

PUBLIC ACCOUNTS COMMITTEE
(1978-79)

(SIXTH LOK SABHA)

HUNDRED AND FIRST REPORT

INCORRECT GRANT OF EXPORT INCENTIVES

MINISTRY OF FINANCE
(Department of Revenue)

[Action taken by Government on the recommendations of the Public Accounts Committee contained in their Forty-Fifth Report (Sixth Lok Sabha) on Incorrect Grant of Export Incentives]



Presented in Lok Sabha on : 19 December, 1978

Laid in Rajya Sabha on : 19 December, 1978

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101st Report of PAC(1978-79)(Sixth Lok Sabha) on Action taken by Government on the recommendations contained in their 45th Report (Sixth Lok Sabha) on Incorrect grant of Export Incentives.

<u>Page</u>	<u>Line</u>	<u>For</u>	<u>Read</u>
(ii)		13,14,20,21	14,15,21,22
3	6	if	it
3	37	persons	personal
3	39	business of	business or
4	2	profits	profession
4	25	claculatic	calculation
16	last	Delete 'to' after 'referred'	
18	4	in	is
18	15	<u>After</u> 'reference' <u>insert</u> 'is'	
18	16	limts	limits
18	19	ministry	Minister
19	25	provide	provided
20	13	<u>After</u> 'have', <u>insert</u> 'been'	

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(1978-79)

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INTRODUCTION

1. The Chairman of the Public Accounts Committee as authorised by the Committee, do present on their behalf this Hundred and First Report on action taken by Government on the recommendations of the Public Accounts Committee contained in their Forty-Fifth Report (Sixth Lok Sabha) on 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.

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

- | | |
|--|------------------|
| 1. Shri P. V. Narasimha Rao— <i>Chairman</i> | |
| 2. Shri Asoke Krishna Dutt— <i>Convener</i> | |
| 3. Shri Vasant Sathe | } <i>Members</i> |
| 4. Shri M. Satyanarayan Rao | |
| 5. Shri Gaurishankar Rai | |
| 6. Shri Kanwar Lal Gupta | |

3. The Action Taken Sub-Committee of the Public Accounts Committee (1978-79) considered and adopted the Report at their sitting held on 10 November, 1978. The Report was finally adopted by the Public Accounts Committee (1978-79) on 6 December, 1978.

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

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

NEW DELHI;
December 6, 1978
Agrahayana 15, 1900 (Saka).

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

CHAPTER I

REPORT

1.1. This Report of the Committee deals with the action taken by Government on the Committee's recommendations/observations contained in their 45th Report (Sixth Lok Sabha) on 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.

1.2. The Committee's Forty-Fifth Report (Sixth Lok Sabha) was presented to the Lok Sabha on 19 December, 1977. It contains 7 recommendations|observations. According to the time schedule for furnishing Action Taken Notes on the Committee's recommendations|observations, the Notes indicating the action taken by Government in pursuance of the recommendations|observations contained in the 45th Report duly vetted by Audit were required to be furnished to the Committee latest by 18th June, 1978. Action Taken Notes were furnished by Government on different dates during the period 5 June to 19 September, 1978.

1.3. The Action Taken Notes received from Government have been broadly categorised as follows:

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

Sl. Nos. 1—3, 5 and 7.

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

NIL.

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

Sl. No. 4, 6.

(iv) *Recommendations|observations in respect of which Government have furnished interim replies:*

NIL.

1.4. The Committee will now deal with the action taken by Government on recommendations at Sl. Nos. 4 and 6 (Paragraphs 1.48 and 1.50) of their 45th Report (6th Lok Sabha).

**WEIGHTED DEDUCTION ON EXPENDITURE ON ADVERTISE-
MENT AND PUBLICITY ABROAD (PARAGRAPH 1.48—SL.
No. 4).**

1.5. In Paragraph 1.48 of their 45th Report (6th Lok Sabha), the Committee had recommended:—

“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 18th 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.

