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DIRECT TAX LAWS COMMITTEE

INTERIM REPORT
December 1977

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GOVERNMENT OF INDIA
MINISTRY OF FINANCE



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CHAPTER 1

INTRODUCTION

1.1 In his budget speech in the Lok Sabha in June 1977, the Hon'ble Shri H. M. Patel, Minister of Finance, Government of India, informed the House as under :—

"As Hon'ble Members are aware, the direct taxes statutes have become increasingly complicated and incomprehensible over the years. It is, therefore, necessary to take immediate action for the simplification and rationalisation of these laws with a view to making them readily intelligible to the taxpayers, reducing litigation, and thus, subserving the interest of the national economy. It is also necessary to examine ways, and means of improving the administration of these laws and expediting assessment, appellate and other proceedings under these laws. It has, therefore, been decided to appoint a Committee of eminent experts to make recommendations for the simplification and rationalisation of the direct tax laws. It is my intention to ask the Committee to submit its report before the end of the year". [Para 82 of the Budget Speech, Part B]

1.2 In accordance with the above assurance to the Lok Sabha, the Government of India, Ministry of Finance, Department of Revenue & Banking (Revenue Wing) passed a Resolution No. A-11019/70/77-Ad. VII, dated the 25th June, 1977 appointing a Committee of Experts to examine and suggest legal and administrative measures for simplification and rationalisation of the direct tax laws and such further alterations as are desirable in the interest of the national economy.

1.3 According to that Resolution, the Committee consisted of the following:—

Shri N. A. Palkhivala, Senior Advocate, Bombay	.. Chairman
Shri C. C. Chokshi, Chartered Accountant, Bombay	.. Member
Shri Harnam Shankar, Former President, Income-tax Appellate Tribunal, New Delhi	Member
Shri C. C. Ganapathi, Chairman, Settlement Commission, New Delhi	.. Member
Shri T. S. R. Narasimham, Commissioner of Income-tax, Bombay	.. Secretary*

1.4 The Committee was specifically directed to:

- (a) recommend measures to simplify and rationalise the laws relating to income-tax, surtax, wealth-tax, gift-tax and estate duty, and to alter those laws with a view to making them readily comprehensible to taxpayers, reducing litigation and thus subserving the interest of the national economy;
- (b) suggest ways and means of improving the administration of those laws and expediting assessment, appellate and other proceedings under those laws;
- (c) examine the advisability of consolidating the four laws relating to income-tax, surtax, wealth-tax and gift-tax into one Act;
- (d) prepare draft of the Bills for being presented before Parliament.

1.5 Bombay was made the headquarters of the Committee and the Committee was directed to submit its Report and draft Bills to the Ministry of Finance by the 31st December, 1977. Copies of the Resolutions dated 25th June, 1977 and 5th September, 1977 of the Government are annexed as Annexure I to this Report.

1.6 Subsequently, consequent on the acceptance of the resignation of Shri N. A. Palkhivala from the Committee (pursuant to his appointment as India's Ambassador in Washington D.C.), Shri C. C. Chokshi, one of the Members of the Committee, was appointed as Chairman of the Committee and Shri Sanatbhai P. Mehta, Advocate, Bombay was appointed a Member of the Committee. These changes were notified in the Gazette of India *vide* Government of India, Ministry of Finance, Department of Revenue, Notification F. No. A-11019/70/77-Ad. VII, dated the 24th September, 1977. A copy of this Notification is annexed and marked Annexure II.

1.7 The Committee held its first meeting at Bombay on the 7th July, 1977, under the Chairmanship of Shri N. A. Palkhivala. At that meeting, the general plan of action was discussed and it was decided that it would be appropriate to invite views from various persons concerned with the direct tax laws in the country. It was also

*Re-designated as Member-Secretary *vide* Government of India Resolution, F. No. A-11019/70/77-Ad. VII, dated the 5th September, 1977.

felt that, having regard to the terms of reference which embraced the entire scheme of the Income-tax Act and other direct tax laws, there was no need to draw up an elaborate questionnaire and restrict the expression of views only within a pre-determined framework.

1.8 Accordingly, the Committee addressed specific requests to persons in different walks of life, such as Judges, Chartered Accountants, Members of the Income-tax Appellate Tribunal, Commissioners of Income-tax, legal experts, etc., seeking their views and suggestions in regard to the matters referred to the Committee. A press note was also issued inviting suggestions from the public in general so that their views would assist the Committee in the task assigned to it. Specific requests were also addressed to leading chambers of commerce and trade associations, including the Associated Chambers of Commerce and Industry and the Federation of Indian Chambers of Commerce and Industry, and leading professional bodies, including the Institute of Chartered Accountants of India, the Bar Council of India, the Institute of Company Secretaries of India, and the Institute of Cost and Works Accountants of India. A copy of the press note is annexed and marked Annexure III. The Committee originally fixed the 10th August, 1977, as the last date by which the views may be communicated to it.

1.9 Immediately after the issue of the press note, there were several representations received from trade, industrial and professional organisations and also members of the public, urging that the time given for submission of suggestions to the Committee was very short and that the date for submission of suggestions should be extended. The Federation of Indian Chambers of Commerce and Industry had informed the Committee that it had to invite views from various constituent chambers of commerce and further that it was organising a conference through its Taxation Committee to obtain views from all over India. The Federation urged that time should be extended at least upto 31st October. Similar requests were also received from bodies like the Institute of Chartered Accountants of India. These representations were considered by the Committee at its meeting held on 10th August, 1977, under the Chairmanship of Shri N. A. Palkhivala. The Committee recognised that, apart from views which may be expressed by individuals, considerable attention would have to be directed to views from representative bodies who had necessarily to formulate such views through the democratic process of consultations and discussion. The Committee, therefore, decided to extend the time for submitting suggestions upto 31st October, 1977. A further press note was accordingly issued at the conclusion of this second meeting of the Committee. A copy of this press note is annexed and marked Annexure IV.

1.10 In response to its invitation for suggestions and views, the Committee has received extremely encouraging response. The Committee was gratified to note that, apart from professional organisations, trade associations, chambers of commerce, lawyers, chartered accountants, income-tax practitioners, departmental officials, etc., even lay members of the public had taken serious interest in the work of the Committee and had come forward with suggestions for simplification and rationalisation of direct tax laws. The Committee wishes to record its appreciation and gratitude to all such organisations and bodies and individuals for the support and encouragement which the Committee has received in its work. Such a widespread interest in the work entrusted to the Committee was naturally to be expected, inasmuch as, direct tax laws directly affect taxpayers all over the country.

1.11 The task of simplifying and rationalising direct tax laws concerns not only the Income-tax Act, 1961 but also the Wealth-tax Act, 1957, the Gift-tax Act, 1958, The Companies (Profits) Surtax Act, 1964, and the Estate Duty Act, 1953. So far as the Income-tax Act is concerned, it has been on the statute book for over a century. The 1961 Act which repealed the 1922 Act was meant to put the Income-tax law on a stable basis. The legislative process of enacting the 1961 Act involved not only an elaborate study by the Direct Taxes Administration Enquiry Committee under the chairmanship of Shri Mahavir Tyagi [appointed by the Government of India under its Resolution No. 4(59)-58 TPL dated 3rd June, 1958, and Report submitted on 30th November, 1959] but also consideration of the draft for many months by the First Law Commission of India consisting of eminent legal experts under the chairmanship of the late Shri M. C. Setalvad, the then Attorney General of India. Apart from this, the Select Committee of the Lok Sabha considered the Bill for several weeks, and the debates in Parliament extended for several days before the Act was finally enacted. It is on record that between 1962 and 1968 the Act has been amended over a wider field and more drastically than during the 40 years that the 1922 Act remained on the statute book. In the Preface to the Seventh Edition of Kanga & Palkhivala's 'The Law and Practice of Income-tax', the authors have stated that, upto 1976, the Act had suffered more than 650 insertions, 600 substitutions and 190 omissions, not to mention the changes made in the Income-tax Rules. As the avowed objective is to simplify and rationalise the direct tax laws, it would be evident that this is a stupendous task.

1.12 The Resolution of the Government and the statement of the Hon'ble Minister in Parliament required the Committee to submit its Report before the 31st December, 1977. However, in the sequence of events narrated earlier and the magnitude of the task of simplification of direct tax laws, consistent with the justifiable requests to entertain views and suggestions until the 31st October, 1977, it became increasingly clear to the Committee that the task entrusted to it could not be disposed of in a summary manner by the 31st December, 1977. Immediately on the reconstitution of the Committee on the 24th September, 1977, referred to earlier, the Chairman called on the Hon'ble Minister of Finance, and, sometime later, on the Secretary, Ministry of Finance, and appraised them of the assessment by the Committee of its task. It was indicated that the work of the Committee would continue at least for another 6 to 8 months after the 31st December, 1977.

1.13 The first meeting of the reconstituted Committee under the chairmanship of Shri C. C. Chokshi was held at Bombay on 28th September, 1977. Further meetings were held on 7th, 14th, 15th, 25th to 28th October, 14th to 26th November, and from 5th to 16th December, 1977. The Committee is being assisted by senior officers from the Income-tax Department at Bombay and Delhi, who have been devoting a part of their time to the work of the Committee. Steps have been initiated in November 1977 for the secondment of sufficient officers and staff on a full-time basis to assist the Committee. Such assistance is essential for properly sifting and collating the large number of views and suggestions received by the Committee in response to its appeal. After this process is completed, these would require critical examination with reference to the tax policies and administrative practices currently in force. It is only then that a comprehensive picture could be presented to the Committee for assisting the Committee to come to definite conclusions after deliberating the problems from all possible aspects.

1.14 As these procedures would obviously extend over a protracted period of time, the Committee felt that, consistent with the statement made by the Hon'ble Minister in Parliament, it would be desirable to communicate its views on some of the more urgent problems which have been highlighted in the functioning of the tax laws. The Committee, therefore, decided to examine about 12 issues in depth forthwith and to communicate the recommendations of the Committee on these issues to the Government in the form of an interim report to enable immediate implementation of the suggestions for simplification and rationalisation, should the same be acceptable to the Government. In doing so, the Committee is fully aware, that if its recommendations are accepted, it would result in extending the present process of amending the existing law, pending the submission of its final report. However, looking to the nature of the problems requiring immediate attention as a major step to simplification, the Committee is of the view that such a course of action is justified in the circumstances.

CHAPTER 2

CHARITABLE TRUSTS

2.1 The provisions relating to the assessment of charitable and religious trusts are one of the most complicated group of sections in the Income-tax Act. What was originally designed as a simple provision for totally exempting from tax the income of a charitable trust has, over the years become a veritable maze of sections, provisos and explanations, with the result that neither the Income-tax Officer nor the tax practitioner (not to speak of the hapless trustee of the charitable trust) is able to say with assurance what the law is at any particular point of time.

2.2 Sections 11 to 13 enjoy the unique distinction of having received almost continuous attention in successive Finance Acts. Between 1971 and 1976 no less than 27 amendments have been made to these sections. The changes in law almost every year by the legislature (no doubt designed to check various abuses which some of the taxpayers were indulging in by taking advantage of the exemption provisions relating to trusts) attempt to regulate almost every sphere of the working of a charitable trust, such as, maintenance of accounts, audit of accounts, receipt of voluntary contributions, application of trust funds and, finally, investment of trust funds. We have no doubt that all these amendments have germinated out of the anxiety of the legislature to ensure that trusts not only obtain tax benefits but such benefits enure for the public good and that trust funds are in fact applied for charitable purposes and not abused by unscrupulous persons. We wonder whether there is any other class of taxpayers whose activities are so totally sought to be regulated by the provisions of the Income-tax Act.

2.3 In trying to ensure that the tax concessions are enjoyed by a charitable trust only where its benefits flow to the public at large, the law has thrust on the tax administration the task of monitoring virtually the entire field of the trust's activities, which at times results in unforeseen difficulties both for the trusts and the tax administration. We are not convinced of the need for such monitoring, through the Income-tax law, of the whole field of the trust's activities and are of the view that the objective of granting the tax concession only to trusts which enure for the public good can be achieved in a simpler manner. The Wanchoo Committee had also felt (para 3.65—page 84 of their Report) that there was a strong case for having an all-India legislation for the purpose of controlling and regulating the working of the various public charitable and religious trusts.

2.4 We are of the view that the provisions contained in the Income-tax Act should have only one underlying objective, viz., to regulate the extent to which and the circumstances in which tax concessions should be granted to charitable trusts. The tax law should not aim at any further objective, which is better left to other legislation. Such separate legislation, apart from providing an effective safeguard for proper utilisation of trust funds, would enable the legislature to relax the various cumbersome restrictions placed on trusts under the Income-tax Act and in the long run reduce the provisions to a few simple and unambiguous rules. *We, therefore, recommend that a uniform central law governing registration of trusts, regulating their fund-raising activities, maintenance of accounts, application of income, investment of trust funds, involvement of trusts in corporate affairs consequent on holding of shares in companies and providing for machinery to deal with the abuse of trust property, etc., should be enacted as soon as possible.*

2.5 The very definition of "charitable purpose" in section 2(15) has caused considerable difficulty to public charitable trusts. Under the existing provisions, a distinction is made between trusts for advancement of education, relief of the poor and medical relief, on the one hand, and trusts for the advancement of any other object of general public utility (henceforth referred to as the fourth category objects for the sake of simplicity) on the other, in the matter of carrying on an activity for profit. While a trust with objects falling under any of the first three categories can carry on business in the course of carrying out a primary purpose of the trust/institution, trusts with the fourth category objects have been regarded as forbidden from indulging in any activity for profit. While the restrictions on charitable trusts with objects of the first three categories were placed recently on the basis of the recommendations of the Wanchoo Committee, trusts with the fourth category objects have been regarded as prohibited from engaging in activities for profit until the position in law has been clarified by the Supreme Court recently. Incidentally, the Wanchoo Committee had (prior to the judgements of the Supreme Court) emphasised in their Report (para 3.55 page 81) that trusts having the fourth category objects should continue to be ineligible for tax exemption if they pursued activities for profit.

2.6 Two Supreme Court judgements in the cases of Lok Shikshana Trust and Indian Chamber of Commerce (101 ITR-256 and 796, respectively) have confirmed the legal position that, if the object of general public utility involves the carrying on of an activity for profit, the purpose of the trust would not be considered as charitable within the meaning of section 2(15). The Madras High Court also, in its judgement in the case of the Madras Stock Exchange (105 ITR-546), held that if the profit-making activity is the appointed means of achieving a charitable object of general public utility, the profit would be taxable. More recently, the Supreme Court, in the case of Dharmodayam Trust (109 ITR-527) has drawn a distinction between a business carried on by a trust for the purpose

of advancing an object of general public utility and a business held as trust property. The latter will not disentitle a trust from the tax exemption under section 11.

2.7 We have received a large number of representations on the hardship caused as a result of the total banning of activity for profit so far as trusts having the fourth category objects are concerned. It has been pointed out that activities for profit are essentially fund-raising in nature, without which charities cannot exist. We find considerable substance in these representations. We are aware that some trusts have abused the provisions enabling them to carry on business and that, sometimes, expansion or consolidation of business is by itself, sought to be justified as furtherance of charity. Such abuses would particularly arise where a business is merely held by a charitable trust as property unconnected with the objects of charity. The remedy, in our opinion, lies in the direction of proper enforcement of the provisions relating to application of trust funds for charitable purposes and not of totally banning all activities for profit. Moreover, it is noticed that charitable trusts generally have objects falling under all the four categories. Very often, a trust has come into difficulties on account of a single object under the fourth category, even though all the important objects fall under the first three categories. *We, therefore, recommend deletion of the words "not involving the carrying on of any activity for profit" occurring in section 2(15).*

2.8 The three judgements of the Supreme Court have clarified the position recently. In order to give effect to the interpretation now placed on the section, several past assessments would have to be disturbed and the Department would be required to analyse cases to draw the distinction spelt out by the Supreme Court. At this would involve considerable difficulty, our recommendation would be to apply the change in law suggested by us retrospectively from the 1st April, 1962. *We, therefore, recommend that the amendment to section 2(15) should have retrospective effect from 1st April, 1962.*

2.9 The effect of the recommendation in paragraph 2.7 would be to continue to allow exemption to trusts with the fourth category objects which carry on an activity for profit. There would be no distinction to be drawn as to whether such activity for profit is for the purpose of advancing a charitable object or whether it is merely a part of property held by the trust. It should, however, not lead to the position that trusts with the fourth category objects enjoy a better position than trusts with the other three categories of objects. In our view, all the four categories of trusts should be subjected to the same restriction. It was pursuant to the recommendation of the Wanchoo Committee (para 3.55—page 81) that trusts with the first three categories of objects were allowed to carry on a business only if the business was carried on in the course of the actual carrying out of a primary purpose of the institution. This was achieved by the enactment of section 13(1)(bb) by the Taxation Laws (Amendment) Act, 1975, with effect from the 1st April, 1977. The trusts with the fourth category objects should likewise be subjected to the same restriction. *We, therefore, recommend that the provisions of section 13(1)(bb) should also be made applicable to the trusts with the fourth category objects with effect from the 1st April, 1977, as in the case of trusts with the other three categories of objects.*

2.10 The effect of the above recommendations in paragraphs 2.7 to 2.9 would be that all charitable trusts (irrespective of the category of object or charitable purpose) will enjoy the tax exemption only if any business carried on by them is in the course of the actual carrying out of a primary purpose of the trust or institution. It would not be permissible to abuse the tax exemption to charitable trusts by allowing such trusts to carry on any business in general as part of the property of the trust. Once these changes are made the provision in section 11(4) enabling a business to be held as trust property would become inconsistent with the scheme of tax exemption outlined above. *We accordingly recommend that section 11(4) should be deleted with effect from the 1st April, 1977.*

2.11 It is noticed that the provisions of section 13(1)(bb) enable a trust to carry on business, only when such business is carried on in the course of carrying out a primary purpose of the trust or the institution. There are a good number of trusts where the business activity of the trust is carried on by the beneficiaries themselves, although, in some of these cases, the business may not have been carried on in the course of carrying out a primary purpose of the institution. We think it but fair to extend the provision of section 13(1)(bb) to cover such cases. *We, therefore, recommend that the provisions of section 13(1)(bb) should be further enlarged to permit business activity, mainly carried on by the beneficiaries even when the business itself is not carried on in the course of carrying out a primary purpose of the trust.*

2.12 We shall now deal with the provisions relating to the computation of the income of charitable trusts. Difficulties have been experienced by trusts, and also by the Department, on account of the fact that the income computed under the Act is at variance with the income which is actually available to the trusts for application to charitable purposes. While the assessable income of charitable trusts too (as in the case of any other taxpayer) has to be determined in accordance with the provisions of the Act, the trusts cannot obviously be required to apply towards charity more than what has been actually received by them. It would, of course, be ideal if the income computed under the Act and the income to be applied for charitable purposes are identical in amount. In the very nature of things, it is very difficult to achieve this ideal state. The Board had attempted to solve the difficulty by stipulating that, for the purpose of application of income, the income should be worked out in a commercial sense. But, even here, the question arises whether, while computing income in a commercial sense, the trust could be given deductions like depreciation, etc. *After careful consideration, we recommend that the law should provide for two different and totally independent computations, one for determining the assessable income, and the other for determining the amount that is to be applied for charitable purposes by the trust. The assessable income under the*

Income-tax Act should be computed strictly in accordance with the Act following the various provisions, taking into account even notional income and granting deductions specifically permitted under the Income-tax Act. On the other hand, the amount that is to be considered for the purpose of application to charitable objects should be the actual gross receipts of the trust less the expenses actually incurred in earning the income or in maintaining the trust property. In this computation, notional incomes or incomes not received, and notional allowances and deductions for amounts not actually expended, will both be left out of account. If the actual income so computed is equal to or less than the statutory income i.e. the income computed under the provisions of the Act, the trust should be required to apply either 75% of the statutory income or the whole of the actual income, whichever is less. However, where the income so worked out on actual basis exceeds the statutory income, it should suffice if the trust applies either 75% of the actual income or the whole of its statutory income, whichever is less. We also suggest that the relevant provisions should be suitably illustrated in the Act itself to make the concept clear.

This may be illustrated by the following examples :—

(1) A. Statutory income of the Trust (from say, house property)	Rs. 1,00,000
B. Income (rents) actually received less expenses of collections, and amounts actually spent on repairs (which in this particular year exceeded, the statutory allowance of 1/6th of the annual value) insurance, taxes, etc.	Rs. 60,000

In this case the trust will be required to apply the whole of the Rs. 60,000 to its objects during the year, as this happens to be less than 75% of the statutory income.

- (2) If in the above example, the income at B happens to be Rs. 80,000 (instead of Rs. 60,000), then the trust will be eligible for exemption under section 11(1), if it applies Rs. 75,000 to its objects; as that amount, being 75% of the statutory income, is less than the actual net income.
- (3) The next year, while the statutory income (at A) is the same, viz., Rs. 1,00,000 but the trust spends a much lower amount on repairs, so that the actual net income at B comes to, say, Rs. 1,20,000. In that event, the trust will be required to apply Rs. 90,000 to its objects, as this is equal to 75% of the actual net income and is also less than the whole of the statutory income.
- (4) If, in the example at (3) above, the actual net income at B is, say, Rs. 1,40,000 (due to, for instance, the recovery of some rents for a past year which were in arrear, and to the very small amount spent on repairs), then, the trust will be required to apply Rs. 1,00,000 (i.e. the whole of the statutory income) to its objects in that year, as this happens to be less than 75% of the actual net income (75% of Rs. 1,40,000 is Rs. 1,05,000).
- (5) If, in any year, the statutory income (A) and the actual net income (B), happen to be the same, i.e., Rs. 1,00,000, the trust will be required to apply Rs. 75,000 to its objects in order to qualify for exemption under section 11(1) on the whole of its income.

2.13 After careful thought we have come to the conclusion that this arrangement would help solve the problems of the trust as well as the Department in the matter of computation of income of the trust for assessment purposes and for purposes of application to its objects. There may still be cases where, due to unforeseen or unavoidable difficulties, the trustees are not able to apply the requisite amount to the objects of the trust before the close of the previous year. To obviate hardship in such cases, we recommend that the existing provision for relating the amounts applied in the immediately following year to the earlier year, at the option of the trust, be retained subject to the modification that the income tax officer may be empowered to extend the time for exercise of the option in deserving cases independently of the time available for filing the return of income.

2.14 The provisions of section 11(1A) deal with capital gains arising to charitable trusts. Consistent with the views expressed in para 2, 12, we recommend that while the Capital gains arising to a charitable trust could be given the same treatment as in the case of any other taxpayer, insofar as the application of funds for charitable purposes is concerned, only the net sale proceeds received by the trust during a given year should be considered for application (which, under the existing law, includes re-investment) in that year. We further recommend that re-investment may be permitted until the expiry of the next following accounting year of the trust

2.15 Section 11(2) contains provisions relating to accumulation of income of charitable trusts. These provisions have been the subject matter of some litigation between the trusts and the Department. The Department contends that the accumulation must be for a specific purpose. The trusts' view is that the amounts could be accumulated even for any general purpose falling within their overall objects. Deriving inspiration from the decisions in the cases of MCT Trust and Others (102 ITR 138) and Shri Kishenchand Charitable Trust (98 ITR 387), trusts argue that the rule-making authority cannot prescribe any additional conditions over and above the specific requirements of the Act. We see no reason for a restriction on the objects to be specified as, sooner or later, the moneys have in any event to be applied for a charitable purpose only. We, therefore, recommend that charitable trusts should be allowed to accumulate their income even for a general purpose falling within the overall objects of the trust. Consequently, the provision in section 11(3A), which empowers the income-tax officer to allow change of the purpose originally indicated for the accumulation, at the request of the trust, will be rendered superfluous, and may, therefore, be omitted.

2.16 As regards the quantum which can be accumulated under section 11(2), in view of the general principles enunciated by us in para 2.12, it is obvious that the trust can accumulate only what had been actually received by it in the year and the question of its accumulating either notional incomes or amounts disallowed by the Department would not simply arise. *We, therefore, recommend that the provisions relating to accumulation should continue to operate in relation to the income required to be applied for charitable purposes as recommended in para 2.12.*

2.17 At present, trusts have to approach the Board for condonation of any delay in giving the notice under section 11(2), and the Board condones the delay in deserving cases, acting under the provisions of section 119(2)(b). As this is a comparatively routine matter, there is no reason why it should not be dealt with at lower levels, so that needless work can be reduced. *We, therefore, recommend that section 11(2) should be amended to empower the Commissioner to condone delays in giving the notice as also in making the investment or deposit under that section. We further recommend that the section may also specify :*

- (a) *The time within which the notice is to be given, which may (as at present, stipulated in rule 17 of the Income-tax Rules) be "the time allowed under sub-section (1) or sub-section (2) of section 139, whether fixed originally or on extension, for furnishing the return of income" and*
- (b) *The time within which the amount accumulated or set apart is to be invested or deposited in the manner laid down in the section, which may be one year from the end of the relevant previous year (instead of six months at present stipulated in form 10).*

2.18 Voluntary contributions towards the corpus of a trust fall outside the purview of the definition of "income" in section 2(24) (ia) and the provisions of section 12. It has been brought to our notice that these provisions have sometimes been used to water down the obligation to apply income for charitable purposes. We understand that incomes of trusts are given away to other trusts as corpus donations. Instances of reciprocal corpus donations have also been noticed. While agreeing that such abuses should be checked, we are of the view that there should be no objection to a trust making a donation from out of its corpus to the corpus of another trust. To prevent the specific abuse pointed out, *we recommend that where a trust makes donations out of its income to another trust, while in the case of the donor trust these will continue to be treated as application of income, in the hands of the recipient trust, these should always be considered as normal income and any stipulation that the contributions are to the corpus of the recipient trust should be disregarded for the purposes of the tax exemption.*

2.19 Section 12 A contains provisions relating to registration of charitable trusts. By virtue of the provisions of section 12A(a), the Commissioner may, in his discretion, admit a belated application for the registration of a trust. While there have been no specific complaints as regards the exercise of these powers by the Commissioners, we feel that the Act itself should permit the filing of the application for registration at any time before the completion of the first assessment of the trust. We may add that such a provision should co-exist with the existing provisions for condonation of longer delays, in appropriate cases, by the Commissioner. Further, the Commissioner may also register a trust later in respect of its pending assessments. It is also felt that there need be no duplication of audit requirements under trust laws where applicable and the provisions of section 12A(b). *We, therefore, recommend that the provisions of section 12A should be amended to provide for an application for registration being entertained at any time before the completion of the first assessment of the trust. We further recommend that, where a trust has failed to register itself within the time limit, it should still be open to it to register itself prospectively at least for future years. In this context, we also recommend that the provision in section 12 A (b) may be amended to clarify that, where the accounts of the trust have been audited under the provisions in this behalf in any state of law, such audit would be regarded as sufficient compliance with the requirements of that provision.*

2.20 Section 13(2) specifies certain categories of transactions which would be regarded as amounting to use or application of the trust income or property for the benefit of any of the excluded persons, for the purposes of section 13(1)(c), and is without prejudice to the generality of the provisions of that section. In relation to the 8 categories of transactions enumerated in section 13(2), the circumstances mentioned thereagainst should alone be regarded as attracting the disqualification of section 13(1)(c). The wider import of section 13(1)(c) should not apply to any other circumstances in relation to the 8 categories of specified transactions. While not wishing to water down the provision in section 13(1)(c), which is, indeed, wider in scope than section 13(2), *we recommend that, insofar as the situations enunciated in section 13(2) are concerned, the provisions of that section should be treated as exhaustive and the law should make it clear that, unless the features spelt out in section 13(2) are present in any of those situations, the transaction will not be treated as use or application of the trust income or property for the benefit of the excluded persons, for the purposes of section 13(1)(c) so as to nullify the exemption in sections 11 & 12.*

2.21 Section 13(2)(a) denies the benefits of section 11 in the case of a trust where it lends money to any person referred to in section 13(3) for any period during the previous year without adequate security or adequate interest or both. We were given to understand that these provisions are sometimes interpreted by taxpayers to mean that either adequate security or adequate interest would constitute enough compliance with this provision. With a view to removing all doubts, *we recommend that the provisions of section 13(2)(a) should be suitably amended so as to make the intention clear that, in a case where a loan is advanced to a person referred to in section 13(3), it should be covered by adequate security and also ensure adequate rate of interest.*

2.22 The provisions of section 13(2)(b) deny the benefits of section 11, where it is found that the funds of a charitable trust are or continue to remain invested during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest. While the Department's view is that these provisions apply to all

investments (whether made by the charitable trust or by others) which happen to be held by the concerned trust, the trusts are, on the other hand, contending that these provisions only apply to investments made by the trustees themselves, after the trust has come into existence, from out of the funds available with them. Without going into the question of the correctness of either view, we are of the opinion that it is not fair to apply these provisions at least to the original assets settled on trust or donations in kind to the corpus including investments in prohibited concerns. We note that the Wanchoo Committee had also felt (para 3.60 of their Report) that the provisions of section 13(2)(h) should not operate where such an investment forms part of the initial corpus. *We, therefore, recommend that the provision in section 13(2)(h) should be amended to clarify that it excludes from its purview the assets originally settled on trust or donated to the corpus of the trust including, in either case, accretion to such assets, by way of bonus shares.*

2.23 The first proviso to section 13(1)(c) already provides for excluding the operation of that section in circumstances where there are mandatory directions under the Trust Deed in the cases of trusts created before 1-4-1962. *In the light of our recommendation that the restrictions in section 13(2)(h) should be excluded from operation in respect of investments forming the original corpus of the trust and donations to the corpus irrespective of the date of creation of the trust, we recommend that the operation of section 13(2)(h) should be so excluded whether or not there is any mandatory direction in this regard in the Trust Deed.*

2.24 Section 13(3) defines "a person who has made substantial contribution" as one who has made a total contribution upto the end of the relevant previous year exceeding Rs. 5,000. The meaning of the term "substantial" naturally varies from person to person and from context to context. We are, therefore, of the view that it would be appropriate to relate this concept to the property of the trust. We note that the Wanchoo Committee observed in para 3.61 of their Report that the term "substantial contribution" should be defined as an amount exceeding 5% of the corpus of the trust. *We recommend that the term "substantial contribution" should be defined to mean the aggregate contribution upto the end of the relevant previous year in a sum equivalent to 10% of the value of the trust assets as at the end of the previous year in which the contribution was made, or Rs. 5,000, whichever is higher.*

2.25 Explanation 1 at the end of section 13 expands the meaning of the word "relative" to cover a variety of relationships. The scope of the expression has been further expanded by the amendments made under the Finance Act, 1972, with effect from 1-4-1973. It has been represented to us that the relationships mentioned have been stretched too far by the Act. It is very difficult to verify each time the trust applied its income whether the intended beneficiary, who may be very distantly related to the settlor, trustees, etc., falls within the mischief of the definition or not. From the point of view of the Department also, it would be virtually impossible to keep and verify long lists of relatives of the various trustees, settlors, etc., including those who are only very remotely related. While agreeing that the trust funds should not be utilised for the benefit of the settlors or the trustees, we think that it is carrying precaution too far to strive at debarring even persons very remotely related from deriving benefit from the trusts. This again is an area which should have been properly regulated by a separate enactment dealing with the functioning of trusts, rather than made the responsibility of the income-tax law. *We recommend that the definition of "relative" in section 13 should be restored to the position existing prior to 1st April, 1973.*

2.26 The provisions of section 13(1)(d) as well as of sections 13(5) & 13(6) have been inserted by the Taxation Laws (Amendment) Act, 1975. These provisions seek to regulate the investment of trust funds. Different modes of investment are prescribed for the original corpus, subsequent contributions to the corpus, and the normal income of the trust. These provisions which were to come into operation from 1-4-1977 have been held in abeyance till 1-4-1981. These provisions have created difficulties for a very large number of trusts many of whom are holding substantial investments for periods exceeding 40 to 50 years. Apart from the difficulty of finding suitable investments permitted by the new provisions, the trustees are faced with the real problem of having to live with reduced incomes *vis-a-vis* their existing commitments. As we see it, the provisions of section 13(1)(d) read with sections 13(5) & 13(6) represent, more or less, the proverbial last straw in the matter of regulating the conduct of charitable trusts. We would once again emphasise, even at the risk of repetition, that this is an area which does not legitimately fall within the domain of the Income-tax Act. That apart, there are provisions in section 13(2) to ensure that the trust funds are not utilised for the advantage of persons connected with the trust. Section 13(2) lists out a variety of circumstances, where it is deemed that the person connected with the trust is benefited. There is also the sweeping provision in section 13(1)(c) itself which enables the Department to deny the benefits under section 11 in any case where the income or the property of the trust is known to have been utilised directly or indirectly for the advantage of any person referred to in section 13(3). With all these restrictions, we do not see the need for any further sweeping restrictions which virtually seek to deny the trustees the right to invest the trust funds in the best manner possible for the maximum advantage of the trust. The matter could also be looked at in another way. Under section 11(1), as it exists today, an obligation to spend 75% of the income on charitable purposes is cast on a charitable trust. This leaves only 25% of the income, besides contributions to the corpus in the hands of the trustees. If it is necessary that trusts should be discouraged from investing these comparatively small sums in shares of private companies and consequently deriving economic power to the trustees, the objective could be achieved more easily and painlessly by vesting voting rights in respect of all shares held by charitable trusts in the Public Trustee, under the Companies Act, irrespective of the magnitude of the shareholding. This could be achieved by appropriately amending section 153B of the Companies Act. We are of the view that the trustees should have freedom for dealing with these amounts (*i.e.*, 25% income and contributions to corpus) for the best advantage of the trust. *We, therefore, recommend the deletion of the provisions*

of section 13(1)(d) together with those of sections 13(5) & 13(6) and substitution in their place of a general provision giving the trustees freedom in the matter of investment subject to the restrictions under section 13(1)(c). We also suggest that section 153B of the Companies Act may be simultaneously amended suitably to vest voting rights in respect of all shares held by charitable trusts in the Public Trustee.

