

**PUBLIC ACCOUNTS COMMITTEE
(1977-78)**

(SIXTH LOK SABHA)

FORTY-FIFTH REPORT

**INCORRECT GRANT
OF
EXPORT INCENTIVES**

**MINISTRY OF FINANCE
(Department of Revenue)**

[Paragraph 20(a) of the Report of the Comptroller and Auditor General of India for the year 1973-74, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes relating to Incorrect Grant of Export Incentives.]

Presented in Lok Sabha on 19th Dec., 1977

Laid in Rajya Sabha on 19th Dec., 1977



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CORRIGENDA

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LOK SABHA) ON INCORRECT GRANT OF
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PART II*

Minutes of the sittings of the Public Accounts Committee held on:

17-11-1976 (FN)

6-12-1977 (FN)

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(1977-78)

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SECRETARIAT

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

Shri Bipin Behari—*Senior Financial Committee Officer.*

*Elected w.e.f. 23 November, 1977 *vice* Sarvasbri Sheo Narain and Jagdambi Prasad Yadav ceased to be Members of the Committee on their appointment as Ministers of State w.e.f. 14-8-77.

INTRODUCTION

I, the Chairman of the Public Accounts Committee as authorised by the Committee, do present on their behalf this Forty-Fifth Report of the Public Accounts Committee (Sixth Lok Sabha) on Paragraph 20(a) of the Report of the Comptroller & Auditor General of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, relating to Incorrect Grant of Export Incentives.

2. The Report of the Comptroller & Auditor General of India for the year 1973-74, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes was laid on the Table of the House on 9 May, 1975. The Public Accounts Committee (1976-77) examined the paragraph 20(a) relating to Incorrect Grant of Export Incentives at their sitting held on 17 November, 1976, but could not finalise the Report on account of dissolution of the Lok Sabha on 18 January, 1977. The Public Accounts Committee (1977-78) considered and finalised this Report at their sitting held on 6 December, 1977. The Minutes of the sittings form Part II* of the Report.

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

4. The Committee place on record their appreciation of the commendable work done by the Chairman and Members of the Public Accounts Committee (1976-77) in taking evidence and obtaining information on this Report.

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

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

NEW DELHI;
December 9, 1977
Agrahayana 18, 1899 (S)

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

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

REPORT

INCORRECT GRANT OF EXPORT INCENTIVES

Audit Paragraph

1.1. As an incentive to the development of export markets for Indian goods on a long-term basis the Finance Act, 1968 introduced section 35-B in the Income-tax Act, 1961 with effect from 1st April, 1968 providing for a weighted deduction, in determining the taxable income from business, of one and one-third times the actual expenses incurred after 29th February, 1968 by domestic companies and other non-corporate tax payers resident in India, to promote the sale outside India, of any goods, services or facilities dealt in or provided by them in the course of their business. While introducing the provision, the Finance Minister had stated:

“As part of the measures designed primarily to assist export promotion, . . . I propose also to provide for the grant of an Export Markets Development Allowance to tax payers other than foreign companies at the rate of one and one-third of the revenue expenditure incurred for the development of export markets.”

1.2. The expenditure qualifying for the weighted deduction is that incurred by the assessee on a long-term basis wholly and exclusively on certain specified activities exercised outside India. The activities specified include, *inter alia*, distribution, supply or provision outside India of such goods, services or facilities and maintenance outside India of a Branch Office or agency for the promotion of the sale outside India of such goods, services or facilities.

1.3. The concession was intended, primarily for development of export markets. Its benefit, however, was obtained also by certain assesseees who had not exported any goods or services but who by the nature of the operations of their business were operating in foreign stations long before the new section came into force.

- (a) Thus in the case of an air transport company, the weighted deduction was allowed in the assessment year 1970-71 in respect of commission paid to other international

airlines for honouring the assessee company's tickets on sectors flown over their flights. The erroneous allowance resulted in excess computation of loss by Rs. 1,35,26,907.

[Paragraph 20(a) of the Report of the C&AG of India for the year 1973-74, Union Government (Civil, Revenue Receipts, Vol. II, Direct Taxes)]

1.4. According to Section 35-B(1) (a) of the Income-tax Act, 1961, introduced from 1 April, 1968, domestic companies and other non-corporate tax payers resident in India, who in our expenditure after 29 February, 1968 under specified heads for development of export markets for Indian goods on a long term basis are entitled to an allowance in the computation of their taxable profits. This allowance consists of a weighted deduction of an amount equal to 1—1/3rd times the amount of the expenditure incurred during the previous year (From 1973-74, it is 1—1.2 times the expenditure incurred after 28 February, 1973 in the case domestic companies in which public are substantially interested).

1.5. The expenditure referred to above is that incurred wholly and exclusively, on:

- (i) advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of business;
- (ii) obtaining information regarding markets outside India for such goods, services or facilities;
- (iii) distribution, supply or provision outside India of such goods, services or facilities, not being expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit; substituted by Finance Act, 1970, 19 of 1970 (retrospectively).
- (iv) maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities;
- (v) preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto;
- (vi) furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities;

- (vii) travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from, and return to, India;
- (viii) performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities;
- (ix) such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed.

