P.A.C. No. 644

PUBLIC ACCOUNTS COMMITTEE (1978-79)

(SIXTH LOK SABHA)

NINETY-SEVENTH REPORT

IRREGULAR ALLOWANCE OF DISCOUNT TO A FOREIGN COMPANY

MINISTRY OF FINANCE

(DEPARTMENT OF REVENUE)

[Action Taken by Government on the recommendations of the Public Accounts Committee contained in their 28th Report (*Sixth Lok Sabha*)]

Presented in Lok Sabha on:

Laid in Rajya Sabha on:

LOK SABHA SECRETARIAT
NEW DELHI

November 1978/*Agrahayana* 1900 (*S*)

Price: *Rs.* 1.80

LIST OF AUTHORISED AGENTS FOR THE SALE OF LOK SABHA SECRETARIAT PUBLICATIONS

Sl. No.	Name of Agent	Agency No.
	ANDHRA PRADESH	
1.	Andhra University General Co-operative Stores Ltd., Waltair (Visakhapatnam).	
	BIHAR	
2.	M/s. Crown Book Depot, Upper Bazar, Ranchi (Bihar).	
	GUJARAT	
3.	Vijay Stores, Station Road, Anard.	
	MADHYA PRADESH	
4.	Modern Book House, Shiv Volas Palace, Indore City.	
	MAHARASHTRA	
5.	M/s. Sunderdas Gianchand, 601, Girgaum Road, near Princess Street Bombay-2.	
6.	The International Book House Pvt., 9, Ash Lane. Mahatma Gandhi Road, Bombay-1.	
7.	The International Book Service, Deccan Gymkhana, Poona-4.	
8.	The Current Book House, Maruti Lane, Raghunath Dadaji Street, Bombay-1.	
9.	M/s. Usha Book Depot, 585/A, Chira Bazar Khan House, Girgaum Road, Bombay-2.	
10.	M & J Services, Publishers, Representatives Accounts & Law Book Sellers, Bahri Road, Bombay-15.	
11.	Popular Book Depot, Dr. Bhadkamkar Road, Bombay-400001.	
	MYSORE	
12.	M/s. Peoples Book House, Opp. Jaganmohan Palace, Mysore-1.	
	UTTAR PRADESH	
13.	Law Book Company, Sardar Patel Marg, Allahabad-1.	
14.	Law Publishers, Sardar Patel Marg, P.B. No. 77, Allahabad—U.P.	
	WEST BENGAL	
15.	Granthaloka, 5/1, Ambica Mookherjee Road, Belgharia, 24-Parganas.	
16.	W. Newman & Company Ltd., 3, Old Court House Street, Calcutta.	
17.	Mrs. Manimala, Buys & Sells, 128, Bow Bazar Street, Calcutta-12.	
	DELHI	
18.	Jain Book Agency, Conaught Place, New Delhi.	
19.	M/s. Sat Narain & Sons 3141, Mohd. Ali Bazar, Mori Gate, Delhi	

CORRIGENDA TO THE 97TH REPORT OF THE PUBLIC ACCOUNTS COMMITTEE (SIXTH LOK SABHA) ON IRREGULAR ALLOWANCE OF DISCOUNT TO A FOREIGN COMPANY.

-.-.

Page	Para	Line	For	Read
3	-	26	1.24	1.124
10	-	26	point of time. "There had been	point of time, "there had been
15	1.8	26	add 'may' after 'information'	
16	1.12	10	instructions	instruction
37	1.12	10-11	directions	direction

CONTENTS

		PAGE
COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE (1978-79)		(iii)
INTRODUCTION		(v)
CHAPTER I	Report	1
CHAPTER II	Conclusions/Recommendations which have been accepted by Government	17
CHAPTER III	Conclusions/Recommendations which the committee do not desire to pursue in view of the replies from Government	18
CHAPTER IV	Conclusions/Recommendations replies to which have not been accepted by the Committee and which require reiteration	20
CHAPTER V	Conclusions/Recommendations in respect of which Government have furnished interim replies	35
APPENDIX	Consolidated statement of conclusions/recommendations	56

PARLIAMENT LIBRARY
Library & Reference Service
Central Govt Publications
Acc. No. B 51293(6)
Date 13.12.78

PUBLIC ACCOUNTS COMMITTEE

(1978-79)