2.27 Section 2(24)(iia) read with section 12 deems as income all voluntary contributions received by a trust created wholly for charitable or religious purposes. This provision is quite understandable in the context of a charitable trust which enjoys the benefits of section 11 and which has the obligation to apply for charity the required percentage of its income. But it operates harshly in cases where exemption under section 11 is denied, notwithstanding the fact that the trust or institution is clearly charitable within the meaning of section 2(15), on account of the operation of the provisions of section 13. In such a situation, the trust will be caught within the mischief of the deeming provisions of section 2(24)(iia) and section 12, without having any of the tax benefits of a charitable trust. For example, a charitable trust whose benefits are restricted to the members of a particular community would lose the benefits of section 11 on account of the operation of section 13(1)(b), while the deeming provisions of section 2(24)(iia) and section 12 would continue to apply. Similarly, a charitable trust which loses the benefits of section 11 on account of a benefit given to a person in the prohibited category would nevertheless be hit by the mischief of section 2(24)(iia) and section 12. We have given careful thought to the question whether it is fair to subject these peculiarly placed trusts to a kind of double jeopardy. We have noted the observations of the Wanchoo Committee at para 3.62 of their Report that there is no justification for exempting from tax any income by way of voluntary contributions of private religious trusts and charitable trusts according benefits to the relatives of the author, founder, etc. While we entirely agree that communal and non-charitable organisations should not receive any state patronage, the question raised here is slightly different. While exemption under section 11 as also the benefits of section 80G can justifiably be denied to them, would it be fair to tax receipts which ordinarily do not constitute income except by a limited fiction? Is it necessary that they should be subjected to a further liability or disadvantage by applying the provisions of section 2(24)(iia) and section 12? In our view, while the state need not encourage the growth of such institutions, there should be no objection whatsoever, for these institutions existing with whatever resources they are able to muster. It would not be proper to say that the objective of promotion of secularism/charity would not be served unless these institutions are put to an additional disadvantage *vis-a-vis* other taxpayers under the Act. *We, therefore, recommend that the law should be amended suitably to stipulate that the deeming provisions of section 2(24)(iia) would not apply to a trust or institution referred to in section 13(1)(a) or (b).*

CHAPTER 3

DEPRECIATION

3.1 One of the important deductions in the computation of business income under the provisions of the Income-tax Act is the one in respect of depreciation, under section 32, read with sections 34 and 43 of the Act. This benefit is also extended to a limited extent, under section 57, in the computation of income under other sources from assets let out on hire.

3.2 There are elaborate provisions for determining the quantum of normal depreciation for different categories of depreciable assets; the quantum of extra shift allowances for plant and machinery used in factories whether seasonal or otherwise, and in approved hotels; and for maintaining particulars of the actual cost and written down value of assets, etc. The existing provisions also deal with the allowance of initial depreciation in certain special cases and the terminal adjustments when depreciable assets of a business are sold, discarded, etc., under section 32(1)(iii) and section 41(2) of the Act.

3.3 Depreciation under the Income-tax Act is not merely a provision for charging against taxable profits the capital expenditure incurred by an undertaking on depreciable assets over the useful life of the assets, but it is also aimed at working as a tax incentive measure affecting the cash flow of business enterprises and generation of internal resources for replacement of assets which have outlived their utility. It is needless for us to set out in detail the various concepts of depreciation. It is now well recognised that capital expenditure incurred in a business should be charged against the profits of the business over the useful life of the assets resulting from such capital expenditure before the true profits can be determined. This is broadly the accountant's concept of depreciation. It is recognised in this concept that the amount charged against the profits should be neither excessive nor should there be an under-charge, as, in either circumstance, the profit would be distorted. This underlying concept of depreciation has been recognised under the provisions of the Companies Act in the matter of presenting a true and fair view of the profits and the state of affairs of a company; in the determination of profits for the purposes of managerial remuneration; and in the determination of profits which constitute distributable profits under section 205 of the Companies Act, 1956. The concepts under the Companies Act are closely linked to the provisions under the Income-tax Act by a specific reference to the quantum of depreciation under the Income-tax Act and Rules being made in section 350 of the Companies Act, 1956.

3.4 Another concept of depreciation is that of retention of funds—by raising a charge in the profit and loss account towards depreciation, that portion of the funds being retained within the business enterprise. Such debit represents a non-cash charge to the profit and loss account and is aimed at retaining that portion of the profits for maintaining the productive equipment of the business. This concept of depreciation is an economic concept generally used to assist the flow of funds in the enterprise. It is, in this context, urged that, in times of rising prices and inflation, the charging of depreciation on the basis of historical cost does not provide an adequate measure of funds necessary for the replacement of assets at the end of their useful life. It is this current of thought which urges the charging of depreciation on the basis of replacement costs. A further extension of this school of thought is the demand for a provision for obsolescence of assets, caused by the fast pace of technological innovation and sophistication which may set in even during the theoretically determined useful life of the asset.

3.5 The economic concept of depreciation as a means to ensure retention of cash for rehabilitation, replacement and modernisation of fixed assets assumes importance in a time of rising prices. In such cases it is recognised that depreciation to the extent of 100% of the actual cost of the asset may not be adequate to serve this function. This was recognised in the tax laws as far back as 1946 when initial depreciation and subsequently when additional depreciation were introduced as incentive measures to provide an earlier plough back of cash resources with the consequent benefit in internal cash accruals.

3.6 This was not found to be an adequate measure and, therefore, development rebate was introduced as an incentive measure and the principle of allowance in excess of 100% of the cost of assets was taken note of by the legislature. One of the recommendations of the Bhoothalingam Committee was to allow a taxpayer to write up his assets on a flat 20% basis and allow depreciation upto 120% of the cost of assets.

3.7 We are not in favour of artificially distorting the concept of depreciation to serve this objective. In the suggestions made by us, the benefit of acceleration involved is preserved. Any further incentive to be allowed would depend upon larger issues of tax policy and involve considerations of selective inducement to industries, dispersal of industries sectorwise or to different geographical locations, etc. Other incentives like investment allowance would serve these objectives. We do not wish at this stage to comment upon these additional incentives in the interim report.

3.8 In analysing the concept of depreciation for tax purposes, it is necessary to keep in mind these different aspects of the problem. There is also the overall consideration of introducing simplicity in the provisions of the tax laws. It has been represented to us that the present provisions, and the elaborate Schedule of rates under the Income-tax Rules are highly complex and complicated. It has further been urged before us that, so long as the overall quantum of depreciation is restricted to the actual cost, total freedom should be allowed to a business enterprise to claim the allowance in one or more years of its choice. In analysing these various claims, we have had regard to the possible uncertainties which may be introduced in the budgetary estimates by a total latitude to the assessee in regard to the claim for depreciation. At the same time, the suggestion merits consideration from the obvious advantages of simplicity.

3.9 *On a consideration of these various aspects, we recommend that the existing practice of allowing depreciation on the reducing balance method, which provides for accelerated depreciation by larger write-offs in the earlier years for assets in general, should continue. The exception in the case of ocean-going ships, where the straight-line method of depreciation has been adopted should also be retained.*

3.10 As regards the quantum of depreciation to be allowed under section 32 in each year, we recommend that the taxpayer should have the option in respect of the actual quantum of depreciation to be claimed against the profits from year to year subject, however, to a maximum rate specified in the law which will be applied to the written down value, except in the case of ocean-going ships where the existing pattern should continue. In this regard, we recommend the following maximum rates of depreciation:—

Buildings including roads, culverts, bridges, etc.	10%
Furniture and Fixtures	20%
Plant and Machinery	40%

3.11 A taxpayer may, thus, choose not to claim depreciation at all in any year or choose to claim depreciation in any amount upto the maximum amount arrived at by the application of the above rates in each year. The option given to the taxpayer should, however, be limited to his choosing one single rate for all assets falling within a class, namely, buildings, furniture and fixtures and plant and machinery, and he should not be allowed to adopt different rates for different items falling within the same class. The option is only to vary the rate from year to year. Unless the taxpayer's choice is thus limited, the whole purpose of the simplification suggested by us may be defeated as the need to maintain separate depreciation records for each asset will persist. The rates would be applied to the original cost of the assets in the first year and to the written down value in subsequent years.

3.12 It may be mentioned that we have opted for a measure of simplification in this regard without at the same time allowing a total latitude to the taxpayers, as that might disturb the budgetary position of the Government. This disturbance of the budgetary position has been experienced by other countries where total latitude was permitted to be adopted.

3.13 At the same time, we are of the view that the tax incentive which flows from the degree of latitude recommended by us should not be permitted to be frittered away by the taxpayer but should be retained within the business for further development. It has been the experience in recent times that companies avail of deduction under the Income-tax Act of high amounts of depreciation without correspondingly providing for such depreciation in the books. Such companies take advantage of the enabling provisions of section 205(2)(b) of the Companies Act to provide for depreciation of lower amounts, and distribute dividends to the shareholders. In order to serve as a restraint on such a practice, we recommend that depreciation under section 32 should be allowed in the manner indicated in para 3.10 only where the quantum of depreciation claimed for Income-tax purposes is actually debited to the profit and loss account of the relevant previous year.

3.14 The method of depreciation outlined above will result in certain incidental advantages to taxpayers. They may choose not to claim depreciation in a year of loss or low profit, and thereby qualify for, or accelerate, their claims for set off of past losses and in respect of deductions by way of tax incentives like amortisation of capital expenditure of certain categories, investment allowances, tax-holiday, etc. This would be consistent with the scheme of tax incentives and the underlying concept of depreciation under the Income-tax law.

3.15 Another measure of simplification in regard to depreciation which has been suggested is to permit the write-off against profits of the full cost of depreciable assets the actual cost whereof does not exceed Rs. 10,000. This would, in effect, amount to allowance of depreciation at the rate of 100% in respect of such items. The suggestion would involve raising the existing limit of Rs. 750 specified in section 32 to Rs. 10,000. This would, incidentally, considerably reduce the need for maintenance of elaborate records for assets of small value. It has further been suggested that the benefit of such full write-off should not be restricted to plant and machinery but be extended to all categories of depreciable assets including buildings and furniture and fixtures. As a consequence of this liberalisation, cases presently eligible to 100% depreciation, enumerated in Para III-F of Part I of Appendix I to the Income-tax Rules, need not have a separate categorisation. We are in agreement with these suggestions. We, accordingly, recommend that full write-off (i.e. depreciation at 100%) should be allowed in the case of all assets where the actual cost of any asset does not exceed Rs. 10,000. Consistent with the recommendation made earlier, in the case of those taxpayers who avail of the option to vary their claim for depreciation to suit the performance of their business from

year to year such depreciation would also be debited to the profit & loss account of the taxpayer of the relevant previous year in which the taxpayer chooses to claim such depreciation, while in other cases it will be allowed in the year in which the assets are brought into use for the purposes of the business.

3.16 The aforesaid recommendations would raise certain related issues. The first would be in cases of taxpayers who do not maintain books of accounts. In such cases, the question of exercising an option by debiting the profit and loss account would not arise. By linking the claim for depreciation with a debit to the profit and loss account, an added incentive would be provided to taxpayers to maintain books of accounts. However, there may still be cases of taxpayers who do not maintain books of accounts. *We recommend that in cases where no books of account are maintained, depreciation should be allowed at the uniform rate of 10% on buildings and 20% on plant and machinery and furniture and fixtures, on the reducing balance method.*

3.17 Another issue which would arise is in regard to companies and the implications of such a recommendation on the presentation of accounts under the provisions of the Companies Act. A basic principle incorporated in the Companies Act is that the annual accounts of a company under section 211 should disclose a true and fair view. For that purpose, depreciation constitutes a charge on the profits. Part III of Schedule VI casts a responsibility for determining the adequacy of depreciation, on the directors of a company. It lays down that an amount which is in excess of that which is considered by the directors as reasonably necessary for depreciation shall be shown as a reserve.

3.18 Section 205 of the Companies Act is concerned with the determination of distributable profits and in such determination, the Act enjoins prior provision for depreciation. In this section, a choice is given to companies to provide depreciation to the extent allowable under the Income-tax Act and Rules or, in the alternative, to adopt the straightline method of depreciation.

3.19 There is a third area under the Companies Act where depreciation has relevance; that is, in the determination of net profits for the purposes of managerial remuneration under sections 309/198 read with sections 349/350 of that Act.

3.20 It is necessary to ensure that the recommendations made by us in regard to depreciation under the Income-tax Act do not result into a conflict with the provisions of the Companies Act. Again, the write off of depreciation can have various implications in the capital structure of companies, determination of debt equity ratio, determination of profits for bonus etc.

3.21 On a consideration of all these aspects, we are of the view that the basic concept of depreciation as a charge in determining the true and fair profits under the Companies Act should not be disturbed. The quantum of such depreciation would be left to the opinion of the directors under the provisions of the Companies Act. This quantum would necessarily be charged to the profit and loss account. In cases where companies choose to make a higher claim in Income-tax law according to our recommendation, the additional amount should also be debited in the profit and loss account. This additional debit may be made "below the line" (that is to say in the appropriation section of the profit and loss account) and would thus represent an appropriation of profits. Consistent with this approach, such amount would be credited to a depreciation reserve and the Income-tax Act should provide that such reserve should not be utilised for purposes of declaration of dividends. It can only be utilised for the purpose of ensuring that 100% of the cost of assets is charged to the profit and loss account by way of depreciation.

3.22 As against cases where companies wish to make larger claims in income-tax, than the fair charge of depreciation referred to in the preceding paragraph, there would likewise be cases where a lower claim or no claim is made in the income-tax assessment. In such cases, the amount to be allowed in income-tax shall be the amount that is charged in the profit and loss account of the previous year in question. If the company desires a nil allowance in income-tax, it should not charge the profit and loss account of that year; in that event such arrears of depreciation would be disclosed by way of a note on the accounts, as permitted by the Companies Act.

3.23 *We, therefore, suggest that the Government may consider consequential amendments to the provisions of the Companies Act so as not to result in any inconsistency with the scheme for allowance of depreciation under the Income-tax Act as recommended by us in para 3.10. The suggestion is that the distinction between the charge of adequate amount of depreciation and the additional amount which may be claimed at the taxpayers' option (as a measure of incentive and simplification under the Income-tax law) should be clearly maintained for all purposes. It would, therefore, not result in any inconsistency with other questions such as payment of dividend, bonus, managerial remuneration and provisions relating to capital issues, etc.*

3.24 The existing provisions for calculating depreciation on each asset separately, year after year, and for maintaining particulars so as to ascertain the written down value of an asset for the purposes of terminal adjustments, are complicated and cumbersome. We feel that, in dealing with business concerns as going concerns not operating with a view to liquidation, these matters can be considerably simplified. Calculation of depreciation separately for each item of asset should be unnecessary. *We recommend that, at every stage of addition of new assets, cost of the new assets may be aggregated with the written down value of the existing block and depreciation allowed on such consolidated block.*

3.25 The suggestion in the preceding paragraph leads to calculation of a lumpsum amount of depreciation for the entire block of depreciable assets in each of the three categories. Depreciation is not identified separately for the different items of assets. This procedure would necessarily lead to the consideration of the terminal adjustments to be made at the point of time when an item of asset is sold, discarded, demolished or destroyed. At present, taxpayers suffer a discomfiture on being taxed on deemed income under section 41(2) when items of assets are sold and other assets are purchased by way of replacement. The objective underlying the terminal adjustment is to ensure that the total depreciation in relation to any particular item of asset is limited to 100%, and this is achieved by allowing the shortfall in the year of sale [under section 32(1)(iii)] and likewise taxing excess depreciation allowed in the past in the year of sale [under section 41(2)]. In place of making these calculations intermittently in a running business with reference to items of assets, the same objective can be achieved by treating assets as a block. This may be achieved by reducing from the asset block the entire sale proceeds (or scrap sales, insurance or salvage monies realised) in the same manner as fresh additions to assets are added on to the cost of the asset block referred to in the preceding paragraph. The interests of revenue would be adequately safeguarded inasmuch as the surplus component in the realisation would go to reduce the written down value of the block and, consequently, the claim for depreciation in subsequent years. In effect, the recapture of the depreciation allowed in the past on such assets would be merely staggered. This would no doubt mean that, where the realisation by the sale of the assets exceeds its original cost, the excess, which is in the nature of a capital gain, will also ultimately suffer tax as ordinary income over a period of years by way of reduced depreciation allowances on the rest of the block. We do not consider this to be a serious disability; in fact, we regard this as a small price to pay for the simplification that would result. *We accordingly recommend that, with a view to obviating meticulous calculations, the entire sale proceeds (or scrap sales, insurance or salvage monies realised) of assets which are sold, discarded, demolished or destroyed should be reduced from the written down value of the asset block and that, if at any stage, the realisations exceed the written down value of the block, the excess should be taxed as profit. We further recommend that, as the entire block of assets whether they be (a) furniture and fixtures, or (b) buildings, or (c) plant and machinery, will continue to be depreciated until ultimately brought down to zero, there should be no deduction by way of a terminal allowance under section 32(1)(iii) at any intermediate stage. The grant of terminal allowance should only arise with reference to the shortfall when the entire block of assets is sold on the closure of the business or the closure of a distinct and separate part thereof.*

3.26 In the context of the scheme of allowing depreciation as recommended by us, *we recommend that the provisions for extra-shift allowance in respect of machinery and plant used in factories (general or seasonal) and approved hotels should be discontinued.*

3.27 Under section 32(2), unabsorbed depreciation of earlier years is carried forward and merged with the depreciation for the current year. There is a right to carry forward unabsorbed depreciation indefinitely. In the light of the changes in the scheme of depreciation suggested by us, these provisions would recede into the background as taxpayers may not choose to claim depreciation in the absence of profits. Nevertheless, there would be cases where taxpayers choose to do so, and cases where the option does not apply. Further, an apprehension has been voiced that the benefit of carrying forward the unabsorbed depreciation in relation to an asset may lapse if that asset is not in existence or in use for the purpose of business in subsequent years though the business itself may continue to be carried on. *We recommend that the existing provisions for carry forward of unabsorbed depreciation should continue. We further recommend that the benefit of carry forward and set off of unabsorbed depreciation should be allowed whether or not the asset in question continues to be used for the purposes of the business in the succeeding accounting years.*

3.28 We have recommended earlier that the charge under section 41(2) should not arise where the sale proceeds are set off from the written down value of the remaining block of assets. Taxpayers, who, re-employ the sale proceeds in purchase of other depreciable assets would be in a position to stagger the tax liability which would have arisen under section 41(2). The same benefit may not be available in cases where assets are fully taken over by the Government or any statutory authority. In such cases, the taxpayer may not have the choice of setting off the compensation amount against any block of assets as the entire assets may be the subject of the take-over. In a corresponding provision in section 54D relating to capital gains on compulsory acquisition of land and buildings, we note that reinvestment within a period of 3 years entails exemption from capital gains tax. *We accordingly recommend that a provision should be made to secure that, where depreciable assets of a business are taken over by the Government or any statutory authority, no profit will be taxed under section 41(2) if the taxpayer re-invests the sale proceeds or compensation moneys in the acquisition of other depreciable assets for any business within a period of three years from the date of acquisition.*

3.29 Our attention has also been drawn to certain anomalous situations in the matter of allowance of depreciation. In certain cases where a full deduction has been allowed in relation to a capital asset under other sections (as for example, section 35 which permits a deduction in respect of capital expenditure for scientific research), the taxpayers have contended that such deduction is independent of the allowance by way of depreciation. In our view, the intention of the legislature is not to allow a double deduction (of 200%) in respect of the same asset, once under section 35 and, again, by way of depreciation under section 32. If and to the extent that there is any anomaly or contrary view possible on a construction of section 35, *we recommend that the law should be clarified to provide that no depreciation under section 32 shall be allowable in respect of capital expenditure for scientific research qualifying for deduction under section 35.*

3.30 Based on the recommendations contained in the Final Report on Rationalisation and Simplification of the Tax Structure by Shri S. Bhoothalingam, that the salient principle should be that no category of business expenditure should fail to qualify for deduction in computation of taxable profits, a new section 35D was introduced by the Taxation Laws (Amendment) Act, 1970. The purpose underlying section 35D is to permit amortisation of various types of preliminary expenditure, which under the law do not constitute allowable revenue expenditure, nor constitute capital expenditure qualifying for depreciation. The various items of expenditure enumerated in section 35D are not exhaustive. Some of the items referred to by Shri Bhoothalingam do not appear in section 35D for no explicable reasons. *We recommend that the following items of expenditure, in particular, should also be eligible for amortisation against profits of a business over a ten-year period for tax purposes :—*

- (1) *Pre-operative expenses on administration and accounts departments and such other expenditure which does not directly relate to erection or acquisition of assets.*
- (2) *Expenses on shifting of a factory.*
- (3) *Payment for acquisition of intangible assets for which there is no other provision for amortisation.*
- (4) *Expenses on construction of Railway sidings and roads on land not belonging to the taxpayer.*

As some of these items are not necessarily "preliminary" in character, but would be incurred in a running business, it would be necessary to enlarge the scope of section 35D to cover these items as well.

3.31 The section already contains an enabling provision to prescribe under rules other items of expenditure which would then qualify for amortisation. Such a provision is essential as, at any given point of time, all possible circumstances cannot be visualised. It may be mentioned that expenditure, which would be allowable as business expenditure under other provisions such as expenditure on maintenance of roads, ordinarily would not fall under section 35D. The provisions of amortisation need apply only to cases where expenditure is not allowable as revenue expenditure and it does not result in the creation of a depreciable asset or it is such as does not qualify for allowance against profits under other provisions like sections 35A, 35E, 35CC, etc. *We recommend that any instance of such expenditure which results in disallowance as revenue expenditure and non-allowance of depreciation, should be promptly notified as and when the attention of the Government is drawn thereto.*

3.32 We are also of the view that, once an expenditure legitimately falls within the purview of the section, there should not be any further artificial restrictions on the quantum of such expenditure which would be eligible for amortisation. The quantum of business expenditure is dependent upon the exigencies of business and cannot be artificially regulated by any arbitrary norms. The fixation of such ceilings also defeats the underlying principle that no business expenditure fails to qualify for a deduction in computing business profits. *We accordingly recommend that the limitation on the totality of such expenditure now appearing under sub-section (3) of section 35D should be removed.*

3.33 Rule 9A under the Income-tax Rules provides for amortisation of expenditure on production of feature films. These rules are highly complex and should be simplified. *We recommend the adoption of the following simple formula:—*

- (a) *If the film is released 90 days prior to the close of the accounting year in which the production is completed, the entire cost of production should be allowed as a deduction in the relevant previous year.*
- (b) *If the film is released at any time within the period of the aforesaid 90 days prior to the expiry of the accounting year, 60% of the cost of production will be allowed in that accounting year and the remaining 40% will be allowed as a deduction in the immediately succeeding accounting year.*

3.34 While on the subject of depreciation, we also considered the practical operation of the provision in section 43A of the Income-tax Act. That provision was introduced in the Income-tax Act soon after devaluation of the rupee on 6th June, 1966. It was aimed at providing a workable basis for allowance of depreciation in cases where industrial concerns in India had acquired capital assets from foreign countries prior to the date of devaluation on deferred payment terms or by taking loans abroad repayable over a period of years. Consequent on the devaluation of rupee, the amount required for payment of the instalments of the purchase price or repayment of the loan, as the case may be, as and when they fell due underwent an increase. The section provides that, in such cases, the increase in the liability of the taxpayer in terms of rupees shall be added on to the actual cost of the asset and depreciation shall be allowed with reference to such increased cost. Correspondingly, the section also provides for a situation where the value of rupee in relation to any foreign currency appreciates at any future date whereby there is a reduction in the rupee liability of the taxpayer for the purpose of making payments towards the cost of the asset or towards the repayment of loan taken in foreign currency for acquiring the asset.

3.35 Conditions in the foreign exchange markets have, in recent years, undergone a sea-change. The rupee is now delinked from the sterling and the foreign exchange value of the rupee fluctuates from time to time as computed with reference to a "basket" of currencies. Accordingly, the provisions of section 43A have become quite cumbersome in actual operation in view of the fact that, as and when the value of the rupee in relation to any foreign currency undergoes fluctuation, the capital cost of assets acquired from abroad as computed earlier would require re-computation for the purpose of allowance of depreciation. We have considered this aspect of the problem and are

of the view that it is no longer necessary in the changed circumstances to make such adjustments to the actual cost of assets acquired from foreign countries for the purpose of depreciation as and when the foreign exchange value of the rupee undergoes any change. It would be simpler to treat such exchange differences on remittances as ordinary business income or expenditure. In the light of the flexibility available to the taxpayer in his depreciation claim, this recommendation would not lead to any hardship. *We, therefore, recommend that the law should be amended to secure that the actual cost of the asset in such cases is taken as originally computed with reference to the exchange rates prevailing on the date of acquisition of the same. Thereafter, any gain or loss occasioned to the taxpayer at the point of actual remittance of instalment of purchase price or loan, as the case may be, should be treated as a revenue gain or loss of the business and the actual cost of the assets should not be disturbed. As regards cases where the actual cost has already been adjusted under the existing provisions of section 43A, the gain or loss would be calculated with reference to such adjusted actual cost. In other words, as from the time the aforesaid suggestion made by us is in force, no further adjustments would be made under section 43A.*

3.36 In the case of certain taxpayers, particularly in the small scale sector, depreciable assets are frequently acquired under hire purchase arrangements. The strict legal position of such arrangements is that the ownership of the asset does not vest in the purchaser until all instalments of the hire purchase contract are fully paid. This may lead to a hardship in regard to the claim for depreciation by the purchaser as ownership of the asset is a precondition for allowance of depreciation. In order that such a hardship is not created on a technical view of ownership, the Board has issued administrative instructions permitting the allowance of depreciation on such assets to the purchaser. These instructions are subject to the condition that the vendor does not seek to claim depreciation as an owner who has hired out the asset in his own assessment. The intention is that depreciation on such asset is allowed only at a single place, viz., the purchaser who is putting the asset to use in his business though he may not technically be the full legal owner. *We recommend that, in the case of assets being acquired under hire purchase agreements, the purchaser should be entitled to claim the depreciation in his assessment provided that as between the purchaser and the vendor it is agreed that the purchaser alone shall be entitled to claim depreciation in respect of the same asset. The administrative instructions should preferably be incorporated in the law.*

CHAPTER 4

AMALGAMATION OF INDUSTRIAL UNITS UNDER SECTION 72A

4.1 Section 72A inserted in the Income-tax Act by the Finance (No. 2) Act, 1977, makes provision for certain tax advantages where a company owning an industrial undertaking amalgamates with another company in circumstances where the Government is satisfied that the amalgamation is in the public interest. The genesis of this provision was explained by the Finance Minister in his Budget speech in the following words :—

“73. Sickness among the industrial undertakings is a matter of grave national concern. Closure of any sizeable manufacturing unit in any industry entails social costs in terms of loss of production and employment, and also waste of valuable capital assets. Experience has shown that taking over of such units by Government is not always the most satisfactory or the most economical solution. A more effective course would be to facilitate the voluntary amalgamation of sick industrial units with sound ones by providing certain incentives and by removing impediments in the way of such amalgamation. It is accordingly proposed to provide that where an amalgamation is accepted by the Central Government to be in public interest, the accumulated losses and unabsorbed depreciation of the amalgamating company will be allowed to be carried forward and set off in the hands of the amalgamated company.”

