID, which provided loans to SNAM, to the effect that the proceeds of the drafts were utilised fully in discharging the loan liabilities of the Indian business. Even so, the world loan liability shows a reduction of 1782(M) Liras on 31-12-1966."

1.44. Asked that if the comparison of figures of liabilities as on 31-12-1966 with that of 31-12-1965 could not provide a reasonable basis for disproving the statement of the Auditors of SNAM as well as that of the Vice President of SOFID, could these figures by themselves be taken to prove the assessee's case. Since, under the law, it was for the assessee to establish his case and should not the Commissioner have tried to satisfy himself, on his own, about the correctness of claim instead of allowing it on the authority of the certificates given by the assessee's Auditors' and Vice President of the assessee's sister financing company. In reply, the Department have explained in a note that:

"The comparison of figures of liabilities of SNAM as on 31st December, 1965 with those as on 31st December, 1966, was only illustrative and was not treated as a conclusive proof, by itself, of Snam's contention that the proceeds of its dollar drafts were utilised for meeting the loan liabilities relating to its Indian business. The evidence in the matter produced by SNAM was scrutinised and viewed in its totality,........."

1.45. The Committee enquired if it was a fact that loans were raised by the financing company (SOFID) not only to meet the working capital requirements of the assessee company but collectively for all the sister concerns and in connection with their world-wide contracts projects. In reply, the Department have informed the Committee that:

"There is no direct evidence available in the assessment records on the basis of which it can be said that loans were raised collectively for all the sister concerns."

1.46. The Committee desired to know if the loans raised by the foreign company in Italy were treated at any stage as liabilities of the Indian branch. In reply, the representative of the Department has said:

"These have been reflected in the head office account. In the Indian branch, there is no separate head under which the liability is reflected. There is no direct evidence. In fact, certificate that has been given is that these liabilities have been incurred for Indian business."

1.47. Asked that if there was no separate head of account in the Indian branch, how was it verified which of the transactions of the foreign company abroad related exclusively and wholly to the Indian business, the witness stated:

> "We have received two certificates, one from the Auditor and the other from the Vice President of the Company which raises finance for their affairs."

### E. Treatment of Discounting Charges as Revenue Expenditure

1.48. In his letter dated 13 May, 1969 addressed to the Inspecting Assistant Commissioner, the Income Tax Officer had expressed the view that "the depreciation of bills of exchange lying in deposits with the assessee company and later on encashed through Swiss Bank would be capital expenditure and not revenue expenditure because the income had already become due on the date the bills were submitted."

1.49 In his note dated 24-3-1972, a copy of which was forwarded to the IAC, Delhi on 25-3-1972 for information and necessary action, the Commissioner of Income Tax, Delhi-II, expressed a view different from the one expressed by the ITO and directed that:

> "The claim for allowance of the actual discounting charges as a revenue deduction is in conformity with our view that in so far as the discounting expenditure is found to be wholly and exclusively laid down for the purpose of the business carried on in India it is an allowance deduction u/s 37(1) in the year in which such expenditure actually arose. * * * As regards the actual discounting charges claimed as a deduction, we have to concede the claim if it is found that the discounting was done to raise finance to meet the liabilities of the business of the non-resident company in India. As regards the discounting charges for interest drafts, the same principle apply......"

1.50 In his D.O. letter dated 19-9-1973, addressed to the Secretary, Central Board of Direct Taxes (FTD), the Commissioner of Income Tax, Delhi accepted Snam's contention that its discounting charges incurred in December 1966 amounted to revenue expenditure allowable as a deduction under Section 37(1) of the Act in computing its business income in India. He further expressed the opinion that Snam's profits for the assessment years 1964-65 to 1971-72 should be computed on the 'completed contract' basis, namely, after making an allowance for SNAM's discounting expenditure on encashment of its dollar drafts in full; converted at the post-devaluation rate of exchange for the year 1967-68 only.

1.51. The Board in its letter dated 22-1-1974 to the Commissioner of Income Tax stated that they had no objection to the Commissioner of Income Tax adopting the suggested procedure.

1.52. The Committee desired to know what considerations weighed with the Commissioner of Income Tax and the Central Board of Direct Taxes in rejecting the view point of the Income Tax Officer and allowing computation of income by treating the entire amount of discount charges as a revenue expenditure. In reply, the Department has stated in a note that:

> "One of the views examined in this connection was that the Bills of Exchange lying in deposit with the Head Office of the Company in Italy, constituted a capital asset and consequently, the discounting charges paid in encashing the said Bills of exchange was an expenditure of a capital nature.
>
> However, on an examination of the facts in the matter, it was found that SNAM continued to carry on its contract business in India not only during the calendar year 1966 but also in subsequent years and that the Bills of Exchange were received by the assessee company on revenue account, being the Compensation received by it from its clients in India for supplying the materials and rendering services for executing its contracts. Interest drafts paid to the company represented payment for interest on principal amount of the contract on account of deferment of payment thereof. It was further found that the dollar drafts could be encashed only on future dates and Snam held them as current assets realisable on future dates Being Bills of exchange Snam could realise the dollar drafts to meet its business requirements. In fact, Snam started negotiating with bankers some time in 1964 for discounting its dollar drafts but the discounting rate then offered to it was as high as 18 per cent. The assessee company therefore continued its negotiations for obtaining more favourable terms and succeeded in the early part of 1966 in getting a lower discounting rate of 12 per cent. Thereafter the formalities were completed and discounting was effected in December 1966 @ 12 per cent. It was also found that Snam had financed its Indian business operations by loans raised abroad and that the entire proceeds of the dollar drafts were utilised by it for meeting such loan liabilities. On these facts which were supported by documentary evidence and on the basis of the legal position as enunciated by the Supreme Court in the case of India Cements Limited (60 ITR 52), it was held that the expenditure was deductible as revenue expenditure under Section 37(1) of the Income-tax Act, 1961."

1.53. The Committee wanted to know whether it was a fact that in this case the claim had been allowed even before the Board gave their decision about admissibility of discounting charges. Admitting this fact, the Department have stated in a note that:

> "The Central Board of Direct Taxes gave its decision in regard to the admissibility of discounting charges in its letter F. No. 9|18|69-ITA(II) dated 22-1-1974.
>
> The claim was allowed while completing the time-barring assessment for the year 1967-68 on a provisional basis on the 28th March, 1972, on the basis of instructions given by the Commissioner of Income-tax, Delhi—II in his note dated 24th March, 1972."

1.54. Since the Commissioner of Income Tax and the Central Board of Direct Taxes were of a different view than the one expressed by the Income Tax Officer on this case and as the matter involved not only questions of fact but also of law, the Committee wanted to know whether before issue of their decision on 22-1-1974 the Board had consulted the Ministry of Law. In reply, the Department stated:

> "The Law Ministry was not consulted before issue of Board's instruction dated 22-1-1974. * * *"

1.55. Asked if it would be correct to say that the Board did not consult the Ministry of Law lest the opinion of that Ministry based on examination of the matter from legal angle should turn out to be against the interests of the foreign company, the representative of the Department said in evidence:

> "It appears that the Board was very clear in their mind. There was no doubt in the mind of the Board."

1.56. However, after giving their decision on 22-1-1974, the Central Board of Direct Taxes sought the opinion of the Ministry of Law in November, 1976 on the point whether the entire discounting charges paid by SNAM were properly allowed as revenue expenditure under Section 37(1) of the Income Tax Act.

1.57. In his note dated 12 November, 1976, the Secretary, the Ministry of Law advised the Department of Revenue and Banking (Central Board of Direct Taxes) as under:

> "From the audit objection it is not clear to what extent (that is, to what percentage of the entire payment) the assessee company has not been able to co-relate, that is whether it was an insignificant amount or a substantial one. If it was insignificant, the

I.T.O. may be justified in accepting the evidence tendered before him by way of certificate from the assessee's Auditors. Secondly, the Audit has raised the objection that some part of the amount discounted was used for payment towards the cost of capital assets. In the reference it has been emphasised that the bills receivable were discounted for the purpose of meeting loan liabilities and not for payment of costs of the capital assets as fact—whether the amount was needed to discharge a loan liability of the business or to meet the cost of capital assets, that is, whether it was to meet an obligation towards payment of the price of capital assets remaining unpaid or whether it was to discharge a loan obligation to a party who may have advanced amounts for the purpose of purchasing a capital asset. On the assumption that the amount was utilised for the purpose of discharging the loan liability of the assessee relatable to the Indian business or, at any rate, a very substantial portion thereof, it cannot be said that the Income Tax Officer erred in allowing discounting charges incurred by the assessee as revenue expenditure.

One point that arises in this connection is whether it is commercially expedient to incur the huge expenditure of payment of discounting charges when the contract is more or less about to be completed in December, 1966. The Audit says that Government is paying interest charge because of the delayed date of maturity of dollar bills. It is essentially a question of fact whether the non-resident assessee is justified in discounting these bills as they did and whether it is commercially expedient for a prudent businessman to do it. If, however, it could be commercially justified, there may be no legal objection to its being allowed and the point that interest is being paid therefor may not by itself be conclusive to determine the justifiability or otherwise of the discounting of the dollar bills in December, 1966.

The Audit has relied on the Supreme Court case in the case of Tata Locomotive and Engineering Company Ltd. (60 ITR p. 405). Apart from the fact that the point considered by the Supreme Court in that case was an entirely different one, the ratio of that judgement also indicates that the nature of transaction would determine whether an expenditure is a revenue expenditure or capital—whether the transaction, namely, payment was in relation to the discharge of loan liability of the business or whether it was relating to purchase of a capital asset for the assessee. If it was purely a loan transaction, then certainly

it will not be unreasonable to take a view that a prudent assessee carrying on business would always like to discharge his loan liability as soon as he is in a position to do so and if for the purpose of discharging the loan liability of the business he discounts the drafts and discharges his liability, the payment of such discounting charges would be considered as an expenditure incurred for the purpose of the business. However, as stated before, this is a factual aspect and I am proceeding on the footing that the payment was to discharge the loan liability.

I do not see any relevancy of the point taken that the contract did not provide for discounting the dollar drafts. To my mind, this point has no relevance on the question of deductibility of the discounting charges as business expenditure and even if there was such a provision for permitting the assessee to discount the drafts, the question still has to be examined whether it is a deductible expenditure under section 37 of the Act or not. The exact point raised with reference to the interest is not clear. The point urged is that since interest at 6 per cent had already been paid to the company for deferment of the payment, a further allowance of discount charges was unjustified. It appears that the interest has been treated as a revenue income. The question, therefore, of the company getting double benefit is not clear.'

1.58. However, the aforesaid opinion of the Ministry of Law was only a tentative one as will be seen from the following extract from the Law Ministry's Note dated 12 November, 1976:—

"The reference was raised in this Ministry on 10th instant, and I was requested to make available my opinion today. As the time at my disposal was very short, my views cannot be said to be based on a thorough study of the matter. The above are my tentative views. Normally, we would have liked to discuss the matter with the Audit before expressing an opinion in the matter. But as it is stated that Audit may not like to participate in the discussion at this stage (because of the PAC meeting on Monday, the 15th instant), I suggest that the above be shown to the Audit and if they have any particular comment in this respect, I shall be glad to take the same into account before expressing any final opinion in the matter."

1.59. The Committee pointed out that it was quite likely that the foreign company might have discounted the drafts at a fantastic discount to meet, as they said, their requirement of funds for their working capital and later

re-purchased the same. If this was what had happened, it was nothing but a cross entry to show losses. The representative of the Department has assured in evidence that Government "will examine it".

1.60. Since the drafts were discounted on 29-12-1966 i.e. only two days before the accounting year of SNAM was due to end on 31-12-1966, the Committee enquired if the ITO tried to make sure that drafts were not repurchased in the subsequent year. In reply, the witness has said:

> "No attempt was made by him to examine this. This obviously did not strike him."

1.61. Asked whether at the time of reassessment efforts would be made at least to find out what amount was required by the foreign company for working capital and whether apart from going in for encashment of drafts at such a fabulous discount, alternative avenues to rise funds from other Banks by pledging of drafts were explored by them, the witness replied in the affirmative.