1.6. Section 35-B was amended by the Direct Taxes (Amendment) Act, 1974 to increase from 1-1/3 to 1½ times the weighted deduction in respect of qualifying expenditure incurred by widely-held domestic companies after 28 February, 1973. The reasons for enlarging the scope of this concession were given by the then Finance Minister in his Budget Speech for the year 1973-74. An extract from the said speech is reproduced below:

“Honourable Members will agree with me that it will be a paying proposition for sizeable development expenditure to be incurred in developing exports, particularly of non-traditional products. At present expenditure on export market development is deductible for tax purposes to the extent of 133.3 per cent of actual costs. In view of the great importance of promoting our exports, I propose to increase the weighted deduction to 150 per cent in the case of widely held companies.”

1.7. Giving reasons for the aforesaid amendment under which the quantum of weightage deduction was increased, the Department of Revenue and Banking have stated in a note that:

“The amendment was sponsored by Government as it was felt that a larger outlay on the development of foreign markets will help promote India's exports. This has been the experience of various agencies connected with export promotion. India being a newcomer in the international market for manufactures has to face stiff competition from other already established exporters. To familiarise the market with Indian products, it is necessary for each exporter to undertake expenditure on promotion, publicity, product adaption, etc. Such expenditure has to be substantial because of the nature of international competition. Since the total benefit in terms of export promotion accruing to the country would be much larger than the benefit

accruing to each individual exporter due to these expenditures, it was felt necessary to give a larger weighted allowance as a deduction."

1.8. On being asked whether any detailed study was made before making the amendment in question, the Department of Revenue and Banking have intimated:

"Measures for export promotion are under the continuous study of the Ministry of Commerce in cooperation with other concerned Ministries. Changes in the various concessions given for export promotion are made after careful consideration and exchange of views between the various Ministries."

1.9. Another change made by the Finance Act, 1973 was to exclude from the scope of Section 35B of the Income Tax Act, 1961 retrospectively from 1 April, 1968 the operational expenses of assesses engaged in shipping, air or other transport business.

Facts of the Case

1.10. The facts of this case as reported by Audit are that in the assessment year 1970-71, Air India International Ltd. (the assessee company) had claimed Export Market Development Allowance under Section 35B of the Income Tax Act, 1961 to the extent of Rs. 7,18,02,650 representing 1/3rd of the expenditure of Rs. 21,54,07,979 incurred on advertisement or publicity outside India (Rs. 2,76,48,832), obtaining information regarding markets outside India (Rs. 18,563), provision of an International Air service (Rs. 16,75,34,364) and the maintenance outside India of branch offices or agencies for the promotion of the sale outside India of Air India's services (Rs. 2,02,06,220). The allowance in respect of the said four items was claimed under sub-clauses (i), (ii), (iii) and (iv) respectively of Section 35B (i)(b). The original return containing this claim was filed on 13 December, 1970. Subsequently in a revised return filed on 25 August 1972, the company claimed an additional allowance under this Section of Rs. 1,35,26,907 representing 1/3rd of the expenditure of Rs. 4,05,80,693 incurred on "booking agents' commission" paid to other International Airlines honouring Air India's tickets on sectors flown over their flights. This additional claim was made under sub-clause (iii) of Section 35B(i)(b). It was allowed by the Income Tax Officer in the assessment made on 17 March, 1973 under sub-clause (iv) of the said Section. As the said sub-clause (iv) covers only the expenditure incurred on the maintenance, outside India, of a branch office or agency and expenses incurred on that account by Air India had been

taken into account in the original claim, the acceptance of the additional claim which did not, in any case, represent expenditure incurred on the maintenance, outside India, of any branch office or agency was not correct. The claim could not also be allowed under any other sub-clause of the Section as the Commission paid to other international Airlines was in the normal course of trade and was not any export promotion expenditure as specified. The incorrect allowance has resulted in an excess computation of loss of an equal amount viz. Rs. 1,35,26,907.

1.11. In their reply dated 9 May, 1975 to Audit, the Ministry have stated that the audit objection has been accepted in principle.

1.12. In their further reply dated 13 June, 1975, the Ministry have intimated that the assessment in question has been set aside by the Commissioner of Income Tax under Section 263 of the Income-tax Act, 1961 and the Income Tax Officer has been directed to frame the assessment *de novo*.

Qualifying Expenditure for grant of Export Market Development Allowance

1.13. Break-up of the expenditure in respect of which the Export Market Development Allowance (MEDA) had been granted, year-wise, to Air India is given below:

Assessment Year	Expenditure on Advertisement or Publicity outside India	Expenditure incurred outside India on Provision of International Air Service	Maintenance outside India of a Branch office or Agency for promotion of sale outside India of Air India Service	Obtaining information regarding markets outside India	Pay and allowance, staff costs, office expenses, fuel and oil
(i)	(ii)	(iii)	(iv)	(v)	(vi)
1968-69 (March, 1968)	27,03,328	1,25,22,950	13,04,253
1969-70	2,23,11,846	14,50,44,491	3,64,54,947(a) 1,72,01,423 (b)	1,00,231	..
1970-71	2,76,48,832	20,81,15,057	2,62,06,220	18,563	..
1971-72	2,81,96,041	19,42,44,255	10,56,15,851	14,018	2,03,87,117
1972-73	2,96,39,960(c)	22,14,43,383	8,04,74,532(d)	12,000	3,03,85,179
1973-74	3,37,95,158	..	9,67,71,651(e)	44,379	..