1.6. In a note dated 28 June, 1978, the Ministry of Finance (Department of Revenue) furnished an interim reply to the effect that recommendation|observation of the Committee was under consideration of the Ministry and that a further reply may be awaited. In a further reply dated 19th September, 1978, the Ministry of Finance informed the Committee that:—

“Kind attention is invited to this Ministry’s reply of even number dated the 28th June, 1978. The question for consideration is whether the weighted deduction u/s 35B in respect of the expenditure incurred on advertisement and publicity outside India should be governed by the limits specified in rule 6B of the Income-tax Rules, 1962

read with sub-section (3) of Section 37 of the Income-tax Act, 1961. This matter was re-examined and the conclusion is that the provisions of sub-section (3) of section 37 applied in respect of the expenditure which qualified for deduction u/s 37(1). However, section 37(1) itself makes it clear that if applied to expenditure other than that referred to in Sections 30 to 36 and Section 80VV. Therefore the provisions of the weighted deduction u/s 35B could not once again be governed by section 37(1). The provisions of Rule 6B read with section 37(3) did not therefore apply to expenditure which qualified for weighted deduction u/s 35B.

The Ministry of Law, Justice & C.A. have confirmed the interpretation set out above *vide* their U.O. No. 23615/78-ADV(B) dated the 20th June, 1978.

U.O. No. 23615/78-ADV(B) dated 20-6-78 the Ministry of Law is reproduced below:—

“The only point for consideration in this reference is whether the limits of expenditure on advertisement, prescribed under rule 6B of the Income-tax Rules, 1962, would apply in respect of advertisement expenses incurred under section 35B of the Act. Under the latter section, Export Market Development Allowance is allowable as a weighted deduction in determining the assessee's profits. Clause (b) of sub-section (1) enumerates the Heads of Expenses that are allowable for that weighted deduction. It, *inter alia*, includes advertisement or publicity outside India in respect of goods, services or facilities which the assessee deals in or provides in the course of his business.

The Public Accounts Committee, in its 45th Report (Sixth Lok Sabha) desired the C.B.D.T. to examine the scope of section 35B and section 37 of the Act and rule 6B of the Rules. The CBDT have now referred the matter to us.

Section 37(1) of the Act, *inter alia*, provides that any expenditure (not being expenditure of the nature prescribed in section 30 to 36 and section 80BB and not being in the nature of capital expenditure or persons expenses of the assessee) laid out or expended, wholly or exclusively, for the purpose of business of profession, shall be allowed in

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computing the income chargeable under the head "Profits or Gains of business or profits. It is well settled that the above section is a residuary section extending the allowance of expenses to items of expenditure not covered by section 30 to 36. The list of allowances enumerated in the above sections is not exhaustive. An item or expenditure, which is wholly or exclusively for the purpose of business, may be allowed to be deducted in computing the profits gains according to the ordinary commercial principles even if it does not fall under any of the above sections. That is how section 37 came to be recognised as a residuary section. But, where an item of expenditure is of the nature described in sections 30 to 36, it does not fall within the residuary provision in section 37. It therefore, follows that if it does not fall under section 37(1), the provision of sub-section (3) of that section would not apply and consequently, the limits of expenditure prescribed in rule 6B would also not apply.

Section 35B enumerates the Heads of Expenses that are allowable for weighted deduction. The different heads of expenditure, enumerated therein, will provide for the sum total of the Export Market Development Allowance which will be entitled to a weighted deduction. Advertisement or publicity outside India is one of the heads of expenditure that would go into the calculation of allowances for Export Market Development Allowance. In other words, it is an item of expenditure dealt with in section 35B and consequently, does not fall under the residuary section (section 37).

There is some controversy whether particular subject of expenditure dealt with in any of those sections (30 to 36); the totality of the subject is dealt with by that section. But for the purposes of dealing with this reference, that point is not material, inasmuch as section 35B(b) dealt with the subject matter of advertisement expenses incurred abroad for the purpose of weighted deduction of Export Market Development Allowance.

Sub-section (3) of section 37 contains a non-abstente clause and it provides that, not with standing anything contained in sub-section (1), expenditure or advertisement etc., should be limited as prescribed. In order that sub-section (3) becomes applicable, the expenditure, first of all, should

have to fall within the scope of sub-section(1). If it does not fall within the scope of sub-section (1), sub-section (3) does not enlarge the scope of sub-section (1) and the limits prescribed in rule 6B on expenditure on advertisement could not become applicable. Expenditure on advertisement is a specified head for Export Market Development Allowance and such expenditure would only be governed by Section 35B and would not be governed by the residuary head of expenditure in section 37. If so, the limits laid down in sub-section (3) of section 37 would not become applicable in respect of those heads of expenditure specified in section 35B.