4.2 Section 72A accordingly permits the carry forward and set off of the accumulated business losses and the unabsorbed depreciation of the amalgamating company (which is a sick industrial unit not financially viable) against the income of the amalgamated company in the following years. Without this special provision, such accumulated business losses and the unabsorbed depreciation would not have been allowed to be set off against the profits of the amalgamated company in the ordinary course, because such set off is available only to the taxpayer who incurred the loss or had the unabsorbed depreciation and not to the successor in business. This factor was considered to be a strong disincentive to the amalgamation of sick industrial units with sound ones and hence the Government felt the need to remove the disincentive as explained by the Finance Minister. In the light of the objective set forth in the Budget speech, as reproduced above, the facility of set off of accumulated losses and unabsorbed depreciation is subject to conditions which are intended to secure that the objective underlying the section is achieved effectively and that there is no misuse of the concession in the generality of cases of amalgamation. The first of these conditions is that the Central Government should be satisfied on the recommendation of the “specified authority” in regard to certain matters, which are as under :—

- (a) The amalgamating company was not, immediately before such amalgamation, financially viable by reason of its liabilities, losses and other relevant factors;
- (b) The amalgamation was in the public interest; and
- (c) Such other conditions as the Central Government may, by notification in the Official Gazette, specify, to ensure that the benefit under the section is restricted to amalgamations which would facilitate the rehabilitation or revival of the business of the amalgamating company.

The Central Government has since notified the constitution of the “specified authority” for the purpose of this provision. According to that notification, the “specified authority” will consist of—

- (1) Secretary, Department of Industrial Development, Ministry of Industry, Government of India; *Chairman*.
- (2) Secretary, Department of Company Affairs, Ministry of Law, Justice and Company Affairs, Government of India; *Member*.
- (3) Secretary, Ministry of Labour, Government of India; *Member*.
- (4) Secretary, Department of Economic Affairs, Ministry of Finance, Government of India; *Member*.
- (5) Chairman, Central Board of Direct Taxes, Ministry of Finance, Department of Revenue, Government of India; *Member*.

The Central Government does not so far appear to have issued any notification specifying any other conditions as referred to in item (c) referred to above. However, the Ministry of Industry (Department of Industrial Development) have recently issued certain guidelines which the Government proposes to keep in mind while examining applications by industrial units for the requisite declaration under the section.

4.3 In addition to the initial exercise of getting the satisfaction of the Central Government on the recommendation of the “specified authority” as set forth earlier, the amalgamated company has to satisfy certain further conditions

in the following years in order that it may continue to enjoy the benefits of set off of the losses and unabsorbed depreciation of the amalgamating company from year to year. These are :—

- (i) The business of the amalgamating company is carried on by the amalgamated company during the relevant previous year without any modification or reorganisation. If the amalgamating company has made any modification or reorganisation in such business with a view to securing greater economy and efficiency, such modification or reorganisation should have the approval of the Central Government.
- (ii) The amalgamated company should furnish along with its return of income for the relevant assessment year in which the set off is claimed, a certificate from the "specified authority" that adequate steps have been taken by that company for the rehabilitation or revival of the business of the amalgamating company.

4.4 The rationale of the various conditions which are required to be satisfied by the amalgamated company in order to become eligible for the tax benefits conferred by the new provision is to prevent misuse of the concession in the generality of cases of amalgamation. However, the provisions as they stand are likely to give rise to certain practical difficulties in actual implementation and unless these difficulties are removed, the amalgamations aimed at may not take place to the extent desired by the Government. These difficulties and the possible solutions to these are set forth in the following paragraphs.

4.5 The first problem which may confront a company which considers taking over of the business of a sick industrial unit in order to qualify for the tax benefits provided by the section arises out of the position that, under this section as it stands, it appears that the amalgamation has to be effected first and thereafter the "specified authority" has to be moved for the purpose of making a recommendation to the Central Government. In the guidelines recently issued by the Government as mentioned in paragraph 4.2 above, it is indicated that, although a formal recommendation to the Central Government under section 72A(1) will be made by the "specified authority" only after the amalgamation of companies has been effected, an application for approval of the scheme of amalgamation may be made to the "specified authority" even before such amalgamation has actually taken place. It is further stated in the said guidelines that, if the "specified authority" is satisfied that the scheme of amalgamation is in the public interest and that the other conditions mentioned in section 72A(1) are also fulfilled, it may indicate to the amalgamated and amalgamating companies that, in the event of the amalgamation being finally effected on the basis of the scheme presented to and approved by the "specified authority", it would make a formal recommendation to the Government for making a declaration under section 72A(1). While this assurance is indeed welcome, *we recommend that, in the fitness of things, the substance of the assurance should be incorporated in the law by a specific provision to permit an application to the Central Government by the concerned company with a scheme of amalgamation for consideration as to whether the terms of the proposed amalgamation as set forth in the scheme are such as to meet the requirements of the section. Once the application is approved, then the companies concerned can go ahead with the scheme and obtain the court's approval to the same and implement it accordingly. Natural justice requires that the Central Government should give an opportunity to the companies concerned to explain the scheme and, if there are any objectionable features, the companies should be allowed to modify the scheme suitably so that it meets with approval.*

4.6 The section provides for deeming the unabsorbed depreciation and the accumulated loss of the amalgamating company as the loss and depreciation of the amalgamated company "for the previous year in which the amalgamation was effected". The procedure for implementing an amalgamation may be protracted and long drawn out as the necessary formalities are required to be carried out under the provisions of the Companies Act and, where applicable, the Monopolies and Restrictive Trade Practices Act, Capital Issues Control Act, Foreign Exchange Regulation Act, etc. This time-lag in completion of formalities may raise questions as to what is the relevant previous year when the amalgamation can be said to be effected. In order to remove any possible doubt or controversy in this regard, *we recommend that the declaration to be issued under the section should clearly specify the previous year of the amalgamated company in which the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss and depreciation of the amalgamated company.*

4.7 The section stipulates the various conditions upon which an amalgamation could qualify for a declaration under the section. As mentioned earlier, the section empowers the Central Government to notify further conditions in the Official Gazette. As notifications may be issued by the Central Government from time to time, the conditions required to be fulfilled would also vary from time to time. *We accordingly recommended that when a scheme is submitted to the Central Government under the abovementioned procedure, the Central Government should examine it only with reference to the conditions spelt out in the section itself and any other conditions which may already have been notified pursuant thereto. In other words, further notifications which may be issued by the Central Government should only apply prospectively to schemes of amalgamation which may be submitted for approval after the date of issue of the notification.*

4.8 The section at present contemplates the satisfaction of the Central Government as a condition distinct and separate from the recommendation of the "specified authority". It is not clear whether, even where the "specified authority" makes a recommendation, the Central Government would apply any further tests before recording its satisfaction or, having regard to the composition of the "specified authority", consisting as it does of four Secretaries of the Central Government in the Ministries concerned with Industrial Development, Company Affairs, Labour and Economic Affairs, and the Chairman of the Central Board of Direct Taxes, the satisfaction of the Central Government would be a virtual certainty once the "specified authority" makes its recommendation. The latter would be the

more reasonable view of the provision as it stands. In that view of the matter, it would be a mere duplication of proceedings—one before the “specified authority” and the other before the Central Government; the former to make the recommendation and the latter to issue the declaration. In our view these should be coalesced. *We accordingly recommend that the section should provide for a declaration being issued by the Central Government (or in the alternative, by the “specified authority”) on an application by the amalgamated company as a single proceeding.*

4.9 As regards the additional conditions to be fulfilled by the amalgamated company whilst availing of the benefits of carry forward and set off from year to year as stipulated in sub-section (2), we feel that the objective can be achieved in a simpler manner. The existing provisions for approval of the Central Government under clause (i) and certificate of the “specified authority” under clause (ii) are unduly complex. *We recommend that the section be*

CHAPTER 5

TAXATION OF CASUAL INCOMES

5.1 Casual and non-recurring receipts were traditionally regarded as not taxable, and were exempted from taxation under section 10(3) of the Income-tax Act as it stood before its amendment in 1972. As such exemption was found to provide an avenue for channelling undisclosed incomes, the Wanchoo Committee recommended withdrawal of the exemption. The predominant consideration was to plug the loophole for evasion rather than to serve as a revenue raising measure. With a view to bringing into the fold of taxation various items of casual and non-recurring receipts, some far-reaching changes have been made in the Income-tax Act in 1972.

5.2 Sub-clause (ix) of clause (24) of section 2 was introduced by the Finance Act of 1972 to bring within the definition of income, winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

5.3 However, winnings from lotteries and crossword puzzles are dealt with differently from the other items of casual income, for the purpose of deduction of tax at source under section 194B which reads as under:—

“The person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle in an amount exceeding one thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force.”

Additionally, winnings from lotteries (but not those from crossword puzzles) in the case of taxpayers other than companies, are treated differently for the purpose of taxation under section 80TT by allowing a deduction of the first Rs. 5,000 and 50% of the balance to determine the taxable portion. This treatment is broadly similar to the treatment accorded to long-term capital gains under section 80T. Other items of casual receipts enumerated in section 2(24)(ix) are taxable in the same manner as ordinary income, subject to exemption of the first Rs. 1,000 as specified in the amended section 10(3). Thus, we have today as many as five sub-divisions in the matter of tax treatment of casual incomes. These are:—

(1) *Taxpayers other than companies :*

- | | |
|---|--|
| (a) Lottery winnings | Rs. 5,000 plus 50% of the balance exempt; rest taxable, tax deductible at source when winnings exceed Rs. 1,000. |
| (b) Crossword puzzles winnings | Excess over Rs. 1,000 taxable as ordinary income. Tax deductible at source when winnings exceed Rs. 1,000. |
| (c) Other casual incomes falling under section 2(24)(ix). | Excess over Rs. 1,000 taxable as ordinary income. Tax is not deductible at source. |

(2) *Companies :*

- | | |
|---|--|
| (a) Lotteries and crossword puzzle winnings. | Excess over Rs. 1,000 taxable as ordinary income. Tax deductible at source when the winnings exceed Rs. 1,000. |
| (b) Other items of casual income falling under section 2(24)(ix). | Excess over Rs. 1,000 taxable as ordinary income. Tax is not deductible at source. |

This scheme, therefore, provides a fertile field for mistakes in assessments and causes needless confusion in the minds of the taxpayers.

5.4 Upto assessment year 1972-73, receipts enumerated in sub-clause (ix) of clause (24) of section 2, enjoyed tax exemption by virtue of section 10(3) as it existed then. Invariably, every recipient was anxious to secure evidence in support of his claim that the receipts were not taxable. In particular, it may be mentioned that cheques were generally insisted upon to collect jackpot winnings from race courses. After section 10(3) was amended by the Finance Act of 1972, a complete change has taken place. There is a reluctance to receive winnings by cheque. Needless to say, such a system encourages breeding of black money and its proliferation. This has thus worked exactly in the opposite direction to what was envisaged by the legislation. In its well-meant attempt to bring into the tax net all items of income which are of casual and non-recurring nature and to make them bear the full brunt of tax with a concessional tax treatment only to lottery winnings in the case of non-corporate taxpayers, the Government seems to have failed to achieve the intended objective.

5.5 The Comptroller and Auditor General's Report for 1975-76 indicates collections from the sources mentioned in sub-clause (ix) of clause (24) of section 2 to be a little over Rs. 1 crore only. Jackpot payments all over the country alone are estimated to run into several crores of rupees. It is, therefore, expedient to devise some procedures for getting some tax at least from such winnings. *To achieve this, we recommend that section 194B should be enlarged to encompass in its fold all the items appearing in sub-clause (ix) of clause (24) of section 2 where the payer is an organised body.*

5.6 *To ensure that taxpayers as far as possible obtain their winnings from various recognised sources such as race clubs, and other social clubs, we further recommend that section 80TT should be amended to include, in addition to lottery winnings all the other items which are mentioned in sub-clause (ix) of clause (24) of section 2 and that all these items should be treated in the same way as lotteries by deducting 50% of the amount in computing the total income, with the difference that in respect of these additional items, the initial deduction should be limited to what is allowable under section 10(3), viz., Rs. 1,000. In the case of companies having any such income, we recommend that the position under the present law may continue, with the modification that the provisions for deduction of tax at source under section 194B as modified as suggested, should apply also to payments of casual incomes made to companies.*

5.7 If the aforesaid recommendation is accepted by Government, it will not only lead to better collection of revenue but will, to some extent at least, bring into legal channels money for economic development.

CHAPTER 6

ADDITIONAL INCOME-TAX ON UNDISTRIBUTED PROFITS

6.1 Sections 104 to 109 of the Income-tax Act provide for the levy of additional income-tax, in certain circumstances, on undistributed profits in the case of closely-held companies, *i.e.*, companies other than those in which the public are substantially interested as defined in section 2(18) of the Income-tax Act and wholly-owned subsidiaries of such companies. All public companies whose shares are listed on a recognised Stock Exchange in India are automatically regarded as companies in which the public are substantially interested and, therefore, these sections do not apply to such companies and their wholly-owned subsidiaries.

6.2 If any company to which the provisions of sections 104 to 109 apply, fails to distribute dividends to the extent of the prescribed percentage of the distributable income, within twelve months of the end of the previous year, it is liable to pay an additional tax. The quantum of this additional tax is 50%, 37% or 25% depending on whether the company is an investment company or a trading company or any other class of company respectively.

6.3 The object of these sections is to prevent avoidance of tax by the shareholders of a closely-held company. By retaining the income in the company without distribution as dividends and by having it distributed in years of their choice, the shareholders in control of a closely-held company, particularly those having income in the higher brackets, would be in a position to avoid or substantially reduce the tax payable by them on such dividends. The position is all the more highlighted in the case of investment companies where shareholders utilise such companies as holding mechanisms for their investments. Companies receiving dividend income also enjoy a further benefit as intercorporate dividends are taxed at a substantially lower rate of tax than the ordinary income of the company. The retention of the balance of profits in the company results in substantial tax savings to the shareholders.

6.4 The scheme for levy of additional tax under section 104 has to be considered in the light of the totality of the tax incidence on companies. At present, closely-held companies are already subjected to higher rates of tax than widely-held companies. The question is whether, despite this higher levy, there is a case for further levy of additional income-tax under section 104.

6.5 The question of declaration of dividends and adequacy of dividends cannot be considered in the abstract. The Supreme Court has, on more than one occasion, observed that the question must be considered objectively, judged by business considerations. Reasonable requirements of the future have also to be considered, apart from the financial position of the company. Factors such as depreciation in the value of investments, anticipated losses of future years, borrowings, general financial position, etc., are all relevant. In the face of such widespread considerations of business exigency, it would be very difficult to sustain an assessment of additional tax under section 104 in a large majority of cases.

6.6 Further, restrictions on dividends was one of the features of the anti-inflationary policy of the Government. Considerable emphasis is currently being placed on the need for restraint in dividend distributions. The need on the part of the companies to plough back resources for development of trade, commerce and industry is also pressing.

6.7 It should also be remembered that the Income-tax Act is a part of a scheme of an integrated tax structure. The provisions relating to "deemed" dividends, under section 2(22), are an effective check on the use of companies' resources for private purposes. It is not easy for the shareholders to take advantage of the corporate veil without adverse consequences under the Income-tax law. Apart from this, there is already a provision for levy of wealth-tax on shares, levy of capital gains tax on transfer of shares and levy of gift tax or estate duty on transmission of shares *inter vivos* or on death.

6.8 Shri Bhoothalingam, in his Report on Rationalisation had suggested the discontinuance of the provisions under sections 104 to 109. The Wanchoo Committee had also come to the same conclusion and recommended abolition of these provisions. In the year 1964, the provisions of these sections were considerably relaxed in the case of industrial companies. The objective then sought to be achieved was to infuse confidence in the corporate sector to augment resources from within and without. The corporate sector was expected to strengthen its resources and augment its capacity to develop. It was also thought desirable to discourage the dissipation of additional resources by payment of higher dividends.

6.9 Contrary to the recommendation of the Wanchoo Committee, the Taxation Laws (Amendment) Act, 1975 extended the levy under section 104 to cover even cases of industrial companies, from the assessment year 1976-77 onwards. This anomaly was promptly set right by excluding industrial companies from the purview of these sections by the Finance (No. 2) Act, 1977. The Hon'ble Finance Minister in his budget speech, observed: "From

the point of view of maximising expansion of industry, I can see little merit in compelling closely-held industrial companies to distribute a high percentage of their net profits as dividends".

6.10 It would not be out of place here to point out that the trend of company legislation in recent years has been to ensure at least a minimum plough back of profits and further to restrict the withdrawals from reserves for payment of dividend under section 205(2A) and section 205A of the Companies Act, 1956. It would, therefore, be prudent to leave the issue of dividend distribution to the business consideration of the Boards of Directors of companies.

6.11 We are of the considered opinion that the latest provision exempting closely-held industrial companies from the ambit of section 104 is a step in the right direction. If there is justification for excluding industrial companies, there is likewise justification for excluding the other categories of companies as well, inasmuch as trading companies and service companies do contribute to economic growth and employment and supplement the role of industrial companies in this regard. These companies provide feeder services to industrial companies and there is hence a case for excluding such companies also from the operation of sections 104 to 109. There is an imperative need to increase corporate savings even in such companies and to channel these into productive investments and thus accelerate the pace of economic growth. In the circumstances explained above and taking a total view of the corporate tax structure, we recommend that the provisions of sections 104 to 109 should be applicable only in the case of closely-held investment companies, while other closely-held companies should be excluded from their purview.

6.12 We have recommended that investment companies should still be subjected to the restrictions under these sections as these companies enjoy a concessional tax treatment in relation to their main source of income, namely, dividend income, where the tax rate is around 27% (Nil in certain cases) against the rate of 68.25% applicable to the other income of such companies in general. This should be viewed in comparison with the personal rate of tax which reaches upto 69%. Thus, whilst the differential in the tax rate between closely-held companies in general and individuals is not significant, there is a significant difference in the tax rate applicable to dividend income of such companies and the personal rates of tax. Again, investment companies are capable of, and are, being used as a medium for holding investments and for acquiring further investments as a means of gaining share-holding control. Non-compulsion in the matter of distribution of dividends in such cases is likely to contribute to concentration of economic power, which needs to be checked. The accumulated earnings are likely to be further utilised in acquiring control over other companies. For strengthening the redistributive role, which direct taxes ought to play, it is necessary that such companies are kept within the restrictions of the penal provisions of section 104. The safeguards at present obtaining for assessing the reasonableness of dividends in genuine cases may be continued even under the amended scheme as recommended by us.

CHAPTER 7

ASSESSMENT PROCEDURE

7.1 One of the terms of reference of the Committee is to suggest ways and means of improving the administration of the direct tax laws and expediting assessment, appellate and other proceedings under those laws. One of the areas to which attention needs to be directed urgently is in the matter of assessment procedure which constitutes the most important operation in the administration of the tax laws.

7.2 Mounting arrears of work has plagued the Income-tax Department for many years. The latest report of the Comptroller & Auditor General of India for the year 1975-76 discloses the following position regarding pendency of income-tax assessments as at the end of each year :—

	No. of assessments pending
1971-72	11,23,705
1972-73	13,92,665
1973-74	17,19,597
1974-75	16,77,481
1975-76	17,26,683

We have been informed that the pendency has gone up to 17,41,838 at the end of March 1977. Apart from this, there are also several loose ends in the form of pending rectifications, orders giving effect to appeal decisions, follow up of audit objections, etc., which also constitute arrears in relation to assessments. Perhaps the number of cases which are pending for rectification would itself constitute a formidable load of arrears.

7.3 During the last 6 years when the Summary Assessment Scheme has been in operation, the arrears of assessments have shot up from 11.23 lakhs to 17.41 lakhs which represents almost 50% of the assesseees as on 31st March, 1977. It is, however, on record that the Department has succeeded in bringing down the pending assessments from the peak figure of 23.47 lakhs in 1966-67. This may be attributed to various reasons, including the reduction in the time limit for completion of assessments on and from assessment year 1968-69. The Finance Act of 1968 reduced the time limit for completion of assessments from 4 years to 2 years. In making this change, the then Deputy Prime Minister and Minister of Finance stated that the measure was aimed at expediting tax assessments. It is, therefore, quite natural that the pendency of cases should have come down. A further reason for reduction of pending assessments would be the provision for summary assessment under section 143(1) introduced from 1st April, 1971 by the Taxation Laws (Amendment) Act, 1970. The aim of the Summary Assessment Scheme was to speed up regular assessments at least in the bulk of the cases which involve no contentious points. Although the legal provisions do not place any limitation on the type of cases in which a summary assessment may be made, in practice, the Summary Assessment Scheme has been limited to certain categories of cases. Cases requiring scrutiny in the interest of revenue are segregated at the initial stage itself and excluded from the Scheme. The check on the disposal of cases under the Scheme is exercised by individual lists prepared separately for scrutiny cases and summary assessment cases, such lists being maintained by the Income-tax Officer, the Inspecting Assistant Commissioner and the Commissioner of Income-tax. It is further contemplated that a certain proportion of the assessments made under the Scheme should be subjected to scrutiny on a selective or, on random sampling basis. The Department aims at ensuring at least 70% of assessments being completed under the Scheme and this percentage is intended to be increased progressively to 90%. Another factor to be noted in this connection is that the exemption limit was raised from Rs. 6,000 to Rs. 8,000 by the Finance Act of 1975, having been earlier increased from Rs. 5,000 to Rs. 6,000 under the Finance Act of 1974. The limit has been further increased to Rs. 10,000 under the Finance Act of 1977. This is apart from the liberalisation of the tax reliefs under section 80C and 80L (Life Insurance Premium/Provident Fund Payments and income from bank interest, dividends, etc.). These measures would have further reduced the number of income-tax assesseees.

7.4 Many efforts have been made to overcome the mounting arrears of assessments and bringing them upto date. Experiments were made in spot assessments, quick assessments, summary assessments, etc., but with little success. From the unitary system the Department switched over to a functional system some years ago and switched back to the unitary system in 1974. This experiment and the ultimate abandonment of the functional system have added to the problems of administration already prevailing in the Department. All the various experiments referred to above have not helped to solve the problems of mounting arrears. It is in the context of the aforesaid measures that the problem of arrears exceeding 17 lakhs calls for appropriate remedial action.

7.5 With a view to better understanding of the problems faced by the Administration in the task of completion of assessments, the Chairman and some of the Members of the Committee visited some of the offices in Bombay.

The problems noticed during these visits were principally in regard to inadequacy of space, and inadequacy of staff even within the sanctioned limits. Correspondingly, the maintenance of the Departmental records was far from satisfactory. The inspection led to the inference that the problem faced by the Department is one of extreme strain on its man-power and other physical resources.

7.6 The pursuit of any over-ambitious objectives makes considerable demands on the man-power requirements, on the one hand, and space for accommodating these officers, staff and files, on the other. In order to meet the increasing work-load, the strength of officers (and corresponding staff) has been steadily augmented over the years, as the following figures will show:—

Sanctioned strength of	On Sept. 1944	On Sept. 1977
C.I.T.	8	80
A.Cs.	53	575
I.T.O. Class I	334	1,454
I.T.O. Class II	83	1,972
	478	4,081

We have come to the conclusion that this system of planning man-power requirements to match the work-load overlooks the fact that, whereas work multiplies without notice, man-power cannot be multiplied instantaneously to keep pace with work-load. It is humanly impossible to continuously expand man-power and other physical resources *pari passu* with the work-load.

7.7 The Administrative Reforms Commission in its Report on Direct Taxes Administration (January 1969) had also drawn attention to the knotty problem of the growth of arrears of assessments. The Commission recommended steps to seek liquidation of the arrears as early as possible and prevention of further accumulation. The strategy proposed was to adopt a summary method of disposal of small income cases which are comparatively unimportant from the revenue point of view, and to devote better attention to the bigger income ones. The Wanchoo Committee broadly approved the general principles underlying the small income assessment scheme but recommended the adoption of uniform norms throughout the country for selection of cases for scrutiny. The Committee also recommended the deployment of Assistant Commissioners for assessment work in investigation and large revenue cases.

7.8 A stage has now been reached when constraints in expanding the man-power and other physical resources have made it imperative to consider alternative and better ways to tackle the mounting work-load. Planning to fit work-load to man-power seems to be the only answer to the problems confronting the Department. At any given point of time man-power position is known; its capacity and optimum level of output can also reasonably be ascertained. The solution would be to dovetail the work-load to match the available man-power resources and the output capable of being efficiently and effectively provided by these resources. Therefore, only that much work-load must be tackled, which can be effectively handled. In regard to the rest of the cases, the returns of income should be virtually accepted. Such a procedure should necessarily be consistent with the interests of revenue and relevant safeguards are indicated.

7.9 The bulk of the returns are received by 30th June and another lot by 31st July every year. *We recommend that the Department must so gear itself that, by deploying its entire work-force, it would be in a position to check whether the returns are complete and payments adequate, within a period of 3 months from the receipt of the returns. To facilitate this, we recommend that the particulars to be submitted with the return should be clearly indicated in a manner easily intelligible to the taxpayer. At the same time the particulars should be such that a rapid scrutiny would reveal compliance by the taxpayer and instances of non-compliance would be readily discernible. In particular, the return should contain :—*

- (i) *Statement showing computation of income under each head separately, disclosing all allowances and deductions claimed;*
- (ii) *Statement showing computation of the tax payable, along with claims for credit for tax deducted at source, advance tax paid and self-assessment tax paid, supported by the relevant certificates and receipted challans;*
- (iii) *Attested copies of trading and profit and loss account or income and expenditure account, balance-sheet, partners'/proprietors' capital accounts, etc; and*
- (iv) *Compulsory deposit receipts.*

7.10 To ensure success of the new procedure, *we recommend that the taxpayer should be cautioned in regard to the following matters :—*

- (a) *If the return is not complete in all respects, it is liable to be treated as an invalid return, with the consequence that the taxpayer will be regarded as being in default for the purposes of interest, penalty and prosecution, as if there is failure on his part to file the return.*

- (b) *Although the assessment may, in the first instance, be completed under section 143(1), the taxpayer will become liable to penalty and prosecution in case the computation of income and deductions is found to be inaccurate and/or any escaped income is brought to assessment.*

The above should follow as a natural consequence of the scheme of voluntary compliance on the part of taxpayers and acceptance of returns. The purpose of the initial scrutiny should be merely to ensure that taxpayers have filed complete and valid returns. At the same time, the data which is brought on record would, on scrutiny or review, enable the Department to initiate re-assessment proceedings, should these become necessary.

7.11 The initial screening is bound to reveal defects and deficiencies in some of the returns. *With a view to encouraging the filing of complete returns, we recommend that there should be a specific legal provision according to which incomplete returns will be treated as invalid ones, attracting consequential interest for delayed submission, to be calculated till the date of filing a correct and valid return. Wherever it is observed that the return is incomplete in any respect, a standard form of notice should be sent to the taxpayer directing him to supply all the relevant missing particulars so as to enable the return to be treated as duly filed. It should be clarified in this notice that the data should be filed within, say, 15 days without any further reminder, reference or extension and that, pending such filing, the return will not be treated as a valid return and the taxpayer will be deemed to be in the position of one who has not filed a return. The return itself need not be sent back to the taxpayer except in cases where some error or commission or omission therein requires to be rectified by him.*

7.12 *As the new assessment procedure outlined above is based on voluntary compliance of tax laws and mutual trust, we recommend that notices under section 139(2) need not be issued to taxpayers already on the registers of the Department. Such notices need be issued only to new taxpayers discovered in the course of searches or survey operations, or persons who have failed to file returns within the time limit.*

7.13 The present law requires passing of an assessment order in each case. If the bulk of the returns are to be accepted without detailed scrutiny, assessment orders in such cases would be superfluous. *We recommend that the law may be amended whereby an assessment is deemed to be completed on the sending of an acknowledgement attached to the return itself as a tear-off slip.*

7.14 The bulk of the returns having been disposed of on the summary basis in accordance with the procedure outlined in the preceding paragraphs, the Department will be in a position to devote greater attention to the scrutiny of cases involving large revenue. *We recommend that, in cases of returns where any unusual features like partition of H.U.F., cessation of business, dissolution of a firm are noticed during rapid scrutiny, they should be referred to the Commissioner for Directions for inclusion in the random sampling scrutiny group. We further recommend that, taking into account the man-power available, the Central Board of Direct Taxes should issue an annual programme laying down the criteria for selection of cases for scrutiny. In our view, the cases selected for scrutiny should cover the following types of cases:—*

- (i) *All company cases.*
- (ii) *Sensitive cases. These will include cases where tax evasion is suspected and cases where the Board considers a detailed scrutiny would be necessary irrespective of income returned on the basis of information available in the return or otherwise. It may include certain trades or professions or even individual cases.*
- (iii) *A certain proportion of other cases picked up by random sampling, depending on the man-power available.*

7.15 Ordinarily, it should not take much time to pick up cases for scrutiny. The Board will decide all the sensitive cases and cases with large revenue implications. Information available with the Intelligence Wing may also help in picking up such cases. The Board, in consultation with the Commissioner, can determine the percentage of cases to be picked up for random sampling. We would like to emphasise that the Board in fixing work-load should ensure that scrutiny of the cases set apart for the purpose, is thorough and systematic in every respect. For this purpose, realistic work norms should be fixed. The success of the scheme lies in trusting the taxpayer and hitting hard when a tax evader is caught. Immediate prosecution should be launched when fraud is detected.

7.16 With the return to the unitary system and with the work-load reduced to controllable limits, the assessing officer will not find it difficult to collect the revenue raised by him through assessments. Even recovery proceedings can be undertaken by him. This will allow the bulk of Recovery Officers to come back into the mainstream of assessment work. This again will enable the Department to increase its scrutiny cases annually. It may take some time before the Recovery Officers are recalled as they are having plenty of work on their hand at the moment. At least some of it ought not to be there as many a complaint has been received that often recovery certificates are issued despite the fact that all taxes have been paid.

