

FIFTY-EIGHTH REPORT
PUBLIC ACCOUNTS COMMITTEE
(1986-87)

(EIGHTH LOK SABHA)

**INCORRECT DEDUCTION IN RESPECT OF INTER-
CORPORATE DIVIDENDS**

**MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)**

[Action taken on 206th Report (Seventh Lok Sabha)]



Presented in Lok Sabha on 11.11.1986

Laid in Rajya Sabha on 11.11.1986

**LOK SABHA SECRETARIAT
NEW DELHI**

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PUBLIC ACCOUNTS COMMITTEE

(1986-87)

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Shri K. H. Chhaya, *Chief Financial Committee Officer*

Shri Brahmanand, *Senior Financial Committee Officer.*

INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this 58th Report on action taken by Government on the recommendations/observations of the Committee contained in their 206th Report (7th Lok Sabha) relating to Incorrect deduction in respect of intercorporate dividend.

2. Noticing that there were certain controversies over the determination of expenses incurred in earning dividend income, the Committee had in their earlier report desired the Government to consider linking the deduction to the gross dividend and to reduce the percentage of deduction. The Ministry of Finance did not accept the said recommendation. The Committee still hold the opinion that change in the present law is necessary. Section 20(1)(ii) of the Income Tax Act, 1961 provides for a formula regarding deduction to be allowed from interest on securities in the case of a banking company. Inter-corporate dividend received by a company stands on the same footing as interest from securities received by a Banking Company. The Committee have, therefore, desired the Government to consider amendment of Section 80M on the lines of Section 20 of the Income Tax Act 1961.

3. The Committee considered and adopted the report at their sitting held on 29 August, 1986. The Minutes of the sitting form Part II of the Report.

4. For facility of reference and convenience, the recommendations and observations of the Committee have been printed in thick type in the body of the report and have also been reproduced in Appendix to the Report.

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

NEW DELHI ;
September 8, 1986
Bhadra 17, 1908 (Saka).

E. AYYAPU REDDY,
Chairman,
Public Accounts Committee.

PART I
CHAPTER I
REPORT

This Report of the Committee deals with the action taken by Government on the Committee's recommendations/observations contained in their Two hundred and Sixth Report (Seventh Lok Sabha) on paragraph 2.20 (iñ) of Report of the Comptroller and Auditor General of India for the year 1981-82, Union Government (Civil), Revenue Receipts vol. II Direct Taxes relating to 'incorrect deduction in respect of inter-Corporate dividends.'

1.2 The Committee's 206th Report was presented to Lok Sabha on 30 April, 1984. It contained 9 recommendations and observations. Action taken notes have been received in respect of all the recommendations/observations. These have been broadly categorised as follows :

- (i) Recommendations and Observations which have been accepted by Government ;

Sl. Nos. 1—3, 6 and 7.

- (ii) Recommendations and Observations which the Committee do not desire to pursue in view of the replies of Government ;

Nil.

- (iii) Recommendations and observations replies to which require reiteration ;

Sl. Nos. 4, 5, 8 and 9.

- (iv) Recommendations and Observations in respect of which Government have furnished interim reply ;

Nil.

1.3 The Committee will now deal with the action taken by Government on some of the recommendations :

Computation of deduction allowable on inter-Corporate dividend.

1.4 In paragraphs 65, 69 and 70 of the 206th Report (7th Lok Sabha), the Public Accounts Committee made the following recommendations :

"The Committee were informed in evidence that the Department had consulted the Additional Solicitor General on the question whether they should appeal against the decision of the Calcutta High Court. They were advised against appeal by the Additional Solicitor General who was of the opinion that the Calcutta High Court had correctly enunciated the law. In reply to a question whether the decision of the Calcutta High Court was in accordance with the intention of Government, the representative of the Central Board of Direct Taxes stated, "our intention was not so". As to the remedial measures, he stated that the only course now open to Government was to amend the law on the subject. However, Government were yet to take a decision in the matter.

The Committee regret to observe that although a period of more than three years has elapsed since Government had obtained the opinion of the Additional Solicitor General they are yet to take a decision on the follow-up action to be taken. This shows how casual the Ministry of Finance are in their approach in the matter."

[Para 65]

"The Committee have been informed that the Income-tax Department have not made any studies on the pattern of taxation on inter-corporate dividend incomes in other countries. During evidence, a Member of the Board promised to consider the suggestion. The Committee desire that the Board should conduct such a study at an early date with a view to introducing, if necessary, suitable structural change in our own system."

[Para 69]

"In view of the foregoing as also considering the controversy attendant on the allocation of expenses in case of inter-corporate dividend incomes as in the present case, the Committee feel that in the interest of proper administration of relief on inter-corporate dividends, Government should consider relating the deduction to gross dividend which is specific amount, instead of net dividend income as at present and to limit the concession by reducing the percentage of deduction suitably. During evidence, the representative of the Board promised to consider the suggestion. The Committee desire that the matter should be examined and necessary follow-up action taken at an early date."

[Para 70]

1.5 In their action taken notes, the Ministry of Finance have

stated as follows :

Para 65 "In C.I.T. Vs. New India Investment Corporation Ltd. (1978) 113 ITR 778 referred to in the Report, the Calcutta High Court observed as under :

"In the instant case it has been found by the Tribunal as follows :

- (a) The assessee held the shares and securities as its stock-in-trade.*
- (b) The dividend was received by the assessee from its stock-in-trade.*
- (c) None of the holdings of the assessee were shown to be held by way of investment only.*

It is not disputed that the assessee had incurred expenditure to earn its income. The Tribunal has also found that dividend earned by the assessee though assessable under a particular head is really a part of the business income of the assessee.

