HUNDRED AND THIRTY-SIXTH REPORT

PUBLIC ACCOUNTS COMMITTEE
(1987-88)

(EIGHTH LOK SABHA)

INCOME ESCAPING ASSESSMENT

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

Presented to Lok Sabha on 29 April, 1988

Laid in Rajya Sabha on 29 April, 1988

LOK SABHA SECRETARIAT
NEW DELHI

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INTRODUCTION

I, the Chairman of the Public Accounts Committee do present on their behalf this 136th Report on Para 2.42(i) of the Report of the C&AG of India for the year 1985-86, Union Government (Civil), Revenue Receipts, Vol. II, Direct Taxes regarding Income escaping assessment.

2. The Report of the Comptroller and Auditor General of India for the year 1985-86, Union Government (Civil) Revenue Receipts Vol. II, Direct Taxes was laid on the Table of the House on 8 May, 1987.

3. In the case under report exemption under Section 10(15) (iv) (c) of the Income tax Act, 1961 was granted to a shipping concern engaged in the business of transportation of goods for freight to acquire a second hand bulk carrier with loan taken from a foreign Bank. The main point raised by Audit is that the exemption granted was irregular because the expression 'industrial undertaking' used in the above provisions of the Income tax Act, 1961 cannot be construed to include a shipping transport concern plying ships and not engaged in any manufacture or construction activity. According to the opinion given by the Ministry of Law in 1973 shipping can also be registered as a service industry and it is not essential that there should be production of goods. Subsequently, when a reference was made to the Attorney General in this regard he also expressed the similar views. Section 10(15) (iv) (c) *ibid* is one of the very important provisions of the Act and its slightest misinterpretation may lead to considerable loss of revenue. The Committee have favoured incorporation of an appropriate definition of the term 'industrial undertaking' in the relevant provisions of the Act with a view to avoiding its misuse or misinterpretation and consequent litigation.

The Committee have also desired the Government to take steps to impart greater uniformity to definitions given and language used in different direct tax laws as recommended by the Economic Administration Reforms Commission (1981—83).

4. The Committee examined the paragraph at their sitting held on 27 October, 1987. The Committee considered and finalised this

Report at their sitting held on 27 April, 1988. The minutes of the sitting form Part II of the Report.

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

6. The Committee place on record their appreciation of the assistance rendered to them in the examination of this Paragraph by the Office of the Comptroller and Auditor General of India.

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

NEW DELHI;
April 28, 1988
Vaisakha 8, 1910 (Saka)

AMAL DATTA.
Chairman,
Public Accounts Committee

REPORT

INCOME ESCAPING ASSESSMENT

—Exemption from assessment of interest payable by an Industrial Undertaking to foreign lender—

Under Section 10(15) (iv) (c) of the Income-tax Act, 1961, the interest payable by an industrial undertaking in India on any money borrowed or debt incurred by it in a foreign country in respect of purchase outside India of raw materials or components, or capital plant and machinery, to the extent to which such interest does not exceed the amount of the interest calculated at the rate approved by the Central Government in this behalf, having regard to the term of the loan or debt and its repayment, shall not be included in computing the total income of a previous year of a person.

2. According to the Ministry of Finance (Department of Revenue), the objective behind granting exemption under this Section, was to enable Indian enterpreneurs to secure loans on such terms of repayment as would minimise the pressure on our balance of payments. The rationale of giving this tax concession to the foreign lenders of commercial loans is that the foreign lender will be more willing to grant loan if he does not have to pay any tax on his interest earnings in India. This would enable Indian enterpreneurs to procure loan on comparatively softer terms.

Facts of the case

3. The audit para* has brought out a case where an assessee concern namely, M|s. South India Shipping Corporation Limited, Madras, engaged in transportation of foodgrains, fertilizers etc. in ships for freight obtained the approval of the Central Government to acquire a second hand bulk carrier. The assessee concern raised a foreign exchange loan of $ 16.5 million from a non-resident bank—the Bank of America, to meet 90 per cent cost of the ship under an agreement approved by Central Government. The interest payable by the company on the loan was not liable to income tax under the agreement. During the previous years relevant to the assessment years 1975-76 to 1981-82 an interest amounting to Rs. 5.97 crores was paid by the assessee company on the loan to the

*Para 2.42 (i) of the Report of C&AG of India for the year 1985-86, Union Government (Civil) Revenue Receipts Vol. II (Direct Taxes) *vide* Appendix I.

foreign bank without the latter having to pay any tax at source on the interest amount. The tax effect as per Audit was Rs. 4.42 crores.