7.17. We also considered the problem of belated returns and the suggestion as to whether such cases should straightaway be taken to scrutiny. It was felt that there may always be genuine cases where delay may be unavoidable. *We, therefore, recommend that such cases should be left to the discretion of the Commissioner to decide on merits whether the circumstances justify the case being taken up for scrutiny.*

7.18 In any scheme of voluntary compliance it should be for the taxpayer to buy time and the cost is to be metered right from the date on which the return is due upto the date of filing the return. We consider that the present rate of 12% per annum reckoned on the final tax payable (that is to say, tax as reduced by the advance tax and tax deducted at source) is not adequate enough. It does not serve as a deterrent at all in cases where a substantial portion of the tax has already been paid by way of advance tax and deductions at source. In fact, the normal scheme of things would be for taxes to be so paid in a large majority of cases. It is, therefore, necessary to have a greater deterrent by increasing the cost of delays in filing returns. *We, therefore, recommend that, while the rate of determining the cost may be retained at 12% per annum, it should be applied to the gross tax on the total income as determined on regular assessment, that is to say, the tax without deduction of advance tax and taxes deducted at source. We further recommend that the taxpayer should be required to calculate this additional sum for each completed month of default on the basis of his return and pay it before filing the return, failing which the Income-tax Officer also should be empowered to calculate the amount at the time of the regular assessment.*

7.19 The law, at present, provides for the levy of a penalty for failing to pay the self-assessment tax, quite apart from the penalty, if any, that may be levied for delay or failure to furnish the return of income. In the context of our recommendation that a return of income, which is not accompanied by proof of payment of the self-assessment tax, would be incomplete and hence invalid, there will be no occasion for invoking the provision for levy of penalty for failure to pay the self-assessment tax. *We, therefore, recommend that the provision in section 140A(3) should be deleted.*

7.20 We also feel that there should be a time limit even for belated filing of return under the "Buy Your Time" concept and *recommend that, in the event of delay beyond a period of 90 days from the due date, the penal provisions should come into play. We also recommend that, in such cases, if the default persists, the Income-tax Officer should complete the proceedings on a best judgment assessment basis even before the end of the assessment year concerned.*

7.21 It will be apparent that the provision for levy of a cost for delayed filing of returns would not be a sufficient deterrent in cases where no tax is payable at all as, for example, returns showing a loss, returns of trusts, etc. *We recommend that, in such cases, the law should provide for an outside time limit to coincide with the end of the assessment year and secure that any such return received after the end of the assessment year will not be treated as a valid return. Claims for refund of tax deducted at source will, however, continue to be entertained upto 2 years from the end of the assessment year, as under the present law.*

7.22 There need be no apprehension that, by accepting returns, substantial revenue will be lost, as the bulk of the taxes is collected before the assessment by way of tax deducted at source, advance tax and self-assessment tax, as would be apparent from the following statistics :—

	31-3-1977	31-3-1976	31-3-1975	31-3-1974
	(Rupees in crores)			
(a) Net collections during the year	2,079.69	1,832.08*	1,544.00	1,304.53
(b) Pre-assessment collections by way of advance tax, tax deducted at source and self-assessment tax	1,959.99	1,757.12	1,479.96	1,201.46
(c) Net collections of regular assessments	119.70	74.96*	64.05	103.07

*Excludes collections of Rs. 199.24 crores under the Voluntary Disclosure Scheme.

[Source : Report of the C. & A.G. on Revenue Receipts, Direct Taxes for the relevant years.]

7.23 The latest available report of the C. & A.G. regarding searches and seizures conducted and assessments completed, as on 31-3-1976 shows the following position:—

Asst. Year	Searches conducted	Assts. Completed
1973-74	538	208
1974-75	2,029	290
1975-76	2,635	826

It is, however, seen that while the Income-tax Officers have disposed of 24,80,619 summary assessments during the year 1975-76, they have not been able to pay adequate attention to search and seizure cases, which are all sensitive cases, where considerable revenue is likely to be involved.

7.24 We would hasten to add that we do not deny for a moment that the Department has all the talent needed to effectively administer the tax laws. The problem is one of overwhelming work-load. In the face of mounting work and statistics required to be maintained, the arrears act as a millstone preventing expeditious and efficient administration of the tax laws. No Income-tax Officer has been able to give undivided attention to cases of fraud, evasion, etc. He is compelled by the force of numbers to spread his attention thinly over thousands of cases with the result that cases are not completed perfectly. Thus, during the year 1975-76, prosecutions for tax frauds were launched

only in 89 cases, although penalties for concealment were levied in 8,234 cases. If an Income-tax Officer is given only the work-load that he can tackle, better results are possible by way of better assessments, better collections and better enforcement of the tax laws. From the following all-India statistics, it would be evident that the Department has been exerting itself towards tackling the problem of arrears although without significant impact on the arrears :—

Year ended 31st March	Work-load for disposal (in lakhs)	Assts. disposed of (in lakhs)	Percentage of Col. (3) to Col. (2)	Balance (in lakhs) Col. (2) less Col. (3)
(1)	(2)	(3)	(4)	(5)
1972	49.67	38.44	77.4	11.23
1973	49.90	35.98	72.1	13.92
1974	51.55	34.36	66.6	17.19
1975	55.18	38.40	69.6	16.78
1976	57.34	40.07	69.9	17.27
1977	56.90	39.49	69.3	17.41

7.25 There are at the moment Central Circles to deal with complicated cases and cases where tax evasion is suspected. This sort of concentration has not resulted in any significant success. The brief talk we had with some of the Commissioners has revealed that the system has resulted in cases with unreliable arrears being passed on after completion of the assessments. Disperse and hit may be a good strategy to tackle tax evasion cases. In view of the new scheme of assessment, there would be no need to superimpose Central Charges on regular charges, and each Commissioner would be having his own Central Charges, so to speak, where Officers with special pay could be usefully deployed in tackling sensitive cases. *We, therefore, recommend that the Central Circles be abolished. Instead, each Commissioner should have an investigation unit within his own charge for handling cases requiring intensive investigation. Officers posted to these circles must have adequate experience in investigation work and should be allowed special pay. It would even be desirable to entrust investigation cases to two income-tax Officers exercising jurisdiction concurrently under the close supervision of an Inspecting Assistant Commissioner. Reasonable disposal targets should be fixed for such investigation work allowing adequate time for scrutiny in depth. Each Commissioner may also have his own Intelligence Unit which would work in close liaison with the Central Intelligence Units organised on an all-India basis.*

7.26 Our attention has been drawn to a lacuna in section 146(2) which imposes a time limit of 90 days for the disposal of an application under section 146(1). The section is silent on the consequence, if any, of the Income-tax Officer's failure to pass an order within that period. *We recommend that the law be amended to provide that if the Income-tax Officer fails to dispose of the application within the specified period of 90 days, the assessment shall be deemed to have been cancelled and proceedings reopened.*

7.27 It is only in a situation under the new assessment scheme as recommended hereinabove that the Department can face each year's task afresh and ensure a fair disposal of assessments, which are neither open to a charge of being perfunctory or to the charge of being overpitched or vexatious. The scheme outlined by us will enable clearance of 96% of the work-load during the same year, as would be evident from the following analysis for the financial year 1976-77 :—

(1) Total work-load of assessments	56.90 lakhs	
(2) Work-load of Summary assessments involving income under Rs. 50,000	32.20 lakhs	[56% of (1)]
(3) Work-load of Scrutiny assessments	24.70 lakhs	
Made up of—		
(a) Company assessments	0.75 lakhs	} [4% of (1)]
(b) Non-Company assessments involving income over Rs. 1,00,000	0.60 lakhs	
(c) Others	23.35 lakhs	[40% of (1)]

Under our scheme, by September end 82% of the work-load would be disposed of on the assumption that scrutiny cases constitute 10% of those involving income below Rs. 50,000 and 20% of those involving income between Rs. 50,000 and Rs. 1,00,000. This is calculated as under :—

A. (1) Income below Rs. 50,000	56%	
(2) Less 10% for scrutiny	6%	
(3) Balance cases disposed of		50%
B. (1) Cases below Rs. 1,00,000 but above Rs. 50,000	40%	
(2) Less 20% for scrutiny	8%	
(3) Balance cases disposed of		32%
Total		82%

The scrutiny assessments comprising 6% plus 8% equal to 14%, of the work-load would also be completed by March end, taking the disposal to 96%. The position would be considerably brighter in future years when arrears are brought down, because the work-load would correspondingly come down from 57 lakhs as on 1st April, 1977 to the level of the total number of taxpayers on the registers, which is around 38 lakhs.

7.28 Considering that there are about 38 lakhs taxpayers and about 3,400 Officers, (sanctioned strength) the average work-load per Officer comes to about 1,100 cases. The Santhanam Committee had considered an average disposal of 1,000 assessments, big and small, to be heavy. Under our scheme, the number of scrutiny assessments to be handled by an Income-tax Officer in a year, would be roughly as follows :—

	No. of cases per I.T.O.
(a) Company cases and cases with income exceeding Rs. 1,00,000	4% of 1100=44
(b) Cases with income between Rs. 50,000 and Rs. 1,00,000—20% out of the total of 40% of such cases	8% of 1100=88
(c) Cases of income below Rs. 50,000—10% out of the total of 56% of such cases	6% of 1100=66
	<hr/>
Total scrutiny cases out of 1,100 assessments per I.T.O.	198
	<hr/>

With only 200 scrutiny assessments to handle in a year, an Income-tax Officer should be in a position to pay adequate attention to them. This would ensure a sufficiently intensive scrutiny and quality of assessment leading to reduction of appeals and better taxpayer compliance.

7.29 Completion of assessments based on selective scrutiny and a more effective use of penal and prosecution provisions, coupled with the emphasis on voluntary compliance of tax laws, would make for a proper climate for the operation of the tax laws. It would result in a more constructive approach on the part of the taxpayers and a greater desire for achieving a higher degree of compliance and discharge of the duties of good citizenship. Likewise, the Department would also assume a healthier look and image in the eyes of the public at large. The Administration would be able to ensure a more effective implementation of the tax laws with corresponding beneficial effects on the collection and costs of collection. The selective scrutiny of cases with significant revenue implications and the review on random sampling basis through senior officers like Inspecting Assistant Commissioners and Commissioners of Income-tax will ensure that justice is done and justice is also seen to be done.

7.30 Better administration of the laws in relation to assessment procedures must necessarily have a beneficial effect on the problem of arrears of taxes. This problem will be separately dealt with by us. We have presently addressed ourselves to the streamlining of the assessment procedures so as to tackle the problem of arrears of assessments and the adverse effect it has on the efficiency of the administration.

7.31 The measures outlined by us will also reduce the public contact in a large majority of cases. Such contact would be restricted to the areas of scrutiny cases which are in turn within the gaze of the Inspecting Assistant Commissioners and the Commissioners of Income-tax. This would necessarily have a beneficial effect in reducing the opportunities for corruption. A taxpayer trying to dodge the law will do so at his own peril and any revelation of dishonesty in compliance will be fraught with penal consequences.

7.32 The completion of the major portion of assessments virtually by acceptance of the returns would also reduce the areas of litigation between the taxpayers and the Department. Fewer cases would, therefore, go up in appeal. This would contribute to minimising the flow of references to various Courts.

7.33 It would also not be out of place to mention that the energies of the taxpayers would be conserved as less time would be required in attending before tax authorities and settling the tax liabilities. The talent, energy and time of the people could be directed towards productive channels with consequential beneficial effects on the national income and the tax revenues of the Government.

7.34 The beneficial results of the scheme can be enhanced by the personal involvement of the higher authorities like the Commissioner of Income-tax and the Inspecting Assistant Commissioner, and a dynamic approach towards its implementation. They should also inspire confidence in the Officers at lower levels and assure them that there will be no general suspicion of, or reflection on an officer, where loss of revenue may have been occasioned through the *bona fide* operation of the scheme.

7.35 It need hardly be emphasised that the present recommendation in regard to assessments is of much wider significance and operation than the scheme at present in force under section 143(1) of the Act. In the circumstances, all the existing directions of the Central Board of Direct Taxes under the present scheme would have to be treated as withdrawn and fresh set of directions issued. The wide area of operation of the scheme suggested by us should not be narrowed down or limited as that would only increase the work-load of the Department.

CHAPTER 8

REGISTRATION OF FIRMS

8.1 Registration of partnership firms for purposes of taxation is one of the most controversial areas in the administration of the Income-tax Act. The law lays down elaborate procedures for making the application for such registration to the Income-tax Officer in the first year in which the firm comes into existence and, thereafter, for continuance of the registration granted for subsequent years' assessments so long as the constitution of the firm remains unchanged. The law gives power to the Income-tax Officer to enquire into the genuineness of the firm as set forth in the Partnership Deed and to refuse registration if he is of the opinion that the firm is not genuine. There are certain provisions under which the firm is liable to be treated as not genuine if any partner is a benamidar of another partner or is a benamidar of an outsider unless, in the latter case, the actual relationship is disclosed to the Income-tax Officer. The procedure for registration including the making of the application, the time limits to be observed, the various documents to be attached, etc., has been found to be unduly cumbersome and the firm runs the risk of refusal of registration due to technical irregularities or lapses. The administration has, no doubt, tried progressively to reduce the area of friction in the matter by giving opportunity to the firm to remedy the irregularities but, nevertheless, instances do occur where registration is refused merely on technical grounds. Registration is also refused on the ground of the firm being held as not genuine for one reason or the other. This has generated an enormous amount of litigation in which courts have held that most of the circumstances in which the Department treated firms as not genuine did not in fact justify refusal of registration. The position today is that there are very few cases in which refusal of the registration on the ground of non-genuineness has been sustained by courts.

8.2 Under the general law, a partnership firm is nothing but an extension of the personalities of the partners; and prior to 1956, the assessment of the firm was merely a step in the assessment of the partners on their respective shares in the income of the firm. However, since 1956, a separate tax is being levied on the income of a registered firm as such, in addition to the tax levied on the partners on their respective shares in the firm's after-tax income. In the case of a firm which is not granted registration or which does not seek registration, tax is levied on the firm as a single unit at the rates of tax applicable to individuals and associations of persons. In that event, no further tax is levied in the hands of the partners on their shares in the firm's income. But, if they have any other taxable income, their share in the firm's income is taken into consideration for rate purposes. The law also gives power to the Income-tax Officer to treat an unregistered firm as a registered firm for the purpose of taxation, and levy tax on the firm and on the partners on that basis. This provision is meant to counter any attempt by individuals having income in the higher brackets to reduce their tax liability by getting the firms, in which they are partners, assessed as unregistered firms, because such taxation would still be lower than the tax which they will have to pay if they were to claim registration and get assessed on that basis.

8.3 The question of evolving a simpler scheme for taxation of firms and their partners has received attention from some of the earlier Committees. Shri Bhoothalingam, who considered this problem in some detail, had recommended that the procedure for registration of firms with the Income-tax authorities was not necessary at all and that every firm registered with the Registrar of Firms should be assessed as a registered firm for the purpose of income-tax. Although that recommendation was accepted by the Government and sought to be implemented through the Taxation Laws (Amendment) Bill, 1969, the Select Committee which considered that Bill decided to retain the existing provision for separate registration of firms under the Income-tax Act. It was found that registration with the Registrar of Firms as a condition precedent to the treatment of firms as registered firms for the purpose of taxation would entail certain serious problems and would cause undue hardship.

8.4 We have given careful thought to the various representations received by us for simplifying the existing procedure for taxation of firms and their partners. *We recommend that the work relating to registration of firms should be centralised with the Commissioners of Income-tax, instead of leaving it with the various Income-tax Officers as at present. For this purpose, every firm should be required to make an application to the Commissioner before the end of the accounting year.*

8.5 Not infrequently, partners function in a representative capacity. It is essential that such particulars should come on the record of the Department. Thus, if a partner represents another firm or if he is a benamidar of any other person or if he is a partner as the karta of a Hindu undivided family, etc., full facts relating to the capacity in which he has become a partner in the applicant firm should be disclosed. We consider this necessary because Courts have held that a partnership firm does not cease to be genuine if any one of the partners is a partner in a representative capacity. In order, therefore, to give recognition to such Court decisions and, at the same time, to facilitate the assessment of the share of such partner, who is a partner in a representative capacity, in the hands of the real owner of that share, the application for registration should give full facts in relation to the shares of representative partners. *We, therefore, recommend that full particulars of representative capacity of partners, if any, should be declared in the application for registration of the firm with the Commissioner.*

8.6 Apart from particulars of the beneficial interest in a partner's share which should be declared, it is essential that certain important particulars relating to the firm are contained in the application for registration. As at present, the application should be signed by all the partners and should be accompanied by the original instrument of partnership along with a certified copy thereof or, in the alternative, two certified copies of the Deed. In the latter case, the original should be produced before the Commissioner, if and when called for. Particulars of the permanent account numbers of the partners and the Income-tax Circle/Ward where each of the partner is assessed should also be disclosed.

8.7 The Commissioner will record the receipt of the applications in a register and intimate such registration to the firm within 30 days of the lodgement of the application. A copy of such intimation would be forwarded to the Income-tax Officer having jurisdiction over the firm for his record. Such intimation will amount to registration of the firm for the purpose of taxation. In case there are any inadequacies in the application, the firm should be given adequate opportunity of rectifying the same. *We recommend that, where an application is complete and lodged with the Commissioner, registration of the firm should be automatic.*

8.8 Along with the return of income, the firm should furnish to the Income-tax Officer a copy of the application with enclosures submitted to the Commissioner at the time of the registration of the firm. As, by this time, the Income-tax Officer would have received the intimation from the Commissioner as to the fact of the registration of the firm, there would be no further hold up in the assessment proceedings on this account. In subsequent years, so long as the constitution of the firm continues without change, all that is necessary will be a declaration to that effect to be furnished as a part of the return of income. This declaration need be signed only by the partner who signs the return and not by each of the partners of the firm. *We accordingly recommend that the form of the return of income of the firm may contain a provision for a declaration that there is no change in the constitution of the firm.*

8.9 In cases where there is a change in the constitution of the firm, the firm will have to file a fresh application to the Commissioner containing all the relevant particulars along with the partnership deed as at the time of original registration. In such cases, a fresh entry of registration would be made by the Commissioner and intimated to the firm and the Income-tax Officer as at the time of the original registration. All the procedures as at the time of original registration shall likewise apply. Likewise, when a firm is dissolved, intimation should be given to the Commissioner to enable him to make appropriate entries in the register.

8.10 A firm, which is registered with the Commissioner in accordance with the above procedure, will be assessed in the status of a registered firm. The income of the firm would be apportioned amongst the partners in accordance with their profit-sharing proportions and taxed directly in the hands of the partners. In a case where a partner is in a representative capacity, the income in question would be taxed in the hands of the beneficial owner.

8.11 The above procedure would considerably simplify the process of registration of firms. The essence of the procedure as outlined above is that there will be no inquiry by the Income-tax Officer into the genuineness of the firm before the assessment is completed. The process of registration is almost automatic.

8.12 It is, however, necessary to consider the procedure for assessing :

- (a) firms which fail to comply with the procedure for registration outlined above;
- (b) cases where in the course of assessment proceedings an Income-tax Officer finds that there is, in fact, no firm in existence;
- (c) cases where an Income-tax Officer finds that the particulars furnished for registration to the Commissioner are inaccurate or false.

We are of the view that, in all such cases, the firm in question cannot be granted the status of a registered firm and the consequent apportionment of income in the hands of the partners. In a case like this, the assessment should be made on the firm in the status of unregistered firm.

8.13 The present procedure of taxing the unregistered firm and concurrently including the share of income from the unregistered firm in the hands of the partners for rate purposes, is cumbersome and leads to several complications. *We, therefore, recommend that tax should be levied and recovered at a single stage in the assessment of the unregistered firm itself and the scheme of further including the share of a partner in the unregistered firm in his personal assessment (even for rate purposes) should be discontinued.*

8.14 In order to encourage firms to seek registration and to discourage taxpayers from resorting to formation of unregistered firms for obtaining the benefit of separate assessments (particularly in cases of taxpayers in the highest brackets of income), the rate of tax on the unregistered firm should be sufficiently high so as to act as a deterrent. The rate should be almost punitive to ensure better compliance by firms with the formalities of registration and the particulars being brought on the record of the Income-tax Department. It should also serve as a deterrent to wrongful declarations being made for obtaining the benefits of registration and apportionment of profits under a registered firm. Such a procedure would be a more effective safe-guard to the revenue as it has been found to be extremely difficult in practice to refuse registration on the ground of non-genuineness of the firm. *We, therefore, recommend that unregistered firms should be required to pay tax at a flat rate of 65% (which is the rate presently enacted*

under section 164 in the case of discretionary trusts). We further recommend that no separate power need be vested in the Income-tax Officer to assess the unregistered firm as a registered firm as presently provided in section 183(b).

8.15 As the above scheme, while largely ensuring that firms would be assessed as registered firms, provides for a deterrent rate of tax to be levied on unregistered firms, provision will have to be made for genuine lapses on the part of taxpayers. In cases of lapses through inadvertence or on technicalities, it would be harsh to deny registration and subject the firm to a deterrent rate of tax. The Commissioner should be empowered to entertain belated applications for registration in certain circumstances. Such delays may be due to genuine ignorance on the part of the partners, losses in postal transit, etc. We recommend that, in the case of the smaller firms, i.e., firms having income below Rs. 25,000, the Commissioner shall condone delays and technical lapses and afford full opportunity to such firms to comply with the registration formalities. In other cases, the Commissioner may condone the lapse if he is satisfied that the delay was due to just and reasonable cause. The powers of the Commissioner in this regard should be comprehensive and cover all forms of non-compliance including non-existence of a deed of partnership within the accounting year.

8.16 When it becomes necessary for an Income-tax Officer to complete an assessment treating a firm as unregistered, the procedure should be as follows:—

- (a) If this is occasioned by non-fulfilment of the formalities for registration by the firm, the Income-tax Officer should direct the firm to take up the matter with the Commissioner; if the Commissioner does not condone the delay, on such decision of the Commissioner being communicated to the Income-tax Officer, he should adopt the status of an unregistered firm.
- (b) The other grounds enumerated earlier for assessing a firm in the status of unregistered firm are where, in the course of assessment proceedings, the Income-tax Officer finds that, in fact, there is no firm in existence or where the particulars furnished to the Commissioner for registration were false or inaccurate. In such cases, the Income-tax Officer should report his findings to the Commissioner, who would review the registration accorded to the firm after affording a reasonable opportunity of being heard to the firm. The Commissioner may then either confirm the registration or direct the Income-tax Officer to treat the firm as unregistered. The Income-tax Officer would then proceed with the assessment on the basis of the directions of the Commissioner.

We recommend that the procedure for assessing a firm as unregistered should be such that the Income-tax Officer cannot, on his own, accord the status of unregistered firm and he can only do so on the basis of a direction from the Commissioner. We further recommend that, as an additional safeguard, the order of the Commissioner should be appealable to the Appellate tribunal and the firm should not be entitled to agitate the question of status as an unregistered firm before the Appellate Assistant Commissioner.

8.17 Wherever the registration accorded to a firm by the Commissioner is subsequently cancelled in relation to any assessment year, consequential provision would be necessary to ensure that the partners' assessments are appropriately rectified as if there were mistakes apparent from record in respect of the shares of income from the firm assessed in their hands.

8.18 As regards the separate tax on registered firms, very strong views have been expressed against the present system which has been described as amounting to double taxation. Both the Law Commission and Shri Boothalingam had suggested that the separate tax should be abolished on this ground. According to the Law Commission:

"This is the least defensible provision of the present income-tax Law. . . . This provision for double taxation is without precedent, so far as we have been able to gather in the history of income-tax legislation, either in this country or in the other countries whose laws we have examined. . . . This type of legislation cannot be supported on any considerations of justice or fairness or any sound principle of taxation. It would work as a dangerous precedent etc. . . ."

Shri Boothalingam's observations on this issue are as follows:—

"I have tried to see whether there can be any valid conceptual basis for this tax. When it was introduced in 1956, the stated objective was simply expressed as discouragement of fragmentation of taxable income by the introduction of bogus partners. There has been no further clarification by way of statements or otherwise. It is extremely doubtful whether fragmentation has or can at all be prevented by a tax of this nature. The urge towards fragmentations comes from elsewhere and has to be dealt with differently, and the only way to deal with it is what I have suggested earlier. On the other hand, the tax having come to stay, has become in effect something like a corporation tax but with two peculiarities: (1) that it is graduated; and (2) that some kind of minimal rebate based on the tax paid by the firm is given to the partner. May be it was the intention of Government to treat firms as a kind of inferior species of corporation. In that case, there would have been no more justification for granting rebates to partners than for giving to shareholders credit for corporation tax already paid. One can still ask what is wrong in treating a partnership like a company because, like a company, it pools resources and expertise for business. But then the base on which the tax on registered firms is levied is wider than that on which the corporation tax is levied. For example, if two persons constitute themselves into a private limited company, the remuneration received by them for management services as well as interest on funds lent by them to the company are deducted as allowable expenses before profit is determined. This is not allowed in the case of registered firms which would again go to show that the conceptual basis of this step is far from clear. The question, therefore, arises whether the existing position could now be rationalised, so to say, by declaring that the intention is that firms, like corporations, should be regarded as personalities distinct from the partners. If that case, it would only be logical to allow for appropriate deductions while computing the income. Any attempt to do so will give rise to many unnecessary complications and difficulties, particularly in determining the value of services rendered by partners to the firm. A more important point, however, is that treating the firm as

a separate and distinct personality is wholly inconsistent with both the unlimited liability of partners and the legal position that any partner can act for all for all purposes. On balance, therefore, there is no case for treating firms as separate personalities. If any group of individuals desire to free themselves from the unlimited liability involved in a partnership or to enjoy the benefits of incorporation, it is always open to them to do so by accepting the liabilities which go with it, viz., payment of the corporation tax. But then so long as firms as are not regarded as distinct personalities but only as an extension of the personalities of partners, there is no logical justification for the continuance of a separate tax on registered firms. As I said earlier, possibilities of fragmentation of income and such like abuses have no relevance in this context. I would therefore recommend the abolition of this tax on registered firms."

Double taxation of the same income may be justified where the taxable entities are legally and factually distinct from one another. This is not the case with firms and their partners. The present system is also regressive in the sense that the impact of double taxation is more acute in the case of a partner having a smaller share and income than in the case of a partner with a larger share and income. The separate tax on a registered firm cannot be justified on any consideration of justice or fairness or sound principle of taxation and its only justification may be that it yields some revenue. But this yield is largely illusory because if the tax were to be discontinued a good portion of it will come back to the exchequer by way of increased tax on the partners. *We would, therefore, recommend the discontinuance of the separate tax on registered firms altogether.*

8.19 Another area in which there is considerable injustice in taxation of registered firms and their partners is the matter of allocation of the loss incurred by a registered firm for being set-off in the hands of the partners in the same year or for being carried forward to subsequent years for set-off in their hands. There is no doubt that this system arises from the fact that the firm itself loses the right of carry forward of the loss to a future year for set-off against its income for the purpose of determining the registered firm's tax. If the recommendation for the abolition of the separate tax on the registered firm is accepted, then this injustice would not survive.

8.20 With a view to ensure that assessment proceedings for determination of income of a registered firm and apportionment thereof between the partners are taken, the law should provide for an obligation on such firms to file returns of income. Such a provision would be expressly necessary, as in the absence of a direct tax liability, there may be no obligation to file a return.

CHAPTER 9

ADVANCE TAX

9.1 Advance payment of tax is another area where the principal of voluntary compliance can be usefully extended. Collections by way of advance tax have been the mainstay of the Department's budget for many years now. The present procedures, however, involve considerable outlay of clerical labour and time. We feel that there is scope for introducing labour-saving procedures in this field without adversely affecting the revenue so that the man-power released can be more usefully deployed elsewhere.

9.2 In the case of existing taxpayers, advance tax becomes payable only if a notice in this behalf is issued by the Income-tax Officer. Only new taxpayers, *i.e.*, those who have not hitherto been assessed, are required to pay advance-tax voluntarily on the basis of an estimate to be made by them of their current income. If new taxpayers, who may not be familiar with the intricacies of our tax laws, can be relied upon to pay their advance tax voluntarily, we do not see any reason why existing taxpayers who ought to be familiar with the procedures should not also be required to comply voluntarily.

9.3 Under the existing law, if an advance tax notice is omitted to be issued to an existing taxpayer, he will have no liability to pay any advance tax whatever. When the Department is bogged down by paper work this is bound to happen and has in fact happened in several cases. The officers have to be periodically prodded to ensure that advance tax notices are issued in all liable cases. The supervising officers have to expend their time and energy to ensure that their directions are complied with. By leaving payment of advance tax to voluntary compliance and by ensuring compliance by appropriate penal provisions, the Department will not only be releasing its man-power to do more fruitful work but also making the flow of advance tax collections smoother by removing the clerical bottlenecks.

9.4 Several suggestions have been made to us that the payment of advance tax should be the subject of voluntary compliance by the taxpayers and there should be no need for the Department to issue notices for payment of advance tax. If the law casts such an obligation on the taxpayers, cases of default would be exceptional and could be separately dealt with. We do not share the apprehensions of the Wanchoo Committee that the provisions of voluntary compliance might seriously affect collections. The cases of default could be dealt with on an exceptional basis. Further power may still be retained with the Income-tax Officer to issue notices for payment of advance tax when defaults are noticed. The time and energy expended under the present procedure, which would be saved in the new scheme, could be effectively used to keep a track on taxpayers who are already on the record of the Department. The Departmental Officers would in any event, maintain statistical registers in which particulars of estimates received and taxes paid would be recorded. *Prima facie* scrutiny of such registers would immediately reveal cases of defaults. Again, it should be possible to maintain such registers more effectively when the Department is released of the burden of issue of notices, revising notices, etc. Determination of estimates for the purposes of budgets would also tend to be more realistic.

