P. A.C. No. 621

PUBLIC ACCOUNTS COMMITTEE (1977-78)

(SIXTH LOK SABHA)

SEVENTY-SEVENTH REPORT

DIRECT TAXES

MINISTRY OF FINANCE

(DEPARTMENT OF REVENUE)

[Paragraphs relating to Direct Taxes, included in the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II]

Presented in Lok Sabha on 25-4-1978
Laid in Rajya Sabha on 25-4-1978

LOK SABHA SECRETARIAT
NEW DELHI

April, 1978/Vaisakha, 1900 (Saka)
Price : Rs. 3.60

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58	4.16	3	not	note
62	4.26	2	upquoted.	unquoted
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63	4.27	8	After 'they', insert 'were'	
66	-	15	their	then
67	-	18	a	the
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1-2-1978 (FN)

2-2-1978 (AN)

3-2-1978 (FN)

4-2-1978 (FN)

19-4-1978 (AN)

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(1977-78)

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3. Shri Bipin Behari—*Senior Financial Committee Officer.*

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INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Seventy-Seventh Report of the Public Accounts Committee (Sixth Lok Sabha) on paragraphs relating to Direct Taxes included in the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II.

2. The Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, was laid on the Table of the House on 13 June, 1977. The Public Accounts Committee (1977-78) examined the paragraphs relating to Direct Taxes at their sittings held from 1 to 4 February, 1978. The Public Accounts Committee (1977-78) considered and finalised this Report at their sitting held on 19 April, 1978.

3. A statement containing conclusions/recommendations of the Committee is appended to this Report (Appendix II). For facility of reference these have been printed in thick type in the body of the Report.

4. The Committee place on record their appreciation of the assistance rendered to them in the examination of these paragraphs by the Comptroller & Auditor General of India.

5. 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;
April 24, 1978.
Vaisakha 4, 1900 (*S*).

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

CHAPTER I

IRREGULAR ALLOWANCE OF RELIEF IN RESPECT OF NEW INDUSTRIAL UNDERTAKINGS

1.1. Under Section 80J of the Income-tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from a new industrial undertaking, the assessee becomes entitled to a tax relief in respect of such profits and gains upto six per cent per annum of the capital employed in the undertaking, in the assessment year in which the industrial undertaking begins to manufacture or produce articles and also in each of the four assessment years immediately succeeding.

* * * * *

1.2. In a case where there is unabsorbed depreciation or loss in the new industrial unit in an earlier year, the depreciation and the loss have to be carried forward and set off against the profits and gains of the unit in the subsequent years before determining if any deduction is allowable towardds tax free profits.

* * * * *

1.3. In another case, a newly established industrial undertaking of an assessee-company commenced its business in the assessment year 1965-66. The unit was entitled to the six per cent tax holiday for the assessment years 1965-66 to 1969-70. The unit did not, however, record any profits or gains for these assessment years. While the relief due for the assessment years 1965-66 and 1966-67 could not be carried forward for adjustment under the law then prevailing, the relief due for the years 1967-68 to 1969-70 was eligible for carry forward and set off against the profits of the new industrial undertaking upto the assessment year 1972-73. This deficiency towards 80J relief aggregating Rs. 2,60,09,763 was set off by the Department in the assessment year 1971-72. This was irregular as the new industrial unit made a profit of Rs. 3,32,62,015 only in the assessment year 1971-72 while the unabsorbed depreciation and development rebate, computed on the basis of the working results of the unit, stood at Rs. 5,42,86,431 which had first to be set off. After this set off, there would be no profit left to adjust the deficiency on account of the 6 per cent tax holiday. As the Department allowed the relief of Rs. 2,60,09,763 incorrectly in computing the total income of the assessee which was a positive figure including income from other sources, there was undercharge of tax of Rs. 1,43,05,370 in the assessment year 1971-72.

1.4. The Department of Revenue and Banking have stated that the assessment was made in this case on the basis of Law Ministry's advice on the point. Subsequently, on the basis of an audit objection in another case, the Board had reconsidered the entire issue and issued general instructions in March, 1976 in accordance with the audit view. They have added that the reopening of the assessment in this case in the light of the subsequent instructions would create several complications.

[Paragraph 30(ii)(b) of the Report of the Comptroller & Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes.]

1.5. The Audit paragraph has brought to light a case where an erroneous concession by way of an inadmissible tax holiday relief was allowed to a paper mill company (Orient Paper Mill), a company belonging to the Birla Group, during the assessment year 1971-72 resulting in an under charge of tax to the tune of Rs. 1.43 crores.

1.6. Orient Paper Mills Ltd. owns two paper mills—one at Brajrajnagar (Orissa) which went into production in 1939 and the other at Amlai (Madhya Pradesh) which started manufacture in February, 1965.

1.7. The examination of this case is dependent on the intention and scope of Section 80-J of the Income Tax Act, 1961. There have been three important judicial pronouncements on this. These are:—

(i) Judgement of Madras High Court in Ashoka Motors Ltd. *Vs.* C. I. T. Madras (41 ITR 397).

(2) Judgement of Madras High Court in Rajapalayam Mills Ltd. (78 ITR 677).

(3) Judgement of Punjab and Haryana High Court CIT. Patiala *Vs.* the Patiala Flour Mills Co. (P) Ltd., Patiala (I.T.R. 16 of 1974).

Legal Provisions

1.8. Section 15 (c) of the Income-tax Act 1922 had stipulated that:—

"Save as otherwise hereinafter provided, the tax shall not be payable by an assessee on so much of the profits or gains derived from any industrial undertaking (or hotel) to which this section applies as do not exceed six per cent per annum on the capital employed in the undertaking (or hotel), computed in accordance with such rules as may be made in this behalf by the Central Board of Revenue."

1.9. Section 80J (1) of the Income-tax Act, 1961, reads as under:—

"Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking or a ship or the business of a hotel, to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains (reduced by the aggregate of the deductions, if any, admissible to the assessee under Sec. 84H) of so much of the amount thereof as does not exceed the amount calculated at the rate of six per cent per annum on the capital employed in the industrial undertaking or ship or business of the hotel, as the case may be, computed in the prescribed manner, in respect of the previous year relevent to the assessment year (the amount calculated as aforesaid being hereafter, in this section, referred to as the relevant amount of capital employed during the previous year)."

Judicial Pronouncements

(i) *Ashoka Motors Ltd.*

1.10. On 4th October, 1960 the Madras High Court in the case of Ashoka Motors Ltd. *Vs.* C. I. T. Madras (41-ITR-397) held as under:—

"The object of this section (15C of Income Tax Act, 1922) is obviously to encourage new industrial undertaking by providing that a certain part of the income should be exempt from tax. The exemption is made available for a period of five years from the commencement of the working of the industrial undertaking. The scope of the exemption appears to be perfectly clear; the section states that where any profits or gains are derived from any industrial undertaking, that portion of it to the extent of six per cent on the capital employed in the undertaking shall be exempt from tax. Firstly, the profit in question must be derived from the industrial undertaking, and secondly, the maximum limit of the exemption is also provided. It is, thus, clear that before an assessee can be eligible for any exemption, there should be profits. If there are no profits, no question of granting the exemption arises. It is equally clear that the profit in respect of which any exemption is available should be derived from the undertaking.

Clearly, therefore, a distinction is made between an assessee and the industrial undertaking. It is the assessee that is granted the exemption on the profits or gains derived by him. It is not the industrial undertaking which is granted the exemption treat-

ing such industrial undertaking as a separate unit of assessment. The object of granting this exemption is to encourage the establishment of new industrial undertakings. That would be wholly defeated if the exemption is to be granted in respect of the profits derived from business of other kinds even though the same assessee conducts such business side by side with the industrial undertaking. The conclusion is irresistable that in this case of even such composite business carried on by the assessee, it is only the profits of the industrial undertaking that would be eligible for exemption."

(ii) *Rajapalayam Case*

1.11. The Madras High Court had, in the case of Rajapalayam Mills Ltd. (78 ITR, p. 677) examined the scope of the exemption under the erstwhile section 15C and held that unless a profit was disclosed in a particular year by the new industrial undertaking after setting off all past losses of the undertaking, the relief contemplated in section 15C would not be availed of. In their Judgement dated 3rd January, 1970, the Madras High Court observed as under:—

"Section 15C speaks of profits or gains derived by the industrial establishment and not the assessee. A clear cut dichotomy is maintained between the status of an assessee and that of a newly established industrial undertaking ushered in by the assessee. The assessee is different from the new undertaking. The profits and gains derived from an assessee is different and differently treated under section 15C from that of the new industrial undertaking. Such segmentation which is projected in the section postulates a differential treatment between the parent assessee and the new born undertaking. The former's tax affairs, therefore, cannot be slided into that of the latter for the latter to gain the statutory exemption under section 15C. Under the mechanics of the section, the fiscal individuality of the new undertaking is maintained and it acts on its own without reference to the assessee and its composite trading activity, though such an assimilation is allowed generally under the tax laws for the computation of the totality of the assessable income of the assessee. Thus interpreted, Section 15C is self-active and the undertaking gains or fails to avail the exemption according to its earning a profit or otherwise, on its own without reference to the assessee."

(iii) *Ministry of Law's Advice of* 1973

1.12. On 19th May, 1973, the Central Board of Direct Taxes referred to the Ministry of Law for advice the case of Tribeni Tissues Ltd. This

case was of a similar nature as decided by the Madras High Court (Rajapalayam case). While submitting the statement of facts of Tribeni, the Central Board of Direct Taxes, concluded that:—

"For purpose of deduction under Chapter VIA, section 80B(5) defines 'gross total income' as the total income computed in accordance with the provisions of the Income-tax Act, 1961 before making any deduction under the said Chapter or under section 280-O. It will be seen that the scope of section 80J (1) is much wider than section 15C of the Indian Income-tax Act 1922 and is also substantially different from the scheme of section 15C of the Act of 1922. This definition needs to be emphasised in the light of the case of Rajapalayam Mills Ltd., quoted above, wherein the scope of exemption under Section 15C of the Income-tax Act, 1922 has been considered. In that case the Madras High Court had held that unless there was a profit disclosed by the industrial undertaking after setting off all past losses etc. the relief contemplated in section 15C cannot be availed of. The decision of the Madras High Court cannot be applied while considering a claim under section 80J of the Income-tax Act, 1961. Section 80J talks of "gross total income" of an assessee, whereas section 15C restricted the "profits or gains derived from any industrial undertaking". In view thereof, if in any year the new industrial undertaking has disclosed profit the deduction contemplated under section 80J will be available and there does not appear to be any warrant to say that such a deduction can be allowed only if there is a profit in respect of the new industrial undertaking after setting off earlier years' losses, unabsorbed depreciation and/or development rebate reserve though these have already been set off against income of existing units in the relevant assessment years. If a loss, depreciation and/or development rebate relating to the new industrial undertaking have been set off against income from other existing years in the relevant accounting years, they do not survive for consideration in subsequent years.

The Madras High Court's decision lays down that for purposes of relief under section 15C, the income of a unit has to be taken in isolation from other incomes and the relief allowed after set off of all the depreciation and development rebate of the unit brought forward from earlier years against the income of that unit alone, even though as a matter of fact, it has been set off against income from other sources. The provisions of section 80J are different in terms in comparison to section 15C of the Indian Income-tax Act, 1922. In view thereof, the

assessee company is entitled to the relief under section 80J for assessment year 1972-73."

1.13. Agreeing with the aforesaid conclusions drawn by the Central Board of Direct Taxes, the Additional Legal Adviser, Ministry of Law, opined in a note dated 12th June, 1973 as follows:—

"Section 15C of the Income-tax Act, 1922 provides that tax shall not be payable on so much of the profits or gains derived from an industrial undertaking...... In order to arrive at the profits on which income tax is payable one has to arrive at the assessable profits.

Section 80J, however, says that if the gross total income of an assessee includes profits from an industrial undertaking, then, deduction shall be allowed upto six per cent of the capital employed in such industrial undertaking. In other words, section 80J does not refer to assessable profits of such an undertaking. What all is required under that section is that the industrial undertaking should make profits and gains in the relevant year. In view thereof I agree with the conclusions drawn in the preceding note.

I mentioned this case to J. S. (A) who agreed with my above views."

(iv) *Patiala Flour Mills Co. (Pvt.) Ltd. case*

1.14. On 28th October, 1976, the Punjab and Haryana High Court delivered a judgement in the Patiala Flour Mills Co. (P) Ltd. (ITR 16 of 1974). The facts of this case are that this assessee carried on several businesses, amongst which was a cold storage business, a new industrial undertaking within the meaning of section 80-J of the Income Tax Act, 1961. It was put up in the accounting year corresponding to the assessment year 1967-68. The company did not make any profit in the Cold Storage business though it did in its other business. The losses, the unabsorbed depreciation and the unabsorbed development rebate attributable to the Cold Storage business during the Assessment Year 1967-68, 1968-69 and 1969-70, were adjusted against the profits of the other business while computing the total income of the assessee for those years. There was no loss, depreciation or development rebate which had remained unadjusted and which was available for adjustment during the assessment year 1970-71. For the assessment year 1970-71 there was a profit of Rs. 1,51,011 from the Cold Storage business. The assessee wanted to adjust the profit against this 'deficiency' under Section 80J of the Income-tax Act for the year 1970-71 and against the 'deficiency' of the earlier years permitted to be

carried forward under section 80J(3). The Department contended that as the losses, depreciation and development rebate of earlier years pertaining to Cold Storage business had already been adjusted in computing the total income of the assessee for those years, such losses, depreciation and development rebate of earlier years should once again be adjusted against the profits of the Cold Storage business for the assessment year 1970-71, not for all purposes but for the very limited purpose of arriving at the conclusion that there were no profits and gains from the Cold Storage business against which, the 'deficiency' under section 80J could be claimed. According to the Revenue Department for the purpose of computing the total income of the assessee for the year 1970-71, the profits and gains from the cold storage business was to be taken as Rs. 1,51,011 and included in the total income but for the purpose of Section 80J, the profits and gains of the Cold Storage business was to be treated as a loss so as to deprive the assessee of the benefit of the 'deficiency'. In other words, the whole of Rs. 1,51,011 was to be included in computing the total income without any deduction for 'deficiency'.

1.15. In their judgement delivered on 28th October, 1976, Punjab and Haryana Hihg Court, (C.I.T. Patiala *Vs.* Patiala Flour Mills, Patiala I.T. (Reference 16 of 1974) had ruled that:—

> "The Tribunal rightly in our opinion, did not accept the contention of the Department...... There is nothing in the language of Section 80J to warrant the contention of the department. It appears to be opposed to the language of section 80J. Having included a sum of Rs. 1,51,011 from the profits and gains of the Cold Storage business in the total income of the assessee, we do not see how the Revenue can urge that it should not be considered as included in the total income for the purposes of Section 80J only."

1.16. The view of the law pronounced in the case of Ashoka Motors Ltd. *Vs.* C.I.T. Madras (41 ITR 397) on 4th October, 1960 was reiterated by the Madras High Court in the case of Rajapalayam case (78 ITR 677) in their Judgement on 3rd January, 1970.

1.17. The following sequence of events is discernible in the case of Orient Paper Mills:

(1) On 9-10-1972, Orient Paper Mills addressed a letter to the Chairman, Central Board of Direct Taxes requesting that necessary instructions may be issued to the Commissioner of Income-tax, West Bengal I to instruct the I.T.O. to issue certificates under Section 197(3) that the Dividend declared by the company for the years ended 31-3-71 and 31-3-72 amounting to

Rs. 56,63,268 and Rs. 89,08,109 respectively is exempt from tax. According to the company whereas the I.T.O. was of the view that the principles laid down by the Madras High Court in the case of Rajapalayam Mills Ltd. *Vs.* CIT Madras (78 ITR 677) were applicable in their case, as per the opinion of their legal advisers the principles enunciated by the Court in the Rajapalayam Mills case were not applicable in their case. To support their claim, the company furnished a copy of the opinion given by a retired Chief Justice of India according to which the principles in the Rajapalayam Mills were not applicable in their case. On 25-6-73 and 7-9-73 the company sent reminders to the Board about their case.

(2) On 11-12-1972, the Commissioner of Income Tax, West Bengal-III referred the case of Tribeni Tissues Ltd. and sought opinion of the Board on correct interpretation of Section 80J and 80K. The Commissioner's own view on this matter was that as section 80J of the new Act was substantially different from the Section of Section 15C of the old Act, the decision taken in 78 ITR 677* can have no application. The Commissioner opined that "There is no scope for the ITO to recompute the profit of the new undertaking as a separate unit, as laid down in 78 ITR 677* in connection with the interpretation of Section 15C of the old Act.

On 18-12-1972 CIT. West Bengal furnished a report on Orient Paper Mills in which it *inter alia* stated:

(3) Recently, C.I.T., West Bengal-III has sought for the instruction of the Board about the applicability of the principles laid down in Rajapalayam Ltd. case under his letter No. 14048/Asstt./61—98/72-73 dated 11-12-72 in the case of Tribeni Tissues Ltd. in which a similar question arose. In the circumstances, no separate discussion is being made by me on this point. Board's decision in the case of Tribeni Ltd. will be applied in all the cases of similar type."

(4) On 12-6-1973, the Central Board of Direct Taxes obtained the advice of the Law Ministry in the case of Tribeni Tissues Ltd. wherein they expressed the view that decision of Madras High Court in Rajapalayam case was no longer valid as provisions of Section 80J of the Income Tax Act, 1961 were different in terms in comparison to section 15C of the Income Tax Act, 1922.

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*Rajapalayam Case.

(5) M/s. Tribeni Tissues Ltd. and M/s. Orient Paper Mills Ltd. were asked by the Board on 19-6-1973 and September 1973 respectively to contact the Commissioners of Income Tax concerned. Communications issued to these companies were endorsed to the Commissioner of Income Tax West Bengal-I and III enclosing thereto a copy of the aforesaid advice given by the Ministry of Law. Based on this advice, the Income Tax Officer completed the assessment of M/s. Orient Paper Mills Ltd. for the assessment year 1971-72 on 7-3-1974.

