FIFTY-FIRST REPORT

PUBLIC ACCOUNTS COMMITTEE (1980-81)

(SEVENTH LOK SABHA)

INCOME TAX, WEALTH TAX AND ESTATE DUTY

MINISTRY OF FINANCE

(DEPARTMENT OF REVENUE)

सत्यमेव जयते

Presented in Lok Sabha on 30 April, 1981
Laid in Rajya Sabha on 30 April, 1981

LOK SABHA SECRETARIAT
NEW DELHI

April, 1981/Vaisakha, 1903 (S)

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CORRIGENDA TO FIFTY FIRST REPORT OF THE PUBLIC ACCOUNTS COMMITTEE(7TH LOK SABHA)

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12-3-1981
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25-4-1981

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PUBLIC ACCOUNTS COMMITTEE
(1980-81)

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INTRODUCTION

I, the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Fifty-first Report of the Public Accounts Committee (Seventh Lok Sabha) on Paragraphs 29(ii), 29(i)(a), 56(iii), 65(ii), 68(iii) and 83(iii) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil), Revenue Receipts, Volume II, Direct Taxes, relating to irregular exemptions given; income escaping assessment; incorrect valuation of shares; incorrect computation of net wealth and estates escaping assessment.

2. The Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes, was laid on the Table of the House on 1 July, 1980.

3. The tax concessions under Sections 80-O and 80-MM have been on the statute book for over ten years. The Committee have suggested that a general review of the working of these Sections should be carried out with a view to finding out how far the objectives in granting the tax concessions have been subserved and what inbuilt safeguards need to be provided to prevent abuse thereof.

The Committee have also expressed concern about the large pendency of writ petitions in income tax cases. Out of 3,652 cases pending in all High Courts as on 1 January, 1981, the pendency pertaining to Calcutta and West Bengal Commissioners' charges alone was 2,074. The Committee have recommended that the question of mounting pendency of writ petitions in Calcutta High Court should be taken up at a high level in the Ministry of Law.

4. The Public Accounts Committee (1980-81) examined paragraph 29(ii) relating to irregular exemptions given at their sitting held on 12 March, 1981. In respect of the remaining paragraphs commented upon in this Reports, only written information was obtained from the Ministry of Finance (Department of Revenue). The Committee considered and finalised this Report at their sitting held on 25 April, 1981. The Minutes of sittings of the Committee form Part II* of the Report.

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

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

6. The Committee place on record their appreciation of the assistance rendered to them in the examination of these paragraphs 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 26, 1981.
Vaisakha 6, 1903 (S).

CHANDRAJIT YADAV,
Chairman,
Public Accounts Committee.

CHAPTER I

IRREGULAR EXEMPTION GIVEN

Audit Paragraph:

1.1. (ii) With a view to encouraging Indian companies to export their technical 'know-how' and skill abroad and to augment the foreign exchange resources, the Income-tax Act, 1961, provides for certain tax incentives. The incentive, as applicable to the assessment years 1969-70 to 1974-75 consists of deduction of the entire income by way of royalty, commission, fees etc. received by an assessee for having exported technical know-how and skill, while computing taxable income. To become eligible for the concession, the following conditions, among others, have to be fulfilled:

(a) the income derived is in consideration for the use outside India of any patent, invention, model, design, secret formula or process or in consideration of technical services rendered;

(b) an agreement for the purpose entered into by the assessee with a foreign enterprise is approved by the Government/Central Board of Direct Taxes; and

(c) the income in convertible foreign exchange is actually brought into India.

1.2. An assessee engaged in manufacture of gramophones and records entered into Matrix Exchange agreement with three enterprises in U.K. and agreements secured the approval of Government in 1964/1965. Under the agreements, the assessee agreed to supply "a matrix or a copy of any local recording" to enable the foreign enterprises to manufacture records therefrom for sale outside India. The agreements were got approved by the Government to obviate any possible delay affecting the export business. During the previous years relevant to the assessment years 1969-70 to 1974-75, the assessee derived income of entire Rs. 15,24,117 and the Income-tax Officer deducted the entire income from total income. It was pointed out in audit in 1976 that the relief allowed by way of deduction was not in order for the following reasons:

(a) The assessee did not export any technical konw-how or skill.

(b) The agreements were not approved by the Government or the Central Board of Direct Taxes specifically for the purpose of availing the relief.

(c) There was no evidence in the assessment records that the assessee brought the income into India in convertiable foreign exchange.

1.3. The undercharge of tax due to incorrect relief amounted to Rs. 8,65,523.

1.4. The Paragraph was sent to the Ministry of Finance in October 1979; they have stated in January 1980 that the objection is under consideration.

(Paragraph 29(ii) of the Report of the Comptroller and Auditor General of India for the year 1978-79 Union Government (Civil) Revenue Receipts Volume I—Direct Taxes (pp. 67-68).

A. Introductory

1.5. The Finance Act, 1966 introduced a new provision, namely Section 85C in the Income-tax Act, 1961 with effect from 1-4-1966 under which Indian companies receiving income by way of royalty, commission, fees or any similar payment from a foreign company in consideration for the use of any patent, model, design, secret formula or process etc. will be subject to tax on such income at the concessional rate of 25%.

1.6. The object of this provision as explained by the Finance Minister in his Budget speech as well as by the C.B.D.T. in the Explanatory Notes on the Finance Act, 1966 was:

(i) "Giving some fiscal encouragement to our industries to encourage them to provide technical know-how and technical services to newly developed countries" (Para 51 of Part B of the Finance Minister's speech).

(ii) "Encorage Indian companies to export their technical know-how and the skill abroad to developing countries in order to expand their business activities and augment the foreign exchange resources of the country". (Para 34 of the Explanatory Memo.)

1.7. The Finance (No. 2) Act, 1967 replaced Section 85C by a new Section 80-C with effect from 1-4-1968 so as to allow a flat deduction at a specific per centage of, the income so earned in the computation of total income itself instead of the earlier method of taxing the income at a concessional rate. The percentage so fixed was 60 with effect from 1-4-1968 and 100 with effect from 1-4-1969.

1.8. The Finance Act, 1974 introduced an important condition to be satisfied, namely, that the income in question should have been received in convertible foreign exchange and should have been brought into India

This condition was given retrospective effect from 1-4-1968 and simultaneously a new sub-section (12) was inserted in Section 155 of the Income-tax Act, 1961, authorising the ITO to amend the order for assessment so as to allow deduction under Section 80-O in respect of such income.

1.9. The conditions of eligibility prescribed in the Act from 1-4-1972 to 31-3-1975 are reproduced hereunder:

The Section was recast and the following additional features were introduced:—

(a) The benefit of the Section was extended to non-corporate assessees also. It was also provided that in the case of resident non-corporate tax-payers (other than co-operative societies), the concession would be available only if the accounts of the tax-payer for the relevant accounting year have been audited by a Chartered Accountant or any other accountant authorised in law to audit the accounts of a company and a report of such audit in a form to be prescribed for this purpose, is furnished along with the return of income.

(b) Previously, the benefit was available if the agreement was with a foreign company. It was now changed to provide that the benefit would be available even when the agreement was with a foreign government or a foreign enterprise.

(c) The benefit was available only for furnishing information *for use outside India* and for services *rendered outside India*.

(d) Instead of the agreement being approved before the 1st day of October, of the relevant assessment year, it was provided that the application for approval should be made before the 1st day of October of the assessment year in relation to which the approval is first sought.

(e) The authority for approving the agreement was changed from the Central Government to the Central Board of Direct Taxes.

1.10. *Present position*:

(a) The Finance Act, 1975 withdrew the benefit extended to the non-corporate assessees in 1972.

(b) The Finance (No. 2) Act, 1980 introduced a new provision in Section 80-MB which the benefit under section 80-O was restricted with effect from 1-4-1981 to the net income received from such sources.

B. Facts of the case

1.11. The facts of the case are that an Indian company (M/s. Gramophone Company of India Ltd.) engaged in the business of manufacture of

gramaphone records entered into agreements with three companies based in U.K. namely (1) M/s. Gramophone Company Ltd., U.K. (2) M/s. Columbia Gramophone Company Ltd., U.K. (3) M/s. Parlophone Company Ltd., U.K. for the supply of matrices to enable the foreign companies to manufacture records from the matericcs on sale outside India. These agreements were approved by the Government of India, Ministry of Industry and Supply in November, 1964. During the previous years relevant to the assessment years 1969-70 to 1974-75 the assessee derived income of Rs. 15.24 lakhs under the terms of the agreements and the entire income was allowed as a deduction under Section 80-O treating it as income from technical know-how. The resultant under-charge of tax was Rs. 8.65 lakhs.

1.12. The assessee-company *viz.*, M/s. Gramophone Company of India Ltd., Calcutta was incorporated on 13-8-1946, but commenced business only from 1-71964 by taking over all the assets and liabilities of the Indian branches of the U.K. based company (M/s. Gramophone Company Ltd.).

1.13. The Committee enquired whether the U.K. based companies had, at any time, any connection with the Indian Company. In reply, the Ministry of Finance, (Department of Revenue) have stated:

> "Before the Indian company became a public limited company, it was a wholly owned subsidiary of the Gramophone Co. Ltd., England."

1.17. The share capital of the company was increased to Rs. 60 lakhs during the previous year relevant to the assessment year 1970-71. The foreign company continues to hold the shares of the face value of Rs. 45 lakhs while the balance was subscribed by other parties in India. The list of share-holders as on 30-6-1969 was as follows:—

LIST OF SHAREHOLDERS AS ON 30-6-1969

	No. of shares (Nominal value Rs. 10/- per share)
1. EMI Limited U.K.	4,50,000
2. The New India Assurance Co. Ltd.	9,550
3. Triton Insurance Co. Ltd.	2,025
4. Vulcan Insurance Co. Ltd.	2,000
5. Mr. Russi Kekee Rastemjee	1,750
6. Mr. Nirmal Kumar Bhattacharjee	1,470
7. The Investment Corporation of India Ltd.	1,200
8. Sassoon J. David and Co. Ltd.	1,200
9. Mr. V.B. Menon	1,000
10. Mr. Ramanlal Pranlal Shah	900
11. Other Indian shre holders	1,28,905
TOTAL	6,00,000

1.15. The share-holding of the Gramophone Company of U.K. (now named as E.M.I. Records Ltd., England) during each of the years 1969-70 to 1974-75 was 4,50,000 shares of Rs. 10/- each.

1.16. Asked whether the share-holding had been diluted under the FERA, (Foreign Exchange Regulation Act) guidelines and if so, the extent thereof, the Ministry have furnished the following note*:

> "Share-holding of E.M.I. Records Ltd., from 30-6-1968 to 30-6-1971 was 4,50,000. During this time E.M.I. Records Ltd.'s holding was 75% of the total paid up capital. In 1972 by Right issue and Public issue to Indian nationals resident in India only, the percentage was brought down to 60%. By subsequent Right Bonus and Public issu in 1976 the share-holding of the above named company was further brought down to 39.84%. Bonus shares issued in 1976 to E.M.I. Records Ltd. were 2,70,000."

1.17. The Committee enquired whether there was any common share-holding among all these four companies. In the reply, the Ministry of Finance have stated:

> "Complete information is not available. However, it is seen from one of the letters available in the assessment records, which was addressed by the assessee company to the then Ministry of Commerce & Industry in connection with the approval of an agreement that E.M.I. Records Ltd. was holding a majority of the shares of capital Records Inc.,' USA."

C. Statutory requirements

1.18. It was pointed out in Audit in 1976 that the relief allowed by way of deduction was not in order for the following reasons:

(a) The assessee did not export any technical know-how or skill.

(b) The agreements were not approved by the Government or the Central Board of Direct Taxes specifically for the purpose of availing the relief.

(c) There was no evidence in the assessment records that the assessee brought the income into India in convertible foreign exchange.

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*Not vetted in audit.

1.19. Initially, the Department, in their reply of February, 1978 did not accept the Audit objection on two grounds viz—

(i) No separate approval from the Board was necessary since the agreement was already approved by the Government prior to 1-4-1972.

(ii) The amounts represented royalty in consideration for use outside India of patent, invention etc. as laid down in Section 80-O.

1.20. One of the primary conditions to be satisfied is that the agreement with the foreign company should be approved by Central Government *in this behalf* before the 1st day of October of the relevant assessment year. In other words, the approval of the Government should be for the specific purpose of allowing the concessional rate of tax. In the instant case, it was seen that the Department of Industry (Ministry of Industry and Supply) gave the approval of the agreement in the year 1964. The Committee enquired about the specific purpose for which approval was accorded. In reply, the Ministry of Finance have furnished a copy of letter No. 3(28)/64-LEI(B) dated 6-11-1964 from the Department of Industry relevant extracts from which are reproduced below:

"...The Government of India have no objection to the conversion of the India Branch of the Gramophone Co. Ltd., England, into a wholly-owned subsidiary of the aforesaid U.K. company, which is a subsidiary of M/s. Electric & Musical Industries Ltd., U.K.

Government have no objection to your concluding a fresh agreement with M/s. Electric a Musical Industries Ltd., U.K. for obtaining technical information pertaining to methods, processes and apparatus used in the recording of sound etc. in place of the existing agreement which is valid upto 1-7-1967. In terms of the proposed new agreement, you may pay to the U.K. company a sum not exceeding 1 per cent of the net ex-factory value of the products manufactured by you subject to production of appropriate certificates from your Auditors to the effect that the amount has actually been spent for the purpose of research, technical services and advice to be received from the U.K. company and subject to further conditions that the Indian Unit's contribution is not higher than the contribution of other units in other countries of the world. Government note your proposal to offer shares to Indian public in stages from the 30th June, 1967. Government have no

objection to consider the question of payment of a royalty of 5 per cent in lieu of the contribution not exceeding 1 per cent of the ex-factory value of the products manufactured, when Indian share of the capital reaches 40 per cent. The agreement With M/s. Electric & Musical Industries Ltd:, U.K. for this purpose will initially be valid for a period of five years with effect from 1st July, 1964.

As regards your Matrix Agreements with (1) M/s. Gramophone Company Ltd., U.K. (2) M/s. Columbia Gramophone Co. Ltd., U.K: and (3) M/s. Parlophone Co. Ltd. U.K., Government approve of your proposals on the same terms and conditions of the existing Matrix agreement between M/s. Gramophone Co. Ltd., (India Branch) and M/s. Electric & Musical Industries Ltd., U.K. Subject to the period being limited to five years from 1-7-1964."

1.21. It is seen that the Central Board of Direct Taxes had issued Instruction No. 794 dated 23-11-1974 to all the Commissioners of Income-tax, wherein apart from explaining the various conditions stipulated in Section 80-O as amended from time to time, the following were *inter-alia* also brought to their notice:

(i) The approval to the agreement should have been granted by the Board specifically for the purposes of Section 80-O and approvals granted by administrative ministries will not meet the legal requirement.

(ii) No deduction shall be allowed unless the I.T.O. has received the Board's approval order from the Commissioner of Income-tax. If an assessee produces his copy of the order of approval by the Board but the I.T.O. has not received his copy of the order from the Commissioner of Income-tax, the matter should be referred to the C.I.T./ Board.

1.22. Asked which Department of the Government is empowered to grant approval for the purposes of allowing the above-said tax incentive, the Ministry of Finance have, in a note, stated as follows:

"From 1-4-66 to 31-3-72—Central Government. This approval was accorded by the concerned administrative Ministry to which the services provided under the agreement related.

From 1-4-73 onwards—Central Board of Direct Taxes."

1.23. The Committee enquired how the approval accorded on a date earlier than the date of insertion of the relevant provision in the Income-tax Act viz., Section 80-O could be construed as an approval "in this behalf" as required under the Act. In a note, it has been stated:

"The above approval was not for purposes of Section 80-O."

1.24. In their letter dated 19 September, 1980 to Audit, the Ministry of Finance had accepted the objection on this count. In the said letter, it was *inter-alia* stated:

> "It has now been ascertained that no specific approval for the purposes of Setcion 80-O was granted for the assessment years involved in the Audit objection. In view of this, the objection is acceptable."

1.25. In this context, the Chairman, Central Board of Direct Taxes informed the Committee during evidence as follows:

> ". . .The third condition was that there should have been a specific approval of the agreement by the Central Government or by the Central Board of Direct Taxes. This condition is not satisfied. Therefore, we have reported that we have accepted the audit objection on the ground that there is no specific approval of the Central Government or of the Central Board."

1.26. The Committee enquired how such an important condition had been ignored. The representative of the Ministry of Finance (F.T.D.) explained as follows:

> "...The agreement came up for consideration by the Ministry of Industry in 1964. The agreement was approved as a Matrices exchange agreement by the Ministry of Industry in November, 1964. A change was made in the Income-tax Act with effect from 1-4-1966 i.e. about one and a half years later, providing for a concessional treatment for income-tax in cases of this type, provided the income is received in pursuance of an agreement which has been specifically approved by the Central Government. The company did not apply for separate approval to the Central Government."

1.27. Instruction No. 794 further stipulated that 'where the money had not been brought into India in convertible foreign exchange, as required under the retrospective amendment introduced through the Finance Act,

1974, immediate action may be taken to withdraw the relief where it has been wrongly allowed (from assessment year 1968-69 onwards) by invoking the provisions of Section 155(12) of the Income-tax Act, 1961.

1.28. The Audit paragraph points out that there was no evidence that the income had been brought into India by the assessee in convertible foreign exchange. The Ministry of Finance in a note stated:

> "The point regarding the condition that the money should be brought into India in convertible foreign exchange does not appear to have been examined by the assessing offices, after the law was amended retrospectively by the Finance Act, 1974."

1.29. In a subsequent note (March 1981), the Ministry of Finance have stated:

> "The Commissioner of Income-tax, West Bengal-III, in whose charge the assessments of M/s. Gramophone Co. of India are made, has now stated that the royalties receivable by M/s. Gramophone Co. of India Ltd. for the period July, 1969 to June, 1974 were adjusted against the royalties payable by them to the foreign companies and the Reserve Bank of India allowed them to remit the balance of Rs. 5,193.34 relating to the aforesaid period. Thus, in terms of explanation (ii) of Section 80-N, the assessee company would be said to have received the companies in convertible foreign exchange for the said period."

1.30. The Committee enquired whether the adjustment in royalties payable and receivable was permissible, the Chairman C.B.D.T. stated in evidence:

> "Yes, Sir. When the Indian company has to receive any royalty from a foreign company, it has to pay a similar royalty to the foreign company. The Reserve Bank has permitted them to make the adjustment of royalty payable in rupees. The balance of Rs. 5,000 which was given to the Indian Company has been brought into India with the permission of the Reserve Bank of India."

1.31. The Committee wanted to know if a concession designed expressly to augment the country's foreign exchange resources could be availed of in the manner stated above without actually bringing the necessary foreign exchange into the country. In reply,* the Ministry of Finance have stated :

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*Not vetted in Audit.

"Royalty was receivable as also payable by the assessee company. There was no embargo so far as remittance of foreign exchange into India was concerned. But remittances from India are always controlled by the Reserve Bank of India. Adjusting the royalties receivable against royalties payable was allowed by the R.B.I. That means that the royalty income received in pound sterling was allowed to be used in the U.K. for payment of the royalties to be remitted from India. Since the R.B.I. permitted such use outside India by netting of royalties, the assessee company could be said to have received the amounts in convertible foreign exchange in terms of Explanation (ii) of Section 80-N of the Income-tax Act."

1.32. The Committee desired to know if—

(a) there were any provisions in the Foreign Exchange Regulation Act to ensure that such monies are brought into the country in foreign exchange and how the Reserve Bank of India kept watch over such matters.

(b) there was any built-in mechanism to collect and collate data simultaneously on transfer pricing in respect of dues receivable and payable by way of royalty etc. for purpose of Section 80-O of the Income-tax Act, 1961.

1.33. In reply the Ministry have stated:

"The requisite information has been called for from the Department of Economic Affairs. It will be furnished on receipt of their reply."

1.34. In reply to another question as to how coordination was ensured between the RBI and the Income-tax Department in such matters, the Ministry of Finance has stated:

"In so far as Section 80-O is concerned, if there is a doubt that monies have not been received in convertible foreign exchange reference would be made to the Reserve Bank of India for verification."

