

**TWENTY-EIGHTH REPORT**  
**PUBLIC ACCOUNTS COMMITTEE**  
**(1980-81)**

(SEVENTH LOK SABHA)

**M/s INTERNATIONAL COMPUTERS LTD. U.K.**



सत्यमेव जयते

**LOK SABHA SECRETARIAT**  
**NEW DELHI**

March, 1981/Chaitra, 1903 (S)

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## \* PART II

Minutes of sittings of the Committee held on:

12-9-1978

13-9-1978

**22-10-1980**

17-3-1981

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

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(1980-81)

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## 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 (Seventh Lok Sabha) on paragraph 26(ii) (a) of the Report of the Comptroller and Auditor General of India for the year 1976-77, Union Government (Civil), Revenue Receipts, Vol. II—Direct Taxes.

2. The Report of the Comptroller and Auditor General of India for the year 1976-77, on Union Government (Civil), Revenue Receipts, Vol. II, Direct Taxes was laid on the Table of the House on 12 April, 1978. The Public Accounts Committee (1978-79) examined the audit paragraph at their sittings held on 12 and 13 September, 1978. The Public Accounts Committee (1980-81) further examined the audit paragraph at their sitting held on 22 October, 1980. The Committee considered and finalised this Report at their sitting held on 17 March, 1981. The Minutes of the sittings of the Committee from Part II\* of the Report.

3. In this Report, the Committee have dealt with a case of excessive allowance of head office expenses year after year while computing the business income of a multinational corporation M/s. International Computers Ltd., U.K. engaged in the business of manufacturing and hiring of data processing machines. This resulted in short levy of tax to the tune of Rs. 42.5 lakhs during the assessment years 1961-62 to 1974-75.

The Committee have observed that there appears to be a total and all pervasive lack of will to regulate the operations of the companies in tune with the pronounced policies, objectives and national interests. The instant case provides one such example. The Committee have emphasised the need for building up management information system to design as well as monitor policy. With this end in view, the Committee have recommended the creation of a separate Cell in the Ministry of Finance to oversee the activities of all enforcement agencies and to collect relevant, authentic and up-to-date data in respect of operations of all multi-national companies.

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

4. A Statement containing the conclusions and recommendations of the Committee is appended to the Report (Appendix III). For facility of reference, these have been printed in thick type in the body of the Report.

5. The Committee place on record their appreciation of the commendable work done by the Chairman and Members of the Public Accounts Committee (1978-79) in taking evidence and obtaining information for this Report.

6. The Committee also place on record their appreciation of the assistance rendered to them in the examination of the subject by the office of the Comptroller and Auditor General of India.

7. The Committee would also like to express their thanks to the officers of the Ministry of Finance (Department of Revenue) for the cooperation extended by them in giving information to the Committee.

NEW DELHI;  
March 25, 1981  

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Chaitra 4, 1903 (S)

CHANDRAJIT YADAV,  
Chairman,  
Public Accounts Committee.

## REPORT

### CHAPTER I

#### THE CASE OF M/S INTERNATIONAL COMPUTERS LTD. U.K.

##### *Audit Paragraph*

1.1. A U.K.-based multinational corporation engaged in the business manufacturing and hiring of data processing business machines, earned income in India from hiring its business assets viz., the machines to its hollyowned subsidiary, an Indian company, on rental basis. The Indian subsidiary, in turn, hired out such machines to various other customers in India. The hire charges receivable by the Indian subsidiary were inclusive of the rental liability payable by it to the foreign multi-national company. Under the arrangement which the Indian company had with the foreign company, an amount equal to forty-five per cent of the gross rental charged by it to its customers was payable to the foreign company as its rental liability in turn. This amount of forty-five per cent of rental in fact represented the Indian turnover of the foreign company viz., the assessed-company. The head office expenses deductible in the computation of business income of the assessee-company should have been related to this turn-over as against the total world turnover. Instead, the assessee claimed and was allowed such expenses in the ratio of the entire rental income of the Indian subsidiary to the world turnover of the assessee-company. The excessive allowance of head office expenses year after year resulted in under-assessment of income of the foreign company by Rs. 64 lakhs in the assessment years 1961-62 to 1974-75 with consequent short levy of tax of about Rs. 42.5 lakhs in these years.

1.2. The paragraph was sent to the Ministry of Finance in September 1977, they have stated in December, 1977 that the audit objection is under active consideration.

[Paragraph 26(ii) (a) of the Report of the Comptroller and Auditor General of India for the year 1976-77, Union Government (Civil) Revenue Receipts, Volume II—Direct Taxes].



### *Background information*

1.3. The question of proper allocation of Head Office expenses in the case of foreign companies having places of business in India had earlier engaged the attention of this Committee in the cases of National and Grindlays Bank and the 18M World Trade Corporation. In para 9.13 of their 176th Report (Fifth Lok Sabha), the Committee recommended:

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

1.4. Pursuant to these recommendations a new section 44C was introduced with effect from 1-6-1976 in the Income-tax Act 1961, by the Finance Act, 1976, providing for the conditions under which and limits upto which deduction towards head office expenditure should be allowed in the case of non-residents. Detailed guidelines were also issued to the assessing officers by the Central Board of Direct Taxes in their Instructions dated 16-6-1975, 6-9-1975, 8-7-1976, 6-1-1978 and 3-2-1978.

### *Facts of the case*

1.5. M/s. International Computers Limited U.K. is a non-resident company incorporated in U.K. It has a wholly owned subsidiary in India called M/s. International Computers Company (I) Pvt. Ltd.

The foreign company earned income in India from hiring its business assets, namely, machines to this subsidiary company in India on rental basis. The Indian subsidiary in turn hired out such machinery to various customers in India. Out of the hire charges received by the Indian Company, 45 per cent was payable to the foreign company.

In the assessments framed on the non-resident company, head office expenses were allowed in the ratio of Indian turnover to the global turnover of the non-resident company, and for that purpose the Indian turn-over of the non-resident was taken as 100 per cent of the rental income as received by the Indian subsidiary. The audit objection is that the head office expenses deductible in the computation of business income of the foreign company should have been with reference to 45 per cent of the rental income as against 100 per cent of the rental income as claimed and allowed to the foreign company as the Indian turnover of the non-resident Company was only to the extent of what it received from the Indian subsidiary i.e. the 45 per cent share. The assessment years involved are from 1961-62 to 1974-75. The audit objection was raised on 23-6-1976.

1.6. Audit had informed the Committee further developments in regard to the case as follows:

“The Ministry of Finance (Deptt. of Revenue) in their reply dated 28-8-1978 have stated that since the assessment orders from assessment years 1962-63 to 1974-75 (both inclusive) were completed more than 2 years prior to the date of receipt of the audit objection, action under Section 263 (cancellation by Commissioner of Income-tax of assessment orders prejudicial to revenue) could not be taken. Again, as all the material facts necessary for the assessments in so far as this issue is concerned, had been, fully disclosed, no action under Section 147(a) (re-opening of assessment for failure on the part of the assessee to disclose fully and truly all material facts) could be taken. The assessments for assessment year 1972-73, 1973-74 and 1974-75 however, have been reopened under Section 147(b), taking the audit objection as ‘information’ referred to in that section.

The assessments for assessment years 1972-73, 1973-74 and 1974-75 have been completed wherein the objection raised by audit has been given effect to. The assessee-company has, however, filed appeal against the assessment orders and the appeals are pending.”

1.7. The Committee desired to know, during evidence in September, 1978, whether there was any difference of opinion between

the Ministry of Finance and the Audit regarding the excessive allowance of Head Office expenses allowed from the assessment year 1961-62 to 1974-75 in the computation of business income of the foreign company mentioned in the audit paragraph. The Joint Secretary, Ministry of Finance (Department of Revenue) stated:

“Actually when we sent the reply to Audit on 28 August, 1978, we conceded that there was a mistake but the loss of revenue was not to the extent indicated in the audit para. That reply was given on the basis of a letter which the company had written to the Income-tax Officer. That letter said that the calculation have been made in this manner. Relying on that letter, the calculations made by audit would be slightly on the high side. That is why, on 28 August, we had said that the calculations need to be revised.

But since then we have gone into the records ourselves and we have found that the statement made by the company was completely uncorroborated by any evidence. There was no evidence, not even a certificate from the London auditors. That letter has not been relied upon in the reassessment proceedings. Therefore, to that extent we would like to modify our reply and now we would say, yes, there is no dispute between audit and the Department that there was over-charge of head office expenses. We agree on the quantum and we agree that there should have been a lesser allowance on account of head office expenses than was allowed.”

The Finance Secretary added:

“The computation of allowance for the head office expenses by the multinationals has been a major problem for the Department. It is in recognition of this problem and the difficulty in assessing the proper allowance for the head office expenses that Government have enacted Section 44C of the Income-tax Act in 1976. Some of the difficulties which we have been hitherto encountering in allowing for head office expenses should now be overcome.