(a) Figure represents expenditure on booking agency commission. Notice under section 148 issued on 24-2-76. Re-assessment pending.

(b) Figure represents expenditure on maintenance of Office. To be scrutinised in re-assessment proceedings.

(c) Allowed on Rs. 2,72,89,948 only under Sec. 154.

(d) Figure represents expenditure on traffic and sales.

(e) Includes booking agency commission on which deduction not allowed.

Weighted Deduction on Booking Agency Commission

1.14. The Committee were informed that under sub-clause (iv) of Section 35B of the Income Tax Act, 1961, Air India had claimed weighted deduction on the following expenditure incurred by them on booking agency commission:

Assessment year	Amount of expenditure (Rs.)	Remarks
1968-69	Nil	—
1969-70	3,64,54,947	Notice u/s 148 issued on 24-2-76 for withdrawing the benefit of weighted deduction allowed. Re-assessment pending.
1970-71	4,05,80,693	Withdrawn by order dated 8-8-1975 in pursuance of Commissioner's order under Section 263 dated 13-3-1975.
1971-72	4,06,80,179	In order u/s 154 dated 24-10-1975 this amount has not been taken into account for 35B.
1972-73	4,35,98,232	Do.
1973-74	5,84,71,590	Not allowed to be added towards qualifying expenditure in assessment order dated 30-3-1976.
1974-75	7,28,90,103	Assessment pending.
1975-76	8,18,93,473	Assessment pending.
1976-77	Nil	Extension of time for filing the return allowed till 20-11-1976.

1.15. The Committee desired to know the number of new offices opened outside India by Air India since 1967-68. In reply, the Department of Revenue and Banking have furnished the following figures:

Financial Year	Assessment Year	No. of new Offices opened	Location
1967-68	1968-69	2	Rotterdam & Dar-es-Salaam .
1968-69	1969-70	2	Barcelona & Las Palmas.
1969-70	1970-71	1	Southall.
1970-71	1971-72	3	Baghdad, Accra & Tannarive.
1971-72	1972-73	2	Copenhagen & Doha.
1972-73	1973-74	2	Teipei, Chittagong.
1973-74	1974-75	1	Hiroshima.
1974-75	1975-76	Nil	..

1.16. Audit paragraph states that weighted deduction allowed to Air India under sub-clause (iv) of Section 35B(1) (b) in respect of commission paid to other international Airlines for honouring the assessee company's tickets on sectors flown over their flights was "erroneous" and had resulted in excess computation of loss by Rs. 1,35,26,907. In this context, the Committee desired to know whether there was any ambiguity or doubt in regard to the scope of sub-clause (iv) and if not how such a big claim for weighted deduction was allowed in this case. In reply, the Department have explained in a note that:

"The import of sub-clause (iv) is quite clear. However, the Income-tax Officer committed an error of judgement in allowing weighted deduction on booking agency commission. The presence of the word 'agency' appearing in sub-clause was perhaps mis-understood by the I.T.O. to mean that booking agency commission is entitled to weighted deduction. He failed to notice that in sub-clause (iv), the expenditure eligible for weighted deduction is the expenditure on maintenance of an agency, and not agency commission. The Income Tax Officer has been warned to be careful in future."

1.17. Asked why this costly mistake could not be detected in Internal Audit, the Department have replied:

"This case was checked by the Inspector of the Internal Audit Party. The Inspector appears to have committed the same error, as committed by the Income Tax Officer. The Inspector has been warned to be more careful in future."

1.18. The Committee desired to know if the concession under Section 35B of Income Tax Act, 1961 was at all admissible in the case of an assessee who, by the nature of his business, had been operating outside India even before the introduction of that section as, for example, Air India. In reply, the Department of Revenue and Banking have stated in a note:

"The weighted deduction under section 35B is admissible to domestic companies and non-corporate resident assesseees in respect of qualifying expenditure incurred by them after 29 February 1968. Hence even where an assessee had been operating outside India before the introduction of this section, he would get the weighted deduction under section 35B in respect of the expenditure of the nature mentioned in section 35B(1) (b) after 29-2-1968."

1.19. The Committee asked if a verification was made to make sure that the expenditure on which weighted deduction was claimed by Air India in the assessment year 1970-71 was actually spent for the purpose for which it was meant. The Chairman, Central Board of Direct Taxes, has said in evidence:

“The review of the facts says it was not. It is a failure on the part of the assessing officer.”

Rectificatory Action

1.20. It would be seen from the Table in paragraph 1.14 that weighed deduction erroneously allowed to Air India on the expenditure of Rs. 4,05,80,693 incurred by it on booking agency commission had since been withdrawn by Order dated 8th August, 1975 in pursuance of Commissioner's Order dated 13th March, 1975 under Section 263 of Income-tax Act.