It seems to me that the intention underlying rule 6B is only to lay down limits for expenses on advertisement in India and not in respect of advertisement expenses incurred abroad for export development purposes (covered under section 35B). The above view is strengthened if reference is made to sub-section (3A) to section 37, inserted by Finance Act, 1978, which lays down limits for aggregate expenditure on advertisement, publicity promotion in India."

As the reference arose out of a report of the Public Accounts Committee, Minister may please see.

Sd/- M. B. RAO

Joint Secretary & Legal Adviser
16-6-1978

M.L.J.C.A.

Sd/- Shanti Bhushan 18-6-78".

1.7. Rule 6B(1)(b) of the Income Tax Rules 1962 limits, for the purpose of deduction from income, expenditure on advertisement outside India involving payment in foreign currency to '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'. Section 35B of the Income-tax Act provides for deductions on account of expenditure inter-alia on advertisement or publicity outside India and lays down its quantum as one and one half times of such expenditure. The Section, as at present worded, does not define what would constitute "expenditure" for the purpose of computing the deduction at the rate of one and one half times. The absence of the definition in the Section of what

would constitute such expenditure is open to abuse as one and one half time of expenditure incurred even beyond that authorised under the Foreign Exchange Regulations Act could be claimed for deduction. The Committee, therefore, recommend that as Rule 6B of the Income-tax Rules does not apply to expenditure covered under Section 35B of the Income-tax Act, a suitable definition as to what will constitute "expenditure" incurred on advertising or publicity outside India should be incorporated in the Section itself.

1.8. Section 35B of the Income Tax Act specifically deals with deductions on account of expenditure inter-alia on advertisement and publicity outside India. It appears that when this section was incorporated in the Act in 1968, consequential changes were not made in the existing Rule 6B(1)(b) of the Income-tax Rules 1962, which covered the same ground as the new Section 35B(1)(b) of the Act. The Committee accordingly recommend that the relevant Rules of the Income-tax Rules 1962 may be reviewed and changes consequential to the incorporation of Section 35B made therein.

Effect of Export Market Development Allowance (Paragraph 1.50—Sl. No. 6)

1.9. Pointing out that no machinery was available in the Income-Tax Department to assess as to whether the tax concessions had actually contributed to export promotion, the Committee had, in paragraph 1.50 of their 45th Report (6th Lok Sabha) recommended:

"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 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 Ex-

port Market Development Allowance given to domestic concerns has achieved the purpose underlying it."

1.10. In an interim reply dated 28-6-78 the Ministry of Finance informed the Committee that:

"A reference has been made to the Ministry of Commerce requesting them to inform us whether any system has been devised by that Ministry to evaluate the impact of these measures."

1.11. In a subsequent Note dated 22-8-78, the Ministry of Finance (Department of Revenue) have stated:—

"A reference is invited to this Ministry's reply of even number dated the 28th June, 1978 wherein the Committee was informed that the Ministry of Commerce has been requested to intimate whether there is any system devised by them to evaluate the impact of these measures on the exports. That Ministry's reply is still awaited.

It may not, however, be feasible for this Department to evolve a system to determine whether and if so to what extent the incentive given has achieved the purpose underlying it. However, a study of a few selected cases will be undertaken by the Board to examine as to whether the incentive had led to increase in the export of goods. It can generally be said that the exports have shown a substantial rise in the recent past and the fiscal incentive provided in section 35B may have contributed to this.

1.12. According to a note dated 28-10-78 received from the Ministry of Finance (Department of Revenue) the view of the Ministry of Commerce on this issue is as under:—

"A reference is invited to this Ministry's reply of even number dated the 22nd August, 1978. The reply of the Ministry of Commerce has since been received. They have stated that there is a whole package of measures adopted for furthering export promotion, such as import replenishment, cash compensatory support, Export Market Development Allowance given under the Income-tax Act, financial assistance to Export Houses under the Market Development Assistance Fund, financial assistance given to exporters through the Export Promotion Councils for sending delegations

study teams etc., concessional export credit (both pre-shipment and post-shipment) to exporters, blanket foreign exchange facilities for foreign travel on export promotion etc. It is, therefore, not feasible to isolate any one of these measures and decide in quantitative terms how much each it has contributed in achieving increases in exports.