We are progressively becoming wiser and trying to catch up with the tricks of the multi-nationals. With the imple-

mentation of the Foreign Exchange Regulations Act, and with the conversion of the branches of foreign companies into Indian companies here, the problem would largely disappear because they have not converted into Indian companies and the question of payment of head office expenses will not hereafter arise in the case of these companies.”

1.8. The Committee desired to know the demand raised as a result of reopening of the assessments for the years 1972-73 to 1974-75. The Ministry of Finance have furnished the following figures:

Assessment year	Demand raised in original assessment	Demand raised in reopened assessment	Difference representing the additional demand
	Rs.	Rs.	Rs.
1972-73	5,78,692	6,25,681	48,989
1973-74	6,32,075	6,56,943	24,868
1974-75	4,18,568	4,78,706	60,138

1.9. The Committee asked whether the assessment for the assessment year 1975-76 had been completed. The Ministry have replied:

“Yes. The assessment for 1975-76 was completed on 12-1-1978. Head Office expenses amounting to Rs. 1,27,151/- were claimed by the assessee. However, an amount of Rs. 97,151/- was disallowed. This disallowance is in conformity with the view taken in the audit para.”

1.10. The Committee desired to know the quantum of the Head Office expenses claimed by the assessee company during the assessment years 1961-62 to 1974-75 and the amount added back by the assessing officer at the time of the original assessment during these

years. In reply, the Ministry of Finance have furnished the following statement:

Asst. Year	H.O. expenses claimed	H.O. expenses added back in original assessments	H.O. expenses now added back on rectification made pursuant to the Audit Para	Rs.
1961-62	9,03,664	Nil		
1962-63	11,81,938	Nil		
1963-64	15,11,401	Nil		
1964-65	12,07,094	Nil		
1965-66	11,14,352	Nil		
1966-67	11,86,667	Nil		
1967-68	11,80,767	Nil		
1968-69	6,35,103	Nil		
1969-70	5,21,766	Nil		
1970-71	4,77,786	Nil		..
1971-72	4,59,666	Nil		..
1972-73	3,18,528	Nil		2,47,214
1973-74	2,28,292	Nil		1,78,292
1974-75	1,79,314	Nil		1,38,666

1.11. The Ministry have further stated that according to the agreement, the UK Company was entitled to 45 per cent of the rentals received by M/s. ICL (India Ltd. on machines hired by it from

the UK Company. Details of the payments made have been indicated are as under:

Assessment Year	Amount in Rs.
1961-62	. 28,36,884
1962-63	. 31,12,277
1963-64	. 34,57,216
1964-65	. 33,04,095
1965-66	. 34,99,727
1966-67	. 32,73,777
1967-68	. 30,16,293
1968-69	. 30,06,399
1969-70	. 28,17,316
1970-71	. 24,59,435
1971-72	. 19,42,464
1972-73	17,52,757
1973-74	12,92,411
1974-75	10,68,696

1.12. The Committee desired to know how much revenue was lost due to inability to take action under law on this point in respect of assessment years 1961-62 to 1971-72. In reply, the Ministry of Finance have stated:

Assessment Year	Demand raised in original assessment	Demand raised in re-opened assessment	Difference representing the additional demand
	Rs.	Rs.	Rs.
1972-73	5,78,692	6,25,681	48,989
1973-74	6,32,075	6,56,943	24,868
1974-75	4,18,568	4,78,706	60,138

“Assessments for the year 1961-62 to 1966-67 cannot be re-opened now. The approximate revenue effect for the years 1961-62 to 1966-67 would work out at about Rs. 25 lakhs. Revenue effect for 1967-68 to 1971-72 is about Rs. 13 lakhs.”

1.13. During evidence in October, 1980, it came to the notice of the Committee that though the Inspecting Assistant Commissioner (Audit) had communicated in August, 1977 to the Inspecting Assistant Commissioner of the Range, the approval of the Commissioner of Income Tax for reopening under Section 147(a) of the Income Tax Act 1961, the assessments for all the years from 1961-62 onwards, the Ministry took the view in August 1978 that Section 147(a) could not be invoked in respect of assessment years 1961-62 to 1966-67, since there was no failure on the part of the assessee to disclose fully and truly all material facts. The Committee desired to find out the circumstances under which the earlier decision was reversed by the Ministry.

1.14. At the instance of the Committee, the Ministry of Finance submitted copies of the documents filed by the Company regarding computation of head office expenses for the assessment years 1961-62 to 1966-67. A perusal of these documents indicates that the foreign company used to file the following statements every year:

- (i) Schedule of Head Office charges showing broadly the major heads under which the head office expenses were incurred and the details under each head-sub-head;
- (ii) Statement showing the analysis of expenses and the apportionment of head office charges to India.

1.15. The documents furnished to the Committee include a communication dated the 30th January, 1963 from the International Computers and Tabulators (India) Pvt. Ltd. to the Income Tax Officer, Company Circle IV(2), Bombay wherein (replying to the query raised by the Income Tax Officer during the earlier interview of the Company's representative with the Income Tax Officer) the Company had justified the existing method of allocation of head expenses taking the ratio of 100 per cent of the rental income from India to the total world rentals, and submitted that the existing method of company head office expenses (as against the suggested ratio of 45 per cent of the rental income from India) should not be disturbed.

1.16. In another communication dated 15 May, 1965 to the Income Tax Officer, the Company had again spelt out in detail the justification for the existing method of allocation of head office expenses.

1.17. According to a written note furnished by the Ministry:

“The arguments of the company were accepted at the time of the original assessments and head office expenses were allowed with reference to 100 per cent of Indian rentals as claimed.

On the basis of the above facts it is clear that the assessee had disclosed all the material facts necessary for assessment. Since the deduction was allowed after considering all the facts, the withdrawal of the excess allowance of Head Office expenses would amount to merely a change of opinion. Section 147(a) cannot be invoked on a mere change of opinion.\* Also it cannot be said that the assessee has failed to disclose fully and truly all material facts necessary for his assessment. Therefore, action under section 147(a) could not be taken.

However, it was also seen that the assessee company had not offered for taxation the sale proceeds of scrapped machines rented out to its Indian subsidiaries. Since the accounting machines were the properties of the assessee company (on which depreciation development rebate and terminal depreciation on scrap were claimed and allowed in the assessments) the assessee company should have offered the sale proceeds of such scrapped machines for taxation. The fact of such sale proceeds was never disclosed to the Income-tax Officer assessing International Computers Ltd., U.K. Assessment under section 147(a) could be reopened on this basis. But it was seen that the sale price of the scrapped machines was less than Rs. 50,000/- in each of the assessment years 1961-62 to 1966-67 and, therefore, in terms of section 149(a) (ii) these assessments could not be reopened. The assessments for the assessment years 1967-68 to 1974-75 could only be reopened on this basis.

No action could be taken also under Section 147(b) because 4 years had already elapsed from the end of the relevant assessment year.

In short, as explained above, the assessments for assessment years 1961-62 to 1966-67 could not be reopened.”

1.18. When asked whether the filling of the accounts claimed deduction on account of head office expenditure at the rate of 100

\*Vide: Supreme court judgement in the case of Calcutta Discount Co. Ltd. vs ITO (41 ITR P. 191) cited else where in the Note of the Department.



per cent of the receipts from Indian instead of 45 per cent, amounted to disclosure of all the material facts necessary for making the assessment, the Joint Secretary (FTD) in the Department of Revenue categorically replied: "To my mind, yes." Supplementing him, Member (Income Tax) (CBDT) stated:

"When he has disclosed a percentage with reference to 100 per cent of the head office expenses or when he has disclosed all the statements giving allocation, it is for the ITO to come to a conclusion whether the ratio should be hundred per cent of Indian turnover or 45 per cent of Indian turnover. To my mind, the onus has been fully discharged. I can quote a number of authorities that after the ITO had been supplied with all the facts it was for him to draw an inference and any subsequent change of opinion would not be correct."

1.19. In this connection, it would be pertinent to go into the provisions of the relevant sections of the Income Tax Act 1961 under which reopening of the past assessments is possible.

1.20. Sections 147, 148 and 149 read as under:

Section 147—If—

- (a) the Income-tax Officer has reason to believe that, by reason of the omission or failure on the part of an assessee (1) to make a return under section 139 for any assessment year to the Income-tax Officer, or (2) to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, or
- (b) notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the assessee, the Income-tax Officer has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or re-assess such income or recompute the loss or the depreciation allowance, as the case may be, for the assessment year concerned (hereinafter in

sections 148 to 153 referred to as the relevant assessment year).

Explanation—I—.....

Explanation—II—... ..

Section 148—(1) Before making the assessment, reassessment or recomputation under section 147, the Income-tax Officer shall serve on the assessee a notice containing all or any of the requirements which may be included in a note under sub-section (2) of section 139; and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section.

(2) The Income-tax Officer shall, before issuing any notice under this section, record his reasons for doing so.