(6) A new unit belonging to Alembic Glass Works Ltd. started production in the previous year relevant to the assessment year 1967-68. Relief under Section 80-J was allowed by the Department to that unit from assessment year 1967-68 onwards. In this case too, Rajapalayam case was not applied. Audit, therefore, objected to that assessment in paragraph 19(ii)(a) of the 1973-74 Report on Direct Taxes and pointed out that the consensus of judicial opinion led to the following guidelines:

"(1) in the case of any assessee managing more than one industrial undertaking, each undertaking should be treated separately for the purpose of relief under section 80-J, separate records of depreciation, development rebate and losses brought forward being maintained;

(2) the profits and gains of the new units should be computed in the normal manner by applying sections 28 to 43 for allowance of relief under the section;

(3) where there is unabsorbed depreciation and loss in the new undertaking carried forward from earlier years, the depreciation and loss will have to be set off before determining the extent of deduction that can be allowed in the assessment year. It is thus established that a notional assessment to determine the relief admissible under section 80-J to a new unit has to be carried out."

Thereupon, the Ministry re-examined the issues involved and decided on 21-2-1975 to accept the audit objection. Following the acceptance of audit objection in the case of Alembic Glass Co.; the Board issued a circular on 4-3-1976 (Appendix....) to all the Commissioners to follow the Rajapalayam case.

(7) Audit Memo, on Orient Paper Mills was received by the I.T.O. dealing with the case in the Calcutta Central Commission's charge on 5-4-1975. Local Audit Report was received by him on 11-9-1975.

(8) Draft Audit para (on Orient Paper Mills) was received by Board on 16-8-1976 with C&AG's letter No. 2078-Receipt A-II|2|76—I dated 11-8-1976.

(9) Judgement of the Punjab and Haryana High Court was delivered on 28-10-1976. This Judgement vindicated the advice given by the Ministry of Law in 1973 in the case of M/s. Tribeni Tissues Ltd. on the basis of which the assesments in respect of M/s. Orient Paper Mills and M/s. Tribeni Tissues were decided.

(10) Letter sent to Director, Receipt Audit regarding the audit objection in the case of Orient Paper Mills on 25-11-1976 stating that re-opening of the assessment would create several complications."

(11) Notice dated 28-9-1977 under Section 154 was sent to Orient Paper Mills Ltd. for rectification of its assessment for 1971-72 on the basis of the audit objection.

(12) Petition was filed on behalf of Orient Paper Mills Ltd. on 7-10-1977 before the Calcutta High Court, seeking injunction against the proceedings under section 154. The High Court has granted temporary injunction directing the ITO to pass the rectification order but not to communicate the same or enforce the demand.

(13) Department's special leave Petition against the judgement of Punjab and Haryana High Court was admitted by the Supreme Court on 5-10-1977. Department has requested the Central Agency to move the Supreme Court for consolidation of the hearing in the appeal filed by the Department against the Judgment of Punjab and Haryana High Court with the appeal of the company against applying in this case the Madras High Court decision in Rajapalayam case (The case is scheduled to be heard on 10-4-1978).

1.18. The Committee desired to know if the way these cases were handled by the Department from time to time did not give the impression as if no clear criterion or procedure was adopted and the two streams of

activity were going on at the same time. In reply, the Finance Secretary, said in evidence that:

"I am afraid that the picture which you have painted is not strictly accurate that there were two simultaneous streams of action going on at the same time. If these two actions had been taken simultaneously, that is to say, if the Board had issued these instructions or the clarification based on the Law Ministry's advice to these two Commissioners covering these two cases and if it had simultaneously on contemporaneously issued a general circular to the Commission to follow the audit view, then, of course it would have been a thing which would smell very high. But it is not so. There is a sequence of events. One action was taken in 1973 and another in 1975."

1.19. Asked what was the loss of revenue involved in the case of Orient Paper Mills, the representative of the Department of Revenue said in evidence:

"If we take the worst view and assume that the department will not succeed in its appeal before the Tribunal, then the loss of revenue will be Rs. 21,26,347 by reason of the fact that the deficiency or shortfall in profits carried forward, amounting to Rs. 63,24,669 would lapse in that case. On the other hand, if we succeed fully before the Tribunal then the loss will diminish to Rs. 4,95,449 because the deficiency that would lapse in that case would be only Rs. 34,41,335. It is not Rs. 1 crore-odd as the Audit Report makes it appear. It is much less."

1.20. When it was pointed out that even on the basis of what the witness had stated, the net relief, in this case, would come to Rs. 96,17,427, the witness said:

"We are open to correction. Whatever the figures are, they will speak for figures are, they will speak for themselves. There is no dispute about figures. The dispute is on interpretation of law."

1.21. The Committee enquired if the tax holiday concession was admissible only to the profits and gains of the new undertakings and not to all undertakings of the assessees taken together, and if so would it not follow that the carried forward depreciation, development rebate losses of the new

undertaking had to be kept distinct and taken into account in computing profits. In reply the Department of Revenue have stated, in a note, that:

"This is the view of the Audit, which has been accepted by the Deptt. The issue is not, however, free from doubt as is seen from the judgement of the High Court of Punjab and Haryana mentioned above."

As regards dispute over interpretation of law, the witness said:

"The Law Ministry's advice is vindicated by the judgement of the Punjab and Haryana High Court which is contrary to the view taken by the Audit."

1.22. The Committee asked whether on the basis of Law Ministry's Advice in Tribeni Tissues Ltd. case the Central Board of Direct Taxes had issued any circular to the Commissioners all over India in 1973 to ensure that the law was applied uniformly in all cases. In reply, the representative of the Department of Revenue explained in evidence:

"We did not issue general instructions in 1973. The reason was that on the basis of an isolated stray case, we did not want to issue general instructions."

1.23. Asked to state as to why then a circular (Instruction No. 933) was issued by the Board subsequently on 4-3-1976 after the Alembic case advising the Commissioners to follow the Rajapalayam case, the witness explained:

"The matter took a different shape when the audit highlighted it and brought it to our notice. We thought that it was right for us to have uniformity in such cases."

1.24. The Finance Secretary explained during evidence:

"Frankly speaking, I feel that a general circular ought to have been issued at that time (1973) by the Board on the basis of Law Ministry's opinion but as things have turned out, it is perhaps fortunate that they did not issue that general circular because had they issued the general circular at that time, as you rightly say, the ITO all over the country including the ITOs in Tamil Nadu who were otherwise following the Rajapalayam case, would have followed this and so the non-issuance of a general circular at that time was beneficial to the Government and beneficial to the revenue."

1.25. The Committee wanted to know if it was a fact that the advice of Ministry of Law given in 1973 was conveyed only to the Commissioners of Income-tax, West Bengal and that the I.T.O. who made the assessment in the case of Orient Paper Mills in March 1974 was not aware of it, the representative of the Department replied in the affirmative.

1.26. As the original decision in the case of Tribeni Tissues Ltd. was based on the advice given by the Ministry of Law in June 1973, the Committee, desired to know if it was not desirable that while reconsidering the matter in the context of Alembic Glass Ltd., the Ministry of Law should have been consulted again by the Central Board of Direct Taxes especially when the view held by Audit was different from the advice given by the Ministry of Law. The Finance Secretary conceded in evidence:

> "In my personal opinion, they should have made a second reference to the Law Ministry."

1.27. The Committee enquired why contrary to the advice given by the Ministry of Law in Tribeni Tissues Ltd. on 12-6-1973, the Department accepted on 12-2-1975 an Audit objection (vide para 19(ii) of the C&AG for the year 1973-74) in the case of Alembic Glass Industries which obviously went against the advice of the Ministry of Law. The Department of Revenue have replied in a note that:

> "This advice was unfortunately overlooked when the decision to accept the Audit objection was taken on 12-2-1975."

1.28. When, however, similar objection (as was raised in the case of Alembic Glass Industries Ltd.) was raised by Audit in the case of Orient Paper Mills Ltd., the Department is stated to have informed Audit on 25-11-1976 that re-opening of the assessment in this case would create "several complications". During evidence, the representative of the Department of Revenue stated that one of the complications which the Department had in mind was that—

> "If we make a demand in 1971-72 assessment by withdrawing this benefit of Rs. 2.6 crores which the company would have got whatever be the tax effect, we may have to give the benefit in 1972-73 assessment simultaneously also."

1.29. Pointing to yet another complication involved in this case, the witness said in evidence:

> "The shareholders of the company were about 3,400 or so. They all got the benefit of what is called tax exemption or holiday under Section 80-K. They got the relief in 1971-72, 1972-73

and 1973-74. Is it worth while to start re-opening 3,400 assessments in order to withdraw the benefit in respect of any particular year even when the tax amount involved in many cases might not be much? But we have to go the whole hog. We cannot simply confine ourselves to past action, withdraw the benefit with a view to getting some revenue in the company's case. We have also to take action in the case of 3,400 shareholders whom we have to deprive of their proportionate share of this benefit. The game may not be worth the candle, if we take into account the time etc. entailed and the question of law that clouds the issue."

1.30. Since the so-called complications were apparently nothing but inevitable consequences of re-opening an assessment in company cases, the Committee asked whether it was the contention of the Department that the cases of big companies cannot be re-opened simply because a large number of shareholders had availed themselves of the benefit of Section 80-K of the Income-tax Act, 1961, the witness stated:

"I did not say that. We have already taken remedial action and we shall follow it up to its logical conclusion. These were the complications, we had in view."

1.31. Section 119(1) of the Income-tax Act, 1961, as it stood before 1-4-1971, provided that all officers and persons employed in the execution of the Income-tax Act shall observe and follow the orders, instructions and directions of the Board. Exception was made only in the case of Appellate Assistant Commissioners by providing that no orders or instructions shall be given so as to interfere with the discretion of Appellate Assistant Commissioners. By Act 42 of 1970, section 119 was amended with effect from 1st April, 1971 by which certain restriction was imposed on the powers of the Board to the effect that the Board shall not issue any order, instruction or direction so as to require any Income-tax authority to make a particular assessment, or to dispose of a particular case in a particular manner.

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

"The question of the Board's giving advance ruling had been raised before the various committees and commissions which inquired into direct tax administration. In this connection the Committee would refer to paragraph 6.179 of Direct Taxes Enquiry Committee's final report (December, 1971). It appears that unless the Board is authorised by law to give advance rulings

the Board should not give advance ruling. The Committee, therefore, desire that in order to place the matter on a legal footing necessary amendment to the law should be considered early."

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

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

1.34. The following instructions were issued by the Board on 22-11-1974:

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

1.35. The Committee enquired that if under the Income-tax Act, making an assessment was a statutory function of the I.T.O., why was he not allowed to exercise that function in the case of Orient Paper Mills. The Committee also desired to know whether it was legally correct for Central Board of Direct Taxes to have intervened in this case and directed that the case be assessed in a particular manner. In reply, the representative said in evidence:

"Till 1969, the Central Board of Direct Taxes could give direction in individual cases. Then the law was amended. Under the law as it stands at present, we cannot give relief in individual cases. Till 1976 whenever justified we used to give replies."

1.36. The Committee pointed out that unwarranted intervention by the Board had obviously added a new dimension to this case. Moreover, a ruling on a reference made by the I.T.O. or the Commissioner was understandable but what was not clear was why the Board had been entertaining references from private assessees as well. The Committee enquired if the number of cases where the Board had intervened in the past was quite large. In reply, the representative of the Board said in evidence;

"I would not say that advice was being given in a very large number of cases* * * *. On individual cases, I would not say. May be, in a year—I am subject to correction, I can check up that—in 100 or 200 cases on points of law the opinion of the Board was being given."

1.37. The Committee asked whether interference of the Board in Orient Paper Mills case in which huge amount of revenue was involved and thereby not allowing the I.T.O. concerned to assess independently the income of the company without any fear or favour could be regarded as a *bona fide* one, the witness deposed that:

"In retrospect we feel that we have done the right thing in not circulating that particular advice to all the Commissioners. The bonafides of the action could not be doubted for two reasons; one is that at that time there was an observation in a commentary by a well known commentator as far back as 1970 that the views were possible in this matter. Apart from this, the practice that was followed in different States was not uniform. In Calcutta, the Commissioner felt very strongly that the Rajapalayam case was not tenable at all; it had no validity at all. In the context of all this, we gave this advice...... There is no reason to believe at all that there was interference, that anything out of the way was done in this case."

1.38. It has been pointed out by Audit that an erroneous tax holiday relief allowed to Orient Paper Mills Ltd. in the assessment year 1971-72 under Section 80J of the Income Tax Act, 1961 has resulted in an undercharge of tax to the tune of 1.43 crores. The assessee company had established a new paper mill at Amlai (Madhya Pradesh) which went into production in February, 1965. The new unit was entitled to 6 per cent tax holiday for the assessment years 1965-66 to 1969-70. The unit did not, however,

record any profits or gains for these assessment years. By the Finance (No. 2) Act 1967, Sections 84 and 85 of the Income-tax Act, 1961 were deleted and new Sections 80J and 80K were inserted. Whereas under the former Sections 84, there was no provision for carrying forward the deficiency, the new Section 80J provided for carrying forward the deficiency from assessment year 1967-68 onwards. In view of this, in the present case, while the relief due for the assessment years 1965-66 and 1966-67 could not be carried forward for adjustment under the law their prevailing, the relief due for the years 1967-68 to 1969-70 was eligible for carry forward and set off against the profits of the new industrial undertaking upto the assessment year 1972-73. This deficiency aggregating Rs. 2.60 crores was set off by the Department in the assessment year 1971-72. As pointed out by Audit, this was irregular as the new unit at Amlai had made a profit of Rs. 3.32 crores in that assessment year while the unabsorbed depreciation and development rebate, computted on the basis of the working results of the unit, stood at Rs. 5.42 crores which had first to be set off. After this set off, there would be no profit left to adjust this deficiency. Though in their reply dated 25-11-1976, the Department of Revenue informed Audit that re-opening of the assessment of the assessee company would create "several complications": the Department later issued a Notice to the assesse company on 28-9-1977 under Section 154 of the Income-tax Act for rectification of its assessment for 1971-72 on the basis of the audit objection. On 7-10-1977, the assessee is stated to have filed a petition before the Calcutta High Court which was granted temporary injunction directing the Income Tax Officer to pass the rectification order but not to communicate the same or enforce the same. It is learnt that this matter is before the Supreme Court in appeals filed by the assessee in the Rajapalayam case and by the Department in the Patiala Flour Mills case. As a matter is sub judice, the Committee would not like to express any opinion on the merits of the case at this stage.

1.39. The Committee, however, cannot help expressing their dismay over the fact that the Department of Revenue had not been following a consistent course of action in handling cases of tax holiday under section 80J of the Income Tax Act, 1961. In their judgement delivered on 4-10-1960, the Madras High Court had in the case of Ashoka Motors Ltd. vs. C.I.T. Madras (41 ITR 397) referred to distinction between an 'assessee' and the 'new industrial undertaking' in Section 15 C of the Income-tax Act, 1922 (corresponding to Section 80-J of the Income Tax Act, 1961) and held that "in this case of even composite business carried on by the assessee, it is only the profits of the industrial undertaking that would be eligible for exemption". This decision was reiterated by Madras High Court in Rajapalayam case (78 ITR P 677). On 19-5-1973, the Department of Revenue (CBDT) made a reference to the Ministry of Law in the case of Tribeni Tissues Ltd. case.

While doing so, the Department expressed the view that the aforesaid decision of Madras High Court in Rajapalayam Case based, as it was, on Section 15C of the Income Tax Act, 1922 cannot be applied while considering a claim under section 80J of the Income-tax Act, 1961. The new Section, it was pointed out, was worded differently and referred to "gross total income" of an assessee, whereas old Section 15C had restricted the "profits or gains derived from any industrial undertaking". In their advice dated 12-6-1973, the Ministry of Law agreed with the view expressed by the Department of Revenue that Madras High Court Judgement in the Rajapalayam Case was no longer valid. Later, the Department of Revenue accepted on 12-2-1975 an objection raised by Audit in the Alembic Glass Industries Ltd. case in their 1973-74 Report on Direct Taxes, and applying the judgement in Rajapalayam case even re-opened the assessments in that case. Explaining this shift in their stand, the Department have, in a note to the Committee, stated that when the decision to accept the audit objection in the Alembic Glass Industries case was taken on 12-2-1975, the advice of the Ministry of Law in Tribeni Case was "unfortunately overlooked". The Committee have, however, on the other hand, a feeling that it was a representation from the Orient Paper Mills, fortified as it was by the opinion of a luminary of the legal profession, which persuaded the Board to make a reference to the Ministry of Law and pass on their advice, which was in favour of the party and against Revenue, to the Commissioner of Income Tax, West Bengal. That, barring this case and the contemporary case of Tribeni Tissues Ltd., the Board had a different view of law is borne out by the Board's subsequent acceptance of the Audit objection in the case of Alembic Glass Industries and the decision of Revenue to go in appeal against the Judgement of the Punjab and Haryana High Court in the case relating to Patiala Flour Mills Ltd.

1.40. What has come as a greater surprise to the Committee is that despite the fact that audit objection had already been accepted in the Alembic Glass Industries case on 12-2-1975, and the principle settled in Rajapalayam case applied, when a similar objection was raised in the present case of Orient Paper Mills, the Department informed Audit that re-opening of assessment of this assessee company would create "several complications". Referring to these complications, the representative of the Department disclosed during evidence that all that they had in mind was that if the benefit of Rs. 2.6 crores given to Orient Paper Mills was withdrawn in the assessment year 1971-72, it may have to be simultaneously given in the 1972-73 assessment and that re-opening of assessment of the company would entail reopening of assessment of more than 3,400 cases of share holders of the company who had been given benefit of tax exemption on dividend declared by the company under section 80K. When the Committee pointed out that these so-called "Complications" were nothing but inevitable consequences of

re-opening of assessments in company cases, the representative of the Department assured that it had since taken remedial action and would follow it up to its "logical conclusion". The Committee regret that by holding over re-opening of assessment for a long time and that too for reasons over which the Board continue to entertain doubt, undue solicitude appears to have been shown to the assessee company. The Committee are of the view that a more prudent course for the Department would have been to re-open the assessment promptly on the basis of audit objection and leave it to the assessee company to appeal against it.