CHAIRMAN

Shri P. V. Narasimha Rao

MEMBERS

Lok Sabha

2. Shri Halimuddin Ahmed
3. Shri Balak Ram
4. Shri Brij Raj Singh
5. Shri C. K. Chandrappan
6. Shri Asoke Krishna Dutt
7. Shri K. Gopal
8. Shri Kanwar Lal Gupta
9. Shri Vijay Kumar Malhotra
10. Shri B. P. Mandal
11. Shri R. K. Mhalgi
12. Dr. Laxminarayan Pandeya
13. Shri Gauri Shankar Rai
14. Shri M. Satyanarayan Rao
15. Shri Vasant Sathe

Rajya Sabha

16. Shri Devendra Nath Dwivedi
17. Shri M. Kadershah
18. Shri Sita Ram Kesri
19. Dr. Bhai Mahavir
20. Smt. Leela Damodara Menon
21. Shri B. Satyanarayan Reddy
22. Shri Gian Chand Totu

SECRETARIAT

1. Shri H. G. Paranjpe—*Joint Secretary.*
2. Shri Bipin Behari—*Senior Financial Committee Officer.*

INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Ninety-Seventh Report on action taken by Government on the recommendations of the Public Accounts Committee contained in their 28th Report (6th Lok Sabha) on Irregular Allowance of Discount to a Foreign Company, commented upon in paragraph 17 of the Report of the Comptroller & Auditor General of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, relating to the Ministry of Finance.

2. On 31 May, 1978, an 'Action Taken Sub-Committee' consisting of the following Members was appointed to scrutinise the replies received from Government in pursuance of the recommendations made by the Committee in their earlier Reports:

1. Shri P. V. Narasimha Rao—*Chairman*
2. Shri Asoke Krishna Dutt—*Convener*
3. Shri Vasant Sathe
4. Shri M. Satyanarayan Rao
5. Shri Gauri Shankar Rai
6. Shri Kanwar Lal Gupta

(3–6: *Members*)

3. The Action Taken Sub-Committee of the Public Accounts Committee (1978-79) considered and adopted the Report at their sitting held on 18 October, 1978. The Report was finally adopted by the Public Accounts Committee (1978-79) on 25 November, 1978.

4. For facility of reference, the conclusions/recommendations of the Committee have been printed in thick type in the body of the Report. For the sake of convenience, the conclusions/recommendations of the Committee have also been appended to the Report in a consolidated form.

5. The Committee place on record their appreciation of the assistance rendered to them in this matter by the Comptroller & Auditor General of India.

NEW DELHI;
November 25, 1978
Agrahayana 4, 1900 (*S*)

P. V. NARASIMHA RAO,
Chairman,
Public Accounts Committee.

CHAPTER I

REPORT

1.1. This Report of the Committee deals with the action taken by Government on the recommendations/observations contained in their 28th Report (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, which was presented to the Lok Sabha on 15 December, 1977.

1.2. Action taken notes have been received in respect of all the 18 recommendations/observations contained in the Report and these have been categorised as follows:

(i) Recommendations/observations that have been accepted by Government:

Sl. No. 2

(ii) Recommendations/observations which the Committee do not desire to pursue in the light of the replies received from Government:

Sl. No. 9

(iii) Recommendations/observations replies to which have not been accepted by the Committee and which require reiteration:

Sl. Nos. 1, 3, 4, 5, 6, 7, 8, 10, 11, 12, 13, 14, 15, 16, 17 & 18.

(iv) Recommendations/observations in respect of which Government have furnished interim replies:
NIL

1.3. The Committee will now deal with the action taken by Government on some of their recommendations/observations.

Irregular Allowance of Discount

1.4. Calling *inter alia* for a detailed examination of the matter of allowing tax exemption on discount charges to the company on the ground that these were incurred wholly and exclusively for the purpose of Indian business of the company and decrying the manner in which concessions were allowed to the company by way of post-dated drafts and allowance of discount

charges and Head Office expenses, the Committee had, in paragraphs 1.122, 1.124—1.129, 1.131—1.139 (Sl. Nos. 1, 3—8, 10—18) of their Report stated:

"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.

General Agreement was entered into on 29th 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-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 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 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 fall due, M/s. Snam were issued post-dated drafts for the entire sum due to them under the contract. On 29th 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 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.

What is even more regrettable is that though under Clause 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."

1.24. 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. Thus 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 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 utilized 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 assessee's 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 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 draft 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 creditability for purposes of tax assessment is doubtful, were relied upon by the Department

of Revenue and Banking without any worthwhile 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 *bona fides* 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 under 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.