Section 149(1)—No notice under section 148 shall be issued—

(a) in cases falling under clause (a) of section 147—

(i) for the relevant assessment year, if eight years have elapsed from the end of that year, unless the case falls under sub-clause (ii),

(ii) for the relevant assessment year, where eight years, but not more than sixteen years, have elapsed from the end of that year, unless the income chargeable to tax which has escaped assessment amounts to or is likely to amount to rupees fifty thousand or more for that year;

(b) in cases falling under clause (b) of section 147, at any time after the expiry of four years from the end of the relevant assessment year.

(2) .....

(3) .....

1.21. The following conditions are to be satisfied for taking action under section 147(a)—

(i) The Income-tax Officer must have reasons to believe that income, profit or gain chargeable to income-tax has escaped assessment.

(ii) The Income-tax Officer must also have reasons to believe that such escapement has occurred by reason of either

(i) omission or failure on the part of the assessee to make a return of his income under section 139 or (ii) omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for that year.

1.22. In a communication dated 12th November, 1980 to the Committee, the Ministry have furnished a statement indicating the upto date position with regard to the reopening of the assessment proceedings. A study of the statement reveals the following position:

- (i) In respect of the assessment years 1967-68 to 1971-72, notices were issued/served to the assessee u/s 148 in 1979 and 1980. In response to the notices, the returns of income have been received but the assessments are pending.
- (ii) For the years 1972-73, 1973-74 and 1974-75, The notices u/s 148 were issued/served in January 1977. In the reassessments made, apart from the amount added back on account of sale of scrap, certain amounts were also added back on account of Head Office Expenses. The additions on account of Head Office Expenses were however, on appeal deleted by the CIT(A) vide his order dated 17th September, 1980."

1.23. Dealing with the reassessments for the period 1972-73 to 1974-75 during evidence, the representative of the CBDT stated:

"The assessments of 1972-73, 1973-74 and 1974-75 were reopened by the IAC on two grounds. Firstly, the Company had made an excessive claim on account of head-office expenses and, secondly, they had suppressed the sale of scrap. The matter has just been decided by CIT (Appeals). The CIT (Appeals) has taken the view that the sale of scrap was definitely suppressed by the non-resident company and, therefore, the taxation of the sale of scrap is correct. He has upheld that decision. But so far as the head-office expenses are concerned, he has deleted the addition. He says, there is no case for making this addition and, therefore, "I delete it". Since the decision has just come, from the facts it appears we will not

be accepting this decision. We will be going to the Tribunal and filing an appeal against it.”\*

1.24. Elaborating further, the representative of the CBDT said that there was divergences of opinion among the High Courts on the point whether on reopening an assessment under section 147(a), the Income Tax Officer has the power to bring to charge also other items falling under Section 147(b) irrespective of the fact that the period of limitation laid down in clause (b) has expired.

1.25. Responding to the strong feelings expressed by the Committee on the issue, the Finance Secretary added:

“So far as this case is concerned, only by way of general response to the points made by the Hon. Member, and having studied this case with the help of my senior colleagues here, it seems to me that there is evidence that they have tried to suppress the value of scrap and, on the basis of that, we are re-opening the assessment. While re-opening the assessment, we can take any advantage of some of the High Court cases which my colleague has cited and we can review the whole thing. We may also look into whether, on this limited point that they have suppressed the sale value of scrap, we are able to levy penalties or impose other appropriate punishment on them.”

1.26. In the case of IBM World Trade Corporation, the assessments for the assessment years 1959-60 to 1973-74 were reopened under Section 147(a) for recomputation of Head Office expenses. In this connection, the Ministry of Finance (Deptt. of Revenue and Insurance) had, in a note submitted to this Committee, stated:

“The assessee had filed a statement showing details of the Head Office expenses of Rs. 46,91,450 allocated to the Indian Branch. The statement (which is unsigned) was

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\*In a communication dated the 6th January, 1981 the Ministry of Finance (Department of Revenue) have informed the Committee as follows:

“Commissioner of Income-tax, Bombay City-II, has informed that second appeals against the order of the Commissioner of Income-tax (Appeals) in this case have been filed before the I.T.A.T. on 15-12-80 for asstt. years 1972-73 to 1976-77”.

sent with company's letters dated 13th October, 1970 (signed by S. Sunder Raman, Tax Specialist, IBM)."

[Para 3.16 of 167th Report (Fifth Lok Sabha)]

"The following are amounts claimed as Head Office expenses by the assessee and allowed by the ITO for the assessment year 1967-68:

Claimed : Rs. 46,91,530

Allowed : Rs. 46,91,580

The ITO had obtained a statement showing a break-up of the aforesaid expenses".

[Para 3.17 of 187th Report (Fifth Lok Sabha)]

In response to query as to how the facts in this case were different from the facts of the present case, and what were the reasons for reopening the assessments for earlier years in the case of M/s. World Trade Corporation and how those reasons were different from those of the present case, the Ministry in their written reply stated as follows:

"Head Office expenses claimed by the assessee were not based on actual services or benefits obtained by the Indian Branch but they were based on the ratio of Indian Branch's turnover to the World turnover of the branches and subsidiaries and thereby an excessive deduction from the total income was allowed while the deduction for actual services and the benefits should have been lower.

The assessments in the case of M/s. IBM world Trade Corporation were reopened on the ground that the claim of the head office expenses was made on a different basis than the actual services or benefits performed in India. Therefore, the dispute was about the basis on which the claim for office expenses was made. On the other hand, in the case of M/s. International Computers Ltd., head office expenses were allowed in the ratio of the Indian turnover with reference to 100 percent of the rental income received by the Indian subsidiary to the global turnover of the non-resident company whereas the head office expenses deductible in the computation of business income of the foreign company should have been worked out with reference to 45 per cent of the rental income received by it and not 100 per cent of the rental income received by the Indian subsidiary. All these facts were disclosed at the time of the original assessment and all that has hap-

pened now is that a different view on the same facts is being taken. As such, action u/s 147(a) does not lie and consequently the assessments of M/s. International Computers Ltd. for the years prior to 1967-68 could not be reopened on the grounds on which the assessments of M/s: May & Baker Ltd. and M/s. IBM World Trade Corporation were reopened."

1.27. The Committee enquired whether it was a fact that the foreign company had not bired any new machines to its Indian subsidiary after assessment year 1968-69 and its business income in India since then had risen out of the existing machines already on hire in India. The Ministry have replied in the affirmative.

1.28. The Committee desired to know whether loans had been raised after assessment year 1968-69 to provide for the assessee's world-wide global business activities and whether the interest paid on them had been included in the amounts of Head Office expenses and allowed as deduction. The Ministry of Finance have replied.

"The interest has been included in the Head Office expenses. The issue of disallowance of interest included in the Head Office expenses has been taken into account while completing the reopened assessments. The total interest included in Head Office expenses is indicated below:

Asst. year	Interest included in Head Office expenses allowed as deduction	Tax effect
	Rs.	Rs.
1969-70	2,16,200	1,51,340
1970-71	1,56,780	1,09,750
1971-72	1,85,450	1,29,820
1972-73	1,44,516	1,01,164
1973-74	96,294	70,776
1974-75	77,230	56,764

1.29. The Committee enquired how such a deduction could be considered to be justified when there had been no addition to the machines already hired to the Indian subsidiary since the previous year relevant to the assessment year 1968-69. The Ministry of Finance have stated:

“This would be considered during the course of the re-assessment proceedings.”

1.30. The Committee are distressed that so soon after the case of erroneous allowance of head-office expenses in the Income-tax assessment of National and Grindlays Bank Ltd. and the IBM World Trade Corporation, commented upon by this Committee in their 176th and 187th Reports (5th Lok Sabha), another case has been brought to light in paragraph 26(ii)(a) of the Audit Report (Civil)—(Direct Taxes) 1976-77 involving huge loss of revenue on account of incorrect deduction allowed as head-office expenses. They take a serious view of wrong deduction towards head-office expenses in the computation of business income of the U.K. based multi-national corporation—M/s. International Computers Ltd., engaged in the business of manufacturing and hiring of data processing machines.

1.31. In this connection, the Committee note that during evidence in September, 1978, the representative of the Ministry of Finance admitted before the Committee that the statements made by the foreign company, on the basis of which assessments were initially made, were “completely uncorroborated by any evidence”, that these were not supported even by “a certificate from the London auditors” and that “there was over charge of head-office expenses”. The Ministry of Finance have, however, submitted before the Committee that no action could be taken under Section 147(a) of the Income Tax Act, 1961 to reopen the assessments in respect of the foreign company for the period 1961-62 to 1971-72 as, in the opinion of the Government, the Company had disclosed fully and truly all material facts necessary for assessment. The approximate loss of revenue on this account, according to the Ministry’s own calculations works out to Rs. 38 lakhs. Since the mistake reveals palpable negligence on the part of the assessing and other supervisory officers resulting in a sizeable loss of revenue, the Committee recommend that the responsibility therefor should be fixed on the officers concerned and appropriate action should be taken against those responsible.

