



GOVERNMENT OF INDIA

MINISTRY OF FINANCE

DIRECT TAX LAWS COMMITTEE

FINAL REPORT

SEPTEMBER, 1978

**DIRECT TAX LAWS COMMITTEE
FINAL REPORT**

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PART I

DIRECT TAX LAWS COMMITTEE

FINAL REPORT

PART I

INTRODUCTION

I-0.1. The Direct Tax Laws Committee constituted pursuant to the statement of the Honourable Minister of Finance in June, 1977, had submitted an Interim Report to the Government in December, 1977. We were expected to submit the whole Report before the end of the year 1977, but having regard to the circumstances set out in the Interim Report, it was not possible to complete the assignment before December, 1977.

I-0.2. We were, therefore, granted time until 31st August, 1978, to submit our Final Report, vide Notification of the Government of India, Ministry of Finance (Department of Revenue) No. A. 11019/70/77-Ad. VII dated 30th January, 1978. A copy of the notification is reproduced as an appendix to this Introduction.

I-0.3. We had progressed with our discussions and deliberations, and at the final stage, we requested the Finance Minister to invite Shri N. A. Palkhivala to visit India to enable the Committee to obtain the benefit of his guidance and advice before finalisation of the Report. We are glad to say that Shri Palkhivala was kind enough to readily respond to the invitation and undertake a special visit to India for the purpose between 4th and 15th September, 1978. After extensive discussions with Shri Palkhivala the Report has emerged in this final form.

I-0.4. In the Interim Report we had examined about 12 issues in depth and submitted our recommendations on those issues to the Government. We are gratified to note that these suggestions are receiving consideration at the hands of the Government as stated by the Finance Minister in the course of his Budget speech in February, 1978. A few of the changes recommended by us were sought to be implemented through the Finance Act, 1978. We are constrained to observe that the provisions as now enacted into law on three of the points contained in the Interim Report are not in conformity with our recommendations and have made the law more complex rather than simple and rational. The attention of the Government has been drawn to these aspects.

I-0.5. The problem of simplification and rationalisation of tax laws cannot be considered in the abstract and divorced from the background of the economic activity in which the tax laws are required to operate. The object of the tax law is mainly to raise the revenue required for the Government's spending. If so, the current of equity and fair play should all along run through it. This principle, which forms the basis of our recommendations, must be respected. Then alone the law could be significantly rationalised.

The process of simplification would then follow in the course of legislative enactment. We are of the view that rationalisation of tax laws follows upon the introduction of equity as underlying principle of tax legislation.

I-0.6. Courts have time and again observed that equity and tax laws are strangers but in our view, a total estrangement between equity and tax laws is not necessary. When the Courts were constrained to observe this, it was not done out of a feeling of helplessness, but only as a reminder to the taxpayer that an interpretation contrary to the clear provision of law is not judicially justified. On the other hand, the Courts' approach has recently been stated in clear terms by the Supreme Court, viz., that the tax laws, like all other laws, "have to be interpreted reasonably and in consonance with justice".

I-0.7. The Courts have, in appropriate cases, advised the administration to ensure that the taxpayer is not put to undue hardships. They have also placed reliance and emphasis on the directions and rulings of the Central Board of Direct Taxes given to mitigate the rigour of the law, and held the Department bound by them. The executive is, therefore, in a position to ensure fair play and justice as also a measure of equity in the course of administering the tax laws. To the extent, therefore, that any aspect of the legislation leads to inequity or hardship, it could always be remedied by a fair and equitable administration of the law.

I-0.8. It should be recognised that the law, however, exhaustively and elaborately it may be rationalised, cannot take care of all possible situations and circumstances which may arise in a developing and complex economy such as ours. The nation is engaged in a process of planned economic growth consistent with social justice, and it has wide and varied components like the public sector, joint sector and the private sector, as also industry, trade, commerce and agriculture, apart from the urban and rural aspects. All these complexities are inherent in a developing economy such as ours and, therefore, tax laws cannot be reduced to a plane of total or absolute simplicity. But best efforts towards simplification still have to be made.

I-0.9. This is inherent in any scheme of taxation where the charge, the scope of the charge and the process for realising the charge, have to be set out with a reasonable degree of certainty. An additional feature which is observed is that tax laws are used for various socio-economic objectives. By way of illustration, the provisions for disallowance of employees'

salaries or perquisites beyond certain limits are not justifiable from a purely fiscal point of view but they are part of the socio-economic measures. Attempts to introduce such measures through the medium of tax laws tend to distort the concept of income which is, in a commercial and accounting sense, reasonably well understood and capable of measurement. Artificial distortions lead to complexities in the law, and complexities lead to increased administrative difficulties.

I-0.10. The instability of our tax laws is another of their worst features. The laws are riddled with uncertainties and statutory amendments are as unpredictable as they are frequent. Surely, after more than half a century of the working of the Income-tax Acts of 1922 and 1961, it should be possible to have an enduring tax structure. In making our Reports we have proceeded on the basis that once the changes we have recommended are made, it should not be necessary to make any significant change in the law for many years to come. Stability in the rates of tax is equally essential, and therefore, we have recommended that the rates once fixed should continue for at least five years.

I-0.11. The most vital element of justice and fairness (apart from stability) of tax laws, the importance of which it is hard to overemphasize, is the reasonableness of the taxburden. In that context it would be most appropriate to quote the following observations from the speech of Shri N. A. Palkhivala at Bombay in June, 1977:—

Ideologues and academics spend hours in convincing themselves that high rates of personal taxation are essential in a socialist economy. The people persist in their obstinate belief that the State is not entitled to take more than half of their income. They are prepared to resort to various devices, even at the risk of being prosecuted, to keep a fair share of their own earnings. Dr. Ludwig Erhard, the author of the German miracle, and Professor Colin Clark have been of the definite view that the maximum rate of personal taxation should not exceed 50 per cent. Professor Kaldor, the eminent socialist, advocated the maximum rate of 45 per cent and said, "These confiscatory tax rates apply only to a small minority of people who cannot avoid their incidence and their long run effect is bound to be wholly pernicious, both in penalising the prospects of certain careers which are vital from the national point of view, and in undermining public morality." The undeniable truth of Professor Kaldor's observation is borne out by Dr. Crick, the British Nobel Laureate, going into tax exile in the U.S. this year to provide a satisfactory income for the remainder of his life, and another British Nobel Laureate, Dr. Perutz, contemplating a similar move as a result of what the *Times* (of London) called "the nonsensical state of our personal tax structure".

I-0.12. All these features do not necessarily mean that one should resign oneself to a complex tax structure. The tax laws can be made tolerable and acceptable to the taxpayers in general by a fair and enlightened administration. If the administration is not shackled by an overpowering fear of adverse inference, it could impart a considerable degree of simplicity to the actual working of the tax laws and inspire confidence in the public. It is for the administration to apply the provisions in a manner consistent with justice and fair play and on the basis of the principle that in case of doubt the benefit should go to the taxpayer.

I-0.13. We have emphasised the need for a healthy attitude towards the taxpayer by the administration. There can be no doubt that the errant taxpayer should not expect nor be shown any indulgence under the law. But, at the same time, the law should not be so stretched as to throw the onus upon the taxpayer in various circumstances with a view to reducing the burden of the administration. The creation of presumptions and adverse inferences against the taxpayer tends to present a general attitude of mistrust of the taxpayer by the administration. The latter's extraordinary powers, without adequate protection to the citizen, to cope with exceptional situations, has also led to disastrous consequences. The recent disclosures in the matter of the use, or rather the misuse, of such powers, establish the dangers of such legislative measures. The approach should be quite the contrary. The law should in our view proceed on a general presumption of honesty of the taxpayer and provide measures for self-compliance by him of most of his obligations. A fiscal law, as much as a penal law, should proceed upon the innate sense of self-discipline and honesty of the public. It is in this regard that a special reference has been made to a good administration of even a difficult and unpalatable law like the tax law. The approach of the administration on the basis of the underlying presumption of honesty would necessarily be less rigid and more fair-minded. Correspondingly in situations where administrative discretion has been used with the sense of justice and fair-play, there should not be a presumption against the integrity of the administration. The exercise of such administrative power should be equated to the exercise of judicial powers in appellate proceedings.

I-0.14. We would also emphasise the need to promote the confidence of the taxpayer in the administration. A climate of mutual trust and fair-play should be fostered so as to make for better voluntary compliance with the tax laws on the part of the taxpayers. In this regard the periodic measures for unearthing unaccounted income through disclosure schemes and other concessions considerably pollute the atmosphere. The frequency and the periodic regularity of such measures generate a sense of frustration amidst the body of honest taxpayers. It may gradually lead to a general feeling that non-compliance of tax laws can be indulged in and the results periodically cleared through the disclosure schemes. The frustration would be greater because, despite the recommendations of the various Committees against such disclosure schemes, the Government has in the past introduced them from time to time. We would like to reiterate that such measures will tend to breed disrespect for the tax laws

and their administration, which in turn will seriously affect the functioning of the laws based upon voluntary compliance. There is, therefore, need for a clear statement that such measures would no longer be repeated and the errant taxpayers would necessarily be dealt with in accordance with the due processes of law.

I-0.15. In the course of formulating our Report, we have considered it necessary to make use of various types of analysis and statistical tables. The existing statistical data and research publications of the Directorate of Inspection proved to be quite inadequate for our purpose. We noticed lack of data in several important areas of the application of the tax laws and important fiscal incentives like accelerated depreciation, tax holiday etc. We are informed that there is a special cell in the Ministry of Finance which has the responsibility of collecting statistics and conducting research in various aspects of the direct tax laws. However, such a cell functions under the administrative control of the Ministry and has therefore necessarily to function within the directives issued to it from time to time.

I-0.16. There is need for continuous fiscal research into various aspects of the tax provisions. Such research should be continuous and not intermittent or sporadic. The advantages of such research would be three-fold. Firstly, it would ensure continuity in the thought underlying the various direct tax laws. The development of tax legislation on the basis of continuity of thought and reasoning would lead to a more balanced and reasonable tax structure. Secondly, fiscal research would enable studies to be carried out in depth on various issues. Such studies would be evolved through the process of discussions with the public and be formulated after an analysis of the various implications. Thirdly, fiscal research would provide a rational basis for arriving at informed decisions which would then replace the *ad hoc* decisions which have hitherto characterised tax legislation from year to year. Research would necessarily involve an objective study by a team of persons who are solely concerned with arriving at proper conclusions uninfluenced by any extraneous considerations.

I-0.17. Continuous fiscal research in a matter conducive to the attainment of the advantages mentioned above can best be undertaken by an independent autonomous body which is outside the administrative control of any Ministry. Such a body should be comprised of experts and it should be entitled to draw upon public opinion freely. It should be in the nature of an expert consultative body to which the Finance Ministry could look for advice on an intricate subject like fiscal legislation. A body functioning in this manner will be to public finance what a well established scientific research institution is to technology. The need for autonomy for such a body is paramount in order to ensure that it can fearlessly express its views on any particular proposal which may be mooted by the Ministry or the officials of the Government. Where considered appropriate, the research body would discuss measures and formulate conclusions through a process of dialogue and discussion.

I-0.18. We are of the view that there is no particular merit or necessity in clothing the budget proposals relating to the tax laws with an undue air of

secrecy. Proposals which are exposed to study by an autonomous research body and dialogue and discussion with the interests likely to be affected and concerned with the matter, would go a long way towards making stable tax legislation. Such a trend is already in evidence in some of the industrially advanced countries like the United Kingdom and the United States of America.

I-0.19. In regard to the substantive law on taxation of income, there are certain concepts which have evolved over a period of time, the most important of these being the yardstick of income as the basis of taxation. The principle of ability to pay has traditionally been measured with reference to the level of income of the taxpayer. This concept of income has not remained static, but has kept pace with changes in the nature and tempo of economic activity. Historically, income was given a very narrow meaning and equated with the fruit of a tree. However, in India, the concept has been extended to cover various types of receipts like capital gains and, more recently, casual and non-recurring receipts. Such extension has largely been motivated by the need to prevent avoidance of tax by camouflaging income receipts as capital. As a result, the fundamental distinction between a revenue receipt and a capital receipt is gradually getting blurred and even eliminated. Taxation of income, which was originally conceived of as taxation of revenue receipts, has, due to changing circumstances, been extended to certain specific types of capital receipts as well. At the same time, the tax laws have sought to encourage the conversion of income receipts into capital through approved modes of saving by the grant of certain tax concessions.

I-0.20. These developments pose the question whether the concept of "total income" which now forms the basis of charge, is in reality a proper and adequate measure of the capacity to pay. The view has been propounded that, considering the recent developments extending the scope of income to include some capital receipts and simultaneously granting tax concessions for building up capital through approved modes, the measure of ability to pay could, with advantage, shift from a person's income to his capacity to spend or consume. It is argued that by using the capacity to consume as the measure of ability to pay, the distinction between capital and revenue would fade into the background and the taxpayer would be exposed to making a due contribution to the exchequer if he is spending out of his resources for consumption, irrespective of their source and nature. Consumption, whether it be of current income or of capital—which is but another name for past income—would stand equally discouraged in this concept. At the same time, certain essential forms of consumption, such as personal medical expenses, income imputed to owner-occupied property and essential expenditure on maintenance of bare living standards, would be regarded as legitimate exclusions from the base before applying the charge of tax. An exercise in this direction is being considered in some of the advanced countries, fully recognising that it is an experiment which would involve a protracted period of implementation.

I-0.21. We are of the view that in the circumstances prevailing in our country at present, where the requirement of rapid economic development is paramount, an

experiment in restructuring the base for the levy of tax, from income to consumption would be unwise and the cost to the nation would be incalculable and unjustifiable. The taxpaying public itself constitutes such a minor part of the population in our country and there are such a large number of persons at or below the poverty line, that any change in the yardstick, at this juncture, would be inappropriate. The taxpaying class as well as the administration are psychologically attuned to the levy of tax on income and towards savings from such income for national development. It would, in our view, be more prudent to extend the area of savings out of income qualifying for tax relief, than change the fundamental yardstick of income as the base for charge of tax.

I-0.22. One other problem which arises in regard to taxation of income is the difficulty in measuring income with a degree of mathematical accuracy. The problem is complicated further by co-relating the measure of income to a particular accounting period. The provisions recently made in the Finance Act, 1978, dealing with enhanced compensation payments which date back for tax purposes to the year of acquisition illustrate this particular problem. An unduly rigid or inflexible approach to the exact determination of income of a single accounting period should thus not be favoured. The concept of income as a base for taxable capacity cannot be artificially confined to a single accounting year and there should be a reasonable flexibility in the law to take into account adjustments which are not necessarily or strictly confined to a single year.

I-0.23. One important phenomenon to be remembered in the context of the incidence of taxation is the incidence measured in terms of the real value of the rupee. In his budget speech for 1977-78, the Finance Minister recognised this phenomenon when he observed that, in a world of rapid and continuing inflation, capital gains arising from the transfer of assets held over a length of time is to a large extent illusory in nature. The phenomenon of inflation is one which cannot be absolutely eradicated. On the contrary there is a trend of economic thinking that mild doses of inflation are indeed necessary in fostering rapid economic development. Such inflation has the corresponding effect of eroding the value of the rupee in real terms or in terms of purchasing power. The following table extracted from "Statistical Outline of India—1978" published by the Department of Economic & Statistics of Tata Services Limited makes interesting reading :

Purchasing Power of Rupee in relation to 1960 Prices				
	Purchasing Power of Rupee (Paise)		Purchasing Power of Rupee (Paise)	
1960	100.0	Oct.	1974*	29.9
1961	96.2	Mar.	1976	35.0
1962	93.5	April	1976	34.6
1963	90.9	May	1976	34.5
1964	80.0	June	1976	34.4
1965	73.0	July	1976	33.7
1966	66.2	Aug.	1976	33.6

	Purchasing Power of Rupee (Paise)		Purchasing Power of Rupee (Paise)	
1967	58.1	Sept.	1976	33.1
1968	56.5	Oct.	1976	32.9
1969	57.1	Nov.	1976	32.7
1970	54.3	Dec.	1976	32.7
1971	52.6	Jan.	1977	32.6
1972	49.5	Feb.	1977	32.3
1973	42.4	Mar.	1977	32.1
1974	32.9	April	1977	31.9
1975	31.2	May	1977	31.4
1976	33.8	Aug.	1977	30.6
1977 (Jan-Aug)	31.6			

Note : The All-India consumer price index for industrial workers (1960—100) has been used as the deflation.

*In October, 1974, the index reached the all-time peak of 335.

I-0.24. We recognise that the above Table is based upon the All-India Consumer Price Index for working classes and may not strictly be representative of the economic position in relation to taxpayers in general. However, the Table is sufficient illustrative of the phenomenon with which we are concerned. The Table demonstrates that the rupee of 1960 and the rupee of 1977 do not at all equate to the same real value in terms of purchasing power. It has depreciated to about 32 per cent of the value obtaining in 1960. If this purchasing power were to be computed with conditions prevailing in 1946-47, the position would indicate a still higher extent of depreciation in the value of the rupee.

I-0.25. It is in this context that the various monetary limits fixed in the direct tax laws require to be considered. Many of the exemptions or concessions which are fixed in absolute rupee terms gradually tend to mean lesser and lesser value in real terms until a stage is reached where the concessions cease to have a meaning. It is with a view to having a built-in check against this phenomenon that some of the tax systems of other countries provide for a system of indexation whereby the monetary limits automatically move upwards or downwards with a rise or fall in the value of the currency. It should, however, be noted that since 1975 inflation is reasonably held in check and in the last few years the value of the rupee in real terms has been held reasonably stable. It is for this reason that we do not make a recommendation for the introduction of indexation in India. If the phenomenon of inflation had continued unabated and the value of the rupee further eroded we would have examined the need for introducing the concept of indexation in our taxing statutes. At present, however, the tax laws need not be complicated by such a provision.

I-0.26. In the course of performing our task, several issues have been highlighted in the memoranda submitted to us, while others have arisen in the course of the evidence tendered by responsible sections of public opinion, and all these have been deliberated upon during our meetings. In order not to burden

the Report with unnecessary verbiage we have, generally, refrained (subject to some exceptions) from discussing and commenting upon issues on which we recommend retention of the existing provisions. We have devoted considerable time to the formulation of our suggestions and recommendations and tried to ensure that the reasoning behind these is adequately reflected in the Report. We are at the same time painfully aware that not all the recommendations are fully prefaced with detailed justifications for the same and with elaborate discussions involving examination of the pros and cons which preceded them. This is because we had to concern ourselves with some of the most complex pieces of legislation on the statute book in a brief period. We have, therefore, restricted ourselves to highlighting the reasoning underlying recommendations of relatively greater importance while refraining from needlessly burdening the other parts of the Report.

I-0.27. This Report is divided into 3 parts. The first part deals with the substantive law of all the direct tax laws except the Estate Duty Act. The second part deals with the procedural provisions of these laws. The third part deals with both the substantive as well as the procedural provisions of the Estate Duty Act, which is operative under circumstances not similar to those of the other direct tax laws.

I-0.28. As mentioned in the introductory remarks to our Interim Report, the general plan of action in regard to the task assigned to the Committee was formulated in July, 1977, under the Chairmanship of Shri N. A. Palkhivala. The approach to the Report as well as the points with reference to which views of the public were sought, were determined during these initial meetings. As mentioned earlier, we had the benefit of detailed discussions with Shri Palkhivala before finalisation of this Report when he provided invaluable guidance and advice. It is a tribute to his unparalleled acumen and deep study of the subject that all his suggestions readily found unanimous acceptance by the Committee. We would be failing in our duty if we were not to record our grateful thanks to Shri Palkhivala for undertaking this special visit to India in the midst of his busy schedule and our sincere appreciation of his inspiring contribution in the finalisation of this Report.

I-0.29. The link between the inspiration provided by Shri N. A. Palkhivala and its translation into the contents of this Report was achieved through the unstinting co-operation and tireless effort of Shri B. A. Palkhivala. He has, at great personal sacrifice, made himself available to us and made a significant contribution.

I-0.30. In now submitting this Report we would like to place on record our appreciation of the spontaneous response received from all sections of the public concerned with the working of the direct tax laws. Elaborate and studied memoranda on various provisions of the direct tax laws were received. Representatives who appeared before us at the personal discussions had also put forward their points of view very effectively and have thereby assisted us in formulating the contents of this Report.

I-0.31. Shri T. S. R. Narasimham, who was the Member-Secretary of the Committee, continued to hold his senior position as Commissioner of Income-tax and was thus required to attend to the onerous tasks as a Commissioner in addition to the work of the Committee. Whilst he took on this task for the initial months even after the submission of the Interim Report, it was felt that the tasks assigned to the Committee under its terms of reference would necessarily require the whole time attention of a senior official who is not simultaneously burdened with the normal tasks of his office. Accordingly, in March, 1978, the Central Government was pleased to appoint Shri D. N. Pathak as a wholetime Secretary to the Committee and Shri T. S. R. Narasimham continued as the Member thereafter.

I-0.32. Even prior to his appointment as the Secretary to the Committee, Shri D. N. Pathak was assisting the Committee in its task and had made studied contributions on several matters entrusted to him. On his full time assignment to the Committee he continued to make his contributions as well as assumed the tasks of co-ordination and leadership of the secretariat of the Committee. His knowledge of the subject and his close association with the administration of the direct tax laws for the past several years have enabled him to discharge his duties admirably and to the fullest satisfaction of all the Members of the Committee. We would like to place on record our appreciation of the able manner in which Shri Pathak performed his tasks.

I-0.33. The Committee is grateful to the senior Assistant Commissioners, Shri K. N. Balasubramanian, Shri M. K. Keshavan, Shri M. K. Sabharwal, Shri A. K. Nasta, Shri S. Govindarajan and Shri D. Laxminarayana, who have done much of the spade work in the respective areas assigned to them. These senior officers assimilated all the points made out before the Committee either in the memoranda or in the oral discussions and ably analysed the same in a manner which enabled the Committee to discuss the issues involved. The high standard with which these tasks were willingly performed and the objective presentation of the various sides of the issues largely contributed to our being able to come to reasoned conclusions.

I-0.34. The Assistant Commissioners were also effectively assisted by a team of responsible and senior Income-tax Officers, viz., Shri R. Krishnamoorthy, Shri Roy Alphonso, Shri R. Raju, Shri A. A. Makhija, Shri V. B. Dewal, Shri S. Padmanabhan and Shri M. M. Bharti, who have also spared no efforts in the respective work assigned to them. They have closely followed the discussions at meetings of the Committee and made timely and detailed notes thereof. The accuracy and the technical content of these notes are clearly reflective of their knowledge of the law and the zeal displayed in following the trend of thought. These have been of great assistance to the Committee particularly because the Committee met at periodical intervals.

I-0.35. It would be appropriate to record that but for the contributions of all these senior Assistant Commissioners and Officers, assisted by the secretariat staff under them, the Committee would not have been able to complete the assignment within the time allowed to it.

APPENDIX

F. No. A. 11019/70/77-Ad. VII

GOVERNMENT OF INDIA

MINISTRY OF FINANCE

(Department of Revenue)

New Delhi, the 30th January, 1978
10th Magha 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, it was stated that the Committee will submit its Report and the draft Bills to the Ministry of Finance by the 31st December, 1977. The Government of India, have now decided to grant the Committee extension of time upto the 31st August, 1978 for submission of its final Report and the draft Bills to the Ministry of Finance.

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 Secy.
Ministry of Finance
Department of Revenue

CHAPTER 1

DEFINITIONS

I-1.1. Chapter I of the Income-tax Act, 1961, deals with the commencement of the Act and the definitions of various terms used in the Act. The recommendations made by us will necessitate several amendments to the Income-tax Act. **It would be appropriate that these amendments are all brought into force at one and the same time and that too with effect from a specified Assessment Year, say, the Assessment Year 1980-81. The unamended Law would apply upto and inclusive of the Assessment Year 1979-80 Except to the Extent that certain amendments are given retrospective effect.**

I-1.2. There are over 50 words and phrases defined for the purposes of the Income-tax Act. Our observations on some of the more important definitions are set out in the following paragraphs.

Amalgamation : [Section 2(1A)]

I-1.3. The expression "amalgamation" has been given a special definition under the Income-tax Act. It requires three conditions to be cumulatively satisfied.

I-1.4. It appears to us to be unnecessary to provide for an elaborate definition of the expression "amalgamation", inasmuch as the concept of amalgamation of companies is well regulated under the Companies Act. The provisions in the Income-tax Act which confer some benefit with reference to amalgamation in the matter of taxation of capital gains, balancing charge, continuance of investment allowance, etc. are largely clarificatory and need not therefore be subject to any additional conditions. The new section 72A which confers a positive benefit in the case of amalgamation is conditional upon the specific approval of the Government and hence a detailed definition of the expression amalgamation is unnecessary. It is also possible that in certain circumstances the conditions under the present definition may not be complied with if the dissenting shareholders exceed 10 per cent though proper provision for such shareholders may have been made by the Court whilst sanctioning the scheme. Under the circumstances, we are of the view that so long as a merger of two or more companies to form a single company is achieved through the process of amalgamation under Company Law, it should be regarded as an amalgamation for the tax laws as well.

I-1.5. We accordingly recommend that the expression "Amalgamation" may be defined to mean the merger of one or more Companies with another Company, or the Merger of two or more Companies to form one Company, under a scheme sanctioned by the Court under section 394 of the Companies Act, 1956, or ordered by the Central Government under section 396 of the said Act.

Capital Asset : [Section 2(14)]

I-1.6. The expression "capital asset" is defined in section 2(14) of the Income-tax Act. The purpose of this definition is to identify the asset, the transfer of which would attract the liability to tax on the capital gains arising therefrom.

I-1.7. A controversy has arisen in regard to the question as to whether a self-generated asset like goodwill can be regarded as a capital asset within the definition. The controversy arising in the matter has been discussed in Chapter 9 of this Report while dealing with the computation of income under the head 'Capital gains'. We appreciate that there is considerable force in the view that a self-generated asset should not be treated as a capital asset for the purpose of tax on capital gains. It would be patently unconscionable to tax the entire consideration arising from the transfer of a self-generated asset. However, we are of the view that there is no particular merit in totally excluding such an asset merely because it is self-generated, from the definition of capital asset and to allow the entire gain accruing therefrom to escape taxation. All assets including intangible assets as well as self-generated assets should, in our opinion, be included in the definition of capital assets. **We, therefore, recommend that an amendment may be made in the definition of Capital Asset to expressly include self-generated Assets like goodwill.** Our recommendation in this regard is, however conditional upon the acceptance of our other recommendation contained in Chapter 9 to allow the cost appropriately determined as explained in that Chapter on grounds of equity and justice.

Company in which public are substantially interested : [Section 2(18)]

I-1.8. The present definition of this expression is extremely cumbersome and long drawn out. The expression is of vital significance insofar as it is relevant for determination of the liability of a company to tax. The rate of tax applicable to such companies is generally lower than that applicable to a company which does not satisfy the definition. The expression has also relevance in regard to compulsory distribution of dividends, as also the definition of dividend under section 2(22)(e).

I-1.9. Over the years, there has been considerable litigation and consequent uncertainty in determining whether a company satisfies the definition or not. It is essential that when the quantum of tax is dependent upon application of a provision of law, such a provision should be simple and unambiguous.

I-1.10. The essential feature in the tests prescribed by the section is the feature of control which is synonymous with the ownership of shares with voting rights

in the case of companies. It, therefore, appears to us that this test of control which presently is put both in a positive form as well as in a negative form could be combined and simplified.

I-1.11. Secondly, in the present definition a further refinement or distinction is made in the case of an industrial company. This additional distinction in determining the concept of substantial public interest is not warranted more particularly when this distinction itself results in different rates of tax as well as differences in regard to the compulsion for distribution of dividends. The definition, therefore, requires simplification by having a uniform test of holding of shares carrying more than 50 per cent of the voting power. The control over the affairs of a company is largely synonymous with the holding of shares carrying the voting power.