In view of the law as laid down by the Supreme Court, it appears to us that the expenditure in the instant case has been shown to be referable to the business activity carried on by the assessee and must be allowable under the head "Business income."

The decision in the aforesaid case is based on the facts of the case. If a person carried on business in purchase and sale of shares, expenditure incurred by him in the course of carrying on of such business is allowable and deduction in computing income under the head 'Profits and gains of business or profession'. Amendment of the provisions of the Income-tax Act to provide that such expenditure shall not be allowed as deduction in computing the income under the head 'Profits and gains of business or profession' but under the head "Other Sources" will not be in conformity with the scheme of the Act. Moreover, only such income as is not chargeable to income-tax under any of the heads specified in section 14, Item A to E namely Salaries, Interest on Securities, Income from House Property, Profits and gains of business or profession and Capital gains, is liable to be taxed under the head 'Income from Other Sources'. Therefore, where a taxpayer carries on business in shares the income derived from such business after deduction of expenses is liable to be taxed under the head 'Profits and gains of business or profession'. However, dividend income is liable to be taxed as income under the head 'Income from Other Sources.' No amendment of the law is considered necessary to

nullify the decision of the Calcutta High Court in the case of CIT Vs New India Investment Corporation Ltd., which is based on the facts of that case."

Para 69—"In pursuance of the above recommendations, the Central Board of Direct Taxes entrusted the study suggested by the P.A.C. to the Directorate of O&M Services (IT).

In their Report, the Directorate of O&M Services (IT) made the following recommendations :

- (i) In the light of the study of assessment of inter-corporate dividends of other countries it is seen that no structural changes are required in the Indian system.
- (ii) The present system of allowing relief as a percentage of net dividend may be continued.
- (iii) If companies which hold shares as stock-in-trade are denied deduction u/s 80M it may lead to a slowing down of industrial growth.
- (iv) The only action required is to have the provisions of the Act so drafted that the intention of the Legislature to restrict the deduction on inter-corporate dividends to the net dividend may be carried through.

Thus on the basis of this study, the only action required is to amend the law so that the intention of the Legislature to restrict the deduction on inter-corporate dividends to the net dividend may be carried through. It may be mentioned that at the time when the study was carried out by the Directorate of O&M Services (IT), the judgement of the Supreme Court dated 1-7-85 in the case of *Distributors (Baroda) Private Limited Vs. Union of India* and two others (W P. No. 2043 of 1981) was not available. As mentioned in our Action Taken Note relating to Para 70 of this Report of the P.A.C., the Supreme Court in the case of *Distributors (Baroda) Private Limited* have overruled their earlier judgement in the case of *Cloth Traders Ltd. Vs. Additional Commissioner of Income-tax* (118 ITR 243) holding that section 80AA of the Income-tax act is declaratory in nature and merely declares what the correct position has always been. Accordingly, no amendment of law has been considered to be necessary. Further, on the basis of the study made by the Directorate of O&M (IT), no structural changes in the system has been considered to be necessary.

Section 80AA and Section 80M(1) are reproduced below :

"80AA. Where any deduction is required to be allowed under

Section 80M in respect of any income by way of dividends from a domestic company which is included in the gross total income of the assessee, then notwithstanding anything contained in that section, the deduction under that section shall be computed with reference to the income by way of such dividends as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) and not with reference to the gross amount of such dividends."

"80M(1) Where the gross total income of an assessee, being a domestic company, includes any income by way of dividends from a domestic company, there shall, in accordance with and subject to the provisions of the Section, be allowed, in computing the total income of the assessee, a deduction from such income by way of dividends of an amount equal to sixty per cent of such income."

Para 70—The suggestion of the PAC that the amount of deduction under Section 80-M may be linked with gross dividend income and concession may be limited by reducing the percentage of deduction is not acceptable for the reasons that it would amount to acceptance of decision of the Supreme Court in the case of *Cloth Traders Limited Vs. Additional Commissioner of Income-tax (118 ITR 243)* which goes against the intention of the Legislature particularly after the judgement of the Supreme Court in the case of *Distributors (Baroda) Private Ltd.* in Writ-petition No. 2043 of 1981, overruling their earlier judgement in the case of *Cloth Traders Private Ltd.* and holding that Section 80-AA of the Income Tax Act is declaratory in nature and merely declares what the correct position has always been.

As per Section 80-AA inserted by Finance (No. 2) Act, 1980 with retrospective effect from 1.4.1968, the deduction under Section 80M is to be computed with reference to net and not gross dividends. Apart from this, certain legal complications, would also arise in the implementation of sections 80N, 80-O, 80-R, etc. In any case, the income from other sources has to be computed in accordance with the provisions of the Income Tax Act. For the computation of such income, expenses such as interest on borrowed capital etc. incurred by an assessee to earn such income will have to be deducted.

If the law is amended to provide that the gross dividend less a statutory percentage thereof for expenses (instead of the actual expenses) will be considered for the deduction under Section 80M, it will lead to inequitable consequences. For instance, if the

statutory percentage of deduction is fixed at 50% in a case where the entire investment is made with borrowed capital and the interest thereon works out to say 90% of the gross dividend, it will be inequitable to restrict the deduction to 50%. Likewise, if the investment in shares is made with the company's own funds, and consequently no interest is payable thereon, it would be inequitable to allow a deduction of 50% for expenditure although none is incurred.