1.21. As regards expenditure incurred by Air India on booking agency Commission during the years relevant to assessment years 1971-72 and 1972-73, it has been stated: “in order u/s 154 dated 24th October, 1975 this amount has not been taken into account for 35B”.

1.22. The Committee pointed out that though Section 35B was amended in 1973 and draft audit paragraph was received by the Ministry in November 1974, rectificatory action in the case of Air India was taken only in 1975. The Committee desired to know the reasons for this delay. In reply, the representative of the Department of Revenue and Banking has said in evidence:

“The notice under Section 154 was issued on 16th January, 1975. On 20th January, 1975 this has been completed. In fact there has been a delay in disposing of this and we have called for the explanation of the officer concerned and we have written to the Commissioner to find out who is responsible and take appropriate action for the delay.”

1.23. In a note furnished after evidence, the Department of Revenue and Banking, however, have intimated that:

“The explanation of the Income-tax Officer concerned has since been received by the Board along with the recommendations of the Commissioner of Income-tax, Bombay City-I for its acceptance. On careful consideration, the recommendation of the Commissioner of Income-tax has been accepted by the Board and no further action is being taken.”

1.24. The Committee enquired if the Central Board of Direct Taxes had brought to the notice of the Commissioners of Income-tax the change in law made by the Finance Act of 1973 to see that concession was withdrawn not only in the case of Air India but also other assessees. In reply, representative of the Department of Revenue and Banking has said:

“We have brought to the notice of the Commissioners the change in the law brought about by the Finance Act of 1973 and we have asked them to review all the cases where export market development allowance has been given. This letter from us is dated 31st August, 1973. We have received Reports saying that such a review has been done in a number of cases and action taken for rectifying the assessments.”

1.25. In a note furnished after evidence, the Department informed the Committee that:

“As a result of the review of 2499 cases, mistakes have been noticed in 26 cases involving likely tax-effect of Rs. 2.31 411.

Weighted Deduction on Expenditure on Advertisement and Publicity abroad.

1.26. The amount of foreign exchange and revenue earned by Air India from assessment years 1966-67 to 1976-77 was as under:

Assessment year	Foreign exchange earned/saved Rs. lakhs	Operating revenue Rs. lakhs
1966-67	492.15	2077.24
1967-68	835.21	4590.14
1968-69	852.54	5501.45
1969-70	1230.55	
1970-71	986.45	
1971-72	1315.54	
1972-73	741.29	
1973-74	1523.12	
1974-75	1796.62	
1975-76	1137.45	
1976-77	3117.00	

Notes : (1) The figures given in Col. 2 above reflect not foreign exchange earned/saved and are stated to have been worked out on the basis of a formula approved by the Government of India.

(2) The figures given in Col. 3 above reflect the total operating revenue of Air India during the respective years. These figures are only of revenue earned out of carriage of passengers, mail, freight, excess baggage, cargo handling charges and charters, excluding revenue earned on account of interest etc.

1.27. The expenditure incurred by Air India on advertisement or publicity outside India on which weighted deduction was allowed to Air India during the assessment years 1968-69 to 1973-74 under Section 35B of the Income-tax Act has been given in the Table at page 9.

1.28. The Committee desired to know if there were any ceilings on expenditure by Air India on advertisement and publicity abroad. In reply, the Department have intimated:

“Air India is reported to be having blanket permission for incurring advertisement and publicity expenses out of its foreign exchange earnings, hence, they have not made any annual claim.”

1.29. Section 37(1) of Income Tax Act stipulates that “any expenditure (not being expenditure of the nature described in Sections 30 to 36 [and Section 80 VV] and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.

1.30. Rule 6B(1) of the Income Tax Rules 1962 stipulates that:

“6B (1) The allowance in respect of expenditure on advertisement shall not in the following cases exceed—

- (a) in respect of articles intended for presentation, Rs. 50 on each such article;
- (b) in respect of any advertisement outside India involving payment in foreign currency, the amount covered by foreign exchange granted to, or permitted to be acquired by, assessee for this purpose under the law relating to foreign exchange for the time being in force.”

1.31. According to intimation received from the Department of Revenue and Banking, the Income Tax Officer has confirmed that expenditure on advertisement (whether in India or abroad) and/or presentation articles, incurred by Air India, did not exceed the limits prescribed under Rule 6B(1) (a) or (b) of the Income Tax Rules, 1962.

1.32. The Committee asked if the expenditure on which weighted deduction was allowed under Section 35B would be subject to Section 37(1) of the Act. The Finance Secretary has stated in evidence:

“Obviously, there is no question of the two sections-applied jointly, one is exclusive of the other.”

1.33. The Chairman, Central Board of Direct Taxes, has clarified the point in following terms:

“It (i.e. section 35B) will not be subject to 37(1). This section is self-contained. It clearly enunciates what should be allowed and what should not be allowed. We do not have to go to any other section for allowing expenditure under this section.”