1.41. It is somewhat puzzling that when the Ministry of Law gave their advice in 1973 in the case of Tribeni Tissues Ltd. on the scope of Section 80J of the Income-tax Act, 1961, the Central Board of Direct Taxes did not issue a general circular in 1973, to ensure that the law was applied uniformly in all cases but only communicated the advice to the Commissioners of Income-tax, West Bengal. The Department felt that they need not issue general instructions on the basis of an isolated case. But when audit raised an objection in the case of Alembic Glass Industries, the Board issued a general circular on 4-3-1976 advising the Commissioners to follow the Judgement in Rajapalayam case. While the Finance Secretary conceded during evidence that a general circular "ought to have been issued at that time" by the Board, he pointed out to the Committee that non-issuance of a circular in 1973 was "beneficial to the Government and beneficial to the revenue". Had such a circular gone out in 1973, he said, "the ITOs all over the country including the ITOs in Tamil Nadu who were otherwise following the Rajapalayam case, would have followed this". This reasoning is not convincing. The Committee are of the view that when decisions having bearing on interpretation of Direct-tax laws are taken in consultation with the Ministry of Law, such decisions should be given widest possible circulation so that the law was not applied differently in different parts of the country, as had happened in this case.

1.42. Section 119(i) of the Income-tax Act, 1961, as it stood before 1-4-1971 had provided that all officers and persons employed in the execution of the Income-tax Act shall observe and follow the orders, instructions and directions of the Board. By Act 42 of 1970, the Section was amended w.e.f. 1-4-1971 by which a restriction was imposed on the powers of the Board to the effect that the Board shall not issue any order, instruction or direction so as to require any Income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner. In paragraph 5.89 of their 128th Report (Fifth Lok Sabha), the Committee had cautioned the Board against giving advance rulings in individual

cases. On 22-11-1974, the Board issued a circular in which it was stated, inter alia, that the Board will not issue any advance rulings|directions instructions in individual cases to any income-tax authority or to any querist though it would continue to oversee administratively the functions of the lower formations and give advice in individual cases if the facts of the case so justify. The Committee hope that the self restraint imposed by the Central Board of Direct Taxes upon themselves by their circular of November, 1974 would be strictly adhered to ..

CHAPTER II

IRREGULAR RELIEF IN RESPECT OF PRIORITY INDUSTRY INCOME

Audit paragraph

2.1. Where the gross total income of a company includes any profits and gains attributable to any priority industry, the Income-tax Act, 1961 provided for a deduction from such profits and gains of an amount equal to eight per cent for the assessment year 1972-73 in computing the total income of the company.

2.2. In the case of an assessee-company producing rayon and artificial silk fabrics, the manufacture of rayon grade "pulp" for the purpose of getting artificial fibre, was treated as a priority industry and the assessee was allowed various concessions admissible to priority industries under the Income-tax Act, 1961. These concessions consisted of development rebate on the machinery employed in the industry, its deduction under section 80E 1 and tax credit certificates under section 280ZB.

2.3. However, as per the list of articles given in the Sixth Schedule to the Income-tax Act, 1961 and First Schedule to the Industries (Development and Regulation) Act, 1951, it was 'paper industry' which came under the category of 'priority industry' and profits from the manufacture of pulp meant for producing paper was entitled to the aforesaid tax concessions. In the case of the above assessee, the pulp was produced for altogether different purpose and hence, it should not have been treated as a priority industry. As a result of the erroneous concessions, the income of the assessee was under-assessed and tax credit certificates were wrongly granted in the seven assessment years from 1966-67 to 1972-73 with an abandonment of revenue aggregating Rs. 2,67,83,365 due to short levy of tax of Rs. 1,19,26,866, surtax of Rs. 28,01,808 and incorrect admission of tax credit certificates for Rs. 1,20,54,691. The quantum of abandonment of revenue will further increase if the development rebate at the enhanced rate allowed in the assessment years 1966-67 and 1967-68 (details of which are awaited from the assessing officer) is taken into account.

2.4. The paragraph was sent to the Department of Revenue and Banking in November 1976; they have stated in February 1977 that the audit objection is under active consideration.

[Paragraph 31(i) of the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes]

2.5. This para reports a case of erroneous tax concessions of Rs. 2.68 (revised to Rs. 2.78 crores) crores allowed to a rayon and artificial silk fabrics manufacturer, M/s. Gwalior Rayon and Silk Manufacturing (Wvg.) Company Limited (Birla Group), during the assessment years 1966-67 to 1972-73.

2.6. The Income-tax Act, 1961 allowed the following three concessions to certain industries occupying "an important place in our economy called priority industries :

(i) A partial tax holiday to the extent of 8 per cent of profits during the assessment years 1966-67 to 1971-72 and 5 per cent of profits during 1972-73. The concession was abolished from 1-4-1973.

(ii) Development rebate in respect of plant and machinery installed for such industries at a higher rate of 35 per cent (against the normal 20 per cent) for the assessment years 1966-67 to 1970-71 and 25 per cent (against the normal 15 per cent) for the assessment years 1971-72 to 1975-76 (for installation prior to 1-6-1974). The development rebate was discontinued from 1-6-1974.

(iii) Tax credit certificates during 1966-67 to 1970-71, at 20 per cent of the excess of tax for the relative assessment year over that for the base year, *i.e.*, 1965-66 or such subsequent year in which the assessee first became liable to tax.

2.7. For the concessions at (i) and (ii), a list of priority industries was given in a schedule to the Income-tax Act, 1961. The relevant item of the schedule read "Paper and Pulp" upto 31-3-1966 and "Paper and pulp including newsprint", thereafter. The concession at (iii) above was admissible to industries mentioned in the first schedule to the Industries (Development

and Regulation) Act, 1951. The relevant entry in his schedule read as under:

"24. PAPER AND PULP INCLUDING PAPER PRODUCTS:

(1) Paper-writing, printing and wrapping,

(2) Newsprint.

(3) Paper Board and Straw Board.

(4) Paper for packaging (Corrugated paper, kraft paper, paper containers and the like)

(5) Pulp—wood pulp, mechanical chemical, including dissolving pulp."

2.8. According to Audit, an assessee who was originally manufacturing pulp meant for paper in one of its units later on (during the assessment years 1966-67 to 1972-73) "diverted the pulp for manufacture of rayon yarn" and all the above concessions "which were meant for paper pulp used for paper products were extended to pulp used for artificial rayon yarn" during the years 1966-67 to 1972-73.

2.9. The short levy of Income-tax and Sur-tax and excess allowance of Tax Credit Certificates in this case has been worked out by Audit as under:

Short levy of Income-tax and surtax on account of

Assessment year	Deductions under Section 80F, 80I	Development rebate	Tax Credit Certificates under Section 280ZB	Total
1966-67	15,82,451	1,59,383	18,36,392	35,78,226
1967-68	19,24,829	8,80,513	22,20,631	50,25,973
1968-69	13,82,778	4,89,451	17,24,442	35,96,671
1969-70	24,40,511	2,25,436	30,98,248	57,64,195
1970-71	25,05,767	2,47,322	31,09,759	58,62,848
1971-72	29,86,212	48,362	..	30,34,574
1972-73	8,13,944	81,611	..	8,95,555
	1,36,36,492	21,32,078	1,19,89,472	2,77,68,042

(The above are revised figures after taking into account the development rebate at enhanced rate allowed for the assessment years 1966-67 and 1967-68).

2.10. The Committee have been informed by the Department of Revenue that the claims for rebates and reliefs were made by the assessee in the Returns of Income in each of the assessment year since assessment year 1966-67 and that no separate claims were required to be made under the Companies (Profits) Surtax Act, 1964. Claims u|s 280ZB were, it has been stated, made in the prescribed performance. It is further stated by the Department of Revenue that as there was no doubt about the correctness of the claim in the mind of the Income-tax Officer, no investigation into the genuineness of the claim was made. The matter was also not referred to the Inspecting Assistant Commissioner or Commissioner of Income-tax before admitting the claims except that the orders under Section 280ZB were approved by the Inspecting Assistant Commissioner. No reference was made to the Central Board of Direct Taxes either, at the time of allowing various claims.

2.11. As already stated in paragraph 2.7, for the concessions of a partial tax holiday and development rebate under the Income-tax Act, 1961, a list of priority industries was given in the Schedule to the Act itself. The relevant items of the Schedule read "Paper and Pulp" upto 31-3-1966 and "Paper and Pulp including newsprint" threafter. Even though the relevant item did not specifically mention pulp for fibres and rayon, tax concessions under the Income-tax Act were allowed to such pulp. The Department was asked as to how far this action was considered legally justified. They have, in reply, stated:

> "It is submitted that the Schedule to the Income-tax Act does not warrant the assumption that only an industry engaged in producing pulp for paper will be entitled to treatment as a priority industry......In the Department's view the assessment made by the Income-tax Officer is justified on facts and in law."

It is further stated by the Department of Revenue:

> "The ITO has been treating the assessee's pulp making unit as a priority industry. Since, however, the correctness of his order has been questioned, it has been pointed out that the ITO has not really made a mistake. The ITO might or might not have been aware of it, but the ITO's interpretation of the word 'pulp' is, in fact, supported by (a) analogous legislation [Industries (Development & Regulation) Act, 1951], (b) the practice followed in classifying rayon-grade pulp with paper for customs, import control and other purposes, and (c) also the use of the word in the industrial world."

2.12. Asked if it was a fact that the pulp produced by the factory, which was meant for paper, was diverted for the manufacture of rayon yarn, the Department have explained :

> "Rayon grade pulp produced by the company was fit for manufacturing Viscose Rayon Fibre and not for manufacturing artificial rayon yarn which is manufactured from petro-chemicals. There was, therefore, no question of diversion of pulp produced by company towards manufacturing artificial rayon yarn......"

2.13. As stated earlier, the concession of tax credit certificates was admissible to industries mentioned in the First Schedule to the Industries (Development and Regulation) Act, 1951. The relevant entry in this Schedule No. 24(5) was :

> "Pulp—wood pulp, mechanical, chemical including dissolving pulp."

The Department of Industrial Development had, at the instance of the Committee, indicated the background of inclusion of the item in the First Schedule to the industries (Development and Regulation) Act. The note, *inter alia,* stated that "no financial concessions are, however, envisaged under the provisions of the Industries (Development and Regulation) Act." The Department of Revenue was, thereupon asked to explain as to how far the tax concession allowed in this case was in keeping with the position enunciated by the Ministry of Industry. In reply, the Department of Revenue have stated in a note:

> "The purview of the Industries (Development & Regulation) Act, 1951 is limited...., but the First Schedule to the Act can be reasonably taken as an index of some of the industries which are of importance to the national economy on which other laws/schemes can fall back for their own purposes. The Industries (Development & Regulation) Act, 1951, does not seek to deal with every aspect of the working of the industries, *e.g.* the financial and other incentives that they may need, taxation of their income, the imposition of excise duties, levy of import duties, the Company Law requirements etc. The selection of industries for inclusion in the different Schedules for the purposes of relief under different provisions of the Income-tax Act is, however, generally made on the basis of discussions among the Secretaries in the Ministry of Finance and the Chief Economic Adviser, Department of Economic Affairs. The Ministry of Industrial Development and the Administrative Min-

istry concerned are also consulted, if considered necessary. Orders of the Finance Minister are obtained on the basis of decision taken as a result of such discussion."

2.14. Even though the Industries (Development and Regulation) Act, 1951, did not seek to deal with taxation aspects of the working of the industries, yet according to the Department:

"There seems to be no justification, in this context, for believing that the nomenclature and classification of the term 'pulp' (including dissolving pulp) and its treatment for Income-tax purposes should differ from its nomenclature and classification in the Industries (Development and Regulation) Act, 1951. The use of the very language of item 24(5) of the First Schedule to the Industries (Development & Regulation) Act, 1951 as item 6 in the list of 'articles', which according to Section 2(5)(c) of the Finance Act, 1964, were not entitled to the relief offered by Section 2(5)(a)(ii) of the Finance Acts 1964 and 1965 to other articles specified in the First Schedule to the Industries (Development and Regulation) Act, also supports the above view. These provisions serve to show how closely the Finance Acts have followed the classification/categorisation adopted in the First Schedule to the Industries (Development & Regulation) Act."

2.15. During evidence, the Committee asked why the Department of Revenue relied on other Acts, *e.g.*, Industries (Development and Regulation) Act, 1951 for allowing tax concessions under the Income-tax Act, 1961. In reply, the representative of the Central Board of Direct Taxes said:

"There is no case law on the subject and there is no specific mention as to what is pulp and paper."

The Committee enquired whether in interpreting an entry (in a schedule) where more than one product was mentioned, should not all the products be read as falling within the same category applying the rule of *ejusdem generis* and if so, how could the entry "pulp and paper" be taken to mean pulp produced for purposes which are not even remotely connected with paper. In reply, the Department of Revenue have explained in a note:

"Neither the rule of *ejusdem generis* nor its special application, namely, *noscitur a socies* can be invoked on the facts of this case: 'Conjunction of two or more words having analogous meaning, when clubbed together may be deemed to have

been used in a cognate sense'. There is no justification for assuming that paper and pulp are analogous or cognate in meaning. The two industries are different, since otherwise separate inclusion of the word pulp in the Schedule would be redundant. It is submitted that what is involved is not so much a question of law, as a question of fact. It is submitted further that if by 'pulp' what was meant was only paper pulp or pulp required for producing paper, there was no need at all for specifying pulp separately because every paper mill has a pulp plant and the only unit producing pulp for paper without manufacturing paper got into production round about 1969. In any case, in the absence of *any restrictive provision*, the plain meaning of the word as commonly understood in industry should prevail."

2.17. The note of the Department of Revenue goes on to say:

"If the intention of the legislature was to limit the benefits of a priority industry to units used in making pulp for paper, it would have been adequate for the purpose to include 'paper' alone in the Fifth Schedule. The separate mention of 'pulp' serves to show that what was meant was pulp in general including pulp needed for rayon. There is no scope or need for ascertaining the profits from pulp production in a paper mill. There are only three mills in the country producing rayon grade pulp and one producing pulp for paper. The possibility of using pulp for paper as well as rayon does not make the expression 'paper and pulp' as used in a cognate sense."

2.18. During evidence, the representative of the Department maintained:

"This is a highly technical matter. Firstly so far as the principle of *ejusdem generis* is concerned, it has been set at rest by the Punjab and Haryana High Court that the introduction of the 'newsprint' does not reduce the meaning of pulp but only enlarges it.

Secondly, when there is no definition in the Act, the common parlance always prevails. In common parlance, pulp includes not only pulp for paper but also pulp for fabrics.... Brussels Nomenclature (Section 10 of 4701) says that pulp is shown as part of paper making material.... Technical pundits have always treated pulp as pulp for paper as well as for rayon."

2.19. Asked that if the policy of the Government was to extend the tax concession to industries producing pulp for purposes other that paper, how was it that in the Finance Acts for 1964 and 1965, the entry "pulp/wood-pulp, mechanical, chemical, including "dissolving pulps" (which was the same as item 24(5) of the First Schedule to the Industries (Development and Regulation) Act was deleted from the list of industries entitled to export incentives under Section 2(5)(a)(ii) of the said Finance Acts. The Department of Revenue have, in a note, stated that:

> "Pulp for production of rayon had been imported for a long time at a considerable cost. his might have been one of the reasons for specifically excluding in the Finance Acts for 1964 and 1965 'pulp/wood-pulp, mechanical, chemical including dissolving pulps......"

2.20. In a note furnished after evidence, the Department of Revenue have advanced the following arguments in support of their view that tax concessions provided for 'Paper and pulp including newsprint' included not only pulp produced for paper but also pulp used for making rayon:

"(1) The technical advice obtained from the Directorate General of Technical Development and also from the Central Revenue Chemical Laboratory has made it clear that the pulp used in making rayon is what is known as the dissolving grade pulp and that this pulp is different from the pulp used in the manufacture of newsprint and ordinary paper. It has been pointed out by the technical authorities that dissolving pulp is used in the manufacture primarily of rayon staple fibre, continuous filament rayon and tyre cord.

(2) Despite the fact that 'dissolving pulp' has very little to do with paper, it has always been classified under the head 'paper and paper board' as the following would indicate:

(i) Explanatory notes to the Brussels Nomenclature (Volume 2, Sections VIII to XV-Chapters 41 to 83, Fifth Impression, June 1967).

(ii) The Government of India, Ministry of Finance (R.D.) Notfn. Cus. No. 90 dated 12.5.1955 (with the relevant portion side-lined). It is significant that item No. 43 of the First Schedule to the Indian Tariff Act, 1943 shows pulp under the head 'Paper and its application' in Section 10 (Vol.I).

(iii) Wealth of India (Industrial Productions), Part VI, published by the Council of Scientific & Industrial Research, New Delhi in 1965 showing marketable pulp, including rayon pulp and mentioning Gwalior Rayon, Silk Manufacturing (Weaving) Company, in particular, under the head Paper and Paper Board (pp.174-200).

(iv) Letter No. 32G(19)/56 dated 18-6-1957 addressed by the Director of Industrial Statistics to the Secretary, Ministry of Commerce & Industry. The classification of industries in the First Schedule to the Industries (Development & Regulation) Act is based broadly on the pattern of the standard International Industrial Classification for the purpose of census of manufacturing industries.

(v) Guidelines for Industries published by the Ministry of Industrial Development in July 1973 showing rayon-grade pulp under the Chapter 'Paper and Pulp including paper products' page 193.

(vi) Definition of the word pulp as comprising paper pulp as well as pulp 'for dissolving purposes' in the Indian Standard publication entitled 'Glossary of Terms used in paper trade and Industry'.

3. 'While there are different statutes in *pari material* though made at different times and not referring to each other, they should be taken and construed together as one system and *explanatory* to each other.' (Maxwell on the Interpretation of Statutes). Part of the revenue which is held to be abandoned, relates to the relief to which the assessee is entitled in terms of Section 280Z, by virtue of dissolving pulp being specifically included under item 24(5) of the First Schedule to the Industries (Development & Regulation) Act, 1951. Since the First Schedule separately includes 'rayon machinery' (Item 8A(3)], 'man-made fibres, including regenerated cellulose' rayon, nylon and the like' (item 19), and 'artificial man-made fibres' under Item 23(5) and since dissolving pulp is used principally in manufacturing rayon and not paper the most reasonable inference will be that the pulp used in making rayon has been treated as an important industry for purposes of the Industries (Development & Regulation) Act, 1951.