I-1.12. We, therefore, recommend a simplification of the definition of a "Company in which the Public are substantially interested". It may be defined to mean a company which is :

- (a) a Government company as defined in section 617 of the Companies Act, or
- (b) a company in which not less than 40 per cent of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a Statutory Corporation or a Corporation owned by the Government or the Reserve Bank of India, or
- (c) a company registered under section 25 of the Companies Act, 1956, or
- (d) a company having no share capital, and which having regard to its objects, the nature and composition of its membership and other relevant considerations declared by the order of the Board to be a company in which the public are substantially interested, or
- (e) a company whose equity shares were as on the last day of the relevant previous year listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, and any rules made thereunder, or
- (f) a company which is a public company as defined in the Companies Act, 1956, and which satisfies the following conditions :—
 - (i) the equity shares in the company were throughout the relevant previous year freely transferable by the holders to the other members of the public; and
 - (ii) the shares carrying more than 50 per cent of its total voting power were at no time during the relevant previous year controlled or held by five or less persons excluding the following persons namely :
 - (1) the Government;
 - (2) a Government company;
 - (3) a Corporation established by a Central or State Act;

- (4) a company in which the public are substantially interested; and
- (5) a wholly owned subsidiary company of a company in which the public are substantially interested.

Explanation.—In computing the number of five or less persons, persons who are relatives of one another and persons who are nominees of any other person together with that other person shall be treated as a single person.

- (g) a wholly owned subsidiary company of a company in which the public are substantially interested.

Divided [Section 2(22)]

I-1.13. Section 2(22) defines the expression "dividend" for the purposes of the Income-tax Act. This provision has been construed under several decisions of the Supreme Court, which have had the effect of reasonably stabilising the law. The definition is very extensive and has also the purpose of encompassing operations between a company and its shareholders yielding results similar to a direct distribution of dividends. We do not consider it necessary to change the basic outline of the provision.

I-1.14. A representation has however, been made to us that hardships and difficulties can arise under clause (e) of the definition. This clause deems as dividend any payment by way of advance or loan to a substantial shareholder by a company in which the public are not substantially interested. This fiction is limited to the extent to which the company possesses accumulated profits. It also covers payments made by the company on behalf or for the individual benefit of a substantial shareholder. The difficulty pointed out to us is that a stray transaction not motivated by considerations of financial accommodation to a shareholder would also be hit by the clause as it is now worded. Again, an apprehension has been expressed that the same quantum of accumulated profits could repeatedly create the fiction of receipt of a dividend by different and successive loans, although a contrary view has been held by the Bombay High Court in *CIT vs. Badiani* (76 ITR—369).

I-1.15. We have carefully considered this representation. In our view clause (e) of the definition has a definite objective to achieve, namely, preventing the use of retained profits of a closely held company for financial accommodation of substantial shareholders. The clause was introduced by the Finance Act, 1955, in the Act of 1922 to check the device of utilising the accumulated profits of a closely held company for the personal benefit of those in control of the company. There is, therefore, not much substance in the representation for deletion of the provisions of sub-clause (e).

I-1.16. Shareholders of closely held companies, and particularly substantial shareholders, should be conscious of the deterrent provision contained in sub-clause (e) and should not complain of the consequences of an infringement thereof. At the same time we consider that the provision should not be so literally construed and administered as to cause unintended injustice in

cases where the breach may be inadvertent and not motivated by a scheme of utilisation of the company's funds.

I-1.17 In these circumstances, It is appropriate that sub-clause (e) of section 2(22) may be excluded from operation in cases where the payment in question is made in such circumstances or for such a brief duration that it cannot in substance be treated to fall within the intent of that sub-clause.

I-1.18. The intention underlying sub-clause (e) is to invoke it in a case where the category of persons mentioned therein derive a benefit by use of the funds of the closely held company. It is meant to deal with circumstances where there is a degree of durability in the benefit which is taken by the category of persons mentioned therein. It is in such circumstances alone that the abuse should be countered by the fiction of deemed dividend. The objective of sub-clause (e) is not to create a hardship where, purely accidentally, there may be an overdrawal of funds or a temporary loan for an insignificant period, say, for a week, may have been given by the company. We accordingly recommend that section 2(22)(e) should be amended to exclude from its operation cases where the payment in question is made in such circumstances or for such a brief duration that the transaction cannot be treated as of the nature which is within the intent and scope of sub-clause (e).

Education : (New definition)

I-1.19. The expression "education" is used in the Income-tax Act whilst defining expression "charitable purpose" in section 2(15). It also appears at other places in the Income-tax Act, particularly in some of the exemption provisions. The scope of the term "education" has come up for discussion by the Supreme Court in the case of Sole Trustee, Loka Shikshana Trust vs. CIT, 101 ITR-234. The observations of one of the Judges, Khanna J. with whom Gupta J. generally concurred was that education in the context of section 2(15) connotes the process of training and developing the knowledge, skill, mind and character of students by normal schooling. In other words, it is limited to scholastic instruction and does not extend to every acquisition of further knowledge whatever be the medium for such acquisition.

I-1.20. The word "education" in the context of charitable purpose has been used for several decades and has been widely construed since the beginning of the previous century. It has always been understood as not being limited within an unduly narrow ambit add as extending much beyond the narrow compass of mere scholastic instruction. The question as to the extent of the area covered by education would naturally be decided by the Court in each case but it is the well settled law in India and England for several decades that the word is not limited in its character to mere scholastic instruction. The concept of education as explained in the observations of Khanna J. are not supported by any judgment of the Supreme Court in India or the Appellate Courts in England. The Court of Appeal in England has in the case of Incorporated Council of Law Reporting for England and Wales vs. Attorney General (47 Tax Cases—321)

sufficiently dealt with the scope of the word "education" and the Supreme Court has not expressed any dissent from that case nor is it, referred to in the judgement. As the issue of what constitutes education generally, as opposed to the issue whether the activities of that particular trust constituted education, was not before the Supreme Court, the observations cannot be construed as laying down the law on what constitutes "education" generally in the context of charitable purpose.

I-1.21. We, therefore, recommend that an Explanatory definition of the term "Education" should be introduced with retropective operation to the effect that "Education shall not be Restricted to Scholastic Instruction only". Since it would be a purely clarificatory amendment, it is appropriate that it should be enacted with retrospective effect as from the commencement of the Act.

Interest : [Section 2(28A)]

I-1.22. The definition of the term "interest" in section 2(28A) was inserted by the Finance Act, 1976. There are two major purposes for which this definition has been considered necessary. The first purpose is that contained in section 40A(8) which provides for disallowance of a portion of the interest on certain forms of borrowings in the case of certain companies. We have, in Chapter 8 of this Report dealt with the provisions of section 40A(8) and recommended the deletion of that provision for the reasons set out therein. The purpose of the definition for section 40A(8) would thus not survive in the light of that recommendation.

I-1.23. The other purpose of the definition is concerned with section 194A which provides for deduction of tax at source on interest other than interest on securities. While it is reasonable that taxes should be deducted at source on payments by way of interest, under the scheme of pre-assessment collection of taxes, there is no warrant or justification for extending the area of such deduction to other forms of payments under borrowing arrangements. Payments made by a debtor to his creditors by way of consideration for the use of money can appropriately attract deduction of tax at source. This is the concept of interest as normally understood. The provision under section 2(28A) has lent itself to a possible view that it extends to other payments made by the debtor to third parties connected with the loan arrangement, as for example, brokerage. To provide for deduction of tax at source from payment of the nature of brokerage on such a construction of section 2(28A) is unconscionable. It amounts to deduction of tax at source from a trading receipt which is contrary to the principle of deduction of tax at source from an item in the nature of income under section 194A. Brokerage is in the nature of a trading receipt, from which the recipient is required to incur considerable expenditure of his organisation, etc. Deduction of tax at source from the gross receipt would lead to hardship apart from it being against the scheme of the section.

I-1.24. In our view, therefore, even for the second purpose there is no necessity to define the term "interest" and the term should be confined to its

normal meaning. We, accordingly, recommend the deletion of the definition of interest in section 2(28A) as in our view an artificial definition is unnecessary and not called for.

Person : [Section 2(31)]

I-1.25. The term 'person' has been defined in section 2(31). Most of the entities which are regarded as persons for the purposes of the Income-tax Act are now reasonably well understood. The same holds true also in regard to the entity known as association of persons. This entity has evolved over the years when historically it was an association of individuals and has been enlarged to encompass an association of persons. The decision of the Supreme Court in *CIT vs. Indira Balkrishna*, 39 ITR-546 has settled the law in regard to the essential tests for determining the status of association of persons. It has been held that, in order to constitute an association, persons must join together, of their own volition or free will in a common purpose or common action and the object of the association must be to produce income—it is not enough that the persons receive the income jointly. Co-ownership, by itself, does not establish the existence of an association of persons, but coupled with other indicia of joint enterprise would make the co-owners assessable as an association of persons. This assessable as an association of persons. This proposition, which has been laid down by the Supreme Court as far back as 1960 continues to be valid over all these years. No change is, therefore, called for in the tests for determining the status of an association of persons.

I-1.26. However, the use of the expression 'body of individuals', which is of more recent origin has, to some extent, disturbed the position in law which was otherwise well settled. Two High Courts, viz., Andhra Pradesh and Gujarat, in the cases of *Deccan Wine and General Stores vs. CIT*, 106 ITR-111 (AP) and *CIT vs. Harivadan Tribhovandas*, 106 ITR-494 (Guj.) have had occasion to consider the scope and connotation of the entity "body of individuals" as distinct from "association of persons". Both the High Courts have come to a common conclusion that the taxable entity "body of individuals" is not the same as "association of persons". In other words, the tests laid down by the Supreme Court to constitute an association of persons need not all be satisfied to constitute a group as a body of individuals. At the same time, the two High Courts have desisted from going to the extent of giving the expression an extreme meaning to cover all cases of conglomeration or combination of individuals irrespective of the object which brought them together and irrespective of the activities they carry on. Thus, while a wider connotation is given to body of individuals as compared to association of persons the concept is limited to refer to a combination of individuals who have come together (may be not of their own volition), who have unity of interest and one or more of whose members carry on some activity with a view to produce income, profits or gains for the benefit of all. In our view this construction placed on the taxable entity "body of individuals" could be accepted and given statutory basis. It may, therefore, be desirable to categorise the status of body of individuals separately in the definition of "person" under

section 2(31). We recommend that Sub-clause (v) of Section 2(31) should, therefore, be divided into two parts as follows :

"(v) An Association of Persons whether Incorporated or not ;

(va) A body of individuals whether Incorporated or not, but not including a combination of individuals who merely receive income jointly without anything further."

I-1.27. The adoption of the revised definitions in terms of sub-clauses (v) and (va) above for the entities "association of persons" and "body of individuals" would settle the controversies in the determination of the status of association of persons and body of individuals. It would follow, as a consequence, that there may be groups of assessee who do not satisfy the tests necessary for being assessed either in the status of association of persons or body of individuals. In such cases the income would be assessable in the individual hands of the persons concerned. However, it should be pointed out that under the provisions of sections 159 to 181 contained in Chapter XV of the Income-tax Act dealing with liability in special cases, situations do arise where a plurality of trustees or executors are specifically assessable in the status of association of persons. Express provision to this effect is contained in section 164 and in section 168(1)(b) of the Act. These are cases of persons who merely receive income jointly without anything further and appropriately they would be assessable neither as an association of persons nor as a body of individuals within the tests referred to above. It should, therefore, follow that such a group of persons should be assessed in the status of "individuals" having regard to the further observations and recommendations made by us in the matter of the taxation of association of persons and body of individuals in Chapter 14 of this Report. Apart from the amendments which would have to be made in sections 164 and 168 to bring about this result. We recommend that Sub-Clause (i) of the definition of "Person" in Section 2(31) should refer to "An Individual Including Individuals who do not fall within Sub-Clause (v) and (va)".

Relative : [Section 2(41)]

I-1.28. The expression "relative" is defined in section 2(41). The definition reads as follows :

"'relative', in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual."

The present definition covers direct relatives and is in our view, adequate. We, however, observe that at other places in the Act, the same expression is given a different definition. In the interest of simplicity of tax laws, the expression should consistently bear the same meaning throughout the statute. There is no particular merit in notionally extending the definition for special provisions of the Act.

I-1.29. The expression "relative" has been used and defined further in section 13 and section 80B where it has been given an extended definition. As regards

the extended definition in section 13, we have observed in our Interim Report that the relationships mentioned therein have been stretched too far. The relationship should be reasonably proximate to the individual concerned and the difficulties created by an artificial extension have been commented upon.

I-1.30. As regards the definition in section 80B, it has relevance for the purposes of Chapter VIA of the Act, particularly for the concession in the matter of expenditure on medical treatment of handicapped relatives under section 80D. Here again, it is appropriate that the proximate relationships referred to in the definition in section 2(41) apply and there is no substantial purpose served by an artificially extended definition. Considerations of simplification would, therefore, justify that the definition as contained in section 2(41) should apply uniformly throughout the Act. We, accordingly, recommend that the definition of relative in section 2(41) should apply for all the provisions of the Income-Tax Act and the Artificial Extension in other provisions, viz., Section 13 and section 80B should be deleted.

Scheme of Reconstruction : (New definition)

I-1.31. For the reasons set out in Chapter 9, we recommend that a definition of a new expression "Scheme of Reconstruction" be enacted in section 2.

Previous Year : [Sections 2(34) and 3]

I-1.32. Under the scheme of the Income-tax Act, income-tax is charged for any assessment year in respect of the total income of the previous year or previous years, as the case may be, of every person. While the assessment year is a fixed concept and coincides with the Government's financial year from 1st April of one year to 31st March of the following year, the income to be brought to tax in a given assessment year may relate to one or more of the previous years according to the circumstances and choice of each taxpayer. "Previous year" has been defined in section 3. Basically, it means the financial year immediately preceding the assessment year. This position applies mainly in the case of taxpayers who have income from sources other than business, where they do not maintain regular accounts in respect of such income from year to year. However, an exception is made in the case of taxpayers who maintain accounts on regular basis from year to year. In their cases, the income of a period of 12 months ending on a date, within the financial year preceding the assessment year, upto which the accounts are made up, will be charged to tax in the assessment year. This would largely be relevant in the case of taxpayers carrying on a business or a profession or those who have extensive investments in house properties, shares, etc. for which they maintain accounts and close such accounts on a date other than 31st March.

I-1.33. Complete and, virtually, unrestricted freedom is allowed to taxpayers to choose the accounting year on the basis of which they will maintain the accounts of their income. There are also elaborate provisions for dealing with the case of a business or a profession coming into existence newly during the

financial year preceding the assessment year or during the twelve months preceding that financial year. In other exceptional cases, in which the ordinary rules for determining the previous year may fail to provide a clear answer, the Central Board of Direct Taxes has been authorised to determine the previous year.

I-1.34. It is also specifically provided that an assessee may have different previous years in respect of different sources of his income. Thus, a person may have a previous year ending on 31st March for his house property income or other investment income, the year ending on 31st December for, say, a cloth business, and a year ending on 31st October for a business in toys, and so on.

I-1.35. The freedom allowed to taxpayers to have any period of 12 months (or even a shorter period in special cases) as the previous year for any source of income, and, in addition, to have different previous years for different sources of income, has attracted criticism and comment from a number of Committees and Commissions which, in the recent past, considered reform of the taxation law with a view to their simplification and rationalisation and combating tax evasion. The last of such Committees to go into this question in some detail was the Direct Taxes Enquiry Committee (Wanchoo Committee).

I-1.36. The Direct Taxes Enquiry Committee dealt with this subject of "previous year" in the course of dealing with the problem of black money and tax evasion and recommended the adoption of a standard previous year coinciding with the budget year (para 2.193). Shri S. Bhoothalingam had also suggested adoption of a uniform tax year beginning on the 1st of July. The Administrative Reforms Commission, while favoring the adoption of a uniform standard previous year, recommended the introduction of this reform only for companies and not for others. Notwithstanding these recommendations of the two Committees and a Commission referred to hereinabove, so far the Government have not implemented this reform which is now overdue.

I-1.37. We have considered this problem at some length. The advantages of having a uniform accounting year for tax purposes are many. Such a reform will facilitate investigation and cross-verification of transactions and restrict the scope for collusive manipulations. Income earned during the same period by different taxpayers will be subjected to tax at the same rate and not at different rates as at present. Budgeting would be rendered more accurate inasmuch as a boom or depression in a particular industry can be duly taken note of in the same year in the case of all taxpayers engaged in that industry or business. Disposal of assessments can be planned in a better manner because all the returns would be received about the same time. It would also accelerate completion of assessments because economic conditions pertaining to a particular class of taxpayers would be common.

I-1.38. One of the objections to such reform may be that it would amount to interference with the time-honoured right of the businessman to adopt an accounting year of his choice, which may be based on religious sentiment or business convenience. Besides, certain laws relating to the working of co-operative

societies, banks and insurance companies, prescribe different periods for closing of accounts. It may also be contended that a uniform accounting year is likely to cast a heavy burden on the auditors by bunching of audit work.

I-1.39. With regard to the objections which may be raised against the change-over, we feel that these are largely superficial and lack substance. The plea of religious sentiments is to our mind not well founded because taxpayers belonging to the same religious group or community have been known to adopt different accounting periods for the maintenance of their accounts. Business convenience is a term of wide import. In this context, it can have relevance only insofar as the standard period which taxpayers may be required to adopt compulsorily by statute for closing of their accounts, might end at a time of hectic activity in a particular business. In that event, taxpayers might have to suspend their normal trading or manufacturing operations for the purpose of stock taking and closing of accounts. Such inconvenience can arise only in the case of seasonal factories, such as, sugar factories, if they are obliged to close their accounts at the height of the crushing season. This argument may, at first blush, be appealing but its importance is to some extent over-emphasised, inasmuch as there does not appear to be complete uniformity among seasonal factories in the period adopted for closing the accounts. As regards laws prescribing a specific date for the closing of accounts in the case of co-operative societies, banks and insurance companies, the two periods which are prescribed are the calendar year in the case of banks and insurance companies, and the year ending on 30th June in the case of co-operative societies. We have kept these special statutory provisions in view while formulating our recommendations on this subject. In regard to the bunching of audit, we are confident that the accountancy profession will be able to cope with it.

I-1.40. In the light of the foregoing discussion, and bearing in mind the practical implications of the change-over to a uniform accounting year for all taxpayers, we make the following recommendations in this behalf :—

- (1) The general rule that previous year means the financial year immediately preceding the assessment year should continue with regard to taxpayers who do not have income from a business or profession and those who do not maintain accounts. This will not unduly disturb revenue collections and will also facilitate the assessments of the salary earner class.
- (2) In respect of companies including statutory corporations, there should be a uniform previous year coinciding with the calendar year which should be applicable to all cases. Banks and insurance companies already maintain accounts on the calendar year basis as required by law. This recommendation would necessitate a change in the accounting period by those companies which follow periods other than the calendar year. In the case of companies which now follow the

financial year ending 31st March, the transition year will consist of only 9 months, while those which follow accounting periods ending on 'Diwali', 30th September, 30th June, etc. will have the transition year covering in period longer than 12 months. This should not, in our opinion, cause them any serious inconvenience in the matter of tax liability nor any significant change in the tax collections during the transition year. We would like to make it clear that there should be no special method of computation of the tax liability in such cases in order to compensate for the variation in the length of the transition year from a period of 12 months. The change-over in the case of companies to the calendar year in the manner suggested above, will not cause any serious inconvenience because such change-over will occur only once on the implementation of the recommendation.

- (3) A non-corporate taxpayer who carries on a business or profession, who maintains Accounts for any source of income and claims the benefit of the exception to the normal rule in regard to previous year, should be required to choose one previous year according to his individual requirements, which would, then, be the previous year in respect of his income from all sources other than share from a firm dealt with in item (5) below.
- (4) In the case of a taxpayer who has chosen, under recommendation (3) above, a year other than the calendar year or the financial year to be his previous year, any change in the previous year in future should be allowed only if he wishes to adopt the calendar year or the financial year and not any other period. Any such change should be allowed without any condition.
- (5) In the case of a partner of a firm, his share of income from the firm will continue to be assessed on the basis of the previous year of the firm as at present. This could result in such a taxpayer having a previous year for his share of income from the firm or as many different previous years as the number of firms in which he is a partner, assuming that these firms choose different previous years for the closing of their Accounts and a separate previous year for his other income. However, as determination of the share of the partner in the profits of a firm automatically follows the separate assessment of the firm, this should not lead to any administrative complication or difficulty.
- (6) The operation of the new provisions based on the above recommendations may be reviewed in due course. If it is observed that the medium of firms is being resorted to with the objective of perpetuating the multiplicity of previous years in the case of non-corporate taxpayers, the previous year for firms in general could also be standardised at a later stage as in the case of companies.

I-1.41. Following upon the above recommendations, all returns of income should be due on 30th June of the assessment year, and the alternative period of four months from the end of the previous year (or the end of the previous year which ends last) should be done away with. This would, virtually mean that taxpayers who select the financial year as the previous year, under recommendation (3) above, will get only three months to close their accounts and prepare their returns. If they find this time too short, they have the option, under recommendation (4) to change over to the calendar year.

I-1.42. In the case of taxpayers who do not have income from a business or profession and those who do not maintain accounts, the time available for furnishing the return after the close of the previous year has always been only three months and there has been no serious complaint that this is too short. The same position will continue in such cases.

I-1.43. Despite the diversity in previous years that may be adopted by taxpayers under the above recommendations, the date of payment of instalments of advance tax should be standardised, vide our recommendation in para 9.6 of the Interim Report.

CHAPTER 2

BASIS OF CHARGE

I-2.1. The basis of charge of income-tax is contained in sections 4 to 6 in Chapter II of the Act. The pattern of the charging section in the Income-tax Act is different from that in the case of the other direct taxes inasmuch as the rates of income-tax are laid down from year to year under a separate enactment, namely, the Finance Act whereas in the other cases the rates of tax are specified in a schedule to the Act imposing the tax. The consequence of such a pattern in the Income-tax Act is that there is no certainty in regard to the rates of income-tax applicable in respect of income earned and to be earned in future years.

I-2.2. It has been represented to us that simplification of tax laws must begin with the introduction of a reasonable element of certainty and stability in these laws, more particularly in regard to the quantum of the tax. This is possible only if the rates of income-tax are not only reasonably stable over a period of years but are also known well in advance. The Government has accepted the principle, since the last ten years that changes in the rates of tax announced in a particular budget should apply prospectively to the succeeding assessment year and these should not apply to the income already earned in the earlier year by the taxpayers. The taxpayer is entitled (and is thus in a position) to know the likely incidence of tax on the income that he is in the process of earning or likely to earn. In this background, it has been suggested that there is no particular merit in the rates of income-tax being separately fixed by a Central Act from year to year and that these rates should more appropriately form part of the Income-tax Act itself. Such a step would impart a certain amount of stability to the rate structure and hold out a reasonable assurance in this regard to the taxpayers besides making the Income-tax Act complete in itself. It would follow that any proposal to alter the rates, would receive adequate examination in the context of the need for such alteration. **We accordingly recommend that the rates of Income-tax should be specified in a schedule to the substantive enactment imposing the tax, instead of being laid down from year to year in a separate Act of Parliament.**

I-2.3. In making the above recommendation we are conscious that the exercise of prescribing the rates of tax on an annual basis is to some extent tied up with the budgeting processes of the Central Government. However, it is being increasingly recognised that mobilisation of resources through direct taxes should be planned concurrently with the Five Year Plans of the Government. Accordingly, the rate structure should remain stable during a Five Year Plan period. Again, the trend in the Union Budgets reveals that greater emphasis and reliance is placed on the mobilisation of resources through indirect taxes which have a substan-

tial revenue potential. The growth in production and introduction of newer products affords continuous scope for the flow of additional revenues through indirect taxes. Relatively, the additional impact of revenue through direct taxes by amendments or modifications in the rate structure is quite marginal. It has also been recognised that the ideal direct tax system is to have a climate of reasonable stability in tax rates and allow for the growth in tax revenues by the natural buoyancy resulting from the growth in the economy. All these factors emphasise the need for maintaining stability in the rates of tax over a period of time. It should particularly be noted that the rates of corporation tax have over the last few years remained, by and large, stable, while in the field of personal taxation, the bold steps taken in recent years of reducing the tax rates has not led to any fall in the revenue but, on the other hand, increased it through better voluntary compliance.

I-2.4. In this context it would be interesting to refer to the genesis of the existing pattern. Income-tax, when it was first introduced was not regarded as a permanent part of the revenue structure or jurisprudence of the country. So long as it was regarded as a temporary measure to raise revenues for a particular eventuality, it was appropriate that the rates of tax were fixed by separate legislation from year to year. This historical feature has since undergone a substantial change and today a revenue structure without the income-tax is almost unthinkable. Now that the levy of income-tax has become a permanent feature, it is surely anomalous that the rates are left to be fixed by a separate Act from year to year. The justification for enacting the rates separately has ceased to have validity in the present context. It is from this point of view also appropriate that the rates are enacted in the Income-tax Act itself.

I-2.5. Still another feature to which attention may be drawn is that in the scheme of all other direct taxes like wealth-tax, gift-tax, surtax and estate duty, the rates of tax are enacted in the respective Acts themselves. The justification for enacting the rates of tax as part of the substantive statute in the case of other direct taxes would apply with greater force to income-tax which effects a larger number of people and has a greater impact on economic activity in the country. The reasons which have weighed in enacting the rates in the other direct taxes should *a fortiori* apply and warrant the enactment of the income-tax rates as part of the Income-tax Act.

I-2.6. We had invited suggestions from the public on the optimum rates of income-tax, surtax, wealth-tax, gift-tax and estate duty. After consideration of the various suggestions received by us, we would like to emphasise that in the determination of an appropriate rate structure for income-tax, two issues arise

for consideration. The first is what should be regarded as the highest rate of taxation on a reasonable basis so as to operate equitably and provide adequate incentive to the taxpayer to duly comply with the provisions of law and urge him to generate larger incomes. The second issue is what is the reasonable level of income above which such maximum rate should become applicable.

I-2.7. From a revenue point of view as well as from the point of view of its importance, it is appropriate to consider these questions in the context of the incidence of income-tax on personal incomes. On the issue of the maximum rate, we are of the view that in the present-day economic context it would be appropriate to limit such rate to 60 per cent. In arriving at this rate we are merely following the existing highest rate of the basic income-tax exclusive of the surcharge of 10 per cent of the basic rate for the assessment year 1976-77 and 15 per cent thereafter. It would be appropriate in this context to refer to the following observations of the National Council of Applied Economic Research :—

“As regards personal taxation, the cumulative impact of income and wealth taxes on entrepreneurs in the higher income groups, who play a crucial and dynamic role in creating new enterprises and pioneering new industries, seriously curtails their capacity to save. After a point the disposable income of an individual declines with every addition to his wealth through savings. At such a level of income the tax liability is generally met at the expense of savings which in the case of most businessmen are likely to be invested. Since the incentive to save is virtually eliminated at this level, there is a sound economic justification, for slowing down the pace of progression of taxes at very high income levels.”

Dr. P. S. Lokanathan has also emphasised this aspect in the following words :—

“Thus the implementation of the nation’s basic economic policy requires not the suppression of private enterprise as some seem to imagine, but the fostering of its continued growth in desired directions. In this context private investment assumes a crucial role. And private saving has an even greater role to play since a considerable part of public investment itself is financed through a draft on private savings. It may, therefore, be said that a central objective of tax policy in India must be to promote the highest possible rate of private saving in the country.”

I-2.8. As early as 1957, the then Finance Minister had observed :—

“I have come to the conclusion that our existing rates of direct tax at top levels deprive the tax structure of all flexibility. It is said that they tend to diminish the incentive for work but I am aware that they encourage large-scale evasion. It is now recognised that the very high rates of direct taxation in the top

income brackets in many countries of the world in practice are tolerated or tolerable only because of considerable evasion that takes place. In other words, the high rates tend to be applied to a corroded tax base.”