1.34. Asked that if Section 35B was independent of other Sections of the Act, did it mean that expenditure on advertisement or publicity on which an assessee may claim weighted deduction was not subject to Rule 6B which was framed under another section, viz., Section 37, according to which allowance in respect of expenditure on advertisement is not to exceed the amount covered by foreign exchange granted to or permitted to be acquired by the assessee. In reply, the Finance Secretary has said in evidence:

“It is not clear to us as to how Rule 6B comes in. Here the expenditure is purported to have been made under section 35B and I am at a loss to find out the nexus between section 35B and Rule 6B because on the face of it, it would *prima facie* appear that Rule 6B is in exercise of the power under Section 37.”

1.35. The Committee pointed out that Rule 6B apparently reflected policy of the Government that expenditure incurred in excess of the foreign exchange sanctioned would, apart from being irregular, not qualify for any tax concession. The Finance Secretary has observed:

“I would respectfully submit that I don't think that the policy of the Government in regard to foreign exchange expenditure should be enshrined in a minor Rule under the Income Tax. I would submit that the policy of the Government should be enunciated in a more prominent way and not tucked away in some obscure Rule in the Income Tax Manual.”

1.36. In order to put the point at issue in its perspective, representative of Audit has observed:

“I am just trying to clarify the issue. The point raised is, whether the limitation mentioned in rule 6B for the purpose of allowing advertisement expenditure be applicable to Section 35B or Section 37 having regard to the policy of the Government. Rule 6B says that any expenditure on advertisement shall not be allowed in excess

of what foreign exchange has been allowed for that purpose. It is a very legitimate rule implying that you cannot spend abroad more than what foreign exchange has been sanctioned to you. Therefore, apart from the technicalities and legalities, whether it is Section 35B or Section 37(1), the basic question is if you have been sanctioned Rs. 1 crore for incurring expenditure specifically for advertisement, could you claim that you have spent Rs. 1.5 crores? That is the basic question. That underlines the policy of the Government as between Section 35B and Section 37(1). It is not that the Audit contends that they allowed it twice. We do admit that they have given it under Section 35B. Having admitted that, we were wondering whether even under Section 35B, you should not claim 1½ times the amount sanctioned for you to be expended abroad for advertisement or you should be allowed more than that. Some other questions will also crop up, namely, if the expenditure has been something more than what the Foreign Exchange Department has allowed, would it not be an offence under the Foreign Exchange Regulation Act? Now, we expect that any citizen, any company, any national would spend only that amount which has been sanctioned under the Foreign Exchange Regulation Act. That is the basic question, and this question could probably have been answered by the Joint Secretary of Economic Affairs by giving the Committee the facts about what was the foreign exchange claimed and allowed for these advertisement and publicity expenses in each of the areas. If these facts are given to the Committee, the Committee could give a judgement whether, under rule 35(B) the amount spent has been in excess of the permissible amount sanctioned to them for being incurred abroad."

1.37. If Rule 6B did not reflect policy of the Government, the Committee asked whether weighted deduction under Section 35B could be allowed by income tax authorities on expenditure incurred abroad on advertisement and publicity even if such expenditure was in excess of foreign exchange sanctioned by Government. The representative of the Department of Revenue and Banking has opined that:

"Rule 6B is based on one policy of the Government, as Mr..... (representative of Audit) has said, about restricting expenditure on advertisement and Section 35B

is based on another policy of the Government to see that our exports are developed. So, it is a question of which policy should be given precedence. Government thought that the policy of restricting expenditure on advertisement should be subordinate to the other policy of encouraging exports."

1.38. The Committee pointed out that if export promotion were to get precedence over foreign exchange regulations, it would mean not only that these regulations could be violated with impunity in the name of export promotion but also that tax concession could be had under Section 35B on foreign exchange spent on advertisement or publicity in excess of the sanctioned limit. The Committee enquired if the Central Board of Direct Taxes had given thought to this matter from that angle. In reply, the Chairman, Central Board of Direct Taxes, has said in evidence:

"This aspect, I have not carefully examined."

1.39. Asked if the Central Board of Direct Taxes would examine this aspect of the matter, the witness has said:

"Yes, we will examine it."

1.40. In a note furnished after evidence, the Committee have been informed that this matter has been referred to the Tax, Planning and Legislation Branch of the Department of Revenue and Banking on 18th November, 1976.

Effect of EMDA on Exports

1.41. The Committee enquired whether any machinery was available to assess as to whether the expenditure on which weighted allowance was allowed under Section 35B had actually contributed towards export promotion or it was merely maintenance expenditure as hithertofore. The Department have admitted in a note that:

"There is no machinery available in the Income-tax Department to assess as to whether the expenditure incurred has actually contributed to export promotion. In fact, the admissibility of weighted deduction is not dependent on the result of the expenditure incurred under specified heads. Moresoever, several measures have been taken in recent years to promote exports of Indian goods and

materials, of which the Export Market Development Allowance is one. The results of these measures may be seen from the increased earnings from exports year after year."