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 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 dollars 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 utilized 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 CBDT with the view of the Commissioner treating discounting charges as revenue and consequently discountable was communicated to the Commissioner on the 22nd 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 PAC. 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 rammifications. 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 E.N.I., 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 interests, 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 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 I.T. Rule 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 be 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' receipts over admissible expenses." In view of the fact that the rule as at present constructed specifically 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 account 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 draft 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.

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 attributable to Snam's borrowings abroad utilized 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 Itlay. 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 utilized 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 deductible 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 1963-67 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 issues like discounting charges where the amount involved was 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 DIOC) 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 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 reassessment, any more tax was found payable by SNAM it should 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 neither estimated the profit under each contract by adopting a fool-proof 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 had 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 Apppellate Assistant Commissioner of Income-tax and *denovo* 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 Chairman of Central

Board of Direct Taxes was frank enough to adit 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.

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 on since March, 1969 and upto 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(1) of the Income-tax Act. The Committee thorougly 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.

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 with effect from 1-4-1971 to the effect that the Board shall not issue any order, instruction or direction 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 evens 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 windfall 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 instruments 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 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 affairs to fix responsibility for the grave lapses that have occurred in the past.

1.5 In reply to paragraph 1.122 (Sl. No. 1) the Ministry of Petroleum, Chemicals and Fertilizers (Department of Petroleum) have, in their note dated 7th September, 1978, stated:—

"(i) *Issue of post dated drafts*:

The contract was negotiated with M/s. Snam Saipen and the payment terms included in the contract were based on the ENI Government of India Agreement dated 29-8-1961. The payment terms provided for acceptance by Indian Refineries Ltd. (now IOC) of all drafts issued by the contractor in regard to deferred payments. Such drafts were dated in relation to the date of realisation of each instalment. It may be stated here that since the main Agreement of August, 1961 between the Government of India and ENI was in the nature of supplier's credit, drafts were issued, which became payable with reference to the deferred instalments, contemplated in the supply Agreement linked to the supplier's Credit Agreement. In other words, the issue of advance Dollar drafts was inherent in the Agreement and was also directly related to the nature of supplier's credit. It cannot, therefore, be argued that the Agreement stipulated only payment in twenty equal half yearly instalments and that there was no provision for issue of advance drafts.

(ii) *Non-availing of full advantage of deferred payment Terms*:

As regards IRL not availing of the deferred payment facility in regard to 50 per cent of the first four half-yearly instalments, as provided in the ENI-Government of India Agreement of 29-8-61, it may be stated that the contract terms were negotiated with Snam. Snam's proposal dated 8-11-1962 to construct the Gauhati-Siliguri Pipeline, which formed the basis of the

negotiations, stipulated payment of the deferred portion of the contract value in 20 equal instalments and did not provide for deferred payment of 50 per cent of the first four instalments. Earlier to the execution of the contract, ONGC had executed a contract with Snam for drilling work in U.P. This contract was also based on the said ENI-Government of India Agreement. But there also, the provision to pay initially only 50 per cent of the amounts of the first four half-yearly instalments was not included. Even though the contract was examined in depth before according Government approval, at this late stage, it is not possible to ascertain from the available records as to why the facility of deferred payment of 50 per cent of the first four instalments was not included in the contract."

1.6. In reply to paragraphs 1.124, 1.125, 1.128, 1.129, 1.131 (partly), 1.133 and 1.137 [Sl. Nos. 3, 4, 7, 8, 10, (partly), 12 & 16], the Ministry of Finance, (Department of Revenue) have stated in their note dated 28th June, 1978:—

As the assessment for the assessment year 1967-68 has been set aside by the A.A.C. and is to be finalised afresh, the company has been asked to lead evidence in support of their claim that the loans were taken for the purposes of Indian business. Books of accounts of the Head Office, copies of accounts of the creditors and the particulars of the repayment of loans, etc., have been asked for. These are awaited. The company has, however, stated that none of the companies' associated with ENI Group has purchased the drafts discounted.

The question of allowability of the discounting charges and applicability of the rate of conversion will be examined in the light of the observations of the Committee.

The company has been asked to substantiate the claims of the financing charges at a rate of 8.5 per cent and the Head Office expenses attributable to the Indian business for all the years. Investigations in this regard are in progress.