(4) It has been held in Webbing and Belting Factory (P) Ltd. *vs.* CIT Delhi (43 ITR at p. 238) that a provision which is intended to

promote industrial development should be given a liberal construction in the light of the object sought to be achieved. It has been further held by the Supreme Court in a number of cases, including Ramavtar Udhe Prasad *Vs.* Assistant Sales Tax Officer (1961:12 STC 286) and Commissioner of Gift-tax Vs. Getty Chettiar (1971 82 ITR 605) that the words occurring in a taxation statute must be construed not in any technical sense but as understood in common parlance' they must be interpreted in their popular meaning which people conversant with the subject matter, would attribute to them. The same view, namely, that the plain meaning or common import of a word should prevail, has been spelt out by the Punjab and Haryana High Court in 98 ITR 78 (1975) in the case of CIT *Vs.* Straw Board Manufacturing Co. Ltd.

(5) It is to be noted that processes for manufacture of pulp for both paper and râyon are practically identical and the same technology, the same machinery and the same principal raw material are required. Only the end products, viz., paper and rayon, are different. That is probably the reason why rayon grade pulp has always been tied to the general head 'paper' by different authorities, including the Industries Department, the Chief Controller of Imports & Exports, the Customs Department and the Industry itself.

* * * * *

2.21. The Committee pointed out that the point at issue in the present case was whether the term 'pulp' occurring in the entry 'Paper and Pulp' (upto 31-3-1965) and 'Paper and Pulp including Newsprint' (after 1-4-1966) of the Fifth Schedule to the Income-tax Act, 1961 meant pulp for paper alone or it included pulp for other purposes also. According to Audit, under the Income-tax Act, only pulp for paper was eligible for tax concessions under that Act. Reacting to the Audit view, the Finance Secretary said in evidence:

> "We do not accept the audit objection. It is not all agreed.... In regard to paper and pulp and pulp and paper, how can we assume what the Finance Minister meant at that time? We cannot assume what he meant."

2.22. The Committee asked that if the Department was so sure of its position on this case why was the audit objection not rejected there and then when it was raised in August 1975. Strangely enough, the Department

informed Audit in February 1977, i.e., two years later, that the objection was under 'active consideration'. The representative of the Department of Revenue said in evidence:

> "We had (in replying to audit objection) used the words 'active consideration'. I am sorry. We should not have used these words....The matter came to our notice on 3 December 1976. Then it was examined on the 15th February 1977. As it was a technical matter concerning interpretation of a technical term it was referred to the Department of Technical Development on 17th March 1977. We received the reply of the Department of Technology on 6th April 1977.... We got the advice of the Department of Revenue on 28th June 1977."

2.23. Asked when a final reply to the audit objection was sent, the witness said:

> "We wrote on 18th July 1977 to the Audit that the audit objection had not been accepted by the department. Before we gave the reply, it was considered by two Members of the Board."

2.24. The Committee wanted to know if rejection of the audit point of view without even consulting the Ministry of Law could be regarded as a right step especially when there were judicial pronouncement* to the effect that the 'intructions' received from the Audit Department by the Income Tax Officer constituted 'information' within the meaning of Section 147(b) of the Income Tax Act and that "the audit department was the proper machinery to scrutinise the assessments of the income-tax officers and point out the errors, if any, in law."

2.25. In reply, the representative of the Department stated that a reference was in fact made to the Ministry of Law on 17 September 1977 (i.e. after the decision to reject the audit objection had already been taken) but the file was later withdrawn from that Ministry on 4 October 1977.

2.26. Explaining the reason for withdrawal of this case before the Ministry of Law could examine various issues involved in this case and tender their advice, the witness said in evidence:

> "The convention has always been that when a discussion takes place with the Law Ministry, the Audit should always be

*Supreme Court Judgement dated 11-8 1977 in the case R. K. Malhotra Income Tax Officer Vs. Kasturbhai Lalbhai.

associated. It should be a tripartite discussion. Since this matter had already gone before the Parliament (PAC), the audit could not be associated."

Asked to furnish the details of such convention indicating the date since when it was in vogue, the Department have in a written note dated stated:

"It has not been possible to trace any note recording the convention. A letter was addressed to Shri R. S. Gupta, Director/Receipt Audit on 23-2-78 for a confirmation on this point. A formal reply is yet to be received from the Director. Meanwhile, the Member (investigation) in the Board discussed the matter with Director, Receipt Audit, Shri V. Gauri Shankar, who confirmed that such a convention had been evolved and also promised to send a formal letter to the same effect."

In reply to the question that if the Department was aware of the aforesaid convention, then why was the matter referred to the Ministry of Law in the first instance in September 1977, the Department had stated as follows:

"The Member (Inv.) came to know about the above convention from the Director (PAC) after the note on the interpretation of the term 'pulp' had been sent to the Law Ministry. As soon as he learnt about it he had the file withdrawn from the Law Ministry. The fact that the meeting of the PAC was to be convened in the middle of October was an additional reason for withdrawing the file on the 4th October 1977."

Asked whether in cases where a difference of opinion arises on a legal matter between a Ministry/Department on the one hand and the Revenue Audit on the other, should not a reference to the Ministry of Law be a rule rather than an exception and in the event of a conflict between the Law Ministry and the Comptroller and Auditor General should not a reference be invariably made to the Attorney General of India, the Finance Secretary said:

"If the Committee is pleased to give this recommendation, it will form part of a new procedure."

2.27. The Committee wanted to know whether differences between the Audit and the Ministry could not be sorted out by making such references before the matters came up to the PAC, the witness replied:

"We have no objection. When you make such a recommendation, we will give it due weight."

2.28. The Committee note that while making assessments for the assessment years 1966-67 to 1972-73, the manufacture of "rayon grade pulp" by M/s. Gwalior Rayon and Silk Mfg. (Wvg.) Company Ltd. (Birla Group) was treated as a priority industry and tax concessions consisting of (i) development rebate (Rs. 1,19,26,866), Surtax (Rs. 28,01,808) and (ii) Tax Credit Certificates (Rs. 1,20,54,691) aggregating to Rs. 2.68 crores (revised to Rs. 2.78) were allowed to the Company under the Income-tax Act, 1961. Audit have objected to these concessions on the ground that "as per the list of articles given in the Sixth Schedule to the Income-tax Act, 1961 and First Schedule to the Industries (Development and Regulation) Act, 1951, it was 'paper industry' which came under the category of 'priority industry' and therefore the profits from the manufacture of pulp meant for producing paper was entitled to the aforesaid concessions" and not pulp produced for other purposes, e.g., manufacture of rayon yarn. The Ministry of Finance (Department of Revenue) have not accepted the audit objection in this case. It has been stated that in the Department's view the assessment made in this case by the Income-tax Officer "is justified on facts and in law."

2.29. The Department of Revenue have sought to justify these assessments by relying largely on the Industries (Development and Regulation) Act, 1951 which, it has been stated, "can be reasonably taken as an index of some of the industries which are of importance to the national economy." Entry No. 24 of the First Schedule of this Act is titled "Paper and Pulp including paper products" and sub-Entry (5) thereof refers to "pulp" as "Pulp—wood pulp, mechanical, chemical, including dissolving pulp". The pulp produced by M/s. Gwalior Rayons for use in the manufacture of rayon yarn (to which the Audit objection pertains) comes in the category of "dissolving pulp." In this connection, Department have pointed out that though "dissolving pulp" has very little to do with paper it had always been classified under the head 'Paper and paper board' as (i) Item 43 of the first schedule to the Indian Tariff Act, 1943, (ii) the Wealth of India (Industrial Products), Part II published by the C.S.I.R. in 1965, (iii) the guidelines for industries published by the Industrial Development in July 1973, (iv) definition of the word pulp in the Indian Standards Publication entitled "Glossary of terms used in Paper trade and industry, (v) Explanatory notes to the Brussels Nomenclature (Volume II) Sections VII to XV—Chapters 42 to 83, Fifth June 1967, would show. The Committee cannot see how the admissibility of concessions under the Income Tax Act, 1961, can as it seems to have been done in this case, be determined much less justified on the basis of other Acts or documents. 'The guidelines for industries' published by the Department of Industrial Development in 1973 has no relevance because the assessments in question relate to years prior to 1973. Moreover, it may be pointed out in

this connection that the Industries (Development and Regulation) Act, 1951 does not deal with tax matters at all, and according to a clarification given by the Ministry of Industry, it envisages no financial concessions.

2.30. The justification for tax concessions allowed to the assessee company has to be judged on the basis of the provisions contained in this behalf in the Income-tax Act, 1961. The Committee find that the relevant entry in this Act, was "Paper and Pulp" upto 31-3-1966, and "Paper and Pulp including Newsprint" thereafter. From 1-4-1975, the entry was again changed to "Paper, Pulp and Newsprint". The Act does not specify whether "Paper and Pulp" means pulp for paper alone or whether it includes pulp for other purposes also. A moot point to be considered is that when the two words "paper" and "pulp" are clubbed together in a single entry, whether they should be not interpreted in a cognate sense. While submitting that what is involved in this case "is not so much a question of law, as a question of fact", the Department of Revenue have contended that "paper" and "pulp" are two different industries. Had it not been so, separate inclusion of the word "pulp" in the schedule would have been redundant. Every paper mill, it has been stated, has a pulp plant and the only unit producing pulp for paper without manufacturing paper got into production round about 1969. The Department has also argued that "if the intention of the legislature was to limit the benefits of a priority industry to units used in making pulp for paper, it would have been adequate for the purpose to include "paper" alone. The soparate mention of pulp, it has been contended, serves to show that what was meant was pulp in general, including pulp needed for rayon. Audit, on the other hand, have pointed out that on the basis of the language used in the Income-Tax Act, "pulp" would mean pulp produced for paper only and not for any other purpose.

2.31. The Committee find that Audit obecjtion in this case was raised as early as in August 1975. The matter came to the notice of the Department on 3-12-1976. The Department of Revenue first informed the Audit in February 1977 (i.e. two years later) that the objection was under 'active consideration' but later it was stated on 18-7-1977 that the objection had not been accepted. The long time aken in considering the audit objection clearly indicates that the Department was not very sure of its stand on this case.

The Committee also note that the decision to reject the interpretation of law given by Audit was taken by the Department of Revenue at their own level, without obtaining an authoritative opinion of the Ministry of Law on the point of law involved. In fact a reference was made by the Department to the Ministry of Law on 17-9-1977 (when a decision to reject the audit objection had already been communicated to the Audit) but before that

Ministry could consider the various issues involved, the file was withdrawn from that Ministry on 4-10-1977 in deference to a 'convention' said to be prevailing in regard to matters contained in the Audit Report with which the PAC is seized. The Committee consider that before taking a final decision in regard to the Audit objection the Department should have obtained the advice of the Ministry of Law. That it was not done in this case even though the Audit objection remained under the consideration of the Department for well-nigh 2 years is regrettable. The Committee recommend that the matter should be referred to the Ministry of Law for their advice.

2.32. The Committee also note that according to the judgement of the Supreme Court in the case of R. K. Malhotra, Income-tax Officer vs. Kasturbhai Lalbhai delivered on 11 August 1977, it was held that "the Audit Department was the proper machinery to scrutinise the assessments of Income-tax Officers and point out the errors, if any, in law, and that the intimation received by the Income-tax Officer constituted 'information' within the meaning of Section 147(b) in consequence of which the Income Tax Officer could reopen the assessment." The Committee feel that in view of the special position of Revenue Audit recognised by the Supreme Court, the Audit objections in regard to assessment of income-tax deserve serious consideration by Government. The Committee recommend that in future whenever a difference of opinion arises in regard to "errors in law" in the case of any assessment or class of assessments, between the Ministry of Finance (Department of Revenue)/Central Board of Direct Taxes on the one hand and the Revenue Audit on the other, the Department should, before taking a final view in the matter, normally obtain the opinion of the Ministry of Law. In case the loss of revenue pointed by Audit is substantial and there is a difference of opinion on a point of law between the Department of Revenue and the Ministry of Law on the one hand and the Revenue Audit on the other, it would be advisable to obtain the opinion of the Attorney General before taking a final decision adversely affecting revenue.

CHAPTER III

DEFERRED ANNUITY POLICIES

Audit Paragraph

3.1. According to the terms of contract between certain film artists and film producers, the artists receive payments partly in the form of cash and partly in the form of single-premium annuity insurance policies purchased from the Life Insurance Corporation of India, in favour of the artists but paid for by the producers in lump. In two such cases the amounts received in cash were shown by two film stars in their returns of income but the remuneration received in the form of annuity policies was not returned on the plea that the assessees followed cash system of accounting for their professional income.

3.2. Failure to treat the premium paid by the producers on account of deferred annuity policy in lieu of the remuneration payable to the artists as income due to them during the assessment years 1972-73 and 1973-74 resulted in an under-assessment of Rs. 11,86,917 leading to a total short levy of tax of Rs. 10,71,112 in respect of the two assessees for both the years.

3.3. The paragraph was sent to the Department of Revenue and Banking in November, 1976; they have stated in February, 1977 that the audit objection is under active consideration.

[Paragraph 50 of the Report of the Comptroller and Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes]

3.4. Under Section 5 of the Income-tax Act, 1961 the total income of any previous year of a person, who is a resident, includes all income from whatever source derived which is received or is deemed to be received in such year by him, or which accrues or arises or is deemed to accrue or arise in India during the year. Section 28 of the Act relates to computation of profits and gains of business or profession which are taxable on accrual basis or cash basis. Section 145 relates to computation of such income in accordance with the method of accounting regularly employed by the assessee.

3.5. According to terms of contracts between film artists (*viz*) Shri Dev Anand and Smt. Sharmila Tagore and film producers, the artists receiv-

-ed payment partly in the form of cash and partly in the form of single premium deferred annuity policies purchased from life Insurance Corporation of India, in favour of these artists but paid for by the producer in lumpsum. The amounts received in cash were shown by the assessees in their returns but the remuneration received in the form of annuity policis was not returned on the plea that assessees conventionally followed cash system of accounting for their professional income. According to the audit the failure to treat premium paid by the producers on account of deferred annuity policies in lieu of remuneration payable to the artists as income due to them in the previous year in which such policy was paid for by the producer had resulted in a total short levy of tax of Rs. 10,71,112.

3.6. The break-up of the under-assessment and the tax thereon as pointed out by Revenue Audit is as under:—

Name	Assessment year	Income (Rs.)	Tax thereon
1. Sh. Dev Anand	1972-73	5,00,000	4,02,312
	1973-74	4,41,649*	4,31,712
	TOTAL	9,41,649	8,34,024
2. Smt. Sharmila Tagore	1972-73	2,45,268	2,37,086
	TOTAL	11,86,917	10,71,110

(*Amount paid to LIC is Rs. 4,36,649)

3.7. The facts of these cases as intimated by the Department of Revenue, in a note, are as under:—

(1) *Shri Dev Anand (Assessment years* 1972-73 *and* 1973-74)

M/s. Navketan Enterprises entered into an agreement on 6th November, 1969 with Shri Dev Anand to act as a hero in the film later named as 'Tere Mere Sapne'. A sum of Rs. 1.5 lakhs was to be paid as remuneration. The payment was by way of taking policies from LIC. The firm took two annuity policies of Rs. 1,00,000 and Rs. 50,000 from LIC on 5th April, 1972 and 22nd July, 1972 respectively. The annuitants were Shri Vijay Anand, partner of the firm and firm respectively. These policies were absolutely assigned to Shri Dev Anand on 2nd April, 1973 and 2nd August, 1972 respetively. Rs. 9020 and Rs. 4705 were to be paid as annuities for 16 years and 15 years respectively. The first instalments were due in 1973.

M/s. Alankar Chitra entered into an agreement on 30th August,. 1971. It was agreed that Rs. 15,000 would be paid in cash and sums of Rs. 14,000 and Rs. 16,500 would be paid for 25 years from 1974. With a view to secure these payments, the firm took two annuity policies of Rs. 2,36,220 and Rs. 2,00,429 on 2nd April, 1973 and 22nd April, 1973 from LIC. The firm and Shri Dev Anand were respectively the annuitant under these policies. The first policy was absolutely assigned to Shri Dev Anand on 11th May, 1973.

(2) *Smt. Sharmila Tagore* (*Assessment year* 1972-73)

M/s. Shakti Films entered into an agreement on 10th June, 1971. It was agreed that Rs. 50,000 would be paid in cash on mutually agreed dates and a sum of Rs. 24,000 would be payable for 20 years from 1978. With a view to secure the payment, the firm took an annuity policy of Rs. 2,45,268 from LIC on 1st March, 1972. The firm was the annuitant. The policy was absolutely assigned to her on 2nd June, 1972.

3.8. Giving the latest position about these cases the Department of Revenue have intimated that:—

(i) In the case of Shri Dev Anand action to re-open assessments for the assessment years 1973-74 has been taken under Section 147(b). Re-assessments are pending;

(ii) In the case of Smt. Sharmila Tagore, action under Section 263 was taken for the assessment year 1973-74. No action was, however, taken for the assessment year 1972-73, as the policy was taken on 3rd April, 1972 and assigned on 2nd June, 1972, which fell during the previous year relevant to the assessment year 1973-74.

3.9. The point at issue in these cases is whether in the case of a film artist who receives remuneration in the form of an annuity policy, it is only the amount of actual annuity received in his hand which is taxable in year of receipt, or whether it is the entire premium paid for the annuity by the producer which is taxable as income in the year in which the premium is paid. This point, the Committee have been informed, was considered by the Ministry of Law more than once in the past.

3.10. The first case in which the Ministry of Law gave their opinion was that of late Shri Guru Dutt, a film actor. He had, on 12th November, 1962, entered into an Agreement with the Producers (M/s. Meena Pictures) for rendering his services for a period of 12 months on a total remuneration of Rs. 105,001 (Rs. 5,001 payable on the date of execution of the

Agreement and the balance of Rs. 100,000 payable in 10 annual instalments of Rs. 10,000 each commencing from 10th January, 1965). The contract period of 12 months expired in November, 1963. On 5th November, 1963, the Producers purchased from the L.I.C. an annuity of Rs. 10,000 per annum terminable after 10 years in the name of their partners, Mohd. Azam. This was an immediate annuity purchased by the Producers for Rs. 85,390 the annual payments under which were to commence from 10th January, 1965. The commencement of the annuity payments thus synchronised with the commencement of the annual instalment of Rs. 10,000 payable to Shri Guru Dutt under his Agreement with the producers. On 22nd November, 1963, the aforesaid Mohd. Azam executed an irrevocable power of attorney in favour of Shri Guru Dutt authorising him to recover the annuity amounts from the L.I.C. and gave a proper and valid discharge from the same. On these facts, the following questions were posed by the Department of Revenue:—

(1) Whether, on the construction of the various agreements, it can be said that the professional income (Rs. 1.05.001) was received by the assessee in November, 1963;

(2) If the entire amount of Rs. 1,05,001 cannot be taxed in the assessment year 1964-65, can the amount of Rs. 85,390 paid by the Producer to purchase the annuity which was transferred to Shri Guru Dutt by an irrevocable power of attorney be held as received by him in the relevant previous years.