1.35. In their Instruction No. 797 dated 23-11-1974 and Circular No. 187 dated 23-12-1975, the Central Board of Direct Taxes indicated that the concession was given "with the twin objective of encouraging export of Indian technical know-how and the augmentation of foreign exchange resources of the country."

For the purpose of this deduction, the term "provision of technical know-how" has been given specified definition in the Act itself under Sub-section (2) of Section 80-M1, as to mean—

(i) the transfer of all or any (rights including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or similar property;

(iv) the imparting of any information concerning industrial, commercial or scientific knowledge, experience or skill.

1.36. It is seen that the assessee company entered into a technical collaboration agreement with M/s. Electric and Music Industries Ltd. (EMI) U.K. on 22-1-65 for supply of technical know-how. M/s. EMI was the parent company to which the other U.K. based company (M/s. Gramophone Company) was a 100 per cent subsidiary. The agreements contemplated that EMI would supply to the Indian company "technical information relating to methods, processes and apparatus used commercially by EMI or its subsidiaries domiciled in the U.K. in the recording of sound or production of sound from sound records" and would also grant to the Indian company "non-exclusively non-transferable licences (without the right to grant sub-licences)." to manufacture:

(i) Apparatus for recording sound

(ii) Apparatus for reproduction of sound from sound records

(iii) Sound records of any kind

(iv) Radio broadcast sound receiver

(v) Radio gramophones.

1.37. In a case, Lurgi India Co., (P) Ltd. *Vs.* CBDT and another, (121 ITR 289 Delhi), the Court sought to define the term technical know-how in the following words:

"The very meaning of technical know-how is the knowledge which would enable the personnel of the company to which the knowledge is imparted to do a thing and the agreement for imparting technical know-how is to give them technical knowledge to do the project."

1.38. It was brought to the notice of the Committee by Audit that the objection was communicated to the Ministry on 15-10-1979. In their interim reply dated 4-3-1980, the Ministry had contended that 'it would not be correct to say that the assessee did not export any technical know-how or skill'.

1.39. Asked if there was any specific mention in the agreements relating to transfer of technical know-how or skill or supply of model or design, the Ministry of Finance stated:

> "The agreements only provide for the supply of matrices."

1.40. The Committee desired to know the salient features of the agreement between the Indian company and the foreign companies. In reply, the Ministry of Finance have stated:

> "The agreements provide for the use of matrices of the foreign companies by the Indian company and *vice versa*. The agreements also provide for payments of royalty for such use."

1.41. The Committee desired to have a break-up of technical fees and royalty paid by the assessee company to U.K. company, which was allowed as deduction, during each of the years from 1969-70 onwards. In reply, the Ministry of Finance have stated:

> "Technical fees and Royalty paid to EMI(UK) Ltd., for assessment years 1969-70 to 1974-75 amounted to Rs. 19,58,340/-.
>
> The entire amount has been allowed as deduction in these assessments."

1.42. The Committee also wanted to know the nature of services rendered by E.M.I. (UK company) to the assessee company. The Ministry of Finance stated in reply:

> "Full details of the technical services rendered by EMI would have to be ascertained from the assessee company. In so far as the royalty for the use of matrices was concerned, this was for producing records in India of foreign music from matrices belonging to EMI."

1.43. The Committee enquired whether the Ministry still held the view that the assessee company was imparting technical know-how to the U.K. company. The Ministry of Finance have stated:*

*Not vetted in Audit.

"It is not the view of the Department that the assessee company was giving technical know-how to the U.K. company. The U.K. company was allowed the use of the matrices of the assessee company which were patents of the assessee company in respect of which it had property rights."

1.44. In their interim reply to Audit dated 4 March, 1980, the Ministry of Finance (Department of Revenue) had stated that the matrix in question could be construed as a model or a design within the meaning of Section 80-O. Matrix is like a mother record from which other records can be made. The Matrix or Mother Shell is stored carefully for future reference. The Matrix can be reused to make Stampers as and when required. If by any chance, the Matrix gets damaged, then the whole process has to be repeated. A gramophone record is nothing but a replica of a Matrix.

1.45. The Committee enquired whether matrices were liable to central excise duty and whether the records made out of matrices were also liable to such levy. The Ministry have stated:

"Matrices fall under item 37A(iv) of the CET and attract duty at the rate of 30 per cent *ad valorem*. However, if matrices for records, impressed, used in the factory in which such matrices for records, impressed, have been produced are exempt from whole of the duty of excise leviable thereon *vide* Notification No. 12/64-CE dated 8-2-1964.

Records made out of matrices are liable to duty at the rate of 15 per cent *ad valorem* under Item No. 37A(iii) of the CET."

1.46. The Committee desired to be furnished with details of the judicial interpretation placed on the words "design" and "model". The Ministry of Finance have furnished the following note:

"Regarding the judicial interpretation of the word 'design', Delhi High Court has considered this aspect in the case of M/s Simon Carves India Ltd., (120 ITR 172). According to Delhi High Court 'design' may mean (i) a design drawn on paper as a drawing or (ii) a design which is actually prepared by constructing the thing itself which had been designed on paper.

However, the word 'model' does not appear to have been interpreted in any income-tax case.

The decision of the Delhi High Court in the case of Simon Carves India Ltd. (120 ITR 172) has been accepted by the Board."

1.47. The Committee desired to know whether in the light of the judgment of the Delhi High Court in the case Simon Carves India Ltd. (120 ITR 172), the Central Board of Direct Taxes still held the view that matrix could be constructed as a 'model' or 'design'. In reply, the Ministry of Finance have stated:

> "Section 80-0 provides, *inter alia,* for a deduction of the whole of the income received, in respect of royalty, Commission, fees etc., from a foreign enterprise in consideration for the use outside India of any patent, invention, model, design, secret formula or process or similar property right. The expression 'similar property right' would include copyright in matrices."

1.48. The Chairman, C.B.D.T. stated in evidence:

> "...We examined it in consultation with the Ministry of Law and the view taken was that copyright royalties are covered by this Section."

1.49. The Committee enquired about the details of copyright obligations in the agreement. The Ministry have stated:

> "Clauses 6 and 13(II)(b) of the agreement with the Gramophone Company Ltd., U.K. are as under:
>
> Clause 6. The company shall be solely responsible for the fulfilment of all copyright obligations whether statutory or otherwise arising from the manufacture and sale of records pressed by the Company from Gramco Matrices. Gramco shall not be required to supply matrices of any recordings containing copyright compositions and mechanical rights of which are controlled by Le Bureau International de L'Edition Mechanique (B.I.E.M.) until and unless on agreement between the company and BIEM shall be in full force and effect.
>
> Clause 13(II)(b): Gramco shall be responsible for the fulfilment of all copyright obligations whether statutory or otherwise arising from the manufacture and sale of records under this Clause manufactured as aforesaid from the said matrices and sold outside the territory.
>
> Similar clauses are there in the other two agreements."

1.50. In a further note on the subject, the Ministry have stated:

> "In our interim reply of even number dated the 4th March, 1980, we had stated that the matrix in question could be constructed

as a model or a design within the meaning of section 80-0. It is now gathered that when the assessee company sought the approval of the Board under section 80-0 for later assessment years, namely, 1976-77 and onwards, the matter had been examined in consultation with the Ministry of Law. The Law Ministry had advised that the company had a copyright in the matrix and the words "similar porperty right" appearing in secion 80-0 would cover copyright also and, therefore, M/s Gramophone Co. of India Ltd. would be entitled to the benefits of section 80-0."

Copies of the reference notes made by Foreign Tax Division to Ministry of Law and the advices received from the Ministry of Law in F. No. 473/140/76-FTD are given in Appendix.

1.51. The Committee, desired to know whether the three conditions regulating grant of relief under Section 80-0 were cumulative or alternative. In reply, the Ministry of Finance have stated:

"The three conditions under Sec. 80-0 are cumulative. In so far as the third condition is concerned, the Section further speaks of information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided or agreed to be made available or provided or in consideration of technical services."

1.52. During evidence, the Committee enquired whether the object underlying the statutory provision could be stretched to cover the instant case in which there was no export of technical know how and skill. The Finance Secretary, stated:

"...This concession was given specifically with a view to stimulate the flow of Indian technology abroad with special reference to developing countries. The wording of the Section as it stands would seem to cover even a case of the kind dealt with in this paragraph. Therefore, a further question arise whether it is worth while and is essential to amend the Section in order to rule out the possibility and deny the benefit of tax concession in a case of this nature. This becomes an issue of policy. No doubt one can argue what you are transferring is the copy right and there is no reason to provide tax concesssion for copyright. Therefore, the relevant law could be amended to prevent such a possibility. We have recourse to amendment of non-tax laws, only where the loss of revenue as a result

of defective or too loose wording of the law is substantial... I asked our Foreign Tax Division which deals with this matter whether they have had too many cases of agreements relating to the copyright coming up for clearance in order to get the benefit of Section 80-0. I understand that out of 1103 cases they have dealt with, only two agreements involved copyright royalties. If this position is correct and I have no reason to doubt that, I would think twice before proposing amendment of the law only for this purpose.

The second issue is, if we amend the law in order to deny the benefit of tax concession for transfer of copyright only, further question would arise whether it would be in public interest? There may well be other cases, may be cases relating to books, involving copyrights, where an Indian company may be able to transfer its copyright to a foreign party abroad and earn in the process foreign exchange and also create larger market for its product. As to whether it would be in the public interest to amend the law in order to deny the benefit of the tax concession. I will have to go into it a little more carefully. I will have to consult the Ministry of Education which deals with books and publications and also the Law Ministry and then take the orders of the Government. I would have been on stronger grounds in urging the amendment of the law, if there had been far too many cases of copyright royalities coming to the Board for approval. If out of 1,103 cases, there are only 2 cases. I would *prima facie* not say that we will not do it. I would hesitate a little before suggesting the extreme step of amending the law. I will also have to weigh carefully the consequences of amending the law because in the process we may unwittingly deny the country the benefit of sale of copyright in some cases.

1.53. He added:

"...From the speech of the Finance Minister, it is clear to me that at the relevant point of time, the intention was that the concession should be given only in cases of transfer of technical know-how and the like. It perhaps was not intended to cover copyright. At any rate, there was no conscious decision to that effect. Under the law as it stands and as interpreted by the Law Ministry, a case of this kind would seem to be covered. The further question is whether we can amend the law. The words "similar property right" have been held to cover instances of this nature. We should change the law

when its interpretation is not in accordance with the intention of the original legislature and where you find that the loss of revenue as a result of such interpretation is high and that far too many cases are covered by that law. Approval of the Board of Direct Taxes is now required and that is being accorded by the Board. According to the information given by the Board, out of over 1,000 cases, only 2 cases of this nature have come to the notice of the Board. Even if there are 2 cases, one can still amend the law, if the amount involved is very large. We will have also to see whether the amendment will have some unintended side effects and hurt others. I would like to proceed carefully in this matter."

1.54. He further added:

"Even granting that some parties would try to take advantage of the interpretation, there is still built-in safeguard in the existing provision and that is that it requires the specific approval of the Central Board of Direct Taxes. In my view, the parties may challenge it in courts. The Central Board of Direct Taxes can reject such applications if it feels that it is not in the public interest or that it does not satisfy the conditions laid down in the Section. It is not as if even in the absence of an amendment, we are totally helpless. All that I am submitting is that, even granting that this interpretation becomes known widely and parties come forward to take advantage of it, if we consider, that the applications are not in public interest, it will be open to the Central Board of Direct Taxes, in exercise of its powers, to reject them."

1.55. Asked whether in view of the Ministry's reply that the subject matter of export in the instant case is a matrix and not the technical know-how the matter did not require further examination, in consultation with Audit and the Ministry of Law at a high level, the Ministry of Finance have informed the Commitee (April, 1981) as follows:

"It is proposed to examine the question further in consultation with the audit and the Ministry of Law at a higher level."

1.56. The Committee desired to be furnished with details of other cases if any, in which similar deductions were allowed. The Ministry of Finance have stated:

"No such case has been reported by the Commissioners of Income-tax."

D. Rectificatory Actions

1.57. In terms of the agreements, the assessee company received the following payments during the previous years relevant to the assessment years 1969-70 to 1974-75 from the foreign companies:

Assessment Year	Total payment received (Amount in Rupees)
1969-70	3,92,540
1970-71	3,54,066
1971-72	3,48,736
1972-73	1,42,826
1973-74	1,57,509
1974-75	2,49,332
TOTAL	16,45,009

1.58. The assessee claimed deduction for the entire amount of Rs. 16.45 lakhs under Section 80-O of the Income tax Act, 1961, and the claims were allowed by the Income tax Officer while completing the assessments on various dates between 24-6-1971 and 16-2-1976.

1.59. Subsequently, relief to the extent of Rs. 1,10,432 for the assessment year 1969-70 and Rs. 10,500 for the assessment year 1970-71 was withdrawn in the rectification orders passed in June, 1975, on the ground that the amounts were received from M/s. Capital Records Inc. U.S.A. which had not been declared as a "Company" under Section 2(17) of the Income-tax Act, 1961. As stated elsewhere in this Report, a majority of the shares of Capital Records.

1.60. The tax effect for each of the assessment years from 1969-70 to 1974-75, as indicated* by the Ministry of Finance is as under:

Assessment year	Tax effect (Rs.)
1969-70	2,35,524@
1970-71	1,94,736%
1971-72	1,91,805
1972-73	80,518
1973-74	90,962
1974-75	1,43,990
TOTAL	9,37,535

*Not vetted in Audit.

@Relief of Rs. 66,200 (approx.) was withdrawn subsequently.

%Relief of Rs. 5,770 (approx.) was withdrawn subsequently.

1.61. Consequent upon incorrect deduction allowed to the assessee company, the short levy of tax as worked out by Audit amounted to Rs. 8,65,523 as per details given below :—

Assessment Year	Deduction allowed	Rate of tax	Short levy of tax
1969-70	2,82,148	60%	1,69,289
1970-71	3,43,566	55%	1,88,961
1971-72	3,48,736	55%	1,91,905
1972-73	1,42,826	55%+ S. C. 2½%	80,518
1973-74	1,57,509	55%+ S.C. 5%	90,961
1974-75	2,49,332	55%+ S.C. 5%	1,43,989
	15,24,117		8,65,523

1.62. The Committee enquired whether the assessing officer had entertained any doubt at any time about the admissibility of the deduction claimed by the assessee company. In reply, the Ministry of Finance (Department of Revenue) have, in a note stated as follows:

"The assessing officers in the assessment orders of the assessment years 1969-70 to 1974-75 have given a finding that the conditions laid down u/s. 80-0 had been fulfilled. For example, in the assessment order for the assessment year 1974-75 he has stated as under:—

"The assessee recived matrix royalty of Rs. 2,49,332 from the Gramophone Co. Ltd., U.K. and Capital Records Inc. USA in consideration for the use of the property right of recordings if the matrix that the assessee company manufactured. This was in terms of the Matrix Exchange Agreement as approved by the Government of India. As the conditions laid down u/s. 90-0 are fulfilled, the assessee is allowed 100 per cent deduction of the royalty which the assessee received as in last year".

1.63. The Committee desired to know if the Ministry had enquired how the assessing officer (s) could go so wrong on the basis that the conditions

were fulfilled, when two of the three conditions were admittedly not fulfilled. In reply, the Ministry of Finance have stated:

> "In so far as the assessment years 1969-70 to 1972-73 are concerned, the condition that the resultant income should have been brought into India in convertible foreign exchange was not looked into at the time of the original assessment as this condition was introduced retrospectively with effect from 1-4-1968 by the Finance Act, 1974. Regarding the condition of specific approval for purposes of Sec. 80-O, it appears that some of the officers have believed that the approval of the Ministry of Industry granted in respect of the Agreement *vide* its letter of 6-11-1964 was equally good for purposes of Sec. 80-O as the said approval "in this behalf" contemplated in that Section had also to be granted by the Central Government, i.e., the Ministry of Industry itself. In this regard it may be mentioned that even the income tax Appellate Tribunal, Calcutta Branch in their order dated 7-3-80 for the assessment year 1971-72 in this case have held that the approval of the Ministry of Industry was sufficient also for purposes of Sec. 80-O".

1.64. The Committee enquired about the rectificatory action and the present position of the case. The Ministry stated (September 1980) as follows:

> "On receipt of the audit objection, notices under section 154 were issued for the assessment years 1971-72 to 1974-75 (action u/s. 154 was already time-barred for the assessment years 1969-70 and 1970-71). Action u/s. 147 (b) was also taken for the assessment years 1972-73 to 1974-75 for which such action was still within time. Assessee company has filed writ petition in the Calcutta High Court against the notice u/s. 148 and has obtained stay of further proceedings.
>
> Orders u/s. 154 have been passed for assessment years 1971-72 and 1974-75 fully withdrawing the benefit given earlier u/s. 80-O. I.T.O. has been asked to explain the reasons for not taking similar action for the assessment years 1972-73 and 1973-74."

1.65. In yet another note furnished at the Committee's instance the Ministry of Finance have stated:

> "Relief was granted in assessment for the years 1968-69 to 1974-75 either in original assessments or by way of rectifications made subsequently. Relief granted for the assessment years 1971-72 and 1974-75 were withdrawn by orders under Section 154 dated 11-5-1977 and 13-2-1980 respectively. The reasons

for taking action under Section 154 are given in reply to.... No relief was allowed for 1975-76 on the ground that the agreements were not approved by the relevant authority for the purpose of Section 80-0. The assessee's appeal against withdrawal of relief for the year 1971-72 was rejected by the Commissioner of Income-tax (Appeals). However, the I.T.A.T. has since then allowed the appeal of the assessee.

C.I.T. (Appeals) had also rejected the appeal for 1975-76 assessment year. The assessee company has gone in appeal to the I.T.A.T."

1.66. The Chairman, C.B.D.T. stated during evidence:

"We had to correct this mistake under Section 154. One of the essential conditions of Section 80-O is that there should be a specific approval. That condition is not fufilled. The approval was wrongly granted. The order under Section 154 itself has not been upheld on the ground that two views are possible—the approval given by the Ministry of Industry might perhaps be taken as a specific approval of the Government."

1.67. The representative of the Ministry of Finance (FTD) added:

"Apart from action under Section 154 for the assessment years 1971-72, 1972-73, 1973-74 and 1974-75 we have taken action u/s. 147(b). Those proceedings have been initiated but they have been stayed by the High Court."

1.68. Scrutiny of the assessment records by Audit in August 1980 disclosed that for the assessment year 1974-75, the I.T.O. issued a notice under section 148 on 18-3-1977 for reopening the assessments under section 147(b). The assessee filed on 25-4-1977 a return showing the same income as declared earlier and denying any escapement of income. However, instead of proceeding to take action under Section 147(b) the I.T.O. issued another notice under section 154 on 30-1-1980 for rectifying the assessment, treating the omission as a mistake apparent from record. The I.T.O. rectified the assessment under section 154 on 13-2-1980. However, this order was cancelled by the I.T.A.T. on 7-3-1980 holding that the matter was debatable and as such no action under Section 154 could be taken.

1.69 When asked to indicate the reasons for not reopening 1974-75 assessment also under Section 147, the Ministry of Finance have, in a note stated:

1.69. When asked to indicate the reasons for not reopening 1974-75 for the assessment year 1974-75. Action under Section 147 for reopening the assessment was also taken on 18-3-1977."

1.70. During evidence the Committee desired to know the time-lag between the receipt of audit objection and the remedial action taken in the matter. The Chairman, CBDT stated:

> "The first assessment involved was 1969-70. But by the time the audit objection was received, the assessment had become time-barred. It was received on 15th June, 1976. We could not take action either under Section 147(b) or under Section 154. For the years 1969-70 and 1970-72, action under Section 147 (b) was not possible. For the assessment year 1971-72 only action that could be taken was under Section 154. That was initiated on 1-2-1977. For the year 1973-74, notice under Section 147(b) was issued on 18-3-77. Notice under Section 154 was also issued. This notice was issued on 22-12-1976. So we have taken action under 147(b) and also under Section 154 fairly quickly."

1.71. He added:

> "By the time the Audit objection was received action under section 147 became time-barred for two years... 1972-73, 1973-74 and for 1974-75 he took action both under Sections 154 and 147 (b) .....Notice under section 148 has been issued for 1974-75 on the ground that there was no specific approval of Section 80(O) and relief under section 80(O) was wrongly allowed."