9.5 The present provisions cast considerable work-load on the Department. In the first quarter of the year, the Department has to be geared up to the issue of advance tax notices in all liable cases of taxpayers on their registers. The advance tax payable is calculated, at this stage, with reference to the income last assessed or any higher income returned for a later year. When fresh returns of income come in, the notices already issued have to be revised if the tax on the basis of such return is higher than the advance tax demanded. The taxpayer has the right to revise the demand downwards on the basis of his own estimate of his current income. Correspondingly, he has also the obligation to make a revision upwards if the tax on his estimated current income exceeds the advance tax demanded by more than 33 $\frac{1}{3}$ % of the latter amount. There are also provisions for charging interest and penalty for failure to comply with the statutory requirements. We see no reason why all these cumbersome procedures should be retained merely for guarding against a possible defaulter who may not comply voluntarily. *We recommend that the system of issuing advance tax notices be discontinued and the law amended to provide that every taxpayer liable to pay advance tax should furnish an estimate of the advance tax payable by him on the basis of the last assessment completed in his case or the return filed by him for a later year, before the date of the first instalment and pay the same in 3 equal instalments. The Income-tax Officer may, however, continue to have the power to issue a notice for advance payment of tax to any taxpayer who does not comply voluntarily with this requirement by the due date of the first instalment.*

9.6 At present, even though advance tax is payable in 3 equal instalments by all taxpayers, the due dates are 15th June, 15th September and 15th December, in some cases, and 15th September, 15th December and 15th March in other cases, depending upon the date of closing of accounts for the major source of income of the taxpayer. We see no particular advantage in this refinement. Many taxpayers may have to pay some tax by way of self-assessment in June/July. Any uniformity of dates would no doubt give some advantage to those who start their accounting

period earlier during the year, but this should not be a serious argument against uniformity in the interest of simplification. It is, in fact, open to other taxpayers to change their accounting year suitably to get the same advantage if they so desire. In any event, such advantage would only be marginal having regard to the integrated scheme of advance tax and self-assessment tax. *We accordingly recommend that advance tax should be uniformly payable on 15th September, 15th December and 15th March by all liable taxpayers.*

9.7 There is, at present, no provision in the law authorising the Income-tax Officer to extend the date for payment of any instalment or to condone any delay in its payment. Indeed there can be no justification for such power merely on grounds of inability of a taxpayer to find the finance by the pre-determined dates. However, even short delays, often caused by no fault of the taxpayer, such as the belated clearance of a cheque issued by him, result in undue injustice and hardship to the taxpayer, inasmuch as an instalment which is late even by a day is considered as not paid in accordance with the law and denied the benefit of grant of interest. Strictly, under the law, such a delay may entail penalty also. *To obviate these difficulties and to impart some flexibility to the system, we recommend that the Board should issue a general direction, under the provisions of section 119(2)(a), that delays in payment of any instalment of advance tax for any period not exceeding 10 days should be condoned and the payment treated as having been made on the due date of that instalment in cases where the Income-tax Officer is satisfied that the delay was attributable to reasonable cause or circumstances beyond the control of the taxpayer.*

9.8 The present law enables a taxpayer having income from commission, which is receivable periodically, to defer the payment of the advance tax relating to such commission to the date on which such income would normally be received or adjusted. This provision is a hang-over from the past. With the abolition of the managing agency system, the scope for invoking these provisions has become limited. After the introduction of the self-assessment scheme, this deferment does not have much utility as, for the purposes of section 140A, only tax already paid can be taken credit for and not any tax which is deferred. We have recommended earlier that the dates of payment of advance tax instalments should be made uniform. We have also suggested that the due date for the last instalment should be 15th March in all cases whereas it is at present 15th December in many business cases. If these recommendations are accepted and implemented, there will be no need to continue the special treatment given to commission receipts. *We, therefore, recommend that the provisions relating to deferment of advance tax on commission not received or adjusted may be deleted.*

9.9 At present, taxpayers have the right to make a lower estimate of their current income and the advance tax payable thereon and pay accordingly when the advance tax on the current income is less than the advance tax demanded under the notice issued by the Income-tax Officer. Such a provision is also necessary as a person cannot be expected to pay tax if he has no corresponding income. Again, in the absence of such a provision, large amounts may be collected which would ultimately have to be refunded after returns are filed. There are also adequate safeguards against wrongful estimates by the taxpayer. *We recommend that the right of the taxpayer to furnish a lower estimate on the basis of his estimated current income should remain in the statute.*

9.10 The present law also casts an obligation on the taxpayer to revise upward, the advance tax payable by him if the tax payable on the basis of his estimated current income is higher than the amount demanded by the Income-tax Officer by more than 33½% of the latter amount. This provision is a source of irritation without any substantial benefit to the revenue. It also creates practical difficulties to the taxpayer in estimating his current income reasonably accurately, particularly where the accounting year has not ended. Now that there is a requirement for payment of self-assessment tax, the interests of revenue are adequately safeguarded by collection of the additional tax within 3 to 4 months following payment of advance tax based upon the last completed assessment or a later return which provides a more stable base for determination and payment of tax. In a later paragraph, we are suggesting that interest should be chargeable on any default relating to any instalment of advance tax from the due date of that instalment. *We recommend that the provisions requiring taxpayers to revise upwards the advance tax payable when the tax payable on the basis of their estimated current income exceeds the advance tax payable on the basis of past income by more than 33½ per cent of the latter amount, be deleted.*

9.11. Under the present law, liability to pay advance tax arises in the case of companies when the total income exceeds Rs. 2,500; in the case of registered firms where the total income exceeds Rs. 30,000; and, in other cases, where the total income exceeds Rs. 10,000. This means that every assessee, not being a company or a registered firm, who is liable to pay any tax is also liable to pay it in advance. The limit of Rs. 10,000, which was fixed at a time when the taxable limit was less, now requires to be raised. *While the limit for companies may remain as it is, we recommend that the minimum income limit for liability to pay advance tax in other cases (excluding registered firms) should be Rs. 5,000 above the minimum taxable limit.*

9.12 The law now provides for payment of interest by the Government on any excess amount paid by way of advance tax. When advance tax is paid on the basis of the taxpayer's own estimate, cases of excess payment may not generally arise. However, excess payments cannot be entirely ruled out, particularly when the taxpayer pays advance tax on the basis of the last completed assessment or return. *We accordingly recommend that the provisions relating to grant of interest on excess payments of advance tax be retained.*

9.13 Interest is at present chargeable on short payments of advance tax on a lower estimate by the taxpayer, when the shortfall exceeds 25% of the assessed tax. Interest is chargeable from the 1st April upto the date of actual assessment. Frequently, taxpayers are put to unnecessary hardship by high-pitched and delayed assessments.

The interest charged has also to be revised at each stage of modification of the assessment in appeal, revision or by rectification, all of which generates unproductive and avoidable clerical work. Under the modified assessment procedure suggested by us elsewhere in this Interim Report, an assessment will be deemed to have been completed as soon as the return of income furnished by the taxpayer is accepted by the Department as a proper and valid return by the issue of an acknowledgement to that effect, without the passing of a formal order of assessment. *We recommend that the charge of interest on short payments of advance tax should terminate on the date a valid and proper return of income is filed and should be computed with reference to the tax payable on the basis of such return. We further recommend that such interest should be chargeable only where the advance tax actually paid falls short of 75 per cent of the tax payable on the basis of the return of income.*

9.14 Interest on short payments of advance-tax is now chargeable only from 1st April of the assessment year even though the instalments of advance-tax are all liable to be paid in the preceding financial year. There is no rationale behind this. Further, in accordance with our recommendation contained in the preceding paragraph, the charge of interest will terminate on the date the return is filed. There will then be no reason why the taxpayer should not be liable to pay interest from the respective due date of each instalment of advance tax, when the instalment is paid in accordance with the taxpayer's own estimate. *We accordingly recommend that, while there should be no charge of interest with reference to instalments paid on the basis of the last completed assessment or the latest return, interest at the rate of 1 per cent per month should be charged on the shortfall in any instalment paid on the basis of the taxpayer's own estimate, computed with reference to one-third of the tax payable on the basis of the return, from the due date for payment of that instalment upto the date the return is filed. Interest should similarly be chargeable when any instalment of advance tax is not paid on the due date.*

9.15 There is at present an unnecessary dichotomy between filing of an estimate and payment of advance tax, which creates avoidable confusion. *We recommend that estimates should be deemed to be invalid, if appropriate payment of advance tax on due dates is not made.*

9.16 Once the charge of interest for any shortfall in the payment of advance tax is related to the tax payable on the basis of the return of income, the taxpayer can be expected to work out exactly his liability in this regard and pay the interest along with the self-assessment tax. If he does this, the need to work out and issue notices for payment of small amounts of interest in a large number of cases will be eliminated. *We, therefore, recommend that the provision relating to self-assessment be suitably amended to require taxpayers to work out and pay voluntarily the interest due on shortfalls in the payment of advance tax along with the self-assessment tax.*

9.17 Under the present law, a taxpayer who files an untrue estimate or fails to furnish an estimate as required by the law, is liable to penalty under the provisions of section 273 of the Income-tax Act. For ensuring strict voluntary compliance penalty provisions are a must. *We recommend that a taxpayer should be made liable to penalty when he has failed to make payment of advance tax which is due or when the advance tax actually paid on the basis of his estimate falls short of 75% of the tax payable on the basis of the return of income.*

9.18 Section 273 does not provide for the levy of a penalty on a taxpayer who, having received an advance tax notice or having himself made an estimate of his current income, nevertheless, fails to pay the amount due. In such cases, a penalty can now be levied only under section 221 as such a taxpayer is deemed to be "an assessee in default" by virtue of the provisions of section 218. The amount of tax due can also be recovered by coercive process. Once the system of issue of advance tax notices is discontinued and an estimate without the appropriate payment is deemed to be invalid, there will be no occasion for the levy of any penalty under section 221. The penalty suggested by us in the preceding paragraph will, however, take care of defaulters. Under the scheme suggested by us there will be no need to recover advance tax by coercive process except where a notice has been issued by the Income-tax Officer. *We, therefore, recommend that the provisions of section 218 be modified suitably.*

9.19 The procedures suggested by us might tempt some taxpayers to underestimate their advance tax liability and correspondingly understate their income in their returns also. In such cases, they may escape both interest and penalty under the scheme suggested by us, even if, on eventual scrutiny, their actual income is found to be much higher. It may not always be possible to make out a cast iron case of concealment against such taxpayers and penalise or prosecute them for that. To plug this loophole and to provide a safeguard to the revenue, *we recommend that interest at the rate of 1% per month should be charged on the difference between the tax eventually assessed and the tax payable on the basis of the return from the date of filing the return upto the date of completion of the assessment made after due scrutiny. To avoid frequent recalculations of interest everytime the income is modified in appeal, etc., the Income-tax Officer may be authorised to revise the interest, where necessary, while giving effect to the last appellate, etc. order.*

9.20 In the recommendations made above, circumstances under which interest shall be paid by the taxpayer have been indicated. The quantum of such interest may sometimes vary depending upon the time taken by the Department to complete the assessment. Interest may also be chargeable where the tax amount is already in the hands of the Government. The present provisions enable reduction or waiver of interest under prescribed conditions. *We recommend that the conditions for reduction or waiver of interest payable by the taxpayer as contained in Rule 40 should continue to apply in all cases of levy of interest.*

9.21 It has been submitted before us that, when there has been an amalgamation taking effect retrospectively on account of the time taken for obtaining the Court's sanction to the scheme, difficulties often arise due to the fact that the advance tax paid by the amalgamating company or companies, in respect of the income of the period falling after the date stipulated in the scheme for the amalgamation to take effect, is not treated as payment of advance tax by the amalgamated company, even though the income in question is assessed in the hands of the amalgamated company. There seems to be no reason why compliance by the amalgamating companies before the Court's sanction to the scheme in this situation should not be deemed as compliance by the amalgamated company for the purposes of the provisions relating to payment of advance tax in respect of income assessable in the hands of the amalgamated company. There are already several provisions in the Act preserving the rights of the amalgamating companies in the hands of the amalgamated company. *We recommend that the law may be clarified to deem the payment of advance tax by an amalgamating company in respect of the income of the period falling after the date of amalgamation included in the assessment of the amalgamated company, as payment of advance tax by the amalgamated company in respect of such income.*

CHAPTER 10

SETTLEMENT OF CASES

10.1 The scheme providing for a machinery to effect speedy, effective and comparatively inexpensive settlement of cases under the direct tax laws, introduced through Chapter XIX-A of the Income-tax Act and Chapter VA of the Wealth-tax Act, from 1st April, 1976 as a result of Wanchoo Committee's recommendations, has been, by and large, welcomed. The Income-tax and Wealth-tax Settlement Commission has been functioning for over a year. It has been brought to our notice that the existing provisions in the Act need some modifications in order to make them more effective and meaningful as well as to facilitate the smooth functioning of the Commission. We are, of course, convinced that the Settlement Commission should not become an escape route for tax evaders who are caught by the Department, but we feel that the anxiety on this account should also not close the doors for taxpayers who realise and admit their past mistakes of omission and commission and want to adopt the path of rectitude.

10.2 Under section 245C, a taxpayer may make an application to the Settlement Commission at any stage of a "case" relating to him. The expression "case" has been defined in section 245A(a) as proceedings in connection with assessment or re-assessment which may be *pending* before an Income-tax authority on the date of the application. Thus, applications to the Settlement Commission can only relate to *pending* proceedings of assessment or re-assessment. There seems to be no reason why the scope of the Settlement Commission should be restricted in this manner. The Settlement Commission should also be empowered to consider applications from taxpayers for settling past instances of evaded or avoided taxes where no proceedings may be pending. Likewise, there may be new taxpayers against whom no proceedings may have been initiated at all. It should be reasonable to permit applications to the Settlement Commission in all such cases. However, we do not consider that applications should be extended to situations where the Settlement Commission can consider scaling down or writing off demands or penalties already finalised and pending payment. *We, therefore, recommend that the definition of "case" be suitably amended to include (1) cases where no proceedings relating to assessment or re-assessment are pending on the date of the application but the taxpayer wishes to settle his past evaded or avoided taxes which have escaped the notice of the Department, and (2) cases where no proceedings were commenced by the Department, viz., cases of taxpayers who hitherto have escaped the notice of the Department.*

10.3 Under the existing provisions, the Settlement Commission shall consist of a Chairman and two Members. It follows that, for validity of its proceedings, all the Members must be in position even though it can act in the absence of a Member from any of its meetings [Sec. 245F(5)]. A situation where one Member dies or retires and the vacancy caused thereby is not immediately filled up can render the Commission temporarily idle. Indeed, this has already happened in the short time the Commission has been in existence. To avoid such a situation, *we recommend that the provisions of Section 245B(2) may suitably be modified to enable the Commission to function with even less than its full strength.*

10.4 There has been strong criticism of the virtual "veto" power that has been conferred on the Commissioner of Income-tax through the second proviso to section 245D, under which he can prevent a settlement application being entertained by the Commission on the ground that fraud or concealment has been, or is likely to be, established. We do not suggest the deletion of this provision altogether since we have no doubt about the salutary principle behind it. However, there is need for a review of the Commissioner's objection by the Settlement Commission. The validity of the grounds on which objection is raised by the Commissioner must be open for examination by the Commission and the application should be rejected only after the Commission is satisfied, on the materials placed before it, that the objection has been raised on proper and valid grounds. The Commission may reject the application only after hearing the Commissioner of Income-tax and the applicant taxpayer. This procedure has the additional merit that it would meet the requirements of natural justice. *We accordingly recommend that the objection by the Commissioner under the second proviso to section 245D(1) should be subject to review by the Commission.*

10.5 Section 245D(6) provides that an order passed under section 245D(4) shall state the terms of the settlement including any demand for taxes, interest and penalty. We addressed ourselves to the question whether the powers are wide enough to settle the tax liability by way of composition and compromise and found that such a course was not permissible under the existing provisions. In recommending a high-powered body to effect settlement of tax cases, the Wanchoo Committee took into consideration comparable authorities existing already in the U.K. and U.S.A., who are competent to enter into closing agreements which may settle the tax liability, taking into consideration the hazards of litigation, the time factor and chances of recovery. *After careful consideration, we recommend that the Government should examine the desirability of vesting powers in the Settlement Commission to compound the tax liability in the cases which are settled by it.*

10.6 We have already stated that we are not in favour of vesting powers of scaling down or writing off demands, generally, with the Settlement Commission. The limited point for consideration by the Government is whether the Settlement Commission can be given the power of scaling down of the demand bearing in mind one's ability to pay in respect of only those cases where the assessments are settled by it. We are aware that there is no power vested in any authority under the income-tax law for writing off, wholly or in part, any part of the Government revenues. This authority is a part of the sovereign authority of the Government and can be exercised only by the Government as such or by any of its subordinate authorities to whom the power is delegated. But in all cases, the write off is open to Parliamentary scrutiny and the Government is answerable to Parliament in this regard. When the Board directs the write off of any demand, they do so, not as the Board, but as the Ministry of Finance (Department of Revenue) and their action is subject to Parliamentary scrutiny. The Settlement Commission is a quasi-judicial body and is to act within the provisions of the Income-tax Act. If it were given such powers of write off of the demands in the generality of cases, it would be acting outside the provisions of the Income-tax Act and under powers delegated to it by the Government. It would thus lay itself open to Parliamentary scrutiny through the Public Accounts Committee. This would detract from its quasi-judicial status and lay it open to audit objections. No organisation can be vested with arbitrary and unbridled powers without being answerable to some one. If any part of the Settlement Commission's order is open to Parliamentary scrutiny it would impinge on its judicial independence. In the circumstances, we are of the view that it may not be desirable to give the Settlement Commission the powers of write off or scaling down the tax liability of a taxpayer generally.

10.7 As the Settlement Commission is a body independent of the Central Board of Direct Taxes, the power to make rules regarding its functioning should be vested with it. *We accordingly recommend the Commission may be specifically given the power to make rules regarding its functioning.*

10.8 Under section 245F(1), the Settlement Commission has all the powers of the income-tax authorities. But, we find no mention of powers of authorities functioning under the Commission for carrying out the duties and functions of the Commission. The Officers attached to the Commission cannot function effectively without being entrusted with statutory powers. *We, therefore, recommend that the existing provisions of section 245F may be suitably modified to expressly provide delegation of powers by the Settlement Commission to its subordinate officers.*

10.9 There has been some controversy whether the Settlement Commission has powers to send a case back to the Department after it has been admitted, on account of non-co-operation by the applicants. *To settle this controversy, we recommend section 245F be suitably modified to enable the Commission to return a case to the Department after it has been admitted, if there is non-co-operation by the applicant. The Commission should remit a case only after giving the applicant an opportunity of being heard.*

10.10 Under the existing provisions contained in section 245H, whereas the Commission has the power to grant immunity from prosecution for any offence under the Income-tax Act and from imposition of any penalty under that Act, so far as the other Central Acts are concerned, the immunity can be granted only from prosecution for any offence under them. There is no provision for grant of immunity from imposition of any penalty under other Central Acts. We are informed that penalties may be as much as five times the amount which may be the subject matter of settlement. This would certainly act as an inhibiting factor in cases where no detection has been made by any of the other Central authorities be they, Central Excise, Customs, Gold Control, Enforcement Directorate, etc. We are, therefore, of the view that unless the fear of penalties under other Acts is removed, the errant taxpayers would not disclose the mode and the manner in which concealed income was earned and any settlement effected without full disclosure would be meaningless and would not seal off chances of continued evasion through similar practices. We are also not unmindful of the possible misuse of such an immunity by persons already caught in offences under other Central Acts. *We accordingly recommend that the law should vest power in the Settlement Commission to grant immunity from penalty under other Central Acts also but a proviso should be added that such immunity may be granted only after due consultation with the appropriate authorities under the concerned acts.*

10.11 Under the existing provisions in section 245M, an applicant cannot approach the Settlement Commission if an appeal has been filed by the Income-tax Officer before the Income-tax Appellate Tribunal. There may be cases also of both the taxpayer and the Income-tax Officer filing appeals before the Income-tax Appellate Tribunal in respect of the same assessment. *After due consideration, we recommend that the rigours of this provision may be mitigated by providing that, with the concurrence of the Commissioner of Income-tax, a case could be taken up by the Settlement Commission where an Income-tax Officer has filed an appeal before the Income-tax Appellate Tribunal under section 253(2) of the Income-tax Act.*

10.12 Incidentally it may be pointed out that suitable modification needs to be made in section 155 of the Income-tax Act to facilitate rectification of assessments in partners' cases or in the case of members of an association of persons, where settlements have been effected in the case of the firm or association of persons, as the case may be.

10.13 Appointments to the Settlement Commission are required to be made from amongst persons of integrity and outstanding ability having special knowledge of and experience in problems relating to direct taxes and business accounts. Outstanding persons who retire as President, Income-tax Appellate Tribunal, Chairman, Central Board of Direct Taxes or even High Court judges would be ideally suitable for appointment on the Settlement Commission having regard to the qualifications visualised by the legislature. At the same time, it is desirable that persons who are appointed on the Commission have a reasonably long tenure. Under the Monopolies and Restrictive Trade Practices Act, a high-powered Commission of a similar nature is set up. In keeping with the status and the extraordinary powers enjoyed by the Commission, *we recommend that the Chairman of the Commission should be of the status of the Secretary to the Government of India. The tenure of office of the Chairman and the members should be for five years or attaining the age of 65 years, whichever is earlier.*

10.14 The discussions in the foregoing paragraphs and the recommendations made therein apply *mutatis mutandis* to the provisions for settlement of cases under the Wealth-tax Act, incorporated in Chapter V-A of that Act. Accordingly, necessary amendments should be made to those provisions as well.

CHAPTER 11

APPEALS AND REVISION

11.1 In our country, tax litigation has been proliferating in an alarming measure in recent years. One has only to look at the growth of the Income-tax Reports in our country to realise the extent of the growth of tax litigation and its complexity. There is hardly any area where litigation does not arise and, once it arises in one case, it picks up in almost all similar cases all over the country.

11.2 Not merely is there too much of litigation, but the delays in the administration of such litigation is equally disheartening. One of the tests of good administration of justice is the speed with which the matter is decided by the appropriate authority. Today, it is a matter of common knowledge that courts of law are flooded with cases and the arrears of cases are alarming.

11.3 This problem can be tackled by ensuring that the area of litigation is minimised and, at the same time, by ensuring that whatever litigation is inevitable, the same will be disposed of as expeditiously as possible. We have examined the matter at great length with a view to achieving the above double objectives, namely, to minimise litigation and to ensure quick disposal thereof.

11.4 The Income-tax Act and the other direct tax laws provide a self-contained machinery for redressal of grievances of taxpayers against orders relating to their taxation liabilities and connected matters. In this regard, the law provides a hierarchy of appellate authorities starting with the Appellate Assistant Commissioner, through the Income-tax Appellate Tribunal and going upto the High Court and Supreme Court on questions of law. Under the amendments made by the Finance (No. 2) Act, 1977, a new category of appellate authority at the level of Commissioner (Appeals) has been added to deal with first appeals in regard to certain matters. The Income-tax Appellate Tribunal is the final authority on facts, while on points of law, the High Courts and Supreme Court can be approached by way of reference in their advisory jurisdiction. The law also provides an alternative avenue for redressal of grievances under which the taxpayer can approach the Commissioner of Income-tax. In such cases, however, there is no further remedy under the Income-tax Act if the taxpayer does not get the relief sought. Complementary to these provisions, the Commissioner of Income-tax is also empowered to over-ride the orders of the Income-tax Officer which are prejudicial to the revenue, subject to certain restrictions. The Commissioner's orders in exercise of this power are appealable to the Appellate Tribunal, with further remedies by way of reference to the High Court and Supreme Court.

11.5 Consequent on the phenomenal increase in the number of taxpayers and in the number of matters in which disputes arise between the taxpayer and the Department, and the complexities involved in these disputes, there has been, in recent times, a significant increase in the number of appeals to the Appellate Tribunal and references to the High Courts and Supreme Court; and the position today is that contentious matters take upto 15 years before they attain finality on the decision of the Supreme Court. There has been considerable accumulation of appeals and references at various stages and, unless concerted efforts are made both by way of changing the procedural and other requirements and by way of augmenting the strength at various appellate levels, matters are bound to get worse rather than better.

11.6 Superimposed on these appeals and references that arise in the ordinary course, there is a substantial number of writs filed directly in the High Court or Supreme Court in regard to tax matters, which are also pending with various courts without any possibility of their early disposal. Quite often, these appeals, references and writs raise identical issues but, unless and until these attain finality, the same issues crop up in subsequent years' assessments in the same case or in different cases, leading to proliferation of appeals and references in the same matter. There is also a number of instances where different High Courts have taken different views on the same question with the result that the lower appellate authorities, as also the assessing authorities, do not have a common yard-stick for judging these issues in other cases which come up before them. As the decision of a High Court is binding on all lower authorities within the jurisdiction of that High Court, we find the same matter being decided differently in different parts of the country, depending upon the views expressed by the High Court of that State on that issue.

11.7 From the statistics supplied to us, we find that, as at 30th June, 1977, there were as many as 10,500 references pending with various High Courts. The largest numbers are in Bombay, Calcutta, Madras, Karnataka and Madhya Pradesh, but the numbers pending before the other High Courts are by no means small. As the High Courts do not have benches for dealing exclusively with tax matters all round the year, the possibility of early disposal of these pending matters is remote. We also understand that, every year, some 3,300 further references are made to the High Courts by various benches of the Income-tax Appellate Tribunal, while the annual disposals of such references by all the High Courts put together amount to about 600 in a year only.

11.8 In the light of the foregoing, it should be clear that the measures should be aimed at :

- (a) Avoiding litigation;
- (b) Reducing litigation;
- (c) Simplifying and rationalising the existing provisions and accelerating disposal of appeals, references and connected matters.

A. Measures to avoid litigation

11.9 One of the characteristics of our tax laws is their complexity and inevitable uncertainty. Today, it takes almost more than a decade before a taxpayer can get a decision from the highest Court in the country. There is no way in which the taxpayer can approach the highest authority under the Act for the determination of any question that has arisen or may arise in a particular transaction. Actually, as the law now stands, the Central Board of Direct Taxes is debarred from considering any individual cases. This is, in our opinion not a very healthy situation.

11.10 We find that, in certain other countries, the highest tax authority performs a very useful function by giving advance rulings on various issues which arise in individual cases. This would serve as a means of reducing litigation. Even the Supreme Court has emphasised the binding nature of the instructions of the Board on assessing officers. In such circumstances rulings by the Board would be enforceable. It would, therefore, be desirable to empower the Board to give advance rulings in specific cases also. The Wanchoo Committee had also made a similar recommendation. *We, therefore, recommend that there should be a specific provision in the Income-tax Act and other Direct tax laws, enabling the Central Board of Direct Taxes to give advance rulings at the request of taxpayers on specific issues, not being purely issues of fact, on payment of the prescribed fees.*

11.11 A taxpayer should be entitled to seek an advance ruling both with reference to facts already obtaining in his case for a past year or with reference to a proposed transaction which he intends to enter into. Where the reference relates to the former category of cases, the taxpayer should be entitled to bring it to the Board for a ruling at any time before the completion of the assessment for the relevant year. Where the assessment has already been completed, if the matter is pending in appeal before the Appellate Assistant Commissioner/Commissioner (Appeals) or the Appellate Tribunal, the taxpayer may yet seek such ruling, provided, in either case, he withdraws the appeal on that point. The Board may give a ruling on such a reference or even decline to give any such ruling. In the latter event, the fees should be refunded and the appeal, if withdrawn, shall be revived. But before deciding the matter, the Board should be required to give the applicant an opportunity of being heard on his application. If the Board gives a ruling on the point referred to it, then, such ruling should be binding on the Income-tax authorities. However, if the taxpayer is not satisfied with the ruling, it should be open to him to take the matter by way of appeal to the Delhi High Court, with a further right of appeal to the Supreme Court by either party. However, where the point referred to the Board relates to a proposed transaction, while the Board's ruling will be binding on the Departmental authorities, the taxpayer will be free to put through the transaction in such form as he deems fit, but he will not have the right of appeal to the Delhi High Court against the Board's ruling.

11.12 If the taxpayer has a right to approach the Board, it is equally desirable that, in appropriate cases, the Board in turn should have the right to approach the highest Court in the country directly with the consent of the taxpayer concerned without waiting for a matter to reach that Court in the normal course. It is not necessary that litigation should arise before a matter could go to the highest Court. The Board may make such a reference in the same manner as under the Civil Procedure Code whereunder a case can be stated to a court of law and its advice obtained. Needless to say that, once the Supreme Court gives its opinion on the matter referred to it by the Board under this provision, there will be no further litigation on the subject throughout the country. *We recommend that a provision be introduced in the law enabling the Board to approach the Supreme Court and seek its advice even at an earlier stage before any litigation has arisen.*

11.13 Frequently, Public Sector Undertakings and Government Companies also get involved in litigation with the tax authorities. Instances are quite common where Public Corporations like Air India, Indian Airlines, Life Insurance Corporation of India and similar Corporations have entered into litigation with the Department on certain questions. This is hardly a desirable trend. It is difficult to understand why such litigation should at all arise and why it cannot be avoided. Ultimately, it is the Government of India on either side and there is no question of any benefit to the Government of India in any form whatsoever by the outcome of the litigation. Similarly, State Corporations have also got involved in litigation with the tax authorities. In all these cases, public funds are frittered away in futile litigation.

11.14 There should be no need for appeal by any Government undertaking or company against any adverse decision in tax matters. If, subsequently, at any time, the same issue is decided differently by a High Court or the Supreme Court in the case of any other taxpayer, then, in view of our recommendation in para 11.16, it would be open to the undertaking/company to claim the benefit of such decision in respect of its past assessments. *We recommend that disputes between public sector undertakings or Government companies and the Income-tax Department should be resolved by the Central Board of Direct Taxes by discussion with the administrative Ministry of the Central Government or the local Government concerned with the undertaking or company and, where necessary, in consultation with the Ministry of Law.*

B. Measures to reduce litigation

11.15 Under the present law, disputed matters have to be agitated by the taxpayer independently for each year. When common disputes arise in the case of different taxpayers, each one of them has to agitate them in appeal independently. This leads to proliferation of appeals. With a view to reducing such proliferation, we recommend that where a taxpayer claims before the assessing authority or any of the appellate authorities [Appellate Assistant Commissioner, Commissioner (Appeals) or the Appellate Tribunal] that, on any issue arising in his case, an appeal or a reference is pending before any higher authority, including a High Court or the Supreme Court, in his own case for an earlier year or in the case of any other taxpayer for any year, and gives an undertaking that he would abide, in respect of his own case, by the decision of the higher authority or the High Court or the Supreme Court, as the case may be, as governs such pending appeal or reference, then, the law should provide that the taxpayer's case should be disposed of in conformity with such decision, as and when it becomes available, without his having to agitate the matter by way of further appeals or references. If the assessment is completed taking a view adverse to the taxpayer, the same should be suitably modified by the appropriate authority when the final decision becomes available, as if it were a mistake apparent from the record in the taxpayer's own case for the relevant year and such modification should be made within four years from the date of such final decision.