3.11. The Ministry of Law considered in detail whether payments to Shri Guru Dutt were in the nature of an actual receipt, constructive receipt, deemed receipt or could be treated to have accrued or deemed to have accrued under the Income-tax Act. The Ministry of Law *inter alia* advised that:—

"It will be seen that in this case, the concept of income received in the form of money's worth is not attracted. The policy of annuity issued by the L.I.C. was in the name of Mohd. Azam mentioned therein as the purchaser and annuitant. There is no nomination in favour of anyone under the policy, nor was there any transfer as such of that to Shri Guru Dutt. All that happened was that the annuitant authorised Shri Guru Dutt to recover the amounts of the annuities year after year by an irrevocable power of attorney. Annuities paid under an insurance policy or other contract are taxable as income from other sources under Section 56. In this case, the policy for the annuity was probably intended as an insurance for Shri Guru Dutt against a possible failure or default on the part of the producer to pay the annual instalments due to him under

the contract. It also secured the producer from being sued by Shri Guru Dutt for such default apart from the saving of Rs. 15,000 by the producer. It is, moreover, conceded that Shri Guru Dutt was not maintaining any regular accounts for his professional income as an actor but was all along assessed on cash basis. Therefore, in this case, also he can be assessed only on the amounts received by him during each year from the L.I.C.

The answers to the two questions referred to us should therefore be in the negative."

3.12. The Commissioner of Income tax, Bombay-I, accordingly, in his letter dated 27th October, 1971, clarified to the Hony. President Film Producers' Guild of India Ltd. that the annuity amounts would be taxable in the year of receipt when these were in the hands of the artists provided the salient features of the policy were as under:—

(i) The annuity policies were taken in the names of the producers; the film artists were not parties to the annuity contract;

(ii) The producers were the annuitants;

(iii) By an irrevocable power of attorney, the annuitants (i.e. the producers) authorised the artistes to recover the amount of the annuities as and when they fall due;

(iv) The annuities were non-commutable;

(v) The artistes maintained their account on cash system.

3.13. The second occasion when the Ministry of Law was consulted by the Department of Revenue was in the case of Miss Waheeda Rehman, a film artiste. The facts of this case were slightly different from that of Shri Guru Dutt. Under the Annuity Policy of Guru Dutt, the proposer was the producer of the film and he was also the annuitant. In the case of Miss Rehman, she was the annuitant and the amounts were directly payable to her. Moreover, Miss Rehman was not only the annuitant under the policy but she had also been given the right to nominate as assignee to receive the amount in the case of her premature death. The Commissioner of Income-tax had in his report expressed the view that because Miss Rehman was the annuitant, it could be said that she had received money's worth equivalent to the amount paid by the producer to the L.I.C. when the annuity was purchased. In their opinion dated 28th January, 1972, the Ministry of Law (Additional Legal Adviser) opined in this case that:—

"Normally when an assessee is said to have received money's worth, it means that he has received something which is equivalent

of cash. Could it be said in this case that she has received something which is equivalent of cash? Under the agreement she is only entitled to receive the amounts on due dates. In other words, she has not received the equivalent of cash in the year of assessment. The assessee follows cash system of accounting and in my view it would not be possible to construe the entire premium paid to the LIC as a receipt in the hands of Miss. Rehman. The fact that Miss Rehman has been given the right to nominate some one else to receive the amounts in case of her premature death also will not make this case different from that of late Guru Dutt."

3.14. The Direct Taxes Enquiry Committee (Wanchoo Committee) had recommended that Income-tax law should be suitably amended to provide for the payment to a film artist through annuity policy. Accordingly it was proposed to introduce a new section 180A in the Income-tax Act under the Taxation laws (Amendment) Bill, 1973 which sought to give effect to this recommendation of the Wanchoo Committee. The proposed Section 180A of the Income Tax Act read as follows:—

"180A. (1) Where any part of the remuneration payable to a person to whom this section applies (hereinafter in this section referred to as the annuitant) is in the form of an annuity and the contract therefor providing for the payment of periodical sums thereunder is approved by the Commissioner under sub-section (2) then, such annuitant shall be taxed in respect of such remuneration only when such periodical sums become payable and tax shall be charged for any assessment year on the sum so receivable by him in the relevant previous year.

(2) Subject to any rules made by the Board in this behalf, the Commissioner shall not approve any contract for the payment of an annuity unless he is satisfied that:—

(a) such contract provides for the first of the periodical sums referred to in sub-section (1) to become payable before the expiry of a period of five years from the date on which it has been entered into;

(b) such contract provides for the payment of annuity over a period which shall in no case exceed ten years;

(c) not more than seventy-five per cent of the entire remuneration payable to the annuitant is converted into the form of annuity;

(d) such contract provides that in case of death of the annuitant before the annuity cases to be payable, payment under such contract shall continue to be made to his heirs or assigns, as the case may be, in the same periodical basis as before his death.

(3) Where a contract for the payment of an annuity approved by the Commissioner under sub-section (2) provides for the payment thereof to the heirs or assigns of an annuitant in case of his death, any payment made under the contract to such heirs or assigns in pursuance thereof shall be liable to tax under this Act as if it were a part of the income of such heirs or assigns in the previous year in which it was made.

(4) Where a contract for the payment of an annuity approved by the Commissioner under sub-section (2) provides for the surrender; commutation or assignment of the annuity payable under such contract by the annuitant or by his heirs or assigns, then, the whole of the sum payable on such surrender, commutation or assignment shall be liable to tax as part of the income of the annuitant or, as the case may be, of the heirs or assigns for the previous year in which the surrender, commutation or assignment is made, at the rate or rates of tax in force in the assessment year relevant to such previous year.

(5) This section applies to any person who is engaged:—

(a) as a professional actor on the stage:

(b) as a professional sportsman;

(c) as a film actor;

(d) in any other activity in the film industry to which having regard to the duration of the period for which a person is likely to be engaged in such other activity, the Central Government, by notification in the Official Gazette, declares this section to apply."

3.15. The Committee have been informed, in a note, that the Central Board of Direct Taxes discussed the various points raised before the Select Committee on the Taxation Laws (Amendment) Bill, 1973 and got the matter examined once again by the Ministry of Law, in February, 1974. The advice of the Ministry of Law on this occasion was as under:—

"This matter has been considered by us more than once in the past. It may be pointed out that in all these cases the income of these films stars is taxable under the head 'Profits and gains of business or profession'. Presumably, these artistes keep their accounts on the cash basis.

If that is so, it follows that during the year in question the only amount which they can be said to have received is the atcual annuity paid by the L.I.C. or other body. Whether this amount is drawn by them on the basis of an irrevocable power of attorney as in Guru Dutt's case, or the policy itself is taken out in favour of the film star as in the case of Miss Rehman is not material. The fact that the producer has parted with the money irrevocably and that it constitutes an expenditure in his hands would not necessarily make the entire amount the income of the person for whose benefit the policy was taken out. The individual cannot be taxed for an income which he has not received and is not entitled to receive during the year in question. Neither would it be appropriate to consider this as a benefit or perquisite under section 28 (iv). The question of valuing a benefit or perquisite would arise only if the assessee has enjoyed the benefit or the perquisite during the relevant previous year. The only benefit which the individual has had is the amount of annuity made over during that year. The intangible benefit, if any, arising out of the satisfaction that one's future is partly provided for is not one which would attract liability to tax.

Neither would it be correct to regard the insurance company as the agent of the artistes for the purposes of receiving the amounts. It may be that the annuitant had agreed to the policy being taken out and money paid to the L.I.C. But the L.I.C. when receiving the amount cannot be said to be acting on behalf of the film star. The prerequisites of an agency would not appear to exist.

Consequently, in so far as the professional persons are concerned, there would appear to be need to revise the earlier opinion that what is taxable As only the actual amount of annuity received by the persons during the course of the year. The fact that it is sought to give certain benefits to professional persons under the proposed section 180 A sought to be introduced by clause 51 of the Taxation Laws (Amendment) Bill, 1973 would not affect the position.

It has also been stated that the annuity in question cannot be commuted and no surrender value is payable under the policy.

Hence in view of the clear language of section 2(e) (ii), this right to annuity cannot be considered to be an asset for the purposes of the Wealth Tax Act. Hence, welath tax is also not payable by the person concerned.

A reference has also been made to the effect that certain managing directors and directions are also receiving remuneration in the form of such annuities. Their cases merit separate examination for the question might arise whether they are employees of the company whose income is assessable under the head "Salaries". This aspect of the matter can be examined separately with reference to a few specimen contracts."

3.16. The Law Secretary agreed with the aforesaid views on 13th March 1974. On 31st January 1975, the Select Committee was, therefore, informed by the Department of Revenue that even under the existing law the artiste would be taxed only on the amount of the annuity received during the years. The Select Committee in its report dated 20th March 1975, recommended for the omission of the proposed section 180A. The Select Committee observed that:

"44. Original Clause 51—The Committee were informed that even under the existing law, more or less the same position, as is envisaged in the proposed provision, is secured in respect of remuneration received by the film artistes in the form of annuity—The Committee, therefore, feel that the proposed provision is not necessary. The clause has been omitted accordingly."

3.17. The bill, which was finally passed as Taxation Laws (Amendment) Act, 1975, did not, therefore, contain the proposed section 180A relating to Annuity Policies.

3.18. In this connection the Committee note from a publication called "Tax Laws and Life Insurance" prepared by the Tax Department of Life Insurance Corporation of India that according to them the film artistes are assessable to income tax in each year in respect of annual sums received by him and not in a single year in respect of the total amount paid to effect annuity policies. To quote the publication:—

"The film artistes have a short span of working life and bulk of the income is received during these few years. It is therefore, advantageous for them if the producer takes out an Immediate

Annuity Policy or a Deferred Annuity Policy providing for payment of fixed annual amounts for a number of years certain, and for the life of the artiste if he survives this period. As per opinion expressed by a well-known Income-tax Counsel, the artiste will be assessable to income-tax in each year, in respect of the annual sum received by him, and not in a single year in respect of the total amount paid to effect the policy, provided that (1) the artiste is not a party to the annuity contract and (2) the annuity policy is non-commutable and non-assignable. Further the policy will get complete exemption from Wealth-tax in the hands of film artistes where premia are payable for a period of ten years or more.

As regards the producer, he will be entitled to a deduction in respect of the total amount paid to purchase the policy in the year in which the policy was taken out."

3.19. In a memorandum dated 31 January, 1978, submitted to the Public Accounts Committee, the Cine Artistes' Association, Bombay, have pointed out that working life of a cine artiste is "rather short and mercurial" depending on many unforseen and unexpected factors. The Association has urged that:—

"(i) The correct legal position as enunciated by the above personalities is that such an Annuity cannot become an income in the year in which the Annuity is purchased in the case of people who are maintaining cash system of accounting. This has been made very clear by the above cited opinions. The view sought to be taken by the Income-tax Officer, will only breed more litigation in which the ultimate result will be in favour of the assessee. It is far better that these litigations are best avoided.

(ii) Even otherwise it may not be ethical for the Income-tax Department to go back on the decision given by them. As mentioned earlier many Cine Artistes-*cum*-Producers, etc., have acquired Annuities relying upon the decision given by the Income Tax Department. It will be wholly unfair for the Department to go back on the earlier decision. Assuming the Department wants to change its policy (which may be legally untenable) still it should be only "PROSPECTIVE" AND NOT "RETROSPECTIVE".

(iii) It is a known fact that the Life Insurance Corporation which is also one of the wings of the Ministry of Finance, just like the Income-tax Department, has been circulating the benefits

of the Annuity Scheme, and thereby inducing the Annuitant to acquire Annuity Insurance Policies for the security of the future lean years of the individuals.

(iv) Moreover by the sudden change in the Department's earlier policy, a number of Cine Artistes-*cum*-Producers-*cum*-Technicians, will come to grief. They will be faced with heavy tax liability while they will get the amount of Annuity instalments much later. It is apparent that the Cine Artistes will not have the necessary where-withals to make the payment of such tax liability. To penalise them for having acted on the Instructions of the Department, will only be too drastic to be imagined. It will also undermine the assessees' confidence in the Department's assurances for future.

(v) It is also likely that if the amount of Annuity is taxed in the year of purchase, then there may be a double taxation. There are chances that when the instalments of Annuity are payable to a Cine Artiste along with interest, the same may be taxable in the year in which the instalment is paid. This type of unintended double taxation can take place which cannot be the desire of the Department. There are cases in which a person has contributed Capital amount for buying Annuity and when the instalments are paid, the same are also taxes as income."

3.20. Dealing with the question of inclusion of value of Annuity policies in the net wealth, the Department of Revenue have, in a note, stated that the value of such annuity policies was not includable in the net wealth upto the assessment year 1974-75 as the same was not included in the definition of 'asset' given in Section 2(e) of the Wealth Tax Act, 1957. However, such annuity policies have been brought within the definition of asset w.e.f. 1-4-1975 by the Finance Act, 1974. Such annuity policies, it has been stated, are not exempt under Section 5 of the Wealth Tax Act, 1957, which allows exemption in respect of policies of insurance.

3.21. The Committee enquired if it was fact that assessments in the case of Shri Dev Anand and Smt. Sharmila Tagore had been re-opend even though the opinion given by the Ministry of Law to the Department did not warrant such re-opening. The Department have replied that as the Revenue Audit had raised objection in the cases of Shri Dev Anand and Smt. Sharmila Tagore, the action was taken by the Department to reopen/revise the assessments as a "protective measure."

3.22. Asked if under the law the film stars were supposed to maintain accounts, the witness replied:

"On 12 January, 1977 we have issued a notification according to which actors and other professionals have to maintain accounts. It is now compulsory. Before that it was not obligatory."

3.23. The Committee wanted to know if it was a fact that the mechanism of payments through taking of policies under the Annuity scheme was also being followed by some big business houses in respect of payments to their top executives. In reply, the Department of Revenue have admitted the fact that some companies have adopted the practice of making payments of commission to their top executives by taking up policies under the Annuity scheme. After ascertaining the position in this regard, the Committee have been informed by the Department that "three Executives of the Indian Tube Company, Calcutta and one of the executives of M/s. Tata Chemicals Ltd; were paid commission by taking up policies under Annuity Scheme."

3.24. In reply to a question, the Department have confirmed that, in such cases, the sum payable by the employers to effect a contract for an annuity is a "perquisite" within the meaning of clause (v) of Sub-Section (2) of Section 17 and as such includable in the income under the head 'salaries'. Apart from Section 17 (2), there is no provision in the Income-tax Act, which provides that the amount paid to secure the annuities is taxable.

3.25. The Committee enquired if the practice of accepting payments of remuneration through deferred annuity policy was proposed to be continued. In reply, the Finance Secretary said in evidence:

"Certainly, this is the view of the Government."

3.26. Disclosing the latest trend on payments of remuneration through Annuity Policies, the Finance Secretary said that:—

"In the world over today there is an increasing trend for pension. Now a suggestion has been made even by the Joint Management Council that an annuity should be started for government servants. The Government servant when he retires is faced with a tremendous drop in his emoluments and today there is a scramble to get extensions. So in order to protect his emoluments, suggestion has been made that all Government servants should be covered by some form of annuity scheme where the premium should be paid by the employer

and the employee partly so that at the time of retirement he can draw a subsidiary pension from the insurance company."

3.27. The Committee desired to know if the Department was aware that there was large scale evasion of tax by film stars. In reply, the Finance Secretary conceded in evidence that:

"So far as we can see, in many of these professional classes, film stars of actors or for that matter even lawyers, doctors, there is a substantial amount of income tax which is evaded and much of the unaccounted money is there in these professional classes. It is extremely difficult to find out....certainly in the case of film stars, we have ample evidence to show that there was under the table payment."

3.28. As regards steps taken to combat tax evasion by film stars, the representative of the Department stated during evidence that a number of raids were effected in the case of film stars. The number of such raids was stated to be:

Year	No. of raids	
1974-75	5	
1975-76	5	
1976-77	40	(including 30 raids in Calcutta).

3.29. The witness also revealed during evidence that in Bombay alone, the total disclosures made amounted to Rs. 4.47 crores on which a sum of Rs. 2.15 crores was realised as tax. The disclosures all over India amounted to Rs. 14.8 crores.

3.30. The Committee asked what guarantee was there that after the benefits under the Deferred Annuity Policies black money transactions in Film Industry will stop. In reply, the witness assured that:—

"We are looking into this"

3.31. According to the facts placed before the Committee by the Department of Revenue, certain amounts received in cash were shown by the two film stars (Shri Dev Anand and Smt. Sharmila Tagore) in their return of income but the remuneration received in the form of annuity policies was not returned on the plea that the assessees followed cash system of accounting for their professional income. According to the Audit paragraph, failure to treat the entire premium paid by the producers on account of deferred annuity policy in lieu of the remuneration payable to the artists as income due to them during the assessment years 1972-73 and 1973-74 has resulted in

an under-assessment of Rs. 11,86,917 leading to a total short levy of tax of Rs. 10,71,112 in respect of the two assessees for both the years. Though the Department of Revenue have pointed out that these assessments were in keeping with the advice of the Ministry of Law, they have, in view of the audit objection, taken action to re-open/revise the assessments in these two cases as a "protective measure".