1.62. The Committee wanted to know that having paid the principal amount and interest at 6 per cent as stipulated in the Agreement, how were the taxation authorities concerned with the expenditure incurred by the assessee Company on discounting of Dollar Drafts. In reply, the Chairman, CBDT has agreed that:

> "To answer this question, taxation aspect should be separated from the payment aspect. The contract is that they shall make payments in drafts, on a deferred basis. On that deferred basis they were required to be paid interest at 6 per cent: because of deferred payment we are paying 6 per cent interest to them. What they do is that they have got those drafts and they discount these drafts at 12 per cent by paying 12 per cent. The point is that in that particular transaction they get six per cent whereas they pay 12 per cent. Suppose they were not required to pay any income tax in our country, even on this contract they would be losers. Now let us bring in the income tax aspect also. The problem has arisen because the encashment of those drafts caused certain losses to them and it has to be seen whether the expenditure by them in discounting these drafts should be allowed as expenditure in the income tax assessment or not. That is a separate matter."

The witness has added:

> "We have given these drafts at 6 per cent. Suppose they give away these drafts in charity, how are we concerned? What do they do with those drafts, it is their business. So far as we are concerned, our liability is to the extent of those drafts and 6 per cent interest. This question assumes importance at the time of making assessment."

1.63. The Committee enquired that as the transaction was not a case of purchase of dollars by payment in rupees involving outflow in Indian Rupees, how was the rate of exchange at all relevant. The witness has pleaded:

> "I would personally think that all these things should better be left now. After all, the assessment has to be made; all these aspects will be taken care. If according to law, it is admissible, then we have to see to what extent it is admissible according to the evidence led before us."

The witness has assured the Committee that:

> "We will keep all your observations in mind and whatever audit has also said, we will keep that in mind. We will scratch our own heads to see that a very reasonable assessment, just to our country as well as to them is framed."

1.64. The Committee asked whether the way the assessment in respect of the foreign company was done in the past did not cast a serious reflection on the performance of the Department and the high officials who handled this case. The witness has said:

> "My personal impression is that the assessments have been made in a perfunctory manner. Since they were provisional, he might have thought—let them be completed in this manner."

1.65. The witness was asked that once the payment was made in dollars, how was the question as to when and at what rate drafts were discounted by the foreign company to meet its global liabilities was relevant. He has stated:

> "The Commissioner proceeded on the finding that this expenditure has been incurred for meeting the India liabilities not for world liabilities."

1.66. The Committee asked if in the light of experience with SNAM other Departments would be alerted to be more cautious in their dealings with them. The Finance Secretary has said in evidence:

"We will bring this particular view expressed by the Committee to notice of the Government and see how they react.

I do not want to give an assurance which I cannot fulfil. * * * * * As of today, I am not quite certain that we have been able to pin anything. * * * * In fact, the position today is that departments of Government, a wing of the Government, rightly or wrongly, has accepted the position that this is a chargeable item of expenditure. Of course, we are re-opening the issue and we hope that a more favourable decision would be forthcoming. But the fact is, if they have put forward a demand, I am just wondering whether it could be treated as amounting to misdemeanour of such a grave character that they should be blacklisted. I leave it to you."

**F. Rate of Exchange for discounting**

1.67. The books of accounts of the Indian Branch of the company were maintained in Indian currency i.e. in terms of rupees. The dollar drafts as and when received were accounted for in the books at the rate of exchange prescribed under Rule 115 of the Income Tax Rules, 1962, Clauses (a) and (b) of Rule 115, in so far as these are relevant, provide as follows:

"The rates of exchange for the calculation of the value in rupees of any income shall be as follows:

(a) in respect of income accuring or arising or deemed to accrue or arise to the assessee or received or deemed to be received by him or on his behalf the 6th day of June, 1966. . . .

US $ 1=Rs. 4.762/-.

(b) in respect of income accruing or arising or deemed to accrue or arise to the assessee or received or deemed to be received by him on his behalf on or after the 6th day of June, 1966.

US $ 1=Rs. 7.50"

1.68. According to the Debit Note dated 31 December, 1966 the Dollar Drafts were discounted in Geneva on 29 December, 1966. Discounting charges amounted to $ 80,28,104 which converted at $=Rs. 4.762 (pre-devaluation rate) worked out to Rs. 3.83 crores. A sum of Rs. 3.83 crores was, therefore, debited by the Head Office in the Branch Accounts.

1.69. While making the assessment for the assessment year 1967-68, however, the discount charges amounting to Rs. 6.05 crores calculated at the post-devaluation rate of exchange of $ 1=Rs. 7.50 were allowed as a deduction in computation of income.

1.70. In his letter dated 19 September, 1973, addressed to Central Board of Direct Taxes, the Commissioner of Income Tax, New Delhi expressed the view that the Dollar Drafts for the principal amount should be accounted for as SNAM income of the year in which they were received at the gross amount thereof and converted into rupees at the rates of exchange specified in Rule 115 of I.T. Rules, 1962 *i.e.* at the pre-devaluation or the post-devaluation rate of exchange depending on whether these drafts were received prior to or, on or after, 6 June, 1966. He gave the following grounds in support of his view:

"(i) Snam has been following the mercantile system of accounting under which its income is taxable at the point of time when it accrues or is earned irrespective of physical receipt thereof, the charge being on the net 'book profits'.

(ii) Upto and inclusive of the assessment year 1966-67, Snam has itself accounted for the dollar drafts relating to its drilling contracts and supply of materials from abroad at their gross amount and not at their realisable value.

(iii) Income accrues or arises when the assessee gets a right to receive it.

(iv) Where a Bill of Exchange has been taken as a discharge of a debt, the date of receipt thereof is the date on which the instrument is received and not the date on which the payment is made under it.

(v) amount of the drafts should be regarded as having been received on the date of receipt of the drafts, unless there is some evidence that the debt represented by the drafts is not worth its face value.

(vi) The national discounting charges claimed by Snam as a liability against the dollar drafts are a contingent liability, as distinct from an accrued and ascertained liability and therefore are not deductible as an 'expenditure' U/S 37(1) of the IT Act.

(vii) The practice of commercial accounting of showing debts realisable in future at their actual realisable value in the relevant year does not affect or modify the basis of charge of

tax under the Income Tax Act or income which has accrued or arisen to or received by the assessee during the previous year."

1.71. The Committee desired to know that when the drafts were all issued prior to the devaluation of rupee in June 1966 and even accounted for at the pre-devaluation rate of exchange why was the allowance in the income allowed at post-devaluation rate of exchange. In reply, the representative of the Department has explained in evidence that:

"This discounting took place on 29 December, 1966. Devaluation was on 6 June, 1966. Therefore this was after devaluation. If it is regarded as expenditure, it has to be done on the basis that this was incurred on 29 December, 1966, that is, after devaluation. Therefore, when converting that into Indian currency, it has to be done at the rate prescribed under rule 115 with effect from the relevant date, that is after devaluation. That is at Rs. 7.50 per dollar. It is on that basis that this was computed at a higher figure than what the assessee had put in the debit note."

1.72. Asked how could Rule 115 of the Income Tax Rules, which applied only to income be applied to expenditure incurred on discounting of drafts, the Department in a note have stated:

"Rule 115 of the Income-tax Rules specifies the rates at which income chargeable to tax and expressed in foreign currency is to be converted into Indian Rupees for the purposes of income-tax assessments in India. As such income necessarily represents the excess of the assessee's receipts over admissible expenses. The rates specified in Rule 115 are applicable both to the receipts and the admissible expenses. The rates prescribed in the said Rule are applicable to all receipts arising and expenses incurred on or after the specified date."

1.73. In this connection, the representative of the Department has expressed the following view in evidence:

"I think this rule is not only for receipt but also for expenditure. We cannot have one rate for receipt and another for expenditure."

1.74. The Committee observed that discounting of drafts appeared to be a case of purchase of future dollars with present dollars and it was not clear why discounting charges were allowed at all and that too at post-devaluation rate when the assessee himself had claimed such charges at

predevaluation rate. The Department of Revenue and Banking have stated, *inter alia,* in a note:

"Rule 115 of the Income-tax Rules has statutory force and its provisions are mandatory. As the post-devaluation rate of exchange of the Indian Rupee at US $ 1=Rs. 7.50, as specified in the amended Rule 115 has retrospective operation with effect from 6-6-1966, and the expenditure on account of discounting charges was incurred by Snam in December, 1966, the income-tax authorities were bound to apply the said post-devaluation rate of exchange in converting the discounting charges into Indian rupees. In this connection, it may be mentioned here that the Commissioner of Income-tax Delhi-II had pointed out in paragraph 17 of his D.O. letter No. JB-2(57)/68-69 dated 19-9-1973 to the Board that although in Snam's profit and loss account of the calendar year 1966, the discounting charges had been claimed by it in a sum of Rs. 3.83 crores at the pre-devaluation rate of exchange, the said discounting charges would be allowable in a sum of Rs. 6.05 crores calculated at the post-devaluation rate of exchange under the operation of Rule 115 of the Income-tax Rules.

The assessee company filed with its letter dated 17-3-1972 to the Income-tax Officer, a revised statement claiming chrages for discounting its dollar drafts at the post-devaluation rate of exchange of the Indian rupee, in a sum of Rs. 6,05.02,350.00.

The action taken in the matter was, therefore, in accordance with the law. In this connection, it may also be pointed out that Snam's non-rupee receipts on or after 6-6-1966 have also been converted into Indian rupees at the post-devaluation rate of exchange, resulting in very substantial addition in framing the assessment for the assessment year 1967-68."

1.75. The Committee pointed out that though in discounting dollar drafts there was neither any loss in exchange nor any rupee transaction, yet the Commissioner seemed to have shown extraordinary generosity to the foreign concern by allowing Rs. 6.05 crores despite the concern having claimed only Rs. 3.83 crores. The Committee enquired whether the foreign concern had sent a formal letter or preferred a formal claim about it or whether the Commissioner had done it on his own. In reply, the representative of the Department said:

"There is no specific letter from the company asking for enhancement of the claim, but it had before the assessment was made

given a computation sheet in which it had worked out the discounting charges at the rate of Rs. 7.50 per dollar."

1.76. The witness has explained that according to a decision of the Supreme Court [Kedar Nath Jute Mfg. Co. Ltd. *vs.* CIT (c), Calcutta] (reported in 82 ITR page 363) the question whether "the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view that the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter.

### G. Head Office Expenses

1.77. The total amount of Head Office expenses claimed and allowed each year in the case of this assessee company from the assessment year 1962-63 onwards were as under:

| Assessment | Amount of H. O. expenses claimed and allowed | Remarks |
|---|---|---|
| 1962-63 . . . . . . | Rs. 5,56,951 | No disallowance made. |
| 1963-64 . . . . . . | Rs. 8,06,517 | Do |
| 1964-65 . . . . . . | Rs. 19,04,154 | Do. |
| 1965-66 . . . . . . | Rs. 56,11,331 | Do. |
| 1966-67 . . . . . . | Rs. 74,74,471 | Do. |
| 1967-68 . . . . . . | Rs. 25,90,265 | Do. |
| 1968-69 . . . . . . | Rs. 1,55,488 | Do. |
| 1969-70 . . . . . . | Rs. 54,893 | Do. |
| 1970-71 . . . . . . | Rs. 22,783 | Do. |
| 1971-72 . . . . . . | Rs. 3,6[illegible]9 | Do. |
| 1972-73 . . . . . . | Rs. 3,400 | Do. |
| 1973-74 . . . . . . | Rs. 4,155 | Do. |
| 1974-75 . . . . . . | Rs. 4,364 | Assessment Pending |
| 1975-76 . . . . . . | Rs. 5,885 | Do. |
| 1976-77 . . . . . . | Not available | |

1.78. The Department of Revenue and Banking have stated that a scrutiny of the assessment records had shown that the ITO had duly called for information from the assessee company about the nature of the expenses claimed as head office expenses. In reply to the ITO's queries, the assessee company, in their letter dated 12 March 1969, furnished a

break-up of the said expenses in respect of the calendar years 1963 to 1966 and also explained the nature thereof. The main items of expenses therein, relevant for the purpose of the present enquiry, are:

(i) financing charges or interest attributable to Snam's borrowings abroad utilised for the purpose of its Indian business, and

(ii) the head office overhead expenses pro-rated to the Indian branch.

1.79. Besides, the direct costs of certain materials produced by SNAM in Italy for the purposes of its Indian contracts, the amount whereof is small, were also included in the head office expenses instead of being charged directly to the profit and loss account of the Indian branch of SNAM.