Again in his budget speech of 1964, the then Finance Minister stated :—

“...It is worthwhile mentioning that the motivating factor behind earned incomes should not be ignored. Much of it is due to the incentive, the initiative and hard work of the earner himself, and for keeping up this effort and to enthuse the earner to greater efforts, it is necessary for him to have a feeling that at least some substantial portion of what he earns is left in his hands.”

Apart from the above observations, there is a pressing need for a rapid increase in the gross national product and there should be adequate incentive to the taxpayers to augment their incomes as well as contribute towards capital formation. The rate of 60 per cent as the maximum would, therefore, be appropriate in that context.

I-2.9. As regards the second issue of determining the level of income above which the maximum rate should apply, we are of the view that this should appropriately be placed at Rs. 2 lakhs. This level is not unduly high in the context of several factors. The level of Rs. 2 lakhs is not an innovation in fiscal legislation. The slab of income over Rs. 2 lakhs as the maximum rate slab was in vogue in the years 1970-71 to 1973-74. In certain years, viz., 1965-66 to 1967-68, the maximum aggregate rate of tax plus surcharge operated on the slab of earned income exceeding Rs. 3 lakhs. It has been well-recognised that in real terms the rupee has consistently and progressively depreciated in value in terms of its purchasing power as the table in the introduction to this Report shows. The limit of Rs. 2 lakhs of today is only the equivalent of about Rs. 25,000 in the year 1939. Again, once a maximum slab is fixed, there is a general tendency to adhere to the same, while the fall in the value of the rupee may continue. It is well-recognised that a certain degree of moderate and controlled inflation is a necessary feature of any growing economy. History also shows that, ever since independence, the rupee has never shown an appreciation in its value significantly and the tendency would rather be a fall in 9 years out of 10. The level of Rs. 2 lakhs has thus to be viewed not only with reference to the past history but it should also represent a reasonable level in the foreseeable future. The maximum aggregate rate of tax plus surcharge applied to the slab above Rs. 1 lakh in terms of earned income for the first time in the year 1960-61. On a comparison of the value of the Rupee then and today, it would be realised that the limit of Rs 1 lakh of the year 1960 would approximate to over Rs. 3 lakhs as of today. Even when the present Prime Minister was the Finance Minister, the highest rate of basic income-tax applied to the slab above Rs. 2,50,000 in the years 1968-69 and 1969-70. The said level of income at the present value of the Rupee would correspond to over Rs. 4 lakhs. From all these points of view it would not

be inappropriate to fix the maximum rate slab at the level of over Rs. 2 lakhs. It follows that the length of income slabs upto Rs. 2 lakhs and the rate of tax applicable in each such slab should be so devised as to achieve a smooth and even progression in the incidence of tax at various lower and middle income levels consistent with the real value of the rupee in terms of its purchasing power today as compared to what it was two decades earlier. We accordingly recommend that the rate structure of Income-tax should provide for a maximum rate of tax of 60 per cent which should be applicable on income exceeding Rs. 2 lakhs with an appropriate smooth and even progression at all levels below Rs. 2 lakhs.

I-2.10. It would also make for considerable simplification if the determination of tax is made by a single calculation. The present system of increasing the tax by surcharges or special surcharges complicate the process of calculation and also result in errors in tax calculation. It appears that if the rate structure be simplified by elimination of surcharges, the tax could be determined by a single calculation similar to the calculation of taxes under the other taxes like wealth-tax, gift-tax and estate duty. We are aware that the surcharges are levied in view of the sharing of tax revenues between the Centre and the States. The revenue impact of these surcharges is not also all that significant so as to present an insurmountable problem and the purpose could be met otherwise. We may clarify that if for any reason the surcharges are also to be continued, the rates of income-tax and surcharges should be so fixed that at the maximum level the aggregate of income-tax and surcharge does not exceed 60 per cent. In other words, the maximum rate of 60 per cent should include both income-tax and surcharge. We accordingly recommend that surcharges in the rate structure should be abolished and the maximum rate of income-tax of 60 per cent should in any event be inclusive of surcharges, if any.

I-2.11. The next aspect which would merit consideration is the possible loss of revenues as a result of the reduction implied in the rate schedule which would have a maximum rate of 60 per cent on income exceeding Rs. 2 lakhs. Though as a matter of mere arithmetical calculation the impact may seem high, it is relevant to note that the experiment on the part of the Government over the last 5 years in reducing tax rates has proved to be successful and there has been no fall in the tax collections. On the contrary, there has been a marked increase in the tax revenues largely due to a better measure of compliance on the part of the taxpayers. It may be further desirable to extend this experiment to the stage of reduction on the lines as suggested earlier. Moreover, the better administration of the tax laws which should be possible if the other recommendations of the Committee are accepted, should result in a better enforcement of the tax laws and thereby add to the tax revenues. These two aspects may in the long run nullify any possible revenue loss by adoption of a rationalised rate structure.

I-2.12. The experiment in reduction of personal tax rates was initiated in the year 1974-75, when it was recognised that prevalence of high rates is the first and

foremost reason for tax evasion because this made the evasion, inspite of attendant risks, profitable and attractive. The maximum marginal rates were, therefore, reduced from 97.75 per cent to 77 per cent in the highest slab of taxable income. The then Finance Minister had observed that the reduction in the rates of income-tax on personal incomes would ordinarily have resulted in a loss of about Rs. 60 crores in a full year and Rs. 36 crores in the financial year 1974-75. However, he had not taken any loss into account in the budgetary estimates as he expected that there would be a better measure of tax compliance and full disclosure of income by all taxpayers. The tax revenue from personal income-tax was, therefore, estimated at Rs. 709 crores.

I-2.13. While moving the budget for the next financial year, viz., 1975-76, the then Finance Minister observed that the policy adopted in the earlier year required to be given a fair trial and the rate structure continued during the next financial year as well. The revised budgetary estimates of personal income-tax collections for the year 1974-75 were placed at Rs. 747 crores thereby indicating that quite apart from any anticipated fall in revenue collections, there was in fact a net increase in the collections of personal income-tax. The final figures of personal income-tax collections for the year 1974-75 as per accounts disclose that the collections in fact amounted to Rs. 874.41 crores, which was a clear addition of about Rs. 130 crores over the actual collections as per accounts for the previous financial year 1973-74. In terms of the budgetary estimates, if the fall of Rs. 36 crores as originally mentioned was to be taken into account, the collections would have been placed at the level of Rs. 673 crores and the actual collections as per accounts show an increase of over Rs. 200 crores on this figure. These figures are sufficient to illustrate the magnitude of the differences that are likely to arise as a result of the experiments in reduction of the rates of tax. Apart from the pecuniary gain to the exchequer in terms of additional resources mobilised and the gain to the economy from a reduction in the volume of unaccounted incomes, there is the more important gain in the improvement in the standards of public morality.

I-2.14. The Indian experiment shows that conditions in India also warrant and justify the progressive reduction in the rates of tax. The result of similar experiments in other parts of the world have also been encouraging. As the ultimate ideal in terms of a maximum marginal rate which should be achieved, it would be appropriate to strive towards the rate of 50 per cent so that the taxpayer is left with at least an equal share of the fruits of his efforts. This ideal maximum rate cannot be achieved within a short period but should nevertheless be set as the ideal to be sought for in the ultimate analysis.

I-2.15. The nation has adopted a planned economic system by a process of quinquennial planning. Investment decisions which are made in expectation of a net return on capital employed can now proceed with a given assumption of a continuity in the tax structure and the risk of fluctuation being considerably reduced. The Government has also in recent times accepted the principle of a rate of return (net of tax) for price fixation purposes. It is, therefore, reasonable to expect

that economic activity and industrial development is also planned in this manner. The structural balance of the system could thus be broadly assured for periods of 5 years at a time. This does not, however, preclude the Government from taking appropriate corrective measures should there be any situations of undue imbalances in the economy caused by any special or extraneous factors. It need be emphasised that this process of regulation and curbing imbalances can be more effectively achieved through indirect taxes leaving the direct taxes to operate under stable conditions.

I-2.16. We have already recommended the need for continuous fiscal research. The manpower released through the process of implementation of our recommendations may be diverted towards a more effective collection of revenue intelligence. Attempts on the part of taxpayers to take any undue advantages of the law could be promptly met without disturbing the basic structure of the direct tax laws.

I-2.17. A recent innovation in the process of the determination of the tax on the total income in the

case of certain non-corporate taxpayers is the provision for aggregation of agricultural income along with non-agricultural income under the annual Finance Act. This novel feature was introduced in the year 1973. The advantage of this scheme of integration is that, though agricultural income as such is exempt from the levy of income-tax, it is taken into account in determining the taxable capacity of a taxpayer having both non-agricultural income and agricultural income. The process of integration under the Finance Act existence of agricultural income does not deny to a taxpayer the benefit of the basic exemption limit of Rs. 10,000, but when the non-agricultural income exceeds Rs. 10,000, the agricultural income has the effect of increasing the effective rate of tax applicable to non-agricultural income.

I-2.18. The revenue statistics compiled by the Government indicate that the number of taxpayers who are affected by this measure is not very large. The results of the aggregation provisions during the three years 1974-75, 1975-76 and 1976-77 are as follows:—

Income groups based on assessed total income (excluding agricultural income)	No. of assessments involving aggregation of agricultural income disposed of during the financial year	Amount of net agricultural income aggregated (in 000s)	Additional demand resulting from aggregation of agricultural income (see note below) (in 000s)
		Rs.	Rs.
1974-75:			
(i) Loss cases	1354	3862	..
(ii) Income upto Rs. 10,000	19951	73829	7136
(iii) Rs. 10,001—Rs. 25,000	16013	53852	9571
(iv) Rs. 25,001—Rs. 50,000	3371	28086	11654
(v) Above Rs. 50,000	778	20019	11654
Total	41467	179648	40015
1975-76:			
(i) Loss cases	2000	6672	..
(ii) Income upto Rs. 10,000	28932	96906	6078
(iii) Rs. 10,001—Rs. 25,000	21932	106017	13949
(iv) Rs. 25,001—Rs. 50,000	4594	39699	15801
(v) Above Rs. 50,000	1475	15164	8139
Total	58933	264458	43967
1976-77:			
(i) Loss cases	1903	7536	..
(ii) Income upto Rs. 10,000	31948	111496	5303
(iii) Rs. 10,001—Rs. 25,000	26330	117687	16801
(iv) Rs. 25,001—Rs. 50,000	6658	43493	13231
(v) Above Rs. 50,000	2192	38009	10209
Total	69031	318221	45544

Common Note for all the above three years:

—There will be no additional demand against item (i), viz., loss cases.

It will be observed that the agricultural income which has been included along with non-agricultural income for the purposes of the Income-tax Act amounted to Rs. 17.96 crores, Rs. 26.45 crores and Rs. 31.82 crores, for the financial years 1974-75, 1975-76 and 1976-77 respectively. Additional income-tax of over Rs. 4 crores in each of the years has been assessed.

I-2.19. It would be readily appreciated that the figures of agricultural income mentioned above represent a very small fraction of the total agricultural income in the country. It is no doubt true that the income assessed under the Income-tax Act as a percentage of the national income is small. Of the national income of Rs. 58,137 crores in 1974-75, about 47 per cent is from agriculture. The income assessed under the Income-tax Act is still a low percentage of even the national income attributable to the non-agricultural sector. While this percentage is itself low, the agricultural income aggregated for determining the income-tax in the third year mentioned above (Rs. 31.82 crores), constitutes a negligible percentage of the total national income from the agricultural sector.

I-2.20. Having regard to an important canon of taxation, of levying a tax in accordance with the capacity to pay, there can be no doubt that agricultural income earned by the taxpayers in addition to the non-agricultural income increases their capacity to pay taxes. We are, therefore, of the view that the revenue presently being derived by the centre through the Scheme of Integration of Agricultural Income with non-Agricultural Income should not be foregone and the Scheme should therefore continue to operate. It is no doubt true that in this process the tax administration has to contend with the difficulties in properly assessing the agricultural income and the burden of determining the tax under the integration process. Administrative difficulty cannot warrant a departure from the salient principle of taxation of levying the tax according to the capacity to pay.

I-2.21. It should also be recognised that the process of integration, facilitates a check on conversion of unaccounted income into official income through the process of fictional agricultural income. The presence of the scheme of integration requires the agricultural income to be declared from year to year and thus prevents an attempt on the part of taxpayers to attribute any unaccounted assets to fictional agricultural income.

I-2.22. At the same time it would not be out of place to consider several converse situations which may exist in practice. There would, in fact, be a large number of persons who principally derive their income from agriculture and who either have no non-agricultural income, or have non-agricultural income which is below the exemption limit. The statistics, obtained under the Income-tax Act, of agricultural income aggregated in the case of taxpayers with income upto Rs. 10,000 would not reflect all the categories of persons whose principal source of income is agriculture referred to in this paragraph. The process of integration under the Finance Act in determining the income-tax liability does not serve to impose any liability under the Income-tax Act where the non-agricultural income is below the exemption limit irrespective

of the quantum of agricultural income. In fact, the tendency on the part of such persons would be to deliberately try and depress the level of non-agricultural income below the taxable limit, more particularly in the context of the Compulsory Deposits Income-tax Payers Scheme.

I-2.23. If the process of integration is justified on the principle of determining the tax liability in accordance with the capacity to pay taxes, the same principle would warrant an extension of the idea in the case of persons with the converse position of having their principal source of income from agriculture.

I-2.24. The question of taxation of agricultural income has been receiving the attention of the Central Government and certain of the State Governments for several years. At present agricultural income-tax is levied by only 10 States and even within these States it has a significant revenue importance only in 5 States. The total revenue yield from agricultural income-tax and taxation through land revenue and surcharge on cash crops was only Rs. 216 crores in the year 1975-76. As a proportion to the national income attributable to agriculture it would constitute less than 1 per cent. Likewise, as a percentage of the total tax revenues of the Central and State Governments put together it would hardly amount to 2 per cent. These figures are indicative of the fact that the taxable capacity in respect of agricultural income has not been fully tapped.

I-2.25. The various aspects of taxation of agricultural income have been examined by the K. N. Raj Committee in the year 1972. More recently the U.P. State Government has had the matter examined by the Committee under the Chairmanship of Dr. D. T. Lakdawalla. The draft Five Year Plan 1978-83 has also emphasised the need for a tax on agricultural income.

I-2.26. The question of agricultural income-tax has various ramifications—constitutional, administrative, political, etc. We do not desire to enter into a detailed discussion on these aspects which have more appropriately been examined by the Raj Committee and the Lakdawalla Committee. We would, however, wish to refer to this question to the extent it is inter-related to the levy of income-tax under the Income-tax Act. To facilitate the administration and the determination of income-tax through the process of integration, it would be of considerable importance and assistance to the assessing officer if a reliable assessment of the agricultural income is readily available. At present some of the State laws provide that in relation to mixed income, that is to say, income which is partly non-agricultural and partly agricultural, such as that from tea estates, sugar, etc., the component as determined by the Income-tax Officer under the Income-tax Act should be adopted for determining the agricultural income-tax liability. In the same manner even in relation to separate assessment of non-agricultural income and agricultural income, and the integration thereof for determination of the rate, the process of independent determination of one by the Central tax authority and the other by the State Government taxing authority would ensure a better administration of the tax laws.

I-2.27. The levy of agricultural income-tax is exclusively within the jurisdiction of the States. Taxation of agricultural income is one of the subjects included in Item 46 of List II of the Seventh Schedule of the Constitution (State List). The Parliament is, therefore, not in a position to legislate and impose a tax on agricultural income.

I-2.28. In the same way, estate duty in respect of agricultural land is Item 48 in List II of the Seventh Schedule whereas estate duty in respect of property other than agricultural land is Item 87 of List I of the Seventh Schedule. At present the Estate Duty Act provides for the levy of estate duty on agricultural lands in those States which have passed appropriate resolutions under Article 252(1) of the Constitution permitting the Centre to levy the estate duty.

I-2.29. It is also relevant to mention that under Article 366(1), agricultural income is defined to mean agricultural income as defined for the purposes of the enactments relating to income-tax. The enactment of the definition of agricultural income in the Income-tax Act would fall within the powers of the Parliament which alone is empowered to legislate for taxes on income other than agricultural income.

I-2.30. On a consideration of the above mentioned provisions of the Constitution, the levy of agricultural income-tax by the Centre could be rendered possible by any of the following three ways :—

- (a) by an amendment of the Constitution and transfer of the entry in relation to the tax on agricultural income to the Union List, or
- (b) by the States following the same procedure under which they have empowered the Centre to levy estate duty on agricultural land, or
- (c) by the definition of agricultural income under the Income tax Act being restricted only to agricultural activities relating to food crops so that all other types of agricultural income of a commercial nature, including income from plantations, cash crops, etc., would be classified for the purposes of the Constitution and the law, as non-agricultural income and as a consequence the levy of tax on such income by the Centre would be within the legislative powers of Parliament.

I-2.31. At present, as already pointed out, none of the above steps has been initiated for consideration. The Centre has gone only as far as providing for integration of agricultural income for determining the tax on non-agricultural income.

I-2.32. As the question of empowering Parliament to levy a tax on agricultural income within the framework of the Constitution is one which impinges upon the relationship between the Centre and the States, we would leave the matter as explained above for further discussion and dialogue. It may, however, have to be recognised that alternative (a) above may not be politically feasible. Further, it appears to us on a careful consideration that a mere amendment to the definition of agricultural income (as per alternative (c) above) under the Income-tax Act by Parliament

may be open to challenge. If, therefore, the consensus arising out of the dialogue and discussion is that the agricultural income-tax should also be imposed under a Central levy, it would be more appropriate in our view to do so by a direct amendment to the Constitution.

I-2.33. If, however, the Centre is not to levy the Agricultural Income-tax we would suggest the following measures for the consideration of the Government :—

- (a) States which do not have any law for taxation of agricultural income at present may be advised by the Central Government to introduce such legislation at an early date.
- (b) The pattern of the legislation may as far as possible be uniform in all the states.
- (c) The uniformity should extend to the levy of the tax on all categories of agricultural income, whether from plantations, cash crops or food crops.
- (d) As far as possible, the principle of progression, with a graded rate structure, should be adopted, broadly conforming to the minimum exemption limit and the maximum rate under the Central Income-tax Law.
- (e) With a view to facilitating administration and eliminating the process of elaborate determination through books and records, the law could provide for a scheme of composition of the Tax. This composition scheme could provide for a flat determination of the Income having regard to the category of the land and the nature of agricultural activity carried out thereon. The composition scheme contained in section 67 of the Karnataka Agricultural Income-tax Act could provide a useful model. Needless to say, the composition scheme should not be available to organised bodies like companies and co-operative societies which are required by law to maintain proper books or account.
- (f) The scheme of integration of agricultural Income for determining the Tax on non-agricultural income under the Finance Act should have a complementary provision incorporated in the state laws for the determination of the Tax on agricultural Income. In other words, the state law should provide for taking the non-agricultural income of a taxpayer into account for determining the rate of tax applicable to his agricultural income. This will be a necessary ingredient of the progression in the rate structure of agricultural Income-tax.

Residence : (Section 6) :

I-2.34. The concept of residence is vital for the purpose of taxation inasmuch as the residential status of the taxpayers determines the extent of his tax liability. At present, taxpayers are placed in three categories according to their residential status. The first category comprises all persons who are "resident" in India during the relevant previous year. In their cases,

the tax liability extends to their world income. The second category comprises individuals and Hindu undivided families who are "resident but not ordinarily resident" in India during the relevant year. Such an individual or Hindu undivided family is not liable to tax in India on his or its foreign income except insofar as such income is derived from a business controlled in or a profession set up in India. The third category comprises persons who are "not resident" in India. In their cases, tax liability extends to their Indian income only.

I-2.35. The tests for determination of residence, in the case of an individual, are three in number. The first of these is a straight counting of the number of days the individual has spent in India during the relevant year. If these aggregate to 182 days or more, then the individual is said to be "resident" in India during that year. The second test involves finding out the number of days for which the individual had maintained, or caused to be maintained for him, a dwelling place in India. If he had maintained such a dwelling place for 182 days or more during the year, and had been in India for 30 days or more in that year, then, he is considered to be a "resident". The third test involves finding out the number of days the individual had been in India during the four years preceding the relevant year. If he had been in India during those four years for an aggregate period of 365 days or more and had also been in India for a minimum of 60 days during the relevant year, then again he is regarded as "resident" in India. In the case of any other taxable entity, residential status is determined with reference to the place where the control and the management of its affairs is situated. While all Indian companies are treated as "resident" in India, a foreign company is also treated as "resident" in India if the control and management of its affairs is situated wholly in India during the relevant year. Every other entity, such as a Hindu undivided family, a partnership firm, an association of persons, etc., is treated as "resident" in India in any year except where the control and management of its affairs is situated wholly outside India during that year.

I-2.36. In the case of an individual and also a Hindu undivided family, there are further tests to be applied for determining whether the individual or the family is "not ordinarily resident" in India. In the case of an individual, the tests are that :—

- either (a) he has not been "resident" in India in nine out of the ten years preceding the relevant year,
- or (b) he has not been in India for an aggregate period of 730 days or more during the seven years preceding the relevant year.

In the case of a Hindu undivided family, the same tests are to be applied with reference to the manager of the family. Where either of the two alternative tests set out above is satisfied, the individual or the family is regarded as "not ordinarily resident" in India during the relevant year. Conversely where neither of the alternative tests is satisfied, the individual or the family is regarded as "ordinarily resident" in India during the relevant year.

I-2.37. Representations, received by us on the subject, pleaded for simplification of the tests to be applied for determining residential status. One of the suggestions for such simplification is that the second test for determining residence, with reference to the number of days for which the individual has maintained a dwelling place in India during the relevant year, may be deleted. Another suggestion is that the category "not ordinarily resident" should be removed from the law. There was also a suggestion that citizenship should be taken into consideration for the purpose of determining residential status, by regarding all individuals who are citizens of India to be "resident" in India, except where they are absent from India for a stipulated minimum period during the year, and all individuals who are not citizens of India to be "not resident" in India except where they are physically present in India for a stipulated minimum period during the year. Under this suggestion, the intermediate category "not ordinarily resident" could be done away with, and the taxability of foreign income in the case of residents linked to the exercise of control over the source of the income from Indian territory, as is the case at present in respect of "not ordinarily resident" persons.

I-2.38. We have carefully considered all these suggestions. While we appreciate the criticism that the intermediate category, "not ordinarily resident", involves a cumbersome exercise of counting the number of days spent by the individual in India over the ten years preceding the relevant year, we do not consider it feasible to replace this by any other simpler test, much less to do away with this category altogether. We have to bear in mind the fact that, with increasing numbers of Indians going abroad on various assignments for longer or shorter duration and remitting or bringing their savings to India in foreign exchange, to the benefit of the country's economy, the concept of "not ordinarily resident" saves them from being taxed on their foreign incomes in the years in which they qualify for this status. If this category were to be done away with, such persons being "resident" in India, would become liable to tax in India on the whole of their foreign income. This might induce them to reduce their contacts with the mother country so as to avoid becoming "residents" in India and result in discouraging frequent visits by them to India and bringing in their earnings in the form of valuable foreign exchange. Further, any such change will also have the effect of persons of foreign citizenship becoming reluctant to come to India even on short assignments which may expose them to the risk of becoming "resident" in India and being subject to tax here on their income from sources outside India. The present tests of "not ordinarily resident" are now reasonably well understood and no changes in the law is called for. We, therefore, do not recommend any change in the concept of "not ordinarily resident" nor any change in the tests for determining whether a person is "not ordinarily resident".

I-2.39. As regards the suggestion for dropping the test of maintenance of dwelling place for determination of residence, we find some substance in this demand. This test was evolved at a time when the income-tax law extended to the former British India, with the princely States outside its purview forming

pockets of 'tax havens' from which a person could conduct or control his activities abroad while being nominally "not resident" in India according to the other two tests. In the present set up, when the whole of India is one unified political entity, the test of maintenance of dwelling place has lost its relevance. On the other hand, this test now causes unintended hardship to individuals seeking their fortunes abroad, who are not in a position to ship their establishment from this country due to various social and other reasons. We are of the view that this test of maintenance of dwelling place in India for determining residence can be omitted without any significant impact on the revenue. We accordingly recommend that the test in section 6(1)(b) should be deleted.

I-2.40. In this connection, an allied problem which was brought to our notice is that arising out of the third test for determination of residence, namely, that an individual who having been in India for an aggregate period of not less than 365 days during the four years preceding the relevant year, is in India for sixty days or more during the relevant year, becomes "resident" in India in that year. Under an amendment made by the Finance Act, 1978, the period of 60 days in this provision has been extended to 90 days. However, this amendment is applicable only over a limited field, that is to say in the case of an individual, being a citizen of India, who is rendering services outside India and who is or has been in India on leave or vacation in the previous year. Accordingly, the amendment would help only those individuals being citizens of India who are on employment abroad and who wish to visit India during their leave from such employment. While welcoming the Government's initiative in this matter, we see no reason why this liberalisation should not be extended to all individuals

and should be confined merely to those who are on employment out of India. Even self-employed persons who wish to spend a longer period in India and thereby utilise their foreign earnings in India should not be discouraged from doing so by restricting their stay to only 60 days. We, accordingly, recommend that section 6(1)(c) should be amended and the words 'sixty days' be replaced by the words 'ninety days' and the explanation to section 6(1) be deleted.

I-2.41. As regards the suggestion for linking residential status with citizenship, we have considered the matter from all aspects. As the present tests for the determination of residence are well understood, we are not in favour of disturbing these by introducing a new concept. We do not, therefore, recommend any basic change in this regard.

Scope of Total Income (Section 5) :

I-2.42. The recommendations in the preceding paragraphs are aimed at simplifying the tests of residence and removing practical difficulties of the taxpayers. It will be noted that we are in favour of retaining the three-fold categorisation of taxpayers into, resident, resident but not ordinarily resident and non-resident. In that light we are of the view that no change is necessary in regard to the scope of total income as contained in section 5 of the Act. The parameters of income liable to be included in total income are now reasonably well-settled and well-accepted.

I-2.43. *Provident Fund accretions (Section 7).—*This is discussed in Chapter 5 of our Report.

I-2.44. *Dividend Income (Section 8).—*This is discussed in Chapter 10 of our Report.

CHAPTER 3

TAXATION OF NON-RESIDENTS ON INCOME DEEMED TO ACCRUE IN INDIA

I-3.1. The provisions in the Income-tax Act relating to taxation of non-residents appear at different places in the Act. The principle of taxing non-residents in India is that the charge is limited to Indian income, that is to say, income which accrues or arises in India or is deemed to accrue or arise in India or is received or deemed to be received in India. Insofar as income is actually received or accrues or arises in India, there is not much of a controversy. The real difficulty arises with reference to the fiction of deeming certain income to accrue or arise in India. This fiction is elaborated in section 9 of the Income-tax Act.

I-3.2. The main difficulty which was experienced in the past in the operation of the section was due to the fiction of taxing income accruing or arising directly or indirectly through or from any business connection in India. However, much of the controversy in regard to assessments through a business connection has been set at rest by the authoritative pronouncement of the Supreme Court in the case of CIT Vs. Aggarwal & Co., 56 ITR 20. The threat of an assessment based upon business connection of every foreigner dealing with India has to a large extent been reduced as a result of the tests laid down by the Supreme Court. It is for this reason that we consider that there is no necessity to disturb the provisions as contained in section 9(1)(i) of the Act. The position is now reasonably clear in regard to income derived by non-residents from business operations in India. Even the risk of assessment through a business connection is largely modified by Double Taxation Avoidance Agreements which have been entered into by the Government of India with some of the principal countries of the world.

I-3.3. The provisions of clauses (ii), (iii) and (iv) of section 9(1) do not call for any comment from us and they may continue to operate as at present.