It should be possible for the assessing officer to determine the interest incurred on investment by ascertaining the source of funds for acquiring the shares. The other expense incurred for earning the dividend income would normally be a relatively insignificant amount and is unlikely to generate controversy or litigation in determination. A reasonably precise determination of net dividend income is possible and is preferable to linking the relief under section 80M to the gross dividend less a statutory percentage for expenses.

As clarified by the Supreme Court in the case of Distributors (Baroda) Private Ltd., (W.P. No. 2043 of 81) while overruling the earlier decision in the case of Cloth Traders Ltd., the main object of the relief under section 80M is to avoid taxation once again in the hands of the receiving company of the amount which has already borne full tax in the hands of the paying company. The amount of dividend which would otherwise suffer tax in the hands of receiving company would not be the full amount but the amount computed in accordance with the Income-tax Act. Hence, the legislature "could certainly be attributed, the intention to prevent double taxation but not to provide an additional benefit which would go beyond what is required for saving the amount of dividend from taxation once again in the hands of the assessee."

1.6 Section 19 of the Income Tax Act 1961 deals with the deductions from interest on securities and Section 20 of that Act deals with the deductions from interest on securities in the case of banking company. These Sections read as under :

"19. Deductions from interest on securities—Subject to the provisions of Section 21, the income chargeable under the head "~~Interest on securities~~" shall be computed after making the following deductions —

- (i) any reasonable sum expended by the assessee for the purpose of realising such interests ;
- (ii) any interest payable on moneys borrowed for the purpose of investment in the securities by the assessee.

20. Deductions from interest on securities in the case of a banking company-- (1) In the case of a banking company—

- (i) the sum to be regarded as a sum reasonably expended for the purpose referred to in clause (i) of section 19 shall be an amount bearing to the aggregate of its expenses as are admissible under the provisions of sections 30, 31, 36 and 37 [other than clauses (iii), (vi), (vii) and (viii) of sub-section (1) of section 36] the same proportion as the gross receipts from interest on securities (inclusive of tax deducted at source) chargeable to income-tax under section 18 bear to the gross receipts of the company from all sources which are included in the profit and loss account of the company ;
- (ii) the amount to be regarded as interest payable on all moneys borrowed for the purpose referred to in clause (ii) of section 19 shall be an amount which bears to the amount of interest payable on all moneys borrowed by the company the same proportion as the gross receipts from interest on securities (inclusive of tax deducted at source) chargeable to income-tax under section 18 bear to the gross receipts from all sources which are included in the profit and loss account of the Company.

(2) The expenses deducted under clauses (i) and (ii) of sub-section (1) shall not again form part of the deductions admissible under sections 30 to 37 for the purposes of computing the income of the company under the head "Profits and gains of business or profession".

Explanation : For the purposes of this section, "moneys borrowed" includes money received by way of deposits."

1.7 In their earlier report, the Committee while considering the question of deduction in respect of intercorporate dividends, had desired the Government to consider relating the deduction to gross dividend instead of net dividend and also to reduce the percentage of deduction suitably with a view to setting a limit to the concession. At present, the deduction allowed under Section 80M of the Income Tax Act 1961 is 60% of income by way of dividend. The Ministry of Finance have not accepted the recommendation of the Committee on the plea that the amendment of the existing provisions on the lines suggested by the Committee would lead to inequitable consequences.

1.8 The recommendation made by the Committee was in the context of controversies attendant on the determination of expenses incurred in earning dividend income leading to incorrect deduction in respect of intercorporate

dividends and rejection thereof in appeals. In order to set at rest all the controversies on the subject, change in the present law is all the more necessary. In this connection, the Committee would like to refer to the provisions of Section 20 (1)(ii) of the Income Tax Act, 1961 which provides for a formula regarding the deduction to be allowed from interest on securities in the case of a banking company.

The section ibid reads as under :

"20. Deductions from interest on securities in the case of a banking company—

(1) In the case of a banking company—

* * * * *

(ii) the amount to be regarded as interest payable on all moneys borrowed for the purpose referred to in clause (ii) of section 19 shall be an amount which bears to the amount of interest payable on all moneys borrowed by the company the same proportion as the gross receipts from interest on securities (inclusive of tax deducted at source) chargeable to income-tax under section 18 bear to the gross receipts from all sources which are included in the profit and loss account of the company."

The Committee feel that inter corporate dividend received by a company dealing in shares stands on same footing as the interest from securities received by a Banking Company. They, therefore, desire that Government should consider amendment of Section 80M on the lines of Section 20 of the Income Tax Act, 1961.

Tests for determining whether the assessee company was dealer in shares or not.

[Sl. No. 5, Para 66]

1.9. The Public Accounts Committee in paragraph 66 of their 206th Report (Seventh Lok Sabha) recommended as follows :

"From a comparison of the schedule of investments of the assessee company as on 31.3.1977 with the list of 38 companies of the same group furnished to the Committee in reply to a question, the Committee observe that the shares of companies of the same group

comprised as much as Rs. 168.35 lakhs out of a total investment of Rs. 1.81 crores of the company for the assessment year 1977-78. As already mentioned, even though the view of the Department all along was that the assessee company were not dealers in shares, the Income-tax Appellate Tribunal had held that they were. The Committee desire the Ministry of Finance to examine whether the tests at present applied for treating an assessee as a trader-in-shares are objective, unambiguous and uniform in the whole country and also in accordance with the intention of Government. In case they are not, the Committee would like the Ministry to examine whether any amendment in law is called for to achieve this end.