1.80. In regard to financing charges or interest aforesaid, it was explained by the assessee company that as it had practically no capital of its own for executing its Indian projects, it had to obtain the necessary finances by borrowing money abroad. Accordingly it had debited to the Indian branch the financing charges attributable to the borrowed moneys utilised for its business in India. It was explained that these financing charges had been calculated at 8.5 per cent which was the prevailing rate of interest in Italy. On this basis, the following financing charges were debited to the Indian Branch and included in the the head office expenses:

| Calendar year | Amount of Financing charges |
|---|---|
| | Rs. |
| 1963 | 15,00,378 |
| 1964 | 46,23,582 |
| 1965 | 64,16,212 |
| 1966 | 61,12,492 |
| 1967 | Nil |
| Total | 1,86,82,664 |

1.81. The amount of the head office overhead expenses, pro-rated to the Indian branch during various years as per information available in the assessment records is as follows:

| Calendar Year | Amount of head office overhead expenses pro-rated to the Indian Branch |
|---|---|
| | Rs. |
| 1963 | 90,218 |
| 1964 | 2,26,841 |
| 1965 | 1,65,242 |
| 1966 | 74,144 |
| 1967 | 1,55,488 |
| Total | 7,11,933 |

1.82. The head office of SNAM was incurring overhead expenditure in relation to its Indian business in respect of general supervision, selection of technical personnel, procurement of equipment and other material, arranging for finances, advice on accounting and legal matters, etc. Such overhead expenses were pro-rated by the head office of SNAM to its Indian branch in the proportion of the total cost incurred by it in India to the total costs of its global business, as certified by SNAM's auditors. Thus, in respect of the calendar year 1967, the said percentage is only 0.633. It was pointed out by the assessee that the overhead charges pro-rated to the Indian branch were nominal when compared to the total turn-over of its Indian contracts. The total amount of the head office overhead expenses pro-rated to the Indian branch of SNAM during the years 1963 to 1967 works out to Rs. 7.12 lakhs only, which is less than 1 per cent of SNAM's total receipts during the relevant period from its Indian contracts. In these circumstances, no disallowance has been made by the ITO out of the head office overhead expenses pro-rated SNAM to its Indian branch.

1.83. SNAM's assessments upto and inclusive of the assessment year 1972-73 were completed before the issue of Board's instruction No. 846 dated 16 June 1975 relating to the scrutiny of claims by foreign concerns for the allowance of head office expenses on general administration and management.

1.84. The Committee referred to their 176th, 187th and 192nd Reports (Fifth Lok Sabha) in which certain bases for allocation of Head Office expenses were suggested and asked why these could not be followed in the case of this foreign company. The representative of the Department has said:

> "The Reports of the Public Accounts Committee came later. The assessments were made earlier."

1.85. The Committee enquired if the assessing officer had called for and examined the books of Head Office in Italy. In reply, the Department have stated *inter alia* that:

> "The Income-tax officer examined the books of accounts of Indian Branch only and not the books of accounts of Head Office in Italy."

1.86. The Committee wanted to know the basis on which the Head Office expenses as claimed by the foreign company were allowed *in toto* without any disallowance whatsoever year after year since 1962-63. In reply, the representative of the Department has stated:

> "These expenses were allowed on a pro-rate basis which are duly supported by the Auditor's certificate."

1.87. Asked if Auditor's Certificate was all that was required to accept a claim for Head Office expenses and no independent scrutiny was necessary in such cases, the Chairman, Central Board of Direct Taxes, said in evidence:

> "The usual practice is that close scrutiny has to be made as to whether the expenses claimed really relate to business carried on in India. If it is not the case it should not be allowed. It should be thoroughly scrutinised. A rather short-cut method was adopted in this case. Some formula was evolved how the head office expenses should be allowed. In all subsequent cases this set formula was applied. Now we have amended the law placing restriction. Head Office expense should not exceed 5 per cent of the income of the business."

1.88. Admitting that proper scrutiny of Head Office expenses was not made, the representative of the Department has stated in evidence:

> "In fact, as regards the Head Office expenses a proper scrutiny was not made, which should have been made at the assessment stage. Now that the assessment is being re-opened, at the time of assessment, we will look into it. In fact, this should have been done at the time of assessment; but it was not done. So, I am sorry, I cannot give full details about the head office expenses."

1.89. Asked if details of Head Office expenses were lacking, how far the assessing officer was justified in going ahead with assessment. the witness has said:

> "Only two possible reasons I can advance. One is this was a provisional assessment. The second is, I think, the officer has been concentrating on much larger issues, like Rs. 6 crores discount and things like that with the result that the head office expenses, which naturally he should have looked into properly, have not been looked into. This is a defect in the assessment, which I must admit."

### H. Assessments

1.90. A statement showing the dates on which returns were filed and assessment for relevant years completed is enclosed (Appendix I).

1.91. The Committee desired to know how is it that the returns of income filed by the foreign company for the assessment years 1963-64 to 1968-69 had to be revised thrice. In reply, the representative of the Department of Revenue and Banking has explained:

> "Broadly, I would mention the various circumstances under which returns were revised. One reason for revising the return was

when the first return was filed, it was done before the books were audited. When the books were audited, they were revised. The second time, the return were revised for making adjustments of receipts or expenses of earlier years. The third time the returns were revised was for giving effect to appeal order claiming set-off for brought forward losses. Regarding 1963-64 assessments, the first return was submitted on 15-10-63 and it showed a loss of Rs. 11 lakhs and odd. That was before the accounts were audited. Subsequently on 1-2-64 another return was submitted, still showing loss to the extent of Rs. 9.71 lakhs. This was after the audit was done. The third return was submitted on 30-9-64 which disclosed a profit of Rs. 8,85,705. This is because a technical fee of Rs. 18,56,716 which was accounted for in the subsequent year was brought back to the earlier year for which year it was rightly due."

1.92. Asked whether any penal action had been taken against the Company for the delayed filing of returns, the Department have confirmed that:

"No penal action can be taken against an assessee if the first return is filed within the time allowed originally or an extension, or where a loss is determined on assessment. **** Penal action for late filing of return has been taken where such action is called for."

1.93. The Committee wanted to know how was it that though the company had received large payments on the contracts executed by it, the income for the assessment years 1963-64, 1964-65 and 1965-66 was assessed at a loss. In reply, the Department have explained in a note that:

"(i) the incomes/losses determined for the assessment years 1963-64, 1964-65 and 1965-66 were as under:

| Assessment Year | Assessed income/loss |
|---|---|
| 1963-64 . . . . . . . . | Rs. 8,90,444 (Income) |
| 1964-65 . . . . . . . . | Rs. 17,53,995 (Loss) |
| 1965-66 . . . . . . . . . | Rs. 47,75,685 (Loss) |

(ii) During the accounting year relating to the assessment year 1963-64, the assessee company received income by way of technical fees from M|s. Durgapore Black Carbon Plant and

Lube Oil Plant. The company also received payments for preparation of project reports. Thus, practically the work on pipe line contracts did not start during the said accounting year. The assessment was finally framed on a total income of Rs. 8,90,444 as against the loss of Rs. 8,22,963 as per the company's books.

(iii) During the accounting years relevant to the assessment years 1964-65 to 1965-66, proceeds from the contracts with Indian Oil Corporation and Oil and Natural Gas Commission were received. In the course of assessment proceedings, it was pointed out by Snam that there were difficulties in determining the correct profits from the contracts for each year, as certain common expenditure and common management expenses had been incurred which could not be distributed accurately amongst various contracts. Huge expenses were incurred under certain contracts for which there were no corresponding receipts during the previous year. The Income-tax Officer, therefore, completed the assessment on the basis of book results for both the assessments for 1964-65 and 1965-66, subject to a recomputation of the profits subsequently on the completed contract basis.

(iv) The losses determined for the assessment years 1964-65 and 1965-66 are largely attributable to allowances for development rebate and depreciation which are considerably higher than the actual provisions made by the assessee in this behalf, in its books of accounts. Further, the assessments for the years 1964-65 and 1965-66 have since been set aside by the Appellate Assistant Commissioner of Income-tax and *de novo* assessments will have to be framed for these assessment years."

1.94. The Committee were informed that during the course of assessment proceedings for the assessment year 1964-65, the assessee company's representative approached the then Commissioner of Income-tax, New Delhi, for getting its assessments finalised on "completed contract" basis. The reason for this request was stated to be that the assessee company had been receiving advance payments from its clients and incurring expenses in executing the contracts and its bills for the jobs done could not be evaluated till joint inspections by the parties as per terms of the contracts. In the case of a contract work running over several years, it was often not possible to ascertain the profits earned during each year before the completion of the contract, because of absence of data for evaluation of the work-in-progress of the jobs actually completed during the year. In such cases, the Department had been following the practice of making an ad-hoc assessment for each year on the basis of the available information subject

to a rectification of re-framing of the assessment (if set-aside on appeal) in the light of facts as ascertained finally on completion of the contract. In view of this position, the then Commissioner of Income Tax, Delhi instructed the Income-tax Officer to complete assessment for 1964-65 accordingly.

1.95. The Board made enquiries in the matter from Commissioners of Income-tax of other charges like Calcutta and Bombay and were informed that the assessments of big contractors were being finalised on 'completed contract' basis where the contract work had been executed over a number of years. Accordingly the Board in its letter F. No. 8|19|69-IT (A.II) dated 24th March, 1970 agreed to the framing of the assessment for 1965-66 on the same basis as was adopted for the assessment year 1964-65 and to keep the appeal pending till the profits for the entire period of the contract were ascertained.

1.96. The Board in its letter F. No. 9/18/69/I T. (A.II) dated 1 April 1970, requested the Commissioner of Income-tax, Delhi-II that the assessee should agree to the rectification on the determination of profits for the contract as a whole. Accordingly the Income-tax Officer requested the assessee company telephonically to communicate its acceptance of the aforesaid basis of finalising the assessments on completed contract basis.

1.97. The "telephonic request" was stated to have been made by the Income-tax Officer in the routine manner for obtaining the acceptance at an early date. The Committee were informed that such routine requests were made quite often by the field officers to obtain various information in connection with assessment proceedings.

1.98. The Committee have also been informed that all the assessments from 1964-65 to 1969-70 have since been set-aside by the Appellate Assistant Commissioner of Income-tax in November, 1976, and that under Board's D. O. No. 7231-M(IT)/76 dated 20 November, 1976, the Commissioner of Income-tax had been instructed to have the assessments completed expeditiously.

1.99. When the Committee pointed out that the Income-tax Act did not contain a provision for provisional assessments, the witness has explained:

> "These are provisional assessments in the sense that these assessments are not made on the basis of completed contract. In fact, the assessee wanted the assessment to be made on the basis of completed, contracts, when the contract is completed to find the profit and then apportion for all these years during which the contract ran. But this has not been done. That is why it is only a provisional assessment."

1.100. The Committee asked that if these assessments were provisional, was an undertaking obtained from the foreign company that they would accept a revised assessment and pay the difference, if any. The representative of the Department said:

> "An assurance has been obtained that he is prepared to accept a revised assessment. He has given it on writing."

1.101. The letter dated 4 June, 1970 containing the aforesaid assurance stated:

> "With reference to the telephonic request, this is to confirm that we will not have any objection to the rectification of the assessment already completed, on determination of profits on completed contract basis, without prejudice to our right to appeal."

1.102. Asked if obtaining of such an assurance in cases of provisional assessments was a normal practice, the witness stated:

> "Normally, this is not done. This is an exceptional procedure, because of the fact that the contracts were not completed at the relevant time."

1.103. The Chairman, Central Board of Direct Taxes has added:

> "I have not come across many such cases. Actually, I can recall when I was an Income Tax Officer, long time ago, some instructions were issued by the Board saying that in the case of construction companies where the contract runs over several years, assessment could be done on a provisional basis, on the understanding that after the contract was completed, then the real income could be determined and allocated amongst the various years."

1.104. In a note furnished after evidence, the Committee were informed that "instructions on this point are not readily available."

1.105. The Committee pointed out that in paragraph 3.69 to 3.75 of their 66th Report (Fourth Lok Sabha) (April 1970), the Committee on Public Undertakings had also pointed out that Bechtals, international concern connected with the Haldia-Barauni-Kanpur Pipeline Project as Consultants and Supervisors managed to clear off from the scene after pocketing more than one crore of rupees as fees and charges without completing the work. In this context, the Committee asked whether SNAM had left sufficient funds in India and if not how far the Income-tax authorities were justified in following an exceptional procedure in the case of SNAM. In reply, representative of the Department has stated:

> "It is a difficult question to answer. I feel that if the Commissioner agreed to these arrangements, he should have ensured

that sufficient funds were left in India by the Company to meet any future liabilities that might arise when the assessments were made."