11.16 We further recommend that where the Supreme Court decides a point of law in any case, it should be open to any taxpayer to claim before the appropriate authorities the benefit of that decision in his own case for any past year for which the assessment has attained finality even though he might not have kept the matter alive by way of appeal or reference or by way of a claim on the lines suggested in the preceding paragraph. Equally, it should be open to the Department also to revise any completed assessment in the case of any taxpayer in the light of the Supreme Court's judgment in any other case, if this is necessary in the interest of revenue. In either case, such action by the taxpayer or the Department should be permissible within a period not exceeding one year from the pronouncement of the Supreme Court's judgment.

C. Measures to simplify and rationalise the existing provisions and accelerated disposal of appeals, etc.

(i) Proceedings before Appellate Assistant Commissioner/Commissioner (Appeals) :

11.17 Under the existing law, section 246 enumerates a long list of orders against which an appeal would lie to the Appellate Assistant Commissioner. In spite of such a long list, avoidable controversies do arise as to whether an appeal would lie against a particular point at issue or not. An obvious example is that of interest payable or chargeable under sections 214 and 215. The Gujarat High Court has held in the case of Sharma Construction Company (100 I.T.R. 603) that no such appeal would lie. The Bombay High Court has taken a view in various cases which is conflicting with the view expressed by the Gujarat High Court. Ultimately, the Bombay High Court had to constitute a Full Bench to resolve the conflict. In our opinion, such controversies are futile and can be resolved by providing that every final order of an Income-tax Officer (that is to say, an order which is not of the nature of an administrative order or an interlocutory order) should be appealable to the higher authorities. We, therefore, recommend that, instead of enumerating the various orders of the Income-tax Officer against which an appeal lies to the Appellate Assistant Commissioner or, as the case may be, the Commissioner (Appeals), in section 246 of the Income-tax Act, there should be a general provision to the effect that every final order of the Income-tax Officer will be appealable to the Appellate Assistant Commissioner or the Commissioner (Appeals), as the case may be. We further recommend that, insofar as the Commissioner (Appeals) is concerned, the law should specify a monetary limit (either in terms of the variation in the income or loss returned, or in terms of the quantum of total income assessed, or the quantum of penalty levied, or the interest charged) so as to demarcate his jurisdiction from that of the Appellate Assistant Commissioner. In addition to such monetary limit the jurisdiction of the Commissioner (Appeals) may also be demarcated in terms of a class of orders, more or less on the lines of the existing provision in section 246.

11.18 Equally futile is the controversy as to whether a taxpayer is entitled to urge before the appellate authorities a ground which he had not raised before the lower authorities. In C.I.T. vs. Karamchand Premchand Ltd. (74 I.T.R. 254) the Gujarat High Court held that if a point arising in the assessment order is not taken up in appeal and, therefore, not dealt with by the Appellate Assistant Commissioner, the appellant cannot raise that point before the higher authorities even if, on a judicial pronouncement subsequent to the order appealed against, the order of the lower authorities is found to be not correct. This judgment proceeds on the basis that in such a case the taxpayer cannot be said to be aggrieved by the said order. With a view to obviating injustice and hardships to taxpayers in such cases, we recommend that the ground of being "aggrieved" appearing in section 246 should be deleted.

11.19 Frequently, taxpayers' requests for rectification of mistakes, etc., are inordinately delayed. We recommend that a specific right of Appeal to the Appellate Assistant Commissioner should be provided against the Income-tax Officer's failure to pass an order on the taxpayer's application for rectification or relief within a period of six months of such application.

11.20 The existing powers available to the Appellate Assistant Commissioner to set aside an assessment with direction to the Income-tax Officer to make a fresh assessment or to remand a case to the Income-tax Officer for further enquiry and report before disposing of the appeal often leads to considerable delays in the finalisation of the matter. With a view to obviating such delays, we recommend that the powers of the Appellate Assistant Commissioner/Commissioner (Appeals) to set aside or remand a case should be taken away and he should be required to decide the points raised in the appeal finally after himself conducting any further enquiry that he may consider necessary for the purpose.

(ii) *Proceedings before the Appellate Tribunal*

11.21 An appeal lies from the order of the Appellate Assistant Commissioner/Commissioner (Appeals) to the Income-tax Appellate Tribunal. At present, section 252 provides for the various qualifications in the matter of appointment of the various Members of the Tribunal as well as the President of the Tribunal. Our attention has been drawn to certain aspects relating to the terms of appointment of such persons and other incidental matters and we think it appropriate to make certain recommendations in that regard.

11.22 The provision in section 252 (2) lays down a period of service of at least 3 years for a member of the Central Legal Service (not below Grade III) for becoming eligible for consideration for appointment to the post of Judicial Member of the Appellate Tribunal. Similarly, 3 years' service for an Assistant Commissioner of Income-tax is required for him to be considered for appointment to the post of Accountant Member of the Appellate Tribunal. In recent times, the growing complexities of the law on the one hand and the conditions of economic activity on the other call for a wider experience and insight in determining contentious issues under tax laws expeditiously. *We recommend that the minimum service qualification for appointment of a member of the Central Legal Service as Judicial Member and for appointment of an Assistant Commissioner of Income-tax as Accountant Member should be raised to 5 years.*

11.23 There has been a general appreciation of the functioning of the Income-tax Appellate Tribunal both on the part of the public at large and the Government. In the preceding paragraph we have made a recommendation to further strengthen the constitution of the Tribunal. It is further desirable that the Members of the Tribunal have a tenure of office similar to judges of High Courts, *i.e.*, until 62 years of age. The President of the Tribunal should have a rank corresponding to a Secretary to the Government of India and other Members should correspond to Additional Secretaries. As the office of the President involves administrative powers and responsibilities, *we recommend that only persons who are already Vice-Presidents of the Appellate Tribunal should be eligible for appointment as Presidents of the Tribunal.*

11.24 Section 253 of the Act provides for the filing of appeals to the Tribunal against specific orders. It further provides under sub-section (1) that the appeals may be filed by an assessee who is aggrieved. In line with the recommendations in paragraphs 11.17 and 11.18 relating to appeals to the Appellate Assistant Commissioner, *we recommend that section 253 should be amended on the same lines as per our recommendations for amendment of section 246.*

11.25 At present, the Rules require that the memorandum of appeal to the Tribunal should be signed by the appellant himself. To obviate hardship, *we recommend that the rules be amended so as to permit a memorandum of appeal being signed by the power-of-Attorney-Holder of the Appellant.*

11.26 Under the existing law, even if the appellant does not appear on the day fixed for hearing, the Tribunal is bound to decide the appeal on merits and cannot dismiss it for default. The Supreme Court held in *C.I.T. vs. S. Chenniappa Mudaliar* (74 I.T.R. 41) that Rule 24 of the Income-tax (Appellate Tribunal) Rules, 1963, insofar as it provides for dismissal of the appeal for default is *ultra vires*. In our opinion, there is no reason why the Tribunal should be required to pass an order on merits where the appellant is not interested in proceeding with the appeal or application. *We recommend that the Appellate Tribunal should be given specific powers to dismiss an appeal or reference application before it on the ground of non-appearance of the appellant/applicant and it should not be required to pass an order thereon on merits. However, there should be a provision for reopening the matter by the Appellate Tribunal at the instance of the appellant/applicant within a period of 30 days. The Appellate Tribunal should also have the power to permit the withdrawal of an appeal or reference application by the appellant/applicant.*

11.27 The provision in section 255(3) relates to powers of a single member Bench of the Appellate Tribunal. *We recommend that the law may be amended to provide that such a single member Bench may dispose of any appeal where the amount of variation in the income or loss in dispute does not exceed Rs. 25,000.*

11.28 The provision in section 255(4) relates to the procedure to be followed where the two members of a Bench of the Tribunal differ on any point. *We recommend that, where the members of a Bench differ in opinion, that matter should be re-heard by a Bench of three or more members which may include the members who originally heard it.*

11.29 Today, the Appellate Tribunal has about 40 Benches functioning throughout the country. It deals with various important questions in various cases quite a few of which go by way of reference to the High Court and subsequently to the Supreme Court. At present, the important decisions of the Tribunal are published by private bodies but there is no authentic publication of such orders. Publication of important orders would go a long way in achieving certain judicial harmony among all the Benches in the country and will also enable the taxpayers to secure easily the official views of the final fact finding authority under the Act. *We recommend that the Tribunal permits a reliable agency to publish an authentic and full text of its orders which the Tribunal regards to be of general importance.*

(iii) *Proceedings before High Courts*

11.30 We are of the view that the Government should consider the establishment of a Central Tax Court to deal with all matters arising under the Income-tax Act and other Central tax laws. We intend to deal with this matter in greater detail in our final Report. There is, at present, heavy pendency of references in the various High Courts as under :—

1. Andhra Pradesh	517
2. Assam	305
3. Bihar	379
4. Bombay	2,544
5. Calcutta	2,228
6. Delhi	75
7. Gujarat	339
8. Karnataka	657
9. Kerala	145
10. Madras	853
11. Madhya Pradesh	711
12. Orissa	57
13. Punjab and Haryana	317
14. Rajasthan	372
15. Uttar Pradesh	818

Similarly, large number of writ petitions are also pending in High Courts and Supreme Court. It is very essential that all litigation must be disposed of expeditiously. This is more true in the case of tax litigation. *We, therefore, recommend that, pending the establishment of a Central Tax Court, the Government may advise the High Courts to constitute, as soon as possible, special tax benches on an ad hoc basis to hear and dispose of the pending matters by continuous sittings throughout the year. To achieve uniformity in this matter, Judges with experience in this branch of law should be appointed on tax benches of High Courts.*

11.31 Under the existing law, when the Tribunal refuses to refer a case to the High Court, an application has to be made to the High Court for directing the Tribunal to draw up the Statement of the Case and to refer certain questions of law to the High Court. This procedure, in practice, results in a certain amount of avoidable delay. The provision in section 256(2) requires the High Court, where it allows an application before it under that section, to call for a statement of the case from the Appellate Tribunal.

11.32 Normally, in a petition filed by either party all relevant papers and documents are presented to the High Court and, where necessary, the other party can, in his reply, complete the necessary records. If the High Court is satisfied that a question of law does arise, it should not be necessary for the High Court to send the matter back to the Tribunal in all cases and ask for a formal statement of the case, if, in its opinion the papers before it are sufficient to enable it to answer the question of law arising from the order of the Tribunal. *We recommend that the law may be amended to enable the High Court to dispense with the formality of calling for statement of the case under section 256(2) where it is satisfied that the papers filed before it are sufficient to enable consideration of the question, and thereupon proceed to treat the application itself as a statement of the case and decide the question.*

11.33 The provision in section 256(3) permits refund of the fee paid in a case where the application is withdrawn within 30 days of the Appellate Tribunal refusing to state a case. *We recommend that the law may be amended to permit such refund of the fee paid also in a case where the application is withdrawn by the applicant before the Tribunal considers it.*

11.34 Frequently, considerable delays arise when the High Court or Supreme Court remits the matter back to the Appellate Tribunal. *We recommend that section 258 may be amended to give power to the High Court and the Supreme Court to alter or reframe the question referred to it without remitting the matter back to the Appellate Tribunal. The Court should also have the power to amend the statement of the case suitably and, thereafter, decide the matter without sending it back to the Appellate Tribunal for making the amendment. The Court should, however, be given the power to direct the Appellate Tribunal to take additional evidence on any point, where it considers this necessary for the purpose of deciding the matter before it.*

(iv) *Proceedings before the Supreme Court*

11.35 Section 257 enables the Appellate Tribunal to make a reference direct to the Supreme Court on any question of law in respect of which there is a conflict in the decisions of High Courts. *We recommend that the law*

may be amended to provide that, if the appellant makes a specific request to the Tribunal in a case where there is a conflict in the decisions of High Courts, it should be incumbent upon the Tribunal to make a reference direct to the Supreme Court. We further recommend that the power to make a direct reference to the Supreme Court may also be given to the Tribunal in the following situations :—

- (a) Where the High Court has already decided the matter in other cases;
- (b) Where the point at issue is of a recurring nature in the case before the Tribunal year after year;
- (c) Where the point at issue is one of public importance.

11.36 Under the existing law, any person aggrieved by the judgement of the High Court has to apply to the High Court for a certificate of fitness for appeal to the Supreme Court and where such certificate is refused by the High Court, an application has to be made for grant of special leave to appeal to the Supreme Court under Article 136 of the Constitution. The existing procedure requiring the certificate from the High Court quite often takes time upto 2 years which, in our opinion, can be easily avoided. We recommend that the requirement of obtaining a certificate of fitness from the High Court before filing an appeal to the Supreme Court be dispensed with so as to enable either party to move the Supreme Court directly in a special leave petition, without obtaining the certificate of fitness from the High Court. Such a provision will be similar to that under Article 136(1) of the Constitution for grant of special leave.

(v) *Proceedings by way of Revision by Commissioner*

11.37 The Commissioner's powers of revision of lower authorities' orders to give relief to the taxpayer under section 264, is excluded from application in cases where the order has been made the "subject of an appeal" to the Income-tax Appellate Tribunal or to the Commissioner (Appeals). There is considerable confusion as to the scope of this term and there are differences of opinion amongst the High Courts on this point. We recommend that the provision relating to revision by the Commissioner should be amended to make it clear that the Commissioner will not be debarred from dealing with any matter under this section except where the same point has been agitated in an appeal to the Appellate Tribunal or the Commissioner (Appeals).

11.38 As a corollary to the above, we recommend that the provision in section 263, empowering the Commissioner to revise the Income-tax Officer's orders which are prejudicial to the revenue, should also be amended so as to clarify that the Commissioner will not be debarred from revising any such order except where the particular point on which he proposes to revise the order has been made the subject matter of appeal before the Appellate Assistant Commissioner, the Commissioner (Appeals) or the Appellate Tribunal.

(vi) *General*

11.39 Where, as a result of any order passed in appeal or other proceeding under the Act, tax would be refundable to the taxpayer and the same is not granted within a period of 6 months from the date of the said order, the taxpayer should have the right to set off the amount of the refund or any part of that amount against any tax, etc., payable by him for the same or any other year. The Wanchoo Committee had made a recommendation on similar lines in para 6.144 of their Report, but this has not so far been implemented by the Government. We recommend that the taxpayer should be given the right to set off any refund due to him as a result of any order in appeal against any tax or other sum payable by him for any year by giving an intimation in writing to that effect to the Income-tax Officer.

CHAPTER 12

ACQUISITION OF IMMOVABLE PROPERTIES

12.1 A large number of representations from diverse quarters have been made to us suggesting the repeal of the provisions of Chapter XXA of the Income-tax Act providing for acquisition of immovable properties in cases where the sale deeds did not allegedly reflect their fair market value. It has been submitted that these provisions merely cause harassment to taxpayers and generate litigation without any corresponding benefit to the revenue.

12.2 Chapter XXA was inserted in the Income-tax Act by the Taxation Laws (Amendment) Act, 1972. The provisions were based on a recommendation contained in the Interim Report of the Wanchoo Committee. The Committee was of the view that understatement of prices in sale deeds of immovable properties had become a widespread method of tax evasion and a major source and channel for the generation and circulation of black money. They felt that the evil had assumed such proportions that it called for a drastic remedy. The Committee, therefore, recommended that Government should be empowered to acquire properties where the consideration is found to be understated in the sale deed with a view to evading tax, on payment of the disclosed sale consideration and a solatium of 15 per cent thereof, in addition.

12.3 The provisions of Chapter XXA came into effect from 15th November, 1972. The experience regarding the working of these provisions for the last 5 years should be adequate for judging the utility and effectiveness of these provisions. The following Table presents the progress of work in this area during the past few years in Bombay where the evil of understatement of property values is considered to be widely prevalent.

Financial year	No. of transfer intimations received	No. of acquisition notices issued u/s 269D(1)	No. of acquisition orders passed u/s 269(F)(6)
1973-74	1734	259	—
1974-75	1059	219	5
1975-76	1332	173	6
1976-77	634	213	9
Total	4759	864	20

The above figures speak for themselves. Notices of acquisition have been issued in only about 20 per cent of the cases where intimations were received from the Registrar. The properties in respect of which acquisition orders have been actually issued constitute a very small fraction of the cases in which notices of acquisition were issued. We understand that, out of 8 appeals so far decided by the Appellate Tribunal at Bombay, the acquisition order has been upheld in only one case. It almost looks as if the Department has been digging a mountain only to catch a mouse. The conclusion is inescapable that the provisions have failed to achieve their intended purpose.

12.4 Practically everyone who had stated anything about these provisions has agreed about their nuisance value and their immense capacity to generate paper work and litigation. It is also submitted that these provisions could be potent tools of harassment and provide avenues for corruption. We see no reason why these ineffective provisions should remain on the statute book any longer. The man-power released by their repeal could be put to more fruitful use.

12.5 It might be argued that these provisions are meant to act as deterrents rather than as remedial or revenue measures. There is, however, no evidence of their deterrent effect. The statistics do not disclose any steep rise in the yield from capital gains tax. Increases in stamp revenue, if any, may merely be part of the general phenomenon of rising tax revenues or the result of increased rates of stamp duty. There is also no indication of any unusual rise in the value of immovable properties disclosed for wealth-tax purposes. On the other hand, claims were made at the time of the land ceiling legislation that property prices had fallen. Such claims could have been made only on the basis of recorded prices.

12.6 There has been a change in the complexion of the situation after the Wanchoo Committee submitted their interim and final Reports. The law relating to ceiling and regulation of urban land, which came into effect in the course of 1976, has considerably reduced the magnitude of the problem. Under the provisions of this law, the "competent authority" of the State Government has to be informed of any proposed sale of land with building and such "competent authority" has the option to take over the property on behalf of the State Government at such price as may be agreed upon with the seller or, where there is no such agreement, at the price calculated in accordance with

the provisions of the Land Acquisition Act, 1894. Having regard to this power of the "competent authority", sellers of house property would be reluctant and extremely ill-advised to under-state the consideration in the sale deeds as they may stand to lose the property without realising anything more than the declared value or the value as determined under the Land Acquisition Act. The "competent authority" under the ceiling law has also the power to grant clearances for sale of open land. As the sale transactions of urban immovable properties are thus, practically subject to a clearance under the ceiling legislation, the scope for invoking the provisions of Chapter XXA is considerably reduced. The provisions of Chapter XXA were mainly designed to prevent tax evasion with reference to urban immovable properties where the scope of abuse was greater. In the context of the provisions of the ceiling law, the scope for abuse is substantially reduced.

12.7 Yet another change in the complexion of the problem has been brought about by the recent enactment of section 54E of the Income-tax Act. By virtue of this section, the capital gains arising from the transfer of a long-term capital asset, which would include immovable property, may be rendered totally free of tax by investing the sale proceeds in certain "specified assets", which include Government securities, units in the Unit Trust of India, shares in public companies which are quoted on the Stock Exchange and fixed deposits in banks for a minimum period of three years. Hence, any temptation for under-statement of the sale consideration in the deed with a view to evading or reducing the capital gains tax liability has largely disappeared.

12.8 In the ultimate analysis, the question has to be viewed from the effectiveness of the provision of section 52(2) of the Income-tax Act, which empowers the Income-tax Officer to assess the capital gain arising on the transfer of a capital asset with reference to its fair market value where he is of the opinion that the consideration has been under-stated in the deed of sale to the extent of more than 15%. This provision was introduced in the law in 1964 and, according to the statement of the Minister of Finance on the floor of Parliament, it was intended to deal with cases where some part of the consideration had been paid outside the deed. If the powers of the Department under section 52(2) are effectively used having regard to well established methods of ascertaining market value, the abuse of tax evasion in property sale transactions can be adequately checked. The primary interest of the Tax Department is proper collection of the tax due and not acquisition of properties through protracted litigation. The effectiveness of the provisions in Chapter XXA for acquisition of property also depends entirely on the ability of the administration to sustain the estimated market value before the Courts. If the market value can be effectively established, the remedy under section 52(2) would be more direct and less cumbersome even from the Department's point of view.

12.9 In view of the foregoing, *we recommend that Chapter XXA of the Income-tax Act should be deleted.*

CHAPTER 13

AUTHORITIES COMPETENT TO INTERPRET THE TAX LAWS

13.1 We have taken note of the fact that, with varied interpretations put forth by different authorities on the complicated provisions of the Income-tax Act, there is a marked tendency, in the Department, to reopen, post haste and indiscriminately, completed assessments on the basis of any opinion advocated against the taxpayer. In the name of abundant caution against such an adverse view ultimately coming to prevail, assessments, not only in the same case but also in other cases, are reopened and decided against the taxpayers, needlessly proliferating litigation. Apart from the fact that this generates an enormous amount of unproductive work at all levels, entailing avoidable waste of time and energy, it causes considerable ire and hardship to the taxpaying public.

13.2 We are of the considered view that, in the administration of fiscal laws affecting more than 35 lakhs of taxpayers, especially in the matter of interpretation and working of the complicated legal provisions, it would not be proper for any one to be unduly assertive. Diverse approaches or views of different authorities, conflicting judgments by High Courts and even overrulings of earlier decisions by the same High Court, all constitute a due process of gradual evolution of the law. In this process, we feel that the Board has a pivotal role to play. The Board is associated right from the stage of policy making for the enactment of a particular provision to the stage of delegated legislation, viz., of framing of rules to effectuate the underlying purpose. With the same objective, the Board is also statutorily empowered to issue binding instructions and guidelines to the field officers with a view to ensuring uniformity in the application of the provisions and resolving practical difficulties in their actual working. Thus, the Board is one of most appropriate authorities for clarifying any points of doubt arising out of the actual working of the legal provisions and also for relieving cases of genuine hardship, so that the provisions are correctly and properly administered both in letter and spirit. In issuing such instructions, the Board is, no doubt, guided by considerations of natural justice, well-settled judicial pronouncements and established canons of interpretation of statutes. Any view adverse to the taxpayer, taken by the Board is, of course, open to further review by the appellate hierarchy provided under the Act.

13.3 Judged in the above perspective, a rigid interpretation, followed quickly by a wooden application of the legal provisions, simply because an adverse view against the taxpayer has been propounded by another authority, has to be strictly eschewed for reducing unnecessary litigation. Keeping this in view, we feel the need for there being a provision in the Income-tax Act itself to enlist all the authorities, which would be competent to give their opinion on the provisions of the Act, so that, on the view expressed by any other authority, the departmental officers should not rush to re-open completed assessments, thereby giving rise to avoidable litigation.

13.4 There should be a reasonable degree of finality in assessments. It would not be out of place to refer in this context to the following observations of the Supreme Court in *Parashuram Pottery Works Co. Ltd. vs. Income-tax Officer (106 ITR-1)*:—

“It has been said that the taxes are the price that we pay for civilization. If so, it is essential that those who are entrusted with the task of calculating and realising that price should familiarise themselves with the relevant provisions and become well-versed with the law on the subject. Any remissness on their part can only be at the cost of the national exchequer and must necessarily result in loss of revenue. At the same time, we have to bear in mind that the policy of law is that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity.”

13.5 We, accordingly, recommend the insertion of a new section 293A in Chapter XXIII of the Income-tax Act, 1961 on the following lines:—

293A. Notwithstanding anything to the contrary contained in any other enactment for the time being in force, the authorities competent and authorised upon the interpretation of the provisions of this Act shall only be the following, namely:—

- (a) The Income-tax authorities mentioned in Chapter XIII;
- (b) The Income-tax Appellate Tribunal mentioned in Chapter XX;
- (c) The Settlement Commission mentioned in Chapter XIXA;
- (d) The High Court mentioned in Chapter XX; and
- (e) The Supreme Court mentioned in Chapter XX.

CHAPTER 14

VALUATION OF HOUSE PROPERTIES

14.1 One of the vexatious problems confronting both the Income-tax Department and the taxpayer is the question of valuation of house properties for the purpose of determining the wealth-tax payable in wealth-tax assessments. At the moment, there is no definite yardstick by which the value of such property can be determined. More often than not, it is left to the Valuation Cell in the Income-tax Department to determine the market value as on the valuation date. These cells are manned by engineers drawn from the Central Public Works Department. When once the valuation is determined by the Valuation Cell, it is binding on the Wealth-tax Officer. This procedure has led to endless litigation.

14.2 Ordinarily, the engineers of the Central Public Works Department have been determining the value of house properties by what is commonly known as 'land and building method'. Where land is inseparably rented out along with the building, this method may not give the correct valuation. The following passage extracted from the judgment of the Supreme Court in the case of *State of Kerala vs. P. P. Hassan Koya* [1968(3) S.C.R. 459], clearly brings out the basis on which land and buildings have to be valued when they are rented out inseparably:—

"The method adopted by the Land Acquisition Officer for determining compensation payable for extinction of the interest of the holder of the land and of the buildings separately was unwarranted. In determining compensation payable in respect of land with buildings, compensation cannot be determined by ascertaining the value of the land and the "break up value" of the building separately. The land and the building constitute one unit, and the value of the entire unit must be determined with all its advantages and its potentialities. ***

When the property sold is land with building, it is often difficult to secure reliable evidence of instances of sale of similar lands with buildings proximate in time to the date of the notification under section 4. Therefore the method which is generally resorted to in determining the value of the land with buildings, especially those used for business purposes, is the method of capitalisation of return actually received or which might reasonably be received from the land and the building".

High Courts have also endorsed the view that determination of value of immovable properties with reference to the income provides a more reliable guide. *We, therefore, recommend that values of house properties should be determined by the method of capitalisation of the return actually received or which could reasonably be received from those properties.*

14.3 The capitalisation rates may be notified by the Board every year for different types of properties. This will bring about uniformity and simplicity in the valuation of house property. Ordinarily, such a rate will be based on the market rate for the use of capital and will not create hardships to taxpayers. In fact, before engineers were brought on the scene, this was the only method by which the Department was determining the market value of house properties. Differences in relative values of the properties would be automatically reflected in the differences in the earning power. This will, therefore, make allowance for the higher values in urban areas as compared to backward or less developed areas. We are of the opinion that the method suggested by us is not likely to create any serious hardships in any case. The taxpayer would have the right to agitate his point in appeal if there is a genuine case of serious hardship. *We recommend that the rates of capitalisation be notified by the Board from year to year.*

14.4 Valuation based upon earning power of an asset is a generally accepted method of valuation. In transactions between a willing buyer and a willing seller (which is basic to the concept of value realisable if sold in the open market) the dominant consideration is no doubt the yield. This is manifest whether we refer to shares quoted on a stock exchange or consider the principle applied by the Supreme Court in valuing unquoted shares of companies in *Mahadev Jalan's case* (86 ITR 621). In the case of most urban properties where disputes arise, the earning power is already being estimated or assessed for income-tax purposes. Adoption of a valuation for wealth-tax on an earning power method would at once be sound and consistent in principle and also reduce scope for litigation, uncertainty and protracted proceedings, in these matters. The downward revenue impact, if any, would also be quite marginal and the same would be fully justified by the corresponding advantages accruing by way of finality of assessments.

14.5 The question would then remain as to how owner-occupied property is to be valued. The present law provides for taking valuation as on the valuation date relevant to the assessment years 1971-72, or the actual price paid for the property, whichever is later for all subsequent assessments. This may not be satisfactory in cases

where the market value as determined by the multiplier method would be lower than the actual price paid for the property. Such cases should not be many, but the possibility may not be ruled out. In all fairness and equity, *we recommend that owners of self-occupied properties too must be allowed this facility of determining post 1971-72 assessment properties at actual cost or at market rate based on the multiplier method, whichever is lower, and accordingly to their advantage.*

14.6 Besides providing a safe index to determining the value of house properties, the aforesaid system will also put an end to endless litigation. Last but not the least, it will save the Government a lot of money as the expenses incurred on the valuation cells throughout the length and breadth of the country during the financial year 1975-76 is over Rs. 84 lakhs, not to speak of the saving in 'social cost' which is, of course, much more.

(C. C. CHOKSHI)

Chairman

(S. P. MEHTA)

Member

(HARNAM SHANKAR)

Member

(C. C. GANAPATHI)

Member

(T. S. R. NARASIMHAM)

Member-Secretary

Bombay,
December , 1977.