1.32. The Committee would, in this connection, invite attention to the Income-tax assessment of IBM World Trade Corporation, examined and commented upon by this Committee in their 187th Report (5th Lok Sabha). In the said report it was pointed out that this Company had furnished to the Income-tax Officer similar information in regard to head-office expenses and the Income-tax Officer had admitted the claim of the foreign company. When the mistake on the part of the Income-tax Officer was pointed out by

**Audit and the Public Accounts Committee, the past assessments in respect of this company were re-opened under section 147(a) of the Income-tax Act, 1961. The latest reply of the Ministry giving the reasons for re-opening the assessments in the case of IBM World Trading Corporation also acknowledges that in the case of IBM itself, the question involved was similar to the present case (International Computers) namely, the basis on which the Head Office Expenses were apportioned as deductible against Indian Income. The Committee are, therefore, unable to appreciate the inconsistent view being canvassed by the Ministry that it is not possible to re-open the past assessments in the case of International Computers Ltd., having re-opened assessments under section 147(a) in the case of IBM under identical circumstances as mentioned above.**

**1.33. The Committee observe in this connection that Inspecting Assistant Commissioner (Audit) had communicated, vide his letter dated 29th August 1977 to the Inspecting Assistant Commissioner of the Range concerned the approval of the Commissioner of Income Tax for re-opening of the assessments for the years 1961-62 to 1972-73 under Section 147(a) of the Income Tax Act for wrong allowance of Head Office expenses. The Committee find it baffling as to why no action on the lines suggested by the Commissioner was taken by the Commissioner in Charge of the Range. It seems that the Ministry's view that the old assessments could not be re-opened under Section 147(a) on the ground of excessive allowance of Head Office expenses, is a belated attempt to justify the culpable inaction on the part of the Inspecting Assistant Commissioner concerned. The causes for inaction on the part of the Inspecting Assistant Commissioner concerned despite the clear direction of the Commissioner need to be thoroughly investigated especially with a view to finding out whether it was inter alia due to any undue influence on the part of the multi-national corporation.**

**1.34. It was admitted before the Committee that the foreign company had not hired out any new machines to its Indian subsidiary after the assessment year 1968-69 and that its business income in India from the year 1969-70 onwards had arisen out of the existing machines already on hire in India. Yet, the Committee find that during the period 1969-70 to 1974-75, a sum of Rs. 8.76 lakhs being the interest paid on loans raised by such foreign company has been included in the head office expenses and allowed as a deduction against Indian Income. Obviously, the loans raised by the company after 1968-69 were for the company's world wide business activities and could not at all be related to the Indian Income. Interest expenditure incurred by the head office, if directly related to the Indian**



business on revenue account would be a direct deductible expenditure in its entirety. Head office expenses are, in fact, only those expenses which are incurred for composite business as such and, therefore, incapable of deduction without apportionment. The Income-tax Officer had thus in any case made an error by not disallowing the interest charges included in the head office expenses. The unjustified allowance of interest, deprived the revenue of tax to the extent of Rs. 6.20 lakhs. The Committee consider this as one more instance of negligence on the part of the assessing authorities which needs to be enquired into.

The Committee would like the Ministry of Finance to take suitable remedial action to recover the tax due from the assessee on this account under intimation to the Committee. The question of issuing suitable instructions for future guidance may also be taken up.

1.35. Considering the nature, gravity and number of errors both of commission and omission noticed in this case, the Committee would urge that this case should be investigated thoroughly by the Special Cell of the Directorate of Inspection (Investigation) in conjunction with the other cases like that of the IBM World Trade Corporation. The Committee would like to be informed of the results of such investigation.

1.36. The Ministry had informed the Committee that assessments for the years 1972-73, 1973-74 and 1974-75 have been re-opened under Section 147(b) of the Income Tax Act taking the audit objection as 'information' referred to in that Section. At a subsequent stage, the Committee were informed that the assessments for the years 1966-67 to 1974-75 have been re-opened under Section 147(a) on the ground of omission on the part of the assessee to disclose the income on account of sale of scrap, and that opportunity has been taken to add back excess amounts allowed as Head Office Expenses. The Committee also learn that on appeal by the assessee Company against re-assessments for the years 1972-73, 1973-74 and 1974-75, the CIT (Appeals) has deleted the amount added back on account of Head Office Expenses and that second appeals against the order of the CIT (Appeals) in this case have been filed before the Income Tax Appellate Tribunal on 15th December, 1980 for assessment years 1972-73 to 1976-77.

1.37. The Committee note the view expressed during evidence that there was divergence of opinion among various High Courts on

the question whether, on re-opening an assessment under Section 147(a), the ITO has the power to bring to charge also other items falling under Section 147(b) irrespective of the fact that the period of limitation laid down in Section 147(b) has expired. The Committee would suggest that in such cases where there is divergence of opinion among different High Courts, the matter should be taken directly to the Supreme Court for determination of the issues and attempts made by the Government for expeditious disposal to avoid harassment both to the assessee and to the department.

## CHAPTER II

### TAXATION OF MULTINATIONAL FOREIGN COMPANIES

2.1. During evidence, the Joint Secretary of the Ministry said:

“When we issued instructions on the Head Office expenses in June 1975, we asked the Commissioners to undertake review of cases in which Head Office expenses have been allowed. This scrutiny was done and we had been advised that 54 organisations' cases have been re-opened like this.”

2.2. In response to a query, the Ministry of Finance have furnished statements showing details of 54 assessments which were re-opened consequent to the issue of instructions on Head Office expenses in June, 1975 as also the details regarding another 24 cases of assessment where wrong allowance was allowed and detected later on (Appendix I & II).

2.3. A study of the statements discloses the following facts.

- (i) The total amount of under-assessment income involved in the 78 cases was of the order of Rs. 9.63 crores, having a tax effects of over Rs. 6 crores.
- (ii) Apart from the cases of National and Grindlays Bank and IBM World Trade Corporation, assessments of 20 other foreign companies for various assessment years ranging from 1960-61 to 1975-76 have ben re-opened.

2.4. In order to know whether the foreign companies were filing returns properly or not, the Committee desired to know the number of foreign companies which were in operation during the years 1961-62 to 1976-77.

In reply, the Ministry have furnished the following statement:

“Details for the years 1961-62 to 1970-71 and for 1974-75 are not available in the Board's Office. The information is being collected. Figures for other years are as under:

Item	Assmnt. Year 1971-72 **	Assmnt. Year 1972-73 **	Assmnt. Year 1973-74 **	Assmnt. Year 1975-76 @	Assmnt. Year 1976-77 £
1. No. of foreign companies who have filed returns and assessments completed	324	572	373	449	378
2. No. of foreign companies who have filed returns and assessments pending	20	269	386	454	578
3. No. of foreign companies where no returns have been filed	38	49	124	127	180
Total Number	382	890	883	1030	1136

\*\* Position as on 31-3-1974

@ Position as on 31-3-74

£ Position as on 31-3-77

2.5. It was noticed from the above statement that 180 foreign companies did not file returns of their income during 1976-77. The Committee desired to know whether any notice was issued to them to file the returns or Government was satisfied that there was no taxable income so far as those companies were concerned. The Joint Secretary of the Ministry replied:

“Actually we had collected details from the Reserve Bank; we had obtained the names of the foreign companies which are operating in India through branches or subsidiaries, and we had supplied those lists to the Commissioners. We had requested the Commissioners to take those cases on the General Index Register and initiate assessment proceedings against them.”

2.6. In a written note furnished to the Committee, the Ministry of Finance have explained the position as follows:

“All the 180 companies were borne on General Index Register. However, it was considered necessary to issue notices calling for returns of income in 151 cases.

Penalty under Section 271(1) (a) has so far been imposed in one case *viz.* M/s. Thorn Lighting Co. (assessed to tax in Karnataka Charge) and the penalty levied is Rs. 9,453/-”

2.7. The Committee desired to know for how many years these companies did not file the returns and what was the tax evasion by them. In reply, the Ministry of Finance have furnished the following note:

“The number of companies which did not submit their returns of income in various years, varied from year to year. For example in assessment year 1974-75, the number of companies which had not filed the returns of income was 7 whereas for 1975-76 assessment years, it was 22.

There are only two cases involving tax evasion. The amount involved is Rs. 5,92,000.”

2.8. The Committee enquired whether any instructions had been issued by the Central Board of Direct Taxes to the Commissioners of Income-tax to find out the number of foreign companies which did not file their returns. The Ministry of Finance have stated:

“No instructions in this regard have been issued by the Board in the last three years. However, locating cases of new foreign companies is a part of the general survey which is carried out by the field officers periodically.

It may, however, be mentioned that in 1973, a list of foreign companies was circulated by the Board to the Commissioners of Income-tax with the direction to ensure that all such cases were borne on the General Index Register.”