3.32. The Committee have been informed that the question of treatment of remuneration received by film artists in the form of single-premium annuity policy for income tax purposes has been considered by the Department of Revenue in consultation with the Minsitry of Law more than once. In 1971, the Ministry of Law had advised in another case (Shri Guru Dutt) that a film star can be assessed only on the amounts received by him during each year from the LIC under the Annuity Policy. The salient features of the Annuity Policy, in that case, were (i) film artist was not party to the annuity contract, (ii) producers were the annuitants, (iii) by an irrevocable power of Attorney, the producers authorised the artist to recover the amount of the annuity and when they fell due (iv) annuities were non-commutable and (v) the artist maintained his account on cash system. In yet another but slightly different case (Miss Waheeda Rehman), the film artist herself was the annuitant of the policy but had been given the right to nominate an assignee to receive the amount in the event of her premature death. The Commissioner of Income-tax was of the view that because Miss Rehman was the annuitant, it could be said that she had received the money's worth equivalent to the amount paid by the producer to the L.I.C. when the annuity was purchased. In their opinion dated 28-1-1972, the Ministry of Law, however, opined that the entire premium paid to the LIC canont be construed as a receipt in her hands in the year of assessment. It was stated that the fact that she was herself the annuitant and had the right of nomination did not make this case different from that of Shri Guru Dutt. The Taxation Laws (Amendment) Bill 1973 sought to make a provision in the Income Tax Act (proposed Section 180A) for the payments by way of annuity policy to the film artists and professional sportsmen but the Select Committee dropped the proposed provision after being informed after re-examination of the entire issue in consultation with the Ministry of Law in February 1974, that even under the existing law the artist would be taxed only on the amount of the annuity received during the year.

3.33. The Department of Revenue have, however, admitted that at present there is no specific provision in the Income-tax Act, 1961 for tax in the case of annuity policies taken for the benefit of cine artists being assessed in the manner in which it was done in the case of Shri Dev Anand and Smt. Sharmila Tagore and that the assessments were made on the basis of legal opinion that income from annuities should be taxed when the right to receive it has

actually accrued to the cine-artistes. But the Committee also note that in the absence of a specific provision in the law a few business houses have adopted the method of annuity policies for avoiding tax liability on payments made to their top executives. There is also the danger of other professional groups taking recourse to this mechanism for tax avoidance. The Committee, therefore, recommend that in order to make the position free from any doubt and also to prevent the abuse of the benefits, a specific provision should be made in the Income-tax Act, 1961 allowing tax benefit in the case of annuity policies, but at the same time restricting the benefit under the scheme to such professional groups only as merit special consideration on account of their short, active professional life.

3.34. The Committee note that hither tofore actors and other professionals were not required by law to maintain accounts of their income and expenditure, and that it was only on 12 January 1977 that a Notification making maintenance of accounts obligatory on their part has been issued by Government. The Committee are surprised how in the absence of accounts, authenticity of figures given in the returns of their income were checked. This was a loophole which should have been plugged by Government long back especially when Government had ample evidence to show that in the case of professionals like film artists there was large scale tax evasion. The Committee were given to understand during evidence that in Bombay alone, the amount of voluntary disclosures was of the tune of Rs. 4.47 crores on which a sum of Rs. 2.15 crores was realised as tax. The Committee trust that efforts to combat tax evasion would not only continue but would be intensified.

CHAPTER IV

INCORRECT VALUATION OF SHARES

Audit Paragraph

4.1. In paragraph 72 of the Audit Report, 1972-73, it was pointed out that, despite the clear difference in the phraseology of the Estate Duty Act and the Wealth-tax Act, the Board extended, by executive instructions issued in March, 1968, the application of a Rule for valuation of unquoted equity shares framed under the Wealth-tax Act to the valuation of such shares under the Estate Duty Act. While, according to the Estate Duty Act, the value of such shares is to be ascertained 'by reference o the value of the total assets of the company' that under the Wealth-tax Act is to be determined by reference to the 'net value of the assets of the business as a whole, having regard to the balance sheet of such business'.

4.2. In the same instructions of March 1968, the Board also extended a special method prescribed by them in October, 1967 for the valuation of unquoted equity shares of investment companies for wealth-tax purposes, to the valuation of such shares for estate duty. Under this method, the value of such shares was to be taken as the average of (i) the break-up value of the shares based on the book value of the assets and liabilities disclosed in the balance sheet and (ii) the value arrived at by capitalising adjusted maintainable profits of the Company at 9 per cent per annum.

4.3. In consequence of the said audit paragraph, the Board cancelled their instructions of March, 1968 in October, 1974, so as to restore the earlier instructions of 1965, according to which valuation of unquoted shares in companies for estate duty purposes was to be based on the market value and not on the book value of the assets of the company. The Board issued further instructions in May, 1975 to clarify that assets of the company would include goodwill also, whether or not shown as such in the balance sheet. Where, however, market value of an individual asset of the company is not ascertainable, the same is to be taken at its book value in the balance sheet of the company nearest to the date of death.

(i) In the case of a deceased person, who died on 16th August, 1971, valuation of unquoted equity shares held by him in a private limited company was made in March, 1974 by taking the value of the assets of the company at their book values apparently under the Board's instructions of March, 1968. The value of the goodwill of the company was also not included. Valuation of unquoted equity shares in yet another company

(an investment company) was than made on 'yield basis' alone. It was noticed in audit in April, 1976 that, despite the issue of executive instructions in October, 1974 and May, 1975, which indicated clearly the correct manner of valuation of unquoted shares under the Estate Duty Act, the original assessment had not been re-opened so as to recompute the value of the shares by taking assets at market value instead of at book value and by including the value of goodwill. The omission involved a short levy of estate duty of Rs. 1,80,90,526.

4.4. The paragraph was sent to the Department of Revenue and Banking on 4th December, 1976. They have stated (January, 1977) that the objection is under consideration.

(Paragraph 112(i) of the Report of the Comptroller & Auditor General of India for the year 1975-76, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes).

4.5. The Audit paragraph relates to a short levy of Estate Duty of Rs. 1.81 crores in a single case due to erroneous valuation of unquoted equity shares in the estate of two companies (Mafat Lal Gangalbhai & Co. Pvt. Ltd. and Surat Cotton Spinning and Weaving Mills Pvt. Ltd.) included in the estate of the deceased person.

4.6. The basic principle of valuation of assets for levy of estate duty, gift tax and capital gains tax is the value in the open market. For the valuation of unquoted shares of companies, computation of their break-up value on the basis of "total assets" of the company is adpted. For levy of Wealth-tax, this computation of break-up value is to be made having regard to the balance sheet of the company concerned, as provided in the Wealth-tax Rules, 1957 framed under the Wealth-tax Act.

4.7. The following Executive instructions/clarifications were issued by the Central Board of Direct Taxes in this regard from time to time:—

(i) A circular was issued on 3rd May, 1965, laying down that for purposes of valuation of unquoted shares under section 37 of the Estate Duty Act, 1953 the value to be taken into consideration should be based on the break-up value by taking the market value of the assets of the company and not the book value if that does not happen to be their market value. Section 37 provides that:—

"37. *Valuation of shares in a private company where alienation is restricted.*—Where the articles of association of a private company contain restrictive provisions as to the alienation of shares, the value of the shares, if not ascertainable by reference to the value of the total assets of the company,

shall be estimated to be what they would fetch if they could be sold in the open market on the terms of the purchaser being entitled to be registered as holder subject to the articles, but the fact that a special buyer would for his own special reasons give a higher price than the price in the open market shall be disregarded."

(ii) On 5th July, 1965 instructions were issued clarifying the scope of section 37 of the Estate Duty Act. It was clarified that:—

"The instructions issued by the Board in their circular letter referred to in para 1 above, were only with regard to the first part contemplated by section 37 of the Act. They do not and were not intended to restrict the application of the second part of section 37, for which purpose it would be open to the assessing officer to adopt some other method of valuation based on yields or profits, etc."

(iii) Rule 1-D was inserted in the Wealth-tax Rules, 1957 w.e.f. 6-10-1967. The Rule stipulates that:—

"1-D. Market value of unquoted equity shares, of companies other than investment companies, and managing agency companies—The market value of an unquoted equity share of any company other than an investment company or a managing agency company, shall be determined as follows:—

The value of all the liabilities as shown in the balance sheet of such company shall be deducted from the value of all its assets shown in that balance-sheet. The net amount so arrived at shall be divided by the total amount of its paid-up equity share capital as shown in the balance-sheet. The resultant amount multiplied by the paid-up value of each equity share shall be the break-up value of each unquoted equity share. The market value of each such share shall be 85 per cent of the break-up value so determined.

Provided that where, in respect of any equity share, no dividend has been paid by such company continuously for not less than three accounting years ending on the valuation date or in a case where the accounting year of that company does not end on the valuation date, for not less than three continuous accounting years ending on a date imme-

diately before the valuation date the market value of such share shall be as indicated in the Table below:—

Number of accounting years ending on the valuation date or in a cess where the accounting year does not end on the valuation date, the number of accounting years ending on a date, immediately preceding the valuation date, for which no dividend has been paid.	Market value	
Three year . . .	82 1/2 per cent of the break-up value of such share.	
Four years	80	Do.
Five years	77	Do.
Six years and above . . .	75	Do.

Explanation I. For the purposes of this rule "balance sheet", in relation to any company, means the balance sheet of such company as drawn up on the valuation date and where there is no such balance-sheet, the balance sheet drawn up on a date immediately preceding the valuation date and in the absence of both, the balance sheet drawn up on a date immediately after the valuation date.

Explanation II. For the purposes of this rule —

(i) the following amounts shown as assets in the balance-sheet shall not be treated as assets, namely:

(a) any amount paid as advance-tax under section 18A of the Indian Income-tax Act 1922 (11 of 1922), or under section 210 of the Income-tax Act, 1961 (43 of 1961).

(b) any amount shown in the balance sheet including the debit balance of the profit and loss account or the profit and loss appropriation account which does not represent the value of any asset;

(ii) the following amounts shown as liabilities in the balance-sheet shall not be treated as liabilities, namely:—

(a) the paid up capital in respect of equity shares;

(b) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the valuation date at a general body meeting of the company;

(c) reserves, by whatever name called, other than those set apart towards depreciation;

(d) credit balance of the profit and loss account;

(e) any amount representing provision for taxation other than the amount referred to in clause (i) (a) to the extent of the excess over the tax payable with reference to the book-profits in accordance with the law applicable thereto.

(f) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares."

(iv) On 31st October, 1967, it was laid down that for valuation of unquoted equity shares of investment companies be taken as the average of:—

"(a) the break-up value of the shares based on the book value of the assets and liabilities disclosed in the balance-sheet; and

(b) the capitalised value arrived at by applying a rate of yield of 9 per cent to the maintainable profits of the company."

This method is stated to have been laid down after taking into consideration the following main factors:

(i) the deliberations in the Conference of Commissioners of Income-tax in November, 1965;

(ii) A comprehensive study made for comparison purposes with reference to the yield and balance-sheets of a number of public limited companies; and

(iii) The views of the Members of the Direct Taxes Advisory Committee.

(v) Despite the clear difference in the phraseology of the provisions in this regard in the Income-tax Act, 1961, Gift-tax Act, 1958 and Estate Duty Act, 1953 on the one hand and in the Wealth tax Act, 1957 and the Rules framed thereunder on the other, the Board extended the application of Rule 1-D of the Wealth-tax Rules to estate duty and gift-tax cases in March, 1968 and to capital gains tax cases in August, 1968. On this mistake being pointed out in para 72 of the Audit Report, 1972-73, the incorrect instructions of March, 1968 were withdrawn by the Board on 29.10.74. In their Instruction No. 771 dated 29.10.74, the Board directed that the contents of the circular dated 26.3.1968 would not apply to valuation of shares covered by section 37 of the Estate Duty Act and that valuation of such shares should be governed by Board's earlier circulars dated 3rd May, 1965 and 5th July, 1965.

(vi) On 24th May, 1975, the Board issued instructions (No. 835) stating *inter-alia* that the expression "value of the total assets of the company" in section 37 of the Estate Duty Act would mean market value of the assets and not the book value. It was further clarified that the expression "total assets of the company" would include goodwill also, whether or not shown as such in the balance-sheet.

(vii) On 5.11.1976, the Board issued a Circular that all the estate duty assessments which were completed during the period 1.11.1973 to the date of receipt of Instruction No. 771 dated 29.10.1974 and in which the instructions contained in the Board's circular dated 26.3.1968 were applied, should be reviewed and re-opened, if necessary under section 59(b) of the Estate Duty Act so as to correctly value the shares in terms of the Board's existing instructions.

4.8 The Committee desired to know why despite the clear difference in phraseology of the provision in this regard in the Estate Duty Act, 1953 and the Rules framed thereunder, the Board had extended the application of Rule 1-D of Wealth Tax Rules to cases of Estate Duty. In reply, the Department of Revenue have intimated that the reasons as recorded in the relevant file of the Board for the extension of Wealth-tax Rule (Rule 1-D) and Board's instruction of October, 1967 to cases of Estate Duty appeared to be as under:—

"(i) The suggestions by the Governor, Reserve Bank, and the Direct Taxes Advisory Committee in their 9th meeting that valuation of unquoted shares of companies for estate duty purposes should be taken to be the same as was determined for the purposes of wealth-tax for the latest assessment year before the death of the deceased;

(ii) To obviate dual proceedings for the valuation of the same assets, one for the purpose of wealth-tax and, again, for estate duty, which causes inconvenience to tax-payers and may also result in differences in valuation; and

(iii) The following statement made by the then Deputy Prime Minister in paragraph 42 of the Budget Speech for 1968-69 (Part-B); 'Further I propose also to have administrative instructions issued to secure that, as far as possible, the same value is adopted for an asset for the purposes of Income-tax, Wealth-tax, Gift-tax and Estate Duty'."

4.9 The facts relating to each of the two companies M/s. Mafatlal Gangalbhai & Co. Pvt. Ltd. and Surat Cotton Spinning & Weaving Mills are indicated in the following paragraphs:

M/s. Mafatlal Gangalbhai & Co. Pvt. Ltd.

4.10 M/s. Mafatlal Gangalbhai & Co. Pvt. Ltd. was incorporated on 22-12-1920. Being a private limited Company, the Articles of Association contained restrictive provisions as to alienation of its shares. The Issued and Subscribed Capital of this Company as at 31.3.1971 consisted of 2,02,100 equity shares of Rs. 100/- each and 75,750 cumulative Preference Shares of Rs. 100/- each. On 16.8.1971 (the date of death of Hemant Mafat Lal), the members of the Mafatlal family held 69.74 per cent of the equity shares. This percentage of shareholding continued unchanged as on 31.3.1971 and 31.3.1972. On 31.3.1971 i.e. immediately prior to the date of death for which the accounts of the company had been made, the Company was treated as "investment company" within the meaning of Rule 1A(g) of the W.T. Rules, 1957. On 31-3-1971, this Company had two Subsidiaries viz. (i) The New Shorrock Spg. & Mfg. Co. Ltd. and (ii) The Standard Mills Co. Ltd.

4.11 Shri Arvind N. Mafatlal, trustee of Seth Hemant Bhagubhai Trust, in his Return showed the value per equity share of this Company as Rs. 161.00 only on the basis of a certificate of an approved valuer. According to the approved valuer, the break-up value of shares of this company as on 31.3.1971 was, by adopting book value method Rs. 297.52 per share and by yield capitalisation method Rs. 189.43 per share. According to Board's instruction of October, 1967, the average of these two prices was to be adopted for valuation of these shares which worked out to Rs. 243.48 per share. The approved valuer had, however, assessed the value per share as Rs. 161.

4.12 The Report of the approved Valuer indicates that the following basis was adopted by him for this valuation:

> "....it will be seen that the normal expectation from investment in well-known investment companies with free transferability near about the valuation date was about 7 per cent. It may be pointed out that the shares of these companies are day in and day out dealt on the Stock Exchange and they, therefore command free marketability. Since, however, this company is a private limited company with restriction on alienation of shares, it suffers from the disadvantage of unmarketability compared to companies whose shares are quoted on the Stock Exchange. Such unmarketability is universally reckoned as a discounting factor and will, therefore, have to be taken into account in estimating the expected rate of return. Authorities show that a higher rate of capitalisation of 1½ per cent to 2 per cent for unmarketability is a reasonable allowance. Having regard to the relevant facts and circumstances

of the case, it would be fair and reasonable to allow a higher rate of capitalisation of 2 per cent on account of unmarketability. We think that an investor would expect at least a yield of 9 per cent from his investment in a company like the one under consideration. On this basis the value as at 31.3.1971 will come to Rs. 161/- per equity share......"

4.13 Giving the reason for not accepting the basis suggested by the Board in their Circular of October, 1967 the approved Valuer had, in his Report, stated that:

"The instruction as contained in the Board's Circular, not being statutory enactment, have no finding force and at best has only persuasive value. The method of finding out the open market value of shares by taking the mean between the tangible assets value and capitalised value on yield basis is not scientific method."

4.14 The Assistant Controller of Estate Duty accepted the value of the shares as given by the approved valuer (Rs. 161 per share) and did not make any independent evaluation.

4.15 The method of valuation adopted by the approved Valuer being not in accordance with the Board's instruction dated 31.10.1967, the Committee asked as to why did the Assistant Controller not value the shares of this Company independently. In reply, the Department of Revenue have intimated:—

"The Assistant Controller of Estate Duty did not value the shares independently but accepted the approved valuer's certificate since the method of valuation was accepted by the Income-tax Appellate Tribunal, Bombay Bench 'D' in certain Gift-tax and Wealth-tax appeals for the assessment years 1969-70 and 1970-71 filed by Smt. Sharadaben B. Mafatlal which was in line with the Supreme Court decision in Mahadeo Jalan's case (80 ITR 621)".

4.16 As regards the break-up value of these shares adopting market value of the assets of the Company including also the goodwill of the Company, Department of Revenue have, in a not, explained that:

"The company had its main income from investments. Goodwill is associated only with business profits. The only business of the company was running a Jute Mill and during the 5 assessment years 1967-68 to 1971-72, the mill had suffered an average loss of Rs. 6.33 lakhs. Therefore, there can be no goodwill for such a mill. As regards market value of invest-

ment, Schedule V of the balance-sheet as on 31st March, 1971 shows that the book value of the company quoted investments of the company as per investment ledger was 4,43,47,668 and the market value of the same was 18,17,02,273. The company had also unquoted investments and building which yielded a rent of Rs. 7,82,801, and other assets. These can be valued by the Assistant Controller only in the course of reopened assessment. Therefore, at this stage, it is not possible to give the break-up value of the shares adopting the market value of the assets."

4.17 According to the balance-sheet of the company the market value of the investments of the company on 31 March, 1971 was Rs. 18.17 crores excluding the value of unquoted investments, building and other assets. Even if, as submitted by the Department to the committee in a written note, the company had no goodwill on account of consistent losses in the previous 5 years, the value of the unquoted shares taken as Rs. 161 per share was ridiculously low. When this fact was pointed out to the representative of the Department during evidence, he offered the following comments:—

"The Audit has valued it at Rs. 1033 per share. But so far as the figure the ITO has taken is concerned, viz. Rs. 161 per share, we have ourselves found out-though after the audit objection—that while taking the figure of Rs. 161, the ITO did not act correctly and that he should have taken at least Rs. 243, even under the standing instructions of the Department. That was a clear mistake.