I-3.4. The amendment made to section 9(1) by the introduction of clause (v) has created several difficulties in the matter of fictional accrual of interest. The law in regard to taxation of interest in India has been in existence even prior to independence. The test to tax interest was the nexus of the funds borrowed and brought to India either in cash or in kind. This test has been well understood and adequately examined by the Courts in India. It would be appropriate to say that the law on the subject was well settled and there was no necessity or justification for disturbing the law by introduction of new clause (v). The position of taxation of interest deemed to accrue or arise in India should be restored to that contained in section 9(1)(i)

prior to its amendment in 1976, as the present clause (v) suffers from infirmities similar to those of clauses (vi) and (vii) dealt with hereafter. We accordingly recommend that clause (v) of section 9(1) be deleted and interest be deemed to accrue or arise in India in the circumstances contained in section 9(1)(i) prior to its amendment in 1976.

I-3.5. A problem of recent origin, however, is in regard to the taxation of income derived by a non-resident out of foreign collaboration arrangements with Indian parties. Our attention has been drawn to the fact that considerable uncertainty prevailed in the matter of the determination of the income liable to tax in India from such activities as well as the quantum of tax to be recovered in India. Difficulties also arose in regard to the person liable to pay the tax when agreements were either tax-free, free of tax or subject to tax. The position in law was further complicated by the decision of the Madras High Court in CIT vs. Carborundum Company in 92 ITR 411 resulting in the Department seeking to disturb a large number of completed assessments. This position has since settled down after the decision of the Supreme Court in Carborundum Company vs. CIT 108 ITR 335, reversing the earlier decision of the Madras High Court. The point to be noted, however, is that there was an atmosphere of considerable uncertainty prevailing in determination of the tax liability under foreign collaboration agreements. The Circulars issued by the Central Board of Direct Taxes also did not clear the atmosphere fully, leaving both the non-residents and the Indian collaborators guessing about the effective incidence of tax.

I-3.6. There is a lot of uncertainty in the mind of the foreign collaborator as to the amount of tax payable on the facts of a given case. Experience has shown that, on an identical set of facts, one Income-tax Officer may hold 10 per cent of the foreigner's income to be chargeable to Indian income-tax and another may hold 50 per cent to be so chargeable. It is obvious that such uncertainty in the incidence of actual taxation is most undesirable. Secondly, it has an adverse impact on the Indian economy since a foreigner, having regard to the uncertainty of the incidence of Indian taxation, would naturally try to protect himself by assuming a higher incidence of taxation than may be ultimately upheld by the court. It is thus eminently in the national interest that some machinery should be devised for making the incidence of tax on foreigners both certain and foreseeable, and at the same time equitable.

I-3.7. An attempt to clear the atmosphere has been made by the introduction of clauses (vi) and (vii) in section 9(1) by the Finance Act, 1976. These clauses were introduced with the idea of deeming all payments by Indian residents to foreign collaborators in the form of royalties and technical service fees as income liable to tax in India, in the circumstances set out therein. To overcome the difficulty in determining the income component of such payments, new section 44D was enacted to provide that no deduction in respect of any expenditure or allowance will be made from royalties and fees for technical services received under agreements concluded after 31st March 1976 and that the gross payment would be liable to tax in India. Further, to overcome the difficulty which would be created by disallowance of genuine expenditure incurred for earning the income in such cases, rates of tax, lower than the normal rates, have been laid down in respect of such income under section 115A. It will, therefore, be observed that the Income-tax Act has chosen a short cut to overcome the difficulties of the administration in bringing to tax payments received by foreign parties under collaboration agreements with Indian concerns. Needless to say, this solution is not in conformity with principles of equity. The attempt to tax gross receipts, though at a concessional rate of tax, would be most inequitable where the quantum of expenditure to be incurred for earning those receipts would be disproportionately high. Again, so far as the non-resident collaborator is concerned, he would necessarily be bargaining for a net take-home remittance and in the circumstances would load the element of tax on the Indian partner. Though the Government of India does not, in recent times, sanction the payment of royalties etc., free of tax and expressly stipulates that all such payments shall be subject to Indian tax, the collaborators gross up the fee by the element of tax and quote the gross fee, thereby passing the entire burden of Indian taxes to the Indian party. A further objectionable feature of the present law is that an invidious distinction is created between residents of countries with which the Government of India has entered into Double Taxation Avoidance Agreements and those of other countries. The recent changes in the law aimed at taking the gross amount of royalties etc., under section 9 read with sections 44D and 115A do not in effect apply to residents of such countries as the provisions of the Double Taxation Avoidance Agreements, virtually freeze the tax liability to what it was under the law before its amendment in 1976. Insofar as the charge of tax was on real income, this distinction was not of much consequence because the Double Taxation Avoidance Agreements were merely concerned with the relative rights of the two Governments to tax the same income. But when the charge is shifted to a gross receipt, the problem is aggravated. The problem would be considerably highlighted if a situation of a turnkey contract or arrangement were examined where a substantial portion of the payments would constitute reimburseable costs and not income at all.

I-3.8. Still another difficulty involved in the provisions of section 9(1)(v), 9(1)(vi) and 9(1)(vii) is the validity of these provisions in the context of the territorial jurisdiction of the tax laws. In Kanga & Palkhivala's "The Law and Practice of Income-tax"—

7th Edition—Volume 1, page 209, the learned author comment on these three sub-clauses as under :—

"The Parliament of India can legislate only for the territory of India. As far as foreigner and foreign income are concerned, the well established principle is that given a *sufficient territorial connection* or nexus between the person sought to be charged and the country seeking to tax him, income-tax may properly extend to that person in respect of his foreign income. The connection must be a *real one* and the liability sought to be imposed must be *pertinent* to that connection. (See *ante* under s. 1, "Territorial connection, and extra-territorial operation of the Act", p. 10.)

Cls. (i) to (iv) of s. 9(1) which deem foreign income to accrue in India, are *intra vires* the powers of Parliament, since they proceed upon a sufficient territorial connection. (See *ante* under "Intra vires", p. 199, and under "Money lent at interest and brought into India...", p. 204.) But cls. (v) (b), (vi) (b) and (vii) (b) seek to charge a foreigner in respect of his income outside India *only because the payment is made by an Indian resident*, even where the income arises under a contract which is made and performed entirely outside India and neither the income nor the contract has any connection with India. Unlike the residence of the assessee himself, the residence of the person from whom the income is received can never afford a sufficient, real or pertinent territorial nexus to justify the levy of income-tax on a foreigner in respect of his income which has nothing to do with India. Under these clauses, the foreigner is made liable to Indian income-tax in every case in respect of interest, royalty or technical fees received abroad from an Indian resident for services or other consideration rendered wholly abroad, the only exception being the case where the payment is made for the purposes of the Indian resident's business, profession or source of income abroad. If the Indian Parliament can cast the net wide enough to collect tax in such cases where the foreigner's income has no nexus with India, only because the income is derived from a transaction with an Indian, it can equally levy a tax on a hotel in a foreign country where an Indian goes to stay or dine, or on a foreign store where an Indian buys shirts or grocery, or on a foreign physician whose services are sought by an Indian while abroad. Not only are these clauses contrary to the well-settled international norms of taxation or a foreigner in respect of his income accruing, arising and received outside the taxing State, but they are against the letter and the spirit of the various tax treaties entered into by India with foreign countries. Further, it is difficult to conceive of more powerful fiscal deterrents to keep away foreign collaborators.

If the scope and validity of these clauses are questioned before a court of law, the alternatives before a court would be either to strike down the provisions as *ultra vires* the legislative powers of the Indian Parliament or to read down the provisions so as to restrict their scope only to those cases where on the facts a sufficient nexus exists between India and the foreigner's income accruing and received abroad.

While cl. (v) (a) deems interest payable by the Government to accrue in India and thus makes it chargeable in the hands of the non-resident recipient regardless of any other consideration, s. 10(15)(iv) exempts interest payable "by Government or a local authority on moneys borrowed by it from sources outside India." Thus, the startling result is that if the Government of India has to pay interest anywhere in the world on the unpaid price of goods supplied to one of its embassies, the seller of the goods would be liable to Indian income-tax in respect of the interest, no borrowing being involved in such cases."

I-3.9. The above observations indicate that what has been attempted as a simplified solution is also not as simple as it may seem. It can give rise to considerable litigation on the true scope of the provisions and the uncertainty in the law would thus continue.

I-3.10. The difficulties are so pronounced that several public sector enterprises have also been confronted with the problems of determination of tax liability. The Standing Conference of Public Enterprises has in their memorandum submitted to us, commented on the provisions of section 9(1)(vi) and section 9(1)(vii) as under :—

*"Deemed incomes under section 9(1)(vi) and (vii) Royalty and Technical assistance fees :—*Through an amendment, the Finance Act of 1976 has brought substantial changes regarding the taxability of Royalty and Technical Assistance Fees received by a "Non-Resident Company" under a collaboration agreement. Prior to this amendment the assessability of such income was based on the general principles of taxation, as to whether the income accrued or arose in India under section 5 of the Act. This position has been confirmed in the recent decision of the Supreme Court in the case of Carborundum Co. Ltd. in appeal No. 89 of 1975 (reported in June 1977 issue of "Taxation").

But in view of the major changes brought about by the Finance Act in 1976 any income covered by section 9(1)(vi) and (vii) which accrues and is received by a non-resident abroad will be deemed to accrue in India by a mere fiction of law and will therefore be taxable in India. Further, the non-resident will get no deduction for expenses incurred in excess of 20 per cent of the gross amount

of royalty, in respect of agreements concluded before 1-4-1976 and in respect of agreements concluded thereafter no deduction at all towards expenses will be allowable, however, bona fide and necessary they may be. It has been observed by eminent jurists that taxation of an income which accrues abroad to a collaborator by mere fiction of law is not consistent with the basic principles of taxation and is contrary to well settled conventions on taxation of foreign income and also goes against the letter and the spirit of various tax treaties entered into by India and foreign countries. It is well known that if a country wants to import advanced technology it cannot but help to conclude technical collaborations with leading manufacturers abroad. Invariably it is found in our negotiations with foreign collaborators that the latter wants to get the payments net of Indian taxes. In other words the obligation to pay taxes is cast on the Indian partner who has to bear unduly heavy taxes as the same is computed on a notionally grossed up (i.e. tax on tax) basis. For example, if the rate of tax is 50 per cent then the tax liability would be at least equal to the consideration payable to the collaborator and not 50 per cent of the actual payment which would have been the case if the collaborator himself were to bear the taxes. This notional calculation apart from imposing undue burden on the Indian parties, ultimately has the impact of increasing the cost of products manufactured under such collaborations."

The following further observations are made in a supplementary note :

*"Section 9 of the Income-tax Act, 1961.—*Sub-section (1)(vi)(c) of this section charges tax on any income by way of royalty payable by a person who is a non-resident, if the payment relates to any right, property or information used on services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India. Sub-section (1)(vii)(c) of this section similarly charges tax on income by way of fees for technical services payable by a non-resident for services utilised in a business carried on in India or for the purposes of earning income in India.

These provisions may lead to considerable difficulty and hardship. For example, an American company executes a contract in India, and, for the purpose of this contract engages, say, a company in West Germany to render certain services. The payment for the services may be made directly to the West German company by the American company outside India, but on a strict reading of these provisions, the West German company may be liable to be taxed in India, because the services are ultimately utilised in India. Apart from hardship, there is the practical

difficulty of administration to be considered. The American company may make the payment from its office in New York to the West German company, say, in Dusseldorf and at that time no question of deduction of tax at source under the (India) Income-tax Act can logically arise. The Indian Income-tax authorities have no means of compelling compliance with such a provision. It is pointless to have in the statute a provision which cannot be administered and enforced in a practical manner. Moreover, the wording of these provisions of the aforesaid sub-sections is at variance with the provisions of sections 44D and 115A which are closely related thereto. Section 44D and section 115A—both refer to payments of the nature of royalties or technical service fees “received from an Indian concern”. Thus sections 44D and 115A are both confined to royalties or fees for technical services when they are received from an Indian concern. Section 9 nevertheless throws the net much wider and includes royalties and fees for technical service even when they are paid by a concern outside India.

It is, therefore, respectfully suggested that: Sub-section (1)(vi)(c) and (1)(vii)(c) of section 9 should be deleted. *It is also respectfully submitted that* such deletion would not adversely affect the rights of the revenue authorities to tax the income of the non-resident for services rendered in India since this right would continue to be adequately protected by section 9(1)(i). In other words, the non-resident would continue to be liable to be taxed in India on any income which actually accrues or arises to him in India or which can be deemed to accrue or arise in India. This would certainly include any income for services rendered in India. There is no need to go beyond this and attempt to tax the income from services rendered outside India, only because such services are ultimately utilised in India.

It may be pointed out that the loss to the Revenue in terms of money would be negligible because of the following circumstances :

- (a) in any case, the existing sub-sections which are proposed to be deleted are so difficult to administer that, in actual practice, it is not likely that they would yield much revenue ;
- (b) the cost of administering such difficult provisions would also be fairly high and this would be saved by deleting the provisions enabling the income-tax authorities to devote their time to more useful pursuits ;
- (c) the legitimate right to the revenue authorities continues to be protected by sub-section (1)(i) of section 9 ;
- (d) even if all income liable to be taxed under sub-section (1)(vi)(c) and (1)(vii)(c) is

honestly reported to the tax authorities, it is unlikely that the amount would be very high because it is customary to make direct arrangement with contractors and sub-contractors where significant services are to be rendered by them. Indirect arrangements through other non-resident contractors or sub-contractors are the exception rather than a rule. This is particularly so now that we have given up in most cases the idea of employing turn-key type of contracts.”

I-3.11. The above observations emphasise the point that the tax sought to be imposed on the collaborator in effect falls on the Indian partner and ultimately, enters the cost of products manufactured under such collaborations. It is, therefore, for earnest consideration whether an attempt to fasten a burden of tax on a non-resident collaborator through a highly fictional provision, achieves any useful or substantive purpose.

I-3.12. Having considered the problem in the light of the above observations, we are of the view that the scope of the charge should not be artificially extended in the manner enacted in section 9. The principle of taxing such income should be to tax such part of the income as is reasonably attributable to the operations carried out in India. In other words, the scheme of the law as originally contained in section 9(1)(i) read with the Explanation thereto should continue to apply to income chargeable in the case of foreign collaborators. The solution to the administrative difficulties involved in determination of this income and recovery of the tax should not be in the direction of arbitrarily extending the law as was done in 1976, by introduction of clauses (vi) and (vii) in section 9(1). The solution should be one which is consistent with the basic frame-work of taxation.

I-3.13. We consider that the difficulty in quantification of the income as well as the consequent uncertainties faced by the foreign collaborator and the Indian taxpayer could be overcome if at the point of time the collaboration agreements are approved, the Central Government determines the component of the income which is liable to tax in India. This determination would be in the nature of a prior ruling on the basis of the facts set out by the collaborator and the Indian party. If later on it is discovered that there is a variation in the facts the tax liability would stand to be revised. Such a procedure would enable the parties to a collaboration arrangement to know the extent of the tax liability and the limited issue between the parties would be to determine what is a fair consideration for the obligations of the collaborator undistorted by tax considerations. In giving the prior rulings referred to earlier, it would follow that the guiding principles already enunciated in the Circulars of the Central Board of Direct Taxes issued prior to the amendments made in 1976 would, no doubt, be taken into account, namely :

- (1) consideration for transfer of know-how outside India against payment outside India will not attract any tax in India ;
- (2) engineering and technical services performed outside India will not attract tax in India :

- (3) services rendered in India will result in income accruing or arising in India and would accordingly be liable to tax but after deduction of all expenditure wholly and exclusively incurred for the purposes of earning such income ;
- (4) royalties paid in consideration of use of know-how property in India shall be liable to tax in India subject to deduction of expenditure incurred for the purposes of earning of royalties ;
- (5) where composite services are rendered, partly in India and partly outside India, the income deemed to accrue or arise in India shall only be such part of the income as is reasonably attributable to the operations carried out in India.

I-3.14. If in the course of approving a collaboration agreement difficulty is envisaged in the determination of expenses which can be claimed, an ad-hoc determination of the expenses on a percentage basis could be agreed upon between the Government and the collaborator. This would obviate the need for proving the expenditure and the administrative difficulties involved in verifying such expenditure.

I-3.15. Our attention has been drawn to difficulties being experienced by foreign collaborators in obtaining unilateral relief in their home country against taxes paid in India which are determined on income. This would create a major difficulty for collaborators and in that context the approach suggested above would obviate problems arising from the denial of such relief.

I-3.16. We accordingly recommend that clauses (vi) and (vii) of section 9(1) be deleted and the deeming of royalties and technical service fees as income in India should be restored to the position obtaining prior to the amendments of 1976. We further recommend that at the point of time when collaboration arrangements are approved by the Central Government, a determination should be made of the quantum of fee which is deemed to accrue or arise in India and the quantum of income component therein (that is to say, fee less expenses attributable thereto), by the Central Government. By this process the collaborator can reasonably know the tax liability in India and the Government as well as the Indian party would be able to arrive at a fair compensation for the obligations of the collaborator without the uncertainties of the tax liability.

I-3.17. The provisions of section 44D are also part of the changes made in 1976. This section provides that no expenditure is allowable against the royalty income and fees for technical services in respect of agreements approved after 1st April, 1976. This provision has also been criticised in the Memorandum of the Standing Conference of Public Enterprises referred to earlier. The observations contained in the Memorandum may be reproduced for ready reference :—

“Section 44D”.—This section virtually taxes the gross receipts of a foreign company by way of royalties or technical service fees without any deduction on account of expenses. These

provisions may be criticised from three main angles, viz., legal, practical, and considerations of national advantage.

Legal position.—The Income-tax Act is an Act for the purpose of taxing income. We may concede that if a particular receipt is basically of the nature of income, the authorities may have the right to determine what expenses, if any, may be allowed against such income. In the process, they may perhaps even go so far as to say that no expenses will be allowed at all, but, it is essential that the receipt must itself be primarily and basically of the nature of income. If a particular receipt is not basically of the nature of income, the Income-tax Act does not justify its taxation in any shape or form. Therefore, while it is possible that a gross receipt of the nature of income may be taxed without allowing any expenses as provided for under section 44D, it would be anomalous if the same rule is applied to pure reimbursement of expenses which are basically not of the nature of income at all.

The existing position is that an over-zealous income-tax authority may interpret section 44D incorrectly, but, nevertheless with considerable hardship to the assessee to imply his right to tax a pure reimbursement to expenses which has no relevance to any income to the recipient. It would, therefore, follow from this discussion that in order to meet the needs of clarity, section 44D should clearly indicate that it is not intended to tax any receipts which are not primarily of the nature of income, e.g., receipts which are pure reimbursement of expenses.

Practical considerations.—When the Income-tax Act attempts to tax income without allowing any deduction for expenses, including in some cases reimbursement of expenditure which is built into a fixed fee, it is inevitable that the foreign contractor will adopt one of two courses if he is not to make an overall net loss on his contract. He may either increase the amount of his fees to such an extent as to cover him for the Indian tax or in the alternative he may demand from the Indian company a tax-free payment. Recent experience has shown that in almost all cases, the foreign contractors are demanding tax-free payments and in most of the cases they refuse to enter into contracts if this is not agreed to.

From the practical angle, therefore, the advantage originally envisaged in respect of section 44D has not really materialised since it is the Indian company which has the brunt of bearing higher tax. The fact that the Indian companies which purchase foreign know-how or technical services are mostly in the public sector further emphasises the point of this argument.

The provisions of section 44D were originally justified on the ground of convenience because of the difficulties in determining the expenses of the foreign contractor. There are many other corresponding difficulties in determining expenses for various purposes of the Act, but they do not justify the taxation of gross receipts particularly when the incidence of such tax is ultimately passed on to the Indian purchaser. It is certainly open to the income-tax authorities to ask for details of expenses and where they are not satisfied they may treat the payment as income disregarding the expenses element, but the mere difficulty in determining expenses cannot justify in a method of taxation which is contrary to all accepted canons of internationally recognised practices in regard to this matter.

National considerations.—The import of technology and technical services in India is directly regulated by various State agencies. There is, therefore, no possibility of unnecessary imports creeping into the Indian economy. Wherever the import of technology or technical service is allowed, every attempt should be made to encourage it and to ensure that it reaches the Indian consumer as cheaply as possible. The existing tax provisions serve the contrary purpose either by making it difficult to attract even the required technical know-how and services, or in the alternative, of increasing their ultimate cost to the Indian consumer by forcing the Indian company purchasing them to pay for them free of Indian taxes.

In several cases, the technical services which are imported from abroad come to India in the form of foreign technicians assigned to work on a project in India. Because of section 44D, even the salary cost of such technicians is not allowed to be deducted from the gross payment to the foreign company sending them, since the gross amounts are taxed in the hands of the foreign company at the rate of 40 per cent. This hardly serves the national purpose of encouraging the import of foreign technicians in the essential areas of our economy. In fact, it discourages this and indirectly neutralises the beneficial effect of the tax exemption given to the foreign technicians themselves. In order to protect themselves, the foreign companies sending the technicians insist on a "tax equalisation clause" in the agreement and the payment for tax equalisation has again to be grossed up by the Indian company so that it reaches the foreign company net of tax. Since there is long-standing exemption of the income of foreign technicians in the Income-tax Act, it must be assumed that this exemption is based on a recognition of national consideration. It is, therefore, anomalous that this purpose should be virtually neutralised and offset by section 44D.

We, therefore, respectfully suggest that (a) Section 44D should be modified to state that it would not operate so as to imply a right to tax any payments of the nature of pure reimbursement of expenses since such payments do not represent "Income" at all;

(b) Where a payment can be split between fees and expenses, the expenses would not be liable to be taxed;

(c) The provisions of section 44D would operate so as to deny the right to deduct any expenses only in a case where a payment is made in a composite amount inclusive of fees and expenses without demarcating the same.

It is also suggested as a further measure that where a payment is made by an Indian concern to a foreign company free of taxes under an agreement approved by the Government of India, the tax portion which is reimbursed to the foreign company should not itself be grossed up. This is suggested on the analogy of a similar provision in the case of the salary of foreign technicians where, it would be recalled, tax-free salaries are permitted without being grossed up.

The advantage of the foregoing suggestion is that it would encourage the import of technology and technical services in essential areas which are regulated by the Government of India including the import of foreign technicians in such areas. A further advantage is that it would reduce the cost of such technology to the Indian consumer. It is also suggested that these recommendations would enable the income-tax authorities to fulfil the social purpose of encouraging industrial development in a manner which is consistent with national policy and Government regulation".

I-3-18. The difficulties faced by Indian concerns due to the operation of section 44D, therefore, merit serious consideration. Following upon the recommendations made by us earlier, section 44D in its present form would stand deleted. In place thereof the section would provide that deduction against royalties and fees for technical services would only be allowable in such amount as may be determined by the Central Government at the point of approval of the collaboration agreements. We accordingly recommend that section 44D be deleted and in its place provision be made for allowance of expenditure against royalties and fees for technical services of only such amount and in such manner as may be determined by the central government while approving the terms of collaboration.

I-3-19. Section 44C of the Income-tax Act limits and restricts the deduction of head office expenditure in the computation of business profits of a non-resident. This section has particular significance to non-residents who are operating in India through branches. Most of these branches are gradually being converted into Indian companies by virtue of the provisions of

the Foreign Exchange Regulation Act. The importance of the provision is, therefore, considerably reduced.

I-3.20. The provision which was introduced by the Finance Act, 1976, was primarily aimed at overcoming the difficulties in properly determining the claim for deduction of head office expenditure. Accordingly the section provides that the lowest of the three amounts shall be allowed as a deduction, *viz*,

- (a) 5 per cent of the adjusted total income,
- (b) the average head office expenditure,
- (c) the actual head office expenditure attributable to Indian business.

It would be observed from the above that the difficulty in determining the head office expenditure attributable to Indian business would still continue and the disputes between the Department and the non-resident taxpayer would not be resolved. The third limit has, therefore, practical difficulties in implementation. So far as the second limit is concerned it has historical significance related to the assessment years 1974-75, 1975-76 and 1976-77. Here again the matters may not be finally decided and can give scope for disputes and differences.

I-3.21. On a consideration of all these difficulties and with a view to simplifying the provision and meeting the difficulties which arise in practice, a flat deduction may be made for head office expenditure at the rate of 5 per cent of the adjusted total income. As this deduction is being standardised, there should be no need for the taxpayer to prove the quantum of his head office expenditure. In every case of a non-resident carrying on business in India a flat deduction in respect of head office expenditure could be allowed at the rate of 5 per cent of the adjusted total income. To cover the deduction in the years of loss, the 5 per cent may be calculated with reference to any one of the immediately preceding three years at the choice of the taxpayer. We accordingly recommend that the provisions in section 44C should be amended to allow a flat deduction of 5 per cent of the adjusted total income as defined in the explanation in respect of head office expenditure in the case of non-residents.

I-3.22. The provisions of section 115A which presently lay down the rates of tax would also require consequential changes. If the recommendations made by us to incorporate the rates of tax in the Act itself is accepted, the rates of tax as applicable to non-residents would also form part of the Act and would not be separately provided for in a section like section 115A.

CHAPTER 4

EXEMPTIONS

I-4.1. Chapter III of the Income-tax Act bearing the title "Incomes which do not form part of total income" contains sections 10, 11, 12, 12A and 13. Of these, sections 11 to 13 deal with exemption of the income of charitable and religious trusts and institutions. We have dealt with these provisions in detail in our Interim Report.

I-4.2. Section 10 is a collection of exemptions of various kinds. The purpose of this section is to exclude altogether, from the scope of total income, different items of income, in a variety of cases of taxpayers. In this Chapter, we are concerned, mainly, with the arrangement of the various exclusions enumerated in section 10, from the point of view of their underlying purpose, simplicity in the language used and ease in understanding. Later, in this Chapter we have discussed the scope of some of these items and made certain recommendations concerning them.

I-4.3. Section 10 opens with the words, "In computing the total income of a previous year of any person any income falling within any of the following clauses shall not be included." Then follows a succession of clauses starting with clause (1) and terminating (at present) with clause (30), including, in between, a few clauses bearing supplementary numbers, namely clauses (4A), (10A), (10B), (13A), (17A), (17B), (18A), (19A), (20A), (22A), (23A), (23B), (23C) and (26A). A few clauses, namely, clause (6) and clause (15) have a number of sub-clauses, while clauses (19) and (27) are no longer part of the law. From the point of view of understanding a particular clause, one has to read the opening words of the section and then the relevant clause, some of which have provisos and Explanations to the substantive provision. An analysis of the various items of exclusions enumerated in section 10 shows that they fall, broadly, into two groups. These are :—

- (1) exclusion of certain types of receipts from the total income, without reference to the status of the recipient; these items are contained in clauses (1), (3), (15), (16), (17A), (17B), (18), (28) and (30);
- (2) exclusion of the whole of the income, or specified categories of receipts, of specified categories of persons; such exclusions are contained in clauses (2), (4), (4A), (5), (6), (7), (8), (9), (10), (10A), (10B), (11), (12), (13), (13A), (14), (17), (18A), (19A), (20), (20A), (21), (22), (22A), (23), (23A), (23B), (23C), (24), (25), (26), (26A), and (29).

Exemptions listed in the second group can be further sub-divided as under :—

- (a) exemptions relating to computation of income under the head "Salaries";

- (b) exemptions designed to give effect to diplomatic immunities enjoyed under international law by citizens of a foreign country employed by a foreign Government and performing their duties in India;

- (c) exemptions relating to institutions, such as universities and other educational institutions, hospitals and other medical institutions, sports associations, housing boards and similar authorities, scientific research associations, public charitable institutions engaged in development of khadi and village industries, other institutions of a national character such as the Prime Minister's National Relief Fund, the Prime Minister's Fund (Promotion of Folk Art), the Prime Minister's Aid to Students Fund, other notified charitable or religious institutions, provident funds, superannuation funds, gratuity funds and public marketing authorities;

- (d) other exemptions of a miscellaneous character.