Ministry of Commerce has further stated that the Export Market Development Allowance is a very important concession given to the exporters. The importance of this measure can be judged by the fact that, when this concession was withdrawn in the Budget proposals in the current year, there was an outcry among the exporting community, with the result that the concession had to be partially restored by Government. However, it would not be possible to quantify the effect of this concession on export performance or to say by how much the exports will come down if this particular concession is withdrawn or modified.

The above reply is stated to have been approved by the Financial Adviser of the Ministry of Commerce."

1.13. Export Market Development Allowance was introduced w.e.f. 1 April, 1968. In paragraph 1.50 of their 45th Report (Sixth Lok Sabha) the Committee had recommended 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". The Ministry of Finance (Department of Revenue) have pointed out that while it may not be feasible to evolve such a system in the Department of Revenue, the Central Board of Direct Taxes will undertake a study of a few selected cases "to examine as to whether the incentive had led to increase in the export of goods". According to the Ministry of Finance "exports have shown a substantial rise in the recent past and the fiscal incentive provided in Section 35B may have contributed to this".

The Ministry of Commerce have stated that there is a whole package of measures adopted for furthering export promotion, such as import replenishment, cash compensatory support, Export Market Development Allowance given under the Income-tax Act, financial assistance to Export Houses under the Market Development Assistance Fund, financial assistance given to exporters through the Export Promotion Councils for sending delegations, study teams etc.,

concessional export credit (both pre-shipment and post-shipment) to exporters, blanket foreign exchange facilities for foreign travel on export promotion etc. According to that Ministry, it is, therefore, not feasible to isolate any one of these measures and decide in quantitative terms how much each has contributed in achieving increase in exports.

The Committee fail to understand as to how the Ministries of Commerce and Finance are taking decisions in regard to the various export incentives schemes in the absence of a regular system of evaluating impact of these incentives on export performance. The Committee would like to point out that the various export incentive schemes are not in the nature of a package. These are separate schemes introduced at different points of time and are being continued, altered, withdrawn or re-introduced from time to time. The Committee are of the view that in order to take rational decisions in this regard, the existence of a regular system of appraising the impact and effectiveness or otherwise of each of these measures is imperative. The Committee, therefore, recommend that such an evaluation system should be introduced forthwith so that the decisions in these matters are taken on a sound and realistic basis.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS THAT HAVE BEEN ACCEPTED BY GOVERNMENT

Recommendation

The Committee note that in the present case Export Market 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.

[Sl. No. 1 (Paragraph 1.45) of Appendix to 45th Report of the PAC (1977-78) (Sixth Lok Sabha)]

Action Taken

The assessee has filed an appeal against the rectificatory order in this case, which has not been decided so far. The Ministry is keeping a watch in the matter.

[Ministry of Finance (Department of Revenue) | O.M. No. 241 | 4/77-
A&PAC II dated 5-6-1978]

Recommendation

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 any agency and not Agency Commission. In Paragraph 1.7 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.

[Sl. No. 2(Paragraph 1.46) of the Appendix to 45th Report of the PAC (1977-78) (Sixth Lok Sabha)]

Action Taken

After reviewing the provisions of section 35B, steps were taken to amend the said section with effect from 1-4-1978 for restricting the scope of its benefit only to the assessee engaged in the following types of business:

- (a) the business of export of goods by a small scale exporter or a holder of an Export House Certificate; or
- (b) the business of providing technical know-how or rendering services in connection thereof to persons outside India.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77-A&PAC II dated 28-6-1978].

Recommendation

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 Market 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 along with 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.

[Sl. No. 3 (Paragraph 1.47) of Appendix to 45th Report of the PAC (1977-78) (Sixth Lok Sabha)].

Action Taken

Apart from the control exercised by the Commissioners of Income-tax in the prompt rectification of mistakes pointed out by Receipt Audit, the Director of Inspection (Income-tax & Audit) also reviews the disposal of receipt audit objections every month and reports to the Central Board of Direct Taxes. He also conducts periodical inspections of the various Commissioners' Charges to ascertain the progress of work. The Central Board of Direct Taxes have also emphasised on the Commissioners that settlement of audit objections is an important area of work which has to be taken care of and monitored from time to time.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77-A&PAC II dated 28-6-1978].

Recommendation

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 1-1/3rd of the expenditure incurred. In view of the great importance of promoting exports, the weighted deduction was raised from 1-1/3rd to 1-1/2 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.