We have called for the explanation and we are examining it. I was not satisfied with the explanation and I have sent a letter to the Commissioner for further details. Of course, we do not accept this figure of Rs. 1033 and there are various reasons for that."

Surat Cotton Spinning and Weaving Mills

4.18 Audit paragraph has pointed out that in the case of yet another company (Surat Cotton Spinning & Weaving Mills Pvt. Ltd.), the valuation of unquoted equity shares was made on 'yield basis' alone. The value adopted in the Estate duty assessment was Rs. 117.38 per share. This value was the same as was shown in the return filed by the Trustees of Seth Hemant Bhagubhai Trust as one of the accountable persons under the Estate Duty Act.

4.19 The Committee learnt from Audit that the assessed value of the estate in this case was Rs. 94,64,098 as against the account filed by the accountable person for Rs. 12,86,113 only. The Committee, therefore, wanted to know if there had been any concealment in respect of additions made to the principal value of the estate. The Department of Revenue have, in a note, intimated:

"Almost all the additions made are on account of difference in interpretation of law and the ACED has not found any concealment."

4.20 Asked if the entire estate duty demand of Rs. 62,65,294 had been collected in this case, the Department of Revenue have confirmed that:—

"The entire estate duty demand has been collected. As the payment was made within time, question of levy of interest u/s. 70 did not arise."

4.21 As the deceased had a vested interest in the income and its accumulation during his life of Hemant Bhagubhai Trust, the Committee enquired if the income and corpus of the trust had been aggregated with his income and net wealth. In reply, the Department has explained that:—

"In the Estate Duty assessment, the entire corpus of the trust estate has been added u/s 7 read with Section 40. This has been confirmed in appeal.

The Department attempted to include income of the trust in the income-tax assessment of the deceased. There was no objection from the assessee upto A. Y. 1957-58. It has been held by AAC and Tribunal from A. Ys. 1958-59 to 1961-62 that the income of the trust will be assessable in the hands of the trustees under the First Proviso to Sec. 41(1) of the Indian Income-tax Act, 1922. From A. Y. 1962-63 onwards the appellate Tribunal has decided that only the amount of Rs. 30,000/- actually received by the deceased each year is to be included in his assessment, if it has not already been aggregated with the income of the trust. The Department has filed a reference before the High Court in this matter for assessments years 1958-59 to 1962-63. The matter is pending. There are similar disputes in the later years.

As regards WT; the life interest was worked out by the Department on the basis of the entire income of the trust and included in the WT assessments. This addition has been deleted by the AAC and Tribunal from 1957-58 to 1965-66. In A. Y.

1966-67, however, an addition of Rs. 3,38,550/- on actuarial basis has been upheld by the Tribunal. From 1967-68 onwards the entire addition has been deleted by the AAC and the matter is pending before the Tribunal. Reference applications before the High Court are pending from A. Y. 1957-58 to 1965—66. In respect of A. Y. 1966—68, the decision of the Tribunal was confirmed by the High Court. The Department was advised by the Solicitor General of India against the filing of special leave petition before the Supreme Court and as such no such petition was filed."

4.22 The Committee enquired if the incorrect valuation of unquoted equity shares of Surat Cotton Spinning and Weaving Mills Pvt. Ltd. had been rectified. In reply, the Department of Revenue have intimated:—

"The assessment has been reopened u/s 59(b) of the Estate Duty Act. The re-assessment has not yet been completed.

4.23 The Committee wanted to know whether in view of the fact that the incorrect instructions of March, 1968 under which case of both these Companies was dealt with have already been withdrawn by the Board in October, 1974, the audit objection has been accepted by Government. In reply, the Department of Revenue have intimated that after considering the audit objection, the following reply had been sent by them to Audit on 26.9.1977:—

"The objection raised by Audit in the above case is accepted in principle, but not the tax effect. The assessment has been reopened under section 59(b) of the Estate Duty Act. The actual quantum of the under-assessment can be determined only after re-assessment proceedings have been completed."

4.24 The Committee asked whether there were any judicial decisions on the point that a clarification as to the correct state of law on any point applied retrospectively and if so, how was it that despite the cancellation of instructions of March 1968 in October, 1974, the original assessment was not reopened in this case. In reply, the Department of Revenue have, in a note, stated:—

"There are more than one judicial decision to the effect that a clarification as to the correct state of law, as well as fact, on a point applied retrospectively so as to constitute information within the meaning of Section 58(b) of the Estate Duty Act (corresponding to Section 147(b) of the Income-tax Act, 1961/24(1)(b) of the Income Tax Act, 1922). The

circumstances under which the assessment could not be re-opened earlier are being ascertained from the Controller of the Estate Duty."

4.25 The Committee desired to know whether on the basis of instructions issued by the Board in October, 1974 that all estate duty assessments which were completed by applying Board's incorrect instructions of March, 1968 should be reviewed and re-opened, if necessary, the review of such cases had been completed and if so what the out come of that review was. In reply, the Department of Revenue have intimated that the results of the review are as under:—

(i) No. of estate duty assessments completed during the period 1-11-1973 to the date of receipt of Board's Instruction No.771 dated 29-10-1974	16,945
(ii) No. out of (i) above in which Board's Circular No. 1-D/ED of 1968 dated 26-3-1968 was applied	91
(iii) No. of assessments, out of (ii) above, reopened under sec. 59(b) of the Estate Duty Act	80*

(*NOTE.— In the balance of 11 cases, no action was considered necessary by the Controllers of E.D. because the Value of shares included in the assessment were very small).

4.26. The Committee have also been informed that in order to consider various problems regarding the valuation of upquoted shares of companies in general, a Study Group was set up by the Board in June, 1976. The report of the Group received in September, 1977 was stated to be still under examination of Government.

4.27. In their instructions issued on 3 May, 1965 the Central Board of Direct Taxes had laid down that for the purposes of estate duty, valuation of unquoted equity shares should be based on the break-up value by taking the market value of the assets of the company and not the book value if that does not happen to be their market value. Despite the clear difference in the phraseology of the provision in this regard in the Estate Duty Act, 1953 and in the Wealth-tax Act, 1957 and the Rules framed thereunder, the Board extended the application of Rule 1-D of the Wealth-tax Rules, 1957 to estate duty cases by executive instructions issued in March, 1968. The extension of Rule 1-D of the W.T. Rules 1957 is stated to have been done on a suggestion by the Governor, Reserve Bank of India and the statement made by the then Deputy Prime Minister in paragraph 42 of his Budget Speech for 1968-69 (Part B) to the effect that he proposed to have administrative instructions issued to secure that, as far as possible, the same value was adopted for an asset for the purpose of Income-tax, Wealth-tax, Gift-tax and Estate Duty. The Board's instructions of March, 1968 also extended a special method prescribed by the Board in October, 1967 for the valuation of unquoted equity shares

of investment companies for Wealth-tax purposes, to the valuation of such shares for estate duty. Under this method, the value of such shares was to be taken as the average of (i) the break-up value of the shares based on the book value of the assets and liabilities disclosed in the balance sheets and (ii) the value arrived at by capitalising adjusted maintainable profits of the company at 9 per cent per annum. When Audit pointed out in para 72 of the Audit Report 1972-73 that March 1968 were erroneous, they withdrawn by the Board on 29 October, 1974 so as to restore the earlier instructions of May, 1965.

4.28. The Committee are surprised to note that in the case of a deceased person (Shri Hemant Mafat Lal) who died on 16 August, 1971, the value of equity shares held by the deceased person in Mafatlal Gangalbhai & Co. Pvt. Ltd., worked out to Rs. 243.48 per share even in accordance with the method of valuation indicated in the instructions issued by the Central Board of Direct Taxes in October, 1967, the Assistant Controller of Estate Duty valued the same at Rs. 161 only on the basis of the Report of an approved Valuer. While conceding that this was a 'clear mistake', the representative of the Department informed the Committee that the explanation of the officer who had adopted such a low valuation of Rs. 161 per share had not been found satisfactory and therefore some further details about this case had been called for from the Commissioner of Income Tax. The Committee would like to be apprised of the outcome of this case. The Committee also recommend that on receipt of the requisite details from the Commissioner, this case should be probed thoroughly from all angles and if any lapse is noticed, responsibility therefor should be fixed.

4.29. It is regrettable that in the case of an other property in the Estate of the deceased also, namely Surat Spinning and Weaving Mills, the valuation of unquoted equity shares for Estate Duty was made on "yield basis" alone and not even in accordance with the Board's instructions of October, 1967 and March, 1968 then in force.

4.30. The Committee view with serious concern the fact that, despite the issue of executive instructions in October, 1974 and May, 1975, which indicated clearly the correct manner of valuation of unquoted equity shares under the Estate Duty Act, the original assessment in this case of two Companies had not been re-opened upto April, 1976 so as to recompute the value of the shares by taking assets at market value which even according to Company's own balance-sheet as on 31.3.1971 was Rs. 18.17 crores against its book value of Rs. 4.43 crores. The Department informed Audit that the objection raised by Audit was accepted in principle, but not the tax effect. The Department have stated that assessment had been reopened under Section 59(b) of the Estate Duty Act and that the actual

[illegible] of under assessment can be determined only after re-assessment proceedings were completed. The Committee recommend that the circumstances in which this inordinate delay in re-opening the original assessment occurred should be investigated. The Committee would also like that suitable steps may be taken to ensure that such delays do not recur in future.

4.31. Now that the assessment in the estate duty case of deceased person has been reopened, the Committee trust that the value of the unquoted shares of these companies will be determined on the basis of the market value of assets including the goodwill of the companies. The Committee would like to be informed of the final outcome of these cases.

4.32. According to a review conducted by the Central Board of Direct Taxes, it has been found that out of 16,945 estate duty assessments completed during the period 1 November, 1973 to the date of receipt of Board's instructions of 29 October, 1974, there were 91 cases where Board's Circular of 26 March, 1968 was applied. Of these 91 cases, assessments are stated to have been re-opened under Section 59(b) of the Estate Duty Act in 80 cases. As regards the balance of 11 cases, the Committee have been informed that no action is contemplated because the value of shares included in the assessments were very small. The Committee would like to know in due course the total amount of additional duty realised in the aforesaid 80 cases.

4.33. The Committee have been informed that in order to consider various problems regarding the valuation of unquoted shares of companies in general, a Study Group was set up by the Board in June, 1976. The Report of the Study Group was received by Government in September, 1977 and was stated to be under examination. The Committee recommend that the examination of that Report should be completed soon and the Committee apprised of the steps proposed to be taken by Government in the light of that Report.

NEW DELHI;
April 24, 1978.
Vaisakha 4, 1900 (*S*).

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

APPENDIX 1

[*Vide* para 1.17(6)]

INSTRUCTION NO. 933

F. No. 178|17|75-IT(AI)

GOVERNMENT OF INDIA

CENTRAL BOARD OF DIRECT TAXES

New Delhi, Dated the 4th March, 1976.

To

All Commissioners of Income-tax.

Sir,

SUBJECT.—*Deduction under section* 80J *of the Income-tax Act,* 1961—*Instruction Regarding*—.

Attention is invited to Board's Instruction No. 904 (F. No. 178|68|75-IT.AI), dated 16th December, 1975 on the above subject.

2. The Board desire to emphasize that while computing the relief admissible under section 80J of I.T. Act, 1961 the profits and gains attributable to the new industrial undertaking should be carefully computed by applying the provisions of section 30 to 43A of the Act as if the new industrial undertaking is a separate business by itself. In other words, in determining the profits earned by a new industrial undertaking for the purposes of granting relief under section 80J, no item of expense or other allowance including unabsorbed depreciation and development rebate relating to the new industrial undertaking should be allowed as a set off against the profits of any other unit or other heads of income of the assessee, even though for the purpose of determining the total income such a set off has to be made under the law. In this connection, the decision of the Madras High Court in the case of Rajapalayam Mills Ltd. (78 ITR, 677) may be referred to.

3. The above instructions may be brought to the notice of all officers working in your charge.

Yours faithfully,

Sd|- T. P. JHUNJHUNWALA,

Secretary, Central Board of Direct Taxes

APPENDIX II

Statement of Conclusions|Recommendations

S. No.	Para No.	Ministry/ Department	Conclusion/Recommendation
1	2	3	4
1	1.38	Ministry of Finance (Deptt. of Revenue)	It has been pointed out by Audit that an erroneous tax holiday relief allowed to Orient Paper Mills Ltd. in the assessment year 1971-72 under Section 80J of the Income Tax Act, 1961 has resulted in an undercharge of tax to the tune of 1.43 crores. The assessee company had established a new paper mill at Amlai (Madhya Pradesh) which went into production in February, 1965. The new unit was entitled to 60 per cent tax holiday for the assessment years 1965-66 to 1969-70. The unit did not, however, record any profits or gains for these assessment years. By the Finance (No. 2) Act 1967, Sections 84 and 85 of the Income-tax Act, 1961 were deleted and new Sections 80J and 80K were inserted. Whereas under the former Section 84, there was no provision for carrying forward the deficiency, the new Section 80J provided for carrying forward the deficiency from assessment year 1967-68 onwards. In view of this, in the present case, while the relief due for the assessment years 1965-66 and 1966-67 could not be carried forward for adjustment under the law their prevailing, the relief due for the years 1967-68 to 1969-70 was eligible for carry forward and set off against the profits of the new industrial undertaking upto the assessment year 1972-73. This deficiency aggregating

			Rs. 2.60 crores was set off by the Department in the assessment year 1971-72. As pointed out by Audit, this was irregular as the new unit at Amlai had made a profit of Rs. 3.32 crores in that assessment year while the unabsorbed depreciation and development rebate, computed on the basis of the working results of the unit, stood at Rs. 5.42 crores which had first to be set off. After this set off, there would be no profit left to adjust this deficiency. Though in their reply dated 25.11.1976, the Department of Revenue informed Audit that re-opening of the assessment of the assessee company would create "several complications, the Department later issued a Notice to the assessee company on 28.9.1977 under Section 154 of the Income-tax Act for rectification of its assessment for 1971-72 on the basis of the audit objection. On 7.10.1977, the assessee is stated to have filed a petition before the Calcutta High Court which was granted temporary injunction directing the Income Tax Officer to pass the rectification order but not to communicate the same or enforce the same. It is learnt that this matter is before the Supreme Court in appeals filed by the assessee in the Rajapalayam case and by the Department in the Patiala Flour Mills case. As a matter is *sub judice*, the Committee would not like to express any opinion on the merits of the case at this stage.
2	1·39	do.	The Committee, however, cannot help expressing their dismay over the fact that the Department of Revenue had not been following a consistent course of action in handling cases of tax holiday under section 80J of the Income Tax Act, 1961. In their judgement delivered on 4.10.1960, the Madras High Court had in the case of Ashoka Motors Ltd. *vs.* C.I.T. Madras (41 ITR 397) referred to distinction between an 'assessee' and the 'new industrial undertaking' in Section 15 C of the Income-tax Act,

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			1922 (corresponding to Section 80-J of the Income Tax Act, 1961) and held that "in this case of even composite business carried on by the assessee, it is only the profits of the industrial undertaking that would be eligible for exemption". This decision was reiterated by Madras High Court in Rajapalayam case (78 ITR P 677). On 19.5.1973, the Department of Revenue (CBDT) made a reference to the Ministry of Law in the case of Tribeni Tissues Ltd. case. While doing so, the Department expressed the view that the aforesaid decision of Madras High Court in Rajapalayam Case based, as it was, on Section 15C of the Income Tax Act, 1922 cannot be applied while considering a claim under section 80J of the Income-tax Act, 1961. The new Section, it was pointed out, was worded differently and referred to "gross total income" of an assessee, whereas old Section 15C had restricted the "profits or gains derived from any industrial undertaking". In their advice dated 12.6.1973, the Ministry of Law agreed with the view expressed by the Department of Revenue that Madras High Court Judgement in the Rajapalayam Case was no longer valid. Later, the Department of Revenue accepted on 12.2.1975 an objection raised by Audit in the Alembic Glass Industries Ltd. case in their 1973-74 Report on Direct Taxes, and applying the judgement in Rajapalayam case even re-opened the assessments in that case. Explaining this shift in their stand, the Department have, in a note to the Committee, stated that when the decision to accept the audit objection in the Alembic Glass Industries case was taken on 12-2-1975, the advice of the Ministry of Law in Tribeni Case was "unfortunately overlooked". The Committee have, however, on the other hand, a feeling that it was a repre-

			sentation from the Orient Paper Mills, fortified as it was by the opinion of a luminary of the legal profession, which persuaded the Board to make a reference to the Ministry of Law and pass on their advice, which was in favour of the party and against Revenue, to the Commissioner of Income Tax, West Bengal. That, barring this case and the contemporary case of Tribeni Tissues Ltd., the Board had a different view of law is borne out by the Board's subsequent acceptance of the Audit objection in the case of Alembic Glass Industries and the decision of Revenue to go in appeal against the Judgement of the Punjab and Haryana High Court in the case relating to Patiala Flour Mills Ltd.
3	1·40	do	What has come as a greater surprise to the Committee is that despite the fact that audit objection had already been accepted in the Alembic Glass Industries case on 12.2.1975, and the principle settled in Rajapalayam case applied, when a similar objection was raised in the present case of Orient Paper Mills, the Department informed Audit that re-opening of assessment of this assessee company would create "several complications" Referring to these complications, the representative of the Department disclosed during evidence that all that they had in mind was that if the benefit of Rs. 2.6 crores given to Orient Paper Mills was withdrawn in the assessment year 1971-72, it may have to be simultaneously given in the 1972-73 assessment and that re-opening of assessment of the company would entail re-opening of assessments of more than 3,400 cases of share holders of the company who had been given benefit of tax exemption on dividend declared by the company under section 80K. When the Committee pointed out that these so-called "Complications" were nothing but inevitable consequences of re-opening of assessments in company cases, the representative of the Department assured that it had since taken remedial action

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			and would follow it up to its "logical conclusion". The Committee regret that by holding over re-opening of assessment for a long time and that too for reasons over which the Board continue to entertain doubt, undue solicitude appears to have been shown to the assessee company. The Committee are of the view that a more prudent course for the Department would have been to re-open the assessment promptly on the basis of audit objection and leave it to the assessee company to appeal against it.
4	1·41	Ministry of Finance (Deptt. of Revenue)	It is somewhat puzzling that when the Ministry of Law gave their advice in 1973 in the case of Tribeni Tissues Ltd. on the scope of Section 80J of the Income-tax Act, 1961, the Central Board of Direct Taxes did not issue a general circular in 1973, to ensure that the law was applied uniformly in all cases but only communicated the advice to the Commissioners of Income-tax, West Bengal. The Department felt that they need not issue general instructions on the basis of an isolated case. But when audit raised an objection in the case of Alembic Glass Industries, the Board issued a general circular on 4.3.1976 advising the Commissioners to follow the Judgement in Rajapalayam case. While the Finance Secretary conceded during evidence that a general circular "ought to have been issued at that time" by the Board, he pointed out to the Committee that non-issuance of a circular in 1973 was "beneficial to the Government and beneficial to the revenue". Had such a circular gone out in 1973, he said, "the ITOs all over the country including the ITOs in Tamil Nadu who were otherwise following the Rajapalayam case, would have follow-

			ed this". This reasoning is not convincing. The Committee are of the view that when decisions having bearing on interpretation of Direct-tax laws are taken in consultation with the Ministry of Law, such decisions should be given widest possible circulation so that the law was not applied differently in different parts of the country, as had happened in this case.
5	1·42	do	Section 119(i) of the Income-tax Act, 1961, as it stood before 1.4.1971 had provided that all officers and persons employed in the execution of the Income-tax Act shall observe and follow the orders, instructions and directions of the Board. By Act 42 of 1970, the Section was amended *w.e.f.* 1-4-1971 by which a restrictions was imposed on the powers of the Board to the effect that the Board shall not issue any order, instruction or direction so as to require any Income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner. In paragraph 5.89 of their 128th Report (Fifth Lok Sabha), the Committee had cautioned the Board against giving advance rulings in individual cases. On 22-11-1974, the Board issued a circular in which it was stated, *inter alia,* that the Board will not issue any advance rulings|directions|instructions in individual cases to any income-tax authority or to any querist though it would continue to "oversee administratively the functions of the lower formations and give advice in individual cases if the facts of the case so justify". The Committee hope that the self restraint imposed by the Central Board of Direct Taxes upon themselves by their circular of November, 1974 would be strictly adhered to.
6	2·28	do.	The Committee note that while making assessments for the assessment years 1966-67 to 1972-73, the manufacture of "rayon grade pulp" by M|s.