1.72. In a subsequent note (March 1981), the Ministry of Finance have communicated the latest position as under:

Assessment year	Date when the order u/s 154 passed	Additional demand raised	Remarks
1	2	3	4
1971-72 . . .	11-5-1977	1,99,775	Demand raised by adjustmnt of the refunds due for 1973-74 and 1974-75 AYs. However, the order u/s 154 was cancelled by I.T.A.T. on 7-3-80 holding that the matter was debatable and as such no action u/s 154 could be taken.
1972-73			Notices u/s 148 were issued on 18-3-1977. However, the Calcutta High Court has stayed the proceedings on the ground "as otherwise the petitioner would suffer extreme hardship". As such no further action is possible.
1973-74			

1	2	3	4
1974-75 . .	13-2-1980	1,43,893	Assessee had applied for stay till disposal. This was granted. C.I.T. (Appeals) in his order dated 8-9-1980 has cancelled the order u/s 154 holding that the matter was debatable and therefore, no action u/s 154 could be taken.

The reasons for rectificatins u/s 154 for the assessment year 1971-72 and 1974-75 are as under:—

(i) A.Y. 1971-72 . . The order refers to wrong deductions u/s 80-O, 80-L and 80-M. In so far as Sec. 80-O is concerned, the reason given in the order is that the agreement had not been approved for purpose of Sec. 80-O.

(ii) A.Y. 1974-75 . . . The reason for rectification given in the order is that "royalty had not been brought into India in accordance with the law in force for regulating the payments and dealings in foreign exchanges, the deduction u/s 80-O could not be allowed."

1.73. The Committee enquired how such a patent mistake in the assessment of a subsidiary of the foreign company remained undetected so long and whether checking at higher level was only on random basis, the Chairman, C.B.D.T. explained as follows:

> "As directed by the PAC earlier, we have created some posts of IAC (Assessment). Our instructions to the field are that important cases and also cases of searches and seizures, etc. should be assigned to those IACs....I must admit that in this particular case this has not been done. We checked up from the Commissioner as to why this had not been done. I was told that other cases like search and seizure which also should receive greater attention or more deeper scrutiny, had been assigned to him. But still I feel that this type of cases should have been dealt with by the IAC (Assessment) .....The responsibility in this case is not that of the income-tax officer or Assistant Commissioner, but that of the Commissioner. He should have assigned it to some senior officers. The mistake is that of the Commissioner rather than of the assessing officer".

1.74. The Committee enquired whether departmental instructions exist about the need for extra care in the assessments of subsidiaries of foreign companies. The Ministry of Finance have, however, stated that "reply will follow".

1.75. However, it is seen that in terms of Instruction No. 794 dated 23-11-1974, the claim for deduction under Section 80-O should be dealt with in detail in a separate and self-contained paragraph in the assessment order rather than doin gsummarily with the claim e.g., by saying "deduction allowed under Section 80-O as claimed by the assessee". Furthermore, para 2(ix) of the Instruction stipulated that deduction to be granted under Section 80-O (including the allocation of expenses against such income) should be qualified by the Income-tax Officer with the approval of the Inspecting Assistant Commissioner who may, in suitable.

1.76. The Committee desired to know when action was initiated against the ITC. The Chairman, CBDT, replied during evidence:

> "After the receipt of this Audit para in the Board, we called for the details of the assessments. It was only then that it came to light that under section 154 action had been initiated in two years, but not finalised with the result that it became time-barred. So, we asked him what action has been taken against the ITO?

1.77. He further added:

> "CIT's Report was received in February, 1980. We have been in correspondence only recently, about six months ago."

1.78. The Committee enquired about action taken or contemplated to be taken against the I.T.O. and other supervisory officers for their failure to initiate timely action for rectification of assessments under Section 154 for the assessment years 1972-73 and 1973-74. In reply, the Ministry of Finance have stated:

> "Commissioner of Income-tax has been asked to call for the explanation of the concerned officers. On receipt of their reply, appropriate action would be considered in the light of the reply received."

1.79. The Committee desired to know whether the case was looked into by Internal Audit. In reply, the Ministry of Finance have stated that:

> "Internal Audit scrutinised all assessments for the year 1969-70 to 1974-75 but no objection was raised by them."

1.80. The Committee, therefore, desired to know whether the Ministry has enquired how the fact about non-fulfilment of the prescribed conditions escaped the attention of Internal Audit consecutively over the years. In reply, the Ministry of Finance have stated:

> "Commissioner of Income Tax has reported that the Internal Audit thought that the approval given by the Ministry of Industries

was sufficient compliance with the provisions of Sec. 80-O and there was nothing on record to show that the other conditions had not been complied with."

1.81. The Committee enquired whether the failure on the part of the assessee company to obtain Government's approval for the agreement before claiming relief under Section 80-O did not also imply failure to disclose all relevant information and if so, whether the question of launching criminal proceedings against the company had been considered. The Chairman CBDT stated:

"I must frankly admit that we have not examined it from the point of view of prosecuting. I do not think that there was *mens rea* in this case for a prosecution."

1.82. Asked if the penal provisions of prosecution were ever used to collect the taxes due to Government, the representative of the Ministry of law stated:

"The *mens rea* aspect has not been considered by us on any reference received from the Department but merely ITO committing some lapses will not be a justifiable ground."

1.83. The Chairman, CBDT added:

"....so far the policy of the Board has not been to make use of prosecution for the purpose of recovering taxes."

1.84. Asked why the proceedings in the case could not be reopened under Section 147(a), the witness stated:

"Since the amount involved is more than Rs. 50,000, it will still be open for us to take action u/s 147(a) because the 16 year period has not expired. The suggestion of the Committee will be taken note of and we will try to take action u/s. 148.... I have my doubts in this matter. We will, however, have this matter examined and if we find that Section 147(a) is applicable, we will reopen these assessments. It is still possible for us to reopen assessments under Section 147(a)."

1.85. The Committee enquired whether the merits of the matter were discussed in the impugned order. The Chairman, C.B.D.T. replied:

"Merits of the matter were not discussed in this order. The order under Sec. 154 had been set aside on the ground that it was a debatable issue."

1.86. Asked whether counter to the petition or for vacation of *ex parte* stay had been filed by the Department, the Chairman, C.B.D.T. stated in reply:

"The counter has yet to be filed."

1.87. The Committee, enquired about the usual procedure followed in such cases where stay is given in writs. The Chairman, CBDT replied:

"We try to get the stay vacated. But we seldom succeed. These are all administrative lapses. In fact, it all depends upon the problems in each charge. There are certain charges where the counter-affidavit is not quickly filed. Calcutta is one of the charges, where particularly in legal matters things get delayed."

1.88. Asked if the Department felt satisfied because of the approach of the High Courts or inadequacy of efforts on the part of the Department was responsible for delays in vacation of stay orders, the Chairman, C.B.D.T. replied:

"Both are responsible. But the main thing is the first one. If there are thousands of writ petitions pending in the High Court, in this particular case the ITO may feel, what is the hurry in filing my counter, because it will take another five or six years for the matter to come up. That attitude is natural and possible."

1.89. Asked if it was a general problem, the Chairman, C.B.D.T. stated that they did not have similar problems in other High Courts. Another witness added:

"In Calcutta, there are writs against 147(a) and also against 144 B. Most of the assessees go to the High Court and get interim stay against 144 B. Our request for vacation of the interim stay is rejected. They take some sort of security for payments, but stay is granted against passing orders."

1.90. In a note furnished subsequently, the Ministry of Finance have stated:

"Notices under section 148 were issued on 18-3-1977 and not 18-5-1977. There has been an undue delay in the filing of the counter affidavit. Commissioner of Income-tax is being asked to ensure that such delays do not occur in future."

1.91. Asked to indicate what the Department proposed to do now to get the stay vacated, the Ministry of Finance have stated:

"The Law Ministry is being requested to try to get the stay vacated."

1.92. At the instance of the Committee, the Ministry have furnished the following statement showing the writs pending in various High Courts, as on 1-1-1981:

S. No.	Charge	Total No. of pendency as on 1-1-1981	Pending for				Remarks
			less than one year	1 to 2 years	2 to 5 years	More than 5 years	
1	2	3	4	5	6	7	8
1	Agra	..	..	..	..	..	
2	Allahabad	39	34	5	..		
3	Amritsar	47	19	28	..	..	
4	A.P.	55	36	10	2	7	
5	Assam	89	33	45	11	..	
6	Baroda	9	9			..	
7	Bihar-I	8	6	2			
8	Bihar-II				..	..	
9	Bombay	263	..	..	263		
10	Bombay (c)	41	17	12	12	..	
11	Calcutta(c)	174		173	1	..	
12	Delhi (c)	59		32	27	..	
13	Delhi	57	57	..	..	..	
14	Gujarat	68	31	29	86	..	
15	Haryana	40	4	..	36	..	
16	Jaipur	73	27	15	3	28	
17	Jodhpur	28	4	7	15	26	
18	Jullundur	4		4	..	..	
19	Kanpur	15	..		15		
20	Karnataka	304	217	52	35	..	
21	Kerala	80	8	31	23	18	

E. Collusive Arrangements.

1.97. A deduction similar to that provided in Section 80-O is also admissible under Section 80-MM to Indian Companies on the income from "provision of technical know-how" received by them from any person carrying on business in India, with the difference that the quantum of deduction is limited to 40 per cent of such income. This concession, which was introduced w.e.f. 1-4-70 by the Finance Act, 1969, had as its objectives, "minimisation of the repetitive import of technology and encouragement of development of local know-how" (para 45 of the Explanatory Notes). In the guidelines issued by the Board for the approval of agreements under Section 80-MM (Circular No. 140 dated 6-7-1974) it was *inter alia* stipulated that any agreement which is a collusive arrangements for abuse of the tax concession will not be approved.

1.98. In the case cited below, which came to the notice of the Audit, the objectives and guidelines stipulated in the Board's cricular dated 6-7-1974 for approval of agreements under Section 80-MM do not seem to have been kept in view:

M/s. Union Carbide Corporation, a non-resident foreign company supplied technical information for the design, fabrication and installation of distillation trays, to its Indian subsidiary (M/s. Union Carbide India Limited), who in turn supplied the technical information to Bhabha Atomic Research Centre, Bombay for a fee of $ 2,50,000. The Indian subsidiary passed on 50 per cent of fee to the foreign company, and on the balance of $ 1,25,000 (Rs. 9,39,144), relief under Section 80-MM was allowed to the extent of Rs. 3,75,658 in the assessment year 1971-72. The agreement in this case was approved by the Ministry of Industrial Development and Internal Trade (Department of Industrial Development). The foreign company had obviously utilised the Indian subsidiary as an intermediary, so as to enable the Indian subsidiary to avail of the tax concession under Section 80-MM, because the Income-tax Act does not provide for a similar concession to foreign companies on fees for technical know-how received by them in India and foreign companies suffer tax at a higher rate than Indian companies.

1.99. The Committee enquired whether the technical collaboration agreements between multinationals and subsidiaries are examined to make sure that transfer pricing was not resorted to and the benefit of tax concession withheld in such cases. The witness replied:

"We are examining the whole question of transfer pricing."

1.100. The Finance Secretary added:

"This matter is dealt with by the Department of Economic Affairs. These are issues of policy which have to be dealt with in a larger forum. Simply because transfer pricing is likely to present problems and difficulties in assessment the country cannot deny itself access to higher technology. The Government have laid down areas in which foreign technology will be welcome. We do not welcome foreign technology indiscriminately. We welcome it in areas of sophisticated technology. Approvals for foreign technology are accorded by the Foreign Investment Board on which Secretary of Department, Science and technology is represented. They go into each case of foreign technical collaboration and clear it only where it is considered to be in the national interest. But I do agree that in such cases where a foreign investment is allowed, there is a possibility of tax obligations being evaded through transfer pricing mechanism. This will have to be carefully examined by the Income-tax Department. But simply because transfer for pricing is going to present problems of taxation, the country cannot on that ground shut out foreign technology and foreign investment. The Government have taken this into account in framing the policy."

1.101. It was brought to the notice of the Committee that M/s. Union Carbide Corporation, a non-resident foreign company, supplied technical know-how to the Bhabha Atomic Research Centre, Bombay, but routed it through their Indian subsidiary, Union Carbide (India) Ltd. who collected the technical know-how fees from Bhabha Atomic Research Centre, Bombay and claimed relief under Section 80-MM. The Committee desired to know whether adequte safeguards have been provided for ensuring supply of technology directly and not through Indian subsidiary of a foreign company. The Finance Secretary stated during evidence:

"So far as the terms of transfer of technology are concerned, whether it could be supplied directly by the foreign company, or through its Indian subsidiary, and what are the terms that should be allowed are being gone into by the Foreign Investment Board, under the Department of Economic Affairs, on which there are representatives of Departments like Science and Technology. So, both the need for acquisition of foreign technology and the reasonableness of the terms are gone into by that body. At that stage the Deptt. of Revenue plays no role. I have given an assurance to the Committee earlier on two points. One is to establish a Special Cell, which is

designed to look into the cases relating to large houses and also investigate some of the cases relating to multinationals. In fact this Cell is already in existence. The cases relating to IBM National Grindlays Bank have been looked into the Special Cell. This process will be continued. More than that, I have also suggested that the Foreign Tax Division in the Central Board of Direct Taxes, during the slack period *i.e.* after the month of March till when they will be busy finalising assessments, should meet some of these Commissnoners at a Central point and exchange ideas with them on problems relating to the assessment of these multi-national companies. We cannot except all the Commissioners to be experts in dealing with this problem. But the Foreign Tax Division has acquired specialised knowledge. I have suggested that they should organise —I would not say Seminar but some kind of meeting for exchange of ideas, between the field staff and the staff of Board. I am sure my colleague will follow it up. I will see that it is followed up. You will appreciate that in 1975-76 we amended the Income-tax law specifically to ensure that some of the problems like head office expenses and royalty were got over by providing specific percentages so that they do not provide room for argument between the assessee and the taxing department and also in the process give scope to these companies to cheat the legitimate taxes due to us."

1.102. The Committee desired to know the precise connotation of the terms 'collusive arrangement' and how such arrangements were guarded against. The Ministry of Finance have, in a note,* stated:

"This item is dealt with in two parts. First part deals with Section 80-O and the second one with Section 80-MM.

Section 80-O

(a) Application under Section 80-O are first examined by the Branch in the Foreign Tax Division. These are then scrutinised by the Director and the Joint Secretary concerned. If necessary, hearing are also given. The papers are then put up to Chairman, Central Board of Direct Taxes for final orders.

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*Not vetted in Audit.

Section 80-MM

(a) (1) For scrutinising the agreements received in the Board for approval under Section 80-MM, a special cell known as 80-MM Cell has been created. This cell comprises of 1 Director/Deputy Secretary and one Assistant.

(2) For the facility of scrutiny of agreements, an applicant is required to furnish certain information in the prescribed proforma along with the application or as soon thereafter as possible.

(3) The Director/Deputy Secretary scrutinises each of the agreements in the light of the information received and, if necessary, he may call for further information or grant a hearing to the party. He then puts up a note containing his recommendation as to the extent to which the agreement qualifies for approval.

(4) The Member in-charge take a decision in the light of the note of Director/Deputy Secretary and the material on record. If necessary, he also grants a hearing to the party.

(b) An agreement between two or more closely connected parties, which is ostensibly for the provision of technical know-how, but which, in reality, is merely a device for tax avoidance, is said to be a collusive arrangement. The basic aim of entering into such an agreement is to divert the income from one company having a substantial income to the consultancy company in whose hands the income will bear no or very little tax as a result of the grant of relief under Section 80-MM.

In order to find out the collusive arrangement, information in the prescribed proforma is sought from each applicant. The information includes particulars about the parties to the agreement, the nature of their business activities, their relationship including the relationship of Directors of one company with the Directors of the other company, details of the applicant's interest in the business of the other party, arrangements and facilities available with the applicant for obtaining and imparting of know-how, manner of imparting the know-how etc. If, after going through the information, it is found that there is a relationship between parties or the applicant has interest in the business of the other party, further enquiries are

made to find out the genuineness of the agreement and the reasonableness of the terms for the provision of technical know-how."

1.103. The Committee desired to know whether the agreement in this case was examined keeping in view the aforesaid guidelines. The Ministry of Finance have, in a note, stated:

"M/s. Union Carbide India Limited submitted an application dated 3-9-1970 to the Ministry of Industrial Development and Internal Trade (Department of Industrial Development), requesting for approval under Section 80-MM of the Income-tax Act, 1961, of its agreement dated 12-3-1970 with Bhabha Atomic Research Centre, Bombay. This agreement was for supply of technical information and know-how relating to the functional design of Distillation Trays required for manufacture of heavy water at a plant to be set-up in Rajasthan. This agreement was approved for the purposes of grant of exemption under Section 80-MM by the Ministry of Industrial Development and Internal Trade (Department of Industrial Development) on 30-10-70.

Guidelines for approval of agreements under Section 80-MM were issued by the Board for the first time *vide* their Circular No. 124 dated 13-11-73. These guidelines were subsequently reviewed and modified and the revised guidelines were issued *vide* Circular No. 140 dated 6-7-74.

As the agreement of Union Carbide India Limited with Bhabha Atomic Research Centre was approved by the Ministry of Industrial Development and Internal Trade (Department of Industrial Development) before the issue of the guidelines, the question of examination of the agreement in the light of the guidelines did not arise."

1.104. Asked about the matter in which the amount of technical fees received from Bhabha Atomic Research Centre were shared between the Indian subsidiary and the foreign company and whether the share received by the foreign company was brought to tax in India, the Ministry have furnished an interim reply, which is reproduced below:

"For supply of technical know-how to Bhabha Atomic Research Centre, the Union Carbide India Limited received a fees of an amount in rupee currency equivalent to U.S. $ 2,50,0000. Out of this, it paid a sum of U.S. $ 1,25,000 to Union Carbide

Corporation, New York under the agreement dated 12-3-70 in consideration of the provision of technical know-how by the Union Carbide Corporation, New York.

M/s. Union Carbide India Limited has also received a fees of U.S. $ 5,15,000 from Bhabha Atomic Research Centre for supply of detailed engineering design. It however, passed on the entire amount to Union Carbide Corporation, New York.

According to its letter dated 20-1-77 filed by Union Carbide India Limited, it claimed relief under Section 80-MM on an amount of U.S. $ 1,25,000 only. The Commissioner of Income-tax, Calcutta has been requested to intimate as to whether the amount of fees received by Union Carbide Corporation, New York, has been brought to tax and if so, the details thereof. The information is still awaited from the C.I.T., Calcutta. It will be sent as soon as it is received."

1.105. The Committee desired to know about the role of the Indian subsidiary in this transaction on whether it was being used merely as a channel to avoid payment of tax dues in India. In reply, the Ministry of Finance have stated:

"As already mentioned, approval to the agreement dated 12-3-70 of M/s Union Carbide India Limited with Bhabha Atomic Research Centre was granted by the Ministry of Industrial Development and Internal Trade (Department of Industrial Development). The Board do not have any information in its file regarding the role of Indian subsidiary in the matter of provision of technical know-how in terms of the agreement. However the C.I.T., Calcutta has been requested to furnish necessary information on this point. The information will be sent as soon as it is received from the C.I.T.".

1.106. Both the concessions (under Section 80-MM and 80-O) have been on the statute book for over ten years. The Committee, therefore, enquired whether the Ministry had at any time conducted any general review to ascertain how far these concessions have achieved the desired objectives. In a note, the Ministry of Finance have stated:

"So far as the concession under Section 80-MM is concerned, the Ministry has so far not conducted any general review to ascertain as to how far the concession has achieved the desired objective".