I-4.4. In addition to the exclusions listed in section 10, there are provisions contained in the annual Finance Acts or, sometimes, in other enactments such as the Unit Trust of India Act, 1963 (section 32), Industrial Development Bank of India Act, 1964 (section 35), etc., which also confer total exemption from tax for all time or for a limited number of years, or which make other provisions for exclusion of certain items of income from the total income of the relevant institution, such as, in the case of the Industrial Finance Corporation of India (section 40 of the Industrial Finance Corporation of India Act, 1948), State Financial Corporations (section 43 of the State Finance Corporations Act, 1951) and the Agricultural Refinance Corporation (section 42 of the Agricultural Refinance Corporation Act, 1963) or for concessional taxation of certain payments made to the shareholders of such institutions. These exemptions and other specific provisions also affect the computation of income of the concerned institutions and their shareholders in some cases and should, logically, find a place within the compass of the Income-tax Act itself, either *in extenso* or, at least, by way of reference to the relevant provision of the concerned enactment.

I-4.5. We have deliberated on the measures necessary to bring simplicity in the provisions of section 10 and facilitate their easier comprehension. Having these basic objectives in mind we make the

following recommendations in regard to the provisions of section 10 :—

(1) The various exemptions and exclusions contained in section 10 may be re-arranged as follows :

- (a) All exclusions relating to computation of income under the head "salaries" should be grouped together; exemptions which are merely designed to spell out the diplomatic immunities and privileges enjoyed under international law by citizens of a foreign country rendering services to their government in the territory of India, should be placed together as at present;
- (b) Exemptions applicable to institutions of various kinds, either in respect of their entire income or in respect of only specified items of their income, should be grouped together, distinct and separate from other exemptions which are operative without reference to the status of the recipient;
- (c) The remaining exemptions, which are either based on the nature of the receipt or which are of a miscellaneous character not capable of a rational classification, may be enumerated separately from the exemptions relating to institutions referred to in item (b);

- (2) Exemptions which are now scattered over the finance acts and other enactments, exempting from tax (for all time or for limited periods) the income of certain corporations and other bodies such as Unit Trust of India, Industrial Development Bank of India, etc., or which make special provisions (short of total exemption), as in the case of Industrial Finance Corporation of India, State Financial Corporations and Agricultural Refinance Corporation, may also be incorporated in the income-tax act either *in extenso* or by way of reference to the relevant provision of the concerned enactment in a schedule; in future, it should be ensured that whenever any such exemption or special provision is enacted, it is specifically mentioned in the Income-tax Act.

I-4.6. Besides section 10, exemptions or deductions from the taxable income are provided under certain other provisions of the Act, such as section 11 which deals with exemption of the income of charitable trusts and institutions, or some of the sections of Chapter VIA providing for certain deductions in arriving at the taxable income. While section 10 operates to exclude the specified income or other receipts altogether in the process of computing the total income, the other provisions come into operation after the total income (or gross total income) has been computed. It has been brought to our notice that the Central Board of Direct Taxes has expressed the view that where there is a specific provision for exemption, the general provisions will not be applicable. In the Board's view, therefore, sports

associations cannot avail of exemption under section 11 of the Income-tax Act as there is a specific exemption provided under section 10(23) to the sports associations. Likewise, educational institutions and hospitals for which specific provision is made in sections 10(22) and 10(22A) respectively, cannot claim exemption available under section 11 of the Act. The aforesaid view of the Central Board of Direct Taxes is patently erroneous and not founded on any judicial authority. The law on this issue has been well settled since the year 1944 in *Charitable Gadodia Swadeshi Stores v. C.I.T.* 12 I.T.R., 385, and the view of the Central Board of Direct Taxes is against the consensus of judicial opinion of over 30 years. As the various exemptions or deductions under section 10 or other sections operate independently of each year, there is no reason why an assessee should not claim whichever benefit he is entitled to on the basis of the facts of the case and on his satisfying the conditions prescribed for the admissibility of any of these benefits. For instance, if a Sports Association is unable to claim exemption on its income under section 10(23) for any reason, there is no reason why it should not be eligible to claim the exemption under section 11 if it satisfies the requirements of that section. The legal position in this regard is quite clear in the sense that the benefit under section 11 cannot be denied in such a case merely for the reason that the Association could not qualify for the exemption under section 10(23). We, therefore, recommend that appropriate instructions should be issued by the Board to the officers not to deny any exemption or deduction which an assessee may claim merely on the basis that it is open to him to claim exemption under some other provision of the act.

I-4.7. We now proceed to examine some of the exemptions in section 10, in some detail. Section 10(4A) exempts from tax, in the case of a non-resident, interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India, in accordance with the Foreign Exchange Regulation Act and any rules made thereunder. The concept of "non-resident", for the purposes of the Foreign Exchange Regulation Act and the rules made under that Act, is different from the concept of non-resident under the Income-tax Act. Accordingly, it is possible that a person who is entitled to open a Non-resident (External) Account under the former Act may qualify to be treated as a resident by the application of the tests specified in the Income-tax Act. In that event, the exemption in section 10(4A) will not be applicable to the interest received by the taxpayer even though the pamphlet issued by the Reserve Bank of India, titled "Facilities for Non-residents of Indian Nationality or origin for remittance of Funds to India" holds out the assurance that the benefit of tax exemption would be available in respect of interest in the case of Non-resident (External) Accounts under the Foreign Exchange Regulation Act. Attempts are also made by the Government agencies to canvass deposits in such accounts by holding out the assurance that the interest income would be exempted from Indian tax. To remove the present anomaly and to ensure that the mobilisation of funds from Indians abroad in the form of deposits in Non-resident (External) Accounts

is not hampered in any way, we recommend that the exemption under section 10(4A) in respect of interest on non-resident (External) accounts should be made available to all assesseees who are non-residents for the purposes of the Foreign Exchange Regulation Act and not only to "Non-residents" under the Income-tax Act.

I-4.8. Section 10(6)(vi) is intended to facilitate Indian industry securing the services of foreign technicians for short periods on a tax-free salary basis. The section provides for exemption from tax of the remuneration of a non-Indian citizen who comes to India as an employee of a foreign enterprise for periods upto 90 days in a year, subject to certain conditions. This exemption is basically intended to facilitate deputation of technicians to India for short durations upto 90 days without their taking up employment under the Indian employer. This provision helps Indian enterprises to get assistance from a foreign enterprise by having the latter send its employees to India to attend to some maintenance or repair problem or other such assignments of a short duration. However, there have been instances where, due to the sophisticated nature of the machinery or process involved, the specific job for which the technician came to India could not be completed within the 90 days' period. This would necessarily involve leaving the job half-finished, and the Indian party being obliged to seek the engagement of another technician to complete the job. In this connection, we note that in India's Agreements for Avoidance of Double Taxation of income concluded with countries such as France, Belgium, West Germany, Japan, etc., a resident of the other country coming to India as an employee of a foreign enterprise is allowed to spend in India upto 180 days in a year without incurring tax liability here. We recommend that the law may be amended to vest power in the Central Government to extend the period of 90 days mentioned under section 10(6)(vi) in appropriate cases.

I-4.9. Provisions for exemption of the remuneration of foreign technicians employed by industrial enterprises in India have been part of the law for over two decades. At present, this exemption is governed by the provisions in section 10(6)(vii) of the Income-tax Act which apply to technicians employed on or after 1st April, 1971. Several representations have been received by us pleading for liberalisation of these provisions. In formulating our views on these representations, we have been guided by the consideration that, while it is desirable to discourage excessive dependence on foreign technicians and build up our own expertise and technical know-how in all relevant fields, insofar as the employment of a foreign technicians is considered necessary and justifiable in any particular industry, within the framework of the industrial policy of the Government, the conditions governing the tax exemption of the technician's remuneration for such employment should be kept to a minimum and the application of these conditions rendered simple and easily understandable, both to the technician himself and to the persons employing him.

I-4.10. Under the existing provisions, the tax exemption is available only where the technician is employed in a capacity in which his specialised knowledge and experience (in the specified fields) is actually utilised. Ordinarily, foreign technicians having special skills are hired for the utilisation of those skills. In any event, while according the approval to the contract of service, which is the *sine qua non* for eligibility to the tax exemption, the administrative Ministry would ensure that the technician's special skills are in fact utilised in the job for which he is being hired. Even where the technician is appointed to what looks like an administrative position (such as, the head of an industrial complex) in exceptional situations, it would be incorrect to regard this as anything other than the utilisation of his special skills, because the administrative job itself would demand these skills for proper performance. The existence of the requirement is likely to lead to needless dispute which can hold up assessments as also lead to uncertainties. Moreover, the Income-tax Officer may hardly be in a position to carry out an effective verification of the requirement. We are, therefore, of the view that the stipulation, that the technician should be employed in a capacity in which his specialised knowledge and experience are actually utilised, is a superfluity and that this requirement should be deleted.

I-4.11. The present provisions apply only where the foreign technician is employed *inter-alia*, in any business carried on in India. Foreign technicians have often to be engaged from the stage of planning and design, through construction of the factory, erection of plant and machinery etc., before the business is set up or has commenced. While such technicians are also clearly eligible for the tax concession, a doubt may be raised whether the expression 'business carried on in India' should have the meaning assigned to it for purposes of section 28. It is, therefore, desirable to clarify this position and place the matter beyond doubt. We, therefore, recommend that it should be clarified that the exemption from tax to foreign technicians should be available even if they are employed in connection with a business to be commenced later.

I-4.12. Another stipulation, which is sometimes found to defeat the purpose of the exemption, is that the technician should not have been a resident of India in the four financial years immediately preceding the year in which he arrives in India. This stipulation prevents the engagement of a foreign technician after he has completed his assignment with another employer in India. His special knowledge of Indian conditions is, therefore, lost to the country and an Indian concern is forced to hire somebody who has no such knowledge, solely because of this stipulation. In this connection, we note that the provision also empowers the Government to waive this condition in appropriate cases but this power is available only where the technician is employed in designing, erecting or commissioning of the plant, or supervising activities connected therewith, and it cannot be exercised in the case of a technician whose services are required for actual production. The grant of exemption to technicians is in any case

subject to approval of the Central Government. As restriction of this nature is, therefore, wholly unnecessary. We recommend that the condition relating to the technician not being resident in India in any of the four financial years immediately preceding the year of his arrival in India should be deleted.

I-4.13. Another difficulty brought to our notice in the operation of the provisions of section 10 (6) (viii) relates to the coverage of the term "remuneration", for the purpose of limiting the exemption to Rs. 4,000/- per month specified in this behalf. By providing for exemption under this section, it is obviously not the intention to deprive the technician of exemption otherwise available under any other provision of the Act. With a view to removing any ambiguity or misunderstanding, We recommend a clarificatory amendment to the effect that "remuneration" for this purpose shall not include allowances such as daily allowance or travelling allowance which are eligible for exemption from tax under any other provision of the law.

I-4.14. Foreign technicians coming to India are often permanent employees of foreign companies with international ramifications and operations, who place their services at the disposal of the Indian concern while retaining their lien over the technician, so that he may revert to his parent company on completion of his assignment in India. For the period of his assignment to India, the parent company often credits the technician's account in their books with certain benefits in conformity with the general service conditions governing their employees, such as provident fund contributions, medical benefits, social security contributions, etc. under the law as it stands, these amounts may be regarded as items liable to be treated as income (to the extent of any vested interest) deemed to accrue in India by virtue of the technician's services being rendered in India, even though the amounts are not paid by the Indian employer. The taxation of such amounts credited to his account abroad by his parent concern would discourage the technician from taking up assignments in India. As this would not be in the national interest. We recommend that payments of the nature of contributions to retirement and social security benefits in the home country of technicians should be specially excluded from liability to tax in India.

I-4.15. The provisions for exemption of foreign technicians, at present, give full exemption of their remuneration upto the specified limit for a period of 24 months, with further exemption for a similar period of 24 months if the employer pays to the Government the tax on the technician's remuneration. Prior to 1971, the period of full exemption was 36 months, with provision for continuing the exemption for a further period of 60 months if the employer pays to the Government the tax on the remuneration of the technician, making in all a total period of eight years for which a technician may be employed on a tax-free salary basis. The cutting down of this period to four years, in effect, under the amended provisions, has been described as too drastic. Here again, it is relevant to note that no exemption is available unless the contract is speci-

cally approved by the Government. The approvals would, therefore, necessarily be selective and hence the law could be more flexible. In the interest of industrial development and flow of technology. We recommend that the period of full exemption may be raised to 36 months, with exemption for a further period of 36 months where the employer pays to government the tax on the technician's salary.

I-4.15. A problem which has been brought to our notice in this connection is the treatment accorded to daily allowances in rupees paid to employees of foreign concerns coming to India. This allowance is granted basically to meet the out-of-pocket expenditure in India during the temporary stay in India to compensate the expatriate for rupee expenditure occasioned by the temporary stay in India. In essence, therefore, the allowance does not partake of the character of remuneration. We are further given to understand that the daily allowance is required to be approved by the Bank of India and/or the Central Government. The question would necessarily arise in the case of technicians covered under section 10(6) (viii) because in such cases the exemption from tax under that clause is limited to Rs. 4,000/- per month. The question would also arise in cases of technicians covered by section 10(6) (vi), inasmuch as the daily allowance may be paid by the Indian concern. It, therefore, becomes necessary in all such cases to decide whether the rupee allowance should be treated as income liable to tax in India.

The Income-tax Officer regards such allowances as falling within section 10(14) of the Act. Ordinarily, therefore, he regards a portion of the allowance as having been expended wholly and necessarily in the performance of his duties and brings to charge the balance on an *ad hoc* basis. Such an *ad hoc* approach leads to unnecessary litigation. In such cases, where the quantum of allowance is fixed/approved by the Reserve Bank of India/Central Government, it would be appropriate to regard the allowance as representing reasonable compensation for the out-of-pocket expenditure to be actually incurred. The question should not be considered in isolation but in accordance with the scheme of laws prevailing for taxation of non-residents. An allowance which is regarded as reasonable compensation for rupee expenditure by one branch of the Government should not be regarded as unreasonable by another branch of the Government. In deciding the quantum of the rupee allowance, the Reserve Bank would have due regard to the extent of expenditure expected to be incurred in India during the temporary stay of the technician. We, therefore, recommend that daily allowances paid by Indian concerns to expatriates in India for temporary periods as in cases of technicians under section 10(6) (vi) and section 10(6) (viii), should not be liable to tax and should be exempted under section 10(14) if such daily allowances have been approved by the Reserve Bank of India or the Central Government.

I-4.17. An allied problem which has also been brought to our notice relates to the taxation of Indian employees of public sector corporations, such as Air India, S.T.C., Shipping Corporation of India, etc., or

of Indian companies, who are posted to foreign branches of such corporations or companies for shorter or longer periods according to the requirements of the posting. It is not always possible to arrange the postings in a manner that the employee could become a non-resident. In these cases, the employees are granted overseas allowances in the foreign country which would help them to meet the increased cost of living in the places of their posting. These allowances are not likely to pass the test of actual expenditure incurred in the performance of duties, under section 10(14), as they are granted to meet higher personal expenses such as house rent, education expenses, etc., in the foreign country. These allowances accordingly become liable to tax in India during the previous year in which the employee is resident. The taxation of these allowances appears to be unjustified as these are merely intended to place the employees in a position to meet the increased cost of living in the foreign countries concerned and ensure their efficiency in their work, without basically altering their substantive emoluments. In this respect, there is hardly any difference between these employees and Indian citizens who are in the service of Government posted to a foreign country, in whose cases the foreign allowances and perquisites are specifically exempted from tax under section 10(7). We, accordingly, recommend that the provision in section 10(7) should be extended to all Indian citizens whether they render services to Government or to any public sector corporation or an Indian employer.

I-4.18. A doubt has recently been raised as to whether payments against claims on life insurance policies constitute income. In the Act of 1922 there was a special clause under section 4 (corresponding to section 10 of the present Act) providing for exemption of such receipts. In omitting that clause in the present Act, the legislature has merely given effect to judicial pronouncements [see *C.I.F. vs. Shaw Wallace & Co.* 6 I.T.C. 178 (PC)] and thereby removed a provision which was otiose. Such receipts are not income under any sense of the term and the provision for exemption was wholly unnecessary. Having regard to this background, we consider that no useful purpose would be served by having a specific clause in section 10 of the Act to exempt receipts under life policies which by their very nature are capital receipts and not income.

I-4.19. Section 10(14) exempts from tax any special allowance or benefit specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit, to the extent such expenses are actually incurred for that purpose. This exemption is subject to two categories of exceptions. The first category comprises entertainment allowances and other perquisites, such as provision of accommodation free of rent or at concessional rent, benefits or amenities granted or provided free of cost or, at concessional rate, etc. The second category covers allowances granted to meet the personal expenses of the employee at the place where the duties of his office or employment are ordinarily performed by him, or at the place where he

ordinarily resides. The latter exceptions were introduced in the law by the Finance Act, 1975, retrospectively with effect from 1-4-1962, with a view to nullifying the decision of the Bombay High Court in the case of *Commissioner of Income-tax vs. Shri D. R. Phatak*, 99 ITR 14. In that case the High Court had held that the compensatory (city) allowance paid to Government servants to compensate them for the extra expenditure which they were called upon to bear by reason of their posting at a particular place was exempt from income-tax under section 10(14).

I-4.20. Representations have been received by us highlighting the injustice of denying exemption from tax in respect of such compensatory allowances. These allowances are *ex hypothesi* granted to employees to compensate them for the additional financial burden entailed by their posting in metropolitan cities where the cost of living is high or at a hill station or other remote locality where also the employees may have to incur additional expenditure, due to the higher cost of living, the unhealthiness of the locality, its distance from the rest of the country, etc. The same situation would also exist in cases of other employers who may require their employees to serve anywhere in India as a condition of service. In such cases also some allowance to compensate disadvantages of particular postings are customarily allowed. In making the amendment excluding compensatory allowances as a class from the scope of section 10(14), Government was apparently motivated by the consideration that without such an exclusion, there could be serious abuse of the exemption under section 10(14) by private employers describing a substantial part of the emoluments of their employees as "compensatory" allowances of one kind or other. So far as Government employees are concerned, we understand that the maximum amount of compensatory allowance which is granted to any Government servant is Rs. 75/- per month. In principle, there is nothing to prevent private employers from granting compensatory allowances without any monetary ceiling to their employees. In this connection, our attention is also drawn to the Madhya Pradesh High Court's decision in the case of *Shri Bishambar Dayal* (103 ITR 813) where the Court observed that a compensatory allowance could be regarded neither as salary nor as perquisite and hence it is not liable to tax notwithstanding its specific exclusion from the scope of the exemption in section 10(14).

I-4.21. After considering the matter from all its aspects, we are of the view that while any general exemption of compensatory allowances would not be desirable, at the same time, it would be justifiable to grant a limited exemption upto the ceiling as applicable to Government employees. We accordingly recommend that section 10(4) be amended to exempt city compensatory allowances from tax upto the limits as applicable to employees of the Central Government.

I-4.22. Section 101(5) exempts from tax a variety of items, generally in the nature of interest. Clause (iv) deals specifically with interest payable on moneys borrowed from sources outside India mainly for industrial development of India. In the cases listed at items (b), (c), (e), and (f) the exemption is conditional on the requirement that the agreement relating to the

borrowings should be approved by the Central Government. Items (c), (d), (e) and (f) specify that the exemption from tax will be available only to the extent of the interest calculated at the rate approved by the Central Government "in this behalf", having regard to the terms of the loan and its repayment. Thus, the exemption under items (c), (e) and (f) involve approval by the Central Government not only of the agreement as a whole, but also a separate approval to the rate of interest which would be eligible for the exemption. We are given to understand that, while the approval in regard to both these aspects is given simultaneously in most cases, there have been some instances where the parties have been obliged to approach the Government twice for getting the approval separately to the two aspects as stated earlier. A view has also been expressed that the approval of the Administrative Ministry of the Central Government may not be adequate and separate approval of the Ministry of Finance (Dept. of Revenue) should be obtained for the exemption under the clause. To avoid infructuous work for Government and to obviate inconvenience to taxpayers, we recommend that approval granted by the Central Government to the agreement of borrowing should be adequate for the exemption under the clause. The words "in this behalf" occurring in the context of approval to be granted to the rate of interest should be deleted.

I-4.23. Section 10(21) exempts from inclusion in the total income, "any income of a scientific research association for the time being approved for the purpose of clause (ii) of sub-section (1) of section 35 which is applied solely to the purposes of that association". The provision in this clause is complementary to the benefit conferred by section 35(1)(ii) by way of deduction of any sums paid to a scientific research association, having the undertaking of scientific research as its object, or to a University, college or other institution, to be used for scientific research, in computing the income under the head "Profits and gains of business or profession". The benefit is available only where the scientific research association, university college or other institution, is for the time being approved for the purposes of that provision by the prescribed authority. Thus, while sums paid to an approved scientific research association, University, college or other institution are deducted from the taxable business or professional income of the person making the payment, the scientific research association itself is exempted from tax on its income under clause (21) of Section 10. [Universities and Colleges are also exempted from tax on their income under clause (22) of section 10, subject to the condition that they exist solely for educational purposes and not for purposes of profit.]

I-4.24. The existence of these tax concessions to the persons making the payment is a very important factor which enables scientific research associations to mobilise contributions from companies and other business houses for the purpose of financing their research activities. While we appreciate that massive expenditure on scientific research is extremely imported for industrial development and the attainment of self-reliance, we would like to emphasise the fact that the giving of tax concessions, such as the ones referred to earlier, cannot by themselves bring about the necessary

scientific research activity of quality and purpose. We understand that hardly any attempts were made in the past to ensure that the huge sums paid to scientific research associations by business houses were spent usefully and effectively or to ascertain the nature of the research activities carried on with the aid of such funds and the results achieved. We are given to understand that, recently the Income-tax Department has been directed to verify whether the sums collected were actually applied for the purposes of research. Preliminary enquiries by the Department seem to have revealed a rather disturbing state of affairs. Instances have come to light where there were no proper accounts kept for the sums collected and also those where the sums collected in the name of research were applied for purposes other than research. We are of the view that, while the Income-tax Department may be in a position to enquire into some of the peripheral aspects of the activities of scientific research associations such as maintenance of proper accounts of the sums collected and the utilisation of such sums while applying the test laid down in clause (21), namely, that the income of the scientific research association should be applied solely to the purposes of that association, the Income-tax Officer is hardly in a position to make an informed technical enquiry into the content and quality of the institution's research activities. This function belongs legitimately to the prescribed authority which grants the approval to the institution in the first instance and it should be in a position to make a technical appraisal of the association's activities from the qualitative and productive angles. It is appropriate that the activities of a scientific research association approved by the prescribed authority for the purposes of section 35(1)(ii) of the Act should be subjected to review every three years to determine its eligibility for the continuance of the approval for the purposes of the tax concessions provided under clause (21) of section 10 to the income of the association and those provided in section 35(1)(ii) and section 35(2A) to the persons making payments to such associations. We recommend that the approval of scientific research associations for the purpose of tax concessions should have a currency of only three years at a time.

I-4.25. Another aspect of the provision in section 10(21) which has been brought to our notice is that a view is being expressed by some officers that section 10(21) applies only to scientific research associations which are established exclusively for the purpose of scientific research and which do not have any object other than scientific research. Approval has in fact been granted for the purposes of section 35(1)(ii) to bodies which have scientific research as only one of their many objects. Disputes have arisen between the taxpayers and the Department about the availability of the exemption in clause (21) of section 10 to such bodies. We are of the view that the exemption conferred by clause (21) of section 10 should be available also to institutions having scientific research as one of their activities though not their sole activity, but only to the extent of the income which is applied or set apart for application to the object of scientific research. We, therefore, recommend that section 10(21) may be clarified to provide firstly, that in the case of a scientific research association approved for the purposes of section 35(1)(ii) which has scientific research as its only object, the whole of its income

will be exempt from tax and, secondly, that in the case of an institution which has scientific research as one of its several objects, and which is approved for the purposes of section 35(1)(ii), its income will be eligible for exemption from tax to the extent it is applied for the purposes of scientific research or set apart for application to such purposes. Here also it would follow that the approval should be granted for three years at a time. This would ensure that even the institutions having scientific research as only one of their several activities would not be in a position to misuse the funds collected in the name of scientific research and that worthwhile results are achieved in the field of scientific research by such institutions also.

I-4.26. Section 10(23A) exempts certain incomes of an association or institution established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or any other profession notified by the Central Government for this purpose, subject to certain conditions. These conditions are, firstly, that the association or institution applies its income or accumulates it for application solely to the objects for which it is established, and secondly, that the association or institution is, for the time being, approved for the purposes of this exemption by the Central Government. The exemption under this provision does not, however, extend to income chargeable under the head "Interest on securities" or "Income from house property" or any income received for rendering any specific services or income by way of interest or dividend derived from its investments. In other words, the exemption extends, mainly, to income by way of membership fees, examination fees, etc. received by such an association or institution and not to its investment income. Such investment income is chargeable to tax in full even where there is a deficit in respect of its major activity of controlling, supervising, regulating or encouraging the profession, including conducting professional examinations, in view of the position that section 44A specifically excludes from its purview any association or institution referred to in section 10(23A).

I-4.27. We have received representations from certain professional bodies, including the Institute of Chartered Accountants of India, pointing out that the present exemption in section 10(23A) is illusory and does not achieve the purpose for which it was intended, namely, to enable such bodies controlling or regulating professions like law, accountancy, medicine, engineering, architecture, etc. from attaining viability within the shortest possible period after their coming into existence. Once the need for encouraging the establishment of such institutions is admitted, it is difficult to understand the logic of denying the exemption from tax to them in respect of their investment income or their income received for rendering specific services. The conditions of the exemption are sufficiently stringent to ensure that these bodies do not misuse their income in any manner and the Government has also the power to monitor the activities of such institutions generally. In view of these considerations, we recommend that the exemption in clause (23A) of section 10 may be extended to cover all

income, from whatever source derived, in the case of an association or institution referred to therein.

I-4.28. Section 10(23A) exempts from tax any income of an institution which is constituted as a public charitable trust or which is registered under the Societies Registration Act, 1860, or any corresponding law, and which exists solely for development of khadi or village industries or both, subject to certain conditions spelt out in that provision. One such condition is that the institution should be approved for the purpose of the exemption by the Khadi and Village Industries Commission. Another condition is that the institution should not exist for purposes of profit. The need for the last mentioned condition is not quite clear. As a matter of fact, institutions promoting khadi and village industries are generally run on a no-profit no-loss basis and have to be subsidised from Government sources most of the time. Apart from this, since the approval by the Khadi and Village Industries Commission is a pre-condition for the availability of the exemption, that Commission should be in a position to ensure that approval is granted only to institutions which do not have profit-making as one of their purposes or objectives. In this background, we recommend the omission of the condition that the institution should not exist for the purpose of profit, from section 10(23B).

I-4.29. Section 10(23C) exempts the income of certain charitable funds, and charitable and religious institutions. Sub-clause (iv) of the clause refers to any fund or institution established for charitable purposes which may be notified by the Central Government in the Official Gazette having regard to the objects of the fund or institution and its importance throughout India or any State. Sub-clause (v) refers to any trust or institution existing wholly for public religious purposes or public charitable purposes or both, which may be notified by the Central Government in the official Gazette having regard to the manner in which the affairs of the trust or institution are administered or supervised for ensuring that the income accruing thereto is properly applied for the purposes of the trust or institution. The notifications issued by the Government for the purpose of sub-clause (iv) are required to be placed before Parliament under the terms of section 296, but there is no such requirement with reference to notifications issued by the Government for the purpose of sub-clause (v). This omission appears to be inadvertent. We accordingly recommend that section 296 may be suitably amended to require notification issued by the Central Government under section 10(23C)(v) also to be laid before Parliament.