The witness has added:

"We have withheld refund due to them to the extent of Rs. 25 lakhs."

1.106. Under the contracts, the tax liability on the income arising to SNAM devolved on Indian Refineries Ltd. in respect of construction of Gauhati-Siliguri Pipeline, on Oil and Natural Gas Commission in respect of construction of Oil pipelines in Gujarat as well as drilling in UP and Punjab. However, tax liability on income arising from Haldia-Barauni-Kanpur Oil pipeline devolved on SNAM itself.

1.107. In other words, out of the five contracts mentioned in para 1.6, it was only for the Haldia-Barauni-Kanpur Pipeline contract that the company was, itself to bear the tax liability.

1.108. At page 304 of their Report (August 1975) the Pipeline Inquiry Commission have observed as under:—

"The note of Shri R. R. Gupta, dated 12-3-1968, at pages 9 to 11 of PIC/IOC-4335, shows that in January, 1968, Messrs Snam Saipem informed Messrs Indian Oil Corporation that according to their calculations, the profits on the Gauhati-Siliguri Contract amounted to Rs. 75.6 lakhs on which Messrs Indian Oil Corporation's liability for income-tax worked out to approximately Rs. 40.4 lakhs and as they i.e. Messrs Snam Saipem, had paid advance-tax to the income-tax Department on that basis, they i.e. Messrs Snam Saipem were pressing for the reimbursement of that amount to them in terms of their Contract. Thereafter, the note goes on to say that a preliminary check of the accounts relating to the contracts executed by Messrs Snam Saipem with Messrs Indian Refineries Limited/ Messrs Indian Oil Corporation and the Oil and Natural Gas Commission revealed that while in the case of Gauhati-Silliguri Contract on the total reciepts of Rs. 3.83 crores, the profit earned by Messrs Snam Saipem worked out to Rs. 77.6 lakhs in respect of the Haldia-Barauni-Kanpur Contract, the profit shown was only of Rs. 28.38 lakhs on a total receipt of Rs. 12.08 crores. As that position appeared to Shri R. R. Gupta to be 'extraordinary' he suggested 'a very detailed checking of the books of accounts of Snam relating to all contracts executed by it with ONGC and IOC' with a view to satisfying themselves as to the extent of their tax-liability. The note further

shows that after discussing the matter with Shri M. V. Rao, Financial Director, Messrs Indian Oil Corporation and Shri Kabra, Joint Director (Finance) of Oil and Natural Gas Commission a certain course of action was decided upon".

1.109. Apprehending, therefore, that Snam had been debiting most of its expenditure to the Haldia-Barauni-Kanpur contract in respect of which Snam were to bear the tax liability, the Committee asked whether Snam had been maintaining separate accounts in respect of each contract. In reply, the Department of Revenue and Banking stated:

> "The bifurcation of expenses was not done because there was a claim that all the expenses were clubbed together and that it was not possible to bifurcate them. Actually, it is absolutely unsatisfactory. The assessee should have kept his accounts separately particularly because we find that the tax liability had to be borne by the assessee on one of the contracts, and in respect of the three others by the ONGC and the Indian Oil Corporation.
>
> The Takru Commission also has gone into this point and commented adversely on this aspect, that the assessee has not kept his accounts separately for each project. It is as a result of this that the ONGC and IOC have not paid any taxes in respect of these contracts because the assessee could not indicate the exact profits made on the contracts separately."

1.110. If SNAM had not been maintaining separate accounts, the Committee enquired how its income under each contract was determined for the purpose of assessment. The representative of the Department has said in evidence:

> "If the assessee is not able to produce evidence as to what is the profit from each project, then the Income Tax Officer can adopt a rought and ready method of estimate. No. attempt whatsoever was made to bifurcate the profits in this manner. In fact, the assessment were not made on proper lines. The accounts should have been scrutinised to find our the profit in respect of each contract. Unless that is done, it is not possible to find out the tax liability which is to be borne by the Indian Oil Corporation and the ONGC and that borne by the assessee. We propose to do that. In the revised assessment it will be made."

1.111. Asked whether any Notice was issued at any time during the last 10 years by the Department to the Oil and Natural Gas Commission and the Indian Oil Corporation for payment of taxes due from them, the witness said: "No Notice was issued."

1.112. When the Committee asked if at that point of time there had been a failure along the line, the witness replied in the affirmative.

### I. Role of the Central Board of Direct Taxes

1.113. The Central Board of Direct Taxes gave their decision on 22 January 1974 in regard to admissibility of discounting charges in this case. In this context, the Committee enquired if the Income Tax Act did not prohibit the Central Board of Direct Taxes from looking into and giving rulings in individual cases of assessment. In reply, the Department of Revenue and Banking have stated in a note that:

> "Section 119(1), as it stood before 1-4-1971, provided that all officers and persons employed in the execution of the Income-tax Act shall observe and follow the orders, instructions and directions of the Board. Exception was made only in the case of Appellate Assistant Commissioners by providing that no orders or instructions shall be given so as to interfere with the discretion of Appellate Assistant Commissioners. By Act 42 of 1970, section 119 was amended with effect from 1st April, 1971 by which certain restriction was imposed on the powers of the Board to the effect that the Board shall not issue any order, instruction or direction so as to require any Income-tax authority to make a particular assessment, or to dispose of a particular case in a particular manner."

1.114. In Paragraph 5.89 of their 128th Report (Fifth Lok Sabha) (1974-75) the Committee had cautioned the Board against giving advance rulings in individual cases. The relevant recommendation read:

> "The question of the Board's giving advance ruling had been raised before the various committees and commissions which inquired into direct tax administration. In this connection the Committee would refer to paragraph 6.179 of Direct Taxes Enquiry Committee's final report (December, 1971). It appears that unless the Board is authorised by law to give advance rulings the Board should not give advance ruling. The Commitee, therefore, desire that in order to place the matter on a legal footing necessary amendment to the law should be considered early."

1.115. On 10 December 1974 the Ministry of Finance furnished the following reply to the aforesaid recommendations [*Vide* page 34 of 153rd Action Taken Report (Fifth Lok Sabha)]:

> "In view of the decision that the Board will not issue any advance rulings, it is not considered necessary to amend the law for taking a power enabling the Board to issue advance rulings."

1.116. The Committee desire to know why despite the above assurance the Board gave their ruling in this particular case. In reply, the Department of Revenue and Banking have intimated that the question regarding the scope of section 119 of the Income Tax Act, 1961 had since been examined by the Board in 1974 in consultation with the Ministry of law, with particular reference to the power of the Board to give advance rulings/directions|instruction in individuals cases and the following clarification was issued by the Board on 22 November 1974 *vide* Instruction No. 796:

> "Section 119 prohibits the Board from issuing orders, instructions or directions so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner. In view thereof, the Board has decided that it will not issue any advance rulings|directions| instructions in individual cases to any income-tax authority or to any querist. However, the Board would continue to over-see administratively the functioning of the lower formations and give advice in individual cases if the facts of the case so justify. Such an advice may also be given in respect of references from the Commissioners only in respect of any difficult proposition of law or fact. Such an advice will not be in the nature of directions or instructions and it would be for the authority concerned to come to a decision on the merits of the case in the light of its individual judgment. As a corollary, it would be necessary to ensure that the Income-tax authorities refrain from quoting or referring to the advice or guidance given by the Board in any orders passed by them. Of course, there would be no objection to their adopting the reasonings contained in the advice or guidance given by the Board."

1.117. The Chairman, Central Board of Direct Taxes, admitted during evidence that:

> "It was quite a common practice for the Board to give instructions in individual cases. *****"

1.118. Asked how is it that such a practice developed despite a clear prohibition about it in the Act, the witness has replied:

> "This is the factual position which we have got to admit."

1.119. The Committee desired to know whether it was a fact that before the Central Board of Direct Taxes gave its ruling in this case on 22 January 1974 about admissibility of discounted charges, the representatives of Snam had been approaching the Board off and on in regard to this

case, and if so, when was the Board approached for the first time and in what manner. In reply, the Department have informed the Committee that:

> "Shri S. P. Chopra of M/s. S. P. Chopra & Co. Chartered Accountant met Shri J. C. Kalra, the then Secretary, CBDT on 12th March, 1969 and filed petition dated the 12th March, 1969."

1.120. Asked how many meetings did the assessee's representatives had with the Board at various levels about this case, the Department of Revenue and Banking have furnished a statement which indicated that during the period 12-3-69 to 8-1-74, assessee's representatives had as many as 15 meetings with various officials of the Central Board of Direct Taxes including the Member incharge of the case, the Joint Secretary of the Foreign Tax Division and the Chairman of the Board at that time.

1.121. The Committee asked whether the ruling given by the Board on the admissibility of discounting charges to a foreign company apart from being an undue interference in the normal processing of this case did not, when viewed against the background of numerous meetings held by company representatives with the Board at various levels, cast a serious reflection on the functioning of the Board at that time. In reply, Chairman, CBDT, said in evidence:

> "This is a matter on which you kindly excuse me if I may not like to comment.***** You can draw your on deduction. It would be highly embarrassing for me to comment on my predecessors."

**1.122. This relates to a case of irregular allowance of discount aggregating to Rs. 6.05 crores in terms of Indian Currency to a foreign company in the assessment for the year 1967-68. The facts of the case are summarised below.**

**A General Agreement was entered into on 29 August, 1961 between the Government of India and M/s. Ente Nazionale Indrocarburi (E.N.I.), a wholly Italian Government owned undertaking, having world-wide operations with a view to establish and develop Indo-Italian co-operation in the petroleum sector. SNAM, a company of ENI Group, entered into specific contracts with the Oil and Natural Gas Commission in 1961 for drilling in UP and Punjab and with Indian Refineries Ltd. (now Indian Oil Corporation) in 1963 for the construction of (i) oil pipeline from Gauhati to Siliguri, (ii) Haldia-Baraunai-Kanpur pipeline and (iii) oil pipeline in Gujarat. The payment was to be made in Rupees as well as foreign currency; the latter, which was to cover the estimated cost of goods and services of non-Indian origin, was expressed in terms of U.S. Dollars. According to clause 6 of the General Agreement, 5 per cent of the foreign currency payment was to be made on the date of signature of each contract, another 3 per cent on the expiry of 12 months from the date of signature,**

and the balance of 92 per cent in 20 equal half yearly instalments starting on the expiry of 2 years after the signature of the contract. In consideration for this credit facility, M/s. Snam was also to receive interest at 6 per cent per annum on the deferred payment up to the date of maturity of each dollar draft, the interest being payble by means of 20 instalments of sub-divided amounts, each to be paid for in Italy in Italian Liras, and to have the same date of maturity as the instalments for the principal amount. However, instead of making half-yearly payments as and when they fell due, M/s. Snam were issued post-dated drafts for the entire sum due to them under the contract. On 29 December, 1966, M/s. Snam had with them, in their head office account 20 post-dated drafts of the aggregate face value of 1,79,66,255 dollars issued by the Indian Refineries Ltd. These were due for payment in 1966—74. Instead of waiting for these drafts to mature, what the foreign company did was to discount these drafts prematurely on 29 December, 1966 with a Bank in Geneva and realised $99,38.150 after paying discount charges at 12 per cent per annum amounting to $80,28,104 (Rs. 6.05 crores).

The issuance of post-dated drafts by the Indian Refineries Ltd. especially when the Agreement did not contain a provision for issue of such drafts is, in the opinion of the Committee, an extraordinary procedure. The representative of the Reserve Bank of India confirmed during evidence that "although drafts were given post-dated, no payment from India in foreign exchange was remitted before the date." It is clear that the action of the Indian Refineries Ltd. to issue post-dated drafts apart from being a departure from the main Agreement, had placed the foreign company in an advantageous position because by virtue of these being negotiable instruments the foreign party could realist the value of these drafts instantly by paying discount charges instead of waiting till the specified dates when the instalments payable under the Agreement became due in the normal course.

What is even more regrettable is that though under Clause 6 of the Agreement it was open to Indian Refineries Ltd. to pay only 50 per cent of the first 4 half-yearly instalments, the remaining 50 per cent of such instalments being added proportionately to the other 16 instalments, Indian Refineries Ltd. did not avail itself of this facility. The Committee would like the Ministry to examine why full advantage of deferred payment terms provided for in the Agreement was not taken.