SUMMARY
of
OBSERVATIONS
and
RECOMMENDATIONS

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

CHAPTER 2—CHARITABLE TRUSTS

1. The provisions relating to the assessment of charitable and religious trusts are one of the most complicated group of sections in the Income-tax Act. (Para 2.1)
2. The provisions contained in the Income-tax Act should have only one underlying objective, viz., to regulate the extent to which and the circumstances in which tax concessions should be granted to charitable trusts. (Para 2.4)
3. A uniform central law governing registration of trusts, regulating their fund-raising activities, maintenance of accounts, application of income, investment of trust funds, involvement of trusts in corporate affairs consequent on holding of shares in companies and providing for machinery to deal with the abuse of trust property, etc., should be enacted as soon as possible. (Para 2.4)
4. The words "not involving the carrying on of any activity for profit" occurring in section 2(15) should be deleted. (Para 2.7)
5. The amendment to section 2(15) should have retrospective effect from 1st April, 1962. (Para 2.8)
6. The provisions of section 13(1)(bb) should also be made applicable to the trusts with the fourth category objects i.e., trusts for the advancement of objects of general public utility other than relief of the poor, education and medical relief, with effect from the 1st April, 1977, as in the case of trusts with the other three categories of objects. (Para 2.9)
7. Section 11(4) should be deleted with effect from the 1st April, 1977 as it would be inconsistent with the scheme of tax exemption outlined above. (Para 2.10)
8. The provisions of section 13(1)(bb) should be further enlarged to permit business activity, mainly carried on by the beneficiaries even when the business itself is not carried on in the course of carrying out a primary purpose of the trust. (Para 2.11)
9. The law should provide for two different and totally independent computations, one for determining the assessable income, and the other for determining the amount that is to be applied for charitable purposes by the trust. The assessable income under the Income-tax Act should be computed strictly in accordance with the Act following the various provisions, taking into account even notional income and granting deductions specifically permitted under the Income-tax Act. On the other hand, the amount that is to be considered for the purpose of application to charitable objects should be the actual gross receipts of the trust less the expenses actually incurred in earning the income or in maintaining the trust property. In this computation, notional incomes or incomes not received, and notional allowances and deductions for amounts not actually expended, will both be left out of account. If the actual income so computed is equal to or less than the statutory income, i.e., the income computed under the provisions of the Act, the trust should be required to apply either 75% of the statutory income or the whole of the actual income, whichever is less. However, where the income so worked out on actual basis exceeds the statutory income, it should suffice if the trust applies either 75% of the actual income or the whole of its statutory income, whichever is less. We also suggest that the relevant provisions should be suitably illustrated in the Act itself to make the concept clear. (Para 2.12)
10. The existing provision for relating the amounts applied in the immediately following year to the earlier year, at the option of the trust should be retained, subject to the modification that the Income-tax Officer may be empowered to extend the time for exercise of the option in deserving cases independently of the time available for filing the return of income. (Para 2.13)
11. While the capital gains arising to a charitable trust could be given the same treatment as in the case of any other taxpayer, insofar as the application of funds for charitable purposes is concerned, only the net sale proceeds received by the trust during a given year should be considered for application (which, under the existing law, includes re-investment) in that year. Further, re-investment may be permitted until the expiry of the next following accounting year of the trust. (Para 2.14)
12. Charitable trusts should be allowed to accumulate their income even for a general purpose falling within the overall objects of the trust. Consequently, the provision in section 11(3A), which empowers the Income-tax Officer to allow change of the purpose originally indicated for the accumulation, at the request of the trust, will be rendered superfluous, and may, therefore, be omitted. (Para 2.15)

13. The provisions relating to accumulation should continue to operate in relation to the income required to be applied for charitable purposes as recommended in para 2. 12. (Para 2. 16)

14. Section 11(2) should be amended to empower the Commissioner to condone delays in giving the notice as also in making the investment or deposit under that section. The section may also specify: (a) The time within which the notice is to be given, which may (as at present, stipulated in Rule 17 of the Income-tax Rules) be "the time allowed under sub-section (1) of sub-section (2) of section 139, whether fixed originally or on extension, for furnishing the return of income" and (b) the time within which the amount accumulated or set apart is to be invested or deposited in the manner laid down in the section, which may be one year from the end of the relevant previous year (instead of six months at present stipulated in form 10). (Para 2. 17)

15. There should be no objection to a trust making a donation from out of its corpus to the corpus of another trust. However, where a trust makes donations out of its income to another trust, while in the case of the donor trust these will continue to be treated as application of income, in the hands of the recipient trust, these should always be considered as normal income and any stipulation that the contributions are to the corpus of the recipient trust should be disregarded for the purposes of the tax exemption. (Para 2. 18)

16. The provisions of section 12A should be amended to provide for an application for registration being entertained at any time before the completion of the first assessment of the trust. Where a trust has failed to register itself within the time limit, it should still be open to it to register itself prospectively at least for future years. (Para 2. 19)

17. The provision in section 12A(b) may be amended to clarify that, where the accounts of the trust have been audited under the provisions in this behalf in any State law, such audit could be regarded as sufficient compliance with the requirements of that provision. (Para 2. 19)

18. Insofar as the situations enunciated in section 13(2) are concerned, the provisions of that section should be treated as exhaustive and the law should make it clear that, unless the features spelt out in section 13(2) are present in any of those situations, the transaction will not be treated as use or application of the trust income or property for the benefit of the excluded persons, for the purposes of section 13(1)(c) so as to nullify the exemption in sections 11 & 12. (Para 2. 20)

19. The provisions of section 13(2)(a) should be suitably amended so as to make the intention clear that, in a case where a loan is advanced to a person referred to in section 13(3), it should be covered by adequate security and also ensure adequate rate of interest. (Para 2. 21)

20. The provision in section 13(2)(h) should be amended to clarify that it excludes from its purview the assets originally settled on trust or donated to the corpus of the trust including in either case, accretion to such assets, by way of bonus shares. (Para 2. 22)

21. As the restrictions in section 13(2)(h) would be excluded from operation in respect of investments forming the original corpus of the trust and donations to the corpus irrespective of the date of creation of the trust, the operation of section 13(2)(h) should be so excluded whether or not there is any mandatory direction in this regard in the trust deed. (Para 2. 23)

22. The term "substantial contribution" should be defined to mean the aggregate contribution upto the end of the relevant previous year in a sum equivalent to 10% of the value of the trust assets as at the end of the previous year in which the contribution was made, or Rs. 5,000, whichever is higher. (Para 2. 24)

23. The definition of "relative" in section 13 should be restored to the position existing prior to 1st April, 1973. (Para 2. 25)

24. The provisions of section 13(1)(d) together with those of sections 13(5) & 13(6) should be deleted and, in their place, a general provision should be substituted giving the trustees freedom in the matter of investment subject to the restrictions under section 13(1)(c). Section 153B of the Companies Act may also be simultaneously amended suitably to vest voting rights in respect of all shares held by charitable trusts in the public trustee. (Para 2. 26)

25. While the state need not encourage the growth of communal and non-charitable institutions, there should be no objection whatsoever, for these institutions existing with whatever resources they are able to muster without being put to an additional disadvantage *vis-a-vis* other taxpayers under the Act. The law should, therefore, be amended suitably to stipulate that the deeming provisions of section 2(24)(iia) would not apply to a trust or institution referred to in section 13(1)(a) or (b). (Para 2. 27)

CHAPTER 3—DEPRECIATION

26. Depreciation under the Income-tax Act is not merely a provision for charging against taxable profits the capital expenditure incurred by an undertaking on depreciable assets over the useful life of the assets, but it is also aimed at working as a tax incentive measure affecting the cash flow of business enterprises and generation of internal resources for replacement of assets which have outlived their utility. (Para 3.3)

27. One of the recommendations of the Bhoothalingam Committee was to allow a taxpayer to write up his assets on a flat 20% basis and allow depreciation upto 120% of the cost of assets. Such artificial distortion of the concept of depreciation to serve the objective of providing funds for replacement of assets at the end of their useful life is not favoured. (Paras 3.4 to 3.7)

28. The present provisions relating to depreciation and the elaborate Schedule of rates under the Income-tax Rules are highly complex and complicated. (Para 3.8)

29. The existing practice of allowing depreciation on the reducing balance method, which provides for accelerated depreciation by larger write-offs in the earlier years for assets in general, should continue. The exception in the case of ocean-going ships, where the straight-line method of depreciation has been adopted should also be retained. (Para 3.9)

30. The taxpayer should have the option in respect of the actual quantum of depreciation to be claimed against the profits from year to year subject, however, to a maximum rate specified in the law which will be applied to the written down value, except in the case of ocean-going ships where the existing pattern should continue. In this regard, the maximum rates of depreciation should be:

Building including roads, culverts, bridges, etc	10%
Furniture and fixtures	20%
Plant and machinery	40%

(Para 3.10)

31. The option given to the taxpayer should be limited to his choosing one single rate for all assets falling within a class, namely, building, furniture and fixtures and plant and machinery, and he should not be allowed to adopt different rates for different items falling within the same class. (Para 3.11)

32. A total latitude to the taxpayers, in the matter of choosing depreciation rates is not desirable as that might disturb the budgetary position of the Government. (Para 3.12)

33. The tax incentive which flows from the degree of latitude allowed in the matter of choice of depreciation rates should not be permitted to be frittered away by the taxpayer but should be retained within the business for further development. To ensure this, depreciation under section 32 should be allowed in the manner indicated above only where the quantum of depreciation claimed for income-tax purposes is actually debited to the profit and loss account of the relevant previous year. (Para 3.13)

34. Full write-off (*i.e.* depreciation at 100%) should be allowed in the case of all assets where the actual cost of any asset does not exceed Rs. 10,000. In the case of those taxpayers who avail of the option to vary their claim for depreciation to suit the performance of their business from year to year, such depreciation should also be debited to the profit and loss account of the taxpayer of the relevant previous year in which the taxpayer chooses to claim such depreciation, while in other cases it will be allowed in the year in which the assets are brought into use for the purposes of the business. (Para 3.15)

35. In cases where no books of account are maintained, depreciation should be allowed at the uniform rate of 10% on buildings and 20% on plant and machinery and furniture and fixtures, on the reducing balance method. (Para 3.16)

36. The basic concept of depreciation as a charge in determining the true and fair profits under the Companies Act should not be disturbed. The quantum of such depreciation should be left to the opinion of the directors under the provisions of the Companies Act. In cases where companies choose to make a higher claim in Income-tax law, the additional amount should also be debited in the profit and loss account "below the line" (that is to say in the appropriation section of the profit and loss account) and such amount should be credited to a depreciation reserve. The Income-tax Act should provide that such reserve should not be utilised for purposes of declaration of dividends. (Para 3.21)

37. If a company desires a nil allowance in income-tax, it should not charge the profit and loss account of that year but should disclose such arrears of depreciation by way of a note on the accounts, as permitted by the Companies Act. (Para 3.22)

38. The Government may, therefore, consider consequential amendments to the provisions of the Companies Act so as not to result in any inconsistency with the scheme for allowance of depreciation under the Income-tax Act as recommended above. The distinction between the charge of adequate amount of depreciation and the additional amount which may be claimed at the taxpayers' option (as a measure of incentive and simplification under the Income-tax law) should be clearly maintained for all purposes. It would then not result in any inconsistency with other questions such as payment of dividend, bonus, managerial remuneration and provisions relating to capital issues, etc. (Para 3.23)

39. In dealing with business concerns as going concerns not operating with a view to liquidation, calculation of depreciation separately for each item of asset is unnecessary. At every stage of addition of new assets, the cost of the new assets should be aggregated with the written down value of the existing block and depreciation allowed on such consolidated block. (Para 3.24)

40. With a view to obviating meticulous calculations, the entire sale proceeds (or scrap sales, insurance or salvage monies realised) of assets which are sold, discarded, demolished, or destroyed should be reduced from the written down value of the asset block and that, if at any stage, the realisations exceed the written down value of the block, the excess should be taxed as profit. As the entire block of assets whether they be (a) furniture and fixtures, or (b) buildings, or (c) plant and machinery, will continue to be depreciated until ultimately brought down to zero, there should be no deduction by way of a terminal allowance under section 32(1)(iii) at any intermediate stage. The grant of terminal allowance should only arise with reference to the shortfall when the entire block of assets is sold on the closure of the business or the closure of a distinct and separate part thereof. (Para 3.25)

41. The provisions for extra-shift allowance in respect of machinery and plant used in factories (general or seasonal) and approved hotels should be discontinued. (Para 3.26)

42. The existing provisions for carry forward of unabsorbed depreciation should continue. The benefit of carry forward and set off of unabsorbed depreciation should be allowed whether or not the asset in question continues to be used for the purposes of the business in the succeeding accounting years. (Para 3.27)

43. On the analogy of the provisions of section 54D, a provision should be made to secure that, where depreciable assets, of a business are taken over by the Government or any statutory authority, no profit will be taxed under section 41(2) if the taxpayer re-invests the sale proceeds or compensation moneys in the acquisition of other depreciable assets for any business within a period of three years from the date of acquisition. (Para 3.28)

44. The law should be clarified to provide that no depreciation under section 32 shall be allowable in respect of capital expenditure for scientific research qualifying for deduction under section 35. (Para 3.29)

45. The following items of expenditure, in particular, should also be eligible for amortisation against profits of a business over a ten-year period for tax purposes :—

- (1) Pre-operative expenses on administration and accounts departments and such other expenditure which does not directly relate to erection or acquisition of assets.
- (2) Expenses on shifting of a factory.
- (3) Payment for acquisition of intangible assets for which there is no other provision for amortisation.
- (4) Expenses on construction of railway sidings and roads on land not belonging to the taxpayer.

As some of these items are not necessarily "preliminary" in character, but would be incurred in a running business, it would be necessary to enlarge the scope of section 35D to cover these items as well. (Para 3.30)

46. Any instance of business expenditure which results in disallowance as revenue expenditure and non-allowance of depreciation, should be promptly notified under section 35D(2)(d) as and when the attention of the Government is drawn thereto. (Para 3.31)

47. The limitation on the totality of preliminary expenditure now appearing under sub-section (3) of section 35D should be removed. (Para 3.32)

48. The following simple formula should be prescribed for amortisation of expenditure on production of feature films in place of the complicated procedure laid down in rule 9A of the Income-tax Rules :

- (a) If the film is released 90 days prior to the close of the accounting year in which the production is completed, the entire cost of production should be allowed as a deduction in the relevant previous year.
- (b) If the film is released at any time within the period of the aforesaid 90 days prior to the expiry of the accounting year, 60% of the cost of production should be allowed in that accounting year and the remaining 40% in the immediately succeeding accounting year. (Para 3.33)

49. As the rupee is now de-linked from the sterling and the foreign exchange value of the rupee fluctuates from time to time as computed with reference to a "basket" of currencies, the provisions of section 43A have become quite cumbersome and difficult to apply. The law should be amended to secure that the actual cost of assets acquired on deferred payment terms, etc., from abroad is taken as originally computed with reference to the exchange rates prevailing on the date of acquisition of the same. Thereafter, any gain or loss occasioned to the taxpayer at the point of actual remittance of instalment of purchase price or loan, as the case may be, should be treated as a revenue gain or loss of the business and the actual cost of the assets should not be disturbed. As regards cases where the actual cost has already been adjusted under the existing provisions of section 43A, the gain or loss would be calculated with reference to such adjusted actual cost. In other words, as from the time the aforesaid suggestion is in force, no further adjustment should be made under section 43A. (Para 3.35)

50. In the case of assets acquired under hire-purchase agreements, the purchaser should be entitled to claim the depreciation in his assessment provided that, as between the purchaser and the vendor, it is agreed that the purchaser alone shall be entitled to claim depreciation in respect of the same asset. The administrative instructions under which this is presently being secured should preferably be incorporated in the law itself. (Para 3.36)

CHAPTER 4—AMALGAMATION OF INDUSTRIAL UNITS UNDER SECTION 72A

51. Section 72A permits the carry forward and set off of the accumulated business losses and the unabsorbed depreciation of the amalgamating company (which is a sick industrial unit not financially viable) against the income of the amalgamated company in the following years. The provisions as they stand are likely to give rise to certain practical difficulties in actual implementation and unless these difficulties are removed, the amalgamations aimed at may not take place to the extent desired by the Government. (Paras 4.2 to 4.4)

52. Under this section as it stands, it appears that the amalgamation has to be effected first and thereafter the "specified authority" has to be moved for the purpose of making a recommendation to the Central Government. In the guidelines recently issued by the Government, it is indicated that an application for approval of the scheme of amalgamation may be made to the "specified authority" even before such amalgamation has actually taken place and that the "specified authority" may indicate to the amalgamated and amalgamating companies that, in the event of the amalgamation being finally effected on the basis of the scheme presented to and approved by the "specified authority", it would make a formal recommendation to the Government for making a declaration under section 72A(1). While this assurance is indeed welcome, in the fitness of things, the substance of the assurance should be incorporated in the law by a specific provision to permit an application to the Central Government by the concerned company with a scheme of amalgamation for consideration as to whether the terms of the proposed amalgamation as set forth in the scheme are such as to meet the requirements of the section. Once the application is approved, then the companies concerned can go ahead with the scheme and obtain the Court's approval to the same and implement it accordingly. Natural justice requires that the Central Government should give an opportunity to the companies concerned to explain the scheme and, if there are any objectionable features, the companies should be allowed to modify the scheme suitably so that it meets with approval. (Para 4.5)

53. The declaration to be issued under section 72A should clearly specify the previous year of the amalgamated company in which the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss and depreciation of the amalgamated company so as to eliminate controversies arising from the time lag in the completion of formalities as to the date on which the amalgamation may be considered as effective. (Para 4.6)

54. When a scheme is submitted to the Central Government under the abovementioned procedure, the Central Government should examine it only with reference to the conditions spelt out in the section itself and any other conditions which may already have been notified pursuant thereto. In other words, further notifications which may be issued by the Central Government should only apply prospectively to schemes of amalgamation which may be submitted for approval after the date of issue of the notification. (Para 4.7)

55. There is, at present, unnecessary duplication of proceedings, one before the "specified authority" and the other before the Central Government; the former to make the recommendation and the latter to issue the declaration. These should be coalesced. The section should provide for a declaration being issued by the Central Government (or in the alternative, by the "specified authority") on an application by the amalgamated company as a single proceeding. (Para 4.8)

56. The section should be amended to provide for the laying down of conditions by the approving authority (Central Government or the "specified authority") upon which the scheme of amalgamation is approved under sub-section (1). These conditions may relate, among other things to,—

- (a) Employment of workers,
- (b) Use of productive capacity,
- (c) Finance to be raised.

The actual allowance would then be subject to the fulfilment of these conditions by the amalgamated company and the satisfaction of the assessing authorities at the time of assessment in the matter of such fulfilment. No further approval of the Central Government (or "specified authority") should be necessary. Thus, if the conditions as laid down by the approving authority in according approval under sub-section (1) are complied with, the set off and carry forward of accumulated losses and unabsorbed depreciation should follow as a matter of course. If, however, the assessing authority finds a breach of the conditions, such set off and carry forward would lapse as from the year of infringement of the conditions. As this would be a decision by the assessing authorities, it would automatically be subject to the normal appellate proceedings under the Act. (Para 4.9)

CHAPTER 5—TAXATION OF CASUAL INCOME

57. The present scheme of taxation of casual income is unduly complex and provides a fertile field for mistakes in assessments and causes needless confusion in the minds of the taxpayers. In its well-meant attempt to bring into the tax net all items of income which are of casual and non-recurring nature and to make them bear the full brunt of tax with a concessional tax treatment only to lottery winnings in the case of non-corporate taxpayers, the Government seems to have failed to achieve the intended objective. (Paras 5.3 & 5.4)

58. Collections from the sources mentioned in sub-clause (ix) of clause (24) of section 2 are a little over Rs. 1 crore only. Jackpot payments all over the country alone are estimated to run into several crores of rupees. To devise some procedures for getting some tax at least from such winnings, section 194B should be enlarged to encompass in its fold all the items appearing in sub-clause (ix) of clause (24) of section 2 where the payer is an organised body. (Para 5.5)

59. To ensure that taxpayers, as far as possible, obtain their winnings from various recognised sources such as race clubs and other social clubs, section 80TT should be amended to include, in addition to lottery winnings, all the other items which are mentioned in sub-clause (ix) of clause (24) of section 2. All these items should be treated in the same way as lotteries by deducting 50% of the amount in computing the total income, with the difference that, in respect of these additional items, the initial deduction should be limited to what is allowable under section 10(3), viz., Rs. 1,000. In the case of companies having any such income, the position under the present law may continue, with the modification that the provisions for deduction of tax at source under section 194B, modified as suggested above, should apply also to payments of casual income made to companies. (Para 5.6)

CHAPTER 6—ADDITIONAL INCOME-TAX ON UNDISTRIBUTED PROFITS

60. The scheme for levy of additional tax under section 104 has to be considered in the light of the totality of the tax incidence on companies. At present, closely-held companies are already subjected to higher rates of tax than widely-held companies. (Para 6.4)

61. The question of declaration of dividends and adequacy of dividends has to be considered objectively, judged by business considerations. Reasonable requirements of the future have also to be considered, apart from the financial position of the company, etc. In the face of such widespread considerations of business exigency, it is very difficult to sustain assessments of additional tax under section 104 in a large majority of cases. (Para 6.5)

62. Considerable emphasis is currently being placed on the need for restraint in dividend distributions with a view to encouraging plough back of resources for development. (Para 6.6)

63. The provisions relating to "deemed" dividends, under section 2(22), are an effective check on the use of companies' resources for private purposes. Apart from this, there is already a provision for levy of wealth-tax on shares, levy of capital gains tax on transfer of shares and levy of gift tax or estate duty on transmission of shares *inter vivos* or on death. (Para 6.7)

64. The trend of company legislation in recent years has been to ensure at least a minimum plough back of profits and further to restrict the withdrawals from reserves for payment of dividend under section 205(2A) and section 205A of the Companies Act, 1956. (Para 6.10)

65. The latest provision exempting closely-held industrial companies from the ambit of section 104 is a step in the right direction. There is likewise justification for excluding the other categories of companies as well, inasmuch as trading companies and service companies do contribute to economic growth and employment and supplement the role of industrial companies in this regard. The provisions of sections 104 to 109 should be applicable only in the case of closely-held investment companies, while other closely-held companies should be excluded from their purview. (Para 6.11)

66. Investment companies should continue to be subjected to the restrictions under these sections as these companies enjoy a concessional tax treatment in relation to their main source of income, namely, dividend income. Again, investment companies are capable of, and are, being used as a medium for holding investments and for acquiring further investments as a means of gaining share-holding control. Non-compulsion in the matter of distribution of dividends in such cases is likely to contribute to concentration of economic power, which needs to be checked. (Para 6.12)

CHAPTER 7—ASSESSMENT PROCEDURE

67. Mounting arrears of work has plagued the Income-tax Department for many years. The various procedures experimented with by the Department have not helped to solve this problem. (Paras 7.2 to 7.4)

68. The problem faced by the Department is one of extreme strain on its man-power and other physical resources. The system of planning man-power requirements to match the work-load overlooks the fact that, whereas work multiplies without notice, man-power cannot be multiplied instantaneously to keep pace with work-load. Planning to fit work-load to man-power seems to be the only answer to the problems confronting the Department. (Paras 7.5 to 7.8)

69. The Department must so gear itself that, by deploying its entire work-force, it would be in a position to check whether the returns are complete and payments adequate, within a period of 3 months from the receipt of the returns. To facilitate this, the particulars to be submitted with the return should be clearly indicated in a manner easily intelligible to the taxpayer. At the same time the particulars should be such that a rapid scrutiny would reveal compliance by the taxpayer and instances of non-compliance would be readily discernible. In particular, the return should contain :

- (i) Statements showing computation of income under each head separately, disclosing all allowances and deductions claimed;
- (ii) Statement showing computation of the tax payable, along with claims for credit for tax deducted at source, advance tax paid and self-assessment tax paid, supported by the relevant certificates and receipted challans;
- (iii) Attested copies of trading and profit and loss account or income and expenditure account, balance-sheet, partners'/proprietors' capital accounts, etc.; and
- (iv) Compulsory deposit receipts. (Para 7.9)

70. The taxpayer should be cautioned in regard to the following matters:—

- (a) If the return is not complete in all respects, it is liable to be treated as an invalid return, with the consequence that the taxpayer will be regarded as being in default for the purposes of interest, penalty and prosecution, as if there is failure on his part to file the return.
- (b) Although the assessment may, in the first instance, be completed under section 143(1), the taxpayer will become liable to penalty and prosecution in case the computation of income and deductions is found to be inaccurate and/or any escaped income is brought to assessment. (Para 7.10)

71. With a view to encouraging the filing of complete returns, there should be a specific legal provision according to which incomplete returns will be treated as invalid ones, attracting consequential interest for delayed submission, to be calculated till the date of filing a correct and valid return. Wherever it is observed that the return is incomplete in any respect, a standard form of notice should be sent to the taxpayer directing him to supply all the relevant missing particulars so as to enable the return to be treated as duly filed. The return itself need not be sent back to the taxpayer except in cases where some error of commission or omission therein requires to be rectified by him. (Para 7.11)

72. Notices under section 139(2) need not be issued to taxpayers already on the registers of the Department. Such notices need be issued only to new taxpayers discovered in the course of searches or survey operations, or persons who have failed to file returns within the time limit. (Para 7.12)

73. The law may be amended whereby an assessment is deemed to be completed on the sending of an acknowledgement attached to the return itself as a tear-off slip. (Para 7.13)

74. Returns where any unusual features like partition of H.U.F., cessation of business, dissolution of a firm, etc., are noticed during rapid scrutiny should be referred to the Commissioner for directions for inclusion in the scrutiny group. Taking into account the man-power available the Central Board of Direct Taxes should issue an annual programme laying down the criteria for selection of cases for scrutiny. The cases selected for scrutiny should cover the following types of cases:—

- (i) All company cases.
- (ii) Sensitive cases, *e.g.*, tax evasion cases.
- (iii) A certain proportion of other cases picked up by random sampling, depending on the man-power available. (Para 7.14)

75. Belated returns should be left to the discretion of the Commissioner to decide on merits whether the circumstances justify the case being taken up for scrutiny. (Para 7.17)

76. In any scheme of voluntary compliance it should be for the taxpayer to buy time and the cost is to be metered right from the date on which the return is due upto the date of filing the return. While the rate of determining the cost may be retained at 12% per annum, it should be applied to the gross tax on the total income as determined on regular assessment, that is to say, the tax without deduction of advance tax and taxes deducted at source. The taxpayer should be required to calculate this additional sum for each completed month of default on the basis of his return and pay it before filing the return, failing which the Income-tax Officer also should be empowered to calculate the amount at the time of the regular assessment. (Para 7.18)

77. The provision in section 140A(3) for levy of penalty for non-payment of self-assessment tax should be deleted. (Para 7.19)

78. In the event of delay beyond a period of 90 days from the due date, the penal provisions should come into play. In such cases, if the default persists, the Income-tax Officer should also complete the proceedings on a best judgment assessment basis even before the end of the assessment year concerned. (Para 7.20)

79. The provision for levy of a cost for delayed filing of returns would not be a sufficient deterrent in cases where no tax is payable at all as, for example, returns showing a loss, returns of trusts, etc. In such cases, the law should provide for an outside time limit to coincide with the end of the assessment year and secure that any such return received after the end of the assessment year will not be treated as a valid return. Claims for refund of tax deducted at source will, however, continue to be entertained upto 2 years from the end of the assessment year, as under the present law. (Para 7.21)

80. There need be no apprehension that, by accepting returns, substantial revenue will be lost, as the bulk of the taxes is collected before the assessment by way of tax deducted at source, advance tax and self-assessment tax. (Para 7.22)

81. Income-tax Officers have not been able to pay adequate attention to search and seizure cases, which are all sensitive cases, where considerable revenue is likely to be involved. The Department has all the talent needed to effectively administer the tax laws. The problem is one of overwhelming workload. No Income-tax Officer has been able to give undivided attention to cases of fraud, evasion, etc. Completion of assessments on the basis of the returns on the lines suggested above will free the Income-tax Officer to carry out scrutiny in depth in such cases. (Para 7.23 to 7.24)

82. Concentration of complicated and tax-evasion cases in Central Circles has not resulted in any significant success in handling such cases. Central Circles should be abolished. Instead, each Commissioner should have an investigation unit within his own charge for handling cases requiring intensive investigation. Officers posted to

these circles must have adequate experience in investigation work and should be allowed special pay. It would even be desirable to entrust investigation cases to two Income-tax Officers exercising jurisdiction concurrently under the close supervision of an Inspecting Assistant Commissioner. Reasonable disposal targets should be fixed for such investigation work allowing adequate time for scrutiny in depth. Each Commissioner may also have his own intelligence unit which would work in close liaison with the Central Intelligence Units organised on an all-India basis. (Para 7.25)

83. Section 146(2) should be amended to provide that, if the Income-tax Officer fails to dispose of the application within the specified period of 90 days, the assessment shall be deemed to have been cancelled and proceedings reopened. (Para 7.26)

84. Under the scheme suggested above an Income-tax Officer will have only 200 scrutiny assessments to handle in a year, and would be in a position to pay adequate attention to them. This would ensure a sufficiently intensive scrutiny and quality of assessment leading to reduction of appeals and better taxpayer compliance. Better administration of the laws in relation assessment procedures will also have a beneficial effect on the problem of arrears of taxes. The measures outlined by us will also reduce the public contact in a large majority of cases. This would necessarily have a beneficial effect in reducing the opportunities for corruption. The completion of the major portion of assessments virtually by acceptance of the returns would also reduce the areas of litigation between the taxpayers and the Department. The energies of the taxpayers would also be conserved and directed towards productive channels with consequential beneficial effects on the national income and the tax revenues of the Government. (Paras 7.28 to 7.33)

85. The beneficial results of the scheme can be enhanced by the personal involvement of the higher authorities like the Commissioner of Income-tax and the Inspecting Assistant Commissioner, and a dynamic approach towards its implementation. They should also inspire confidence in the Officers at lower levels and assure them that there will be no general suspicion of, or reflection on an officer, where loss of revenue may have been occasioned through the *bona fide* operation of the scheme. (Para 7.34)

CHAPTER 8—REGISTRATION OF FIRMS

86. Registration of partnership firms for purposes of taxation is one of the most controversial areas in the administration of the Income-tax Act. This has generated an enormous amount of litigation but there are very few cases in which refusal of the registration on the ground of non-genuineness has been sustained by Courts. Simplification of these procedures is an urgent necessity. (Para 8.1)

87. The work relating to registration of firms should be centralised with the Commissioners of Income-tax, instead of leaving it with the various Income-tax Officers as at present. For this purpose, every firm should be required to make an application to the Commissioner before the end of the accounting year. (Para 8.4)

88. Full particulars of representative capacity of partners, if any, should be declared in the application for registration of the firm with the Commissioner. (Para 8.5)

89. As at present, the application should be signed by all the partners and should be accompanied by the original instrument of partnership along with a certified copy thereof or, in the alternative, two certified copies of the Deed. In the latter case, the original should be produced before the Commissioner, if and when called for. Particulars of the permanent account numbers of the partners and the Income-tax Circle/Ward where each of the partner is assessed should also be disclosed. (Para 8.6)

90. The Commissioner will record the receipt of the applications in a register and intimate such registration to the firm and the Income-tax Officer within 30 days of the lodgement of the application. Where an application is complete and lodged with the Commissioner, registration of the firm should be automatic. (Para 8.7)

91. In subsequent years, so long as the constitution of the firm continues without change, all that is necessary will be a declaration to that effect to be furnished as a part of the return of income which should contain a provision for such declaration. (Para 8.8)

92. In cases where there is a change in the constitution of the firm, the firm will have to file a fresh application to the Commissioner and a fresh entry of registration would be made by the Commissioner. Likewise, when a firm is dissolved, intimation should be given to the Commissioner to enable him to make appropriate entries in the register. (Para 8.9)

93. A firm, which is registered with the Commissioner in accordance with the above procedure, will be assessed in the status of a registered firm. The income of the firm would be apportioned amongst the partners in accordance with their profit-sharing proportions and taxed directly in the hands of the partners. In a case where a partner is in a representative capacity, the income in question would be taxed in the hands of the beneficial owner. (Para 8.10)