I-4.30. Section 10(29) exempts from tax any income from letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities, derived by an authority constituted under any law for the time being in force for the marketing of commodities. There was some doubt as to whether State Warehousing Corporations came within the scope of this exemption, but the matter has since been settled by the decisions of the Allahabad High Court and the Punjab High Court holding that State Warehousing Corporations did come under the scope of this provision, as they were authorities constituted under law

for the marketing of commodities. However, with a view to avoiding any further controversies in the matter, we recommend that a suitable amendment may be made in section 10(29) referring specifically to state warehousing corporations.

I-4.31. Sections 11 to 13 of the Income-tax Act deal with the exemptions granted to the income of public charitable trusts. These provisions have been fully discussed in our Interim Report in Chapter 2. It was considered desirable to discuss the subject of tax exemption to charitable trusts in the Interim Report because the changes in the law and pronouncements of the Courts had given rise to hardships to several charitable trusts having far-reaching effects.

I-4.32. The role of charitable trusts for promoting public good cannot be under-estimated. The philanthropic motive must be encouraged at all levels of society and the Income-tax law should not place hurdles in the way of public charity. As long as a charity is set up for the public good, it should continue to get the benefit of tax exemption so that the income, which is irrevocably and without reservation earmarked for public charity, is available for the charitable object and not diminished by the impact of taxation.

I-4.33. One point of view which may be urged is that all such charity should appropriately be channelised and routed through the State and through governmental agencies like the National Relief Funds or the State Relief Funds. This extreme view may urge that there is no justification for extending tax concessions to charitable trusts outside the State sector. In a poor country like India such an extreme view cannot be supported. Every effort, however small it may be, in the direction of alleviating human suffering or promoting the public good must be encouraged and whatever good is achieved is, in the ultimate analysis, a benefit to the nation. Such charities supplement the efforts to the State agencies and their role has been recognised both nationally and internationally, particularly in times of major disasters such as famine, flood, earthquake or other calamities. If it is recognised that such

institutions have been serving a public purpose and have been making a contribution in various spheres of national life, there can be no justification for an extreme view to totally disregard such effort.

I-4.34. If that be recognised, the question is whether the tax exemption should be total and absolute thereby leaving the charitable institutions total freedom to conduct their affairs. We do not subscribe to this extreme view that the State should confer a total tax exemption and leave the charity trusts to a total and unfettered discretion. It should be recognised that while such institutions play a useful role, there is always a potential danger of abuse of power and utilisation of the medium of tax exemption for promoting concentration of wealth and economic power. Such a danger should be effectively checked and it is for this reason that we have suggested a uniform Central law to regulate the activities of all charitable trusts. We have further recommended that no form of economic control should be capable of being exercised through charitable trusts. Accordingly such trusts should be prohibited from engaging in any business activity not connected with the actual carrying out of the purpose of the trust. Likewise we have recommended that voting rights of all shares held by charitable trusts should vest in the Public Trustee.

I-4.35. Our recommendations, therefore, aim at striking a balance between placing obstacles in the way of promoting the philanthropic motive amongst the citizens on the one hand, and, an unfettered use of the mechanism of charitable trusts for gaining economic power on the other. It is in the light of these objectives that the various recommendations have been made for amendments to sections 11 to 13 of the Act.

I-4.36. Our recommendation for the retrospective amendment of the law is also aimed at preventing disturbance to a large number of charity trusts which have been adversely affected. The construction placed by the Supreme Court on the expression "not involving the carrying on of any activity for profit" is perhaps much beyond what was intended by the Legislature. The remedy is, therefore, to effect a retrospective amendment as recommended in the Interim Report.

CHAPTER 5

COMPUTATION OF INCOME UNDER THE HEAD SALARIES

I-5.1. Chapter IV of the Income Tax Act contains the provisions for computation of total income and is by far, the most important chapter amongst the substantive provisions of the law. The first section in the chapter, namely section 14 directs that income shall for the purposes of charge of income-tax and computation of total income be classified under six different heads of income. Our observations in the succeeding chapters will result in the number of such heads of income being reduced to five. In this chapter of our Report we shall deal with the first head namely "Salaries".

I-5.2. Part A of Chapter IV comprising sections 15, 16 and 17 of the Act contains the provisions relating to computation of income under the head "Salaries". Section 15 sets out the basis upon which the income is brought to charge. Section 16 provides for deductions in the computation of income under this head. Section 17 defines the expressions "salary", "perquisite" and "profits in lieu of salary".

I-5.3. These sections by themselves are not exhaustive of the provisions dealing with computation of income under the head "Salaries". Several exemptions relating to this head of income are contained in section 10 vide clauses (5), (6), (7), (8), (10), (10A), (10B), (11), (12), (13), (13A) and (14). Further, sections 80R and 80RRA provide for partial deduction from salary in certain cases. Section 89(1) in Chapter VIII of the Act provides for grant of relief where more than 12 months' income is brought to charge under the head "Salaries". Provisions in the Fourth Schedule, together with rules framed under the Income-tax Rules, dealing with provident funds, superannuation funds and gratuity funds are also relevant for computation of income under this head.

I-5.4. The above discussion explains the various sections which have a bearing on the subject of computation of income under the head "Salaries". These provisions are scattered at different places in the present Act. In view of the emphasis placed by us on voluntary compliance with the tax laws by taxpayers, it would be desirable to frame the law in a manner which would make it easily intelligible to the taxpayer. We, accordingly, recommend that the various provisions relating to the computation of income under the head "Salaries and deductions therefrom should be grouped together under the chapter dealing with computation of income under the head "Salaries". As regards the provisions in the Fourth Schedule to the Act, the procedural aspects are dealt with in Part II of our Report. Provisions of a substantive nature which deem

certain amounts to be income under the head "Salaries" should be included in the Chapter dealing with computation.

I-5.5. Our attention has been drawn to the fact that the term "salary" has been defined differently for different purposes of the Act. In the first place, a comprehensive definition has been given in section 17(1) where the purpose is to describe all items which are chargeable under the head "Salaries". The second definition of salary is that given in rule 2(h) of Part A of the Fourth Schedule, where salary includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites. This is a very narrow definition given to the word salary for the purposes of provident fund, superannuation fund and gratuity fund. The same definition is used for the purposes of the exemption of gratuity under section 10(10), in section 80C for regulating relief on provident fund contributions and in rule 2A of the Income-tax Rules for determining the taxable component of house rent allowance. In evaluating the perquisite in respect of residential accommodation provided to employees, the same expression bears a different definition in rule 3 of the Income-tax Rules. In that rule, the attempt is to extend the meaning of the term so that the base of 10 per cent is widened in evaluating the perquisite. When the law provides for a limitation on the allowance of expenditure on salary, as in section 40A(5), the definition as contained in section 17 is drawn upon. The distinction between salary and perquisite is brought out in that section for the purposes of limiting the extent of deduction of salary on the one hand and perquisites on the other in computation of business income. This has to be considered in the context of the extensive litigation in the determination of the scope of these expressions.

I-5.6. It has been urged that for all these various purposes, there should be a uniform definition of the term "salary". A reference, however, to the different contexts in which the same term has been used will make it abundantly clear that the adoption of a standard norm or a single definition would not serve all the diverse objectives. We are, therefore, not in favour of amending the definition of salary so as to have a uniform definition, for different purposes as the benefit of simplification would be more than offset by the complications and inequities that would result by adoption of a single norm for different objectives.

I-5.7. Section 15 provides that income under the head "salaries" would comprise—

- (a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not ;

- (b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due in that year or before it become due to him ; and
- (c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Thus, under these provisions, salary income is primarily chargeable to tax in the year in which it is due, but if any salary is received in a particular year even though not due in that year but relating to an earlier or a later year, it will be chargeable to tax as income of the year in which it is received, if not already charged in the year in which it was due. Thus, the provision in section 89(1) becomes necessary in order to provide relief from taxation at a higher rate if the salary which is received in arrears or in advance had been received in the respective years to which it pertains.

I-5.8. Section 16 provides for deductions to be allowed in the computation of income under the head "salaries". This section has been considerably simplified since 1974. The section provides for a standard deduction expressed as a percentage of salary. This deduction is allowed specifically in respect of expenditure incidental to the employment, although it is not dependent upon any further verification by the assessing authority and is not contingent upon any requirement of actual expenditure by the employee.

I-5.9. The standard deduction which is allowed under section 16 is at present on a graduated scale of 20 per cent on the first Rs. 10,000 and 10 per cent on the balance, subject to an overall ceiling of Rs. 3,500. Having regard to the fact that this deduction is specifically allowed for expenditure incidental to the employment, it should bear a fair relationship to such expenditure. The most important category of such expenditure would be the expenditure on maintenance of a conveyance. In recent times there has been a significant increase in the capital cost of motor vehicles as also in the maintenance expenditure on normal running and repairs. The class of salary earners is also such that the standard deduction should be reasonably liberal having regard to the fact that the entire income is earned by personal exertion. Bearing these considerations in mind, and also as a measure of simplification we recommend that the standard deduction may be calculated at a uniform rate of 20 per cent at all levels of salary and the ceiling be increased correspondingly from Rs. 3,500 to Rs. 5,000.

I-5.10. A refinement in the matter of the standard deduction is to limit it to Rs. 1,000 in cases where the employee is either in receipt of a conveyance allowance or is entitled to the use of a motor vehicle provided by the employer for his personal use. A blanket provision of this nature creates difficulties to employees who receive comparatively small amounts by way of conveyance allowance. At the same time there is a need to reduce the standard deduction where

the use of a vehicle for private purposes is enjoyed by the employee. As a corollary to the recommendation relating to the rate and the maximum amount of standard deduction in the generality of cases, we recommend that in the case of an employee having the use of a conveyance the deduction should be raised to Rs. 2,500 from the present limit of Rs. 1,000, further in cases where conveyance allowance is granted the ceiling should be fixed at Rs. 5,000 as reduced by the amount of taxable conveyance allowance of Rs. 2,500 whichever is higher.

I-5.11. The allowance of the standard deduction is in respect of expenditure incidental to the employment of the taxpayer. The standard deduction is, therefore, related to the exercise of an employment. It would follow that a pensioner who has retired from an active employment cannot be considered as having an employment and would thus be ineligible for the standard deduction. It is not unusual that such pensioners even after cessation of employment continue to act in an honorary or advisory capacity on an ad hoc basis. Denial of the standard deduction is thus not fully warranted. The pension is in any event taxable under the head "salaries". But in recognition of the fact that the obligation to incur expenditure may not be there, we recommend that the standard deduction should be allowed also to a person in receipt of a pension from a former employer at half the normal rate, i.e., at the rate of 10 per cent subject however, to a ceiling of Rs. 1,000 per year.

I-5.12. The scheme of allowing standard deductions in the computation of salary income was introduced by the Finance Act, 1974, as a measure of simplification. In place of specific items of deductions which could be claimed by a taxpayer from his salary income, the law standardised the deductions on an ad hoc basis, so as to enable the deductions to be claimed, irrespective of proof of the expenditure having been incurred. The items which stood substituted by the standard deductions were items like expenditure on purchase of books, taxes on profession or employment, conveyance expenditure and lastly, the residual item of expenditure which the salary earner was required to spend out of his remuneration wholly, necessarily and exclusively in the performance of his duties. The measure of simplification that is achieved is, of course, a welcome feature as it makes for administrative convenience. However, it should be recognised that there may be cases of salary earners who in fact incur expenditure out of the salary wholly, necessarily and exclusively for the purposes of employment where the quantum of such expenditure may in fact be in excess of the standard deductions permissible even at the enhanced rates suggested by us in the preceding paragraphs. Consistent with our emphasis on income-tax being a tax on real income and not on notional or illusory income, it is appropriate that where factually a salary earner incurs expenditure wholly, necessarily and exclusively for the purposes of employment and he is able to establish that such expenditure exceeds the quantum of standard deduction applicable to his case, such a salary earner should be entitled to the option of either adopting the deduction on the standard basis without proof or in the alternative, claiming the actual expenditure to the satisfaction of the Income-tax Officer and being assessed accordingly.

We, therefore, recommend that section 16 which provides for the standard deduction should give an option to the salary earners to claim, in place of the standard deduction, a deduction of the actual expenditure incurred out of the remuneration wholly, necessarily and exclusively for the purposes of employment, to claim the deduction of the actual expenditure in place of the standard deduction. Such a provision should also extend to situations where an amount which has been taxed as salary due is ultimately not received or has been found to be irrecoverable in the light of the observations in CIT v. B. N. Shah, 104 ITR 551 at 562.

I-5.13. One of the merits of a standard deduction is to enable employers to take into account such deduction while deducting taxes at source. The whole approach is that in regard to salary income the taxes deducted at source should equate the liability which would ultimately result on assessment. By such a scheme, the bulk of the tax assessments of salary earners would hardly result in a demand or refund, thereby simplifying the assessments of a substantial section of the taxpayers. It may be urged that a provision for allowing actual expenditure in place of the standard deduction will disturb the aforesaid scheme. We are of the view that the large majority of salary earners would ordinarily opt for the standard deduction because of the fact that, either the expenditure incurred would be less than the standard deduction or, in the alternative, the difficulties of establishing their claims for expenditure of higher amount would deter such tax payers from making such claims. For the small group of other salary-earners, it is appropriate that employers do not take into account such claims as the claims have to be established on a case to case basis. The provision for deduction of taxes at source should therefore entitle the employer only to take into account the standard deduction and claims for excess deduction would be preferred by the taxpayer in the course of his assessment. Such an approach would not place either the taxpayer or the department in any manner different from situations involving income under any of the other heads in the light of our discussions in this Report. We, accordingly, recommend that though section 16 may empower a salary earner to claim the actual expenditure in lieu of the standard deduction, deduction of taxes at source should be effected by employers on the basis of the standard deduction.

I-5.14. Section 17 defines the expressions "salary" and also "perquisite" and "profits in lieu of salary" which are themselves treated as components of "salary", for the purposes of computation of income under the head "salaries". The definition of perquisite as contained in section 17(2), has been in existence for a sufficiently long period of time and is well understood and accepted in practice. However, considerable controversy exists in regard to the valuation of the perquisites and the determination of the monetary value to be included in the total income. Rule 3 of the Income-tax Rules provides for the determination of the value of perquisites.

I-5.15. As regards residential accommodation provided free of rent, rule 3 by and large results in the

perquisite being taken at 10 per cent of the salary. A further adjustment is made in the case of employees in the private sector where, in addition to the initial 10 per cent, the excess of the rental value over 20 per cent of the salary (30 per cent in case of metropolitan cities of Delhi, Bombay, Calcutta and Madras) is also treated as the perquisite value. It has been represented to us that this additional value placed in the case of employees in the private sector is unreasonable and in some cases unrealistic. In cities like Bombay where there is acute shortage of accommodation, even reasonable accommodation involves a very high cost by way of compensation. To bring to tax the entire excess over 30 per cent of the salary in such cases results in taxing an employee on a value not necessarily related to a fair rent of the premises but occasioned by costs arising out of the acute scarcity of accommodation. There is considerable force in the point made before us. Employees in the public sector are immune from this difficulty as this further adjustment is not applicable in their cases. At the same time, we cannot ignore the phenomenon of ostentation of luxurious living by certain executives in the corporated sector. To overcome the difficulty of assessing the excess over 20 per cent (30 per cent), such executives resort to various subterfuges such as treating a portion of the accommodation as used for official purposes or used as a guest house. On a consideration of these aspects. We recommend that the addition in respect of the excess over 20 per cent or 30 per cent as the case may be, should be subject to a limit of 15 per cent of the employees salary. This limit should, however, not apply in respect of residential accommodation where the annual cost to the employer is not less than Rs. 36,000 per annum. The annual cost should necessarily include not only the direct costs of the accommodation but also incidental costs such as interest, maintenance, depreciation, etc.

I-5.16. In regard to conveyance provided to employees for personal use (which is a perquisite covered under rule 3), while we agree that the present provisions for determining the value of this perquisite should continue, we would like to mention that the present practice of attributing a perquisite value to the facility of the use of a conveyance provided by the employer for the limited purpose of transporting the employee from his residence to the office and back, appears to be somewhat unjust. We are of the view that the mere provision of such a facility to the employee for attending the office (without the conveyance being made available to him for any other personal or household use) should not be equated with the provision of a conveyance for the personal use of the employee. This is largely with a view to advance the interests of the employer. We, therefore, recommend that no perquisite value should be attributed to the provision of a mere transport facility to an employee from his residence to the office and back.

I-5.17. There is also a provision in rule 3 empowering the Income-tax Officer to determine the value of any other benefit or amenity in a fair and reasonable manner. Under certain executive instructions issued by the Board, the perquisite value of domestic help such as sweeper or watchman provided by the employer at the residence of the employee has to be taken

at a maximum of Rs. 60 per month in each case. The instructions issued by the Board would, in ordinary circumstances, be appropriate where the employer directly engages the services of sweepers, watchmen, gardeners, etc., to preserve and maintain the accommodation, more particularly in cases where such accommodation is situated at mofussil centres. In all such cases, it would be appropriate to limit the perquisite value in accordance with the Board's instructions because the provision of the services of such employees by the employer is not directly with a view to the provision of a perquisite to the employee but principally on considerations of commercial expediency for the employer's business. However, instances have been noticed where the employer does not directly engage the services of sweepers, watchmen, gardeners, etc., and instead pays a cash amount to the executive concerned by way of reimbursement of the expenses on such staff engaged by the executive concerned. In such cases, in the employer's records the actual costs of engaging the sweeper, watchman, gardener, etc., would not be recorded as such services are obtained by the executive from out of the cash sum obtained from the employer. This is likely to lend itself to a measure of abuse and, to discourage the same, it would be appropriate to evaluate the perquisite value in such cases at 50 per cent of the amount paid by the employer to the executive without any upper monetary limit. We, accordingly, recommend that the existing administrative instructions regarding the perquisite value of domestic help should continue where the employer directly meets the costs of such services. Where, however, such services are engaged by the employee and in turn the employer pays the employee a cash amount by way of reimbursement, the perquisite value should be determined at 50 per cent of the amount paid by the employer without any upper monetary limit.

I-5.18. It is customary for employers to grant loans and advances to employees for various purposes. In most cases the grant of such loans is regulated by Schemes framed by the employers. Some of these schemes relate to loans for housing accommodation, conveyance/motor car, etc. They also cover contingencies such as marriage, illness, etc. The grant of such loans is generally an employee welfare measure which also has beneficial effects on the business activities of the employer by virtue of the employees concerned being provided for in time of need. Most concerns including those in the public sector provide such facilities either at no interest or at nominal interest. Not all employees avail of these loans inasmuch as it is dependent upon the fulfilment of the terms upon which the loans are granted. In such circumstances it would be reasonably clear that the contractual arrangement does not necessarily require the employer to charge a full rate of interest or a rate of interest at which loans could be obtained from outside sources. In the larger perspective this cannot be regarded as an amenity or benefit to the employers concerned. Although no instance of difficulty or assessment of such benefit has been reported to us, the observations of the Madras High Court in the following cases, C.I.T. v. C. Gulandaivelu Konar, 100 I.T.R. 629, and Addl. C.I.T. v. Late A. K. Lakshmi and others, 113 I.T.R. 368, may give an impression

that such an arrangement can be regarded as a perquisite. However, those decisions have to be distinguished on the facts of the particular cases involving managing director and director. The practice of granting loans to directors even in the case of public companies on grounds of business expediency is prevalent. The Central Government, in exercise of the powers conferred on it under section 295 of the Companies Act, expressly grants approvals to loans to directors even in the case of public companies. As such loan arrangements are largely motivated by business considerations, it would not be justified if an attempt is made to impute a value to this facility as a benefit or amenity. We recommend that despite the observations of the Madras High Court in the cases referred to above, no attempt should be made to tax employees on an imputed benefit by virtue of loans granted by the employer under the rules of the schemes of loans to employees. The present practice which has by and large not sought to tax any imputed benefit should continue. If necessary administrative instructions be issued to that effect. It would, however, follow that where loans or advances made show abuse of power, the department should of course be entitled to take appropriate action in bringing to tax the value of the benefit enjoyed.

I-5.19. A similar position arises in regard to the provision of medical facilities by employers. The Board has issued administrative instructions to exempt the value of perquisites in the case of ordinary medical treatment of employees and their dependants. Difficulties may arise in the determination of what constitutes ordinary medical treatment. Here again, it should be emphasised that the incurring of such expenditure by employers in the course of carrying on business does not necessarily result in a perquisite in the hands of employees. Such expenditure is normally incurred as an employee-welfare measure as also with a view to promoting the business interests. We, therefore, recommend that as long as such expenditure is within reasonable bounds of commercial expediency, no attempt should be made to draw any distinction between ordinary medical treatment and other medical treatment and consequently no attempt should be made to bring to tax any such expenditure in the hands of the employees as perquisites. In other words, the administration should continue to be liberal in the matter of determination of perquisite in relation to medical facilities.

I-5.20. Under the provisions of section 15 of the Income-tax Act, salary income is chargeable to tax in the year in which it becomes due, whether received or not. In addition, any salary actually received during a year is also taxed as income of that year notwithstanding that it was not due in that year, but would become due only in a subsequent year. Besides, any arrears of salary received during a year is also charged as the income of that year if it had not been taxed in an earlier year on the due basis. These provisions may lead to a situation where salary for a period exceeding 12 months becomes chargeable to tax during a year by reason of the inclusion of salary received in arrear or in advance. Under the progressive rate schedule of tax applicable to individuals, salary relating to past years or any future year, if it is subjected to tax on the basis of receipt in

a given year would bear a higher rate of tax than would have been the case if the salary had been received in the year to which it relates and taxed as the income of that year. With a view to mitigating the hardship involved by such taxation, section 89(1) makes provision for the grant of relief in such cases. The principle underlying this section is that the ultimate tax liability should be limited to what it would have been if the arrears of salary or advance salary were subjected to tax as the income of the year to which it pertained. The actual method of calculating the relief is not spelt out in the Act itself, but is left to be prescribed under the Income-tax Rules. Rule 21A of the Income-tax Rules accordingly lays down the method of calculating the relief in such cases.

I-5.21. The provisions of section 89(1) and those of rule 21A of the Income-tax Rules, cover not only cases of salary received in arrears or in advance, but also cases where gratuity or compensation for loss of employment or a payment in commutation of pension or any other payment which ranks as "profit in lieu of salary" is received during a year and thereby the effective rate of tax becomes much higher than what it would have been if such amounts had been received over a period of years.

I-5.22. The provisions of section 89 have been found to cause certain practical difficulties and lead to unnecessary paper work and also hardships to salaried taxpayers in having to suffer deduction of tax at source in the first instance and then claim refunds in the subsequent year. Our discussions relating to these matters reveal that it is possible to simplify the procedural aspects of these provisions so as to make them virtually self-operative and reduce the administrative work of the Department in salary cases and obviate the hardships to employees.

I-5.23. Section 89(1), as it stands, speaks of a situation where, by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than 12 months or a payment which under the provisions of section 17(3) is a profit in lieu of salary, his income is assessed at a rate higher than that at which it would otherwise have been assessed. Section 89 as it stands empowers the Income-tax Officer to give relief on an application made by the taxpayer. The taxpayer is required to establish that his income is assessed at a higher rate and it is on the basis of such application that the Income-tax Officer can give the relief. This procedure clearly prevents the employer from taking into consideration the relief available under section 89 at the time of deduction of tax at source. The provisions of section 89 are, therefore, unnecessarily complicated and they also cause undue inconvenience to the employees. The section may also be construed in a manner that assessments have to be made first and the relief allowed in a subsequent proceeding.

I-5.24. In recent years, instances of receipt of salary in arrears have multiplied enormously by reason of the periodical revision of pay-scales, both in the Government and in the private sector, as well as sanction of additional instalments of dearness allowance

to keep pace with the steady rise in the cost-of-living index. As such salary revisions and grant of dearness allowance necessarily involve some delay, such increases are very often made with retrospective effect. In addition to such periodical revisions of salary and dearness allowance, there are also a number of instances of wage revisions in the industrial sector as a result of collective bargaining or of decisions of Industrial Tribunals, etc., besides cases where bonus has been sanctioned for past years. Thus, the number of cases qualifying for the grant of relief under section 89(1) has become very large in recent years. In many of these cases, most of the employees would not have become liable to tax at all but for the fact that the salaries and allowances etc., relating to several past years were granted in one lumpsum in a later year. The deduction of tax at source in such cases and the grant of refunds on completion of assessments in the subsequent year lead to unnecessary work for the Department and hardship to the employees concerned. As a matter of administrative practice, however, we are given to understand that employers generally approach the Department for permission to take into account the relief in tax which would be available under section 89 even at the time of deducting tax at source from the salary payments. In view of the specific provisions in the law, as mentioned earlier, the Department finds itself in a somewhat difficult position in such cases.

I-5.25. With a view to simplifying the operation of these provisions, we recommend that section 89(1) should be recast so as to allow that section to be applied at the time of calculating the tax to be deducted at source from payments of salary in the circumstances referred to in that section. This would obviate the hardship to the employees concerned and also reduce the administrative work of the Department in making formal assessments in a large number of cases, where there would have been no tax liability in the ordinary course, so as to grant refund of the tax deducted at source. We further recommend that the provisions of section 192, relating to deduction of tax at source from salary payments should also be amended to enable the employer to take into account the provisions of section 89(1) while calculating the tax to be deducted at source. While doing so, the employer should be required to make such calculations only with reference to the salary income of the employees concerned for the relevant years and there should be no obligation on the employer to enquire into the other income, if any, of the employees. If, in any case, some further tax becomes payable due to the fact that the employee has income other than salary, the employee will be bound by the statutory obligation to file a return and pay the extra tax due, while it will also be open to the Department to make the necessary assessment and recover the tax in the following year, as under the existing practice. The annual return of salaries, to be furnished by the employer can also be suitably expanded to include information relating to the manner in which relief under section 89(1) has been calculated while making deduction of tax at source.

I-5.26. The only other matter that requires consideration in this connection is the manner of computing the relief under section 89(1). Rule 21A now

requires that where the arrears or advance of salary relates to several previous years, the re-calculation of the income and tax should be made by apportioning such arrears or advance to the years to which they pertain and the tax payable on the arrears or advance for the year in which they are actually received should be limited to the tax which would have been payable on the basis of such apportionment. While this method sounds reasonable and fair, it might, in some cases, involve recomputation of the income and tax for a number of past years, depending upon the period to which the arrears relate.

I-5.27. It is, therefore, desirable to simplify and reduce the calculation work in such cases. We recommend that wherever the arrears relate to a period exceeding 5 years, the arrears should be spread equally over five years inclusive of the year of payment. The amount so included should be added to the total income of each of these years and the tax determined accordingly. By this process the calculations can be considerably simplified. Such a simplification would also enable the tax to be recovered and deducted at source by the employer in this manner. The provision could thus be effectively incorporated in Section 89 itself.

I-5.28. So far as payments by way of gratuity, compensation for loss of employment, computation of pension, etc. are concerned, the existing provisions in rule 21A provide for the spreadover of these payments over a maximum period of three years preceding the year of receipt. While this is a simple basis for computing the relief, we find that the computation involves the calculation of the "average rate of tax" for the year in which the gratuity, etc., is received and for each one of the preceding three years to which it is apportioned, and then finding out the average of such average rates of tax for the preceding three years.

I-5.29. In the interest of uniformity and simplification, the same scheme as outlined above in regard to arrears of salary could also be applied to such lumpsum retirement payments. We recommend that these payments may be spread over, over the last 5 years equally including the year of retirement. The amount allotted to each year may be added to the total income of such year and tax determined accordingly. The tax could thus be determined in a simpler manner. This change in method may affect certain cases adversely as compared with the present scheme under rule 21A. However, such marginal difficulties should not come in the way of an overall simplification of the entire process of collection and recovery of tax. The interests of voluntary compliance of tax laws would necessitate the adoption of a simpler formula. This formula could likewise be incorporated in the Act itself and not left to the Income-tax Rules.