4. Audit has objected to the non-assessment of interest income in the hands of the foreign bank on the ground that the Indian company did not constitute an 'industrial undertaking' for the purpose of exemption under section 10(15) (iv) (c) of the Income tax Act for the following reasons;

(1) The Income-tax Act, 1961 does not define the expression 'industrial undertaking' for the purpose of the exemption of interest payments.

(2) According to the Constitution of India (Seventh Schedule—Union list) shipping is classified under a separate Entry 30 namely "carriage of passengers and goods by railways, sea or air or by national waterways in mechanically propelled vessels" and not under "industries" (Entry 52).

(3) According to Industries (Development and Regulation) Act 1951, the term "industrial undertaking" means any undertaking pertaining to scheduled industry carried on in one or more factories by any person or authority including Government and First Schedule to the Act details the industries engaged in the manufacture or production of any article including ships and other vessels drawn by power. Plying of ships for goods or passengers does not figure in the Schedule.

(4) The Central Government's approval did not specify the specific section of Income-tax Act under which exemption was granted.

The Ministry's Stand

5. The Ministry of Finance (Deptt. of Revenue) have not accepted the audit objection on the strength of Law Ministry's opinion given in May, 1973 that companies engaged in transport of goods can be regarded as 'industrial undertakings'. Regarding the omission to quote the specific section of the Income tax Act in the Government letter the Ministry have intimated that this seems to be a genuine error. The sanction letter, however, mentions about the interest rate and the exemption to interest money from tax.

6. On a clarification sought on the implications/scope of the term 'industrial undertaking', the Ministry of Finance (Deptt. of Revenue) again referred the matter to the Law Ministry who in turn, keeping in view the complicated nature of the issue, referred the same to the Attorney General for his considered opinion.

7. The Attorney General while concurring in the opinion tendered by the Ministry of Law, held the view that (i) activity of transportation of passengers and goods by an air company or shipping company is an 'industrial undertaking' within the meaning of Section 10(15)(iv)(c) of the Income tax Act, 1961, (ii) to be an industrial undertaking it is not necessary that the unit should be engaged in manufacture of production; and (iii) ships and aircrafts can be said to be covered by the words 'capital plant and machinery' as appearing in section 10(15)(iv)(c) of the Income Tax Act, 1961. He also averred that any activity systematically or habitually undertaken, *inter-alia*, for rendering of service to the community at large would be an undertaking and it need not necessarily be involved or engaged in the production of goods.

According to the Ministry of Finance (Department of Revenue) the opinion of Attorney General is binding on them.

8. There are several provisions* in the Income tax Act, 1961 containing the term 'Industrial undertaking' which is nowhere defined except for the purposes of Section 33B. The absence of definition of the expression in the Income tax Act, 1961 has given rise to doubts as to its real connotation in the context of section 10(15)(iv)(c). What had added to the confusion was the meaning given to the term in the Industries (Development and Regulation) Act, 1951 and classification of 'Shipping' in the Seventh Scheduled to the Constitution of India where it appears under Entry 30—'Carriage of goods and passengers by rail, sea or air or by national waterways in mechanically propelled vessels' and not under Entry 52—'Industries'. The Ministry of Law and the Attorney General were also moved to find out appropriate meaning of the expression as appearing in the impugned section and they gave their opinions after scanning variety of judicial pronouncements and English dictionaries. Section 10(15)(iv)(c) of the Income tax Act, 1961 is one of the very important provisions of the Act and the slightest misinterpretation thereof may lead to loss of considerable amount of revenue to the exchequer especially because the foreign lenders

*Sections 32, 32A, 33B, 80HH, 80H 'A, 80I, 80J and 280ZA

are involved. The Committee feel that such a term should not be left undefined. The Committee, therefore, strongly favour incorporation of an appropriate definition of the term 'Industrial Undertaking' in the relevant provisions of the Act so as to avoid its misuse or misinterpretation and consequent litigation.

9. The Economic Administration Reforms Commission (1981—83), while dealing with the 'Problems relating to Legislative drafting',* did not find uniformity in definitions given, language used and terms appearing in the Direct tax laws. They also observed that even within the same statute the same term had different meanings for different purposes and different words were used in different sections, even though meant to convey the same sense. In view of the fact that a greater measure of uniformity would make the law more elegant and intelligible and less prone to distortions in inteprtation and consequent litigation, the Commission recommended that a conscious effort should be made to impart greater uniformity to the definitions and procedures in the different direct tax laws. The aim should be to evolve a common code of difinitions and procedures applicable to the administration of all direct taxes except where the special purpose of a particular Act or provision warranted a departure. The Commission therefore, considered it necessary to have uniformity in the language used in the various provisions in the different tax laws when the intention was the same.

The Committee hope that the Ministry of Finance (Deptt. of Revenue) would act promptly on the above recommendation of the Commission. They would like to be apprised accordingly.