1.123. The Committee are amazed to find that though the main Agreement of 29 August, 1961 between the Government of India with E.N.I. was in the nature of a supplier's credit and had visualised payment in Italian currency only, the specific contracts entered with SNAM provided for payment in U.S. Dollars in respect of supplies, etc. arising abroad. It was explained to the Committee that as Italy was (and is) in the "Convertible Account Group", in terms of foreign exchange it would be immater-

ial whether the payment was made in Lira (Italian currency) or in U.S. Dollar. The Ministry of Finance have however admitted in a note that prior to devaluation of rupee they did not have "an awareness of the problem arising out of variations in exchange" nor "a conscious policy of overcoming any assurance for exchange protection". From what the Ministry of Finance have stated, it is patently clear that issue of Dollar drafts in this case did involve a tacit protection against fluctuation in the exchange rate. Moreover, if during the relevant years there was devaluation of Lira vis-a-vis U.S. Dollar at any time while the drafts were held, the possibility of the foreign company having derived another windfall benefit on this account could not have been ruled out.

1.124. The Committee find that in the assessment for the year 1967-68 an amount of Rs. 6.05 crores, stated to be discount charges incurred by the foreign company on discounting of dollar drafts outside India, was allowed as deduction in the computation of their income from Indian business. This allowance was stated to have been made under Section 37(1) of the Income Tax Act, 1961. Section 37(1) of the Income Tax Act, 1961 stipulates that any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expanded "wholly and exclusively" for the purposes of the business or profession, shall be allowed in computing the income. In order, therefore, to claim the benefit of that Section, the foreign company had to establish that the discount charges had been incurred wholly and exclusively for the purposes of the Indian business. It was stated by the Board that the company contended, in their detailed note dated 30th August 1971, that the whole of the amount realised by discounting of its dollar drafts was utilised for the payment of loan liabilities relating to their Indian business and in support of that statement filed a certificate dated 2 August, 1971 from its Auditors and another certificate dated 3 August, 1971 from the Vie President of SOFID, a special Financing Company of the E.N.I. Explaining the extent to which evidence given by the company was scrutinised by the Department before accepting this huge claim the Department of Revenue and Banking stated that the assessees' contention was also cross checked with reference to their world balance sheet and other relevant statements of accounts. But when it was pointed out that according to the world balance sheet of the company, its loan liabilities were reduced to tht extent of 1982 million liras only as between 31st December, 1965 and 31st December 1966 whereas the proceeds realised by the discounting of drafts on 29.12.1966 amounted to 6211 million liras (9,939,150$ converted at the rate of 625 liras), the Department took the view that such a comparison canaot provide a reasonable basis for disproving the statement of the Auditors of Snam as well as that of Vice President of SOFID. The representative of the Department, however, admitted during evidence that loans raised by the foreign company in Italy for the Indian business were

reflected in the head office account but not shown as a liability of the Indian Branch and that no direct evidence was available to show which of the transactions of the foreign company abroad related exclusively and wholly to the Indian business. It was also admitted that the Income Tax Officer had not examined the books of accounts of the Head office of the company. The assessee company, in response to various queries, had also informed the Department in 1971 that as it maintained consolidated account for its world business, it would not be possible for it to relate every single dollar receipt on account of discounting or drafts to a dollar standing as a liability in its account. The assessee company is stated to have pleaded that had this question been raised in 1967 it would have been less difficult for it to attempt such co-relation. Such a plea coming as it did from a foreign company belonging to ENI Group of Enterprises, owned by the Government of Italy, and whose accounts are said to be maintained on a computerised system is difficult to accept.

In the circumstances, the Committee cannot resist the impression that in allowing this huge claim of Rs. 6.05 crores in the assessment for the year 1967-68, the certificates furnished by the assessee company whose credibility for purposes of tax assessment is doubtful, were relied upon by the Department of Revenue and Banking without any worth-while scrutiny. The company itself had failed to establish the clam within the requirements of section 37(1) and the Indian accounts which were the only accounts examined by the Income Tax Officer did not provide any evidence to support it. The Committee are of the view that the Department should call for all relevant accounts and details and examine this aspect of the matter in greater detail, not only to find out whether there was any lack of bonafides in the solicitude shown to the company but also whether the claim was clearly established on facts and admissible in law as directly relating to the Indian business and chargeable thereto.

**1.125. The Committee learn that as Snam's own capital available for employment in its business (including projects undertaken in India on long term credits) was virtually nil, it had to raise funds through outside borrowings especially when Italy itself was engulfed by economic and financial crises during 1963 and 1965. Snam, it has been stated, had been making efforts since 1964 for discounting of drafts but it was only in December, 1966 that it was able to secure a favourable rate of discounting charges. It is significant that Snam discounted these drafts hardly two days before their accounting year 1966 was about to end on 31-12-66 and they have claimed to have paid as discount charges as much as 45 per cent of the value of the drafts (discount charges of 80,28,104 dollars paid for drafts of the value of 1,79,66,255 dollars). In this context the Committee would suggest that the [illegible] officer should also investigate whether the Drafts, after being dis-**

counted by the Geneva Bank in December 1966, were sold by this Bank to any organisation or institution and if so, to which party(s) on what date and on what terms and conditions.

1.126. Under Section 37(1) of the Income Tax Act, 1961, only revenue expenditure and not capital expenditure qualifies for deduction in computation of income. While the Income Tax Officer was of the view that in this case "the depreciation of bills of exchange lying in deposit with the assessee company and later on encashed through Swiss Bank would be capital expenditure and not revenue expenditure because the income had become due on the date the bills were submitted", the view of the Commissioner of Income Tax with which the Central Board of Direct Taxes agreed was that the discounting charges incurred by Snam amounted to revenue expenditure allowable as a deduction under Section 37(1) of the Income Tax Act, 1961. The Department of Revenue and Banking explained that Snam continued to carry on its contract business in India not only during the calendar year 1966 but also in subsequent years and that the Bills of Exchange were received by the assessee company on revenue account, being the compensation received by them from their clients in India for suplying the materials and rendering services for executing their contracts. The Committee are of the opinion that while the earning of dollar drafts was a trading transaction of the Indian business, their holding in the hands of the Head Office and subsequent discounting or utilisation cannot be regarded as trading transactions of the Indian business. Once the dollar drafts were received by Snam and sent to its headquarters office abroad, these would form part of the capital funds of the foreign company and could not, in any case be treated as part of a trading transaction of its Indian business. It has also been admitted by the Department that except the Certificates furnished by Snam from their Auditors and Vice President of SOFID there is no direct 'evidence' to prove that the proceeds of the dollar drafts were utilised for meeting the loan liabilities relating to its Indian business. Further out of a total cost of Rs. 21.45 crores incurred in Italy, an amount of Rs. 3.76 crores (i.e. 18 per cent) was utilised for the purchase of capital assets. The Committee are unable to appreciate why this 18 per cent of discount charges attributable to capital assets could not be treated as capital expenditure especially when Snam themselves are understood to have stated that borrowed funds had been invested by them also in fixed assets which formed part of the fixed assets transferred to India in the form of plant and equipment. The Committee recommend that these aspects should be kept in mind while reassessing the Snam's income for tax.

1.127. The Committee find it rather perplexing that while the agreement of the Central Board of Direct Taxes with the view of the Commissioner treating discounting charges as revenue and consequently discountable

was communicated to the Commissioner on the 22 January 1974, the Board sought the opinion of the Ministry of Law on this point only in November 1976—a couple of days before the evidence of the representatives of the Government on this subject before the P.A.C. The Committee also note that while giving their opinion the Ministry of Law had specifically pointed out that as the time at the disposal of the Ministry was very short, the views could not be said to be based on a thorough study of the matter and were only tentative. The Committee would like to emphasise upon the Board the need for exercising utmost caution in dealing with individual cases involving legal ramifications. Where the advice of the Ministry of Law appears necessary, a reference should be made to the Ministry of Law promptly. This was a fit case where the considered and conclusive reply of the Ministry of Law should have been obtained much earlier.

1.128. A pertinent question that compels attention is whether even after giving to the foreign company dollar drafts representing the principal amount and the interest due thereon at the rate stipulated in the General Agreement between the Government of India and ENI further allowance of discount charges which was not provided for in that Agreement was at all justified. It appears to the Committee that under the agreement the goods and services to be supplied from abroad were to be supplied on the basis of a long term credit and in consideration thereof the Agreement provided for payment of interest on deferred instalments, such interest itself, being paid in similar deferred instalments. Viewed against this background it was apparently not the intention that the foreign company would discount all the drafts in one go throwing a further substantial burden, in addition to the aforesaid interest, on the Indian Exchequer by reducing the foreign party's tax liabilities. As far as the Committee can see, the moment dollar drafts for the principal amount and interest at the prescribed rate were issued to the foreign company, the entire liabilities under the contract should have been deemed to have been discharged and if the foreign company instead of waiting till the dates of maturity of these drafts discounted the same at a time of their own choosing, it cannot in fairness to itself and the Indian Taxation authorities, claim any tax concession on any expenditure that may have been incurred by it on such discounting.

1.129. Yet another point on which the Committee could not get a satisfactory explanation from the representative of the Department of Revenue and Banking was as to why for the purpose of assessment for the year 1967-68 discounting charges of 80,28,104 dollars were allowed to be converted at the post-devaluation rate of exchange ($-Rs. 7.50) to Rs. 6.05 crores when the drafts were all issued prior to the devaluation of the rupee on 6 June, 1966 and were even accounted for at the pre-devaluation rate ($-4,762) at Rs. 3.83 crores. The Committee under-

stand that the representative of the M/s. Snam had also confirmed that discounting charges had been duly debited by their Head Office Accounts to its Indian branch and (as per Debit Note received in this regard) these amounted to Rs. 3.83 crores. Since the discounting was effected on 29. 12.1966 i.e. after devaluation of the rupee, the discount charges were allowed to the foreign company at post-devaluation rate under the provision of Rule 115 of the Income-Tax Rules, 1962 which, it was stated, had statutory force and was mandatory. In response to a query from the Committee whether Rule 115 of the Income Tax Rules, 1962 which applied only to income could also applied to expenditure incurred on discounting of dollar drafts, the Department have stated that the rule applied to expenditure as well because "income necessarily represents the excess of the assessee's receipts over admissible expences." In view of the fact that the rule as at present constructed specifically and categorically confines its applicability to "income accruing or arising or deemed to accrue or arise. . . . .", the interpretation placed upon it by the Department does not appear to the Committee to be wholly free from doubt. The Committee, therefore, recommend that this aspect may be re-examined if necessary in consultation with the Ministry of Law.

It transpired during evidence that discount charges at higher rate were allowed to the foreign company despite the fact that it had not put in any formal claim for such enhancement. Moreover, Snam has been following mercantile system of accounting under which its income is taxable at the point of time when it accrues i.e. when the assessee gets a right to receive it. As pointed out by the Commissioner of Income-Tax, the date of receipt of a Bill of Exchange is "the date on which instrument is received and not the date on which payment is made under it." The dollar drafts were already out of India. The discount charges did not represent any fresh remittance of money from abroad for expenditure in India. The devaluation of the rupee could not, there, throw any extra burden on the Company. Apparently these points were either overlooked or not given the importance they deserved. **The Committee cannot but express their displeasure at the failure of the Department to safeguard the interests of the national exchequer. The Committee would suggest that Government should have this matter examined from the vigilance angle as well.**

**1.130. The Committee note the plea advanced by the Department that "as the contracts do not contain any stipulation, express or implied, restraining Snam from premature realisation of the dollar drafts it was open to Snam to realise the said drafts." The Committee find that the agreement between the ENI and the Government of India provided for a part of the payment being made in equal half-yearly instalments. Leaving aside the authority for premature realisation of dollar drafts by having them discounted, the agreement did not contain any provision even for the issue of post-dated drafts.**

1.131. The Committee find that the assessee foreign company claimed and was allowed each year large amounts as Head Office expenses consisting of (i) financing charges or interest attribute to Snam's borrowings abroad utilised for the purpose of its Indian business and (ii) the head office overhead expenses prorated to the Indian branch. During the years 1963 to 1967, the Head Office expenses allowed totalled Rs. 1.94 crores out of which Rs. 1.87 crores were "financing charges", calculated at 8.5 per cent which was the prevailing rate of interest in Italy. The assessee company is stated to have explained that it had practically no capital of its own executing its Indian projects and, therefore, had to borrow money abroad and debit the financing charges attributable to the borrowed money utilised for its business in India to its Indian Branch. The Committee are surprised how a foreign company with no capital of its own could be entrusted the work of construction of pipelines and drilling for oil and how amounts calculated at a flat rate of 8.5 per cent and not representing actual expenses incurred could be allowed in its income tax assessments.