[S. No. 5 (Paragraph 1.49) of the Appendix to 45th Report of the PAC (1977-78) (Sixth Lok Sabha).]

Action taken

The Public Accounts Committee has not made any specific recommendation in this paragraph.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77-A & PAC-II, dated 19-9-1978.]

Recommendation

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 those cases, in consultation with Statutory Audit.

[Sl. No. 7 (Paragraph 1.51) of Appendix to the 45th Report of the PAC (1977-78) (Sixth Lok Sabha)].

Action Taken

In all cases referred to in the paragraphs relating to Corporation Tax included in Chapter II of the Report of the C&AG of India for the year 1974-75, suitable remedial action, wherever necessary, has been/is being taken in consultation with the Statutory Audit.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77-A&PAC II dated 27-6-1978].

CHAPTER III

**RECOMMENDATIONS|OBSERVATIONS WHICH THE COMMIT-
TEE DO NOT DESIRE TO PURSUE IN THE LIGHT OF THE
REPLIES RECEIVED FROM GOVERNMENT.**

NIL

CHAPTER IV

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

Recommendation

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

[S. No. 4 (Para 1.48) of Appendix to 45th Report of
PAC (1977-78) (Sixth Lok Sabha).]

Action taken

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

[Ministry of Finance (Department of Revenue) O.M.
No. 241|4|77--A&PAC II, dated 28-6-1978].

Further Information

Kind attention is invited to this Ministry's reply of even number dated the 28th June, 1978. The question for consideration is whether

the weighted deduction u/s 35B in respect of the expenditure incurred on advertisement and publicity outside India should be governed by the limits specified in rule 6B of the Income-tax Rules, 1962 read with sub-section (3) of Section 37 of the Income-tax Act, 1961. This matter was re-examined and the conclusion is that the provisions of sub-section (3) of Section 37 applied in respect of the expenditure which qualified for deduction u/s 37(1). However, section 37(1) itself makes it clear that it applied to expenditure other than that referred to in Sections 30 to 36 and Section 80VV. Therefore the provisions of the weighted deduction u/s 35B could not once again be governed by section 37(1). The provisions of Rule 6B read with section 37(3) did not therefore apply to expenditure which qualified for weighted deduction u/s 35B.

The Ministry of Law, Justice and Company Affairs have confirmed the interpretation set out above *vide* their U.O. No. 23615/78-ADV (B), dated the 20th June, 1978 (*Copy annexed*).

[Ministry of Finance (Department of Revenue) O.M.
No. 241/4/77-A&PAC II, dated 19-9-1978.]

Copy of U.O. No. 23615/78-ADV (B), dated 20-6-1978 of the Ministry of Law addressed to C.B.D.T.

The only point for consideration in this reference is whether the limits of expenditure on advertisement, prescribed under rule 6B of the Income-tax Rules, 1962 would apply in respect of advertisement expenses incurred under section 35B of the Act. Under the latter section, Export Market Development Allowance is allowable as a weighted deduction in determining the assessee's profits. Clause (b) of sub-section (1) enumerates the Heads of Expenses that are allowable for that weighted deduction. It, *inter alia*, includes advertisement or publicity outside India in respect of goods, services or facilities which the assessee deals in or provides in the course of his business.

The Public Accounts Committee, in its 45th Report (Sixth Lok Sabha) desired the C.B.D.T. to examine the scope of section 35B and section 37 of the Act and rule 6B of the Rules. The C.B.D.T. have now referred to the matter to us.

Section 37(1) of the Act, *inter alia*, provides that any expenditure (not being expenditure of the nature prescribed in section 30 to 36 and section 80BB and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended, wholly or exclusively for the purpose of business or profession, shall be allowed in computing the income chargeable under the head "Profits and Gains of business or profession." It is well settled that the above section is a residuary section extending the allowance of expenses to items of expenditure not covered by section 30 to 36. The list of allowances enumerated in the above sections is not exhaustive. An item of expenditure, which is wholly or exclusively for the purpose of business, may be allowed to be deducted in computing the profits and gains according to the ordinary commercial principles even if it does not fall under any of the above sections. That is how section 37 came to be recognised as a residuary section. But, where an item of expenditure is of the nature described in sections 30 to 36, it does not fall within the residuary provision in section 37. It therefore, follows that if it does not fall under section 37(1), the provision of sub-section (3) of that section would not apply and consequently, the limits of expenditure prescribed in rule 6B would also not apply.