1.10 The Ministry of Finance (Department of Revenue) have in their action taken note stated as follows :

"The question as to whether a particular assessee is a trader in shares or an investor is essentially a question of fact to be determined on the facts of each case. The presence of commercial motive is a primary legal requisite of trade. The intention of an assessee as reflected by his actions would enable the assessing officer to determine whether or not an assessee is a trader or investor in share.

It is not practicable to make any provision in law laying down tests for this determination because, such provision cannot possibly cover all possible situations that may arise. It is preferable to leave the matter to the assessing officer to determine as to whether or not the shares acquired by a tax payer represent his trading asset or investment."

1.11 The status of the assessee if he was a dealer in shares was viewed differently by Central Board of Direct Taxes and the Income Tax Appellate Tribunal. While the Board had all along held the view that the company was not a dealer in shares, the Income Tax Appellate Tribunal had held that it was. The Committee in their earlier Report, had desired that the Ministry of Finance should examine whether the tests applied by them for determining the nature of the company were objective, uniform and in accordance with their intention and if they were not, suitable changes in law should be considered. The Ministry of Finance have not favoured any change in the existing provisions of law.

1.12 The Committee reiterate their earlier recommendation keeping in view the difficulties that may arise in the course of deciding the nature of business of the assessee. To say that the existing position may continue does not appeal to reason. Since the Board could have their own reasons

for holding that the assessee company was not dealer in shares, it is imperative for the Board to examine as to why their stand was not accepted by the Income Tax Appellate Tribunal. The Committee hope that the Ministry of Finance (Department of Revenue) would reconsider their stand on the recommendation and initiate suitable legislative measures or issue necessary guidelines for officers of the Department in order to avoid any confusion or doubts over the nature of the assessee's business or trade.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN ACCEPTED BY GOVERNMENT

Recommendation

Under the Income-Tax Act, 1961, the deduction on account of Inter-corporate dividends is governed by the provisions of Section 80M. In *Cloth Traders (P) Ltd. Vs. Additional Commissioner of Income-Tax, Gujarat (118 ITR 243)*, the Supreme Court considered the question whether the deduction was allowable as a percentage of the actual gross amount of dividend or it was confined to the net dividend income as computed in accordance with the provisions of the Act, *i.e.*, after making the deduction specified in Section 57 including deduction on interest paid on borrowings for making the investment. In their Judgement delivered on 4 may, 1979, the Supreme Court held that the deduction was allowable with reference to the gross amount of dividends and not with reference to the net dividend income. Thereupon, Section 80AA was inserted in the Act by Finance (No. 2) Act, 1980 retrospectively from 1-4-1968 to provide specifically that deduction under Section 80M would be calculated with reference to the net amount of dividends. The Central Board of Direct Taxes clarified in a Circular dated 22-9-1980 that the intention all along was to grant deduction on the net dividend income and not on gross dividends.

In the assessment of an Indian domestic company M/s Karam Chand Thapar and Bros. Ltd. for the assessment year 1977-78 completed in September, 1980, deduction was allowed with reference to the amount of gross dividend income instead of the net dividend income. Even after the amendment of law in 1980, the mistake was not rectified by the assessing officer. As a result, according to Audit, an excess allowance of deduction of Rs. 10,54,045 with an under-assessment of income by the same amount and under-charge of tax of Rs. 7,29,386 persisted.

The audit objection was not accepted by the Ministry of Finance who, in their reply dated 31-1-1983 to Audit stated that the expenses towards collection charges were negligible. Also, it would not be correct to apportion the expenses shown in the profit and loss account

on the income ratio and in the present case there was no deductible expenditure against dividend income. In a further reply to Audit on 21-3-1983, the Ministry of Finance reiterated that there were hardly any outgoings or collection charges attributable to the dividend income. In a written reply to the Committee, the Ministry have again clarified that there were no deductions permissible under Section 57 in the case and deductions under that Section cannot be computed on an ad-hoc or pro rata basis. (Para 62)

The Committee find it difficult to appreciate the above explanation of the Ministry in view of the fact that under Section 57 of the Income-tax Act, apart from collection charges, interest, if any, paid on loans utilised for the purpose of shares, management expenses etc have to be deducted from the gross dividend income. Considering the fact that out of the total income of Rs. 110.36 lakhs, the dividend income accounted for Rs. 65.96 lakhs as against business income of Rs. 4.86 lakhs only and also keeping in view the huge expenditure of over Rs. 1 crore, including expenditure of Rs. 21.85 lakhs on interest and financing, the Ministry's contention that there were no deductible expenses ascribable to intercorporate dividend income does not appeal to reason. Nor does it stand to reason that for earning a business income of only Rs. 4.86 lakhs, the whole or even a major portion of expenditure of over a crore of rupees could have been incurred. The Committee find no ostensible reason why the amount paid as interest on loans taken for investment in shares with the resultant dividend income at least should not have been considered as an 'outgoing' under Section 57. (Para 63)

Apparently, in rejecting the Audit objection, the Department had relied on the decision (28-2-1978) of the Calcutta High Court in C.I.T. Vs. New Delhi Investment Corporation Ltd. (113 ITR 778). In that case the Calcutta High Court had held that where shares constitute stock-in-trade of the assessee, the dividend income is in the nature of business income and the entire expenses relating thereto could be allowed in the computation of business income without allocating anything specifically to the dividend income. Prior to this judgement, there was another High Court judgement in the case of Madras Motors and General Insurance Company (99 ITR 243) holding that no part of the business expenses can be alienated to dividend income. In this case, the Department had filed a Special Leave Petition to the Supreme Court which was refused. The Committee have been informed during evidence that the Department had all along held that the assessee company were not dealers in shares. But the Income Tax Appellate Tribunal had upheld the assessee's claim that they were dealer in shares. The Chairman, Central Board of Direct Taxes informed the Committee in extenuation that "finding of facts rests with the Tribunal" and "that unless there is a feeling that

the decision is perverse, the Department cannot even go to the High Court". (Para 64)

[S. No. 1 to 3 (Paras 62 to 64) of the Appendix of the 206th Report of the P.A.C. (1983-84) (7th Lok Sabha)].