1.132. The Committee are further more surprised that even when the Indian Refineries Ltd. had paid financing charges to the foreign company amounting to Rs. 1.87 crores the discounting charges in respect of the post-dated drafts, as claimed by Snam, were allowed to be treated as on revenue account and thus held deductable from income for the purpose of tax. This had the effect of giving double benefit to the company and to that extent reducing the value of the credit facility extended to this country by ENI. This aspect of the matter requires to be probed.

1.133. The Committee also find that Head Office expenses (other than financing charges) amounting to Rs. 7.12 lakhs were allowed to the assessee company during the years 1963—1967 without detailed adequate scrutiny. It transpired during evidence that Head Office expenses were allowed on ad hoc basis and the books of accounts of Head Office in Italy were not called for and examined. The representative of the Department of Revenue admitted during evidence that scrutiny of Head Office expenses was defective but explained that the assessing officer had possibly been concentrating on much larger issue like discounting charges where the amount involved was much more. The Committee are not impressed by this argument and feel that the assessing officer had failed in his primary duty of safeguarding the revenues of the State by accommodating the claims of the foreign assessee companies to the farthest extent possible. The Committee hope that while making a revised assessment, a thorough scrutiny would be made before accepting any claim on this account.

1.134 Under the contracts, while the tax liability on income accruing to Snam from the work in respect of the Gauhati-Siliguri pipelines was to be borne by the Indian Refineries Ltd. (Now IOC), that from construction

of oil pipelines in Gujarat and drilling in UP and Punjab, by ONGC. The tax liability on the profits from the construction on Haldia-Barauni-Kanpur was to be borne by Snam itself. The Committee note with regret that though under the contracts tax liability developed on different companies, Snam had not been maintaining separate accounts for each contract in the absence of which it is difficult to apportion expenses, profits and tax liability as between the Indian company and Snam. Consequently ONGC and IOC have not been able to pay any taxes in respect of these contracts. This matter should have been taken up by the Income-tax Department with the the company. The Committee were told that assessments for the years 1962-63 to 1968-69, completed during 1965-72 were ad hoc and that assessing authorities had yet to take a final view on this case. The Committee were informed that if no re-assessment, any more tax was found payable by Snam it would be possible to effect recovery from them because a refund of Rs. 25 lakhs dut to them had been witheld. However, if the tax liability exceeds that amount, it may pose a problem. The Committee regret that the assessing authority concerned neither estimated the profit under each contract by adopting a foolproof method on the basis of scrutiny of accounts at the stage of ad hoc assessment nor did he ensure that sufficient funds were left in India by the Company to meet any future liabilities that might arise when final assessments are made. The representative of the Department admitted during evidence that at that point of time, "there has been failure all along the line."

1.135. The Committee find that for the assessment year 1963-64 the income of the company was assessed at Rs. 8.90 lakhs whereas for the years 1964-65 and 1965-66, the assessment showed a loss of Rs. 17.54 lakhs and Rs. 47.96 lakhs respectively. The Committee also find that the assessment for the years 1964-65 and 1965-66 have since been set aside by the Appelate Assistant Commissioner of Income-tax and de novo assessment will have to be framed for these assessment years. The Committee hope that while making the re-assessment for these years, the assessing authority will thoroughly scrutinise the accounts of this company so as to ensure that the financial results for the assessment years 1964-65 and 1965-66 reflect the correct position.

1.136. The Committee deplore the casual manner in which the Central Board of Direct Taxes have handled the assessment case of this foreign company. The C[illegible] of Central Board of Direct Taxes was frank enough to admit that in this case his person[illegible] impression was that the assessments had been made in a "perfunctory manner." He, however, assured the Committee that [illegible] made earlier were all [illegible] and that every effort would be made to settle at [illegible] which would be fair to our country as well as to the foreign company. The Committee [illegible] the Central Board of Direct Taxes [illegible] the Commit-

sioner concerned on 20 November, 1976 to complete the assessments expeditiously. The Committee would like to be informed about the details of the final assessment.

1.137. The Committee view with grave concern the fact that representatives of the foreign company had been approaching the Central Board of Direct Taxes off and no since March, 1969 and up to 8 January, 1974 held as many as 15 meetings with them at various levels including meetings with the Member incharge of the case, Joint Secretary of the Foreign Tax Division and the Chairman of the Board culminating in the Board's giving ruling on 24 January, 1974 that discounting charges were admissible for deduction in computation of income under Section 37(i) of the Income-tax Act. The Committee thoroughly disapprove this sort of back-stage manoeveuring calculated to influence the official of the Board. The Committee desire that difinite instructions in this regard should be issued by the Ministry.

1.138. The Committee find that despite there being a statutory restriction in the Income Tax Act, itself (vide Act 42 of 1970) which amended Section 119 w.e.f. 1.4.1971) to the effect that the Board shall not issue any order, instruction or direction so as to require any income tax authority to make a particular assessment, or to dispose of a particular case in a particular manner, a "common practice" to give instructions in individual cases had developed in the Board. In this connection the Committee recall that in paragraph 5.89 of their 128th Report (1974-75) they had cautioned the Board against giving advance rulings in individual cases. The Board have in consultation with the Ministry of Law issued instructions on 22 January, 1974 to the Commissioners of Income Tax clarifying that it would "continue to over-see administratively the functioning of the lower formations and give advice in individual cases if the facts of the case so justify". The Commissioners have, however, been advised to "refrain from quoting or referring to the advice or guidance given by the Board in any orders passed by them". The Committee reiterate their recommendation and trust that the Board would respect the law on this point and refrain from giving order, instruction or direction as to the manner in which assessment should be done in any specific case.

1.139. To sum up, the whole chain of events in the case fall into [illegible] pattern. Although the general agreement provided for the payment of [illegible] foreign exchange component in Italian currency, the payment was actually made in U.S. dollars affording an opportunity to the company to obtain a windfall benefit in the event of a de-valuation of the Italian currency, vis-a-vis, U.S. dollars at any time whil it held the dollar drafts. The payment was made in the form of [illegible] drafts which co[illegible] negotiable [illegible] in the hands of the comp[illegible] who could discount them at any

time. This was a clear departure from the main Agreement. An allowance for discount charges calculated at over Rs. 6 crores was made in the assessment for the year 1967-68 merely on the basis of certificates given by the company related and its auditors without any scrutiny though the company had, admittedly, not been able to relate these charges to the purposes of their Indian business which was an essential condition for this allowance under the relevant provisions of the Income-tax Act, 1961. The Taxation authorities did not examine the head office books of accounts and did not even check up, whether the drafts discounted just two days before the end of the company's accounting year had subsequently been repurchased by it or by its associates. Instead, they went out of their way to give an allowance of Rs. 6.05 crores against the company's claim of Rs. 3.83 crores on the plea that the allowance was admissible at the post de-valuation rate of exchange wihout even realising that there, apparently, was no fresh expenditure involving any remittance from abroad. Further, although it was known that out of 5 contracts being executed by this company, the company had undertaken the tax liability only in respect of this one contract and would, therefore, be tempted to debit more than its proper share of expenses to this contract so as to depress its taxable income, no precautions were taken to see that proper contract-wise accounts were made out and rendered to the taxation authorities for purposes of assessment. The Central Board of Direct Taxes and the senior offices of the Department interfered freely with the jurisdiction of the lower assessing authorities in contravention of the provisions of the Income-tax Act. Lastly, inspite of the magnitude of the concessions and the points of law involved, the Ministry of Law were not consulted at any stage; they were hustled into recording an opinion without a thorough study of the matter two days before the P.A.C. meeting. The whole chain of events is such that the Committee cannot but have a suspicion about the bonafides of the case. In the interest of revenue as much as of justice and in the overall national interest, the Committee would recommend that Government should institute a thorough inquiry into this whole affair to fix responsibility for the grave lapses that have occured in the past.

NEW DELHI;

*November 28, 1977*

*Agrahayana 7, 1899(S)*

C. M. STEPHEN,

*Chairman,*

*Public Accounts Committee.*

## APPENDIX I

*Statement showing the dates on which returns of income were filed and assessments for relevant years completed*

| Assessment year | Accounting year | Date of filing return | Amount of Income/Loss shown in return |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| 1. 1963-64 | 1962 | 15-10-1963 | Rs. 11,00,103 which is the book loss without Audit. |
| | | 1-2-1964 | Rs. 9,71,010 which is the book loss after Audit. |
| | | 30-9-1964 | Rs. 8,85,705 profits after considering technichal fees of Rs. 18,56,716 on accrual basis though accounted for in the books of 1963. |
| | | 22-5-1965 | Rs. 8,85,706 profits but claimed set-off of loss of Rs. 1,25,493 for assessment year 1962-63. |
| 2. 1964-65 | 1963 | 30-9-1964 | Rs. 18,32,969 loss again at book profits of Rs. 54,394. Technical fees of Rs. 18,56,716 already added in assessment year 1963-64 and, therefore, loss was shown with other minor adjustments. |
| | | 22-12-1964 | Rs. 18,32,969 loss showing deduction of Rs. 7,186 at source. |
| | | 6-7-1968 | Rs. 50,94,103 loss by allocating profits on the basis of completion of contracts during accounting years 1963 to 1966 as per Chart filed. |
| | | 11-12-1968 | Rs. 57,27,279 after settling some disputes with Indian Oil Corporation. |
| 3. 1965-66 | 1964 | 21-1-1966 | Rs. 19,15,588 loss against book loss of Rs. 28,43,872 which includes loss of Rs. 9·28 lakhs of earlier years. |
| | | 11-12-1968 | Rs. 35,97,533 loss due to allocation of profits during the account year 1963 to 1966 as per Chart filed. |
| | | 7-8-1969 | Rs. 40,21,592 by reallocating profits upto 1966 to earlier years. |
| 4. 1966-67 | 1965 | 14-10-1966 | Rs. 35,43,299 profits against profits of Rs. 6,60,296 which includes loss of Rs. 28·43 lakhs of earlier years. |

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| | | 11-12-1968 | Rs. 53,21,501 by reallocation of profits upto 1966 to earlier years. |
| | | 7-8-1969 | Rs. 48,37,405 by adjustment of losses of earlier years. |
| | | 5-1-1971 | Rs. 36,25,091 after adjustment of losses of earlier years. |
| 5. 1967-68 | 1966 | 6-1-1968 | Rs. 1,03,29,415. |
| | | 11-12-1968 | Rs. 55,95,773 by reallocating profits upto 1966 to earlier years. |
| | | 7-8-1969 | Rs. 53,43,487 by adjustment of losses of earlier years. |
| 6. 1968-69 . | 1967 | 27-11-1968 | Rs. 6,06,182 profits against book profits of Rs. 6,64,663 after adjustment of depreciation etc. |
| | | 7-8-1969 (Assessment completed on 28-3-72) | Rs. 3,86,082 profits after claiming adjustments of Rs. 2,20,100 as per settlement with ONGC. |
| 7. 1969-70 . | 1968 | 30-6-1969 (Assessment completed on 28-3-72) | Rs. 45,345 profits against book profits of Rs. 38,314. |
| 8. 1970-71 . | 1969 | 27-6-1970 (Assessment completed on 22-3-73) | Rs. 15,302 which is the book profits. |
| 9. 1971-72 . | 1970 | 30-7-1971 (Assessment completed on 7-11-73) | Rs. 10,98,154 which is the book profits. |
| | | 26-8-1971 | Rs. 10,98,154 profits but claimed exemption of interest under section 10(15)(iv). |
| 10. 1972-73 . | 1971 | 13-7-1972 (Assessment completed on 30-9-74) | Rs. 9,54,730 profits which is the book profits |
| 11. 1973-74 . | 1972 | 7-7-1973 | Rs. 7,01,186 profits against book profits of Rs. 6,96,185 |
| | | 23-9-1974 (Assessment completed on 28-7-75) | Rs. 19,45,000 lost by claiming set-off of losses of earlier years. |
| 12. 1974-75 | | 29-6-1974 | Pending. |
| 13. 1975-76 . | | 30-6-1975 | Pending |
| 14. 1976-77 | | 30-6-1976 | Pending. |