1.107. The Committee enquired whether the Board had come across similar other arrangements of foreign companies chanelling technical know-how through Indian subsidiaries and thus indirectly availing of the tax concessions and low tax rates not meant for them. The Ministry of Finance replied in the affirmative and added:—

"In the case of M/s Lurgi India Private Ltd. approval under Section 80 MM was sought in respect of an agreement dated 22-5-72 with M/s Godrej Soaps Private Ltd. M/s Lurgi India Private Limited was incorporated in the year 1964. Out of its share capital, 55 per cent is held by Lurgi Gesellschaften, Frankfurt according to which Lurgi India was appointed to act as correspondence in India by Lurgi Frankfurt. Under the collaboration agreement, Lurgi Frankfurt agreed to make available to Lurgi India all technical advice and assistance in their possession in the field of chemical engineering. The Board refused approval to the agreement of M/s. Lurgi India Private Limited with M/s. Godrej Soaps Private Ltd. on the ground that the technical know-how had, in fact, been made available to M/s. Godrej Soaps Private Ltd. by the foreign company, though it was done through the Indian company. While refusing approval to the agreement, it was mentioned that M/s. Godrej Soaps Private Limited could not make the necessary agreement directly with the foreign company because of difficulties of foreign exchange and the agreement was made with the Indian company to overcome these difficulties. M/s. Lurgi India Private Limited filed a Writ petition against the Board's orders before the Delhi High Court. The Delhi High Court has held that there is no bar in Section 80-MM for an Indian company which claims the benefit under that Section, to obtain technical know-how and processes from a foreign company. The High Court has quashed the Board's order and directed the Board to reconsider the application for grant of approval. The Judgement of the High Court is reported in 121 ITR 141".

1.108. The Committee desired to have a break-up of the extent of deductions allowed under Sections 80-MM and 80-0 during each of the last 6 years to:

(i) Indian subsidiaries of foreign companies;

(ii) Other Indian companies.

In reply*, the Ministry of Finance have stated:

> "In the Board no record is maintained, giving the extent of deductions allowed under Sections 80-MM and 80-0 and its break-up between (i) Indian subsidiaries of this foreign companies; and (ii) other Indian companies. This information will have to be collected from Commissioners all over Indian and it will take a considerable time. The information will have to be culled out by going through the relevant assessment records of all the companies for the last six years, namely, the financial years 1974-75 to 1979-80. It may also be mentioned that during the period prior to 1-4-1975, relief under Sections 80-0 and 80 MM was also admissible to non-corporates assessees. Therefore, to collect the information in respect of financial year 1974-75 even the records of non-corporate assessees will have to be examined. In view of these difficulties, it is requested that this information may not be insisted upon.

1.109. The Public Accounts Committee (Fifth Lok Sabha) had, in paragraphs 9.15 and 9.16 of 176th Report of the Public Accounts Committee, observed that the agreement for transfer of technology between sister foreign companies could be a facade to facilitate tax evasion. The Committee desired to be furnished with information on the following points:

(a) The arrangements to ensure that such agreements between foreign companies and their Indian subsidiaries do in fact, involve transfer of technology relevant to the Indian needs;

(b) How is it ensured that the price agreed is a reasonable price and not a cover for tax evasion?

(c) Since transfer pricing in this matter is a notorious world wide phenomenon, would it not be proper to put a total ban on the transfer of technology to their own subsidiaries

(d) Is that not one of the suggestions before the U.N. Commission on transnationals for being put in the code of conduct for the transnationals?

In reply, the Ministry of Finance have stated that "the information is being collected (and) further reply will follow:"

1.10. In reply to the Committee's suggestion** that technical collaboration agreements should provide for a periodical review from the point of view of their continued relevance to the changing needs of a developing

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*Not vetted in audit.

**51st Report of PAC (6th Lok Sabha) (Paragraph 1—26).

indigenous technology; the Ministry of Finance had stated that the duration of such agreements had been reduced from 10 to 5 years so that they could automatically come up for review at the time of extension, it sought for.

1.110. It was brought to the notice of the Committee that the duration of technical collaboration agreements had been again changed to more than five years. The Committee therefore enquired about the justification for such change.

In reply, the Ministry of Finance have stated:

> "Department of Industrial Development who are concerned with the subject, has been requested to furnish the requisite information directly to the PAC". The information is still awaited. (April 81).

1.111. The Committee find that the assessee Company viz. Gramophone Company of India Ltd. Calcutta engaged in the business of manufacturing of gramophone records entered into agreements with three companies based in UK for the supply of matrices to enable the foreign Companies to manufacture records from the matrices for sale outside India. The entire income of Rs. 15.24 lakhs derived by the company during the previous years relevant to the assessment years 1969-70 to 1974-75 was allowed as a deduction under Section 80-0 treating it as income from technical know-how. The deductions were considered inadmissible by audit as the assessee Company did not satisfy the following conditions of Section 80-0:

(i) There was no evidence that the income had been brought into India by the assessee in convertible foreign exchange.

(ii) The agreements were not approved by the Government or the Central Board of Direct Taxes for the purpose of availing of this relief; and

(iii) The assessee did not export any technical know-how or skill.

1.112. So far as the first condition is concerned, the Ministry stated in the first instance that "the point does not appear to have been examined by the assessing officers, after the law was amended retrospectively by the Finance Act, 1974." At a later stage, the Committee were however informed that the royalties receivable by the assessee Company for the period July 1969 to June 1974 were adjusted against the royalties payable by them to the foreign companies and the Reserve Bank of India allowed them to remit the balance of Rs. 5,193 relating to the aforesaid period. Thus, according to the Ministry, the assessee company would be said to have received the amounts in convertible foreign exchange for the said period.

1.113. The Committee observe that the Central Board of Direct Taxes had issued instructions in November, 1974 to the effect that where the money had not been brought into India in convertible foreign exchange, immediate action be taken to withdraw the relief (from the assessment year 1968-69 onwards.) The Ministry's reply shows that no such review was carried out. In fact, necessary verification was made from the Reserve Bank of India after the matter was taken up by this Committee. This indicates not only the failure on the part of the assessing and supervising officers to follow the instructions of the Board out also the absence of an effective mechanism under which information on such important matters could be concurrently collected. This is further evidenced from the fact that the Board have not been able to enlighten the Committee regarding the system devised by Government to ensure that such money is actually brought into the country in foreign exchange. The Board do not also appear to have devised any machinery to collect and collate data in respect of dues receivable and payable by way of royalty etc. for purposes of Section 80-0 of the Income-tax Act. The Committee are of the view that in order to ensure that there is no abuse of the concession given under the Income Tax Act, the Board should maintain close coordination with the Reserve Bank of India and the Department of Economic Affairs and devise a system for maintenance of the requisite data so as to facilitate proper monitoring of the scheme.

1.114. As for the second condition, the Committee observe that the agreement was approved initially by the Ministry of Industry in 1964. It has since been stated by the Ministry of Finance that the audit objection is acceptable as the above approval was not for purposes of Section 80-0. The Act specifically provides that the agreement with the foreign Company should be approved by the Central Government in this behalf i.e. for the specific purpose of allowing the concession in tax. In fact, the instructions issued by the Board had made it abundantly clear that approval granted by the administrative Ministries will not satisfy the legal requirement. The Committee consider it vary unfortunate that the assessing officers completely overlooked the explicit provisions of the Act and the instructions issued in pursuance thereof. It is regrettable that this important condition escaped the notice of Internal Audit as well.

1.1115. The Committee find that the case was not scrutinised by the IAC also. The contention of the Ministry that scrutiny by the IACs is done on a random basis is in conflict with the instructions of the Board that the deductions to be claimed under section 80-0 should be quantified by the ITO with the approval of the IAC.

It would thus appear that there has been failure at all levels in this case. The Committee therefore, desire that the lapses should be brought to the notice of all concerned, for remedial action. The Committee also

recommend that a thorough review of all such agreements should be carried out by the CBDT under a time bound programme and the results communicated to the Committee.

1.116. Coming to the third condition, the Committee find that the Ministry have taken shelter under the advise of the Ministry of Law that since the company had a copyright in the matrix, and the words' similar property right' appearing in Section 80-0 would cover copyright also, the assessee would be entitled to the benefits under this Section. The crucial question is whether such right is similar to the right to patent, invention, model, design etc. mentioned in the Section. All these involve transfer of technical know-how, since they convey to the other party information and knowledge as to how to make a thing. Copyright relating to a matrix does not obviously involve any transfer of technical know-how. In fact, reverse is the case as the know-how for producing materices has been obtained by the Indian Company from the foreign companies. The Finance Secretary stated in evidence that the wording of the Section as it stands would seem to cover even a case of the kind dealt with in the Audit paragraph. He, however, conceded "from the speech of the Finance Minister, it is clear to me that at the relevant point of time the intention was that the concession should be given only in cases of transfer of technical know-how and the like. It perhaps was not intended to cover copyright.'

1.117. The Committee recommend that the desirability of amending the Income-tax Act may be considered, if necessary, after obtaining the views of the Attorney General, on whether the Act as it stands at present really does not bring out the intention of the Government fully.

1.118. As pointed out in the Audit paragraph, short levy of tax conseqent upon incorrect deduction allowed to the assessee company amounted to Rs. 8.65 lakhs as per details given in paragraph 1.61. On receipt of Audit objection, notices under Section 154 (with a view to rectifying any mistake apparent from record) were issued for the assessment years 1971-72 to 1974-75. Action under Section 147 (b) was also taken for the assessment years 1972-73 to 1974-75 for which such action was still within time.

1.119. The Committee find that while orders have been passed fully withdrawing the benefit given under section 80-0 for assessment years 1971-72 and 1974-75, the ITO has been asked to explain the reasons for not taking similar action for the intervening two years viz. 1972-73 and 1973-74. The Committee would like to be informed of the circumstances in which such lapses occurred and what action has been taken against the defaulting officers.

So far as the earlier years viz. 1969-70 and 1970-71 are concerned, the Committee have been informed that action was already time barred when the audit objection was received. The Committee consider that the question whether the failure of assessee company to obtain Government's approval to the agreement before claiming relief under section 80-0 would not amount to failure to disclose fully and truly all material facts has to be examined carefully in the light of the facts of the case. It was stated in evidence that since the amount involved is more than Rs. 50,000 and the 16 year period had not expired, it was still open for the Department to take action under Section 147(a). The Committee would like to be apprised of the outcome at an early date.

1.120. The Committee find that the proceedings in respect of assessment years 1972-73 and 1973-74 have been stayed ex-parte by the Calcutta High Court on the ground that "as otherwise the petitioner would suffer extreme hardship". The Ministry have informed the Committee that "there has been an undue delay in the filing of the counter affidavit. Commissioner of Incometax is being asked to ensure that such delays do not occur in future. The Law Ministry is being requested to try to get the stay vacated."

1.121. The committee find that no action was taken by the Department to get the stay vacated for as long as three years. The Ministry of Law are being approached only now as a follow up of deliberations in this Committee. It is unfortunate that in spite of a number of instructions issued by the Board on this subject between 1968 and 1979 such delays continue to occur. The Committee cannot view this situation with equanimity. Continued disregard of the instructions erodes Board's own authority. The Board must, therefore, find out methods of effective implementation of the instructions and their monitoring. The Committee also consider that unless some deterrent measures are taken, the situation would not improve. As would be seen from the preceding paragraphs, there have been a series of lapses of omission and commission on the part of the assessing and supervising officers in this case. The Committee, therefore, require that responsibility should be fixed and the officers concerned should be suitably taken up for these lapses. The Committee would like to be apprised of the action taken against the defaulting officials.

1.122. In this connection the Committee note with concern that the total pendency of writ petitions against orders of the Income-tax authorities in various High Courts was as high as 3,652 as on 1 January 1981 out of which as many as 1384 were pending for 2 to 5 years and 198 for more than 5 years. Out of this, the pendency pertaining to Calcutta and West Bengal Commissioners' charges was as high as 2074 of which 896 were 2 to 5 years old and 143 were more than 5 years old. During their

visit to Calcutta, a Study Group of the Committee were informed that the legal assistance available to the Department was not adequate. It was suggested that the Department should have the freedom to choose its own Counsel from a panel of approved lawyers so that the lawyers knew that they have to handle briefts in active and full consultation with the Department and not as though they were dealing with an anonymous client.

1.123. Considering the very large number of income tax cases in which proceedings have been stayed by the Calcutta High Court, the Committee recommend that the Board should give serious consideration to the above suggestion so that it should become possible for the Department to get the stay orders vacated expeditiously and also to pursue the proceedings in the Appellate Tribunals, High Court etc. in a concerted manner.

1.124. The Committee find that there is no machinery in the Ministry or in the Board to monitor progress of cases pending due to stay orders given by the Courts on writ petitions. This aspect should be looked into and the Committee apprised of the measures taken.

1.125. The Committee further recommend that the question of mounting pendency of writ petitions in Calcutta High Court should be taken up at a high level in the Ministry of Law, with a view to devising ways and means to see that huge revenues due to Government do not remain locked up due to vexatious and time-consuming proceedings in Courts of law.

1.126. In connection with their examination of the case of M/s. Gramophone Co. of India Ltd., the Committee have come across another case of M/s. Union Carbide Corporation, a non-resident foreign company, which utilised its Indian subsidiary M/s. Union Carbide India Ltd., as an intermediary. In this case, the technology was imported from a foreign country and no local know-how was involved; the case did not, therefore, satisfy the objectives behind the enactment of Section 80-MM. The tax concession extended to the Indian subsidiary resulted in decrease in tax revenue on 50 per cent of the income derived on the sale and retained by the Indian subsidiary (only 50 per cent was passed on to its principal).

1.127. The Finance Secretary admitted in evidence that in such cases there is a possibility of tax obligations being evaded through transfer pricing mechanism. In the light of this statement, the Committee are constrained to note from a written reply furnished by the Ministry that prior to the guidelines being laid down by the Board requiring scrutiny/review of all such agreements, the agreement (between Union Carbide of India Ltd., and Bhabha Atomic Research Centre) was approved by the Ministry of

Industrial Development and Internal Trade without any such scrutiny to prevent misuse of the provisions in law. Information is also not available with the Department as to whether the remaining 50 per cent of the fees received by Union Carbide Corporation, New York has been brought to tax.

1.128. In reply to some further specific questions regarding the mechanism available with the Ministry/C.B.D.T. to ensure that such agreements do not, in fact, involve transfer of technology not relevant to Indian needs; that the price agreed is reasonable and it is not a cover for tax evasion; whether it would not be proper to put a total ban on the transfer of technology by foreign firms to their subsidiaries in India etc., the Committee were informed that the information was being collected and further reply would follow. The same is still awaited (April, 1981).

1.129. In reply to a further question, the Committee were informed that no general review has so far been made by the Department to ascertain how far the concession given under Section 80-MM has achieved the desired objectives.

1.130. So far as Section 80-0 is concerned, the Committee find that in November, 1978 instructions were issued by the Board directing the CsIT to maintain a register containing information regarding the deductions allowed based on details to be furnished by the ITOs once in a quarter—the idea being to have all the data on a centralised basis. No such information could however be made available to the Committee on the plea that it will have to be culled out by going through the relevant assessment records. Obvisouly, the Board's instructions have remained on paper only.

1.131. The Committee consider that a periodical and systematic review and evaluation of the concessions given under Section 80-MM and 80-0 is essential to ensure that the underlying objectives are in fact achieved. There is a Special Cell (called 80-MM Cell) already in existence for scrutinising the agreements that come up to the Board for their approval. The Committee consider that this Cell should not rest content merely in scrutinising the agreements but should obtain the requisite data of all assessments under this Section from the CsIT and subject the same to critical scrutiny. The Cell should therefore be strengthened for the purpose without delay.

1.132. The Committee further recommend that a general review of the working of sections 80-MM and 80-0 should be carried out by the Board with a view to findings out how far the objectives in granting the tax concessions have been subserved and what inbuilt safeguards need to be provi-

ded to prevent abuse thereof. Such a study should be initiated immediately and the findings intimated to the Committee within six months.

1.133. The Committee would also be interested to have the ministry's reply to the question posed by them in an earlier paragraph (para 1.128) particularly with regard to disallowing the tax concession under Section 80-MM to Indian Companies who remit any part of their realisation on sale of technology to their principals or to any foreign company.

1.134. It has also come to the notice of the Committee that the periodicity of reviews of technical collaboration agreements which had been reduced from 10 to 5 years has again been changed to more than 5 years. The Committee would like to be informed of the precise position and the rationale for the change, if any.

CHAPTER-II

IRREGULAR EXEMPTIONS GIVEN

Audit Para:

2.1. (i) The Income-tax Act, 1961 provides that financial corporations engaged in providing longterm finance for industrial or agricultural development in India are entitled to a deduction, in the computation of their taxable profits, of the amount transferred by them out of such profits to a special reserve account, upto a specified percentage of their total income as computed before making any deduction under Chapter VI A of the Act. The Board issued instructions in November, 1969 to the effect that this deduction is to be calculated by applying the specified percentage to the total income arrived at after the deduction. Subsequently, the Board issued a clarification to the Department of Banking in November, 1973 to the effect that the percentage should be applied to the total income computed before making the said deduction. The clarification being contrary to law was not accepted in Audit and the matter was taken up with the Board in December, 1975. In Jan. 1977 the Board stated that the viewpoint expressed by Audit was acceptable to them. Necessary instructions in this respect were, however, issued only in August, 1979. In the meantime the assessing officers continued to act upon the Boards clarification of Nov. 1973. This accounted for a number of costly mistakes.

2.2. (a) In the case of a financial corporation it was observed that this deduction was worked out and refund of tax granted by the department for the assessment years 1961-62, 1964-65 to 1966-67 and 1968-69 to 1973-74 at the prescribed percentage of income of the corporation, before deducting this allowance, on the basis of the Commissioner of Income-tax's order on a revision petition filed by the corporation in December, 1974, resulting in short computation of income by Rs. 6,47,681 for all the assessment years with consequent excess refund of tax of Rs. 3,60,466.

2.3. The Ministry of Finance have stated that the very fact that the Board had to issue instructions on this point three times shows that the matter was not so obvious or clear.

[Paragraph 29(i)(a) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes].

2.4. Under Section 36(1)(viii) of the Income Tax Act, 1961 a Financial Corporation engaged in providing long term finance for industrial or agricultural development in India is entitled, in respect of any special reserve created by it, to deduction in the computation of its taxable profits, at a percentage of the total income transferred by it to such reserve account. In the case of a Financial Corporation set up under the State Financial Corporation Act, 1951 the prescribed percentage is restricted to 40 per cent of the total income computed *before* making any deduction under Chapter VI-A. In case of other Corporations, the permissible deduction is 10 per cent or 25 per cent of such total income depending on whether the paid up share capital exceeds Rs. 3 crores or not. In either case the Act clearly says that the percentage is to be worked out on "total income (computed before making any deduction under Chapter VI-A) and carried to such reserve account". It follows that the percentage is to be applied to the total amount arrived at *after* allowing deduction under section 36(1)(viii) itself.

2.5. In the assessment of M/s. A. P. State Financial Corporation (assessable under ITO's charge—C Ward—Company Circle, Hyderabad) it was noticed that pursuant to the CIT's passed on a revision petition filed by the Corporation in December 1974 the deduction was worked out and refunds of tax of Rs. 1,04,830 in the assessment year 1972-73 and Rs. 2,57,258 in the assessment years 1961-62 to 1966-67 and 1968-69 to 1971-72 were granted by the Department by applying the prescribed percentage to the income arrived at *before* allowing deduction under Chapter VI-A and Section 36(1)(viii). This was irregular in view of the fact that "total income" means income arrived at after allowing all deductions, the only exception specially made is in respect of deductions under Chapter VI-A. This action of income-tax authority resulted in short computation of income by Rs. 6,47,681 and consequent excess refund of tax of Rs. 3,60,466.

2.6. Indicating the background of the deductions allowed to Financial Corporations and clarificatory institutions issued by the Central Board of Direct Taxes, the Ministry of Finance stated:

> "The provisions for allowing such deductions to financial corporations were first introduced by adding a new clause 10(xiv)(a) to I.T. Act, 1922 in the year 1961. This clause permitted a deduction in respect of the amount (not exceeding 10 per cent of the total income) carried to a special reserve account. Instructions issued by the Board *vide* circular No. 15(LXXVI-38) D of 1961 dated 30-5-1961 directed that the maximum permissible deduction should be calculated at 1/11th of the total income before allowing the deduction under this section, which

means that the deductions should be worked out by applying the specified percentage on the total income after allowing the said deduction.

In 1969 the Board issued clarification by its Instruction issued *vide* letter F. No. 36/19/65-IT(Audit) dated 25th November, 1969 to the effect that deduction allowable under Setcion 36(i)(viii) was to be calculated on total income arrived at after allowing the deduction under this section but before allowing relief under Chapter VI-A of the Act.