Action taken

Paras 62 to 64 broadly deal with the general background on the application of Section 80M of the I.T. Act and on the facts of the case of M/s K. C. Thapar & Sons. These are commentative in nature and have been noted by the Ministry.

[M/o Finance (Deptt. of Revenue) OM. No 241/6/84—A&PAC-II dated 26.2.1986]

Recommendation

The Committee find that there are a number of Court decisions on gross and net dividend income. In these judgments, certain criteria have been laid down to find who are 'dealers in shares'. The Committee have been informed that the case reports are supplied to the ITOs and the Board does not issue guidelines. In the opinion of the Committee, this is not enough. They feel that once Government have taken a view on a contentious matter, it should be the duty of the Board to issue suitable guidelines to the assessing officers, otherwise there is a risk of differential treatment being meted out to different assessees by different assessing officers. The Committee desire that, pending examination of the matter as suggested in the preceding paragraph, the Central Board of Direct Taxes should issue necessary guidelines to the field formations on the tests to be applied to determine who are dealers-in-shares. They should also issue instructions to lower formations to take special care to scrutinise the balance sheets and profit and loss accounts of such assessee companies as claim to be 'dealers-in-shares'.

[Sl. No. 6 (Para 67) of the Appendix of the 206th Report of the P.A.C. (1983-84) (7th Lok Sabha)]

Action taken

The matter has been considered. It does not appear practicable to lay down guidelines for the field formations on the tests to be applied to determine who are dealers in shares. However, instructions have been issued that the assessing officers should examine all aspects of the matter and determine whether or not the shares acquired by the tax-payer

represent his trading assets or investments. He would also be required to take special care to scrutinise the balance-sheets and profit and loss accounts of such assessee companies as claim to be 'dealers-in-shares.'

(M/o Finance (Deptt. of Revenue) OM. No. 241/6/84-A&PAC-II
dated 30.4.1986]

Recommendation

The Committee observe that the Department's intention all along has been to grant deduction on the net dividend income and not on gross dividend income. In their judgement delivered on 4.5.1979, the Supreme Court held that the deduction was allowable with reference to the gross amount of dividends and not with reference to the net dividend income. To get over the Supreme Court's decision, a new Section 80AA was inserted in the tax Act, 1961 by the Finance (No. 2) Act, 1980 retrospectively from 1-4-1968 to specify that deduction under Section 80M would be calculated with reference to the net dividend income as computed in accordance with the provisions of the Income-tax Act and not with reference to the gross amount of dividends. Finance (No. 2) Act, 1980 was brought into force on 21.8.1980. Apparently, it can be safely inferred that in almost all the cases decided by the assessing officers between 4.5.1979 and 21.8.1980 relief has been given on the gross amount of dividends and this fact was also conceded by a Member of the Board during evidence. The Committee regret to observe that although Section 80AA has been brought into force with retrospective effect more than three and a half years back no review has yet been ordered by the Board. In order that the purpose behind the retrospective effect is not lost, the Committee desire that the Board should order an immediate time-bound review of all cases assessed upto 21.8.1980 for appropriate rectificatory action. The Committee would like to be informed of the action taken in the matter, together with the outcome thereof.

[Sl. No. 7 (Para 68) of the Appendix of the 206th Report of the
P.A.C. (1983-84) (7th Lok Sabha)]

Action Taken

Para 68 deals with the provision of Section 80-AA read with Section 80'M' regarding the admissibility of deduction under Section 80'M' on net dividend. This matter has been examined and the issue of instruction has been kept pending till the Judgement of Supreme Court in the case of M/s Cloth Traders (P) Ltd. vs. Commissioner of Income-tax, Gujarat is delivered on the Writ Petition Challenging the validity of retrospective amendment.

(Vide M/O Finance OM. No. 241/6/84-A&PAC-II dated 30-10-1984)

Further Information

Kind attention of the Hon'ble Committee is invited to the Office Memorandum of even number dated the 30th October, 1984 wherein an Action Taken Note on para 68 of 206th Report was submitted.

Suitable instructions have already been issued to the Field Officers in this matter.

This issues with the approval of the Additional Secretary to the Government of India.

[M/o Finance (Deptt. of Revenue) OM No. 241/6/84-A & PAC-II
dated 15.7.1986]

CHAPTER III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN THE LIGHT OF THE REPLIES RECEIVED FROM GOVERNMENT

-NIL-

CHAPTER IV

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

Recommendation

The Committee were informed in evidence that the Department had consulted the Additional Solicitor General on the question whether they should appeal against the decision of the Calcutta High Court. They were advised against appeal by the Additional Solicitor General who was of the opinion that the Calcutta High Court has correctly enunciated the law. In reply to a question whether the decision of the Calcutta High Court was in accordance with the intention of Government, the representative of the Central Board of Direct Taxes stated, "our intention was not so". As to the remedial measures, he stated that the only course now open to Government was to amend the law on the subject. However, Government were yet to take a decision in the matter.