As regards the last point discussed in para 1.131, the matter has already been referred to the Ministry of Petroleum whose comments are still awaited. A further reply may kindly be awaited.

1.7. In reply to paragraph 1.131 (Sl. No. 10), the Ministry of Petroleum, Chemicals and Fertilizers (Department of Petroleum), have in their note dated 7th September, 1978, stated:

Even though financial competence of a company is always taken into consideration while awarding contract, from the

available records it cannot be said with any degree of certainty whether the status of the company was gone into in the case of Snam Saipem. However, it may be added that Snam Saipem is a subsidiary of the State-owned Italian Company ENI (Ente Nazionale Idrocarburi).

1.8. Replying to paragraphs 1.126, 1.127, 1.132, 1.134, 1.135, 1.136, 1.138, and 1.139 (Sl. Nos. 5, 6, 11, 13, 14, 15, 17 and 18), the Ministry of Finance (Department of Revenue have, in their note dated 28th June, 1978 sated:—

"The observations|recommendations of the Committee are under active consideration of the Ministry. A further reply may kindly be awaited."

In their subsequent communication of 15th July, 1978, the Ministry have stated:—

Kind attention of the Committee is invited to the Ministry's O.M. of even number dated the 28th June, 1978.

The assessments for the assessment years 1964-65 to 1969-70 were set aside by the A.A.C. on 10th November, 1976. With a view that proper and detailed enquiries as recommended by the Committee are conducted, the case of the company was transferred to an I.A.C. The I.A.C. had requested the company to give contract-wise details, information regarding the head-office expenses and other particulars as recommended by the Committee. Notices have also been issued for the production of books of accounts including that of the head-office. Specific questions have been asked regarding the discounting of the dollar drafts. Inspite of a number of reminders and discussions the company has neither produced the books of accounts of the Head-office nor furnished some of the relevant particulars so far. The company has been informed that the non-furnishing of the proper and relevant information lead to best judgement assessment.

The question of instituting an enquiry for fixing the responsibility for the lapses that have occurred in the past will be taken up after the completion of the re-assessments made on the basis of complete data and investigations as suggested by the Committee.

1.9. In paragraph 1.122 of the original report, the Committee had regretted that full advantage of deferred payments of 50 per cent for the first 4 half-yearly instalments, provided for in the agreement, was not taken and had desired the Ministry of Petroleum and Chemicals to examine why it could not be done. The Committee are surprised at the reply of the

Ministry of Petroleum and Chemicals that "at this late stage it is not possible to ascertain from the available records as to why the facility of deferred payment of 50 per cent of the first 4 instalments was not included in the contract." The Committee deplore the perfunctory reply furnished by the Ministry of Petroleum and Chemicals to the Committee and desire that an inquiry should be instituted to fix responsibility for the lapse on the part of the officers concerned which has placed the country in a financially disadvantageous position.

1.10. The Committee are perturbed that desired documents and particulars have not been made available by the Company to the newly appointing assessing officer "inspite of a number of reminders and discussions". They desire that the matter should be pursued vigorously so as to finalise the re-assessments without further delay.

1.11. As regards the recommendation of the Committee to institute an enquiry for fixing responsibility for the past lapses on the part of the assessing officer and the reply of the Government that this would be done after the completion of the reassessment, the Committee need hardly point out that the lapses pointed out by them in the initial assessment of the Company for tax were concrete and absolutely clear meriting an enquiry to be conducted. They are afraid that if the enquiry is inordinately delayed it would loss much of its significance and afflux of time could create other difficulties for the enquiring authority inhibiting fair conclusions and clear apportioning of responsibility. They therefore reiterate that the inquiry suggested in para 1.139 of their original Report should be instituted forthwith.

1.12. The Committee expected that the recommendations contained in paras 1.127 and 1.138 of their original Report would be replied to separately and individually as these were, though arising out of the present case, of general nature. The Committee would reiterate the recommendation made in para 1.127 that the Board should exercise utmost caution in dealing with individual cases involving legal ramifications and where the advice of the Ministry of Law appears necessary, a reference should be made to that Ministry promptly. They would also once again reiterate the recommendation made in para 1.138 of their original Report that the Board should respect the Law and refrain from giving order, instructions or directions as to the manner in which assessment should be done in any specific case.