In 1973 the Board considered the matter again on a reference from Reserve Bank of India and came to the conclusion that since claiming of deduction and carrying of such deductions to a reserve account which would be a simultaneous process, the deduction should be calculated by applying the specified percentage to the total income computed before allowing any deduction under this Section. A clarification to this effect was sent to R.B.I. *vide* letter F. No. 204/35/73-ITA. II dated 12.11.1973. This decision was taken without reference to instruction of 1969 referred to above.

On receipt of objection from Audit the matter was re-examined by the Board. Audit's view that the Instruction of 1969 provided the correct way to determine the amount of deduction under Section 36(i)(viii) was accepted by the Board and Instruction No. 1275 (F. No. 204/72/75-ITA. II) dated 13-8-79 was issued to all Commissions directing that the deduction under section 36(i)(viii) should be computed by applying the specified percentage to total income arrived at after allowing deduction under Section 36(i)(viii) of the Act."

2.7. In reply to another question by the Committee the Ministry of Finance stated: "A letter was received from C&AG's office in December 1975 in which a view was expressed that clarification issued *vide* letter No. 204/35/73-ITAII dated 12.11.73 to the RBI was not in order. The said letter was sent because the financial corporations had been allowed deductions in accordance with the Board's clarification issued to Reserve Bank of India in 1973.

The Board agreed with the Audit's view point in January, 1977.

Board issued General instructions in August, 1979. However, letter to concerned Commissioner and C&AG was sent in January, 77 itself."

2.8. The Ministry of Finance also admitted that a similar objection was taken by Audit in the case of the same assessee for assessment year 1975-76 in the Audit Report for 1977-78, and the objection was accepted by the Ministry on 11th September 1979. The assessment for the year 1975-76 was revised under Section 147(b) of the Income-tax Act. Additional demand raised and collected is Rs. 4,61,780.

2.9. When enquired as to what stage the mistake occured and whether any remedial measures have been taken for preventing such occurences in future, the Ministry of Finance stated:

> "A different interpretation of the provisions was adopted in November, 1973 though without referring to eariler instruction of the Board of 1969. The Board considered that since the claiming of deduction and carrying the deduction to a special reserve account was a simultaneous process, the amount to be deducted under Section 36(i)(viii) should be calculated by applying the percentage to total income as arrived at *before* allowing the deduction. As stated above, general instruction was issued in 1979 to all officers on the lines of 1969 instructions withdrawing the letter of 1973. According to instruction No. 1275 dated 13th August, 1979, it was desired that remedial action wherever feasible to withdraw the higher deduction allowed should be taken."

2.10. When asked to indicate whether similar cases were reviewed to find out similar incorrect reliefs, if any, given to assessees and if so, what was the outcome of such reviews, the Ministry informed the Committee that in paragraph 4 of CBTD's instructions No. 1275 dated 13-8-1979 it was stated that the remedial action wherever feasible should also be taken to withdraw the higher deduction allowed and that the Commissioners, of Income-tax were requested on 15th December, 1980 to furnish the details of remedial action taken by them to the Board by 31st December, 1980. The Committee have not been supplied any such information so far.

2.11. Section 36(1) (viii) of the Income-tax Act, 1961 provides that Financial Corporations engaged in providing long term finance in industrial or agricultural development in India are entitled to a deduction, in computation of their taxable profits, of the amount transferred by them out of such profits to a special reserve account, upto specified percentage of their total income as computed before making any deduction under Chapter VI-A of the Act. Clarifying the scope of this provision in an instruction issued in November, 1969, the Board of Direct Taxes

stated that the allowance should be computed with reference to the total income arrived at after allowing the deduction under section 36(i)(vii) itself but before allowing the deductions under Chapter VI-A of the Act. Subsequently in 1973 on receipt of a reference from the Department of Banking seeking clarification on this point, the Board, without making any reference to their own earlier instruction of 1969, issued a letter dated 12-11-1973 to the Department of Banking saying that the deduction would be related to the amount arrived at before deduction under section 36(i)(viii). This letter of the Board was circulated by the Reserve Bank of India to all State Financial Corporations on 1-2-1974 and thus an erroneous interpretation of law got currency. It came to the notice of Audit during examination of certain assessments of financial corporations in 1975 that the letter conveyed a wrong interpretation of law and ignored a valid instruction of the Board itself issued in 1969 without even referring to it. The matter was taken up by Audit with the Board in December 1975. It was only in January, 1977 that the Board informed the concerned Income-tax Commissioner and the Audit that the view point expressed by Audit was acceptable to them and action was being taken to reiterate the earlier instruction of 1969. Thereafter it took more than two and a half years for the Board to issue general instructions in August, 1979 to reiterate that the instructions issued in 1969 were correct and were to be followed. In the meanwhile, the mischief created by the Reserve Bank Circular containing the Board's revised instruction of 1973 resulted in erroneous deductions being allowed in a large number of cases.

2.12. It is bad enough that an erroneous interpretation of a relatively simple provision of the Income-tax Act should have gained currency at the instance of the Board of Direct Taxes itself. But what pains the Committee ever more is the twin failure disclosed by the facts, firstly, that the erroneous clarification of 1973 was issued not as a deliberate revision of the earlier clarification of 1969, but in total disregard of it, and, secondly, that even after the Audit pointing out the mistake in December, 1975 it took the Board almost 4 years to rectify the mistake. It is amazing that the Central Board of Direct Taxes, a body invested with the power of administering the Income-tax Act, should not have a system to ensure that while interpreting a certain provision of the Act all relevant materials, and in particular the views, if any, already formulated by the Board itself on such provisions, are duly taken into account. The Committee would strongly recommend that Government should make a thorough probe into this matter to ascertain the reasons for such systems failure and fix responsibility under intimation to the Committee within a period of three months from the presentation of this report. The Committee recommend that Government should ensure that a proper and foolproof system is devised to see that such instructions seeking to interpret certain provisions of the Act are

not issued without taking into account all relevant materials including all earlier instructions on the same subject.

2.13. The Committee are equally distressed at the long period of time taken by the Board in rectifying the situation after the mistake having been brought to their notice by Audit. In spite of the fact that the correct interpretation, as pointed out by the Audit in December 1975, was in accord with the Board's own Instruction of 1969, it took the Board more than a year to accept that position and almost 4 years to issue formal instructions reiterating the clarification given in 1969. The Committee cannot but feel that the Central Board of Direct Taxes did not seem much concerned with the interest of revenue in this case.

2.14. In pursuant to a query by the Committee, the Board asked all the Commissioners of Income-tax to furnish by 31st December 1980 the details of remedial action taken by each in his charge following the Board's revised circular dated 13-8-1979. The Committee regret to note that this information has not been furnished by the Board so far. The mistake pointed out by Audit in the instant case have resulted in short computation of income by Rs. 6,47,681 for the assessment years 1961-62, 1964-65 to 1966-67 and 1968-69 to 1973-74 with consequent excess refund of tax of Rs. 3,60,466. Similar cases of short computation of income have been pointed out by Audit in their Reports for the year 1975-76 and 1977-78. The Committee would like to know the total quantum of revenue lost on account of wrong instructions given by the Board in this matter and the remedial action taken to realise such revenue.

CHAPTER III

INCOME ESCAPING ASSESSMENT

Audit Para

3.1. (iii) Assessment of two assessees, individuals, for the assessment year 1971-72 which were completed on 28th June, 1976 included interest income on investment of Rs. 5 lakhs each with a firm. It was seen in audit (February 1979), that the assessees did not file returns of income for the assessment years 1972-73 and onwards, nor any notice under Section 139(2) of the Income-tax Act, 1961, calling for the returns of income, was issued by the department. As a result, income of at least Rs. 48,750 in the case of one assessee and Rs. 45,000 in the case of the other representing interest on investment with a firm escaped assessment for each of the assessment years 1972-73 to 1977-78, leading to abandoning of total revenue of Rs. 1,81,80 besides penalty for failure to furnish the return of income.

3.2. The Ministry of Finance have accepted the objection.

[Paragraph 65(iii) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes]

3.3. Section 139(1) of the Income Tax Act, 1961 lays down that every person, if his total income in respect of which he is assessable under the Act during the previous year exceeded the maximum amount which is not chargeable to income-tax shall furnish a return of his income in the prescribed form. Section 139(2) provides that in the case of any person who, in the Income Tax Officer's opinion is assessable under the Act whether on his total income or on the total income of any other person during the previous year, the Income-Tax Officer may, before the end of the relevant assessment year, issue a notice upon him requiring him to furnish within 30 days from the date of serving of the notice, or such date as may be extended by the Income Tax Officer on an application made by the assessee, a return of his income in the prescribed form. Section 271(1)(a) of the same Act lays down that failure to furnish the return shall attract levy of penalty.

3.4. The Audit paragraph relates to two individual assessees 'A' and 'B' under the charge of ITO, a Ward, Raigarh, CIT(II) M.P., Bhopal. The last assessment in respect of assessee 'A' for the assessment year

1971-72 on income of Rs. 51,750 (income from property Rs.3,000 and interest income of Rs. 48,75 on an investment of Rs. 5 lakhs with a firm) and in respect of assessee 'B' on interest income of Rs. 45,000 on investment of Rs. 5 lakhs were completed on 5th March, 1973. Thereafter, the assessees did not file income tax returns for the assessment years 1972-73 to 1977-78 nor was any notice given by the ITO under Section 139(2) of the Income-tax Act, 1969 till it was seen in the Audit during February, 1979.

3.5. The Ministry of Finance, in reply to a question by the Committee, have furnished the following information:

Assessee 'A'

"The returns of income for the assessment years 1972-73 to 1979-80 were not filed till 6th October, 1979 when a notice u/s 148 for the assessment years 1975-76 to 1977-78 were issued by the ITO. The notices u/s 148 for the assessment years 1972-73 to 1974-75 were issued on 18th December, 1979 after getting the GIT's approval u/s 151(2). Notices u/s 139(2) were issued for the assessment years 1978-79 and 1979-80. In response to these notices, the assessee filed returns for all the years on 22nd September, 1980. The return of income for the assessment year 1980-81 was also filed voluntarily on 22nd September, 1980".

Assessee 'B'

"The returns of income for the assessment years 1972-73 to 1979-80 were not filed till 6th October, 1979. Notices u/s 148 for the assessment years 1975-76 to 1978-79 were issued by the Income-tax Officer. For the assessment years 1972-73 to 1974-75, the notices u/s 148 were issued on 18th December, 1979 after getting the CIT's approval u/s 151(2). Notice u/s 139(2) for the assessment year 1979-80 was issued on 6th October, 1979. Returns for three years were filed on 22nd September, 1980. No return was filed for the assessment year 1980-81 as the income was below the taxable limit".

3.6. The Committee desired to know the reasons why the Income-tax Officer did not issue the notice to the assessees under section 139(2) of the Income Tax Act, 1961. The Ministry of Finance have stated: "The records and registers of the ITO do not indicate any reason as to why

the ITO did not issue notices u/s 139(2) . The only reason appears to be that it escaped the ITO's notice".

3.7. Indicating the latest position as to the particular demand raised and collected, the Ministry of Finance have informed the Committee that assessment, since completed have resulted in demand for Rs. 1,54,626 being raised against assessee 'A' as tax due for the assessment years 1972-73 to 1980-81 (of which Rs. 57,102 has been collected) and a demand of Rs. 7,660 being raised against the assessee 'B' as tax due for the assessment years 1972-73 to 1979-80.

3.8. In reply to another question, the Ministry have stated that there was no other case in the concerned Income Tax Officer's Ward where normal notices calling for returns had not been issued.

3.9. The Committee note that although it was clear from the incomes and investments revealed in the two completed assessment of the assessees 'A' and 'B' that they would have taxable incomes in subsequent years also, the Income Tax Officer did not issue any notice calling for the returns of income even on the assessee's failure to file their returns. It was only during Audit in February 1979 that the failure of the ITO in not issuing the requisite notices under the Income Tax came to light. The Committee are at a loss to know as to how the failure occurred and how it escaped the notice of the income tax authorities for so long.

3.10. Apparently the internal control, as well as the internal audit systems of the department are not working effectively. The Committee would recommend that the responsibility for toning up and enforcing these systems should be placed squarely on the supervisory officers of the level of Inspecting Assistant Commissioners and Commissioners of Income-Tax. These officers, during their periodical inspections, must ensure not only that the prescribed control records are properly maintained in the assessment wards, but also see that such records are made use of to obtain the desired results. In particular, the Committee recommend that it should be part of the duty of Inspecting Assistant Commissioners to see during heir inspections that there are no glaring cases of this type where the assessees have suddenly stopped filing their returns and the Income-Tax Officer has nevertheless failed to call for the returns.

CHAPTER IV

INCORRECT VALUATION OF SHARES IN COMPANIES— QUOTED AND UNQUOTED

Audit Para

4.1. (ii) In paragraph 72 of the Audit Report, 1977-78, certain defects in Rule 1-D of the Wealth-tax Rules, 1957 for valuation of unquoted equity shares in companies *vis-a-vis* the requirements of section 7 of the wealth tax Act, 1957 and certain other rules were pointed out. It was also pointed out that no rule had been prescribed for valuation of unquoted equity shares in investment companies and that the instructions of the Board for valuation of such shares issued in October, 1967 were also defective. Action to remedy the defects, where necessary, has not so far been taken by the Board (March 1980). In the meantime, under-assessments due to undervaluation of such shares resulting from the application of the defective rules and instructions continue. Some of the important cases of undercharge of tax noticed in test check by Audit are given below:—

4.2. (a) An individual assessee held 89,997 unquoted equity shares out of a total of 90,000 shares in an investment company on the valuation dates relevant to the assessment years 1973-74 to 1975-76. The department determined the value of those shares by adopting the book value of assets including the written down value of a house property owned by the company and computed the value of each share at Rs. 3.21 for 1973-74 and Rs. 3.22 for 1974-75 and 1975-76. The market value of the house property held by the company was, however, ascertainable on yield method by taking 16 years' purchase of its net maintainable rents and this market value would be much higher than the book value/written down value of the property as shown in the balance-sheets of the company. The value of share on this basis alone would work out to Rs. 10.13 instead of Rs. 3.21 or Rs. 3.22 per share as adopted by the department. The market value of shares would be higher if the other assets of company were also valued at their market value. The incorrect determination of the value of shares led to under-assessment of wealth aggregating Rs. 18,66,537 with consequent tax under-charge aggregating Rs. 48,868 for the three assessment years, computed with reference to the value of Rs. 10.13 per share.

Further, the value of house property owned by the company was determinable at Rs. 8,26,080 on yield method and since the property was situated in an urban area the assessee was also liable to be charged with additional wealth-tax on the proportionate value of the shares which was relatable to the value of the property. But the deparment did not levy any such tax. This resulted in non-levy of additional wealth-tax aggregating Rs. 44,742 for the three assessment years 1973-74 to 1975-76. Additional Wealth-tax leviable for the assessment years 1971-72 and 1972-73 was also not levied.

4.3. The audit paragraph was sent to the Ministry of Finance in September, 1979, their final reply is awaited (March, 1980).

[Paragraph 65(ii) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts Volume II—Direct Taxes.]

4.4. In the present case, the assessee (under CIT charge West Bengal-I, Calcutta) had 89,997 unquoted equity shares out of a total of 90,000 shares in an investment company (M/s. Ranken & Co. Pvt. Ltd., assessed in 'B' Ward, Company District II, Calcutta, on the valuation dates relevant to the assessment years 1973-74 to 1975-76. The Department determined the value of these shares by adopting the book value of assets including the written down value of a house property owned by the company and computed the value of each share at Rs. 3.21 for 1973-74 and Rs. 3.22 for 1974-75 and 1975-76. The market value of the house property held by the company was, however, ascertainable on yield method by taking 16 years' purchase of its net maintainable rents and this market value would be much higher than the book value/written down value of the property as shown in the balance sheets of the company. The value of share on this basis along would work out to Rs. 10.13 instead of Rs. 3.21 or Rs. 3.22 per share as adopted by the Department. The market value of the share would be higher if the other assets of the company were also valued at their market value. The incorrect determination of the value of shares led to under charge aggregating Rs. 18,66,537 with comsequent tax under charge aggregating Rs. 48,868 for the three assessment years, computed with reference to the value of Rs. 10.13 per share.

4.5. Further, the value of house property owned by the company would be determinable at Rs. 8,26,080 on yield method and since the property was situated in an urban area. The assessee was also liable to be charged with additional wealth-tax on the proportionate value of the shares which was relatable to the value of the property. However, the Department did not levy any such tax. This resulted in non-levy of additional wealth-tax

aggregating Rs. 44,742 in the three assessment years 1973-74 to 1975-76. Additional wealth-tax leviable for the assessment years 1971-72 and 1972-73 was also not levied.

4.6. Explaining non-levy of additional wealth-tax as pointed out by Audit, the Ministry of Finance stated:

> "The WTO has completed the assessment has gone through the balance sheet of the Limited Company.
>
> It has been reported by the C.I.T. that the value of shares of M/s. Ranken & Co. Pvt. Ltd. held by the assessees and as adopted in the Wealth-tax assessments was less than Rs. 3 lakhs. Moreover, the assessee did not have any immovable property. Therefore, the question of levy of additional Wealth-tax on urban assets did not arise."

4.7. The provisions in the Wealth-tax Act, 1957 for valuation of assets for levy of Wealth-tax are contained in Section 7. Sub-section (1) thereof provides that the value of any asset, except cash, is the price which, in the openion of the wealth-tax. Officer would fetch if sold in the open market on the valuation date. This principle of valuation, however, is subject to rules, any, made for the purpose of valuing any specific asset.

4.8. The principle of valuation incorporated in sub-section (2) of section 7 of the Act is what is popularly known as "global valuation". This method is applicable under the circumstances, namely, (a) where the accounts of the business carried on by the assessee are maintained regularly [Section 7(2)(a)]; and (b) where assessee is a non-resident company which does not have separate balance-sheet for the affairs of its business in India [Section 7(2)(b)].

4.9. Rules 1-B, 1-BB, 1-C, 1-D, 2, 2-H and 2-L of the Wealth-tax Rule have been framed to provide for the valuation under section 7(1) of the Wealth-tax Act. While Rules 2-A to 2-G provide for the valuation under section 7(2)(a) thereof.

4.10. In paragraph 72 of the Audit Report 1977-78, certain defects in Rule 1-D of the Wealth-tax Rules, 1957 for valuation of unquoted equity shares in companies *vis-a-vis* the requirement of Section 7 of the Wealth-tax Act, 1957 were pointed out. It was also pointed out that no rule had been prescribed for valuation of unquoted equity shares in investment companies and that the instructions of the Board for valuation of such share issued in October 1967 were also defective. The Central Board of Direct Taxes has not taken any action so far to remedy the

defects in the rules as pointed out by Audit. In the meantime, under assessment due to under valuation of such shares in companies consequent to the application of the defective rules and instructions continues. One of such under assessments relates to an assessee under the charge of CWD-West Bengal-I, Calcutta.

4.11. With reference to rule 1-D of the Wealth-tax Rules 1957, the Public Accounts Committee in paragraph 4.22 of their 226th Report (Fifth Lok Sabha) observed: "Companies which do not declare dividends presumably with a particular design and accumulate profits in the reserves also derive a tax advantage....." This tax advantage results from the allowance of discount from the break-up value of unquoted equity shares for non-declaration of dividends (by Private Limited Companies as their equity shares are unquoted) under the aforesaid rule 1-D, even when they have accumulated deserves.

4.12. The Ministry of Finance stated in the Action Taken note (February 1977) on this recommendation of the Public Accounts Committee, "The rules regarding valution of share are under-examination of the Committee appointed for the purpose. The report of the said Committee is expected after April, 1977."

4.13. In reply to a question, the Ministry of Finance informed the Committee that there was no wealth-tax rule for valuation of unquoted equity shares in investment companies and for valuation of such shares in companies other than investment companies, the provisions were contained in Rule 1-D of the Wealth-tax Rules.

4.14. The Committee desired to know why was it that the instructions issued by the Board in October 1967 provided that the break-up value of the unquoted equity shares in investment companies shall be calculated under rule 1-D. The Ministry of Finance stated that "circular dated 31st October 1967 lays down certain method of valuation for unquoted equity shares of the investment companies. It does not say that the valuation shall be made as per rule 1-D."