The Committee regret to observe that although a period of more than three years has elapsed since Government had obtained the opinion of the Additional Solicitor General they are yet to take a decision on the follow-up action to be taken. This shows how casual the Ministry of Finance are in their approach in the matter.

[S. No. 4 (Para 65) of the Appendix of the 206th Report of the P.A.C. (1983-84) (7th Lok Sabha)].

Action taken

In *C.I.T. Vs. New India Investment Corporation Ltd.* (1978) 113 ITR 778 referred to in the Report, the Calcutta High Court observed as under :—

"In the instant case it has been found by the Tribunal as follows :—

- (a) The assessee held the shares and securities as its stock-in-trade.
- (b) The dividend was received by the assessee from its stock-in-trade.

- (c) None of the holdings of the assessee were shown to be held by way of investment only.

It is not disputed that the assessee had incurred expenditure to earn its income. The Tribunal has also found that dividend earned by the assessee though assessable under a particular head is really a part of the business income of the assessee.

In view of the law as laid down by the Supreme Court, it appears to us that the expenditure in the instant case has been shown to be referable to the business activity carried on by the assessee and must be allowable under the head "Business income."

The decision in the aforesaid case is based on the facts of the case. If a person carries on business in purchase and sale of shares, expenditure incurred by him in the course of carrying on of such business is allowable as deduction in computing income under the head 'Profits and gains of business or profession'. Amendment of the provisions of the Income-tax Act to provide that such expenditure shall not be allowed as deduction in computing the income under the head 'Profits and gains of business or profession' but under the head "Other Sources" will not be in conformity with the scheme of the Act. Moreover, only such income as is not chargeable to income-tax under any of the heads specified in section 14, Item A to E namely Salaries, Interest on Securities, Income from House Property, Profits and gains of business or profession and Capital gains, is liable to be taxed under the head 'Income from Other Sources'. Therefore, where a taxpayer carries on business in shares the income derived from such business after deduction of expenses is liable to be taxed under the head 'Profits and gains of business or profession'. However, dividend income is liable to be taxed as income under the head 'Income from Other Sources'. No amendment of the law is considered necessary to nullify the decision of the Calcutta High Court in the case of CIT Vs. New India Investment Corporation Ltd., which is based on the facts of that case.

[M/o Finance (Deptt. of Revenue) OM No. 241/6/84-A & PAC-II
dated 26.7.86]

Recommendations

From a comparison of the schedule of investments of the assessee company as on 31.3.1977 with the list of 38 companies of the same group furnished to the Committee in reply to a question, the Committee observe that the shares of companies of the same group comprised as much as Rs. 168.35 lakhs out of a total investment of Rs. 1.81 crores of the company for the assessment year 1977-78. As already mentioned, even though the view of the

Department all along was that the assessee company were not dealers in shares, the Income-tax Appellate Tribunal had held that they were. The Committee desire the Ministry of Finance to examine whether the tests at present applied for treating an assessee as a trader-in-shares are objective, unambiguous and uniform in the whole country and also in accordance with the intention of Government. In case they are not, the Committee would like the Ministry to examine whether any amendment in law is called for to achieve this end. (Para 66)

The Committee have been informed that the Incometax Department have not made any studies on the pattern of taxation on inter-corporate dividend incomes in other countries. During evidence, a Member of the Board promised to consider the suggestion. The Committee desire that the Board should conduct such a study at an early date with a view to introducing, if necessary, suitable structural changes in our own system. (Para 69)

In view of the foregoing as also considering the controversy attendant on the allocation of expenses in case of inter-corporate dividend incomes as in the present case, the Committee feel that in the interest of proper administration of relief on inter-corporate dividends, Government should consider relating the deduction to gross dividend which is a specific amount, instead of net dividend income as at present and to limit the concession by reducing the percentage of deduction suitably. During evidence, the representative of the Board promised to consider the suggestion. The Committee desire that the matter should be examined and necessary follow-up action taken at an early date. (Para 70)

[Sl. No. 5, 8 and 9 (Para 66, 69 and 70) of the Appendix of the 206th Report of the P.A.C. (1983-84) (7th Lok Sabha)]

Action Taken

Para 66 The question as to whether a particular assessee is a trader in shares or an investor is essentially a question of fact to be determined on the facts of each case. The presence of commercial motive is a primary legal requisite of trade. The intention of an assessee as reflected by his actions would enable the assessing officer to determine whether or not an assessee is a trader or investor in share.

It is not practicable to make any provision in law laying down tests for this determination because, such provision cannot possibly cover all possible situations that may arise. It is preferable to leave the matter to the assessing officer to determine as to whether or not the shares acquired by a taxpayer represent his trading asset or investment.

Para 69 In pursuance of the above recommendations, the Central Board of Direct Taxes entrusted the study suggested by the P.A.C. to the Directorate of O&M Services (IT).

2. In their Report, the Directorate of O&M Services (IT) made the following recommendations :—

(i) In the light of the study of assessment of intercorporate dividends of other countries it is seen that no structural changes are required in the Indian system.

(ii) The present system of allowing relief as a percentage of net dividend may be continued.

(iii) If companies which hold shares as stock-in-trade are denied deduction u/s 80M it may lead to a slowing down of industrial growth.

(iv) The only action required is to have the provisions of the Act so drafted that the intention of the Legislature to restrict the deduction on inter-corporate dividends to the net dividend may be carried through.