2.9. The Committee desired to know the quantum of foreign exchange paid to the foreign companies. The Joint Secretary, Ministry of Finance (Department of Economic Affairs) stated:

“So far as the outflow of foreign exchange is concerned, it takes place in the form of profits of branches, dividends of companies, royalties, technical know-how fees and interest payment by the foreign companies operating in India. I can give the figures of the various items as in 1975-76, for which we have got the latest data. In 1975-76, the profits remitted by foreign branches operating in

India were Rs. 20.36 crores, the dividends remitted by them were Rs. 24.85 crores. Technical know-how fees remitted by them—Rs. 25.66 crores; interest payment on the loans which they had advanced Rs. 24.65 crores. This was the total outflow of foreign exchange under various heads.”

2.10. In reply to another question, the witness said:

“So far as the outflow is concerned, the total comes to Rs. 90 crores to Rs. 100 crores under various heads. So far as the inflow is concerned, it is mainly in the form of retained earnings of the foreign companies operating in India which will be of the order of Rs. 35 crores to Rs. 40 crores. So far as the fresh foreign equity inflow is concerned, it is not of a significant magnitude. It would be of the order of Rs. 2 crores to Rs. 3 crores per annum. The rest is by way of suppliers’ credit and loans which are furnished. These are also on the decline. They may be of the order of Rs. 25 crores to Rs. 30 crores at the moment.”

2.11. In a written note furnished to the Committee, the Ministry have stated that the aggregate foreign liabilities (inflow) in the corporate industrial and commercial enterprises had been generally on the increase as shown below:

	(Rs. in crores)
1964	894.0
1965	1002.3
1966	1058.0
1967	1471.7
1968	1552.1
1969	1619.3
1970	1640.9
1971	1679.6
1972	1755.7
1973	1816.3

2.12. The Committee pointed out that the inflow had shown a definite upward trend upto 1973 and enquired whether it was still

being maintained. The Joint Secretary of the Department of Economic Affairs stated:

“As on 31 March 1973, the total foreign investment was of the order of Rs. 1857 crores and, as on 31 March, 1974, the total foreign investment was of the order of Rs. 1943 crores.”

2.13. The representative of the Ministry of Finance was asked during evidence in October, 1980 whether the system was encouraging multi-nationals and attracting more of them to this country. He replied:—

“There has been an increase (in foreign investment) in absolute terms, partly because many of them went into capital intensive areas. On the whole our impression is that multinationals have been kept under sufficient control.”

2.14. Asked to indicate the latest figures of foreign investments in this country, he said that the Reserve Bank of India's last published data was for the year 1973, which alone could be treated as authentic.

2.15. Replying to another question, the Joint Secretary of the Department of Economic Affairs stated:

“Expert Committee of U.N. has now set up a specialised agency for dealing with the transnational corporations and there is a permanent centre at the U.N. One of the things discussed and in which that is engaged at present is the evolution of a code of conduct for the transnational corporations. One other thing which is being dealt with there is the taxation of multi-nationals. Where there is a disclosure, there is an exchange of information between various countries and other inter-governmental agencies. That will be essential in ensuring that the trans-national do not avoid or evade tax in various countries—both developing and developed countries. This is a matter which is engaging the consideration of the specialised body. There has been a special report on accounting and taxation practices of multi-nationals. This also is being considered by the group. After the code of conduct for the multi-nationals is framed, one of the areas where special attention will be paid is the exchange of information and cooperation amongst the

developed and developing countries in regard to the practices of multi-nationals on taxation and exchange of information between them in regard to that. It has to some extent minimised the problem."

2.16. The Ministry of Finance were asked to state whether the working of the Foreign Tax Division of the Department of Revenue was reviewed by any authority and whether any annual report was brought out on the working of this Division. In the written reply furnished to the Committee, the Ministry have stated as follows:—

"In pursuance of the recommendations of the PAC contained in para 9.14 of their 176th Report, a Group under the Chairmanship of Finance Secretary [Other Members were the then Chief Economic Adviser (Dr. Manmohan Singh), the then Additional Secretary, Deptt. of Economic Affairs (Shri Narasimhan) and the former Chairman, CBDT (Shri S. R. Mehta) was set up to undertake a comprehensive review of the working of the Foreign Tax Division. The report of the Group was sent to the C&AG on 8-11-1976.

As regards an annual report, no separate annual report on the working of the Foreign Tax Division as such as brought out. The Foreign Tax Division being part of the Ministry of Finance, the report on its working is also incorporated in the annual report of the Ministry of Finance."

The Ministry were further asked as to what exercise was being done by the Foreign Tax Division and the Internal Audit to ensure that any of the Foreign Companies do not avoid or evade tax even though no complaints were received against:

In reply, the Ministry have stated:

"Instructions are issued by the Foreign Tax Division from time to time whenever considered appropriate. Cases of foreign companies are checked by the Internal Audit with a view to find if there is any under assessment or apparent evasion of tax on the basis of material on record."

2.17. During evidence in September 1978, the Committee desired to know whether it would be feasible for Government to scrutinise the affairs of foreign companies thoroughly from the point of view



of taxation. The Member, Central Board of the Direct Taxes stated:

“As a result of the recommendation of the Public Accounts Committee, a special cell has been entrusted with some of the larger cases—two international companies or multi-nationals, whatever we may call them—that is the IBM and the Coco Cola and also the eleven foreign banks doing business in this country. In addition to this, as the Secretary pointed out, the Central Circles, Calcutta, Bombay and Delhi also deal with certain foreign companies. You can reasonably expect that the assessments in those cases would have been done properly because they are done under the direct guidance of the Commissioner and the Assistant Commissioner—for instance, eight oil companies in Calcutta, four foreign tea companies in Calcutta, two companies in Delhi, one in Bombay. In respect of all these foreign companies, sufficient attention is given to all aspects of the problem.”

2.18. Again during evidence in October, 1980, Chairman, PAC highlighted the problems of taxation of the multi-nationals operating in this country and asked the Finance Secretary as to what steps were taken by the Government to meet the situation. He said:

“.....These multi-nationals get away with their tricks and also feel that they can take for a ride every country they are operating in. They can employ various ways and means to take advantage of the faults in the systems etc. They feel they can get rid of all the stipulations. ....It has been admitted that our country has been put to a loss of crores of rupees. These companies have taken advantage of our limitations. What steps have you taken to meet the situation?”

The Finance Secretary, answering the Chairman's query, stated:

“We had recognised that the surveillance of multi-national corporations from various angles—taxation, profits, their incomes and regulation of their activities within the country—poses special problems. Not only in our country, but in other countries also—more developed than India—these problems have been encountered. But I am

confining my observations for the present to the limited issue of taxation of these multi-national corporations....

The two major problems which have defied a perfect solution are the "head office expenses" and "transfer pricing." They have presented difficulties and will continue to do so, while we deal with such corporations.

So far as head office expenses are concerned, the Finance Act of 1976 introduced Section 44C seeking to lay down certain limits on such expenses, so as to contain the damage likely to be caused, within reasonable limits.... Since the foreign companies are now, under the FERA, diluting equity and converting them into Indian companies, their problems may get solved to some extent, because whatever payment they send abroad, will be on account of dividend on share-holdings, royalty or other technical services rendered. The question of head office expenses may not arise.

The other more serious problem is about transfer pricing. When a company operates in different countries, it is possible for it, while transferring products or processing raw materials from one country to another, to fix prices in such a way that its maximum tax liability arises in a country where the rate of taxation is relatively low, and its liability is limited where the tax burden is relatively high.... We discussed this problem with our officers. The only way we can deal with this satisfactorily is to see that we place these assessments in the hands of specially trained officers. The Foreign Taxes Division of the CBDT should also provide guidelines within the framework of the law, to the Income Tax Officers. Naturally, these assessments will vary. We cannot expect all persons to have the same degree of expertise in this regard....

The special division for dealing with foreign taxes in the CBDT was created sometime in 1972 or so. This division was created under a Joint Secretary because we recognised the importance of sharpening the instruments of taxation against multi-national corporations. Once this division was set up, naturally certain ideas were generated and in 1975 and later in 1976, we effected certain amendments. But it has to be a continuous process. As

you are fully aware, as much as I am, every year prior to the presentation of the Budget or finalisation of the Finance Bill, the Board does take note of the difficulties reported to them from the field in regard to the legal provisions; they take note of the judicial decisions which may have created difficulties; and then we seek to amend the law in order to get over those difficulties. A few changes are made to get over certain problems, but not all the problems. For example, the problem of transfer pricing cannot be tackled through mere legislation; it can be tackled only through an effective scrutiny of the assessments, and we are trying to ensure that by centralising the assessments in the hands of relatively senior officers; we shall also ensure that these officers are brought together periodically and there is an exchange of ideas between them so that they become progressively more efficient in the assessments of these companies.”

2.19. The Ministry of Finance (Deptt. of Revenue) were subsequently asked to describe the mechanism that existed prior to 1970 to scrutinise the accounts and making assessments in respect of foreign companies and also to indicate precisely the improvements made since then. They have in a written note furnished to the Committee stated as follows:—

“The mechanism applicable in existence prior to 1970 was that the assessing officer was expected to exercise his diligence in properly scrutinising the expenses claimed and allow only such amount as he considered reasonable. However, with a view to simplifying and rationalising the taxation of foreign companies, the Finance Acts of 1975 and 1976 introduced certain important changes so as to safeguard the interests of revenue.”