4.15. Explaining the position further, the Ministry of Finance stated: "Rule 1-D prescribes its own method for valuation of unquoted equity shares of non-investment companies. Similarly, Circular dated 31-10-76 lays down a method for valuation of unquoted equity share of investment companies. Broadly speaking, it may be said that they are based on what is generally called the "global Valuation" or "going concern".

4.16. The Ministry further added: "As stated above, both Rule 1-D and Circular dated 31-10-67 prescribed their own respective methods of valuation of unquoted equity shares. They have been evolved keeping in

view the relevant facts and circumstances. There is nothing to suggest that Rules made under section 7(1) or the instructions regarding the valuation of an asset for which rules have not been framed under section 7(1), should be of the same type as under section 7(2).

4.17. The Committee enquired about the reasons for not rectifying the defects in the instruction of October 1967 although it was pointed out by the Audit as early as 1975 that they were working to the detriment of revenue. The Ministry stated : ".....the Board had appointed a committee on the entire question of valuation of unquoted equity shares of companies. After the Committee's report was received, the same was discussed at length by the Board and as a result of the same, further follow-up action is being taken."

4.18. As regards the nature of the assets, a company may own assets which are (i) specific to its activities and which cannot be dispensed with, such as, Plant and Machinery particular to the manufacturing activities of a Company and plant/factory building; (ii) non-specific and easily realisable assets, such as, investments in other companies and in real property. Excess of the Market value of non-specific and realisable assets of a company over their book value is a 'secret reserve'.

4.19. Regarding treatment of such assets for purposes of valuation, the Committee posed the following questions to the Ministry of Finance;

> "(i) What are the reasons for giving the same treatment to these two types of assets of a company?
>
> (ii) Is it correct that the present rules and instructions do not take into account these secret reserves while computing break-up value of unquoted equity shares in companies? What is justification for ignoring these 'secret reserves' especially where such companies are family controlled?"

4.20. In reply, the Ministry stated that "rule 1-D of the Wealth-tax Rules and Circular of 1967 prescribe certain methods of valuation which were laid down keeping in view the relevant facts and circumstances."

4.21. In reply to another question, the Ministry informed the Committee that the broad principles laid down in the Jalan's case (86 ITR 621) for valuation of unquoted equity shares in companies were:

> "(1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.
>
> (2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company the value is determined by reference to the dividends if

any, reflecting the profiteering capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value. The dividend and earning method or yield method are not mutually exclusive; both should held in ascertaining the profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

(3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.

(4) Where the dividends yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set-back is temporary then it is perhaps possible to take the estimate of the value of the shares before set-back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

(5) Where the company is ripe for winding up then the break-up value method determines what would be realised by that process.

(6) Valuation by reference to the assets would be justified where the fluctuations of profits and uncertainty of the conditions at the date of the valuation prevented any reasonable estimation of prospective profits and dividends."

4.22. As to the requirements to be fulfilled for application of 'yield basis' of valuation of unquoted equity shares in companies, the Ministry stated: "The requirements to be fulfilled for application of 'yield basis' would depend on facts of a case. The essential requirements, however, is that the company should be a going concern, should make profits over a period of years and should be capable of making profits. Further, there should not be fluctuations of profits and uncertainty of conditions preventing any reasonable estimation of profit-earning capacity."

The Ministry further added: "For determining 'yield' under the 'yield' capitalisation method, certain adjustments to the book profits have normally to be made with a view to arriving at, to the extent possible, the real profits which could be maintained in the future. In this connection reference may be made to para No. 2 of Circular dated 31-10-1967."

4.23. The Ministry admitted that after Supreme Court decision in Jalan's case (86 ITR 621) and Kasumban Mahadevia's case the CBDT instructions of October 1967 did not hold ground.

4.24. The valuation of unquoted shares fall under section 7(1) of the Wealth-tax Act. The Committee enquired whether the Board had issued any new guidelines for the valuation of unquoted equity shares and if not the reasons therefor. The Ministry stated: "The Board are seized of the matter and issue of necessary instructions in supersession of the Circular dated 31-10-1967, pending finalisation of the rules on the subject, is under active consideration of the Board."

4.25. As regards to the book value of the assets of the company in the present case, the Ministry informed the Committee thus:

"The year-wise details of book value of assets is as under.

Assets as on 31-3-1973:	
(i) Fixed assets (including Building Book (value of which is Rs. 2,60,823/-)	2,88,357
(ii) Investment in debenture of East India Clinic	2,300
(iii) Loans, advances, cash and bank balance	1,31,522
Assets as on 31-3-1974:	
(i) Fixed assets (including Building Book value of which is Rs. Rs. 2,54,302)	2,79,083
(ii) Investment in debenture of East India Clinic	2,300
(iii) Loans, Advances, cash & bank balance	1,33,814
Assets as on 31-3-1975 :	
(i) Fixed assets (including Building Book value of which is Rs. 2,47,994)	2,70,248
(ii) Investment in debenture of East India Clinic	2,300
(iii) Loans, advances, cash and bank balance	1,30,330"

The Ministry further added: "The market value of the assets of the company have not been ascertained by the WTO because either under Rule 1-D or under Board's Instruction No. 2-WT dated 31-10-1967 regarding valuation of shares of Investment companies, the question of ascertaining the market value of assets of the company does not arise."

4.26. When asked whether the assessment has been rectified and if so with what results, the Ministry stated:

"Not rectification of the wealth tax assessments has been carried out.

In the assessment year 1973-74 the shares were taken at the returned value of Rs. 3.21 per share. In the assessment year 1974-75 they were originally returned at Rs. 3.22 per share but the value was revised by the assessee to Rs. 2.01 per share relying on Board's instruction No. 2 (WT) of 31-10-1967 which prescribes the procedure for valuing shares of investment companies for wealth tax purposes. The WTO, however, took the value at Rs. 3.22 per share. For assessment year 1975-76 also the assessee returned the shares at Rs. 2.01 per share relying on Board's Instruction, but the WTO adopted the rate of Rs. 3.22 per share. The assessee filed appeals against the order for the assessment years 1974-75 and 1975-76. The appeals were allowed by the AAC. The AAC's orders have been accepted by the assessee and the Department. As a result of the AAC's order, requiring adoption of the value of the shares under rule 1-D of the WT Rules, the value of the shares for assessment year 1974-75 and 1975-76 will be Rs. 3.11 and 3.01 respectively. Accordingly the value to be taken for the shares as per the AAC's orders will be less than those taken in the assessment orders. In this connection, it may be mentioned that as per Board's Instruction No. 2-WT of 1967 prescribing method for valuing shares of investment companies, the value of the shares for the 3 assessment years would be as under:

Assessment year	
1973-1974	Rs. 2.63 per shares
1974-1975	Rs. 2.61 per share
1975-1976	Rs. 2.55 per share

4.27. The Committee have noticed that there are two methods of valuation of the unquoted equity shares of companies, namely 'break-up value method' and 'yield method'. Under the 'break-up value method', the value of such shares is based on the value of net assets of the company. Under the 'yield method', the value of the shares is treated as equal to the principal amount which would have earned simple interest equal to the given yield on shares at the interest rates of gilt-edged securities. The principle of valuation of shares which has been adopted under Direct Taxes Acts is that the value of any asset, other than cash, shall be estimated to be the price, which in the opinion of the assessing Officer it would fetch if sold in the open market on the relevant date. So, the value computed under the two methods has to correspond to a hypothetical value on a hypothetical sale in a hypothetical market in accordance with the aforesaid principle which has been established through a number of decisions of the Supreme Court of India.

4.28. For valuation of unquoted equity shares in companies other than investment companies and managing agencys' companies, Rule 1-D of the

Wealth-tax Rules, 1957 framed by the Board under section 7(1) of the Wealth-tax Act 1957 applies. The Rule incorporates break-up value method only. Consequently, it has been provided in the rule that in making computation of the value all liabilities as shown in the balance-sheet of the company and the dividends pertaining to the preference share-holders shall be deducted from the value of all its assets shown therein; a discount of 15 per cent shall be allowed to arrive at the value of the net assets. The balance value of the net assets shall be distributed over the equity shares to arrive at their value. Again, if the company has not declared dividends for 3 to 6 years, the discount allowable shall be increased from 17½ per cent to 25 per cent.

4.29. Audit has repeatedly pointed out that where a company has undisclosed assets or where the book value of assets is much below their fair market value on the relevant date, valuation under the above provision of Rule 1D based on book value of assets only would not be in conformity with the principle of true market value contemplated in Section 7 of the Wealth-tax Act. This defect in the Rule has not been rectified so far.

4.30. Further with reference to the said Rule 1D the Public Accounts Committee in paragraph 4.22 of their 226th Report (Fifth Lok Sabha) (August 1976) observed, "companies which do not declare dividends presumably with a particular design and accumulate profits in their reserves also derive a tax advantage ". Wealth-tax is avoided because of the allowance of discount at increasing rates, under the aforesaid Rule 1D, in the break-up method for valuing the unquoted equity shares on the grounds of non-declaration of dividends for specific number of years while, in fact, the profits are getting accumulated (without being distributed) with such private limited companies.

4.31. The subject matter of valuation of unquoted equity shares in investment companies and other companies was also commented upon in paragraph 72 of the Audit Report 1977-78. In that regard, the Ministry of Finance have stated in March, 1981 that rule 1-D of the Wealth-tax Rules and Board's circular of October 1967 were discussed by a Committee set up by the Board on valuation of unquoted equity shares of companies. The said report had been discussed by the Board and follow-up action by way of framing suitable rules was likely to be completed soon. Again, the Board have stated that they "are seized of the matter and issue of necessary instruction in supersession of the circular dated 31st October, 1967 and finalisation of the rules on the subject is under active consideration of the Board." . .

4.32. The Committee regret to note that even after the Supreme Court of India judgement in Jalan's case (86 ITR 621), delivered in 1972, the Ministry of Finance had not taken steps to amend the rule or to issue fresh instructions. The avoidable delay of more than 7 years has, in the meantime, been causing under-assessment of Wealth-tax. The Committee recommend that the Government should rectify the position without further loss of time. As pointed out by Audit in the instant case due to absence of any rule or its clarification the exchequer had lost Rs. 48,868 by way of Wealth-tax.

CHAPTER-V

INCORRECT COMPUTATION OF NET WEALTH AND ESTATE ESCAPING ASSESSMENT

AUDIT PARAS

5.1. As mentioned in paragraphs 5.2 and 5.3 of the Public Accounts Committee's 186th Report (1975-76), the Committee have almost year after year commented upon the continuation of a very common mistake involving the dropping of one lakh of rupees or the wrong transcription of a digit from a substantial amount resulting in under-assessment of tax in tax big income cases. Similar mistakes still continue to occur. Instances of such errors were reported in paragraphs 34(vi) and 95 of the Audit Report, 1975-76 and paragraph 61.6 of the Audit Report, 1977-78. Another costly mistake is given below:—

5.2. An individual held shares in different companies valued at Rs. 11, 67,954 on the valuation date relevant to the assessment year 1967-68. While computing the aggregate value of such shares the department erroneously arrived at a figure of Rs. 12,17,954 (by overstating the total by Rs. 50,000). The figure of Rs. 12,17,954 so wrongly computed was, however, taken into the assessment, completed in March, 1978, only as Rs. 1,21,794. Thus, the dropping of a digit led to under-assessment of wealth of Rs. 10,46,160 (Rs. 11,67,954 minus Rs. 1,21,794) and short levy of tax of Rs. 23, 725 for the assessment year 1967-68.

5.3. The Ministry of Finance have accepted the audit objection.

[Paragraph 68(iii) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts, Volume II Direct Taxes].

5.4. In the estate duty assessment, completed in August 1977, in respect of a deceased person (died in May 1968), the assessing officer, while aggregating the values of all properties to determine the net principal value of the estate, omitted to include a sum of Rs. 1,51,395 being the value of five movable properties. This omission resulted in under-assessment of the estate by Rs. 1,51,395 with consequent undercharge of duty of Rs. 45,418.

5.5 The Ministry of Finance accepted the audit objection.

[Paragraph 83(iii) of the Report of the Comptroller and Auditor General of India for the year 1978-79, Union Government (Civil) Revenue Receipts, Volume II Direct Taxes].

5.6. Audit Para 68 (iii) relates to an individual assessee under CIT's Charge, W.T. (WB) Calcutta-II, Calcutta. There was incorrect computation of net wealth due to two errors committed by Income-Tax Officer one in totalling aggregated value of shares held by the assessee in different companies and the second was arithmetical mistotalling. The total arrived at was Rs. 12,17,954 instead of Rs. 11,67,954. Wrong total was carried over into further calculation as Rs. 1,21,794 through lack of care (that is out of six digits in sequence, one digit was dropped for want of care). Consequently there was an under assessment of wealth by Rs. 10,46,160 (Rs. 11,67,954 minus Rs. 1,21,794) and short levy of wealth-tax Rs. 23,725 for the assessment year 1967-68. The assessment was completed in 1978.

5.7. The objection raised by the Audit has been accepted by the Ministry of Finance and the assessment in question has been set aside in appeal by the CIT (Appeal) and fresh assessment has been ordered. The Ministry have further stated that though the case was required to be checked by Internal Audit Party but it was not checked and the reasons for the failure were being ascertained.

5.8. While pointing out that year after year instances have been continuously reported by the Audit and also pointed out by the Public Accounts Committee of the wrong transcription of digits, mistakes of calculations, wrong application of rates, etc. the Committee desired to know what action had been taken by the CBDT from time to time for ensuring proper arithmetical and clerical check of the assessments. The Ministry, in reply, stated that instructions for exercising checks on such mistakes have been issued periodically e.g. instructions issued on 24th October 1969, 23rd October 1970, 25th August 1973 and 10th January, 1974.

5.9. Referring to several cases of such errors as pointed in test audit, for example, paragraph 34 (vi) and 95 (i) (a) (b) of the Audit Report 1975-76, 19 (i), (ii), (iii) and 61.6 of the Audit Report 1977-78 and 77 and 87 (ii) of the Audit Report 1978-79, the Committee enquired whether these instances were indicative of the weakness of Internal Audit and administrative inspections. The Ministry stated that the number of Internal Audit Parties (including Special Audit Parties) is not adequate to check all cases of assessments which were required to be checked. Question of augmenting the strength of the Internal Audit Parties was engaging the attention of the Board. The Miinstry also informed the Committee that all IACs under the CIT West Bengal-X, where this mistake occured, and all Commissioners in the West Bengal Charge, Calcutta have been directed to undertake review to see whether there are similar mistakes in case of net wealth of Rs. 10 lakhs or more during the financial years 1977-78 to 1980-81. The result of the review is awaited, the Ministry added. .. ....

5.10. Audit paragraph 83 (iii) relates to an assessee under CIT's charge, Controller of Estate Duty, Calcutta. In this case certain properties of the deceased for the purposes of estate duty were omitted. In this case, the estate duty assessment was completed in August 1977 in respect of a deceased person who died in May 1968. While aggregating the value of all the properties of the deceased to determine the net principal value of the estate, a sum of Rs. 1,51,395 being the value of five movable properties was omitted though the account filed by the accountable person showed these movable properties. This resulted in under assessment of the estate by Rs. 1,51,395 with consequent undercharge of duty of Rs. 45,418.

5.11. When asked as to how the assessing officer missed the same, the Ministry of Finance stated: "The figures were taken in the inner column of the assessment order but were not taken in the total value of the estate".

5.12. In reply to another question whether this transcription of figures from the accounts filed to the assessment order could not be checked as part of arithmetical check of assessments, the Ministry stated: "Transcription of figures from the return filed to the assessment order should have been checked as part of arithmetical check of assessment. Similar procedure has been laid down by the Board in Instruction No. 598 dated 25.8.1973".

5.13. The Ministry admitted that the mistake occured in this case due to omission to exercise the prescribed arithmetical check of assessments.

5.14. When asked as to how does the continuance of such errors reflect on the adequacy or otherwise of arithmetical check, Internal Audit and administrative inspections, the Ministry stated: "The Ministry is alive to the possibilities of arithmetical errors crepting in at the stage of computation of total income and thereafter computation of tax and the need for adequate safeguards to eliminate such mistakes as far as possible. With this end in view a number of instructions have been issued by the C.B.D.T. and DI. (IT & Audit) some of which are noted below :—

(i) Instruction No. 119 dated 24.10.69

(ii) Instruction No. 233 dated 23.10.70

(iii) Instruction No. 598 dated 25.8.73.

(iv) Instruction No. 646 dated 10.1.74

(v) Board's circular F. No. 36/40-67-IT (Audit) dated 13.12.68.

(vi) DI (IT&A)'s Circular F. No. Audit/73-74/DIT dated 11.3.74.

(vii) DI (IT&A)'s Circular No. 103 dated 5.6.80.

** ** ** **

5.15. In particular, in para 3 of the Board's Instruction No. 598 dated 25.8.73 the assessing officers have been directed to record a very concise reconciliation memo as an office note below the assessment order reconciling the returned income and the assessed income. This applies to the assessment orders under other direct taxes also. As regards post-assessment check after the completion of the assessments, these are taken up for audit by the Special Audit Party/Internal Audit Party under a scheme of priorities which in so far they relate to the Estate Duty assessments is as under:—

5.16. As per the Circular of the Directorate Audit—9/76/DIT dated 6th September, 1976 special Audit Parties have to check estate duty cases where the principal value of the estate is Rs. 1 lakh or more.

5.17. The Board's instructions contained in Circular No. DI(IT&A)'s F. No. Audit/73-74/DIT dated 11.3.74 and sub para (xvii) of para 21 of Chapter XII of the office Manual Volume II Section II) reads as under:—

"The Income-tax Officer/WTO/GTO/AGED is responsible for accuracy in computation of total income/loss, net wealth, taxable gift and principal value of the state and calculation of relevant tax. He will personally re-check the calculation tax/refund in all cases of total income over Rs. 1 lakh and refund over Rs. 10,000. For other direct taxes, calculation in the undermentioned category of cases must also be rechecked by the Income-tax Officer himself:—

(i) where the net wealth is Rs. 10 lakhs or more

(ii) where the taxable gift is Rs. 1 lakh or more

(iii) where the principal value of an estate is Rs. 2 lakhs or more

(iv) where a refund exceeds Rs. 5,000."

"The Income-tax Officer must give at the foot of the office copy of the assessment order, a concise note reconciling the returned and the income/wealth etc. assessed."

"The staff must first make an arithmetical check of the computation of income, wealth etc. determined by the Income-tax Officer. They should ensure that they charge tax on the correct total income as determined by the I.T.O. calculation of tax/refund made by an Upper Division Clerk must be checked by another Upper Division Clerk and signed in full on the reverse of the assessment form in token of their having satisfied themselves about the accuracy of the same".

"For income-tax cases with income above Rs. 20,000 refund of over Rs. 1,000 wealth-tax cases with net wealth of over Rs. 3 lakhs, gift-tax cases with taxable gift of over Rs. 30,000 and all estate duty cases, the Head Clerk or Supervisor will check the calculation and affix full signature on the form ITNS 150/150 A etc. Before signing the notice of demand/refund order Income-tax Officer must make sure that this has been done.

The working sheet of calculations must in all cases be placed in the miscellaneous record duly signed by the Income-tax Officer and/or the staff concerned."

5.18. The Committee desired to know as to how and at what stage it is seen in administrative inspections that the prescribed internal checks on the arithmetical accuracy were being exercised and that they were adequate. The Ministry of Finance, in reply, stated: "The Administrative Inspection of the ITOs is carried out by the IACs. IACs are the administrative heads of the Ranges and are expected to ensure the smooth functioning of the ITOs within the Ranges and to guide them in the matter of assessments and recovery. The IAC has to inspect 8 assessments completed by each ITO during his inspection. The inspection report of the IAC deals with all aspects of work carried out by the Income-tax Officer such as the number of assessments made under Income-tax and other direct taxes, demand and collection, achievement of Action Plan targets work relating to advance tax, summary assessments penalties, survey, settlement of audit objections, budget collection, watch over issue of recovery certificates and so on. In regard to the eight individual cases to be inspected by the IAC the objective of the inspection is to evaluate the quality of assessment work of the Income-tax Officer and to guide the Income-tax Officer to improve upon the quality of assessments. In such inspection of individual cases, if instances of arithmetical inaccuracies are noted the IAC would naturally comment upon them and get them rectified".