1.42. As the main object of introducing the Export Market Development Allowance by way of weighted deduction at the rate of 1-1/3 (increased to 1½ w.e.f. 28th February, 1973) of the qualifying expenditure was promotion of exports, the Committee desired to know how it was ensured that this concession was utilised by the assessee for the purpose for which it was given and did lead to higher exports. Chairman, Central Board of Direct Taxes has stated in evidence:

"There are various types of concessions given by the Ministry of Foreign Trade for improving our exports. This is only one of such incentives. So it is not possible for us to say that because of this particular provision there has been improvement in export. To what extent the improvement has been caused by this incentive alone it is very difficult to say."

1.43. Asked whether the Ministry of Foreign Trade gave any feedback reports to the Department of Revenue and Banking on how far the export incentive given in the form of tax concession had been recompensated by improvement in the economy of our country, the witness has replied in the negative.

1.44. The Committee wanted to know how the Department of Revenue and Banking could continue giving the Export Market Development Allowance without caring to find out its impact on country's exports. In reply, the witness has said in evidence:

"My role is limited to see that the expenditure claimed by the assessee falls within the four corners of the law. If somebody spends Rs. 10 lakhs which according to the provision of the law is admissible and in the course of the next year or two he does not improve his quantum of exports, I cannot deny him the concession."

1.45. The Committee note that in the present case Export Markets Development Allowance amounting to Rs. 1,35,26,907 representing 1/3rd of the expenditure of Rs. 4,05,80,693 incurred by Air India on booking agency commission paid by it to other International Airlines for honouring Air India's tickets on sectors flown over their flights was allowed by the assessing officer in the assessment year 1970-71

under Clause (iv) of Section 35B of the Income Tax Act. Audit objected to this allowance on the ground that sub-clause (iv) covers only the expenditure incurred on the maintenance outside India, of a branch office or agency and not on the booking agency commission as such. The objection has been accepted by Government and the aforesaid allowance withdrawn.

1.46. The Committee find that though sub-clause (iv) of Section 35B(1) (b) of the Income Tax Act, 1961 had provided for weighted deduction to be given on expenditure incurred wholly and exclusively on "Maintenance outside India of a Branch Office or Agency for the promotion of the sale outside India of such goods, services or facilities", the Income tax Officer misunderstood the word "Agency" appearing in that sub-clause to mean booking agency Commission for entitlement to weighted deduction. Obviously the Income Tax Officer concerned failed to notice that under the aforesaid clause the expenditure eligible for weighted deduction was the expenditure on maintenance of an agency and not Agency Commission. In paragraph 12.7 of their 186th Report (Fifth Lok Sabha), the Committee had expressed the hope that "if Assistant Commissioners of Income-tax are given assessment powers to assess directly cases of over Rs. 5 lakhs, which are not too many, the standard of performance will improve and the possibility of mistakes reduced." The Committee feel that the misinterpretation of law in the present case could possibly have been avoided, if the case had been handled at a senior level. The Committee recommend that Government may review the relevant provisions of the Income-tax Act, 1961 and if any ambiguity is found lending itself to mis-interpretation Government should take steps to amend the law to make the position clear beyond doubt.

1.47. The Committee find that though Section 35B of the Income Tax Act, 1961 was amended in 1973 and the draft Audit paragraph containing the objection to the grant of Export Markets Development Allowance to Air India on booking agency commission paid by it to other International Airlines was received by the Ministry in November 1974, rectificatory action to withdraw this allowance was initiated only in 1975. The Committee have been informed that the explanation of the Income Tax Officer concerned for this inordinate delay was called for by the Central Board of Direct Taxes and received by it alongwith the recommendations of the Commissioner of Income Tax, Bombay City-I. The Committee have also been informed that on careful consideration, the Board has decided to accept the recommendation of the Commissioner and accordingly no further action is proposed to be taken against the Income Tax Officer concerned. The Committee are unaware of the circumstances in which

delay in regard to this particular case took place. They would, however like to emphasise that cases of assessment/ reassessment should be dealt with promptly and there should be an appropriate control mechanism to see that there is no slackness on the part of Income Tax Officers in dealing with cases.

1.48. The Committee are concerned to note that while granting Export Market Development Allowance by way of weighted deduction on the expenditure incurred by Air India on advertisement and publicity abroad under Section 35B of the Income Tax Act, 1961, no attempts were made by the Income Tax Authorities to ensure that such expenditure was not in excess of the limits imposed by Rule 6B of the Income Tax Rules 1962. It was explained to the Committee that this rule had been framed under another section of the Act, namely, Section 37 and as Section 35B was an independent provision, Rule 6B was not followed in such cases. However, the Chairman, Central Board of Direct Taxes has assured the Committee that he would re-examine the matter from this angle. According to a note furnished by the Board on 4 January 1977, the matter was referred to their Tax, Planning and Legislative Branch on 18 November 1976 for re-examination. The Committee recommend that the re-examination of this matter may be completed soon and intention and scope of Sections 35B and 37 of the Income Tax Act, 1961 and Rule 6B of the Income Tax Rules, 1962 made clear beyond doubt.