I-5.30. Under section 7 of the Act the annual accretion to an employee's account in the previous year in a recognised provident fund is deemed to be the income received in the previous year to the extent provided in rule 6 of Part A of the Fourth

Schedule. Rule 6 should really form part of the definition of salary in section 17 as it is substantive in nature. The accretion to the credit of the employee's account in the provident fund, which is deemed to be the employee's income under rule 6 in Part A of the Fourth Schedule, may consist of two parts. The first part is the employer's contribution in excess of 10 per cent of the salary of the employee. The second part of the taxable portion of the accretion relates to interest credited to the account of the employee. Under the rule, interest credited in excess of the notified rate, or insofar as the amount of the interest exceeds 1/3rd of the salary of the employee, is to be treated as the employee's income. The first element, viz., interest credited in excess of the notified rate, would be common to all the employees participating in a given fund, whereas the second element will be present only in the case of a few employees whose accounts show a large balance built up by a number of years' service. In fact, the provision for deeming such interest in excess of 1/3rd of the salary to be the employee's income amounts to penalising thrift, inasmuch as an employee who allowed the balance to accumulate in his account is likely to be a loser as compared to another employee who has been withdrawing from his account from time to time. Apart from this, there are stringent limitations on the pattern of investment of provident fund moneys under which the bulk of such moneys have to be compulsorily invested only in low yielding investments. In view of these limitations, the possibility of any provident fund being in a position to pay interest to the participants at a rate higher than the notified rate is extremely remote. In the circumstances, we recommend that Rule 6 in Part A of the Fourth Schedule should be amended to provide that only contributions of the employer in excess of 10 per cent of the salary of the employee shall be deemed to be the employees' income and that no part of the interest credited to the Employee's Account shall be deemed to be his income.

I-5.31. Rule 8 in Part A of the Fourth Schedule provides for excluding from the total income of the employee the accumulated balance due and becoming payable to him from a recognised provident fund, in certain circumstances. This is in the nature of an exemption and should legitimately find a place along with other exemptions, by way of elaboration of the provisions of section 10(12) or in the provisions relating to computation of income from "Salaries", rather than in the rules relating to grant of approval to provident funds.

I-5.32. Rule 9(1) in Part A of the Fourth Schedule makes a special provision imposing an additional tax liability in cases where the accumulated balance due to an employee participating in a recognised provident fund becomes liable to tax as his income owing to rule 8 being not applicable. Sub-rule (2) of rule 9 also imposes an additional tax liability on the employee in relation to the assessment year 1932-33 or any earlier assessment year with reference to the element of the accumulated balance which is not to be included in his total

income under the provisions of rule 8, when such amount is ultimately paid to him. Both these provisions are substantive in character. While sub-rule (2) can have little relevance today and could be omitted, the provision in sub-rule (1) of rule 9 should find a place in the substantive law in the Chapter dealing with the computation of income from "Salaries", rather than in the rules relating to the grant of approval to provident funds.

I-5.33. Rule 11 in Part A of the Fourth Schedule also imposes a tax liability when recognition is accorded to a provident fund with existing balances. These provisions should also find a place in the substantive law in the Chapter relating to computation of income from "Salaries".

I-5.34. We, accordingly, recommend that provisions of a substantive nature presently contained in the rules of the Fourth Schedule should be included in the sections of the Law dealing with the computation of Income from "Salaries".

I-5.35. Rule 6 in Part B of the Fourth Schedule makes a provision for deduction of tax when contributions made by an employer to an approved superannuation fund, along with the interest on such

contributions, if any, are paid to an employee during his life time in circumstances other than those referred to in clause (13) of section 10. The perusal of this rule, together with the provision in clause (13) of section 10 and the definition of "profits in lieu of salary" in section 17(3), indicates that the provisions, as they stand, do not achieve the purpose in view effectively. It is possible for an employee to contend that any tax deducted at source from such payment should be refunded to him in the subsequent year in view of the specific provision in section 17(3) that *any payment from an approved superannuation fund* is outside the purview of the definition of "profits in lieu of salary". We, therefore, recommend that these provisions should be recast so as to achieve their purpose and avoid unnecessary litigation.

I-5.36. Rule 72 of the Income-tax Rules provides that amounts withdrawn by the employee from his provident fund account which are not repaid or are not utilised for the purpose for which they were withdrawn may be deemed to be his income for the year in which the default took place, etc. This provision is substantive in nature and we recommend that it should find its place in the substantive law and not in the rules framed by the Board.

CHAPTER 6

INTEREST ON SECURITIES

I-6.1. Sections 18, 19, 20 and 21 in Part B of Chapter IV of the Income-tax Act lay down the substantive provisions relating to computation of income chargeable to tax under the head "Interest on Securities". The income which falls to be taxed under this head is :—

- (a) interest on securities of the Central or State Governments ;
- (b) interest on debentures or other securities issued by a local authority, a company or a statutory corporation.

It is, therefore, clear that this head deals with a limited category of interest income. Other types of interest income, such as interest on deposits with banks, deposits with companies, loans on mortgages etc., are not taxable under this head.

I-6.2. The types of interest income which are taxable under this head also do not have any peculiar characteristics as to require the computation of income under any special rules or under a separate head. The broad scheme of taxing such income is to tax the income as and when it falls due. The expenditure allowable in the computation of the taxable interest is restricted to the items stipulated in section 19. Such expenditure is either expenditure for realising the interest income or expenditure by way of interest on monies borrowed for the purpose of investment.

I-6.3. The scheme as set out above is substantially similar to the provisions relating to computation of income under the residuary head "Income from other sources", dealt with in Part F of Chapter IV, comprising sections 56 to 59. Still another feature of the categories of income chargeable under the head "Interest on securities" is that such income would be earned substantially by institutions like banking companies and others engaged in the lending of money, where the character of the income would essentially be in the nature of business income. It is because of this feature that a special provision has been made in section 26 for allocating the expenditure incurred by a banking company between such income and the other normal income from business. This artificial separation of income which is basically in the nature of business income and partly computing the business income under one head and partly under the other head "business" creates other practical difficulties. Questions have arisen in the case of banks, relating to the right of carrying forward business losses and their set off against business profits. The Supreme Court has in *CIT vs. Cocanada Radhaswami Bank Lt.*, 57 ITR 306, held that profits and gains of business are not only profits and gains computed under section 28 but also

include other income which though computed under another head is in reality derived from a business activity.

I-6.4. Having regard to the above observations, we recommend that the category of income presently assessable under a separate head "Interest on securities" should more appropriately be assessed under the head "Profits and gains or business or profession" where the income partakes of the character of business income, and under the residuary head "income from other sources" where it is not derived from a business activity. The existing provision in section 20 will, then, no longer be necessary. This recommendation would result in a substantial portion of the income from Central and State Government securities and debentures being assessed under the head of business as the preponderant majority of the holders of such securities would be banks and financial institutions. The other category of large holders of such securities are funds like provident funds, superannuation funds, gratuity funds and charity trusts, where the income would largely be exempt from tax.

I-6.5. As regards such income in the hands of holders of securities who are investors, our recommendation would result in such income being assessed under the residuary head 'Income from other sources'. The scheme of assessing the income under the residuary head would, therefore, apply to such income. The allowance of expenditure against such income would be governed by section 57 where, essentially, all expenditure laid out or expended wholly and exclusively for the purposes of making or earning such income would constitute the allowable expenditure. This is wide enough to cover the two items of deductions presently allowable under section 19 of the Act.

I-6.6. The separate and distinct head of "Interest on securities" is largely a relic of the past which in present circumstances has become an anachronism. In the past it was the normal feature for investors to prefer Government securities to other investments and it was regarded as being the most appropriate method for investing one's savings. Government securities, therefore, were the favoured form of investment for people who wanted safety. However, that position has now ceased to obtain. Today the bulk of Government securities is held by institutions. The need for a separate head of income has, therefore, not much relevance in the present context.

I-6.7. As regards the basis of inclusion of such income when assessable under the head 'Income from other sources,' the issue for consideration is whether the existing basis as contained in section 18 need be reproduced in section 56. Income which is generally chargeable under the residuary head under section 56

is computed in accordance with the method of accounting regularly employed by the taxpayer (section 145). On the recommendation that interest on securities should be assessable under section 56 it would follow that such income would also fall for computation in accordance with the method of accounting regularly employed by the taxpayer. In our view, it is not necessary to make any special provision in section 56 to correspond to the present basis as contained in section 18 of the Act. It is not necessary to specifically provide in section 56 that the income from interest on securities would be taxed on a due basis or on a receipt basis as under section 18(1) or 18(2), but such income should fall into the scheme of section 56 and be taxable in accordance with the method of accounting regularly followed by the taxpayer. Quite apart from this being consistent with the income chargeable under the residuary head, such a method of taxation would result in simplification of the scheme of taxing interest on securities. The taxpayer would have the choice as in relation to other income to adopt either the mercantile system of accounting and offer such interest for tax on the basis of accrual or in the alternative to adopt the cash basis of accounting and offer such interest for tax on the basis of actual receipt. The concept of the income becoming taxable with reference to a due date would thus be discontinued. Where no method of accounting is employed by a taxpayer, such income would be charged on the basis of actual receipt. This change in the basis is not only warranted on the ground of simplification but is also consequential upon our recommendation to discontinue the separate head. As pointed out earlier, the preponderant majority of recipients of such income would be required to offer such income for tax under the head 'business' which is necessarily governed by the method of accounting. In the interest of uniformity other recipients of the same class of income may also, therefore, adopt the same basis, viz., the offering of the income for tax in accordance with their method of accounting. Section 145 of the Act applies the basis of the method of accounting not only to business income but also to income from other sources. We accordingly, recommend that

interest on securities which is presently chargeable under a separate head should be subject to tax in accordance with the method of accounting regularly employed by the taxpayer and in the absence of accounts such interest should be subjected to tax as income of the year in which it is received.

I-6.8. It would follow from the above recommendation that the process of taxing interest on securities would be regulated by and large by the method of accounting. However, there would still be stray cases where the income would be taxed on actual receipt basis in the absence of the maintenance of accounts. In some of these cases there may be situations where interest on securities for a number of years is collected in one year. Such cases would, however, be exceptional. In the changed scheme recommended by us we do not consider it necessary to continue the provisions of section 89(2) for allowing relief where interest on securities is received in arrears. This discontinuance is suggested because cases falling under such circumstances would be exceptional in the altered scheme suggested by us. Even such exceptional cases would not be different from cases where other types of income under other sources are received in arrears. The need for a special provision for this category of income is, therefore, unnecessary.

I-6.9. Section 94 of the Income-tax Act makes provision for countering avoidance of tax by certain transactions in securities. It is aimed at preventing the escapement of tax by what are popularly known as bond-washing transactions. Though the abuses contemplated by that section would be considerably reduced as a result of the altered scheme of taxing interest on securities, we, nevertheless, are of the view that the provision should continue to remain on the statute book. The existence of such provisions which are aimed at preventing systematic tax avoidance are necessary, however limited the number of operations of the nature contemplated therein may be. We, therefore, recommend that the provisions of section 94 should be continued.

CHAPTER 7

INCOME FROM HOUSE PROPERTY

I-7.1. Sections 22 to 27 in Part C of Chapter IV of the Income-tax Act contain the substantive provisions relating to computation of income chargeable under the head "Income from house property". The person who is liable to pay income-tax in respect of such income is the owner of buildings or lands appurtenant to the buildings. The concept of the term "owner" is vital in the determination of the person liable to pay tax. Ownership is thus distinguished from mere occupation or possession.

I-7.2. Certain practical difficulties have arisen in relation to this concept. Under the Transfer of Property Act, no transfer of ownership of immovable property exceeding Rs. 100 in value can be effected except under an instrument in writing duly registered. Cases have therefore arisen where all incidents of ownership are transferred by a seller to a purchaser but yet the transfer of legal ownership within the meaning of the transfer of Property Act is not completed. In such cases, the seller retains the bare husk of the legal title and in a practical sense the beneficial ownership in the property is transferred to the purchaser. The non-execution of a written instrument or non-registration thereof may be due to various circumstances. But, to all intents and purposes, the sale would be complete and factual in the sense that the sale price would have been fully received by the vendor and the purchaser would have assumed full possession of the property and control over the income from the property.

I-7.3. The interpretation placed by the Calcutta and Bombay High Courts in *CIT vs. Ganga Properties Ltd.* 77 ITR 637, *CIT vs. Union Land & Buildings Society Ltd.* 83 ITR 794, and *CIT vs. Zorastrian Building Society Ltd.* 102 ITR 499 leads one to the position that the legal owner is the person liable to pay tax under section 22 of the Income-tax Act until there is the legal transfer of ownership under the Transfer of Property Act. This could lead to cases of double taxation in the sense that the legal owner is liable to pay tax under section 22 whilst the purchaser who has assumed control over the income of the property is also concurrently liable to pay Income-tax on the rental income under the head "Income from other sources". The adoption of the strict legal test of ownership under the Transfer of Property Act and its application to the Income-tax Act can lead to this unintended hardship. The Income-tax Act is not designed to tax the same income twice, though in different hands in circumstances explained above.

I-7.4. A somewhat similar situation has been considered by the Supreme Court in *Jodhamal Kuthiala vs. CIT* 82 ITR 570. In that case, the legal owner had no control over the property which was vested in the Custodian of Evacuee Property. The Supreme

Court held that tax could not be levied on the legal owner on the facts of that case, as the word "owner" must mean, in the context of the section, a person who can exercise the rights of the owner and is entitled to the income from the property. In the language of the Court :

"It is true that equitable considerations are irrelevant in interpreting tax laws. But, those laws, like all other laws, have to be interpreted reasonably and in consonance with justice...." The provision cannot be so construed that it is "capable of being made an instrument of oppression".

I-7.5. It appears to us that the construction placed by the Supreme Court on the concept of "owner" in section 22 of the Act should be adopted generally. If this concept was adopted in the circumstances cited above, it would be the purchaser who would be assessable under section 22 and there would be no occasion to tax the legal owner on the same income on the mere technicality of his legal ownership. The position would be comparable to the circumstances of cases falling under section 53A of the Transfer of Property Act where part performance of a transaction of sale of immovable property can yet vest almost absolute rights in the transferee. We accordingly, recommend that the concept of "owner" under section 22 should be consistent with the observations of the Supreme Court cited above and should not be unduly strictly construed in the manner held by the Calcutta and Bombay High Courts. In other words, where actual income is received by a person other than the legal owner, he alone should be assessed and no concurrent assessment should be made on the legal owner under section 22 of the Act. In all such cases the beneficial owner should be assessed on such income under the head "Income from House Property".

I-7.6. Under the existing provisions, tax on income from house property is levied with reference to the annual letting value of the property. The tax is charged on the artificial or notional income even if the owner receives no income whatever and he is himself in occupation of the property. It is true that in respect of self-occupied properties, certain concessions are provided for. These concessions are in the nature of an outright deduction of one half of the annual letting value or Rs. 1,800, whichever is less, and further limiting the taxable income from such property to 10 per cent of the other income of the taxpayer.

I-7.7. Despite this concessional treatment, it would be evident that what is brought to tax in respect of self-occupied property is a notional or imputed income, which is distinct from the actual income. The

general scheme of taxation of income under the Income-tax Act is to levy a tax on real or actual income which is an appropriate test of a person's ability to pay tax. This departure from the general scheme of income-taxation by providing for a tax on notional income does not appear to have any particular justification under the present law.

I-7.8. We have received several representations from owner-occupiers of house properties seeking to remedy this position under the Act. It has been urged that the provision for taxing such imputed income in the case of self-occupied house property was adopted on the basis of the U.K. law as it existed several years back. Even in the U.K. this provision has been discontinued. The historical significance, if any, of the measure has, therefore, no validity at present.

I-7.9. It is further urged that under the other direct taxes Acts, specific incentives are provided for ownership of house property. Under the Estate Duty Act, exemption is provided in respect of one house property in which the deceased lived, upto a value of Rs. 1 lakh. Under the Wealth-tax Act also an exemption in respect of one house property is granted upto a limit of Rs. 1 lakh. The previous requirement of occupation of such property by the owner has since been discontinued.

I-7.10. Under section 80GG of the Income-tax Act, specific provision is made for deduction of expenditure in respect of rent for residential accommodation by taxpayers in general. This is to put the general class of taxpayers on a parallel position with salaried taxpayers who are either in receipt of house rent allowance which qualifies for exemption under section 10(13A), or who obtain the benefit of residential accommodation evaluated as a perquisite on a concessional basis. The relief under section 80GG is not available to the taxpayer who owns any residential house property. The owner is, therefore, at a further disadvantage in that the benefits analogous to those available to other taxpayers are not available to him.

I-7.11. The general objective in regard to taxation of income from house property should be to encourage taxpayers to acquire their own residential accommodation. The measure for taxing income on a notional basis from such accommodation runs counter to this general objective. The information placed before us also indicates that no significant revenue is realised by the Income-tax Department by bringing to tax the notional income on self-occupied properties. In the light of the above observations we recommend that one house property used by the taxpayer for his own residence should be exempt from tax under section 22 of the Act.

I-7.12. At the same time, we realise that several taxpayers who have returned income under self-occupied properties have been claiming a loss. This loss principally arises due to the construction or acquisition of the house property out of borrowed funds including funds provided by the Life Insurance Corporation of India with a view to encouraging the acquisition of

house properties. Our recommendation is aimed at preventing a hardship to assesseees by bringing an amount to tax on notional basis. It should not, however, result in a situation where an allowance of a factual loss on account of interest paid by the taxpayer for acquiring a residential house is denied to him in the computation of his total income. We have, therefore, in Chapter 13 of this Report, whilst dealing with deductions under Chapter VIA, suggested an express provision for allowance of such interest.

I-7.13. Another consequential issue arising out of our recommendation for not taxing a notional income on self-occupied property is in regard to the exemption presently available under section 23(3) of the Act. This exemption relates to a residential house which the owner is unable to occupy by reason of his having to reside at another place. The recommendation made by us above should be in addition to the concession available to the taxpayer under section 23(3).

I-7.14. One of the measures introduced in section 23(1) to promote the construction of residential house is to allow a flat deduction for the initial 5 years of completion of new residential buildings. The deduction amounted to Rs. 1,200 per year in the case of houses constructed between April, 1970 and March, 1978. Thereafter, the limit has been increased to Rs. 2,400. This deduction is tied in with a condition which reads "so, however, that the income in respect of such residential unit is in no case a loss". It is clear that the function of the proviso is to grant a deduction from the annual letting value. The deduction is subject to the condition that it should not result in a loss. However, our attention has been drawn to the fact that this provision is being interpreted to lay down a substantive provision that no loss shall be allowed in respect of such new residential units even when a loss may arise apart from the deduction provided for by way of incentive. Such a construction of the provision is wholly unwarranted and results in denial of a legitimate loss irrespective of the claim for the incentive deduction. Apart from such an unwarranted construction of the provision, it should be emphasised that as the provision is by way of an incentive it should not be subject to any condition for denial of loss. We recommend that the condition that this allowance under section 23(1) should not result in a loss should therefore, be deleted.

I-7.15. A feature which is incidental to the joint ownership of properties through co-operative societies is that the management of the properties is entrusted to the co-operative society. In such cases the society collects consolidated amounts from each member to cover not only the municipal taxes for which a consolidated bill is raised on the society, but also to cover various outgoings for external repairs, common services like lifts, security, etc. Specific deduction is allowable in respect of the taxes met by the individual members. However, there is no specific provision for deduction of the other contributions to the society though in practice it is rightly allowed in many cases in computing the annual value itself. When a member lets out his flat to a tenant a portion of the recovery from the tenant is intended to cover the outgoings

payable by the member of the society. It is, therefore, a clear case of expenditure wholly and necessarily incurred for the purposes of earning the income. We, therefore, recommend that to make the position clear the outgoings recovered from its members by a Co-operative Society to meet various charges should be expressly allowed as a deduction in the computation of income from property in the hands of the members, so however, that where such charges are already allowable in the computation no double deduction of the same item should be made. Here again, in the light of our earlier recommendations, the question of such allowance will generally arise only where the property is let out by the owner to a tenant or other occupant.

I-7.16. The emphasis placed by us on the computation of income including income under the head 'house property' is that the income should correspond to real income as commercially understood. At present the computation of income under this head provides for an ad hoc deduction of 1/6th of the annual letting value for repairs whether actually incurred or not and even where the expenditure on repairs may exceed the amount of deduction of 1/6th. This results in a notional deduction and, therefore, operates as a disincentive to property owners from incurring expenditure on repairs. It is appropriate that where the expenditure on repairs is actually incurred, such expenditure should be allowed as a deduction and not artificially restricted to the ad hoc deduction of 1/6th. Moreover, in the context of our recommendation contained in Chapter 12 of this Report for the carry forward of losses under the head "house property", the taxpayer would be able to set off excessive expenditure on repairs incurred in one year against the income in subsequent years. The scheme for allowance of deduction for repairs should, therefore, be changed from the notional basis to the actual basis. This is further necessary because we are of the view that actual expenditure incurred in relation to the income under any head should be allowed as a deduction in computing the income under that head. At the same time it should be recognised that the deduction on the flat basis of 1/6th is in the nature of a standard deduction to save both the taxpayers as well as the administration from the administrative tasks of establishing expenditure in all cases. A large majority of property owners may yet prefer to obtain the deduction on the basis of the standard deduction of 1/6th and it would be the balance of property owners who genuinely incur larger expenditure and are able to establish such expenditure to the satisfaction of the tax authorities, who would appropriately be entitled to have such expenditure allowed on an actual basis. Corresponding thus to the provisions for standard deduction in regard to the head of "salaries," it is desirable that the notional deduction at the rate of 1/6th continues to operate. The claim for expenditure in excess of such deduction of 1/6th should, therefore, be appropriately regulated to prevent situations where taxpayer obtains, so to say, the best of both worlds. Expenditure on current repairs is generally of such a nature that it cannot necessarily be determined on an annual basis and

compared with the standard deduction as in the case of salary income. Repairs to properties may be occasioned over a period of time and the appropriate comparison between the actual allowance and the deduction on the notional basis should also be related to a period of time. Therefore, wherever the expenditure on repairs is claimed on actual basis as being in excess of the deduction of 1/6th, such excess expenditure should only be allowed if the actual repairs in the year of claim as well as the 5 years immediately preceding exceed the standard deduction of 1/6th for such years in the aggregate. We, accordingly, recommend that the Income under the head "House Property" should be computed after allowance in respect of repairs on the basis of 1/6th of the Annual Letting value under Section 24(1)(i) as at present, with a right to the taxpayer to claim the actual expenditure if it is in excess of the deduction on the basis of 1/6th. To determine such excess the comparison should not be limited to a single year but to the year of assessment and five years immediately preceding. In other words, the claim for the actual expenditure as is in excess of 1/6th of the annual letting value should only be allowed if such actual expenditure together with the actual expenditure in the preceding 5 years is in excess of the amount actually allowed in the preceding 5 years and 1/6th of the annual letting value of the current year. To illustrate, if 1/6th of the annual letting value in respect of a property is Rs. 16,000 and the taxpayer incurs actual expenditure of Rs. 80,000 and claims the deduction of Rs. 80,000 instead of Rs. 16,000, the allowance of the extra amount of Rs. 64,000 shall be subject to the position of allowance in the preceding 5 years. If in the preceding 5 years, the expenditure incurred was as under :—

	Rs.
Immediately preceding year	5,000
Preceding year	7,000
Preceding year	8,000
Preceding year	2,000
Preceding year	8,000
	30,000

Then, in the preceding 5 years the taxpayer had obtained a deduction of Rs. 16,000 each year aggregating to Rs. 80,000 against the actual expenditure of Rs. 30,000. The difference of Rs. 50,000 would be first set off against the claim of the extra amount of Rs. 64,000 and the taxpayer would only be allowed the amount of Rs. 16,000+Rs. 14,000 in the year of assessment.

I-7.17. Further to the observations in the preceding paragraph, it should be recognised that there may be several other instances of expenditure which a property owner may have to incur. All these individual items of expenditure cannot be visualised and many of these items may arise in future,

such as contributions to house repair funds, property taxes based upon the floor area of accommodation, etc. Some of these levies may even be introduced with retrospective effect. The present scheme of deductions under section 24 does not take into account all such situations as could possibly arise. It is, therefore, appropriate in our view that a residuary deduction corresponding to section 37 in relation to business income and section 57 in relation to income from other sources should be provided for under section 24. The taxpayer should be entitled to obtain a deduction for all expenditure, which may be wholly and exclusively incurred for the purpose of earning income from house property. We, accordingly, recommend that Section 24 should expressly provide for a residuary item of deduction for other expenditure (not being in the nature of Capital Expenditure) laid out or expended wholly and exclusively for the purpose of making or earning income under the head income from House Property.

I-7.18. Another deduction allowable in the computation of income is in respect of unrealised rents. The conditions to be satisfied for entitlement to such deduction are stipulated in rule 4 of the Income-tax Rules. Some of these conditions are not capable of fulfilment and have created practical difficulties. It is common knowledge that the eviction of tenants from properties is a very complicated matter involving protracted litigation. In several cases defaulting tenants continue to remain in occupation of the property. Again, the nature of the occupancy may also be in dispute. The requirement for taking all reasonable steps and legal proceedings is also one where practical difficulties may be encountered. In the matter of allowance of doubtful debts in computation of business income we have in Chapter 8 of

this Report made certain recommendations for simplification. Likewise, in regard to irrecoverable rents, we recommend that if the rents are in arrears for a period of two years, the taxpayer should be entitled to the deduction, without any further requirements as at present stipulated in the rule. Needless to say, the deduction should be allowable only if the income in question had been assessed in the past. Further, a provision should be made for bringing to tax amounts subsequently realised, in the year of realisation, so that the relaxation in the conditions for allowance do not result in an undue benefit to taxpayers.

I-7.19. In the principal cities, ownership of house properties in the traditional sense is more an exception. Pressures of space have resulted in the construction of multi-storeyed apartments owned by several persons. In most instances such ownership is through the medium of co-operative societies. To encourage this trend section 27 of the Act specifically creates a fiction to treat individual members of co-operative societies as the owners of a portion of the building and, accordingly, assessable to tax under the head "Income from house property". Instances have been mentioned to us where such multiple ownership of the same building is achieved through the medium of a limited company. If this medium is adopted and the limited company conforms substantially to a model housing co-operative society, there is no particular justification for not extending to the case the fiction under section 27. We accordingly, recommend that in the case of a limited company owning house property occupancy/possession of which is divided among several members, the fiction of treating each member as the owner of a portion of the property should be extended.

CHAPTER 8

PROFITS AND GAINS OF BUSINESS OR PROFESSION

I-8.1. Part D of Chapter IV of the Income-tax Act, comprising sections 28 to 44D, contains the substantive provisions relating to computation of income under the head "Profits and gains of business or profession". These provisions have been regarded as the most important of the substantive provisions in the entire income-tax law. Income under this head covers a wide range of economic activity in the non-agricultural sector and constitutes over 55 per cent of the aggregate incomes coming within the scope of taxation under the Income-tax Act. Tax revenue in respect of such income accounts for over 65 per cent of the total revenue from income-tax. The provisions in these sections have also far-reaching effects in the area of industrial, financial and commercial activities.

I-8.2. In view of the significance of these sections, both in regard to the incomes brought to tax and the quantum of the tax, these provisions have generated the maximum amount of litigation and have led to the development of voluminous case law. In our Interim Report we have dealt with but one out of the various aspects relevant to the computation of such income. The matter taken up on the Interim Report is in regard to depreciation which is dealt with primarily in section 32 and supplemented by some of the provisions in sections 34, 38, 41 and 43A of the Income-tax Act. In the present Chapter, therefore, we shall deal with the other aspects concerning the computation of income chargeable under the head "Profits and gains of business or profession".