1.13. The Committee regret that Government have so far not replied to the observation contained in para 1.137 of their original Report disapproving the acquiescence of the Board to calculated efforts on the part of interested parties to influence the officers of the Board. The Committee reiterate their desire that definite instructions in this regard should be issued by the Ministry.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS THAT HAVE BEEN ACCEPTED BY GOVERNMENT

Recommendation

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 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.

[S. No. 2 (Para 1.123) of Appendix II to 28th Report of the Public Accounts Committee (1977-78) (Sixth Lok Sabha)]

Action Taken

The Department of Economic Affairs are concerned with the recommendation made by the Committee in para 1.123. That department has intimated that the observations of the Committee have been noted.

[Ministry of Finance O.M. F. No. 241/3/77-A&PAC-II dated the 6th June, 1978.]

CHAPTER III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN THE LIGHT OF THE REPLIES RECEIVED FROM GOVERNMENT

Recommendation

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."

[S. No. 9 (Para 1.130) of Appendix II of the 28th Report of the Public Accounts Committee (6th Lok Sabha)]

Action Taken

In this connection reference may be invited to clauses No. 6.4.1 and 6.4.2 of the ENI—Government of India Agreement of 29.8.61 which are reproduced below:

6.4.1.

"ENI Companies will prepare and send to Govt., on the dates to be specified on each contract, drafts covering the repayments on the due dates of deferred instalments in respect of the principal together with interest at the rate of six per cent per annum in terms of the contract. Government Companies/agencies will accept such drafts within one/two months and send them to ENI Companies through the State Bank of India, provided they are found to be in order."

6.4.2.

"Within one/two month(s) from the date of signature of each contract, the State Bank of India will furnish the ENI Companies or first class Italian banks to be nominated by ENI Companies

contract by contract, a letter of guarantee covering the payment in Italian currency on due dates of all drafts drawn under the contract and accepted by the Government Companies/agencies concerned as above."

It may be stated that Snam proposal dated 8-11-1962 and is subsequent revisions contained the provision for acceptance by Indian Refineries Ltd. of drafts issued by Snam in regard to the deferred payment. In normal commercial parlance such drafts are always negotiable instruments in the hands of the party receiving the drafts in their favour.

[Ministry of Petroleum, Chemicals & Fertilizers (Deptt. of Petroleum) O.M. No. R-38018/1/78-OR.I dated 7-9-1978.]

CHAPTER IV

RECOMMENDATIONS/OBSERVATIONS REPLIES TO WHICH HAVE NOT BEEN ACCEPTED BY THE COMMITTEE AND WHICH REQUIRE REITERATION

"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.

General Agreement was entered into on 29th 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-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 goods and services of non-Indian origin, was expressed in terms of U.S. Dollars. According to clause 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 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 fall due, M/s. Snam were issued post-dated drafts for the entire sum due to them under the contract. On 29th 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 draft, 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 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.

What is even more regrettable is that though under Clause 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."

1.124. 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. Thus 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 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 utilized 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 assessee's 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 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 draft 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 creditability for purposes of tax assessment is doubtful, were relied upon by the Department of Revenue and Banking without any worthwhile 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 *bona fides* 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 terms credits) was virtually nil, it had to raise funds through outside borrowings especially when Italy itself was engulfed by economic and financial crises under 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.

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 Departmental of Revenue and Banking explained that SNAM continued to carry on its contract business in India not only during the calendar years 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 utilized 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 CBDT with the view of the Commissioner treating discounting charges as revenue and consequently discountable was communicated to the Commissioner on the 22nd 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 PAC. 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 rammifications. 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 E.N.I., 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 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 effecting 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 I.T. Rule 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 be applied to expenditure incurred on discounting of dollar drafts, the Department have state that the rule applied to expenditure as well because "income necessarily represents the excess of the assessee' receipts over admissible expenses." In view of the fact that the rule as at present constructed specifically 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 account 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 draft 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.

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 attributable to Snam's borrowings abroad utilized 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 utilized 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 deductible 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 1963-67 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 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 com-

panies 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 DIOC) 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 shou'd 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 reassessment, any more tax was found payable by SNAM it should 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 neither estimated the profit under each contract by adopting a fool-proof 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 arisen when final assessments are made. The representative of the Department admitted during evidence that at that point of time. "There had been failure all a'ong 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 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.

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 Chairman of Central Board of Direct Taxes was frank enough to adit 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.

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 on since March, 1969 and upto 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(1) 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.