94. In the case of an unregistered firm, tax should be levied at a single stage on the firm itself and the scheme of further including the share of a partner in the firm in his personal assessment (even for rate purposes) should be discontinued. (Para 8.13)

95. To encourage firms to seek registration, unregistered firms should be required to pay tax at a flat rate of 65% (which is the rate presently enacted under section 164 in the case of discretionary trusts). No separate power need be vested in the Income-tax Officer to assess the unregistered firm as a registered firm as presently provided in section 183(b). (Para 8.14)

96. In the case of the smaller firms, *i.e.*, firms having incomes below Rs. 25,000, the Commissioner shall condone delays and technical lapses and afford full opportunity to such firms to comply with the registration formalities. In other cases, the Commissioner may condone the lapse if he is satisfied that the delay was due to just and reasonable cause. The powers of the Commissioner in this regard should be comprehensive and cover all forms of non-compliance including non-existence of a deed of partnership within the accounting year. (Para 8.15)

97. The procedure for assessing a firm as unregistered should be such that the Income-tax Officer cannot, on his own, accord the status of unregistered firm and he can only do so on the basis of a direction from the Commissioner. As an additional safeguard, the order of the Commissioner should be appealable to the Appellate Tribunal and the firm should not be entitled to agitate the question of status as an unregistered firm before the Appellate Assistant Commissioner. (Para 8.16)

98. Where registration accorded to a firm is subsequently cancelled in relation to any assessment year, consequential provision would be necessary to ensure that the partners' assessments are appropriately rectified as if there were mistakes apparent from record in respect of the shares of income from the firm assessed in their hands. (Para 8.17)

99. Double taxation of the same income may be justified where the taxable entities are legally and factually distinct from one another. This is not the case with firms and their partners. The present system is also regressive in the sense that the impact of double taxation is more acute in the case of a partner having a smaller share and income than in the case of a partner with a larger share and income. The separate tax on a registered firm cannot be justified on any consideration of justice or fairness or sound principle of taxation and its only justification may be that it yields some revenue. But this yield is largely illusory because if the tax were to be discontinued a good portion of it will come back to the exchequer by way of increased tax on the partners. The separate tax on registered firms should, therefore, be altogether discontinued. (Para 8.18)

100. The law should provide for an obligation on registered firms to file returns of income as in the absence of a direct tax liability, there may be no obligation to file a return. (Para 8.20)

CHAPTER 9—ADVANCE TAX

101. Advance payment of tax is another area where the principle of voluntary compliance can be usefully extended. The present procedures involve considerable outlay of clerical labour and time and there is scope for introducing labour saving procedures in this field without adversely affecting the revenue. (Para 9.1)

102. The system of issuing advance tax notices be discontinued and the law amended to provide that every taxpayer liable to pay advance tax should furnish an estimate of the advance tax payable by him on the basis of the last assessment completed in his case or the return filed by him for a later year, before the date of the first instalment and pay the same in 3 equal instalments. The Income-tax Officer may, however, continue to have the power to issue a notice for advance payment of tax to any taxpayer who does not comply voluntarily with this requirement by the due date of the first instalment. (Para 9.5)

103. Advance tax should be uniformly payable on 15th September, 15th December and 15th March by all liable taxpayers. (Para 9.6)

104. To obviate difficulties and to impart some flexibility to the system, the Board should issue a general direction, under the provisions of section 119(2)(a), that delays in payment of any instalment of advance tax for any period

not exceeding 10 days should be condoned and the payment treated as having been made on the due date of that instalment in cases where the Income-tax Officer is satisfied that the delay was attributable to reasonable cause or circumstances beyond the control of the taxpayer. (Para 9.7)

105. The provisions relating to deferment of advance tax on commission not received or adjusted may be deleted. (Para 9.8)

106. The right of the taxpayer to furnish a lower estimate on the basis of his estimated current income should remain in the statute. (Para 9.9)

107. The provisions requiring taxpayers to revise upwards the advance tax payable when the tax payable on the basis of their estimated current income exceeds the advance tax payable on the basis of past income by more than 33½ per cent of the latter amount should be deleted. (Para 9.10)

108. The minimum income limit for liability to pay advance tax in all cases other than companies and registered firms should be Rs. 5,000 above the minimum taxable limit. (Para 9.11)

109. The provisions relating to grant of interest on excess payments of advance tax should be retained. (Para 9.12)

110. The charge of interest on short payments of advance tax should terminate on the date a valid and proper return of income is filed and should be computed with reference to the tax payable on the basis of such return. Such interest should be chargeable only where the advance tax actually paid falls short of 75 per cent of the tax payable on the basis of the return of income. (Para 9.13)

111. While there should be no charge of interest with reference to instalments paid on the basis of the last completed assessment or the latest return, interest at the rate of 1 per cent per month should be charged on the shortfall in any instalment paid on the basis of the taxpayer's own estimate, computed with reference to one-third of the tax payable on the basis of the return, from the due date for payment of that instalment upto the date the return is filed. Interest should similarly be chargeable when any instalment of advance tax is not paid on the due date. (Para 9.14)

112. Estimates should be deemed to be invalid, if appropriate payment of advance tax on due dates is not made. (Para 9.15)

113. The provisions relating to self-assessment should be suitably amended to require taxpayers to work out and pay voluntarily the interest due on shortfalls in the payment of advance tax along with the self-assessment tax. (Para 9.16)

114. The taxpayer should be made liable to penalty when he has failed to make payment of advance tax which is due or when the advance tax actually paid on the basis of his estimate falls short of 75 per cent of the tax payable on the basis of the return of income. (Para 9.17)

115. As there will be no need to levy penalty under section 221 or to recover advance tax by coercive process under the scheme suggested above except where a notice has been issued by the Income-tax Officer, the provisions of section 218 be modified suitably. (Para 9.18)

116. To provide a safeguard to the revenue against under-estimates of advance tax followed by under-statement of income in the return, interest at the rate of 1 per cent per month should be charged on the difference between the tax eventually assessed and the tax payable on the basis of the return from the date of filing the return upto the date of completion of the assessment made after due scrutiny. To avoid frequent recalculation of interest every time the income is modified in appeal, etc., the Income-tax Officer may be authorised to revise the interest, where necessary, while giving effect to the last appellate, etc. order. (Para 9.19)

117. The conditions for reduction or waiver of interest payable by the taxpayer as contained in Rule 40 should continue to apply in all cases of levy of interest. (Para 9.20)

118. To save hardship when an amalgamation takes effect retrospectively on account of the time taken for obtaining the Court's sanction to the scheme, the law may be clarified to deem the payment of advance tax by an amalgamating company in respect of the income of the period falling after the date of amalgamation included in the assessment of the amalgamated company, as payment of advance tax by the amalgamated company in respect of such income. (Para 9.21)

CHAPTER 10—SETTLEMENT OF CASES

119. The existing provisions in the Act relating to 'Settlement of Cases' need some modifications in order to make them more effective and meaningful as well as to facilitate the smooth functioning of the Settlement Commission. While the Settlement Commission should not become an escape route for tax evaders who are caught by the Department, the doors for taxpayers who realise and admit their past mistakes of omission and commission and want to adopt the path of rectitude should not be closed. (Para 10.1)

120. The definition of "Case" in section 245A(a) should be suitably amended to include (1) cases where no proceedings relating to assessment or re-assessment are pending on the date of the application but the taxpayer wishes to settle his past evaded or avoided taxes which have escaped the notice of the Department, and (2) cases where no proceedings were commenced by the Department, viz., cases of taxpayers who hitherto have escaped the notice of the Department. (Para 10.2)

121. The provisions of section 245B(2) may suitably be modified to enable the Commission to function with even less than its full strength. (Para 10.3)

122. The objection by the Commissioner under the second proviso to section 245D(1) should be subject to review by the Commission. (Para 10.4)

123. The Government should examine the desirability of vesting powers in the Settlement Commission to compound the tax liability in the cases which are settled by it. (Para 10.5)

124. The authority for writing off, wholly or in part, any part of the Government revenues can be exercised only by the Government as such or by any of its subordinate authorities to whom the power is delegated and such write off is open to Parliamentary scrutiny. The Settlement Commission is a quasi-judicial body and is to act within the provisions of the Income-tax Act. If it were given such powers of write off, it would thus lay itself open to Parliamentary scrutiny which would detract from its quasi-judicial status. It may not, therefore, be desirable to give the Settlement Commission the powers of write off or scaling down the tax liability of a taxpayer generally. (Para 10.6)

125. The Commission may be specifically given the power to make rules regarding its functioning. (Para 10.7)

126. The existing provisions of section 245F may be suitably modified to expressly provide delegation of power by the Settlement Commission to its subordinate officers. (Para 10.8)

127. Section 245F be suitably modified to enable the Commission to return a case to the Department after it has been admitted, if there is non-co-operation by the applicant. The Commission should remit a case only after giving the applicant an opportunity of being heard. (Para 10.9)

128. The law should vest power in the Settlement Commission to grant immunity from penalty under other Central Acts also but a proviso should be added that such immunity may be granted only after due consultation with the appropriate authorities under the concerned Acts. (Para 10.10)

129. The rigours of the provisions in section 245M may be mitigated by providing that, with the concurrence of the Commissioner of Income-tax, a case could be taken up by the Settlement Commission where an Income-tax Officer has filed an appeal before the Income-tax Appellate Tribunal under section 253(2) of the Income-tax Act. (Para 10.11)

130. Suitable modification needs to be made in section 155 of the Income-tax Act to facilitate rectification of assessments in partners' cases or in the case of members of an association of persons, where settlements have been effected in the case of the firm or association of persons, as the case may be. (Para 10.12)

131. The Chairman of the Settlement Commission should be of the status of the Secretary to the Government of India. The tenure of office of the Chairman and the members should be five years or till attaining the age of 65 years, whichever is earlier. (Para 10.13)

132. The provisions for settlement of cases under the Wealth-tax Act, incorporated in Chapter V-A of that Act should also be amended on the same lines as indicated above. (Para 10.14)

CHAPTER 11—APPEALS AND REVISION

133. In our country, tax litigation has been proliferating in an alarming measure in recent years. Not merely is there too much of litigation, but the delays in the administration of such litigation is equally disheartening. (Paras 11.1 & 11.2)

134. This problem can be tackled by ensuring that the area of litigation is minimised and, at the same time, by ensuring that whatever litigation is inevitable, the same will be disposed of as expeditiously as possible. (Para 11.3)

135. The measures should be aimed at:

- (a) Avoiding litigation;
- (b) Reducing litigation;
- (c) Simplifying and rationalising the existing provisions and accelerating disposal of appeals, references and connected matters. (Para 11.7)

A. Measures to avoid litigation

136. There should be a specific provision in the Income-tax Act and other direct tax laws, enabling the Central Board of Direct Taxes to give advance rulings at the request of taxpayers on specific issues, not being purely issues of fact, on payment of the prescribed fees. (Paras 11.9 to 11.10)

137. A taxpayer should be entitled to seek an advance ruling both with reference to facts already obtaining in his case for a past year or with reference to a proposed transaction which he intends to enter into. A reference in the former types of cases may be made at any time before the completion of the assessment for the relevant year or where the assessment has already been completed and the matter is pending in appeal provided he withdraws the appeal on that point. The Board may give a ruling on such a reference or even decline to give any such ruling. In the latter event, the fees should be refunded and the appeal, if withdrawn, shall be revived. The ruling given by the Board should be binding on the income-tax authorities. However, it should be open to the taxpayer to take the matter by way of appeal to the Delhi High Court, with a further right of appeal to the Supreme Court by either party. Where the point referred to the Board relates to a proposed transaction while the Board's ruling will be binding on the Departmental authorities, the taxpayer will be free to put through the transaction in such form as he deems fit, but he will not have the right of appeal to the Delhi High Court against the Board's ruling. (Para 11.11)

138. A provision may be introduced in the law enabling the Board to approach the Supreme Court and seek its advice even at an earlier stage before any litigation has arisen. (Para 11.12)

139. To avoid public funds being frittered away in futile litigation, disputes between public sector undertakings or Government companies and the Income-tax Department should, instead of being taken in appeals, etc., be resolved by the Central Board of Direct Taxes by discussion with the Administrative Ministry of the Central Government or the local Government concerned with the undertaking or Company and, where necessary, in consultation with the Ministry of Law. (Para 11.14)

B. Measures to reduce litigation

140. Where a taxpayer claims before the assessing authority or any of the appellate authorities, that, on any issue arising in his case, an appeal or a reference is pending before any higher authority, including a High Court or the Supreme Court, in his own case for an earlier year or in the case of any other taxpayer for any year, and gives an undertaking that he would abide, in respect of his own case, by the decision of the higher authority or the High Court or the Supreme Court, as the case may be, as governs such pending appeal or reference, then, the law should provide that the taxpayer's case should be disposed of in conformity with such decision, as and when it becomes available, without his having to agitate the matter by way of further appeals or references. If the assessment is completed taking a view adverse to the taxpayer, the same should be suitably modified by the (appropriate authority) when the final decision becomes available, as if it were a mistake apparent from the record in the taxpayer's own case for the relevant year and such modification should be made within four years from the date of such final decision. (Para 11.15)

141. Further, where the Supreme Court decides a point of law in any case, it should be open to any taxpayer to claim before the appropriate authorities the benefit of that decision in his own case for any past year for which the assessment has attained finality even though he might not have kept the matter alive by way of appeal or reference or by way of a claim on the lines suggested in the preceding paragraph. Equally, it should be open to the Department also to revise any completed assessment in the case of any taxpayer in the light of the Supreme Court's judgment in any other case, if this is necessary in the interest of revenue. In either case, such action by the taxpayer or the Department should be permissible within a period not exceeding one year from the pronouncement of the Supreme Court's judgment. (Para 11.16)

C. Measures to simplify and rationalise the existing provision and accelerated disposal of appeals, etc.

(i) Proceedings before Appellate Assistant Commissioner/Commissioner (Appeals)

142. To avoid controversies and also simplify the provisions, instead of enumerating the various orders of the Income-tax Officer against which an appeal lies to the Appellate Assistant Commissioner or, as the case may be, the Commissioner (Appeals), in section 246 of the Income-tax Act, there should be a general provision to the effect that every final order (*i.e.*, an order which is not in the nature of an administrative order or an interlocutory order) of the Income-tax Officer will be appealable to the Appellate Assistant Commissioner or the Commissioner (Appeals), as the case may be. Insofar as the Commissioner (Appeals) is concerned, the law should specify a monetary limit so as to demarcate his jurisdiction from that of the Appellate Assistant Commissioner. In addition, his jurisdiction may also be demarcated in terms of a class of orders, more or less on the lines of the existing provisions in section 246. (Para 11.17)

143. To avoid the controversy as to whether a taxpayer is entitled to urge before the appellate authorities a ground which he had not raised before the lower authorities, the condition that the taxpayer should be "Aggrieved" appearing in section 246 should be omitted. (Para 11.18)

144. Specific right of appeal to the Appellate Assistant Commissioner should be provided against the Income-tax Officer's failure to pass an order on the taxpayer's application for rectification or relief within a period of six months of such application. (Para 11.19)

145. With a view to obviating delays in disposal of appeals finally, the powers of the Appellate Assistant Commissioner/Commissioner (Appeals) to set aside or remand a case should be taken away and he should be required to decide the points raised in the appeal finally after himself conducting any further enquiry that he may consider necessary for the purpose. (Para 11.20)

(ii) Proceedings before the Appellate Tribunal

146. The minimum service qualification for appointment of a member of the Central Legal Service as judicial member and for appointment of an Assistant Commissioner of Income-tax as Accountant Member should be raised to 5 years. (Para 11.22)

147. The Members of the Tribunal should have a tenure of office similar to judges of High Courts, *i.e.*, until 62 years of age. The President of the Tribunal should have the rank corresponding to a Secretary to the Government of India and other Members should correspond to Additional Secretaries. As the office of the President involves administrative powers and responsibilities only persons who are already vice-Presidents of the Appellate Tribunal should be eligible for appointment as President of the Tribunal. (Para 11.23)

148. Section 253 should be amended on the same lines as section 246. (Para 11.24)

149. The rules should be amended so as to permit a memorandum of appeal being signed by the Power of Attorney-holder of the Appellant. (Para 11.25)

150. The Appellate Tribunal should be given specific powers to dismiss an appeal or reference application before it on the ground of non-appearance of the Appellant/Applicant and it should not be required to pass an order thereon on merits. However, there should be a provision for reopening the matter by the Appellate Tribunal at the instance of the Appellant/Applicant within a period of 30 days. The Appellate Tribunal should also have the power to permit the withdrawal of an appeal or reference application by the Appellant/Applicant. (Para 11.26)

151. The law may be amended to provide that such a single member bench may dispose of any appeal where the amount of variation in the income or loss in dispute does not exceed Rs. 25,000. (Para 11.27)

152. Where the members of a bench differ in opinion, that matter should be re-heard by a bench of three or more members which may include the members who originally heard it. (Para 11.28)

153. As publication of important orders would go a long way in achieving certain judicial harmony among all the Benches in the country and will also enable the taxpayers to secure easily the official views of the final fact finding authority under the Act, the Tribunal should permit a reliable agency to publish an authentic and full text of its orders which it regards to be of general importance. (Para 11.29)

(iii) Proceedings before High Courts

154. The Government should consider the establishment of a Central Tax Court to deal with all matters arising under the Income-tax Act and other Central Tax Laws. (Para 11.30)

155. For liquidating the heavy pendency of references in the various High Courts pending the establishment of a Central Tax Court, the Government may advise the High Courts to constitute, as soon as possible, special tax.

benches on an *ad hoc* basis to hear and dispose of the pending matters by continuous sittings throughout the year. To achieve uniformity in this matter, judges with experience in this branch of law should be appointed on tax benches of High Courts. (Para 11.30)

156. The law may be amended to enable the High Court to dispense with the formality of calling for statement of the case under section 256(2) where it is satisfied that the papers filed before it are sufficient to enable consideration of the question, and thereupon proceed to treat the application itself as a statement of the case and decide the question. (Para 11.32)

157. Section 256(3) may be amended to permit a refund of the fee paid also in a case where the application is withdrawn by the applicant before the Tribunal considers it. (Para 11.33)

158. Section 258 may be amended to give power to the High Court and the Supreme Court to alter or reframe the question referred to it without remitting the matter back to the Appellate Tribunal. The Court should also have the power to amend the statement of the case suitably and, thereafter, decide the matter without sending it back to the Appellate Tribunal for making the amendment. The Court should, however, be given the power to direct the Appellate Tribunal to take additional evidence on any point, where it considers this necessary for the purpose of deciding the matter before it. (Para 11.34)

(iv) *Proceedings before the Supreme Court*

159. Section 257 may be amended to provide that, if the appellant makes a specific request to the Tribunal in a case where there is a conflict in the decisions of High Courts, it should be incumbent upon the Tribunal to make a reference direct to the Supreme Court. We further recommend that the power to make a direct reference to the Supreme Court may also be given to the Tribunal in the following situations :—

- (a) Where the High Court has already decided the matter in other cases;
- (b) Where the point at issue is of a recurring nature in the case before the Tribunal year after year;
- (c) Where the point at issue is one of public importance. (Para 11.35)

160. The requirement of obtaining a certificate of fitness from the High Court before filing an appeal to the Supreme Court be dispensed with so as to enable either party to move the Supreme Court directly in a special leave petition, without obtaining the certificate of fitness from the High Court. Such a provision will be similar to that under Article 136(1) of the Constitution for grant of special leave. (Para 11.36)

(v) *Proceedings by way of Revision by Commissioner*

161. The provisions in section 264 relating to revision by the Commissioner should be amended to make it clear that the Commissioner will not be debarred from dealing with any matter under this section except where the same point has been agitated in an appeal to the Appellate Tribunal or the Commissioner (Appeals). (Para 11.37)

162. As a corollary to the above, the provision in section 263, empowering the Commissioner to revise the Income-tax Officer's orders which are prejudicial to the revenue, should also be amended so as to clarify that the Commissioner will not be debarred from revising any such order except where the particular point on which he proposes to revise the order has been made the subject matter of appeal before the Appellate Assistant Commissioner, the Commissioner (Appeals) or the Appellate Tribunal. (Para 11.38)

(vi) *General*

163. The taxpayer should be given the right to set off any refund due to him as a result of any order in appeal against any tax or other sum payable by him for any year by giving an intimation in writing to that effect to the Income-tax Officer. (Para 11.39)

CHAPTER 12—ACQUISITION OF IMMOVABLE PROPERTIES

164. The experience regarding the working of the provisions of Chapter XXA, which was inserted in the Income-tax Act on the basis of the interim report of the Wanchoo Committee for the last 5 years should be adequate for judging the utility and effectiveness of the provisions. The statistics relating to the progress of work in this area during the past few years in Bombay, where the evil of understatement of property values is considered to be widely prevalent, show that notices of acquisition have been issued in only about 20 per cent of the cases where intimations were received from the Registrar and acquisition orders have been actually issued only in a very small fraction of these cases. The acquisition order has been upheld in only one case. The conclusion is inescapable that the provisions have failed to achieve their intended purpose. (Para 12.3)

165. There is no evidence of the deterrent effect of these provisions. The statistics do not disclose any steep rise in the yield from capital gains tax. Increases in stamp revenue, if any, may merely be part of the general phenomenon of rising tax revenues or the result of increased rates of stamp duty. There is also no indication of any unusual rise in the value of immovable properties disclosed for wealth-tax purposes. (Para 12.5)

166. There has been a change in the complexion of the situation after the Wanchoo Committee submitted their interim and final Reports. The law relating to ceiling and regulation of urban land, which came into effect in the course of 1976, has considerably reduced the magnitude of the problem. With the recent enactment of section 54E, any temptation for understatement of the sale consideration in the deed with a view to evading or reducing the capital gains tax liability has largely disappeared. (Paras 12.6 & 12.7)

167. The effectiveness of the provisions in Chapter XXA for acquisition of property also depends entirely on the ability of the administration to sustain the estimated market value before the Courts. If the market value can be effectively established, the remedy under section 52(2) would be more direct and less cumbersome even from the Department's point of view. (Para 12.8)

168. Chapter XXA of the Income-tax Act should be deleted. (Para 12.9)

CHAPTER 13—AUTHORITIES COMPETENT TO INTERPRET THE TAX LAWS

169. With varied interpretations put forth by different authorities on the complicated provisions of the Income-tax Act, there is a marked tendency, in the Department, to re-open post haste and indiscriminately, completed assessments on the basis of any opinion advocated against the taxpayer. (Para 13.1)

170. A rigid interpretation, followed quickly by a wooden application of the legal provisions, simply because an adverse view against the taxpayer has been propounded by another authority, has to be strictly eschewed for reducing unnecessary litigation. (Para 13.3)

171. There should be a reasonable degree of finality in assessments. As observed by the Supreme Court in *Parashuram Pottery Works Co. Ltd. Vs. ITO (106 ITR-1)* stale issues should not be reactivated beyond a particular stage and lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies. (Para 13.4)

172. A new section 293A may be inserted in the Income-tax Act, to provide that the only authorities competent and authorised to pronounce upon the interpretation of the provisions of the Act should be the income-tax authorities, the Income-tax Appellate Tribunal, the Settlement Commission, the High Court and the Supreme Court. (Para 13.5)

CHAPTER 14—VALUATION OF HOUSE PROPERTIES

173. One of the vexatious problems confronting both the Income-tax Department and the taxpayer is the question of valuation of house properties for the purpose of determining the wealth-tax payable in wealth-tax assessments. (Para 14.1)

174. Ordinarily, the engineers of the CPWD have been determining the value of house properties by what is commonly known as 'land and building method'. Where land is inseparably rented out along with the building, this method may not give the correct valuation. (Para 14.2)

175. Values of house properties should be determined by the method of capitalisation of the return actually received or which could reasonably be received from those properties. (Para 14.2)

176. The rates of capitalisation should be notified by the Board from year to year. (Para 14.3)

177. In all fairness and equity, owners of self-occupied properties too must be allowed the facility of determining post 1971-72 assessment properties at actual cost or at market rate based on the multiplier method, whichever is lower. (Para 14.5)

ANNEXURES

ANNEXURE I
No. A-11019/70/77-Ad. VII
GOVERNMENT OF INDIA
Department of Revenue & Banking
(Revenue Wing)

New Delhi, dated the 25th June, 1977

4th Asadha 1899 (Saka)

RESOLUTION

The Government of India have decided to appoint a Committee of Experts to examine and suggest legal and administrative measures for simplification and rationalisation of the direct tax laws and such further alterations as are desirable in the interest of the national economy.

2. The Committee will consist of the following :—

Shri N. A. Palkhivala, Senior Advocate, Bombay	Chairman
Shri C. C. Chokshi, Chartered Accountant, Bombay	Member
Shri Harnam Shankar, former President, Income-tax Appellate Tribunal, New Delhi	Member
Shri C. C. Ganapathi, Chairman, Settlement Commission, New Delhi	Member
Shri T. S. R. Narasimham, Commissioner of Income-tax, Bombay	Secretary

3. The Committee will—

- (a) recommend measures to simplify and rationalise, the laws relating to income-tax, surtax, wealth-tax, gift-tax and estate duty, and to alter those laws with a view to making them readily comprehensible to taxpayers, reducing litigation and thus subserving the interest of the national economy;
- (b) suggest ways and means of improving the administration of those laws and expediting assessment, appellate and other proceedings under those laws;
- (c) examine the advisability of consolidating the four laws relating to income-tax, surtax, wealth-tax and gift-tax into one Act;
- (d) prepare drafts of the Bills for being presented before Parliament.

4. The headquarters of the Committee will be at Bombay. The Committee will devise its own procedure, and may call for such information as it considers necessary.

5. The Department of Revenue and Banking will provide the secretariat of the Committee.

6. The Committee will submit its Report and the draft Bills to the Ministry of Finance by 31st December, 1977.

ORDER

Ordered that a copy of the Resolution be communicated to all concerned and that it be published in the Gazette of India for general information.

Sd/-
(H. N. Ray)
Secretary
Ministry of Finance

ANNEXURE I (Contd.)
F. No. A-11019/70-77-Ad. VII
GOVERNMENT OF INDIA
MINISTRY OF FINANCE
Department of Revenue

New Delhi, dated the 5th September, 1977

14th Bhadra 1899 (Saka)

RESOLUTION

In the Government of India Resolution No. A-11019/70-77-Ad. VII, dated the 25th June, 1977, setting up the Committee of Experts to examine and suggest legal and administrative measures for simplification and rationalisation of the Direct Tax Laws, Shri T. S. R. Narasimham, Commissioner of Income-tax, Bombay, was notified as Secretary to the Committee. The Government of India have now decided that he will be Member-Secretary to the Committee.

ORDER

Ordered that a copy of the Resolution be communicated to all concerned and that it be published in the Gazette of India for general information.

Sd/-
(O. V. Kuruvilla)
Additional Secretary
Ministry of Finance
Department of Revenue

ANNEXURE II
F. No. A-11019/70/77-Ad. VII
GOVERNMENT OF INDIA
MINISTRY OF FINANCE
Department of Revenue

New Delhi, dated the 24th September, 1977

2nd Asvina, 1899 (Saka)

RESOLUTION

Consequent on the acceptance of resignation of Shri N. A. Palkhivala from the Committee of Experts on Direct Tax Laws set up *vide* Government of India Resolution No. A-11019/70/77-Ad. VII, dated the 25th June, 1977, on his appointment as Ambassador of India in Washington, the Government of India have decided that the Committee will now consist of the following:—

1. Shri C. C. Chokshi,
Chartered Accountant,
Bombay Chairman
2. Shri Sanatbhai P. Mehta,
Advocate,
Bombay Member
3. Shri Harnam Shankar
former President,
Income-tax Appellate Tribunal,
New Delhi Member
4. Shri C. C. Ganapathi,
Chairman,
Settlement Commission,
New Delhi Member
5. Shri T. S. R. Narasimham,
Commissioner of Income-tax,
Bombay Member-Secretary

ORDER

Ordered that a copy of the Resolution be communicated to all concerned and that it be published in the Gazette of India for general information.

Sd/-
(O. V. Kuruvilla)
Additional Secretary
Ministry of Finance
Department of Revenue

ANNEXURE III

The Committee appointed by the Government of India by its resolution dated 25th June, 1977 to examine and suggest legal and administrative measures for simplification and rationalisation of the Direct Tax Laws and such further alterations as are desirable in the interest of the national economy—invites suggestions from the public on the following:—

- (1) ways and means of simplifying and rationalising the substantive provisions of the Income-tax Act, 1961, the Companies (Profits) Surtax Act, 1964, the Wealth-tax Act, 1957, the Gift-tax Act, 1958, and the Estate Duty Act, 1953;
- (2) ways and means of simplifying the procedural provisions of the above laws, improving the administration thereof, and expediting assessment, and appellate and various other proceedings thereunder;
- (3) alterations in the substantive provisions of the above laws for making them readily comprehensible to taxpayers, reducing litigation, and subserving the interest of the national economy;
- (4) measures to reduce regional imbalances;
- (5) the optimum rates of income-tax, surtax, wealth-tax, gift-tax and estate duty;
- (6) advisability of consolidating the four laws relating to income-tax, surtax, wealth-tax and gift-tax into one Act or in any event providing a consolidated return for these taxes.

Suggestions from the public should be sent by August 10, 1977 to Mr. T. S. R. Narasimham, member-secretary of the Committee, at Aayakar Bhavan, Maharshi Karve Road, Bombay-400020.

ANNEXURE IV

Extension of time for submitting suggestions to the Palkhivala Committee on Direct Taxes

The response of the public to the Committee's invitation for suggestions has been very heartening. But several individuals and professional bodies have asked for extension of time for submitting their memoranda. Others have submitted their suggestions on the Income-tax Act but have asked for time as regards other direct tax laws. Some have asked for an opportunity to appear before the Committee and give oral evidence in elucidation of their written statements. Several professional bodies have complained that the pre-occupation of their members with the preparation of tax returns to be filed by the 31st July have precluded them from giving adequate time to the question of submitting their suggestions.

The Committee has decided to extend time till the 31st October 1977 so as to give adequate time to the public interested in the subject to submit their suggestions to the Committee. The suggestions may be sent by this extended date to Mr. T. S. R. Narasimham, Secretary, Direct Tax Laws Committee, Aayakar Bhavan, Maharshi Karve Road, Bombay-400020.

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