3. Thus on the basis of this study, the only action required is to amend the law so that the intention of the Legislature to restrict the deduction on inter-corporate dividends to the net dividend may be carried through. It may be mentioned that at the time when the study was carried out by the Directorate of O&M Services (IT), the judgement of the Supreme Court dated 1-7-85 in the case of Distributors (Baroda) Private Limited v. Union of India and two others (W.P. No. 2043 of 1981) was not available. As mentioned in our Action Taken Note relating to Para 70 of this Report of the P.A.C., the Supreme Court in the case of Distributors (Baroda) Private Limited have overruled their earlier judgement in the case of Cloth Traders Ltd. v. Additional Commissioner of Income-tax (118 ITR 243) holding that section 80AA of the Income tax Act is declaratory in nature and merely declares what the correct position has always been. Accordingly, no amendment of law has been considered to be necessary. Further, on the basis of the study made by the Directorate of O&M (IT), no structural changes in the system has been considered to be necessary.

4. Section 80AA and Section 80M(1) are reproduced below :

“80AA. Where any deduction is required to be allowed under section 80M in respect of any income by way of dividends from a domestic company which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, the deduction under that section shall be computed with reference to the income by way of such dividends as computed in accordance with the provisions of this Act (before making any

deduction under this Chapter) and not with reference to the gross amount of such dividends."

"80M(1) Where the gross total income of an assessee, being a domestic company, includes any income by way of dividends from a domestic company, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such income by way of dividends of an amount equal to sixty per cent of such income."

Para 70 The suggestion of the PAC that the amount of deduction under section 80-M may be linked with gross dividend income and concession may be limited by reducing the percentage of deduction is not acceptable for the reasons that it would amount to acceptance of decision of the Supreme Court in the case of Cloth Traders Limited *vs* Additional Commissioner of Income-tax (118 ITR 243) which goes against the intention of the Legislature particularly after the judgement of the Supreme Court in the case of Distributors (Baroda) Private Ltd. in Writ-petition No. 2043 of 1981, overruling their earlier judgement in the case of Cloth Traders Private Ltd. and holding that section 80-AA of the Income tax Act is declaratory in nature and merely declares what the correct position has always been.

As per Section 80-AA inserted by Finance (No. 2) Act, 1980 with retrospective effect from 1-4-1968, the deduction under section 80-M is to be computed with reference to net and not gross dividends. Apart from this, certain legal complications, would also arise in the implementation of sections 80-N, 80-O, 80-R, etc. In any case, the income from other sources has to be computed in accordance with the provisions of the Income tax Act. For the computation of such income, expenses such as interest on borrowed capital, etc. incurred by an assessee to earn such income will have to be deducted.

If the law is amended to provide that the gross dividend less a statutory percentage thereof for expenses (instead of the actual expenses) will be considered for the deduction under section 80M, it will lead to inequitable consequences. For instance, if the statutory percentage of deduction is fixed at 50%, in a case where the entire investment is made with borrowed capital and the interest thereon works out to say 90% of the gross dividend, it will be inequitable to restrict the deduction to 50%. Likewise, if the investment in shares is made with the company's own funds, and consequently no interest is payable thereon, it would be inequitable to allow a deduction of 50% for expenditure although none is incurred.

It should be possible for the assessing officer to determine the interest

incurred on investment by ascertaining the source of funds for acquiring the shares. The other expenses incurred for earning the dividend income would normally be a relatively insignificant amount and is unlikely to generate controversy or litigation in determination. A reasonably precise determination of net dividend income is possible and is preferable to linking the relief under section 80M to the gross dividend less a statutory percentage for expenses.

As clarified by the Supreme Court in the case of Distributors (Baroda) Private Ltd.—(W.P.No. 2043 of 81) while overruling the earlier decision in the case of Cloth Traders Ltd. The main object of the relief under section 80M is to avoid taxation once again in the hands of the receiving company of the amount which has already borne full tax in the hands of the paying company. The amount of dividend which would otherwise suffer tax in the hands of receiving company would not be the full amount but the amount computed in accordance with the Income-tax Act. Hence, the legislature "could certainly be attributed, the intention to prevent double taxation but not to provide an additional benefit which would go beyond what is required for saving the amount of dividend from taxation once again in the hands of the assessee."

[Vide M/o Finance (Deptt. of Revenue) OM No. 241/6/84-
A&PAC-II dated 29-11-1985]

CHAPTER V

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH GOVERNMENT HAVE FURNISHED INTERIM REPLIES

—NIL—

NEW DELHI ;
September 8, 1986
Bhadra 17, 1908 (Saka)

E. AYYAPU REDDY
Chairman,
Public Accounts Committee

PART II

MINUTES OF THE 15TH SITTING OF THE PUBLIC ACCOUNTS COMMITTEE HELD ON 29 AUGUST, 1986

The Public Accounts Committee sat from 1500 hours to 1640 hours on 29th August, 1986 in Committee Room 'B', Parliament House Annexe, New Delhi. The following were present :

CHAIRMAN

Shri E. Ayyapu Reddy

MEMBERS

2. **Shri Amal Datta**
3. **Shrimati Prabhawati Gupta**
4. **Shri G.S. Mishra**
5. **Shri Rameshwar Neekhara**
6. **Shri Rajmangal Pande**
7. **Shri H. M. Patel**
8. **Shrimati Jayanti Patnaik**
9. **Shri Simon Tigga**
10. **Shri Girdhari Lal Vyas**
11. **Shri Bhuvnesh Chaturvedi**
12. **Shri Ghulam Rasool Kar**
13. **Shri A.K. Antony**
14. **Shri Nirmal Chatterjee**
15. **Shri Virendra Verma**