1.49. According to Section 35B of the Income Tax Act, 1961, introduced from 1 April 1968, domestic companies and other non-corporate tax payers resident in India, who incurred expenditure after 29 February 1968 under specified heads for development of export markets for Indian goods on a long term basis were granted an allowance in the computation of their taxable profits. This allowance consisted of a weighted deduction of an amount equal to 1-1/3rd of the expenditure incurred. In view of the great importance of promoting exports, the weighted deduction was raised from 1-1/3 to 1½ by the Direct Taxes (Amendment) Act, 1974. This amendment was stated to have been sponsored by Government as it was felt that India being a newcomer in the international market for manufacturers had to face stiff competition from other already established exporters, and therefore, a larger outlay on the development of foreign markets would help promote India's exports. The Committee find that though the concession was intended, primarily, for development of export markets, its benefit has gone even to assesses like Air India who had not exported any goods or services but who by the nature of the operations of their business were operating in foreign stations long before the new section came into force.

1.50. The Committee have been given to understand during evidence that no machinery is available in the Income Tax Department to assess as to whether the tax concession has actually contributed to export promotion. The Chairman, Central Board of Direct Taxes has stated in evidence that it is not possible for them to indicate the extent to which improvement in exports has taken place because of the Export Market Development Allowance. The admissibility of weighted deduction, the Committee gather, is not dependent on the results of the expenditure incurred. Further, there is no system of sending feedback reports to the Department of Revenue and Banking by the Ministry of Commerce, with the result that no idea can be had of the impact of this tax concession.

The Committee, therefore, recommend that some system may be evolved whereby it may be possible to determine whether, and if so, to what extent, the incentive like Export Market Development Allowance given to domestic concerns has achieved the purpose underlying it.

1.51. For lack of time, the Committee have not been able to examine paragraphs relating to Corporation Tax included in Chapter II of the Report of the Comptroller and Auditor General of India for the year 1974-75. Union Government (Civil). Revenue Receipts, Volume II, Direct Taxes. The Committee expect, however, that the Ministry of Finance (Department of Revenue) and the Central Board of Direct Taxes will take necessary remedial action in these cases, in consultation with the Statutory Audit.

NEW DELHI;
December 9, 1977
Agrahayana 18, 1899 (S).

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

APPENDIX

Statement of Conclusions/Recommendations

S.No	Para No	Ministry, Department	Conclusions/Recommendations
1	2	3	4
1	1.45	Ministry of Finance (Department of Revenue)	The Committee note that in the present case Export Markets Development Allowance amounting to Rs. 1,35,26,907 representing 1/3rd of the expenditure of Rs. 4,05,80,693 incurred by Air India on booking agency commission paid by it to other International Airlines for honouring Air India's tickets on sectors flown over their flights was allowed by the assessing officer in the assessment year 1970-71 under Clause (iv) of Section 35B of the Income Tax Act. Audit objected to this allowance on the ground that sub-clause (iv) covers only the expenditure incurred on the maintenance outside India, of a branch office or agency and not on the booking agency commission as such. The objection has been accepted by Government and the aforesaid allowance withdrawn.
2	1.46	Do	The Committee find that though sub-clause (iv) of Section 35B (1) (b) of the Income Tax Act, 1961 had provided for weighted deduction to be given on expenditure incurred wholly and exclusively on "Maintenance outside India of a Branch Office or Agency for the promotion of the sale outside India of such goods, services or facilities", the Income Tax Officer misunderstood the word "Agency" ap-

pearing in that sub clause to mean booking agency Commission for entitlement to weighted deduction. Obviously the Income Tax Officer concerned failed to notice that under the aforesaid clause the expenditure eligible for weighted deduction was the expenditure on maintenance of an agency and not Agency Commission. In paragraph 12.7 of their 186th Report (Fifth Lok Sabha), the Committee had expressed the hope that "if Assistant Commissioners of Income-tax are given assessment powers to assess directly cases of over Rs. 5 lakhs, which are not too many, the standard of performance will improve and the possibility of mistakes reduced." The Committee feel that the misinterpretation of law in the present case could possibly have been avoided, if the case had been handled at a senior level. The Committee recommend that Government may review the relevant provisions of the Income-tax Act, 1961 and if any ambiguity is found lending itself to mis-interpretation Government should take steps to amend the law to make the position clear beyond doubt.

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Do

The Committee find that though Section 35B of the Income Tax Act, 1961 was amended in 1973 and the draft Audit paragraph containing the objection to the grant of Export Markets Development Allowance to Air India on booking agency commission paid by it to other International Airlines was received by the Ministry in November 1974, rectificatory action to withdraw this allowance was initiated only in 1975. The Committee have been informed that the explanation of the Income Tax Officer concerned for this inordinate delay was called for by the Central Board of Direct Taxes and received by it alongwith the recommendations of the Commissioner of

Income Tax ,Bombay City-I. The Committee have also been informed that on careful consideration, the Board has decided to accept the recommendation of the Commissioner and accordingly no further action is proposed to be taken against the Income Tax Officer concerned. The Committee are unaware of the circumstances in which delay in regard to this particular case took place. They would, however, like to emphasise that cases of assessment/reassessment should be dealt with promptly and there should be an appropriate control mechanism to see that there is no slackness on the part of Income Tax Officers in dealing with cases.