These are as under:

- (i) the income of foreign shipping enterprises is estimated as a percentage of their freight earnings from Indian Ports. (Sec. 44B and Sec. 172).

- (ii) limits have been prescribed for the admissibility of head office expenses in the assessment of branches of foreign companies (Sec. 44C).
- (iii) royalty, fees for technical services and dividends received by foreign companies are taxable at prescribed rates on the gross amount of the royalty etc., if paid by residents of India [Sec. 9(1) (vii) and Sec. 115A]. Source rules have also been provided for taxation of interest royalty and fees for technical services. [Sec. 9 (1) (v), Sec. 9 (1) (vi) and Sec. 9 (1) (vii)].

Administratively, the following steps have been taken:—

- (i) cases of income of over Rs. 5 lakhs have been assigned to Inspecting Assistant Commissioners of Income-tax for framing the assessments.
- (ii) assessments in certain cases of foreign enterprises are being supervised by the Special Cell of the Directorate of Inspection Investigation.)”

2.20. The representative of the CBDT, however, pointed out during evidence that the improvements in law made in 1975 and 1976 would be applicable to future operations of the multinationals in India. According to him “the problem would be there about their earlier assessments when they were governed by the old provision of the law which provided taxes on net basis. That will continue to exist because the foreign expenses will have to be verified and income taxed on a net basis. So, in that connection, we have issued instructions from time to time as and when difficulties were pointed out to us by the field officers in the scrutiny of the cases. We issued instructions saying that this is what you are supposed to verify and this would be the best method of doing it.

**2.21.** The Committee are distressed to note the extent of complacency denoted by the statement made by the representative of the Ministry while giving evidence that 'on the whole our impression is that multi-national companies have been kept under sufficient control'. It is well known that the multi-national companies or their principals command large resources which are ruthlessly deployed by them the world over with the sole purpose of maximising profits either in violation or skillful avoidance of the laws, rules and regulations of the host countries particularly the developing countries. It is also a fact that they adopt dubious means to avoid local taxes. They also use lavish hospitality, monetary inducements and pay-offs to persons holding positions of authority with a view to subjugating the will of the poorer countries not even stopping short of subverting their sovereignty.

**2.22.** Two fold justification has been advanced for the operation of multi-national companies viz., the necessity for import of sophisticated technology and (ii) conservation of foreign exchange resources through the building up of export potential. In actual fact, it is a matter of common knowledge that several foreign companies are engaged in manufacturing highly lucrative and non-essential consumer goods for which their vast propaganda machine is able to build up ready and sheltered markets rather than in goods and industries requiring sophisticated technology. In their earlier reports\*, the Committee have had occasion to point out specific cases where the so-called import of technology was of a highly dubious nature. For example in their report\*\* on operation of the IBM World Trade Corporation, the Committee had pointed out how stale and third-rate technology was actually imported into this country. In another Report@ the Committee had emphasised the need for a review of the technical collaboration agreements so as to ensure that the import of technology was consistent with our needs as gauged by the development of indigenous know-how.

**2.23.** As for the second limb of the basic justification, i.e. the building up of export potential, it has been admitted in evidence that during 1975-76 there was an outflow of foreign exchange of over Rs. 95 crores on account of profits/dividends, technical fees and

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\*c.f. Para 9.16 of 176th Report (5th Lok Sabha) and paras 2.23 and 2.25 of 187th Report (5th Lok Sabha)

\*\*c.f. 221st Report (5th Lok Sabha)

@c.f. Para 2.25 of 187th Report (5th Lok Sabha)

interest payments alone. If account is also taken of the import of raw materials and equipment it remains a matter for inquiry as to whether the working of these companies had contributed at all to the conservation of foreign exchange resources of the country.

2.24. The Ministry of Finance have stated that the total foreign investment increased from Rs. 894 crores in 1964 to Rs. ~~1,857~~ crores in 1974, showing a growth of 117 per cent over the 10-year period. As for the latest investment figures, the Ministry of Finance were content with the statement that the Reserve Bank of India's latest published data were for the year 1973. In the absence of the relevant and up-to-date data, the control that can be exercised on the operations of these companies can at best be illusory. Hence the Committee's distress at the complacent statement quoted at the outset.

2.25. The specific cases that have come before the Committee from time to time are examples of abuse by the foreign companies as a result of complacency on the part of the Ministry of Finance. In an earlier Report\* the Committee had pointed out the doubtful nature of scientific research in respect of which deductions in income tax assessments were claimed by a foreign company. The Committee had also occasion to comment† on an irregular deduction of over Rs. 6 crores on account of discount charges which could not really be related to the Indian business. In the present case of M/s. International Computers, the same sort of irregularity has come before the Committee in respect of interest charges allowed without enquiring about their relation to the Indian business. In their earlier Reports@ the Committee drew attention to an almost total lack of control both by the taxation authorities, as well as the Reserve Bank of India about the claims made by these companies in respect of Head Office expenses. As a result of the Committee's enquiries, it has now been reported that that past assessments in a very large number of cases have been re-opened involving amounts in crores of rupees. It has also been reported that amendments to the law have been made and suitable executive instructions have been issued on the subject of Head Office expenses. The Committee are, however, constrained to note that apart from reacting to the specific irregularities pointed out by

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\*c.f. Para 1.31 of 187th Report (5th Lok Sabha)

†c.f. Para 1.124 of 28th Report (6th Lok Sabha)

@c.f. Para 9.13 of 176th Report (5th Lok Sabha) Para 9.31 of 187th Report (5th Lok Sabha) and Para 1.31 of 28th Report (6th Lok Sabha)

Audit or by the Committee there is little evidence of the Ministry itself showing the necessary initiative in these matters.

2.26. In para 1.55 of their 56th Report (Fourth Lok Sabha) the Committee had given expression to their impression that the mal-practices of over-invoicing and under-invoicing of exports and imports had not been effectively checked. On the Committee's suggestion, Government had appointed a Study Team on leakage of foreign exchange through invoice manipulation. The recommendation of this Study Team resulted in a number of amendments to the Foreign Exchange Regulation Act, and the allied legislation. The effect of these amendments is not known and the problems, like transfer-pricing, still continue to defy solution, as admitted by the Finance Secretary in evidence.

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2.30. A reference was made during evidence to the attempted evolution of a Code of Conduct for the transnational corporations by Expert Committee of the United Nations. While the Committee welcome this development they would like to emphasise that no such Code can be a substitute for our own effort. It is important that compliance with our laws, rules and procedures by these foreign companies is ensured by our own enforcement agencies and the laws, rules and procedures themselves are constantly reviewed and kept in tune with our pronounced policies and national objectives. The Committee would strongly recommend creation of a separate Cell preferably within the Ministry of Finance in respect of the work of regulating the foreign capital in this country. This focal point should oversee and collate the activities of all the enforcement agencies, collect relevant authentic and up-to-date data and other management information and analyse and interpret such data and such information and suggest remedial measures or modifications of the existing control systems, wherever found necessary. It is only then that the type of failure shown by the fact that despite the legal

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\*c.f. Para 9.14 of 176th Report (5th Lok Sabha)

@c.f. Para 1.25 of 192 Report (5th Lok Sabha)



requirement of the companies filing their annual accounts every year, the latest figures compiled by the Reserve Bank are stated to be upto the year 1973-74 only, can be remedied. The sectoral enforcement agencies in Taxation, in Industrial Licensing, in Reserve Bank etc. should all be fitted into this total frame-work..

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2.32. In particular, the Committee would like to be informed of the latest figures of the foreign investment together with its industry-wise break-up, the nature of the non-residential share holding. Such as cash contribution, bonus shares etc., the remittances made abroad by the foreign companies under different categories, together with their export earnings. The Committee would also like to be informed of the progress in respect of the re-opened assessments of all the foreign companies and the steps taken to ensure that all these companies are brought on the General Index Register and all of them file their income-tax returns.

NEW DELHI;  
 March 25, 1981  
 Chaitra 4, 1903 (S).

CHANDRAJIT YADAV,  
 Chairman,  
 Public Accounts Committee.

## APPENDIX I

*Details Regarding the 54 Assessments reopened consequent to the issue of instructions on Head Office Expenses in June 1975.*

S. No.	Name and particulars of the companies	Years for which assessments were reopened	Amount involved in each of the assessment years	Other main points due to which assessments were reopened.
1	2	3	4	5
			Rs.	
1	M/s. Grindlays Bank Ltd.	1966-67	33,49,146	(i) To disallow contribution to unrecognised Grindlays Superannuation fund.
2	"	1967-78	43,09,645	
3	"	1968-69	50,78,563	(ii) To disallow excessive depreciation claimed in respect of machinery
4	"	1969-70	58,24,836	
5	"	1970-71	78,41,375	
6	M/s. Cheseborough Ponds Inc., Greanwhich, Connection-U.S.A.	1970-71	18,023	(i) Manufacturing commission was sought to be disallowed.
	"	1971-72	14,160	
8	M/s. Comentation Co. Ltd.	1966-67	7,00,000	
9	"	1967-68	10,00,000	
10	"	1971-72	12,55,310	
11	"	1972-73	9,35,483	
12	M/s. Hindustan Petroleum Ltd. (formerly Esso Eastern Inc.)	1970-71	25,79,882	
13	M/s. United Artists Corpn. Co. A.F. Ferguson & Co. C.As. Bombay.	1970-71	5,19,230	Share of producer's shares should have been assessed in the hands of the assesses.