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 with effect from 1.4.1971 to the effect that the Board shall not issue any order, instruction or direction 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 evens 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 windfall 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 instruments 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 Companies' claim of Rs. 3.83 crores on the plea that the allowance was admissible at the post devaluation 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 on 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, in spite 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 affairs to fix responsibility for the grave lapses that have occurred in the past.

[S. Nos. 1, 3, 4, 5, 6, 7, 8, 10, 11, 12, 13, 14, 15, 16, 17 & 18 (Paras 1.122, 1.124, 1.125, 1.126, 1.127, 1.128, 1.129, 1.131, 1.132, 1.133, 1.134, 1.135, 1.136, 1.137, 1.138 & 1.139) of Appendix II to the 28th Report of the Public Accounts Committee (Sixth Lok Sabha)]

Action Taken

Sl. No. 1

"(i) *Issue of post dated drafts*:

The contract was negotiated with M/s. Snam-Saipem and the payment terms included in the contract were based on the ENI-Government of India Agreement dated 29-8-1961. The payment terms provided for acceptance by Indian Refineries Ltd. (now IOC) of all drafts issued by the contractor in regard to deferred payments. Such drafts were dated in relation to the date of realisation of each instalment. It may be stated here that since the main Agreement of August, 1961 between the Government of India and ENI was in the nature of supplier's credit, drafts were issued, which became payable with reference to the deferred instalments, contemplated in the supply Agreement linked to the supplier's Credit Agreement. In other words, the issue of advance Dollar drafts was inherent in the Agreement and was also directly related to the nature of supplier's credit. It cannot, therefore, be argued that the Agreement stipulated only payment in twenty equal half yearly instalments and that there was no provision for issue of advance drafts.

(ii) *Non-availing of full advantage of deferred payment Terms*:

As regards IRL not availing of the deferred payment facility in regard to 50 per cent of the first four half-yearly instalments, as provided in the ENI-Government of India Agreement of 29-8-61, it may be stated that the contract terms were negotiated with Snam. Snam's proposal dated 8-11-1962 to construct the Gauhati-Siliguri Pipeline, which formed the basis of the negotiations, stipulated payment of the deferred portion of the contract value in 20 equal instalments and did not provide for deferred payment of 50 per cent of the first four instalments. Earlier to the execution of the contract, ONGC had executed a contract with Snam for drilling work in U.P. This contract was also based on the said ENI-Government of India Agreement. But there also, the provision to pay initially only 50 per cent of the amounts of the first four half-yearly instalments was not included. Even though the contract was examined in depth before according Government approval, at this late stage, it is not possible to ascertain from the available records as to why the facility of deferred payment of 50 per cent of the first four instalments was not included in the contract."

[Ministry of Petroleum, Chemicals & Fertilizers (Department of Petroleum) O.M. No. R-38018/1/78-OR.I, dated 7-9-1978]

Sl. Nos. 3, 4, 7, 8, 10 (*Partly*), 12 & 16

"As the assessment for the assessment year 1967-78 has been set aside by the A.A.C. and is to be finalised afresh, the company has been asked to lead evidence in support of their claim that the loans were taken for the purposes of Indian business. Books of accounts of the Head Office, copies of accounts of the creditors and the particulars of the repayment of loans, etc., have been asked for. These are awaited. The company has, howver, stated that none of the companies' associated with ENI Group has purchased the drafts discounted.

The question of allowability of the discounting charges and applicability of the rate of conversion will be examined in the light of the observations of the Committee.

The company has been asked to substantiate the claims of the financing charges at a rate of 8.5 per cent and the Head Office expenses attributable to the Indian business for all the years. Investigations in this regard are in progress.

As regards the last point discussed in para 1.131, the matter has already been referred to the Ministry of Petroleum whose comments are still awaited. A further reply may kindly be awaited."

[Ministry of Finance (Deptt. of Revenue) O.M. No, 241/3/77-A&PAC-II dated 24-6-1978]

Sl. No. 10 (*Partly*)

Even though financial competence of a company is always taken into consideration while awarding contract, from the available records it cannot be said with any degree of certainty whether the status of the company was gone into in the case of Snam Saipem. However, it may be added that Snam Saipem is a subsidiary of the State-owned Italian Company ENI (Ente Nazionale Idrocarburi).

[Ministry of Petroleum, Chemicals & Fertilizers (Department of Petroleum) O.M. No. R-38018/1/78-OR.I, dated 7-9-1978]

Sl. Nos. 5, 6, 11, 13, 14, 15, 17 & 18

"The observations/recommendations of the Committee are under active consideration of the Ministry. A further reply may kindly be awaited."