# APPENDIX II

*Statement of Conclusions/Recommendations*

| Sl. No. | Para No. of Report | Ministry/ Deptt. | Conclusions/Recommendation |
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| 1 | 1.122 | Ministry of Finance (Deptt. of | This relates to a case of irregular allowance of discount aggregating to Rs. 6.05 crores in terms of Indian Currency to a foreign company in the assessment for the year 1967-68. The facts of the case are summarised below: A General Agreement was entered into on 29 August, 1961 between e Government of India and M/s. Ente Nazionale Indrocarburi (E.N.I.), wholly Italian Government owned undertaking, having world-wide ope- 'ions with a view to establish and develop Indo-Italian co-operation in · petroleum sector. SNAM, a company of ENI Group, entered into ·cific contracts with the Oil and Natural Gas Commission in 1961 for drilling in UP and Punjab and with Indian Refineries Ltd. (now Indian Oil Corporation) in 1963 for the construction of (i) oil pipeline from Gauhati to Siliguri, (ii) Haldia-Barauni-Kanpur pipeline and (iii) oil pipeline in Gujarat. The payment was to be made in Rupees as well as foreign currency; the latter, which was to cover the estimated cost of |

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| | | | goods and services of non-Indian origin, was expressed in terms of U.S. Dollars. According to clause 6 of the General Agreement, 5 per cent of the foreign currency payment was to be made on the date of signature of each contract, another 3 per cent on the expiry of 12 months from the date of signature, and the balance of 92 per cent in 20 equal half yearly instalments starting on the expiry of 2 years after the signature of the contract. In consideration for this credit facility, M/s. Snam was also to receive interest at 6 per cent per annum on the deferred payment upto the date of maturity of each dollar draft, the interest being payable by means of 20 instalments of sub-divided amounts, each to be paid for in Italy in Italian Liras, and to have the same date of maturity as the instalments for the principal amount. However, instead of making half-yearly payments as and when they fell due, M\|s. Snam were issued post-dated drafts for the entire sum due to them under the contract. On 29 December, 1966 M\|s. Snam had with them, in their head office account 20 post-dated drafts of the aggregate face value of 1,79,66,255 dollars issued by the Indian Refineries Ltd. These were due for payment in 1966—74. Instead of waiting for these drafts to mature, what the foreign company did was to discount these drafts prematurely on 29 December, 1966 with a Bank in Geneva and realised 99,38,150 after paying discount charges at 12 per cent per annum amounting to 80,28,104 (Rs. 6.05 crores).<br><br>The issuance of post-dated drafts by the Indian Refineries Ltd. especially when the Agreement did not contain a provision for issue of such |

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| | | | drafts is, in the opinion of the Committee, an extraordinary procedure. The representative of the Reserve Bank of India confirmed during evidence that "although drafts were given post-dated, no payment from India in foreign exchange was remitted before the due date". It is clear that the action of the Indian Refineries Ltd., to issue post-dated drafts apart from being a departure from the main Agreement, had placed the foreign company in an advantageous position because by virtue of these being negotiable instruments the foreign party could realise the value of these drafts instantly by paying discount charges instead of waiting till the specified dates when the instalments payable under the Agreement became due in the normal course.<br><br>What is even more regrettable is that though under Clause 6 of the Agreement it was open to Indian Refineries Ltd., to pay only 50 per cent of the first 4 half-yearly instalments, the remaining 50 per cent of such instalments being added proportionately to the other 16 instalments, Indian Refineries Ltd., did not avail itself of this facility. The Committee would like the Ministry to examine why full advantage of deferred payment terms provided for in the Agreement was not taken. |
| 2 | 1.123 | Do. | The Committee are amazed to find that though the main agreement of 29 August, 1961 between the Government of India with E.N.I. was in the nature of a supplier's credit and had visualised payment in Italian currency only, the specific contracts entered with SNAM provided for payment in U.S. Dollars in respect of supplies, etc. arising abroad. It was explained to the Committee that as Italy was (and is) in the "Convertible Account Group", in terms of foreign exchange it would be |

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| | | | immaterial whether the payment was made in Lira (Italian currency) or in U.S. Dollar. The Ministry of Finance have however admitted in a note that prior to devaluation of rupee they did not have "an awareness of the problem arising out of variations in exchange" nor "a conscious policy of overcoming any assurance for exchange protection". From what the Ministry of Finance have stated, it is patently clear that issue of Dollar drafts in this case did involve a tacit protection against fluctuation in the exchange rate. Moreover, if during the relevant years there was devaluation of Lira *vis-a-vis* U.S. Dollar at any time while the drafts were held, the possibility of the foreign company having derived another windfall benefit on this account could not have been ruled out. |
| | 1.124 | Do. | The Committee find that in the assessment for the year 1967-68 an amount of Rs. 6.05 crores, stated to be discount charges incurred by the foreign company on discounting of dollar drafts outside India, was allowed as deduction in the computation of their income from Indian business. This allowance was stated to have been made under Section 37(1) of the Income Tax Act, 1961. Section 37(1) of the Income Tax Act, 1961 stipulates that any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended "wholly and exclusively" for the purposes of the business or profession, shall be allowed in computing the income. In order, therefore, to claim the benefit of that Section, the foreign company had to establish that the discount charges had been incurred wholly and exclusively for the purposes of the Indian |

business. It was stated by the Board that the company contended, in their detailed note dated 30th August, 1971, that the whole of the amount realised by discounting of its dollar drafts was utilised for the payment of loan liabilities relating to their Indian business and in support of that statement filed a certificate dated 2 August, 1971 from its Auditors and another certificate dated 3 August, 1971 from the Vice President of SOFID, a special Financing Company of the E.N.I. Explaining the extent to which evidence given by the company was scrutinised by the Department before accepting this huge claim, the Department of Revenue and Banking stated that the assessees' contention was also cross checked with reference to their world balance sheet and other relevant statements of accounts. But when it was pointed out that according to the world balance sheet of the company, its loan liabilities were reduced to the extent of 1782 million liras only as between 31st December, 1965 and 31st December, 1966 whereas the proceeds realised by the discounting of drafts on 29-12-1966 amounted to 6211 million liras (9,939,150 $ converted at the rate of $ 625 liras), the Department took the view that such a comparison cannot provide a reasonable basis for disproving the statement of the Auditors of Snam as well as that of Vice President of SOFID. The representative of the Department, however, admitted during evidence that loans raised by the foreign company in Italy for the Indian business were reflected in the head office account but not shown as a liability of the Indian Branch and that no direct evidence was available to show which of the transactions of the foreign company abroad related exclusively and wholly to the Indian business. It was also admitted that the Income Tax Officer had not examined the books of accounts of the Head Office of the company. The assessee company, in response to various queries, had also informed the

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| | | | Department in 1971 that as it maintained consolidated account for its world business, it would not be possible for it to relate every single dollar receipt on account of discounting of drafts to a dollar standing as a liability in its account. The assessee company is stated to have pleaded that had this question been raised in 1967 it would have been less difficult for it to attempt such co-relation. Such a plea coming as it did from a foreign company belonging to ENI Group of Enterprises, owned by the Government of Italy, and whose accounts are said to be maintained on a computerised system is difficult to accept.<br><br>In the circumstances, the Committee cannot resist the impression that in allowing this huge claim of Rs. 6.05 crores in the assessment for the year 1967-68, the certificates furnished by the assessee company whose credibility for purposes of tax assessment is doubtful, were relied upon by the Department of Revenue and Banking without any worth-while scrutiny. The company itself had failed to establish the claim within the requirements of section 37(1) and the Indian accounts which were the only accounts examined by the Income Tax Officer did not provide any evidence to support it. The Committee are of the view that the Department should call for all relevant accounts and details and examine this aspect of the matter in greater detail, not only to find out whether there was any lack of bonafides in the solicitude shown to the company but also whether the claim was clearly established on facts and admissible in law as directly relating to the Indian business and chargeable thereto. |

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| 4. | 1.125 | —Do— | The Committee learn that as Snam's own capital available for employment in its business (including projects undertaken in India on long term credits) was virtually nil, it had to raise funds through outside borrowings especially when Italy itself was engulfed by economic and financial crises during 1963 and 1965. Snam, it has been stated, had been making efforts since 1964 for discounting of drafts but it was only in December, 1966 that it was able to secure a favourable rate of discounting charges. It is significant that Snam discounted these drafts hardly two days before their accounting year 1966 was about to end on 31-12-1966 and they have claimed to have paid as discount charges as much as 45 per cent of the value of the drafts (discount charges of 80,28,104 dollars paid for drafts of the value of 1,79,66,255 dollars). In this context, the Committee would suggest that the assessing officer should also investigate whether the Drafts, after being discounted by the Geneva Bank in December, 1966, were sold by this Bank to any organisation or institution and if so, to which party(s) on what date and on what terms and conditions. |
| 5. | 1.26 | —Do— | Under Section 37(1) of the Income Tax Act, 1961, only revenue expenditure and not capital expenditure qualifies for deduction in computation of income. While the Income Tax officer was of the view that in this case "the depreciation of bills of exchange lying in deposit with the assessee company and later on encashed through Swiss Bank would be capital expenditure and not revenue expenditure because the income had become due on the date the bills were submitted", the view of the Commissioner of Income Tax with which the Central Board of Direct Taxes agreed was that the discounting charges incurred by Snam amounted to revenue expenditure allowable as a deduction under Section 37(1) of the In- |

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| | | | come Tax Act, 1961. The Department of Revenue and Banking explained that Snam continued to carry on its contract business in India not only during the calendar year 1966 but also in subsequent years and that the Bills of Exchange were received by the assessee company on revenue account, being the compensation received by them from their clients in India for supplying the materials and rendering services for executing their contracts. The Committee are of the opinion that while the earning of dollar drafts was a trading transaction of the Indian business, their holding in the hands of the Head Office and subsequent discounting or utilisation cannot be regarded as trading transactions of the Indian business. Once the dollar drafts were received by Snam and sent to its headquarters office abroad, these would form part of the capital funds of the foreign company and could not, in any case, be treated as part of a trading transaction of its Indian business. It has also been admitted by the Department that except the certificate furnished by SNAM from their Auditor and vice President of SOFID, there is no direct evidence to prove that the proceeds of the dollar drafts were utilised for meeting the loan liabilities relating to its Indian business. Further out of a total cost of Rs. 21.45 crores incurred in Italy, an amount of Rs. 3.76 crores (i.e. 18 per cent) was utilised for the purchase of capital assets. The Committee are unable to appreciate why this 18 per cent of discount charges attributable to capital assets could not be treated as capital expenditure especially when Snam themselves are understood to have stated that borrowed funds had been invested by them also in fixed assets which formed part of the fixed |

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| | | | assets transferred to India in the form of plant and equipment. The Committee recommend that these aspects should be kept in mind while reassessing the Snam's income for tax. |
| 6. | 1.127 | —Do— | The Committee find it rather perplexing that while the agreement of the Central Board of Direct Taxes with the view of the Commissioner treating discounting charges as revenue and consequently discountable was communicated to the Commissioner on the 22 January 1974, the Board sought the opinion of the Ministry of Law on this point only in November 1976—a couple of days before the evidence of the representatives of the Government on this subject before the P.A.C. The Committee also note that while giving their opinion the Ministry of Law had specifically pointed out that as the time at the disposal of the Ministry was very short, the views could not be said to be based on a thorough study of the matter and were only tentative. The Committee would like to emphasise upon the Board the need for exercising utmost caution in dealing with individual cases involving legal ramifications. Where the advice of the Ministry of Law appears necessary, a reference should be made to the Ministry of Law promptly. This was a fit case where the considered and conclusive reply of the Ministry of Law should have been obtained much earlier. |
| 7. | 1.128 | —Do— | A pertinent question that compels attention is whether even after giving to the foreign company dollar drafts representing the principal amount and the interest due thereon at the rate stipulated in the General Agreement between the Government of India and E.N.I., further allowance of discount charges which was not provided for in that Agreement was at |