Section 35B enumerates the Heads of Expenses that are allowable for weighted deduction. The different heads of expenditure, enumerated therein, will provide for the sum total of the Export Market Development Allowance which will be entitled to a weighted deduction. Advertisement or publicity outside India is one of the heads of expenditure that would go into the calculation of allowances for Export Market Development Allowance. In other words, it is an item of expenditure dealt with in section 35B and consequently, does not fall under the residuary section (section 37).

There is some controversy whether particular subject of expenditure is dealt with in any of those sections (30 to 36); the totality of the subject is dealt with by that section. But for the purpose of dealing with this reference, that point is not material, in as much as section 35B (b) (1) deals with the subject matter of advertisement expenses incurred abroad for the purpose of weighted deduction of Export Market Development Allowance.

Sub-section (3) of section 37 contains a non-abstente clause and it provides that, not with standing anything contained in sub-section (1), expenditure or advertisement etc., should be limited as prescribed. In order that sub-section (3) becomes applicable, the expenditure, first of all, should have to fall within the scope of sub-section

(1). If it does not fall within the scope of sub-section (1), sub-section (3) does not enlarge the scope of sub-section (1) and the limits prescribed in rule 6B on expenditure on advertisement could not become applicable. Expenditure on advertisement in a specified head for Export Market Development Allowance and such expenditure would only be governed by Section 35B and would not be governed by the residuary head of expenditure in section 37. If so, the limits laid down in sub-Section (3) of section 37 would not become applicable in respect of those heads of expenditure specified in section 35B.

It seems to me that the intention underlying rule 6B is only to lay down limits for expenses on advertisement in India and not in respect of advertisement expenses incurred abroad for export development purposes (covered under section 35B). The above view is strengthened if reference made to sub-section (3A) to section 37, inserted by Finance Act, 1978, which lays down limits for aggregate expenditure on advertisement/publicity of promotion in India.

As the reference arose out of a report of the Public Accounts Committee, Ministry may please see.

Sd/- (M. B. RAO),

Joint Secretary and Legal Adviser.
16-6-1978.

M.L. J.C.A.

Sd/- SHANTI BHUSHAN,
18-6-1978.

Recommendation

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 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, there-

fore, 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.

[S. No. 6 (Para 1.50) of Appendix to 45th Report of PAC (1977-78) (Sixth Lok Sabha)].

Action taken

A reference has been made to the Ministry of Commerce requesting them to inform us whether any system has been devised by that Ministry to evaluate the impact of these measures on the exports.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77--A&PAC II, dated 28-6-1978].

Further Information

A reference is invited to this Ministry's reply of even number dated the 28th June, 1978 wherein the Committee was informed that the Ministry of Commerce has been requested to intimate whether there is any system devised by them to evaluate the impact of these measures on the exports. That Ministry's reply is still awaited.

It may not, however, be feasible for this Department to evolve a system to determine whether and if so to what extent the incentive given has achieved the purpose underlying it. However, a study of a few selected cases will be undertaken by the Board to examine as to whether the incentive had led to increase in the exports of goods. It can generally be said that the exports have shown a substantial rise in the recent past and the fiscal incentive provide in section 35B may have contributed to this.

[Ministry of Finance (Department of Revenue) O.M. No. 241/4/77--A&PAC-II, dated 22-8-1978].

Final Reply

A reference is invited to this Ministry's reply of even number dated the 22nd August, 1978. The reply of the Ministry of Commerce has since been received. They have stated that there is a whole package of measures adopted for furthering export promotion, such as import replenishment, cash compensatory support, Export Market Development Allowance given under the Income Tax Act financial assistance to export Houses under the Market Development Assistance Fund, financial assistance given to exporters through the Export Promotion Councils for sending delegations, study teams etc., concessional export credit (both pre-shipment and post-shipment) to

exporters, blanket foreign exchange facilities for foreign travel on export promotion etc. It is, therefore, not feasible to isolate any one of these measures and decide in quantitative terms how much each it has contributed in achieving increase in exports.