10. In reply to a question, the Ministry of Finance (Department of Revenue) have stated that they have no information about the shipping concerns or other industrial undertakings who had claimed exemption earlier under Section 10(15)(iv)(c) of the Income tax Act 1961 as the approvals are given by the Department of Economic Affairs in the Ministry of Finance and the other concerned Ministries. However, subsequently, the Department of Revenue collected information from the Ministry of Shipping and Transport and furnished the same to the Committee. It is disquieting to note that the Ministry of Finance who are charged with the responsibility of administration of Income tax Law are not aware of the cases of exemption having bearing on revenue. The Committee have also been informed that the opinion of the Attorney General

Vide EARC Report No. 24 (30-6-1983).

of India is being sought for through the Ministry of Law regarding the propriety of the practice of giving the tax concession under Section 10(15)(iv)(c) of the Income Tax Act 1961 by the administrative Ministries instead of the Ministry of Finance (Department of Revenue) who is responsible for the administration of Direct Tax Laws. The Committee are of the opinion that a procedure should be evolved under which the Central Board of Direct Taxes should invariably be involved before the sanction granting exemption from payment of Income Tax under Section 10(15)(iv)(c) ibid **is accorded. This will facilitate uniformity and the Ministry of Finance will also be aware of financial implications of such exemptions. The Committee would like to be apprised of further developments in this regard in the light of advice of the Attorney General of India.**

NEW DELHI;
April 28, 1988
Vaisakha 8, 1910 (*S*).

AMAL DATTA
Chairman,
Public Accounts Committee.

APPENDIX 1

(*Vide* Para 3 of the Report)

PARAGRAPH 2.42(i) OF THE REPORT OF THE C&AG OF INDIA FOR THE YEAR 1985-86, UNION GOVERNMENT (CIVIL) REVENUE RECEIPTS, VOL. II, DIRECT TAXES

2.42 *Income escaping assessment*

(i) Under the Income-tax Act, 1961, in computing the total income of a person, interest payable by an industrial undertaking in India on any moneys borrowed by it in a foreign currency from sources outside India, under an approved loan agreement, shall not be included in the total income.

The expression 'industrial undertaking' has not been defined in the Act for the purpose and in its absence, law is fairly well settled that it would be open to look for its meaning by reference to the definitions in other provisions in sister legislations and also to the plain legal meaning of the expression.

It has been judicially held that industry in the wide sense of the term would be capable of comprising three different aspects, (i) raw materials, which are an integral part of the industrial process, (ii) the process of manufacture or production, and (iii) the distribution of the products of the industry. It has also been held judicially that to be an industrial undertaking the work of manufacture or production should be carried on in one or more factories by any person or authority including Government.

In the entries in the Union List (Seventh Schedule) to the Constitution of India, the carriage of passengers and goods by railway, sea or air or by national waterways in mechanically propelled vessels has been separately classified (in Entry 30) and not along with 'industries' (in Entry 52). The Industries (Development and Regulation) Act, 1951, defines 'industrial undertaking' to mean any undertaking pertaining to a scheduled industry carried on in one or more factories by any person or authority including Government. In the relevant Schedule to the Act, reference has been

made only to industries engaged in the manufacture or production of articles. Mere plying of ships for carriage of goods/passengers for freight could not, therefore, be classified as an 'industrial undertaking'.

The Income-tax Act, 1961, provides that a person responsible for making interest payment to a company, other than a domestic company, is required to deduct income-tax thereon, at the time of making payment at the rates prescribed by the relevant Finance Act. Failure to deduct tax at source renders the person responsible for deducting the tax, liable to pay interest at twelve per cent per annum on the amount of such tax. The Act also provides that if no such deduction is made in respect of any interest chargeable under the Act, which is payable outside India, the interest will not be allowed as a deduction in computing the income.

A widely held domestic company dealing in the business of transport of foodgrains, fertilisers etc. in ships for freight in international tramping trade raised a foreign exchange loan of Dollar 16.5 million from a non-resident foreign bank to meet 90 per cent cost of a ship acquired in May 1974, under an agreement approved by the Government of India in May 1974. Under the agreement the interest payable by the company on the loan was free from Indian Income-tax. During the previous year relevant to the assessment years 1975-76 to 1981-82, the assessee company paid interest aggregating to Rs. 5,97,69,965 on the loan to the foreign bank. No deduction of income-tax at source on the amount of interest paid to the foreign bank was made relying on the sanction of the Ministry of Shipping and Transport. In the assessments completed for the assessment years 1975-76 to 1981-82, the assessing officer allowed the interest payments in the assessments of the company but did not consider the assessability of the interest income in the hands of the non-resident foreign bank. In addition, the assessee company, being a cargo carrier for freight is not classifiable as an 'industrial undertaking' in the light of the judicial decision and in view of the distinction meted out to carriage of passengers and goods by sea etc. In the Union List by not including it under 'industries' and accordingly, the interest payments made by the company will not be exempt from Indian Income-tax. The Central Government's approval for the foreign loan and payment of interest thereof is also silent regarding the specific section of the Income-tax Act, 1961, under which the exemption was granted. The

omission to include the interest amount led to escapement of income of Rs. 5,97,69,965 involving a total non-levy of tax of Rs. 4,41,60,149 for the seven assessment years.