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| | | | all justified. It appears to the Committee that under the agreement the goods and services to be supplied from abroad were to be supplied on the basis of a long term credit and in consideration thereof the Agreement provided for payment of interest on deferred instalments, such interest itself, being paid in similar deferred instalments. Viewed against this background it was apparently not the intention that the foreign company would discount all the drafts in one go throwing a further substantial burden, in addition to the aforesaid interest, on the Indian Exchequer by reducing the foreign party's tax liabilities. As far as the Committee can see, the moment dollar drafts for the principal amount and interest at the prescribed rate were issued to the foreign company, the entire liabilities under the contract should have been deemed to have been discharged and if the foreign company instead of waiting till the dates of maturity of these drafts discounted the same at a time of their own choosing, it cannot in fairness to itself and the Indian Taxation authorities, claim any tax concession on any expenditure that may have been incurred by it on such discounting. |
| 8 | 1.129 | —Do— | Yet another point on which the Committee could not get a satisfactory explanation from the representative of the Department of Revenue and Banking was as to why for the purpose of assessment for the year 1967-68 discounting charges of 80,28,104 dollars were allowed to be converted at the post-devaluation rate of exchange ($=Rs. 7.50) to Rs. 6.05 crores when the drafts were all issued prior to the devaluation of the rupee on |

6 June, 1966 and were even accounted for at the pre-devaluation rate ($=4.762) at Rs. 3.83 crores. The Committee understand that the representative of the M/s. Snam had also confirmed that discounting charges had been duly debited by their Head Office Accounts to its Indian branch and (as per Debit Note received in this regard) these amounted to Rs. 3.83 crores. Since the discounting was effected on 29-12-1966 i.e. after devaluation of the rupee, the discount charges were allowed to the foreign company at post-devaluation rate under the provision of Rule 115 of the Income-tax Act, 1962 which, it was stated, had statutory force and was mandatory. After the sentence ending with 'mandatory', *add* "In response to a query from the Committee whether rule 115 of the Income Tax Rules, 1962 which applied only to income could also applied to expenditure incurred on discounting of dollar drafts, the Department have stated that the rule applied to expenditure as well because "income necessarily represents the excess of the assessee's receipts over admissible expenses." In view of the fact that the rule as at present constructed specifically and categorically confines its applicability to "income accruing or arising or deemed to accrue or arise....", the interpretation placed upon it by the Department does not appear to the Committee to be wholly free from doubt. The Committee therefore, recommend that this aspect may be re-examined if necessary in consultation with the Ministry of Law." It transpired during evidence that discount charges at higher rate were allowed to the foreign company despite the fact that it had not put in any formal claim for such enhancement. Moreover, Snam has been following mercantile system of accounting under which its income is taxable at the point of time when it accrues i.e. when the assessee gets a right to receive it. As pointed out by the Commissioner of Income-tax, the date of

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| | | | receipt of a Bill of Exchange is "the date on which instrument is received and not the date on which payment is made under it". The dollar drafts were already out of India. The discount charges did not represent any fresh remittance of money from abroad for expenditure in India. The devaluation of the rupee could not, therefore, throw any extra burden on the Company. Apparently, these points were either overlooked or not given the importance they deserved. The Committee cannot but express their displeasure at the failure of the Department to safeguard the interests of the national exchequer. The Committee would suggest that Government should have this matter examined from the vigilance angle as well. |
| 9. | 1.130 | -Do.- | The Committee note the plea advanced by the Department that "as the contracts do not contain any stipulation, express or implied, restraining Snam from premature realisation of the dollar drafts it was open to Snam to realise the said drafts". The Committee find that the agreement between the ENI and the Government of India provided for a part of the payment being made in equal half-yearly instalments. Leaving aside the authohrity for premature realisation of dollar drafts by having them discounted, the agreement did not contain any provision even for the issue of post-dated drafts. |
| 10. | 1.131 | -Do.- | The Committee find that the assessee foreign company claimed and was allowed each year large amounts as Head Office expenses consiting of (i) financing charges or interest attributable to Snam's borrwings abroad uti- |

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| | | | lised for the purpose of its Indian business and (ii) the head office overhead expenses prorated to the Indian branch. During the years 1963 to 1967, the Head Office expenses allowed totalled Rs. 1.94 crores out of which Rs. 1.87 crores were "financing charges", calculated at 8.5 per cent which was the prevailing rate of interest in Italy. The assessee company is stated to have explained that it had practically no capital of its own for executing its Indian projects and therefore had to borrow money abroad and debit the financing charges attributable to the borrowed money utilised for its business in India to its Indian Branch. The Committee are surprised how a foreign company with no capital of its own could be entrusted the work of construction of pipelines and drilling for oil and how amounts calculated at a flat rate of 8.5 per cent and not representing actual expenses incurred could be allowed in its income-tax assessments. |
| 11. | 1.132 | -Do.- | The Committee are further more surprised that even when the Indian Refineries Ltd. had paid financing charges to the foreign company amounting to Rs. 1.87 crores the discounting charges in respect of the post-dated drafts, as claimed by Snam, were allowed to be treated as on revenue account and thus held deductable from income for the purpose of tax. This had the effect of giving double benefit to the company and to that extent reducing the value of the credit facility extended to this country by ENI. This aspect of the matter requires to be probed. |
| 12. | 1.133 | -Do.- | The Committee also find that Head Office expenses (other than financing charges) amounting to Rs. 7.12 lakhs were allowed to the assessee company during the years 1963—67 without detailed adequate scrutiny. It transpired during evidence that head office expenses were allowed on |

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| | | | *ad hoc* basis and the books of accounts of Head Office in Italy were not called for and examined. The representative of the Department of Revenue admitted during evidence that scrutiny of Head Office expenses was defective but explained that the assessing officer had possibly been concentrating on much larger issues like discounting charges where the amount involved was much more. The Committee are not impressed by this argument and feel that the assessing officer had failed in his primary duty of safeguarding the revenues of the State by accommodating the claims of the foreign assessee companies to the farthest extent possible. The Committee hope that while making a revised assessment, a thorough scrutiny would be made before accepting any claim on this account. |
| 13. | 1.134 | -Do.- | Under the contracts, while the tax liability on income accruing to Snam from the work in respect of the Gauhati-Siliguri pipelines was to be borne by the Indian Refineries Ltd. (Now IOC), that from construction of oil pipelines in Gujarat and drilling in UP and Punjab, by ONGC. The tax liability on the profits from the construction on Haldia-Baruni-Kanpur was to be borne by Snam itself. The Committee note with regret that though under the contracts tax liability devolved on different companies, Snam had not been maintaining separate accounts for each contract in the absence of which it is difficult to apportion expenses, profits and tax liability as between the Indian company and Snam. Consequently ONGC and IOC have not been able to pay any taxes in respect of these contracts. This matter should have been taken up by the Income-tax Department |

with the company. The Committee were told that assessments for the years 1962-63 to 1968-69, completed during 1965—72 were *ad hoc* and that assessing authorities had yet to take a final view on this case. The Committee were informed that if, on re-assessment, any more tax was found payable by Snam it would be possible to effect recovery from them because a refund of Rs. 25 lakhs due to them had been withheld. However, if the tax liability exceeds that amount, it may pose a problem. The Committee regret that the assessing authority concerned either estimated the profit under each contract by adopting a foolproof method on the basis of scrutiny of accounts at the stage of *ad hoc* assessment nor did he ensure that sufficient funds were left in India by the Company to meet any future liabilities that might arise when final assessments are made. The representative of the Department admitted during evidence that at that point of time, "there has been failure all along the line".

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| 14. | 1.135 | -Do.- | The Committee find that for the assessment year 1963-64 the income of the company was assessed at Rs. 8.90 lakhs whereas for the years 1964-65 and 1965-66, the assessment showed a loss of Rs. 17.54 lakhs and Rs. 47.96 lakhs respectively. The Committee also find that the assessment for the years 1964-65 and 1965-66 have since been set aside by the Appellate Assistant Commissioner of Income-tax and *de novo* assessment will have to be framed for these assessment years. The Committee hope that while making the re-assessment for these years, the assessing authority will thoroughly scrutinise the accounts of this company so as to ensure that the financial results for the assessment years 1964-65 and 1965-66 reflect the correct position. |

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| 15. | 1.136 | -Do.- | The Committee deplore the casual manner in which the Central Board of Direct Taxes have handled the assessment case of this foreign company. The Chairman of Central Board of Direct Taxes was frank enough to admit that in this case his personal impression was that the assessments had been made in a "perfunctory manner". He, however, assured the Committee that assessments made earlier were all provisional and that every effort would be made to strike at a reasonable assessment which would be just to our country as well as to the foreign company. The Committee learn that the Central Board of Direct Taxes instructed the Commissioner concerned on 20 November 1976 to complete the assessments expeditiously. The Committee would like to be informed about the details of the final assessment. |
| 16. | 1.137 | -Do.- | The Committee view with grave concern the fact that representatives of the foreign company had been approaching the Central Board of Direct Taxes off and on since March 1969 and up to 8 January 1974 held as many as 15 meetings with them at various levels including meetings with the Member incharge of the case, Joint Secretary of the Foreign Tax Division and the Chairman of the Board culminating in the Board's giving ruling on 24 January 1974 that discounting charges were admissible for deduction in computation of income under Section 37(i) of the Income-tax Act. The Committee thoroughly disapprove this sort of backstage manoeuvring calculated to influence the officials of the Board. The Committee desire that definite instructions in this regard should be issued by the Ministry. |

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| 17. | 1.138 | -Do.- | The Committee find that despite there being a statutory restriction in the Income Tax Act, itself (vide Act 42 of 1970 which amended Section 119 w.e.f. 1-4-1971) to the effect that the Board shall not issue any order, instruction or direction so as to require any income tax authority to make a particular assessment, or to dispose of a particular case in a particular manner, a "common practice" to give instructions in individual cases had developed in the Board. In this connection the Committee recall that in paragraph 5.89 of their 128th Report (1974-75) they had cautioned the Board against giving advance rulings in individual cases. The Board have in consultation with the Ministry of Law issued instructions on 22 January, 1974 to the Commissioners of Income Tax clarifying that it would "continue to over-see administratively the functioning of the lower formations and give advice in individual cases if the facts of the case so justify". The Commissioners have, however, been advised to "refrain from quoting or referring to the advice or guidance given by the Board in any orders passed by them". The Committee reiterate their recommendation and trust that the Board would respect the law on this point and refrain from giving order, instruction or direction as to the manner in which assessment should be done in any specific case. |
| 18. | 1.139 | -Do.- | To sum up, the whole chain of events in the case fall into a pattern. Although the general agreement provided for the payment of the foreign exchange component in Italian currency, the payment was actually made in U.S. dollars affording an opportunity to the company to obtain a wind-fall benefit in the event of a de-valuation of the Italian currency, *vis-a-vis*, U.S. dollars at any time while it held the dollar drafts. The payment was made in the form of post-dated drafts which constituted negotiable instru- |

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| | | | ments in the hands of the company who could discount them at any time. This was a clear departure from the main Agreement. An allowance for discount charges calculated at over Rs. 6 crores was made in the assessment for the year 1967-68 merely on the basis of certificates given by the company belatedly and its auditors without any scrutiny though the company had, admittedly, not been able to relate these charges to the purposes of their Indian business which was an essential condition for this allowance under the relevant provisions of the Income-tax Act, 1961. The Taxation authorities did not examine the head office books of accounts and did not even check up, whether the drafts discounted just two days before the end of the company's accounting year had subsequently been repurchased by it or by its associates. Instead, they went out of their way to give an allowance of Rs. 6.05 crores against the company's claim of Rs. 3.83 crores on the plea that the allowance was admissible at the post de-valuation rate of exchange without even realising that there, apparently, was no fresh expenditure involving any remittance from abroad. Further, although it was known that out of 5 contracts being executed by this company, the company had undertaken the tax liability only in respect of this one contract and would, therefore, be tempted to debit more than its proper share of expenses to this contract so as to depress its taxable income, no precautions were taken to see that proper contract-wise accounts were made out and rendered to the taxation authorities for purposes of assessment. The Central Board of Direct Taxes and the senior officers of the Department interfered freely with the |

jurisdiction of the lower assessing authorities in contravention of the provisions of the Income-tax Act. Lastly, inspite of the magnititude of the concessions and the points of law involved, the Ministry of Law were not consulted at any stage; they were hustled into recording an opinion without a thorough study of the matter two days before the P.A.C. meeting. The whole chain of events is such that the Committee cannot but have a suspicion about the bonafides of the case. In the interest of revenue as much as of justice and in the overall national interest, the Committee would recommend that Government should institute a thorough inquiry into this whole affair to fix responsibility for the grave lapses that have occurred in the past.



GMGIPMRND—Job I—2093 L.S.—J.C. 3089—6-12-77—12.00