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I-48

Ministry of Finance
(Department of Revenue)

The Committee are concerned to note that while granting Export Market Development Allowance by way of weighted deduction on the expenditure incurred by Air India on advertisement and publicity abroad under Section 35B of the Income Tax Act, 1961, no attempts were made by the Income Tax Authorities to ensure that such expenditure was not in excess of the limits imposed by Rule 6B of the Income Tax Rules 1962. It was explained to the Committee that this rule had been framed under another section of the Act, namely, Section 37 and as Section 35B was an independent provision, Rule 6B was not followed in such cases. However, the Chairman, Central Board of Direct Taxes has assured the Committee that he would re-examine the matter from this angle. According to a note furnished by the Board on 4th January, 1977, the matter was referred to their Tax, Planning and Legislative Branch on 18th Novem-

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ber, 1976 for re-examination. The Committee recommend that the re-examination of this matter may be completed soon and intention and scope of Sections 35B and 37 of the Income Tax Act, 1961 and Rule 6B of the Income Tax Rules, 1962 made clear beyond doubt.

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1-49

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According to Section 35B of the Income Tax Act, 1961, introduced from 1st April, 1968, domestic companies and other non-corporate tax payers resident in India, who incurred expenditure after 29th February, 1968 under specified heads for development of export markets for Indian goods on a long term basis were granted an allowance in the computation of their taxable profits. This allowance consisted of a weighted deduction of an amount equal to $1\frac{1}{3}$ rd of the expenditure incurred. In view of the great importance of promoting exports, the weighted deduction was raised from $1\frac{1}{3}$ to $1\frac{1}{2}$ by the Direct Taxes (Amendment) Act, 1974. This amendment was stated to have been sponsored by Government as it was felt that India being a newcomer in the international market for manufacturers had to face stiff competition from other already established exporters, and therefore, a large outlay on the development of foreign markets would help promote India's exports. The Committee find that though the concession was intended, primarily, for development of export markets, its benefit has gone even to assesseees like Air India who had not exported any goods or services but who by the nature of the operations of their business were operating in foreign stations long before the new section came into force.

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Ministry of Finance
(Department of Revenue)

The Committee have been given to understand during evidence that no machinery is available in the Income Tax Department to assess as to whether the tax concession have actually contributed to export promotion. The Chairman, Central Board of Direct Taxes has stated in evidence that it is not possible for them to indicate the exten to which improvement in exports has taken place because of the Export Market Development Allowance. The admissibility of weighted deduction, the Committee gather, is not dependent on the results of the expenditure incurred. Further, there is no system of sending feedback reports to the Department of Revenue and Banking by the Ministry of Commerce, with the result that no idea can be had of the impact of this tax concession.

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The Committee, therefore, recommend that some system may be evolved whereby it may be possible to determine whether, and if so, to what extent, the incentive like Export Market Development Allowance given to domestic concerns has achieved the purpose underlying it.

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Do

For lack of time, the Committee have not been able to examine paragraphs relating to Corporation Tax included in Chapter II of the Report of the Comptroller and Auditor General of India for the year 1974-75, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes. The Committee expect, however, that the Ministry

of Finance (Department of Revenue) and the Central Board of Direct Taxes will take necessary remedial action in these cases, in consultation with Statutory Audit.

Sl. No.	Name of Agent	Agency No.	Sl. No.	Name of Agent	Agency No.
DELHI.					
24.	Jain Book Agency, Connaught Place, New Delhi.	11	33	Oxford Book & Stationery Company, Scindia House, Connaught Place, New Delhi-1.	68
25.	Sri Narain & Sons, 3141, Mohd. Ali Bazar, Mori Gate, Delhi.	3	34.	People's Publishing House, Rani Jhansi Road, New Delhi.	76
26.	Atma Ram & Sons, Kashmere Gate, Delhi-6.	9	35.	The United Book Agency, 48, Amrit Kaur Market, Pahar Ganj, New Delhi.	88
27.	J. M. Jaina & Brothers, Mori Gate, Delhi.	11	36.	Hird Book House, 82, Janpath, New Delhi.	95
28.	The Central News Agency, 23/90, Connaught Place, New Delhi.	15	37.	Bookwell, 4, Sant Naran-kari Colony, Kingsway Camp, Delhi-9.	96
29.	The English Book Store, 7-L, Connaught Circus, New Delhi.	20	MANIPUR		
30.	Lakshmi Book Store, 42, Municipal Market, Janpath, New Delhi.	23	38.	Shri N. Chaoba Singh, News Agent, Ram Lal Paul High School Annex, Imphal.	77
31.	Bahree Brothers, 188 Lajpatrai Market, Delhi-6.	27	AGENTS IN FOREIGN COUNTRIES		
32.	Jayana Book Depot, Chapparwala Kuan, Karol-Bagh, New Delhi.	66	39.	The Secretary, Establishment Department, The High Commission of India India House, Aldwych, LONDON. W. C.-2.	59

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