1	2	3	4	5
14	M/s. United Artists Corpn. C/o. A.C. Ferguson & Co. C As Bombay.	1971-72	Rs. 4,28,607	
15	M/s. May & Baker Ltd.	1966-67	Rs. 17,62,551	Profit and Loss account and B/s of India Branch was not filed even though maintained and assessments were completed applying Rule 10 the I. T. Rules. Hence, there was under assessment.
16	"	1967-68	Rs. 14,03,565	
17	"	1968-69	Rs. 8,81,876	
18	"	1969-70	Rs. 66,42,353	
19	"	1970-71	Rs. 62,50,390	
20	"	1971-72	Rs. 77,79,268	
21	M/s. Nicholas of India Ltd., C/o. M/s. H.B. Dhondy & Co. Ltd. Bombay.	1972-73	Rs. 53,599	
22	M/s. I.B. M. World Trade Corpn. New Delhi.	1965-66	Rs. 16,41,734	
23	"	1966-67	Rs. 19,46,338	
24	M/s. I.B.M. World Trade Corpn. New Delhi.	1967-68	Rs. 8,93,365	
25	"	1968-69	Rs. 11,12,489	
26	"	1969-70	Rs. 9,32,986	
27	"	1970-71	Rs. 3,34,373	
28	"	1971-72	Rs. 1,46,487	
29	"	1972-73	Rs. 11,24,196	
30	"	1973-74	Rs. 15,74,836	
31	M/s. B. I.C.S. Ltd.	1970-71	Rs. 1,39,549	
32	"	1972-73	Rs. 1,35,691	
33	M/s. Humphravs & Glasgow Over seas Ltd.	1967-68	Rs. 84,000	
34	"	1969-70	Rs. 1,08,000	
35	M/s. 20th Century Fox Int. Corpns, U.S.A.	1967-68	Rs. 1,12,087	
36	"	1968-69	Rs. 2,35,297	
37	M/s. Grant Advertisement International , U.S.A.	1967-68	Rs. 49,095	
38	"	1968-69	Rs. 36,172	

1	2	3	4	5
39	M/s. Get. B. & Co Inc. .	1967-68	Rs. 91,725	
40	„	1968-69	Rs.95,417	
41	M/s. Chicago Bridge & Iron Co. U.S.A.	1967-68	Rs.10,83,700	
42	„	1968-69	Rs. 77,782	
43	M/s. Universal Picture India P. Ltd. As agent to Uni - versal International Film Inc. U.S.A.	1967-68	Rs.10,38,710	
44	M/s. Metro Golden Mayer — India Ltd. U.S.A.	1967-68	Rs. 1,43,812	
45	M/s. Metro Golden Mayer India In. U.S.A.	1967-68	Rs. 1,02,187	
46	M/s. Vick s Products Inc. USA	1967-68	Rs.13,27,500	
47	„	1968-69	Rs. 7,31,015	
48	M/s. Consolidated Pneumatic Tools	1968-69	Rs 6,60,247	
49	„	1969-70	Rs 5,06,400	
50	„	1967-68	Rs 4,86,000	
51	M/s. Pears Leslie Co. Ltd.	1972-73	Rs. 20,727	
52	„	1973-74	Rs. 22,046	
53	M/s. May & Baker Ltd.	1965-66	Rs.14,11,825	
54	M/s. Universal Pictures India P. Ltd., as agents to Universal International Film Inc. U.S.A.	1971-72	Rs. 6,23,130	

**APPENDIX II**

*Details regarding Assessments where wrong Allowance was allowed and detected later on  
(Assessments reopened)*

S. No.	Name and particulars of companies	Years for which assessments were reopened	Amount involved in each assessment year
1	2	3	4
			Rs.
1	M/s. Hindustan Petroleum Corpn. Ltd. (formerly Easso Eastern Inc.)	1971-72	25,36,206
2	Do.	1972-73	14,98,379
3	Do	1973-74	11,52,464
4	Do.	1974-75	7,70,432
5	M/s. May & Baker Ltd.	1960-61	9,67,533
8	Do.	1961-62	21,37,050
7	Do.	1962-63	12,33,952
8	Do.	1963-64	24,68,332
9	Do <sup>o</sup>	1964-65	41,07,136
10	M/s <sup>o</sup> I.B.M. World Trade Corpn. New Delhi	1959-60	65,000
11	Do.	1960-61	85,770
12	Do.	1961-62	1,72,386
13	Do.	1962-63	2,53,993
14	Do <sup>o</sup>	1963-64	3,73,903
15	M/s. I.B.M. World Trade Corpn. New Delhi	1964-65	5,65,836
16	M/s. International Computers	1967-68	74,636
17	Do.	1968-69	98,553
18	Do.	1969-70	1,05,805
19	Do.	1970-71	51,945
20	Do.	1971-72	90,275
21	Do.	1972-73	41,422
22	Do.	1973-74	14,150
23	M/s. West Patent Press Co. Ltd. Panipat	1970-71	1,000
24	M/s. Nuvovo Pignon S..P.A. C/o P.S. Khurana & Co. CA Delhi	1975-76	2,80,000

## APPENDIX III

### *Conclusions/Recommendations*

Sl. No.	Para No. of the Report	Ministry/ Deptt. concerned	Conclusions/Recommendations
1	2	3	4
1	1.30	Finance (Deptt. of Revenue)	<p>The Committee are distressed that so soon after the case of erroneous allowance of head-office expenses in the Income-tax assessment of National and Grindlays Bank Ltd. and the IBM World Trade Corporation, commented upon by this Committee in their 176th and 187th Reports (5th Lok Sabha), another case has been brought to light in paragraph 26(ii) (a) of the Audit Report [Civil]—Direct Taxes] 1976-77 involving huge loss of revenue on account of incorrect deduction allowed as head-office expenses. They take a serious view of wrong deduction towards head-office expenses in the computation of business income of the U.K. based multi-national corporation—M/s. International Computers Ltd., expenses in the computation of business income of the U.K.-based cessing machines.</p>
2	1.31	-do-	<p>In this connection, the Committee note that during evidence in September, 1978, the representative of the Ministry of Finance Officer had admitted the claim of the foreign company. When the mistake on the part of the Income-tax Officer was pointed out by</p>

admitted before the Committee that the statements made by the foreign company, on the basis of which assessments were initially made, were "completely uncorroborated by any evidence", that these were not supported even by "a certificate from the London auditors" and that "there was over charge of head-office expenses". The Ministry of Finance have, however, submitted before the Committee that no action could be taken under Section 147(a) of the Income Tax Act 1961 to reopen the assessments in respect of the foreign company for the period 1961-62 to 1971-72 as, in the opinion of the Government, the Company had disclosed fully and truly all material facts necessary for assessment. The approximate loss of revenue on this account, according to the Ministry's own calculations works out to Rs. 38 lakhs. Since the mistake reveals palpable negligence on the part of the assessing and other supervisory officers resulting in a sizeable loss of revenue, the Committee recommend that the responsibility therefor should be fixed on the officers concerned and appropriate action should be taken against those responsible.

3 . 1.32 Finance (Deptt. of Revenue)

The Committee would, in this connection, invite attention to the Income-tax assessment of IBM World Trade Corporation, examined and commented upon by this Committee in their 187th Report (5th Lok Sabha). In the said report it was pointed out that this Company had furnished to the Income-tax Officer similar information in regard to head-office expenses and the Income-tax

Audit and the Public Accounts Committee, the past assessments in respect of this company were re-opened under section 147 (a) of the Income-tax Act, 1961. The latest reply of the Ministry giving the reasons for re-opening the assessments in the case of IBM World Trading Corporation also acknowledges that in the case of IBM itself, the question involved was similar to the present case (International Computers) namely, the basis on which the Head Office Expenses were apportioned as deductible against Indian Income. The Committee are, therefore, unable to appreciate the inconsistent view being canvassed by the Ministry that it is not possible to re-open the past assessments in the case of International Computers Ltd., having re-opened assessments under section 147 (a) in the case of IBM under identical circumstances as mentioned above.