[Ministry of Finance (Deptt. of Revenue) O.M. No. 241/3/77-A&PAC-II dated 28-6-1978]

Kind attention of the Committee is invited to the Ministry's O.M. of even number dated the 28th June, 1978.

The assessments for the assessment years 1964-65 to 1969-70 were set aside by the A.A.C. on 10th November, 1976. With a view that proper and detailed enquiries as recommended by the Committee are conducted, the case of the company was transferred to an I.A.C. The I.A.C. had requested the company to give contract-wise details, information regarding the head-office expenses and other particulars as recommended by the Committee. Notices have also been issued for the production of books of accounts including that of the head-office. Specific questions have been asked regarding the discounting of the dollar drafts. In spite of a number of reminders and discussions the company has neither produced the books of accounts of the Head-office nor furnished some of the relevant particulars so far. The company has been informed that the non-furnishing of the proper and relevant information may lead to best judgement assessment.

The question of instituting an enquiry for fixing the responsibility for the lapses that have occurred in the past will be taken up after the completion of the re-assessments made on the basis of complete data and investigations as suggested by the Committee.

[Ministry of Finance (Deptt. of Revenue) O.M. No. 241/3/77-A&PAC-II dated 15-7-1978]

CHAPTER V

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH GOVERNMENT HAVE FURNISHED INTERIM REPLIES

NIL

NEW DELHI;
November 25, 1978
Agrahayana 4, 1900 (*S*)

P. V. NARASIMHA RAO,
Chairman,
Public Accounts Committee.

2716 LS—4

APPENDIX

Statement of Conclusions/Recommendations

Sl. No.	Para No. of the report	Ministry concerned	Conclusions/Recommendations
1	1·9	Min. of Petroleum & Chemicals	In paragraph 1.122 of the original report, the Committee had regretted that full advantage of deferred payments of 50 per cent for the first 4 half-yearly instalments, provided for in the agreement, was not taken and had desired the Ministry of Petroleum and Chemicals to examine why it could not be done. The Committee are surprised at the reply of the Ministry of Petroleum and Chemicals that "at this late stage it is not possible to ascertain from the available records as to why the facility of deferred payment of 50 per cent of the first 4 instalments was not included in the contract." The Committee deplore the perfunctory reply furnished by the Ministry of Petroleum and Chemicals to the Committee and desire that an inquiry should be instituted to fix responsibility for the lapse on the part of the officers concerned which has placed the country in a financially disadvantageous position.
2	1·10	Min. of Finance (Deptt. of Revenue)	The Committee are perturbed that desired documents and particulars have not been made available by the Company to the newly appointing assessing officer "in spite of a number of reminders and discussions". They desire that the matter should be pursued vigorously so as to finalise the re-assessments without further delay.
3	1·11	—do—	As regards the recommendation of the Committee to institute an enquiry for fixing responsibility for the past lapses on the part of the assessing officer and the reply of the Government that this would be done after

			the completion of the reassessment, the Committee need hardly point out that the lapses pointed out by them in the initial assessment of the Company for tax were concrete and absolutely clear meriting an enquiry to be conducted. They are afraid that if the enquiry is inordinately delayed it would lose much of its significance and afflux of time could create other difficulties for the enquiring authority inhibiting fair conclusions and clear apportioning of responsibility. They therefore reiterate that the inquiry suggested in para 1.139 of their original Report should be instituted forthwith.
4	1·12	—do—	The Committee expected that the recommendations contained in paras 1.127 and 1.138 of their original Report would be replied to separately and individually as these were, though arising out of the present case, of general nature. The Committee would reiterate the recommendation made in para 1.127 that the Board should exercise utmost caution in dealing with individual cases involving legal ramifications and where the advice of the Ministry of Law appears necessary, a reference should be made to that Ministry promptly. They would also once again reiterate the recommendation made in para 1.138 of their original Report that the Board should respect the Law and refain from giving order, inst ructions or directions as to the manner in which assessment should be done in any specific case.
5	1·13	—do—	The Committee regret that Government have so far not replied to the observation contained in para 1.137 of their original Report disapproving the acquiescence of the Board to calculated efforts on the part of interested parties to influence the officers of the Board. The Committee reiterate their desire that definite instructions in this regard should be issued by the Ministry.

GMGIPND—I—2716 LS—1-12-78—1150