1	2	3	4
			Gwalior Rayon and Silk Mfg. (Wvg.) Company Ltd. (Birla Group) was treated as a priority industry and tax concessions consisting of (i) development rebate (Rs. 1,19,26,866), Surtax (Rs. 28,01,808) and (ii) Tax Credit Certificates (Rs. 1,20,54,691) aggregating to Rs. 2.68 crores (revised to Rs. 2.78) were allowed to the Company under the Income-tax Act, 1961. Audit have objected to these concessions on the ground that "as per the list of articles given in the Sixth Schedule to the Income-tax Act, 1961 and First Schedule to the Industries (Development and Regulation) Act, 1951, it was 'paper industry' which came under the category of 'priority industry' and therefore the profits from the manufacture of pulp meant for producing paper was entitled to the aforesaid concessions" and not pulp produced for other purposes, e.g. manufacture of rayon yarn. The Ministry of Finance (Department of Revenue) have not accepted the audit objection in this case. It has been stated that in the Department's view the assessment made in this case by the Income-tax Officer "is justified on facts and in law."
7	2·29	Ministry of Finance (Deptt. of Revenue)	The Department of Revenue have sought to justify these assessments by relying largely on the Industries (Development and Regulation) Act, 1951 which, it has been stated, "can be reasonably taken as an index of some of the industries which are of importance to the national economy." Entry No. 24 of the First Schedule of this Act is titled "Paper and Pulp including paper products" and sub-Entry (5) thereof refers to "pulp" as "Pulp—wood pulp, mechanical, chemical, including dissolving pulp". The

			pulp produced by M|s. Gwalior Rayons for use in the manufacture of rayon yarn (to which the Audit objection pertains) comes in the category of "dissolving pulp." In this connection, Department have pointed out that though "dissolving pulp" has very little to do with paper it had always been classified under the head 'Paper and paper board' as (i) Item 43 of the first schedule to the Indian Tariff Act, 1943, (ii) the Wealth of India (Industrial Products), Part II published by the C.S.I.R. in 1965, (iii) the guidelines for industries published by the Industrial Development in July 1973, (iv) definition of the word pulp in the Indian Standards Publication entitled "Glossary of terms used in Paper trade and industry, (v) Explanatory notes to the Brussels Nomenclature (Volume II) Sections VIII to XV—Chapters 41 to 83, Fifth June 1967, would show. The Committee cannot see how the admissibility of concessions under the Income Tax Act, 1961 can, as it seems to have been done in this case, be determined much less justified on the basis of other Acts or documents. 'The guidelines for industries' published by the Department of Industrial Development in 1973 has no relevance because the assessments in question relate to years prior to 1973. Moreover, it may be pointed out in this connection that the Industries (Development and Regulation) Act, 1951 does not deal with tax matters at all, and according to a clarification given by the Ministry of Industry, it envisages no financial concessions.
8	2·30	do.	The justification for tax concessions allowed to the assessee company has to be judged on the basis of the provisions contained in this behalf in the Income-tax Act, 1961. The Committee find that the relevant entry in this Act, was "Paper and Pulp" upto 31.3.1966, and "Paper and Pulp including Newsprint" thereafter. From 1.4.1975, the entry was again

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			changed to "Paper, Pulp and Newsprint". The Act does not specify whether "Paper and Pulp" means pulp for paper alone or whether it includes pulp for other purposes also. A moot point to be considered is that when the two words "paper" and "pulp" are clubbed together in a single entry, whether they should be not interpreted in a cognate sense. While submitting that what is involved in this case "is not so much a question of law, as question of fact", the Department of Revenue have contended that "paper" and "pulp" are two different industries. Had it not been so, separate inclusion of the word "pulp" in the schedule would have been redundant. Every paper mill, it has been stated, has a pulp plant and the only unit producing pulp for paper without manufacturing paper got into production round about 1969. The Department has also argued that "if the intention of the legislature was to limit the benefits of a priority industry to units used in making pulp for paper, it would have been adequate for the purpose to include "paper" alone. The separate mention of pulp, it has been contended, serves to show that what was meant was pulp in general, including pulp needed for rayon. Audit, on the other hand, have pointed out that on the basis of the language used in the Income-tax Act, 'pulp' would mean pulp produced for paper only and not for any other purpose.
9	2·31	Ministry of Finance (Deptt. of Revenue)	The Committee find that Audit objection in this case was raised as early as in August 1975. The matter came to the notice of the Department on 3.12.1976. The Department of Revenue first informed the Audit

			in February 1977 (i.e. two years later) that the objection was under 'active consideration' but later it was stated on 18.7.1977 that the objection had not been accepted. The long time taken in considering the audit objection clearly indicates that the Department was not very sure of its stand on this case. The Committee also note that the decision to reject the interpretation of law given by Audit was taken by the Department of Revenue at their own level, without obtaining an authoritative opinion of the Ministry of Law on the point of law involved. In fact a reference was made by the Department to the Ministry of Law on 17-9-1977 (when a decision to reject the audit objection had already been communicated to the Audit) but before that Ministry could consider the various issues involved, the file was withdrawn from that Ministry on 4-10-1977 in deference to a 'convention' said to be prevailing in regard to matters contained in the Audit Report with which the PAC is seized. The Committee consider that before taking a final decision in regard to the Audit objection the Department should have obtained the advice of the Ministry of Law. That it was not done in this case even though the Audit objection remained under the consideration of the Department for well-nigh 2 years is regrettable. The Committee recommend that the matter should be referred to the Ministry of Law for their advice.
10	2·32	do.	The Committee also note that according to the judgement of the Supreme Court in the case of R. K. Malhotra, Income-tax Officer vs. Kasturbhai Lalbhai delivered on 11 August 1977, it was held that "the Audit

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			Department was the proper machinery to scrutinise the assessments of Income-tax Officers and point out the errors, if any, in law, and that the intimation received by the Income-tax Officer constituted 'information' within the meaning of Section 147(b) in consequence of which the Income Tax Officer could reopen the assessment." The Committee feel that in view of the special position of Revenue Audit recognised by the Supreme Court, the Audit objections in regard to assessment of income-tax deserve serious consideration by Government. The Committee recommend that in future whenever a difference of opinion arises in regard to "errors in law" in the case of any assessment or class of assessments, between the Ministry of Finance (Department of Revenue)|Central Board of Direct Taxes on the one hand and the Revenue Audit on the other, the Department should, before taking a final view in the matter, normally obtain the opinion of the Ministry of Law. In case the loss of revenue pointed by Audit is substantial and there is a difference of opinion on a point of law between the Department of Revenue and the Ministry of Law on the one hand and the Revenue Audit on the other, it would be advisable to obtain the opinion of the Attorney General before taking a final decision adversely affecting revenue.
11	3·31	Ministry of Finance (Deptt. of Revenue)	According to the facts placed before the Committee by the Department of Revenue, certain amounts received in cash were shown by the two film stars (Shri Dev Anand and Smt. Sharmila Tagore) in their return of income but the remuneration received in the form of annuity policies was not returned on the plea that the assessees followed cash system of

			accounting for their professional income. According to the Audit paragraph, failure to treat the entire premium paid by the producers on account of deferred annuity policy in lieu of the remuneration payable to the artists as income due to them during the assessment years 1972-73 and 1973-74 has resulted in an under-assessment of Rs. 11,86,917 leading to a total short levy of tax of Rs. 10,71,112 in respect of the two assessees for both the years. Though the Department of Revenue have pointed out that these assessments were in keeping with the advice of the Ministry of Law, they have, in view of the audit objection, taken action to re-open/revise the assessments in these two cases as a "protective measure".
12	3·32	do.	The Committee have been informed that the question of treatment of remuneration received by film artists in the form of single-premium annuity policy for income tax purposes has been considered by the Department of Revenue in consultation with the Ministry of Law more than once. In 1971, the Ministry of Law had advised in another case (Shri Guru Dutt) that a film star can be assessed only on the amounts received by him during each year from the LIC under the Annuity Policy. The salient features of the Annuity Policy, in that case, were (i) film artist was not Party to the annuity contract, (ii) producers were the annuitants, (iii) by an irrevocable power of Attorney. the producers authorised the artist to recover the amount of the annuity as and when they fell due (iv) annuities were non-commutable and (v) the artist maintained his account on cash system. In yet another but slightly different case (Miss Waheeda Rehman). the film artist herself was the annuitant of the policy but had been given the right to nominate an assignee to receive the amount in the event of her premature death. The

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			Commissioner of Income-tax was of the view that because Miss Rehman was the annuitant, it could be said that she had received the money's worth equivalent to the amount paid by the producer to the L.I.C. when the annuity was purchased. In their opinion dated 28-1-1972, the Ministry of Law, however, opined that the entire premium paid to the LIC cannot be construed as a receipt in her hands in the year of assessment. It was stated that the fact that she was herself the annuitant and had the right of nomination did not make this case different from that of Shri Guru Dutt. The Taxation Laws (Amendment) Bill 1973 sought to make a provision in the Income Tax Act (proposed Section 180A) for the payments by way of annuity policy to the film artists and professional sportsmen but the Select Committee dropped the proposed provision after being informed after re-examination of the entire issue in consultation with the Ministry of Law in February 1974, that even under the existing law the artist would be taxed only on the amount of the annuity received during the year.
13	3·33	Ministy of Finance (Deptt. of Revenue)	The Department of Revenue have, however, admitted that at present there is no specific provision in the Income-tax Act, 1961 for tax in the case of annuity policies taken for the benefit of cine artists being assessed in the manner in which it was done in the case of Shri Dev Anand and Smt. Sharmila Tagore and that the assessments were made on the basis of legal opinion that income from annuities should be taxed when the right to receive it has actually accrued to the cine-artistes. But the Committee also note that in the absence of a specific provision in the law a few business houses have adopted the method of annuity policies for avoiding

			tax liability on payments made to their top executives. There is also the danger of other professional groups taking recourse to this mechanism for tax avoidance. The Committee, therefore, recommend that in order to make the position free from any doubt and also to prevent the abuse of the benefits, a specific provision should be made in the Income-tax Act, 1961 allowing tax benefit in the case of annuity policies, but at the same time restricting the benefit under the scheme to such professional groups only as merit special consideration on account of their short, active professional life.
14	3·34	do.	The Committee note that hithertofore actors and other professionals were not required by law to maintain accounts of their income and expenditure, and that it was only on 12 January 1977 that a Notification making maintenance of accounts obligatory on their part has been issued by Government. The Committee are surprised how in the absence of accounts, authenticity of figures given in the returns of their income were checked. This was a loophole which should have been plugged by Government long back especially when Government had ample evidence to show that in the case of professionals like film artists there was large scale tax evasion. The Committee were given to understand during evidence that in Bombay alone, the amount of voluntary disclosures was of the tune of Rs. 4.47 crores on which a sum of Rs. 2.15 crores was realised as tax. The Committee trust that efforts to combat tax evasion would not only continue but would be intensified.
15	4·27	do	In their instructions issued on 3 May, 1965 the Central Board of Direct Taxes had laid down that for the purposes of estate duty, valuation

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			of unquoted equity shares should be based on the break-up value by taking the market value of the assets of the company anl not the book value if that does not happen to be their market value. Despite the clear difference in the phraseology of the provision in this regard in the Estate Duty Act, 1953 and in the Wealth-tax Act, 1957 and the Rules framed thereunder. the Board extended the application of Rule 1-D of the Wealth-tax Rules, 1957 to estate duty cases by executive instructions issued in March, 1968. The extension of Rule 1-D of the W.T. Rules 1957 is stated to have been done on a suggestion by the Governor, Reserve Bank of India and the statement made by the then Deputy Prime Minister in paragraph 42 of his Budget Speech for 1968-69 (Part B) to the effect that he proposed to have administrative instructions issued to secure that, as far as possible. the same value was adopted for an asset for the purpose of Income-tax. Wealth-tax, Gift-tax and Estate Duty. The Board's instructions of March 1968 also extended a special method prescribed by the Board in October, 1967 for the valuation of unquoted equity shares of investmeunt companies for Wealth-tax purposes, to the Valuation of such shares for estate duty. Under this method, the value of such shares was to be taken as the average of (i) the break-up value of the shares based on the book value of the assets and liabilities disclosed in the balance sheets and (ii) the value arrived at by capitalising adjusted maintainable profits of the company at 9 per cent per annum. When Audit pointed out in para 72 of the Audit Report 1972-73 that March 1968 were erroneous, they withdrawn by the Board on 29 October, 1974 so as to restore the earlier instructions of May, 1965.

16	4.28	do	The Committee are surprised to note that in the case of a deceased person (Shri Hemant Mafat Lal) who died on 16 August, 1971, the value of equity shares held by the deceased person in Mafatlal Gangalbhai & Co. Pvt. Ltd. worked out to Rs. 243.48 per share even in accordance with the method of valuation indicated in the instructions issued by the Central Board of Direct Taxes in October, 1967, the Assistant Controller of Estate Duty valued the same at Rs. 161/- only on the basis of the Report of an approved Valuer. While conceding that this was a 'clear mistake', the representative of the Department informed the Committee that the explanation of the officer who had adopted such a low valuation of Rs. 161/- per share had not been found satisfactory and therefore some further details about this case had been called for from the Commissioner of Income Tax. The Committee would like to be apprised of the outcome of this case. The Committee also recommend that on receipt of the requisite details from the Commissioner, this case should be probed thoroughly from all angles and if any lapse is noticed, responsibility therefor should be fixed.
17	4.29	do	It is regrettable that in the case of an other property in the Estate of the deceased also, namely, Surat Spinning and Weaving Mills, the valuation of unquoted equity shares for Estate Duty was made on "yield basis" alone and not even in accordance with the Board's instructions of October, 1967 and March, 1968 then in force.
18	4.30	do	The Committee view with serious concern the fact that, despite the issue of executive instructions in October, 1974 and May, 1975, which indicated clearly the correct manner of valuation of unquoted equity

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			shares under the Estate Duty Act, the original assessment in this case of two Companies had not been re-opened upto April, 1976 so as to re-compute the value of the shares by taking assets at market value which even according to Company's own balance-sheet as on 31-3-1971 was Rs. 18.17 crores against its book value of Rs. 4.43 crores. The Department informed Audit that the objection raised by Audit was accepted in principle, but not the tax effect. The Department have stated that assessment had been re-opened under Section 59(b) of the Estate Duty Act and that the actual quantum of under assessment can be determined only after re-assessment proceedings were completed. The Committee recommend that the circumstances in which this inordinate delay in re-opening the original assessment occurred should be investigated. The Committee would also like that suitable steps may be taken to ensure that such delays do not recur in future.
19	4.31	do.	Now that the assessment in the estate duty case of deceased person has been reopened, the Committee trust that the value of the unquoted shares of these companies will be determined on the basis of the market value of assets including the goodwill of the companies. The Committee would like to be informed of the final outcome of these cases.
20	4.32	do.	According to a review conducted by the Central Board of Direct Taxes, it has been found that out of 16,945 estate duty assessments completed during the period 1 November, 1973 to the date of receipt of Board's

		instructions of 29 October, 1974, there were 91 cases where Board's Circular of 26 March, 1968 was applied. Of these 91 cases, assessments are stated to have been re-opened under Section 59(b) of the Estate Duty Act in 80 cases. As regards the balance of 11 cases, the Committee have been informed that no action is contemplated because the value of shares included in the assessments were very small. The Committee would like to know in due course the total amount of additional duty realised in the aforesaid 80 cases.
4·33	do.	The Committee have been informed that in order to consider various problems regarding the valuation of unquoted shares of companies in general, a Study Group was set up by the Board in June, 1976. The Report of the Study Group was received by Government in September, 1977 and was stated to be under examination. The Committee recommend that the examination of that Report should be completed soon and the Committee apprised of the steps proposed to be taken by Government in the light of that Report.

GMGIPMR—814 LS—8-7-78—1150.