The omission to treat the interest payment as assessable income also resulted in non-deduction of tax at source by the assessee company rendering it liable to levy of interest for the default.

The comments of the Ministry of Finance on the paragraph are awaited (December 1986).

APPENDIX II

Statement of Conclusions and Recommendations

Sl. No.	Para No.	Recommendation
1	2	3
1.	8	There are several provisions* in the Income tax Act, 1961 containing the term 'Industrial undertaking' which is nowhere defined except for the purposes of Section 33B. The absence of definition of the expression in the Income tax Act, 1961 has given rise to doubts as to its real connotation in the context of Section 10(15)(iv)(c). What had added to the confusion was the meaning given to the term in the Industries (Development and Regulation) Act, 1951 and classification of 'Shipping' in the Seventh Schedule to the Constitution of India where it appears under Entry 30—'Carriage of goods and passengers by rail, sea or air or by national waterways in mechanically propelled vessels' and not under Entry 52—'Industries'. The Ministry of Law and the Attorney General were also moved to find out appropriate meaning of the expression as appearing in the impugned section and they gave their opinions after scanning variety of judicial pronouncements and English dictionaries. Section 10(15)(iv)(c) of the Income tax Act, 1961 is one of the very important provisions of the Act and the slightest misinterpretation thereof may lead to loss of considerable amount of revenue to the exchequer especially because the foreign lenders are involved. The Committee feel that such a

*Sections 32,32A,33B,80HH,80HHA,80I,80J,and 280ZA.

1	2	3
		term should not be left undefined. The Committee, therefore, strongly favour incorporation. of an appropriate definition of the term 'Industrial Undertaking' in the relevant provisions of the Act so as to avoid its misuse or misinterpretation and consequent litigation.
2.	9	The Economic Administration Reforms Commission (1981-83), while dealing with the 'problems relating to Legislative drafting'@, did not find uniformity in definitions given, language used and terms appearing in the Direct tax laws. They also observed that even within the same statute the same term had different meanings for different purposes and different words were used in different sections, even though meant to convey the same sense. In view of the fact that a greater measure of uniformity would make the law more elegant and intelligible and less prone to distortions in intepretation and consequent litigation, the Commission recommended that a conscious effort should be made to impart greater uniformity to the definitions and procedures in the different direct tax laws. The aim should be to evolve a common code of definitions and procedure applicable to the administration of all direct taxes except where the special purpose of a particular Act or provision warranted a departure. The Commission, therefore, considered it necessary to have uniformity in the language used in the various provisions in the different tax laws when the intention was the same. The Committee hope that the Ministry of Finance (Deptt. of Revenue) would act promptly on the above recommendation of the Commission. They would like to be apprised accordingly.

@ *Vide* EARC Report No. 24 (30-6.83)

1	2	3
3.	10	In reply to a question, the Ministry of Finance (Department of Revenue) have stated that they have no information about the shipping concerns or other industrial undertakings who had claimed exemption earlier under Section 10(15)(iv)(c) of the Income tax Act 1961 as the approvals are given by the Department of Economic Affairs in the Ministry of Finance and the other concerned Ministries. However, subsequently, the Department of Revenue collected information from the Ministry of Shipping and Transport and furnished the same to the Committee. It is disquieting to note that the Ministry of Finance who are charged with the responsibility of administration of Income tax Law are not aware of the cases of exemption having bearing on revenue. The Committee have also been informed that the opinion of the Attorney General of India is being sought for through the Ministry of Law regarding the propriety of the practice of giving the tax concession under Section 10 (15) (iv) (c) of the Income tax Act 1961 by the administrative Ministries instead of the Ministry of Finance (Department of Revenue) who is responsible for the administration of Direct Tax Laws. The Committee are of the opinion that a procedure should be evolved under which the Central Board of Direct Taxes should invariably be involved before the sanction granting exemption from payment of Income Tax under Section 10(15) (iv) (c) *ibid* is accorded. This will facilitate uniformity and the Ministry of Finance will also be aware of financial implications of such exemptions. The Committee would like to be apprised of further developments in this regard in the light of advice of the Attorney General of India.