5.19. The Committee desired to know in how many cases a review has been ordered in recent past by the IACSs/Commissioners in ward which is prove to such errors of calculation transcription, application of incorrect rates, the Ministry in reply, stated: "Errors of calculation, transcription, application of incorrect rates etc. are due to human failure and much depends upon the care and attention devoted by the individual assessing officer. In the circumstances it cannot be said that any particular Income-tax ward is prone to such errors. However, a special audit of all completed assessments of Estate duty in which the net principal value assessed was Rs. 2 lakhs or more during the financial years 1979-80 and 1980-81 has been ordered by the Controller of Estate Duty, Calcutta so that mistakes if any are detected and corrected in time".

5.20. In reply to another question, the Ministry, while admitting that it was a case of non-compliance by the Assistant Controller of Estate Duty with Board's instructions, enumerated the following steps taken to strengthen the Internal Audit:—

(i) Supervisors heading the Internal Audit Parties were replaced by Inspectors who are better qualified for this technical work.

(ii) The Recommendation of the Public Accounts Committee that the level of the personnel working in the Internal Audit set-up should be comparatively high, was accepted in principle. Accordingly, 40 Special Audit Parties were created in 1976. Each Special Audit Party consists of an Income-tax Officer Class-I (Senior Scale), two Inspectors and one Tax Assistant/ U.D.C. These Special Audit Parties are checking cases involving higher revenue, namely company assessments, assessments in Central Circles, Estate Duty assessments, where the principal value of the estate is over Rs. 1 lakh and other important cases.

(iii) Posts of Income-tax Officer (Internal Audit) were created to head the Ordinary Internal Audit Parties. After the creation of the posts of Tax Assistants, instructions have been issued that U.D.Cs working in the Internal Audit Parties should be replaced by Tax Assistants.

(iv) In order to improve the efficiency of the personnel manning the Internal Audit set-up, instructions were issued by the D.B.D.T. that the Inspectors working therein should have qualified in the Income-tax Officers' examination and UDCs and Tax Assistants working in the Internal Audit Parties should have qualified in the Inspectors' Examination.

(v) Greater attention is being paid to improve the technical competence of the personnel manning the Internal Audit set-up. The I.R.S. (DT) Training College at Nagpur, along with the Regional Training Institute at Bombay, Calcutta, Bangalore and Kanpur, mount special training courses for the personal working in the Audit set-up with particular emphasis on audit of company assessments".

5.21. As regards the streamlining the administrative inspections by the range IACs, the Ministry informed the Committee that "the matter was discussed in the Commissioner's Conference in May 1976 and it was decided that each territorial IAC should conduct six inspections in a year. Similarily each IAC in a Central Range and a Company Range has to do

4 inspections in a year. The inspection report of IAC should cover comments on assessments in 8 cases, 4 of ITO's choice and 4 of IAC's selection. Each IAC has to prepare his annual plan of inspection in early April for approval by the Commissioner of Income-Tax. The IAC is expected to plan his annual inspection work in such a manner that all the inspections are completed before the end of December. In selecting Circles for inspection, the IACs have been instructed to give preference to those circles that have remained uninspected for a long time and proceed in the same order until a complete round of all the Circles in a Range is made. The lay-out of the inspection report was revised in 1980 so as to enable the IACs to give a more meaningful appraisal of the ITO's performance and make inspections more effective.

5.22. The Director of Inspection (ITAA) supervises and reviews the work of the internal audit. He inspects the work of IAC (Audit), Internal Audit Parties and Special Audit Parties by visiting the charges of Commissioners to ensure that prescribed procedures are followed and adequate measures are taken for expeditious checking of high revenue cases. Further he makes monthly and quarterly review of the performance of the IAP/SAP, settlement of Audit objections etc. He also makes an annual review of the working of the Audit set-up as a whole for the information of the Board. As regards administrative inspections, DI(IT&A) lays down general policy for inspection by IACs, prescribes inspection programmes of IACs and examines and reviews inspection reports sent by the IACs".

5.23. When enquired about the result of action taken to rectify the assessment as a result of Audit objection, the Ministry stated: "It has been reported by the Controlled of Estate Duty that the assessment in question was rectified u/s 61 of the Estate Duty Act raising additional demand of Rs. 39,90/-out of which Rs. 27,314/-has been collected on 29-12-1979".

5.24. Under-assessment of taxes of substantial amounts have been noticed year after year, on account of mistakes due to carelessness or negligence, which could have been avoided had the Assessing Officers and their staff been a little more vigilant. Such cases of under-assessment have been the subject matter of several recommendations of the Public Accounts Committee in the past. The Committee in paragraph 5.2 of their 186th Report (Fifth Lok Sabha) had observed that the commonest mistake that has been adversely commented upon by the Committee, almost year after year, is the dropping of digits, generally one lakh of rupees either from the assessed total income or from the amount of tax payable.

5.25. Again, the Committee had observed that a mistake, commonly committed, was the wrong transcription of digit or the dropping of a digit, from a substantial amount, resulting in under-assessment of income-tax (paragraph 5.3 of the same Report). The Committee in an earlier report (51st Report, Fifth Lok Sabha), had reviewed the trend of mistakes

in computing income and tax and made specific recommendations on the four main contributory factors, namely, rush of work towards the end of the year, continued inefficiency of Internal Audit, lapses of check on computation income and the lack of counter-check on such computations.

5.26. It is evident from the executive instructions (vide para 9.12 ante) that the assessing officers and their subordinate staff are required to carry out Internal Checks on the computation of income, value of assets and on the amount of tax resulting therefrom, as part of their regular duties and responsibilities.

5.27. Apparently the instructions issued by the Central Board of Direct Taxes are not being strictly followed by field offices of the Department. Otherwise the important instructions issued by the Board from time to time for ensuring arithmetical and transcription accuracy in the work done in various Wards, would have been enforced by the range Inspecting Assistant Commissioners during their administrative inspection and by the Internal Audit and the failures of the type noticed in Revenue Audit would not occur so frequently.

5.28. The weaknesses of administrative inspection have been the subject matter of comment by the Public Accounts Committee in paragraph 5.10 of their 186th Report (Fifth Lok Sabha) wherein they observed:

> "Another factor that came to the notice of the Committee was the weakness of inspections by the Inspecting Assistant Commissioners of Income-tax. In paragraph 1.65 of their 3rd Report (Fourth Lok Sabha) the Committee desired that instructions should be issued to the Commissioners to chalk-out a programme of inspection of all the circles at regular intervals. In reply (vide page 57 of the 80th Report) (Fourth Lok Sabha), the Ministry stated that necessary instructions have been issued in December 1968 for programme of inspection by Inspecting Assistant Commissioners to be drawn up in such a manner so that every circle was inspected at least once in three years".

5.29. The Committee, however, note that the layout of the inspection report of IAC was revised only recently in 1980 to enable the IAC to give a more meaningful appraisal of the ITO's performance and make inspections more effective.

5.30. The Committee note that though the case was required to be checked by the Internal Audit Party but had not been checked and the Ministry is ascertaining the reasons for this failure on the part of Internal Audit Party. The Committee would like to be apprised of the reasons so ascertained.

5.31. The Committee cannot but observe that such simple but costly mistakes continue to persist not merely because of the initial human failure, but more so because of the lack of supervision and failure of the systems of internal control and internal audit. The Board of Direct Taxes seems to be content with issuing repeated instructions on the subject and informing the Committee of their having done so. The results, however, clearly indicate that neither superior supervision, nor internal audit, have actually been brought upto the desired level so far. The Committee would recommend that these continuing problems should be discussed by the Board, or its Members, in periodical review meetings with the Commissioners of Income-tax, and other field officers so as to get a proper feed-back as to why the instructions issued by the Board are not having the desired effect and then to devise effective corrective measures based on such feed-back. The Committee would also recommend that in the field also the Commissioners of Income Tax and the Inspecting Assistant Commissioners should hold similar periodical review meetings to understand such basic problems in their proper perspective, which alone can make for meaningful solutions.

5.32. The internal audit organization continues to be weak despite the various steps taken in pursuance of the earlier recommendations of the Committee. Cases of this type involving substantial revenue continue to be reported by Revenue Audit where either the internal audit did not check up the case at all, or it failed to point out the particular mistake. It is necessary that the Director of Inspection (IT & A), who is entrusted with the responsibility of supervising and reviewing the working of internal audit, discharges this responsibility in a manner to build up the internal audit organization to a level of efficiency where at least the bigger cases are all checked in internal audit and checked properly.

NEW DELHI;
April 26, 1981
Vaisakha 6, 1903 (*S*)

CHANDRAJIT YADAV,
Chairman,
Public Accounts Committee.

APPENDICES

APPENDIX I

Copies of the reference made by Foreign Tax Division CBDT to the Ministry of Law in File No. 473/140/76-FTD (Foreign Tax Division C.B.T.D. (Vide *Paragraph* 1.50)

* * * *

We have two cases in which assessees have sought approval of their agreements for purposes of section 80-0 whereby they are receiving certain royalties for sale of their copyrights. In one case, approval has been sought for purposes of section 80-0 in respect of an agreement made by Messrs. Gramophone Company of India Limited, Calcutta use with Messrs EMI Records Limited, U.K. which provides for use of matrices by the Indian company and payment of certain royalties calculated in respect of the sales so made. A matrix for a record is like a mother record from which more records can be taken out. Thus, the use of a matrix would mean that the English company can take out more records from that matrix and thereby effect sales of records so made. Royalties would be paid calculated on the basis of the sales.

2. In the second case, the Indian company have transferred the sole and exclusive right to the publication of the book containing specialised photographs and the articles published in 'The Statesman Limited' in respect of Mother Teresa. These were acquired by the applicant company from The Statesman Limited, which is a 100 per cent subsidiary. It has been stated that the copyright of the work would, however, remain with the Indian company and would be so acknowledged on each copy of the publication.

3. The question for consideration is whether any royalty received by sale of such copyrights can be said to be covered by the words 'Similar property right' appearing in section 80-0. This section provides, *inter alia*, for the deduction in respect of royalty, etc. received in consideration for the use outside India of any "patent, invention, model, design, secret formula or process or a similar property right". The word 'similar' would, therefore, imply that the property right should be of the same genre as a patent, invention, model, design, secret formula or process. It would appear that a copyright would not fall in any of these categories.

4. As the matter is not free from doubt, we would be grateful for the advice of the Ministry of Law whether such cases would qualify for purposes of section 80—0, if the other conditions are fulfilled. In the first case of Messrs. Gramophone Company of India Limited, opinion of Dr. H.

Saharay, Advocate of Calcutta submitted by the Company, may kindly be seen at pages 77-79/c.

Sd./- (V. P. MITTAL)
Dy. Secy. to the Govt. of India

Ministry of Law (Shri M. B. Rao, Joint Secretary and L.A.) Central Board of Direct Taxes (FTD) U.O.F. 473/140/76-FTD, dated 26th February, 1977.

Ministry of Law, Justice and Company Affairs
(Department of Legal Affairs)
Advice (B) Section

Section 80-0 of the Income Tax Act, 1961 provides *inter alia*, for a deduction of the whole of the income received in respect of royalty, commission, fees etc., from a foreign enterprise in consideration for the use of outside India of any patent, invention, model, design, secret, formula or process or *similar property right*, or information concerning industrial, commercial or scientific knowledge, experience or skill under an agreement approved by the Board in this behalf.

2. The question for consideration is whether the expression "similar property right" would include a copyright. This leads us to the questions whether copyright is a property right and secondly whether it is similar to the other property rights mentioned in the section.

3. A question some what similar to the question whether copyright is a property right arose in the case of *Weatherby & Sons* v. *International Horse Agency And Exchange* (1910)2 ch. 297. In that case Parker, J(at p. 305) has said that, "Copyright is a right of property and a person is entitled to come to the Court for the protection of that property". It has been followed in *Hawkes and Son (London) Ltd.* v. *Paramount Film Service Ltd.*, (1934 ch. 593), See also *Jefferys* v. *Boosey* (1854) 4 H.L.C. 815 and para 3 of Copinger on Copyright. It can, therefore, be concluded that copyright is a property right.

4. The next question is whether this right is similar to the right to patent, invention, model, design, etc. A Perusal of section 80-0 would indicate that it generally includes incorporeal rights. A copyright is also an incorporeal right. Therefore, on applying the principle *ejusdem generis* it can be said that a copyright would be covered by the expression "similar property right." In the light of the view expressed above the Department may take appropriate decision in the cases.

. Sd/- Dr. V. K. AGARWAL)
Asstt. Legal Adviser
12-5-1977
Tele: 389006

CBDT

Mnstry of Law, Justice & C.A., U.O. No. 21194/77/Adv.(B) Sec. dated: 17.5-77.

* * * * *

Section 80-0 applies to patent, inventions, model, design secret formula or processes etc. or other *similar property rights*. Are not the various specific items enumerated, indicative of rights to industrial patents or industrial secret processes? Would we accordingly be justified in holding that the various specified property rights are merely indicative of all incorporeal rights and copyright being an incorporeal right should also qualify for the benefit of section 80-0?

The Law Ministry may like to re-consider their advice.

Sd/- (J. C. Kalra)
Joint Secretary.
20-5-1977

Ministry of Law (Shri M. B. Rao, Joint Secretary) Y

CBDT, u.o. F. No. 473/140/76-FTD dated 21-5-1977

Ministry of Law, Justice and Company Affairs
(Department of Legal Affairs)
Advice (B) Section

Reference preceding note.

2. The perusal of section 80-0 of the Income-tax Act, 1961 would indicate that the sources of income such as by way of royalty, commission, fee etc., are very wide. They include patent, invention, model, design, secret formula or commercial and scientific knowledge, experience or skill made available to a foreign enterprise. These items indicate that the intention of the section was that it should not be restricted to only incorporeal industrial rights but to include all other sources as indicated in the section. There is nothing in the section to restrict its operation to incorporeal industrial rights. We, therefore, feel that the view expressed by us earlier at page 4/ante needs no change.

Sd/- (Dr. V. K. AGARWAL)
Asstt. Legal Adviser
2-6-1977

C.B.D.T.

Ministry of Law, Justice & C.A., (Deptt. of Legal Affairs), U.O. No. 22879/77/Advice (B) dated: 3-6-1977.

APPENDIX II

Statement of conclusions/Recommendations

S No.	Para No.	Ministry/Deptt.	Conclusions/Recommendations
1	2	3	4
1.	1.11	Ministry of Finance (Department of Revenue)	The Committee find that the assessee Company *viz.* Gramophone Company of India Ltd. Calcutta engaged in the business of manufacturing of gramophone records entered into agreements with three companies based in UK for the supply of matrices to enable the foreign Companies to manufacture records from the matrices for sale outside India. The entire income of Rs. 15.24 lakhs derived by the company during the previous years relevant to the assessment years 1969-70 to 1974-75 was allowed as a deduction under Section 80-0 treating it as income from technical know-how. The deductions were considered inadmissible by audit as the assessee Company did not satisfy the following conditions of Section 80-0: (i) There was no evidence that the income had been brought into India by the assessee in convertible foreign exchange.

(ii) The agreements were not approved by the Government or the Central Board of Direct Taxes for the purpose of availing of this relief; and

(iii) The assessee did not export any technical know-how or skill.

2. 1.112 Do.

So far as the first condition is concerned, the Ministry stated in the first instance that "the point does not appear to have been examined by the assessing officers, after the law was amended retrospectively by the Finance Act, 1974." At a later stage, the Committee were however informed that the royalities receivable by the assessee Company for the period July 1969 to June 1974 were adjusted against the royalities payable by them to the foreign companies and the Reserve Bank of India allowed them to remit the balance of Rs. 5,193 relating to the aforesaid period. Thus, according to the Ministry, the assessee company would be said to have received the amounts in convertible foreign exchange for the said period.

3. 1.113 Do.

The Committee observe that the Central Board of Direct Taxes had regarding the system devised by Government to ensure that such money had not been brought into India in convertible foreign exchange, immediate action be taken to withdraw the relief (from the assessment year 1968-69 onwards). The Ministry's reply shows that no such review was carried out. In fact, necessary verification was made from the Reserve Bank of India after the matter was taken up by this Committee. This indicates not only the failure on the part of the assessing and supervising officers to follow the instructions of the Board but also the absence of

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			an effective mechanism under which information on such importance matters could be concurrently collected. This is further evidenced from the fact that the Board have not been able to enlighten the Committee regarding the system devised by Government to ensure that such money is actually brought into the country in foreign exchange. The Board do not also appear to have devised any machinery to collect and collate data in respect of dues receivable and payable by way of royalty etc. for purposes of section 80-0 of the Income-tax Act. The Committee are of the view that in order to ensure that there is no abuse of the concession given under the Income Tax Act, the Board should maintain close coordination with the Reserve Bank of India and the Department of Economic Affairs and devise a system for maintenance of the requisite data so as to facilitate proper monitoring of the scheme.
4.	1.114	Ministry of Finance (Department of Revenue)	As for the second condition, the Committee observe that the agreement was approved initially by the Ministry of Industry in 1964. It has since been stated by the Ministry of Finance that the audit objection is acceptable as the above approval was not for purposes of Section 80-0. The Act specifically provides that the agreement with the foreign Company should be approved by the Central Government in this behalf i.e. for the specific purpose of allowing the concession in tax. In fact, the instructions issued by the Board had made it abundantly clear that approval granted by the administrative Ministries will not satisfy the legal require-

ment. The Committee consider it very unfortunate that the assessing officers completely overlooked the explicit provisions of the Act and the instructions issued in pursuance thereof. It is regrettable that this important condition escaped the notice of Internal Audit as well.

5. 1.115 Do.

The Committee find that the case was not scrutinised by the IAC also. The contention of the Ministry that scrutiny by the IACs is done on a random basis is in conflict with the instructions of the Board that the deductions to be claimed under section 80-O should be quantified by the ITO with the approval of the IAC.

It would thus appear that there has been failure at all levels in this case. The Committee therefore, desire that the lapses should be brought to the notice of all concerned, for remedial action. The Committee also recommend that a thorough review of all such agreement should be carried out by the CBDT under a time bound programme and the results communicated to the Committee.

6. 1.116 Do.