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The Committee observe in this connection that Inspecting Assistant Commissioner (Audit) had communicated, *vide* his letter dated 29 August, 1977 to the Inspecting Assistant Commissioner of the Range concerned the approval of the Commissioner of Income Tax for re-opening of the assessments for the years 1961-62 to 1972-73 under Section 147(a) of the Income Tax Act for wrong allowance of Head Office expenses. The Committee find it baffling as to why no action on the lines suggested by the Commissioner was taken by the Commissioner incharge of the Range. It seems that the Ministry's view that the old assessments could not be re-opened Income-tax officer had thus in any case made an error by not disallowing the interest charges included in the head office expenses. The



under Section 147(a) on the ground of excessive allowance of Head Office expenses, is a belated attempt to justify the culpable inaction on the part of the Inspecting Assistant Commissioner concerned. The causes for inaction on the part of the Inspecting Assistant Commissioner concerned despite the clear direction of the Commissioner need to be thoroughly investigated especially with a view to finding out whether it was *inter alia* due to any undue influence on the part of the multi-national corporation.

5 1.34 Finance (Deptt. of Revenue)

It was admitted before the Committee that the foreign company had not hired out any new machines to its Indian subsidiary after the assessment year 1968-69 and that its business income in India from the year 1969-70 onwards had arisen out of the existing machines already on hire in India. Yet, the Committee find that during the period 1969-70 to 1974-75, a sum of Rs. 8.76 lakhs being the interest paid on loans raised by such foreign company has been included in the head office expenses and allowed as a deduction against Indian Income. Obviously, the loans raised by the company after 1968-69 were for the company's world wide business activities and could not at all be related to the Indian Income. Interest expenditure incurred by the head office, if directly related to the Indian business on revenue account would be a direct deductible expenditure in its entirety. Head office expenses are, in fact, only those expenses which are incurred for composite business as such and, therefore, incapable of deduction without apportionment. The

unjustified allowance of interest, deprived the revenue of tax to the extent of Rs. 6.20 lakhs. The Committee consider this as one more instance of negligence on the part of the assessing authorities which needs to be enquired into.

The Committee would like the Ministry of Finance to take suitable remedial action to recover the tax due from the assessee on this account under intimation to the Committee. The question of issuing suitable instructions for future guidance may also be taken up.

6 1.35 Finance (Deptt. of Revenue)

Considering the nature, gravity and number of errors both of commission and omission noticed in this case, the Committee would urge that this case should be investigated thoroughly by the Special Cell of the Directorate of Inspection (Investigation) in conjunction with the other cases like that of the IBM World Trade Corporation. The Committee would like to be informed of the results of such investigations.

7 1.36 Do.

The Ministry had informed the Committee that the assessments for the years 1972-73, 1973-74 and 1974-75 have been re-opened under Section 147(b) of the Income Tax Act taking the audit objection as 'information' referred to in that Section. At a subsequent stage, the Committee were informed that the assessments for the years 1966-67 to 1974-75 have been re-opened under Section 147(a) on the ground of omission on the part of the assessee to disclose the income on account of sale of scrap, and that opportunity

has been taken to add back excess amounts allowed as Head Office Expenses. The Committee also learn that on appeal by the assessee Company against re-assessments for the years 1972-73, 1973-74 and 1974-75, the CIT (Appeals) has deleted the amount added back on account of Head Office Expenses and that second appeals against the order of the CIT (Appeals) in this case have been filed before the Income Tax Appellate Tribunal on 15-12-1980 for assessment years 1972-73 to 1976-77.

8 1.37 Finance (Deptt. of Revenue)

The Committee note the view expressed during evidence that there was divergence of opinion among various High Courts on the question whether, on re-opening an assessment under Section 147 (a), the ITO, has the power to bring to charge also other items falling under Section 147 (b) irrespective of the fact that the period of limitation laid down in Section 147 (b) has expired. The Committee would suggest that in such cases where there is divergence of opinion among different High Courts, the matter should be taken directly to the Supreme Court for determination of the issues and attempts made by the Government for expeditious disposal to avoid harassment both to the assessee and to the department.

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9 2.21 Do.

The Committee are distressed to note the extent of complacency denoted by the statement made by the representative of the Ministry while giving evidence that 'on the whole our impression

is that multi-national companies have been kept under sufficient control'. It is well known that the multi-national companies or their principals command large resources which are ruthlessly deployed by them the world over with the sole purpose of maximising profits either in violation or skillful avoidance of the laws, rules and regulations of the host countries particularly the developing countries. It is also a fact that they adopt dubious means to avoid local taxes, they also use lavish hospitality, monetary inducements and pay-offs to persons holding positions of authority with a view to subjugating the will of the poorer countries not even stopping short of subverting their sovereignty.

10                    2.22    Finance (Deptt. of Revenue)

Two fold justification has been advanced for the operation of multi-national companies viz., the necessity for import of sophisticated technology and (ii) conservation of foreign exchange resources through the building up of export potential. In actual fact, it is a matter of common knowledge that several foreign companies are engaged in manufacturing highly lucrative and non-essential consumer goods for which their vast propaganda machine is able to build up ready and sheltered markets rather than in goods and industries requiring sophisticated technology. In their earlier reports, the Committee have had occasion to point out specific cases where the so called import of technology was of a highly dubious nature. For example in their report on operation of the IBM World Trade Corporation, the Committee had pointed out how stale and third-rate technology was actually imported into this country. In another Report the Committee had emphasised the need for a review of the

technical collaboration agreements so as to ensure that the import of technology was consistent with our needs as gauged by the development of indigenous know-how.

11 2.23 Finance (Deptt. of Revenue)

As for the second limb of the basic justification, i.e. the building up of export potential, it has been admitted in evidence that during 1975-76 there was an outflow of foreign exchange of over Rs. 95 crores on account of profits/dividends, technical fees and interest payments alone. If account is also taken of the import of raw materials and equipment it remains a matter for inquiry as to whether the working of these companies had contributed at all to the conservation of foreign exchange resources of the country.

12 2.24 Do.

The Ministry of Finance have stated that the total foreign investment increased from Rs. 894 crores in 1964 to Rs. ~~1757~~ <sup>1943</sup> crores in 1974, showing a growth of 117 per cent over the 10-year period. As for the latest investment figures the Ministry of Finance were content with the statement that the Reserve Bank of India's latest published data were for the year 1973. In the absence of the relevant and up-to-date data, the control that can be exercised on the operations of these companies can at best be illusory. Hence the Committee's distress at the complacent statement quoted at the outset.

13 2.25 Do.

The specific cases that have come before the Committee from time to time are examples of abuse by the foreign companies as a

result of complacency on the part of the Ministry of Finance. In an earlier Report the Committee had pointed out the doubtful nature of scientific research in respect of which deductions in income tax assessments were claimed by a foreign company. The Committee had also occasion to comment on an irregular deduction of over Rs. 6 crores on account of discount charges which could not really be related to the Indian business. In the present case of M/s. International Computers, the same sort of irregularity has come before the Committee in respect of interest charges allowed without enquiring about their relation to the Indian business. In their earlier Reports the Committee drew attention to an almost total lack of control both by the taxation authorities, as well as the Reserve Bank of India about the claims made by these companies in respect of Head Office expenses. As a result of the Committee's enquiries, it has now been reported that past assessments in a very large number of cases have been re-opened involving amounts in crores of rupees. It has also been reported that amendments to the law have been made and suitable executive instructions have been issued on the subject of Head Office expenses. The Committee are, however, constrained to note that apart from reacting to the specific irregularities pointed out by Audit or by the Committee there is little evidence of the Ministry itself showing the necessary initiative in these matters.

14 2.26 Finance (Deptt. of Revenue

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imports had not been effectively checked. On the Committee's suggestion, Government had appointed a Study Team on leakage of foreign exchange through invoice manipulation. The recommendation of this Study Team resulted in a number of amendments to the Foreign Exchange Regulation Act, and the allied legislation. The effect of these amendments is not known and the problems, like transfer-pricing, still continue to defy solution, as admitted by the Finance Secretary in evidence.

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18 2.30 do.

gulating the foreign capital in this country. This focal point should oversee and collate the activities of all the enforcement agencies, collect relevant authentic and upto-date data and other management information and analyse and interpret such data and such information and suggest remedial measures or modifications of the existing control systems, wherever found necessary. It is only then that the type of failure shown by the fact that despite the legal requirement of the companies filing their annual accounts every year, the latest figures compiled by the Reserve Bank are stated to be upto the year 1973-74 only, can be remedied. The sectoral enforcement agencies in Taxation, in Industrial Licensing, in Reserve Bank etc. should all be fitted into this total frame-work.

19 2.31 Finance (Deptt. of Revenue)

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Within the Revenue Department again the role of Foreign Tax Division, as well as the Special Cell needs to be enlarged as well as streamlined. While the former should initiate the studies and provide active guidance to the field units, the latter should carry out investigations into at least the bigger cases of tax assessment of foreign companies with a view to providing necessary information to the assessing authorities on the one hand and the Foreign Tax Division on the other.

20 2.32 Do.

In particular, the Committee would like to be informed of the latest figures of the foreign investment together with its industry-wise break-up, the nature of the non-residential share holding, such as cash contribution, bonus shares etc., the remittances made abroad

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