REPRESENTATIVES OF THE OFFICE OF THE C&AG

1. **Shri T. M. George — Addl. Deputy Comptroller and Auditor General of India (Reports—Central)**
2. **Shri P. C. Asthana — Addl. Deputy Comptroller and Auditor General of India (Railways)**

3. Shri M. Parthasarthy — Director of Audit (Defence Services)
4. Shri A. K. Jain—Director of Audit, Central Revenue—II
5. Shri Baldev Rai—Director of Audit, Receipt Audit—I
6. Shri C. V. Srinivasan — Director of Audit (Air Force and Navy)
7. Shri K. Thyagrajan — Director of Audit (P&T)
8. Shri Gopal Singh — Joint Director (P&T)
9. Shri N. R. Rayalu — Joint Director (Reports—Central)
10. Shri P. N. Misra — Joint Director (Railways)
11. Shri N. L. Chopra — Joint Director (Defence Services)
12. Shri P. K. Jena — Joint Director (Air Force and Navy)
13. Shri K. Krishnan — Joint Director of Receipt Audit—I

SECRETARIAT

1. Shri K. H. Chhaya — *Chief Financial Committee Officer*
2. × × × ×
3. The Committee then took up consideration of the following draft Reports :
 - (i) Action Taken on 206th Report (7th Lok Sabha) Relating to incorrect deduction in respect of intercorporate dividends.
 - (ii) × × × ×
4. The Committee adopted these Reports subject to certain modifications as shown in Annexure I.
5. The Committee authorised the Chairman to incorporate in the Reports certain other minor modifications/amendments arising out of factual verification of the same by Audit. The Committee also authorised the Chairman to persent these Reports in the House.

The Committee then adjourned.

ANNEXURE-I

Modification/Amendments made by the Public Accounts Committee in the Report on Action taken by Government on Recommendations Contained 206th Report (Seventh Lok Sabha) Relating to Incorrect Deductions in Respect of Inter-Corporate Dividends.

Page	Para	Line	Modifications/Amendments
12	1.8	5 from bottom	For 'similar lines' Read 'same footing'
14	1.12	13	After 'measures' Insert 'or issue necessary guidelines for officers of the Department'

APPENDIX

Statement of Recommendations/Observations

Sr. No.	Para No.	Ministry/Deptt.	Recommendations/Observations
1	2	3	4
1	1.7	Finance (Revenue)	<p>In their earlier report, the Committee while considering the question of deduction in respect of intercorporate dividends, had desired the Government to consider relating the deduction to gross dividend instead of net dividend and also to reduce the percentage of deduction suitably with a view to setting a limit to the concession. At present, the deduction allowed under Section 80M of the Income Tax Act 1961 is 60% of income by way of dividend. The Ministry of Finance have not accepted the recommendation of the Committee on the plea that the amendment of the existing provisions on the lines suggested by the Committee would lead to inequitable consequences.</p>
2	1.8	—do—	<p>The recommendation made by the Committee was in the context of controversies attendant on the determination of expenses incurred in earning dividend income leading to incorrect deduction in respect of intercorporate dividends and rejection thereof in appeals. In order to set at rest all the controversies on the subject, change in the present law is all the more</p>

necessary. In this connection, the Committee would like to refer to the provisions of Section 20(1)(ii) of the Income Tax Act, 1961 which provides for a formula regarding the deduction to be allowed from interest on securities in the case of a banking company. The section *ibid* reads as under :

“20. Deductions from interest on securities in the case of a banking company—

(1) In the case of a banking company—

X X X X X

(ii) the amount to be regarded as interest payable on all moneys borrowed for the purpose referred to in clause (ii) of section 19 shall be an amount which bears to the amount of interest payable on all moneys borrowed by the company the same proportion as the gross receipts from interest on securities (inclusive of tax deducted at source) chargeable to income-tax under section 18 bear to the gross receipts from all sources which are included in the profit and loss account of the company.”

The Committee feel that inter-corporate dividend received by a company dealing in shares stands on same footing as the interest from securities received by a Banking Company. They, therefore, desire that Government should consider amendment of Section 80M on the lines of Section 20 of the Income Tax Act, 1961.

The status of the assessee if he was a dealer in shares was viewed differently by Central Board of Direct Taxes and the Income Tax Appellate Tribunal. While the Board had all along held the view that the company was not a dealer in shares, the Income Tax Appellate Tribunal had held that it was. The Committee in their earlier Report, had desired that the Ministry of Finance should examine whether the tests applied by them for determining the nature of the company were objective, uniform and in accordance with their intention and if they were not, suitable changes in law should be considered. The Ministry of Finance have not favoured any change in the existing provisions of law.

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—do—

The Committee reiterate their earlier recommendation keeping in view the difficulties that may arise in the course of deciding the nature of business of the assessee. To say that the existing position may continue does not appeal to reason. Since the Board could have their own reasons for holding that the assessee company was not dealer in shares, it is imperative for the Board to examine as to why their stand was not accepted by the Income Tax Appellate Tribunal. The Committee hope that the Ministry of Finance (Department of Revenue) would reconsider their stand on the recommendation and initiate suitable legislative measures or issue necessary guidelines for officers of the Department in order to avoid any confusion or doubts over the nature of the assessee's business or trade.