Coming to the third condition, the Committee find that the Ministry have taken shelter under the advice of the Ministry of Law that since the company had a copyright in the matrix, and the words 'similar property right' appearing in Section 80-O would cover copyright also, the assessee would be entitled to the benefits under this Section. The crucial question is whether such right is similar to the right to patent, invention, model, design etc. mentioned in the Section. All these involve transfer of technical know-how, since they convey to the other party information and knowledge as to how to make a thing. Copyright relating to a matrix does not obviously involve any transfer of technical know-how. In fact,

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			reverse is the case as the know-how for producing matrices has been obtained by the Indian Company from the foreign companies. The Finance Secretary stated in evidence that the wording of the Section as it stands would seem to cover even a case of the kind dealt with in the Audit paragraph. He, however, conceded "from the speech of the Finance Minister, it is clear to me that at the relevant point of time the intention was that the concession should be given only in cases of transfer of technical know-how and the like. It perhaps was not intended to cover copyright."
7.	1.117	Ministry of Finance (Department of Revenue)	The Committee recommend that the desirability of amending the Income-tax Act may be considered, if necessary, after obtaining the views of the Attorney General, on whether the Act as it stands at present really does not bring out the intention of the Government fully.
8.	1.118	Do.	As pointed out in the Audit paragraph, short levy of tax consequent upon incorrect deduction allowed to the assessee company amounted to Rs. 8.65 lakhs as per details given in paragraph 1.61. On receipt of Audit objection, notices under Section 154 with a (view to rectifying any mistake apparent from record) were issued for the assessment years 1971-72 to 1974-75. Action under Section 147(b) was also taken for the assessment years 1972-73 to 1974-75 for which such action was still within time.
9.	1.119	Do.	The Committee find that while orders have been passed fully withdrawing the benefit given under section 80-O for assessment years 1971-72

		and 1974-75, the ITO has been asked to explain the reasons for not taking similar action for the intervening two years *viz.*, 1972-73 and 1973-74. The Committee would like to be informed of the circumstances in which such lapse occurred and what action has been taken against the defaulting officers. So far as the earlier years viz. 1969-70 and 1970-71 are concerned, the Committee have been informed that action was already time barred when the audit objection was received. The Committee consider that the question whether the failure of assessee company to obtain Government's approval to the agreement before claiming relief under section 80-O would not amount to failure to disclose fully and truly all material facts has to be examined carefully in the light of the facts of the case. It was stated in evidence that since the amount involved is more than Rs. 50,000 and the 16 year period had not expired, it was still open for the Department to take action under Section 147(a). The Committee would like to be apprised of the outcome at an early date.
10.	1.120	Do.	The Committee find that the proceedings in respect of assessment years 1972-73 and 1973-74 have been stayed *ex-parte* by the Calcutta High Court on the ground that "as otherwise the petitioner would suffer extreme hardship". The Ministry have informed the Committee that "there has been an undue delay in the filing of the counter affidavit. Commissioner of Income-tax is being asked to ensure that such delays do not occur in future....The Law Ministry is being requested to try to get the stay vacated."
11.	1.121	Do.	The Committee find that no action was taken by the Department to get the stay vacated for as long as three years. The Miinistry of Law are being approached only now as a follow up of deliberations in this Committee. It

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			is unfortunate that in spite of a number of instructions issued by the Board on this subject between 1968 and 1979 such delays continue to occur. The Committee cannot view this situation with equanimity. Continued disregard of the instructions erodes Board's own authority. The Board must, therefore, find out methods of effective implementation of the instructions and their monitoring. The Committee also consider that unless some deterrent measures are taken, the situation would not improve. As would be seen from the preceding paragraphs, there have been a series of lapses of omission and commission on the part of the assessing and supervising officers in this case. The Committee, therefore, require that responsibility should be fixed and the officers concerned should be suitably taken up for these lapses. The Committee would like to be apprised of the action taken against the defaulting officials.
12.	1.122	Ministry of Finance (Department of Revenue)	In this connection, the Committee note with concern that the total pendency of writ petitions against orders of the Income-tax authorities in various High Courts was as high as 3.652 as on 1 January 1981 out of which as many as 1384 were pending for 2 to 5 years and 198 for more than 5 years. Out of this, the pendency pertaining to Calcutta and West Bengal Commissioners charge was as high as 2074 of which 896 were 2 to 5 years old and 143 were more than 5 years old. During their visit to Calcutta, a Study Group of the Committee were informed that the legal assistance available to the Department was not adequate. It was suggested that the Department should have the freedom to choose its own Counsel

			from a panel of approved lawyers so that the lawyers knew that they have to handle briefs in active and full consultation with the Department and not as though they were dealing with an anonymous client.
13.	1.123	Ministry of Finance (Department of Revenue)	Considering the very large number of income tax cases in which proceedings have been stayed by the Calcutta High Court, the Committee recommend that the Board should give serious consideration to the above suggestion so that it should become possible for the Department to get the stay orders vacated expeditiously and also to pursue the proceedings in the Appellate Tribunals, High Court, etc. in a concerted manner.
14.	1.124	Do.	The Committee find that there is no machinery in the Miinstry or in the Board to monitor progress of cases pending due to stay orders given by the Courts on writ petitions. This aspect should be looked into and the Committee apprised of the measures taken.
15.	1.125	Do.	The Committee further recommend that the question of mounting pendency of writ petitions in Calcutta High Court should be taken up at a high level in the Ministry of Law, with a view to devising ways and means to see that huge revenues due to Government do not remain locked up due to vexatious and time-consuming proceedings in Courts of Law.
16.	1.126	Do.	In connection with their examination of the case of M/s. Gramophone Co. of India Ltd., the Committee have come across another case of M/s. Union Carbide Corporation, a non-resident foreign company, which utilised its Indian subsidiary, M/s. Union Carbide India Ltd., as an intermediary. In this case, the technology was imported from a

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			foreign country and no local know-how was involved; the case did not, therefore, satisfy the objectives behind the enactment of Section 80-MM. The tax concession extended to the Indian subsidiary resulted in decrease in tax revenue on 50 per cent of the income derived on the sale and retained by the Indian subsidiary (only 50 per cent was passed on to its principal).
17.	1.127	Ministry of Finance (Department of Revenue)	The Finance Secretary admitted in evidence that in such cases there is a possibility of tax obligations being evaded through transfer pricing mechanism. In the light of this statement, the Committee are constrained to note from a written reply furnished by the Ministry that prior to the guidelines being laid down by the Board requiring scrutiny/review of all such agreements, the agreement (between Union Carbide of India Ltd., and Bhabha Atomic Research Centre) was apparently approved by the Ministry of Industrial Development and Internal Trade without any such scrutiny to prevent misuse of the provisions in law. Information is also not available with the Department as to whether the remaining 50 per cent of the fees received by Union Carbide Corporation, New York has been brought to tax.
18.	1.128	Do.	In reply to some further specific questions regarding the mechanism available with the Ministry/C.B.T.D. to ensure that such agreements do not, in fact, involve transfer of technology not relevant to Indian needs; that the price agreed is reasonable and it is not a cover for tax evasion;

		whether it would not be proper to put a total ban on the transfer of technology by foreign firms to their subsidiaries in India etc. the Committee were informed that the information was being collected and further reply would follow. The same is still awaited (April, 1981).
19.	1.129	Do. In reply to a further question, the Committee were informed that no general review has so far been made by the Department to ascertain how far the concession given under Section 80-MM has achieved the desired objectives.
20.	1.130	Do. So far as Section 80-O is concerned, the Committee find that in November, 1974 instructions were issued by the Board directing the CSIT to maintain a register containing information regarding the deductions allowed based on details to be furnished by the ITOs once in a quarter—the idea being to have all the data on a centralised basis. No such information could, however, be made available to the Committee on the plea that it will have to be called out by going through the relevant assessment records. Obviously, the Board's instructions have remained on paper only.
21.	1.131	Do. The Committee consider that a periodical and systematic review and evaluation of the concessions given under Section 80-MM and 80-O is essential to ensure that the underlying objectives are in fact achieved. There is a Special Cell (called 80-MM Cell) already in existence for scrutinising the agreements that come up to the Board for their approval. The Committee consider thast this Cell should not rest content merely in scrutinising the agreements but should obtain the requisite data of all assessments under this Section from the CSIT and subject the same to critical scrutiny. The cell should, therefore, be strengthened for the purpose without delay.

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22.	1·132	Ministry of Finance (Department of Revenue)	The Committee further recommend that a general review of the working of sections 80-MM and 80-O should be carried out by the Board with a view to finding out how far the objectives in granting the tax concessions have been subserved and what in-built safeguards need to be provided to prevent abuse thereof. Such a study should be initiated immediately and the findings intimated to the Committee within six months.
23.	1·133	Do.	The Committee would also be interested to have the Ministry's reply to the question posed by them in an earlier paragraph (para 1.128) particularly with regard to disallowing the tax concession under Section 80-MM to Indian Companies who remit any part of their realisation on sale of technology to their principals or to any foreign company.
24.	1·134	Do.	It has also come to the notice of the Committee that the periodicity of reviews of technical collaboration agreements which had been reduced from 10 to 5 years has again been changed to more than 5 years. The Committee would like to be informed of the precise position and the rationale for the change, if any.
25.	2·11	Do.	Section 36(1) (viii) of the Income-tax Act, 1961 provides that Financial Corporations engaged in providing long term finance in industrial or agricultural development in India are entitled to a deduction, in computation of their taxable profits, of the amount transferred by them out of such profits to a special reserve account, upto specified percentage

of their total income as computed before making any deduction under Chapter VI-A of the Act. Clarifying the scope of this provision in an instruction issued in November, 1969, the Board of Direct Taxes stated that the allowance should be computed with reference to the total income arrived at after allowing the deduction under section 36(i) (viii) itself but before allowing the deductions under Chapter VI-A of the Act. Subsequently in 1973 on receipt of a reference from the Department of Banking seeking clarification on this point, the Board, without making any reference to their own earlier instruction of 1969, issued a letter dated 12-11-1973 to the Department of Banking saying that the deduction would be related to the amount arrived at before deduction under section 36(i) (viii). This letter of the Board was circulated by the Reserve Bank of India to all State Financial Corporations on 1-2-1974 and thus an erroneous interpretation of law got currency. It came to the notice of Audit during examination of certain assessments of financial corporations in 1975 that the letter conveyed a wrong interpretation of law and ignored a valid instruction of the Board itself issued in 1969 without even referring to it. The matter was taken up by Audit with the Board in December 1975. It was only in January, 1977 that the Board informed the concerned Income-tax Commissioner and the Audit that the view point expressed by Audit was acceptable to them and action was being taken to reiterate the earlier instruction of 1969. Thereafter it took more than two and a half years for the Board to issue general instructions in August 1979 to reiterate that the instructions issued in 1969 were correct and were to be followed. In the

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25.	2·11	Ministry of Finance Department of Revenue)	meanwhile, the mischief created by the Reserve Bank Circular containing the Board's revised instruction of 1973 resulted in erroneous deductions being allowed in a large number of cases.
26.	2·12	Do.	It is bad enough that an erroneous interpretation of a relatively simple provision of the Income-tax Act should have gained currency at the instance of the Board of Direct Taxes itself. But what pains the Committee even more is the twin failure disclosed by the facts, firstly, that the erroneous clarification of 1973 was issued not as a deliberate revision of the earlier clarification of 1969, but in total disregard of it, and, secondly, that even after the Audit pointing out the mistake in December, 1975 it took the Board almost 4 years to rectify the mistake. It is amazing that the Central Board of Direct Taxes, a body invested with the power of administering the Income-tax Act, should not have a system to ensure that while interpreting a certain provision of the Act all relevant materials, and in particular the views, if any, already formulated by the Board itself on such provisions, are duly taken into account. The Committee would strongly recommend that Government should make a thorough probe into this matter to ascertain the reasons for such systems failure and fix responsibility under intimation to the Committee within a period of three months from the presentation of this report. The Committee recommend that Government should ensure that a proper and foolproof system is devised to see that such instructions seeking to inter-

		pret certain provisions of the Act are not issued without taking into account all relevant materials including all earlier instructions on the same subject.
27. 2.13	Do.	The Committee are equally distressed at the long period of time taken by the Board in rectifying the situation after the mistake having been brought to their notice by Audit. In spite of the fact that this correct interpretation, as pointed out by audit in December 1975, was in accord with the Board's own Instruction of 1969, it took the Board more than a year to accept the position and almost 4 years to issue formal instructions reiterating the clarification given in 1969. The Committee cannot but feel that the Central Board of Direct Taxes did not seem much concerned with the interest of revenue in this case.
28. 2.14	Do.	In pursuance to query by the committee the Board asked all the commissioners of Income-tax to furnish by 31st December 1980 the details of remedial action taken by each in his charge following the Board's revised Circular dated 13-8-1979. The Committee regret to note that this information has not been furnished by the Board so far. The mistake pointed out by Audit in the instance case have resulted in short computation of income by Rs. 6,47,681 for the assessment years 1961-62, 1964-65 to 1966-67 and 1968-69 to 1973-74 with consequent excess refund of tax of Rs. 3,60,466. Similar cases of short computation of income have been pointed out by Audit in their Reports for the years 1975-76 and 1977-78. The Committee

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			would like to know the total quantum of revenue lost on account of wrong instructions given by the Board in this matter and the remedial action taken to realise such revenue.
29.	3·9	Ministry of Finance (Department of Revenue)	The Committee note that although it was clear from the incomes and investments revealed in the two completed assessments of the assessees 'A' & 'B' that they would have taxable incomes in subsequent years also, the Income Tax Officer did not issue any notice calling for the returns of income even on the assessees' failure to file their returns. It was only during Audit in February 1979 that the failure of the ITO in not issuing the requisite notices under the Income Tax Act came to light. The Committee are at a loss to know as to how the failure occured and how it escaped the notice of the income tax authorities for so long.
30.	3·10	Do.	Apparently the internal control, as well as the internal audit systems of the department are not working effectively. The Committee would recommend that the responsibility for toning up and enforcing these systems should be placed squarely on the supervisory officers of the level of Inspecting Assistant Commissioners and Commissioners of Income Tax. These officers, during their periodical inspections, must ensure not only that the prescribed control records are properly maintained in the assessment wards, but also see that such records are made use of to obtain the desired results. In particular, the Committee recommend that it should be part of the duty of Inspecting Assistant Commissioners to see during their inspections that

there are no glaring cases of this type where the assessees have suddenly stopped filing their returns and the Income Tax Officer has nevertheless failed to call for the returns.

31. 4.27 — Do.

The Committee have noticed that there are two methods of valuation of the unquoted equity shares of companies, namely, 'break-up value method' and yield method under the break value method the value of such shares is based on the value of net assets of the company. Under the 'yield' method, the value of the shares is treated as equal to the principal amount which would have earned simple interest equal to the given yield on shares at the interest rates of gift-edge securiies. The principle of valuation of shares which has been adopted under Direct Taxes Acts is that the value of any asset, other than cash, shall be estimated to be the price, which in the opinion of the assessing Officer it would fetch if sold in the open market on the relevant date. So, the value computed under the two methods has to correspond to a hypothetical value on a hypothetical sale in a hypothetical market in accordance with the aforesaid principle which has been established through a number of decisions of the Supreme Court of India.

32. 4.28 — Do.

For valuation of unquoted equity shares in companies other than investment companies and managing agencys' companies, Rule 1—D of the wealth-tax Rules, 1957 framed by the Board under section 7 (1) of the Wealth-tax Act 1957 applies. The Rule incorporates break-up value method only. Consequently, it has been provided in the rule that in making computation of the value all liabilities as shown in the balance-sheet of the company and the dividends pertaining to the preference share-holders shall

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			be deducted from the value of all its assets shown therein; a discount of 15 per cent shall be allowed to arrive at the value of the net assets. The balance value of the net assets shall be distributed over the equity shares to arrive at their value. Again, if the company has not declared dividends for 3 to 6 years, the discount allowable shall be increased from 17 and half per cent to 25 per cent.
33.	4.29	Ministry of Finance (Department of Revenue)	Audit has repeatedly pointed out that where a company has undisclosed assets or where the book value of assets is much below their fair market value on the relevant date, valuation under the above provision of Rule 1D based on book value of assets only would not be in conformity with the principle of true market value contemplated in Section 7 of the Wealth-tax Act. This defect in the Rule has not been rectified so far.
34.	4.30	Do.	Further with reference to the said Rule 1D the Public Accounts Committee in paragraph 4.22 of their 226th Report (Fifth Lok Sabha) (August 1976) observed, "companies which do not declare dividends presumably with a particular design and accumulate profits in their reserves also derive a tax advantage....." Wealth-tax is avoided because of the allowance of discount at increasing rates, under the aforesaid Rule 1D, in the break-up method for valuing the unquoted equity shares on the grounds of non-declaration of dividends for specific number of years while, in fact, the profits are getting accumulated (without being distributed) with such private Limited Companies.

35. 4.31	Do.	4.31 The subject matter of valuation of unquoted equity shares in investment companies and other companies was also commented upon in paragraph 72 of the Audit Report 1977-78. In that regard, the Ministry of Finance have stated in March, 1981 that rule 1-D of the Wealth-tax Rules and Board's circular of October 1967 were discussed by a Committee set up by the Board on valuation of unquoted equity shares of companies. The said report had been discussed by the Board and follow-up action by way of framing suitable rules was likely to be completed soon. Again, the Board have stated that they "are seized of the matter and issue of necessary instruction in supersession of the circular dated 31st October 1967 and finalisation of the rules on the subject is under active consideration of the Board".
36. 4.32	Do.	4.32 The Committee regret to note that even after the Supreme Court of India Jugement in Jalan's case (88 ITR 621), delivered in 1972 the Ministry of Finance had not taken steps to amend the rule or to issue fresh instructions. The avoidable delay of more than 7 years has, in the meantime, been causing under-assessment of wealth-tax. The Committee recommend that the Government should rectify the position without further loss of time. As pointed out by Audit in the instant case due to absence of any rule or its clarification the exchequer bad lost Rs. 48,868 by way of Wealth-tax.
37. 5.24	Do.	Under-assessment of taxes of substantial amounts have been noticed year after year, on account of mistakes due to carelessness or negligence, which could have been avoided had the Assessing Officers and their staff

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			been a little more vigilant. Such cases of under-assessment have been the subject matter of several recommendations of the Public Accounts Committee in the past. The Committee in paragraph 5.2 of their 186th Report (Fifth Lok Sabha) had observed that the commonest mistake that has been adversely commented upon by the Committee, almost year after year, is the dropping of digits, generally one lakh of rupees either from the assessed total income or from the amount of tax payable.
38.	5.25	Ministry of Finance (Department of Revenue)	Again, the Committee had observed that a mistake, commonly committed, was the wrong transcription of digit or the dropping of a digit, from a substantial amount, resulting in under-assessment of income-tax (paragraph 5.3 of the same Report). The Committee in an earlier report (51st Report, Fifth Lok Sabha), had reviewed the trend of mistakes in computing income and tax and made specific recommendations on the four main contributory factors, namely, rush of work towards the end of the year, continued inefficiency of Internal Audit, lapses of check on computation income and the lack of countre-check on such computations.
39.	5.26	Do.	It is evident from the executive instructions (vide para 9.12 *ante*) that the assessing officer and their subordinate staff are required to carry out Internal Checks on the computation of income, value of assets and on the amount of tax resulting therefrom, as part of their regular duties and responsibilities.

40. 5·27	Do.	Apparently the instructions issued by the Central Board of Direct Taxes are not being strictly followed by field offices of the Department. Otherwise the important instructions issued by the Board from time to time for ensuring arithmetical and transcription accuracy in the work done in various Wards, would have been enforced by the range Inspecting Assistant Commissioners during their administrative inspection and by the Internal Audit and the failures of the type noticed in Revenue Audit would not occur so frequently.
41. 5·28	Do.	The weakness of administrative inspection have been the subject matter of comment by the Public Accounts Committee in paragraph 5.10 of their 186th Report (Fifth Lok Sabha) wherein they observed : "Another factor that came to the notice of the Committee was the weakness of inspections by the Inspecting Assistant Commissioners of Income-tax. In paragraph 1.64 of their 3rd Report (Fourth Lok Sabha) the Committee desired that instructions should be issued to the Commissioners to chalk-out a programme of inspection of all the circles at regular intervals. In reply (vide page 57 of the 86th Report) (Fourth Lok Sabha), the Ministry stated that necessary instructions have been issued in December 1968 for programme of inspection by Inspecting Assistant Commissioners to be drawn up in such a manner so that every circle was inspected at least once in three years".
42. 5·29	Do.	The Committee, however, note that the layout of the inspection report of IAC was revised only recently in 1980 to enable the IAC to give a more meaningful appraisal of the ITO's performance and make inspections more effective.

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43.	5·30	Ministry of Finance (Department of Revenue)	The Committee note that though the case was required to be checked by the Internal Audit Party but had not been checked and the Military is ascertaining the reasons for this failure on the part of Internal Audit Party. The Committee would like to be apprised of the reasons so ascertained.
44.	5·31	Do.	The Committee cannot but observe, that such simple but costly mistakes continue to persist not merely because of the initial human failure, but more so because of the lack of supervision and failure of the systems of internal control and internal audit. The Board of Direct Taxes seems to be content with issuing repeated instructions on the subject and informing the Committee of their having done so. The results, however, clearly indicate that neither superior supervision, nor internal audit, have actually been brought upto the desired level so far. The Committee would recommend that these continuing problems should be discussed by the Board, or its Members, in periodical review meetings with the Commissioners of Income-tax, and other field officers so as to get a proper feed-back as to why the instructions issued by the Board are not having the desired effect and then to devise effective corretcive measures based on such feed-back. The Committee would also recommend that in the field also the Commissioners of Income Tax and the Inspecting Assistant Commissioners should hold similar periodical review meetings to understand such basic problems in their proper perspective, which alone can make for meaningful solutions.

45. 5.32	Do.	The internal audit organisation continues to be weak despite the various steps taken in pursuance of the earlier recommendations of the Committee. Cases of this type involving substantial revenue continue to be reported by Revenue Audit where either the internal audit did not check up the case at all, or it failed to point out the particular mistake. It is necessary that the Director of Inspection (IT & A), who is entrusted with the responsibility of supervising and reviewing the working of internal audit, discharges this responsibility in a manner to build up the internal audit organiszation to a level of efficiency where at least the bigger cases are all checked in internal audit and checked properly.

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