Ministry of Commerce has further stated that the Export Market Development Allowance is a very important concession given to the exporters. The importance of this measure can be judged by the fact that, when this concession was withdrawn in the Budget proposals in the current year, there was an outcry among the exporting community, with the result that the concession had to be partially restored by Government. However, it would not be possible to quantify the effect of this concession on export performance or to say by how much the exports will come down if this particular concession is withdrawn or modified.

The above reply is stated to have approved by the Financial Adviser of the Ministry of Commerce.

[Ministry of Finance (Department of Revenue) O.M
No. 241/477-A&PAC II, dated 28-10-1978.]

CHAPTER V

**RECOMMENDATIONS|OBSERVATIONS IN RESPECT OF WHICH
GOVERNMENT HAVE FURNISHED INTERIM REPLIES**

—N I L—

NEW DELHI,
December 6, 1978
Agrahayana 15, 1900 (S).

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

APPENDIX

Conclusions|Recommendations

Sl. No.	Para No.	Ministry/Department concerned	Conclusions/Recommendations
1	2	3	4
1	1.7	Ministry of Finance (Department of Revenue)	<p>Rule 6B(1) (b) of the Income Tax Rules 1962 limits, for the purpose of deduction from income, expenditure on advertisement outside India involving payment in foreign currency to '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'. Section 35B of the Income-tax Act provides for deductions on account of expenditure <i>inter-alia</i> on advertisement or publicity outside India and lays down its quantum as one and one half times of such expenditure. The Section, as at present worded, does not define what would constitute "expenditure" for the purpose of computing the deduction at the rate of one and one half times. The absence of the definition in the Section of what would constitute such expenditure is open to abuse as one and one half time of expenditure incurred even beyond that authorised under the Foreign Exchange Regulations Act could be claimed for deduction. The Committee, therefore, recommend that as Rule 6B of the Income-tax Rules does not apply to expenditure covered under</p>

Section 35B of the Income-tax Act, a suitable definition as to what will constitute "expenditure" incurred on advertising or publicity outside India should be incorporated in the Section itself.

2 2.18 Ministry of Finance
 (Deptt. of Revenue)

Section 35B of the Income Tax specifically deals with deductions on account of expenditure *inter-alia* on advertisement and publicity outside India. It appears that when this section was incorporated in the Act in 1968, consequential changes were not made in the existing Rule 6B(1) (b) of the Income-tax Rules 1962, which covered the same ground as the new Section 35B(1) (b) of the Act. The Committee accordingly recommend that the relevant Rules of the Income-tax Rules 1962 may be reviewed and changes consequential to the incorporation of Section 35B made therein.

3. 1.13 -do-

Export Market Development Allowance was introduced *w.e.f.* 1st April, 1968. In paragraph 1.50 of their 45th Report (Sixth Lok Sabha) the Committee had recommended 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". The Ministry of Finance (Department of Revenue) have pointed out that while it may not be feasible to evolve such a system in the Department of Revenue, the Central Board of Direct Taxes will undertake a study of a few selected cases "to examine as to whether the incentive had led to increase in the export of goods". According to the Ministry of Finance "exports have shown a substantial rise in

the recent past and the fiscal incentive provided in Section 35B may have contributed to this".

The Ministry of Commerce have stated that there is a whole package of measures adopted for furthering export promotion, such as import replenishment, cash compensatory support, Export Market Development Allowance given under the Income-tax Act, financial assistance to export Houses under the Market Development Assistance Fund, financial assistance given to exporters through the Export Promotion Councils for sending delegations, study team etc., concessional export credit (both pre-shipment and post-shipment) to exporters, blanket foreign exchange facilities for foreign travel on export promotion etc. According to that Ministry, it is therefore not feasible to isolate any one of these measures and decide in quantitative terms how much each has contributed in achieving increase in exports.

The Committee fail to understand as to how the Ministries of Commerce and Finance are taking decisions in regard to the various export incentives schemes in the absence of a regular system of evaluating impact of these incentives on export performance. The Committee would like to point out that the various export incentive schemes are not in the nature of a package. These are separate schemes introduced at different points of time and are being con-

tinued, altered, withdrawn or re-introduced from time to time. The Committee are of the view that in order to take rational decisions in this regard, the existence of a regular system of appraising the impact and effectiveness or otherwise of each of these measures is imperative. The Committee, therefore, recommend that such an evaluation system should be introduced forthwith so that the decisions in these matters are taken on a sound and realistic basis.