I-8.3. The first and foremost issue which arises for consideration is the nature of incomes which are chargeable under this head. This head covers not only income from business as generally understood but also that from profession. The Income-tax Act has defined the concept of business in section 2(13) to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. This definition is aimed at covering under this head the widest possible types of activities. The Supreme Court, in *Narain Swadeshi Weaving Mills v. C.E.P.T.* 26 I.T.R. 765, has explained the concept of business as connoting some real, substantial and systematic or organised course of activity or conduct with a set purpose. On the question of the extended concept of business, the Supreme Court has again in *Venkataswami Naidu v. C.I.T.* 35 I.T.R. 594 indicated important considerations which are to be borne in mind in determining the character of isolated or single transactions. The Court has approvingly quoted the observation of Lord Clyde that a single plunge may be enough to constitute a business provided it is shown to the satisfaction of the court that the plunge is made in the waters of trade. The

emphasis is on the design or purpose underlying a transaction. The conclusion has to be drawn from the total effect of all relevant factors and circumstances to determine the character of the transaction. The distinction between an adventure in the nature of trade and a capital, or casual transaction has to some extent lost its significance in the context of the present scheme of the Income-tax Act where income from casual transactions as well as gains from certain capital transactions are brought to tax.

I-8.4. Insofar as this head of income is concerned, no distinction has been drawn between a business and a profession. However, in certain other provisions of the Act (e.g., section 64) a distinction is made between income from business and income from 'profession'. "Profession involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an operation which is substantially the production or sale, or arrangements for the production or sale, of commodities" (*I.R. v. Maxse* 12 Tax Cases 41). Section 2(36) provides that "profession" includes vocation. The Supreme Court in *Krishna Menon v. C.I.T.* 35 I.T.R. 48, has held that it was not necessary to show that a vocation was an organised activity and that it was indulged in with a motive of making profit; it was well established that it was not the motive of a person doing an act which decided whether the act done by him was the carrying on of a business, profession or vocation. It is not necessary to consider whether a particular activity amounts to business or profession or vocation, since for the purposes of assessment under the Act profits from these three sources are treated and taxed alike under the same head.

I-8.5. It would not be out of place to mention that the only concession extended to professional income is by way of marginally lower rates of income-tax in the case of registered firms which derive income from professional activity as compared to other registered firms. It has been urged before us that income from profession being, by its very nature derived by exercise of intellectual skill, there is a case for extending some concession also in the matter of computation of the chargeable income from profession. There are no provisions for grant of personal allowance or for measuring the wear and tear on the individual exercising a profession. Whilst one view is that professionals like old soldiers never retire and, therefore, have an extended period of earning life, there are, on the other hand, some professions where the earning span may be severely limited. **We are of the view that the law should recognise the peculiar nature of income**

derived from professional activity by the exercise of intellectual skill which should be encouraged by suitable incentives in the computation of the chargeable income.

I-8.6. The next principle which arises in the computation of business income is the significance of sections 28 and 29. Whilst the purpose of section 28 is to extend the scope of the charge beyond the normal concept of profits and gains of business or profession, it should be remembered that courts have emphasised the significance of the expression "profits and gains" on the one hand and "the carrying on of business", on the other. From this emphasis follows the principle that what can fall within the scope of the charge is not the gross receipts of the business but what is truly and clearly the profits or gains therefrom. The test to be applied is the "true profits and gains as understood in a natural and proper sense—in a sense which no commercial man would misunderstand". The Supreme Court has in *Badridas Daga v. CIT* 34 ITR 10, held that losses and other items would be deductible in the very process of determining true profits and gains even without a specific provision in the law for such deduction. Whether such a claim is admissible or not will depend on whether, having regard to the accepted commercial practice and trading principles, the loss can be said to arise out of the carrying on of the business or to be incidental to it. If it is established to be so, then the deduction must be allowed provided, of course, there is no provision against it, express or implied, in the Act. It is, therefore, clear that the Supreme Court has laid great emphasis on the computation of business profits and gains in accordance with ordinary principles of commercial accounting. This position has been well accepted both by the assessing authorities and by the taxpayers and it is one of the fundamental principles governing the computation of business profits.

I-8.7. Section 28 covers profits and gains of any business or profession carried on by the taxpayer at any time during the previous year. In addition, it also covers compensation payments of the nature referred to in clause (ii), income of a trade association, etc., from specific services and lastly, benefits or perquisites arising from business or profession. These additional categories of income which are taxable under the head "Profits and gains of business" are specifically regarded as income for the purposes of the Income-tax Act by express provisions in the definition of income under section 2(24). The emphasis in the main part of section 28 dealing with business or profession is on the carrying on of the business or profession. It was, accordingly, held that, where receipts relating to a business or profession are obtained after its discontinuance they do not fall within the scope of section 28. One such category of income would relate to gains realised on the sale of depreciable assets. In order to ensure that such gains do not escape tax, the Explanations in section 41 expressly provide for a fiction deeming the business or profession to continue to be in existence. Likewise, section 176(3A) and section 176(4), expressly bring other receipts to tax. Section 176 forms part of the chapter largely dealing with procedural requirements to prevent loss of revenue. Sub-section (3A) and sub-section (4) are, however, in the nature of

charging provisions and it would, accordingly be more appropriate that they are enacted in section 28 and excluded from section 176. We accordingly, recommend that section 28 should be extended to cover income of a business or profession which is discontinued as is presently referred to in section 176(3A) and section 176(4). All the deductions as available to a continuing business should be allowed to the closed business in the computation of the income as discussed in para I-8.11. below.

I-8.8. Coming to the question of expenditure incurred, sections 30, 31, 35 and 36 deal with certain specific items of expenditure which may be said to be largely of an illustrative nature. This is because of the general provision contained in section 37(1) which provides for allowance of all expenditure laid out or expended wholly and exclusively for the purposes of the business or profession, excluding, of course, capital and personal expenditure. This general principle has been examined by the Supreme Court in *CIT vs. Malayalam Plantations Ltd.* 53 ITR 140, where it has been held that the expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profit". The court held that the scope of this expression is wide and may comprehend many acts which are incidental to the carrying on of a business. In *Eastern Investments Ltd. vs. CIT* 20 ITR 1, the Court held that the test is not whether the other party benefited, nor indeed whether there was a prudent transaction which resulted in ultimate gain to the assessee but whether it was properly entered into as a part of the assessee's legitimate commercial undertaking in order indirectly to facilitate the carrying on of its business. The only question is whether this was done in the ordinary course of business for the purposes already pointed out, however mistaken the directors and shareholders of the company may have been. The emphasis here again is on the allowance of expenditure based on grounds of commercial expediency. Viewed from another point of view, expenditure in the course of the trade which is unremunerative is none the less a proper deduction as wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense. [*Hughes v. Bank of New Zealand* 6 ITR 636 (HL)]

I-8.9. We have dealt with these aspects in some detail to indicate that for several decades the concept of allowance of business expenditure has been clearly pronounced upon and the principles are fairly well settled. We are, therefore, of the view that the general provision in section 37(1) should have primary in the scheme of computation of income from business or profession and should come immediately after sections 28 and 29. The other sections which specifically refer to certain items of expenditure do so either with a view to illustrating the categories of business expenditure or, alternatively, to identify certain items of business expenditure in order to place restrictions upon the allowability of such expenditure. For example, in dealing with deduction for repairs, sections 30 and 31 refer to expenditure on current repairs; while dealing with interest section 36(1)(iii) refers to monies borrowed for the purposes of the business; etc. It appears to us unnecessary to place restrictions of this nature on the allowance of business expenditure. In

our view, the sole test for allowance of business expenditure should be that laid down in section 37(1), namely, whether the expenditure is laid out or expended wholly and exclusively for the purposes of the business or profession not being capital expenditure or personal expenditure. If, therefore, section 37(1) is the governing provision for the deduction of expenditure in the computation of business profits, it would not be necessary to specifically enumerate other items of expenditure individually.

I-8.10. The adoption of the basis explained above and as enunciated by the Supreme Court on various occasions, would considerably reduce the area of unnecessary and unproductive litigation between the taxpayer and the administration. We, accordingly, recommend that all expenditure incurred wholly and exclusively for the purposes of the business or profession, other than personal expenditure of the taxpayer, should be allowed as a deduction in computing the profits and gains. If the expenditure is in the nature of revenue expenditure it should be allowed in the year in which it is incurred in accordance with the method of accounting followed by the taxpayer. If the expenditure is of the nature of capital expenditure, it should still be allowable in the process of computation of taxable profits through allowances such as depreciation or amortisation as explained in our interim report, paras 3.30 and 3.30 and 3.31.

I-8.11. The critical test for the allowance of business expenditure is that it should be wholly and exclusively incurred for the purposes of business and it should not amount to either capital expenditure or personal expenditure. The recommendation in the preceding paragraph would set at rest the eternal conflict between capital and revenue expenditure. The concept of expenditure for the purposes of business likewise gives rise to situations where expenditure may be regarded as confined to the duration when a business is carried on. As a consequence, expenditure incurred prior to the commencement of business and likewise expenditure incurred after the closure of the business may stand for disallowance. Insofar as expenditure is incurred prior to the commencement of business, provision is already made for amortisation of such expenditure under section 35D to which we have made specific reference in our Interim Report. Expenditure may, however, be incurred for the purposes of business but such expenditure may be incurred after the closure of the business. Instances of such expenditure would be retrenchment compensation payable under the Industrial Disputes Act, gratuity to the extent not already allowed in the computation of business profits, other compensation based on past service of employees, claims for termination of contractual obligations, etc. In the light of our recommendation that section 28 should be extended to cover income of a business or profession even after its discontinuance, it would follow that the computation under the head "profits and gains of business" would be necessitated even after the discontinuance of business. The income of such period should necessarily be computed in accordance with the provisions of section 29 to 44D and, accordingly expenditure of the nature referred to earlier incurred after the closure of the

business would constitute deductible expenditure in the computation of the business profits/losses. If a liability is not allowed during the continuance of the business because it remains contingent, it should be allowed when it crystallises into an actual liability on and after the closure of the business. The obligation had nevertheless been contracted and had arisen to the taxpayer in his character as a businessman. A provision which entitles the department to tax the income after the closure of a business cannot be one sided and correspondingly the taxpayer should be entitled to claim losses and expenditure relating to the business after its closure. We, therefore, recommend that expenditure which would have been allowable had the business continued should be allowed even after the closure of the business, and profit or loss should be computed accordingly. The expenditure arising out of the closure of the business should also be regarded as expenditure incurred for the purposes of the business.

I-8.12. Even though, as mentioned above, the approach of the courts of law has been ultimately to tax the real income of an assessee by allowing all expenditure on the principle of commercial expediency, the approach of the legislature appears to be to depart from this principle and provide for special disallowances for special reasons. Instances of such disallowances are : entertainment expenditure, expenditure on maintenance of guest houses, travelling expenses, limits on salaries and perquisites, and more recently expenditure on advertisement and sales promotion. Even though in consonance with the principles laid down by the Supreme Court, these expenses are strictly allowable as business expenditure, the Legislature marks them out for special disallowance for various reasons. Naturally, such kind of special disallowances result in the distortion of the concept of real income which courts have gradually evolved. They have also the effect of increasing the incidence of tax on the business income. Such special disallowances also bring about a certain amount of avoidable litigation, between the taxpayer and the administration. Though it would have been ideal that under the income-tax law the concept of real income is adhered to and no such special disallowances are provided, in the society in which we live, where tax law is not merely an instrument of collection of tax but also an instrument for achieving various socio-economic objectives, it may not be possible at this stage to follow that ideal. All we would emphasise is that at least for future such artificial disallowance should be kept at the minimum and the Government should accept the concept of real income evolved by courts of law over the years.

I-8.13. From the emphasis laid by us on expenditure being allowed in conformity with the principles of commercial accounting it would follow that the taxpayer also should not be entitled to distort his claims for allowance of expenditure. If the expenditure is allowed under any provision of the Act for any year then no deduction should be admissible in respect of the same expenditure under any other provision in the same year or any other year. So far as business expenditure is concerned, on the basis of recommendations made by us it would either be allowable as a revenue expenditure or if it is held to

be of a capital nature it would be allowed by way of depreciation or amortisation or write off. This process of allowance of expenditure in computation of business profits should not be confused with specific allowances which may be granted by way of incentives in the process of computation of business profits. The Legislature has expressly granted an extra allowance by way of weighted deduction for certain categories of expenses as also investment allowance by way of incentive. Such benefits which may expressly be granted by the Legislature are in the nature of allowances by way of incentives and they do not partake of the character of deductions. It is appropriate that where any such incentive or extra deduction is desired to be granted the intention should be expressly and clearly stated.

I-8.14. Another area of litigation in regard to allowance of business expenditure is in the matter of the year to which the expenditure relates. Several matters have been taken right upto the Supreme Court to decide whether an expenditure is allowable in one particular year or another. This could result in an expenditure being disputed for deduction either on the ground that it relates to an earlier year or on the ground that it relates to a later year. Such litigation is to our mind wasteful when the only bone of contention is the year to which the expenditure relates without any dispute as to the allowability of the expenditure itself. The instances in point are compensation claims, bonus payments, etc. In all such cases we recommend that if the Income-tax Officer disallows an expenditure in the course of any assessment he should simultaneously be required to determine the year to which such expenditure relates. If it relates to a past year then he should be required to simultaneously revise such past assessment and allow the deduction. If it relates to a future year, the assessment order should record a finding in regard to the year to which it relates and such a finding should be binding on the Income-tax Officer or his successor so far as the assessment for such subsequent year is concerned.

I-8.15. There is, however, one area in which disputes between the taxpayers and the administration are bound to continue. This area relates to the question as to what constitutes expenditure wholly and exclusively incurred for the purposes of the business. Our observations earlier indicate that this test should be the primary test for allowance of business expenditure. There has been considerable amount of litigation on this question and several principles or tests have now emerged as a result of judicial pronouncements. However, it is not feasible to totally remove all areas of dispute between the taxpayer and the administration nor would it be feasible for the law to lay down all the tests to determine the allowability of such expenses in specific instances. It is in this context that an enlightened imaginative and independent administration can effectively function in mitigating the rigours of the legislation and ensuring that, by and large, justice is meted out to the taxpayer. There are instances where on sound judicial principles, expenditure has been held to be for the purposes of

business but which decisions are over ridden by subsequent legislative enactments. An instance in point is where wealth-tax is paid on assets used for a business; such tax should appropriately constitute a deduction in determination of the true profits of the business as held by the Supreme Court in *Indian Aluminium Co. Ltd. v. CIT* 84 ITR 735. However, this decision has been superseded by legislative amendments with retrospective effect.

I-8.16. Similarly, there are judicial decisions which apply to the facts of a given case. Sometimes such decisions may create genuine hardship where in the interests of equity and balance of justice, the expenditure should appropriately qualify for deduction. It is here that we emphasise that there should not be a total estrangement between equity and the tax laws. The administration should promptly step in and ensure that appropriate directions are issued to the tax officers to prevent disallowance of expenditures in such circumstances. Instances in point would be expenditure incurred to redeem or recover confiscated goods, and expenditure incurred in taking or defending proceedings in connection with activities in the course of business.

I-8.17. Similarly, there has sometimes been a tendency to extend the scope of a judgment which is limited to the facts of a particular case, in a manner so as to apply it generally. An instance of this tendency is the attempt to disallow pensions paid to widows of deceased employees based upon the decision in *Gordon Woodroffe Leather Mfg. Co. Ltd. V. CIT* 44 ITR 551, which was clearly rendered on the special facts of the particular case. This is a situation where inequity is brought about by the administration, which is possibly motivated by a fear of criticism, if loss of revenue were to result by adopting a view restricting the judgment only to peculiar facts of the particular case. It is in such circumstances that appropriate administrative instructions issued without fear or favour would remedy injustices and prevent fruitless litigation. It should be remembered that not all taxpayers would be in a position to carry issues higher and many may helplessly accept the Department's verdict without demur. This casts an added responsibility on the administration to adopt a fair and equitable approach in the administration of the tax laws. We may, therefore, observe that all situations of deduction of business expenditure cannot be legislated upon and much would depend upon an enlightened approach in the administration of the law based on considerations of equity and justice.

I-8.18. We now proceed to examine some of the specific provisions dealing with the computation of business income :

Investment Allowance—Section 32A : The Finance Act, 1976, inserted a new section 32A in the Income-tax Act to provide for the grant of investment allowance. This allowance is a deduction in the computation of business profits by way of an incentive measure to encourage investment in new machinery and plant. The conditions for the grant of investment

allowance are broadly similar to those which were applicable to the grant of development rebate. The law in regard to the grant of development rebate has been in force for several years and is now reasonably well settled. The principles enunciated by the courts in that regard would be broadly applicable to the provisions relating to investment allowance.

I-8.19. The investment allowance is to be allowed in the year in which the asset qualifying for the investment allowance is acquired or installed. However, as it is also conditional upon the use of the asset for the purposes of business, the section provides for the grant of the allowance in the year of commencement of use if such commencement is in the previous year immediately following the year of acquisition/installation. This condition tying up the grant of the allowance to the first use of the asset in the previous year immediately following the year of acquisition/installation does not appear to have any particular justification, but, on the contrary, can result in hardship in cases where the commencement of use may be delayed by circumstances beyond the control of the taxpayer. Ordinarily, any taxpayer who invests in an asset qualifying for investment allowance would be interested in bringing such asset to use at the earliest possible opportunity. However, exceptional circumstances such as non-availability of power, or raw material, etc., may result in the asset not being brought into use in the immediately succeeding previous year but being brought into use in a later previous year. The denial of the allowance in such circumstances would be unjustified. We, accordingly, recommend that where the asset qualifying for investment allowance is acquired or installed in one previous year but brought into use in any subsequent previous year, not necessarily the previous year immediately following the year of acquisition/installation of the asset, the investment allowance should be granted in the year in which the asset is first put to use for the purposes of the business.

I-8.20. The grant of investment allowance is subject to fulfilment of various conditions. One of the conditions is that the asset should not be transferred for eight years from the end of the previous year in which it was acquired or installed. The section makes exceptions in cases where as a result of an amalgamation another company succeeds to the business of the company which was eligible for the allowance, and where there is succession to the business of a firm by a company. In such cases of succession, the law expressly permits the successor to obtain the benefit of the unabsorbed investment allowance on the conditions being continued to be fulfilled by the successor. The law also provides that in such cases investment allowance already granted to the predecessor shall not be withdrawn. We recommend that corresponding provisions qualifying the successor for investment allowance should also be made in the following types of cases involving a change of ownership of assets :—

- (a) Where an individual proprietor of a business expires and his successor inherits the business;
- (b) Where the change in ownership takes place as a result of partition of the property of a

Hindu undivided family which is carrying on the business;

- (c) Where a sole proprietor converts his business into a partnership and continues as a partner for the unexpired period of non-transferability of the asset.

I-8.21. Another condition required to be fulfilled for obtaining the benefit of investment allowance is that a reserve styled "Investment Allowance Reserve" should be created by appropriate debit to the Profit and Loss Account and credit to the Investment Allowance Reserve Account. Inasmuch as the actual quantum of investment allowance that would ultimately be allowed in an assessment may not always be predicted with reasonable certainty, the Explanation to sub-section (4) of section 32A provides a relief. By virtue of this Explanation, if the reserve created is inadequate with reference to the actual allowance, the Income-tax Officer is required to afford an opportunity to the taxpayer to make good the shortfall. The Explanation thus provides for a situation where there is an inadequacy in the reserve created. There may still be cases where there is total absence of any reserve in view of the claim being nil as per the return, but on assessment a particular figure is determined. On a literal reading, the Explanation may be taken to mean that it covers only cases of inadequacy and not cases of absence of reserve altogether. In circumstances where the absence arises out of the position as per the return, it is appropriate that the same opportunity should be available to the taxpayer. We, accordingly, recommend that the explanation may suitably clarify that it covers not merely cases of inadequacy of the reserve but also absence of any reserve under similar circumstances.

I-8.22. Under the existing provisions of section 32A, an assessee engaged in the business of operation of ships or aircraft is entitled to investment allowance only in respect of a new ship or a new aircraft. Other plant and machinery acquired by such an assessee and used in the same business operation of ships or aircraft does not qualify for the investment allowance. It is common knowledge that in such highly capital intensive business, supporting plant and machinery for the proper maintenance and repairs of ships and aircraft may also have to be acquired. The denial of investment allowance on such other items of plant and machinery is not justified. We, accordingly recommend that in the case of assessee engaged in the business of operation of ships or aircraft, investment allowance should also be granted in respect of any new plant and machinery installed for the purposes of such business.

I-8.23 *Rehabilitation Allowance—Section 33B* : Section 33B of the Income-tax Act provides for the grant of a rehabilitation allowance to a taxpayer who has suffered extensive damage to, or destruction of, capital assets used for purposes of business due to natural calamities, riot or civil disturbance, enemy action, etc. The allowance, at present, is an amount equal to 60 per cent of the terminal allowance admissible under section 32(1)(iii) of the Act in respect of the depreciable assets such as building, plant and machinery, which have suffered damage or destruction. It has been represented to us that the allowance in

this form may prove to be inadequate to overcome the financial constraints involved in the rehabilitation of the undertaking. In the first place, the quantum of the deduction itself may not be very significant, particularly in the light of our recommendations in the Interim Report relating to depreciation. Secondly, the deduction would only materialise as and when the taxpayer derives profits from the undertaking after it is re-established, reconstructed or revived. The cash impact of the deduction would, therefore, be deferred until the actual earning of profits and the measure would not contribute materially to the process of reconstruction or rehabilitation.

I-8.24. It appears to us that in circumstances such as these the taxpayer suffers several losses. There would be the revenue losses arising from the destruction of the stock-in-trade, non-recoverability of debts, etc. There would also be the terminal allowance in respect of depreciable assets which are demolished or destroyed. A sizable amount of loss which can ordinarily be set off against business profits would arise in relation to the year in which the destruction and damage takes place. Apart from the rehabilitation allowance which the taxpayer would qualify to get under section 33B, these deductions by themselves would take a considerable period of time for absorption against future profits. If the taxpayer is given a right to carry back these losses and set the same off against business profits which have already suffered tax in the three years preceding the year of damage, the benefit would be more meaningful. This would enable the taxpayer to claim a set off of these losses against past income on which taxes have been paid and which would therefore result in a refund of taxes to him. This would serve to provide him with cash resources which would further facilitate the process of rehabilitation and revival. From the revenue point of view also the concession would not be unduly significant because such losses would otherwise have been absorbed in later years against future profits. It is merely a question of timing of the set off.

I-8.25. We, accordingly, recommend that in the circumstances mentioned in section 33B of the Income-tax Act, the taxpayer should be entitled to carry backward business losses and other admissible allowances and deductions to the three years immediately preceding the year in which the business was disrupted, to be set off against the profits assessed for those years. If there is still any loss or other amount which remains unabsorbed by such set off, such loss, etc., may be allowed to be carried forward for future set off in the same manner as at present. Such right to carry backward and set off losses should, however, be allowed only if the taxpayer satisfies the Income-tax Officer at the time of assessment that he has taken adequate steps for the revival, re-establishment or reconstruction of the disrupted business.

I-8.26. *Expenditure on acquisition of patent rights or copyrights—Section 35A* : The provisions in section 35A allow the amortisation of capital expenditure incurred by the assessee on the acquisition of patent rights or copyrights used for the purpose of business. Such amortisation is at present allowed over a maximum period of fourteen years, but where some period

has elapsed since the patent was registered, the cost to the assessee is allowed in equal instalments, over the remaining years of the 14-year period. Thus, in a case where five years had elapsed before the patent was acquired by the assessee, the assessee's cost of acquisition is amortised over nine years. The period of fourteen years as the maximum period for amortisation under these provisions has been fixed apparently in view of the provision in the law relating to patents that fourteen years would be the maximum term of a patent. However, under section 53 of the Patents Act, 1970, while the term of a patent is ordinarily fourteen years, it could be as low as five years in some cases. Moreover, in the case of copyrights, the term of 14 years has no relevance. Even in the case of patents there is nothing to prevent the owner of the patent from exploiting it for any number of years. For these considerations, we are inclined to think that the period of fourteen years under the Income-tax law has no particular merit. In line with the period of amortisation specified in other provisions of the Income-tax Act, such as sections 35D and 35E, we recommend that in the case of patents and copyrights too, the cost of acquisition should be amortised over a ten-year period. The period which had already elapsed before the acquisition of the rights by the assessee will be irrelevant for the purpose of amortisation. Once the rights are acquired, whatever be the unexpired term of the patent or copyright, its cost to the assessee should be amortised over a ten-year period.

I-8.27. *Bonus—Section 36(1)(ii)* : One of the permissible deductions in the computation of profits and gains of business or profession is payments by way of bonus or commission to employees. The general rule in this regard is that such expenditure is allowable having regard to the practices obtaining in the trade. By an amendment made through the payment of Bonus (Amendment) Act, 1976, in September, 1975, the section expressly limits the deduction allowable in respect of bonus to employees covered by the Bonus Act to the bonus payable under the Bonus Act. The consequence is that if an employer pays bonus in excess of that payable under the Bonus Act, such additional amount will not be allowable as a deduction. Whilst this provision may apparently seem logical insofar as it aims at disallowing extra-statutory payments, it is largely unrealistic. The realities of business indicate that in several instances there is the compulsion of labour for payment of bonus in excess of the statutory limits. Employers have sometimes to yield under coercion to the injustice of such demands largely on grounds of commercial expediency. In recent times, the spate of industrial unrest all over the country is indicative of the realities of such coercive demands and the inability of any administrative machinery to effectively prevent such demands. Apart from the injustice of the burden on employers, it should be recognised that the provision for disallowance in the income-tax assessment further compounds such injustice. The test of admissibility of business expenditure is not necessarily restricted to one of statutory compulsion; it is equally valid when arising out of contractual obligations incurred on grounds of commercial expediency. We, accordingly, recommend that the first proviso to section 36(1)(ii) which creates this injustice should be deleted.

I-8.28 Bad Debts—Section 36(1)(vii) : Section 36(1)(vii) of the Act read with section 36(2) provides for the deduction of any debt or part thereof which is established to have become a bad debt in the previous year. The emphasis in the section is on the establishment of the claim by the taxpayer as also on the fact of the debt having become bad in a particular previous year. In regard to fulfilment of these conditions, there can be differences of opinion between the taxpayer and the Income-tax Officer which, in turn, give rise to litigation. In regard to the time element, viz., the previous year to which the claim relates, the law has made adequate provision to ensure the grant of the deduction in one year or the other, inasmuch as, if the Income-tax Officer is of the view that the claim relates to an earlier year, he is required to rectify the assessment for the earlier year. The section requires the debt to be written off in the accounts of the taxpayer. A write-off in the accounts of a relevant year would *prima facie* be indicative of the judgment of the taxpayer as regards the year to which the claim would relate and no useful purpose may be served in displacing the year of the claim.

I-8.29. As regards the other issue, however, viz., the establishment of the nature of the bad debt, the law leaves scope for disagreement between the taxpayer and the Income-tax Officer. The Income-tax Department has generally been adopting a strict approach almost bordering upon the need for absolute proof of the debt having become bad or irrecoverable. The normal practice is to enquire whether all the legal remedies have been tried and exhausted and the extent to which the debt remains unrecovered after exhaustion of all such remedies. The taxpayer, however, may not always resort to the legal remedies open to him particularly, when, having regard to the circumstances of the debtor, he is satisfied that these remedies would be futile. To deny the deduction in such cases would leave the taxpayer with a loss on his hands and without the legitimate set off of such loss against his taxable income. In this connection, it may be observed that the language of the corresponding provision in the 1922 Act was somewhat different. Under that Act, the section referred not only to bad debts but also to doubtful debts. The present Act refers only to any debt or part thereof which has become bad. The Central Board of Direct Taxes has, in a Circular dated 13th January, 1971, referred to this difference between the Act of 1922 and the present Act. Referring to the observations of the Law Commission, which was of the view that the word "doubtful" was unnecessary and did not add anything, the Board has stated that the provision in section 36(1)(vii) also covers doubtful debts. This is obviously because the clause refers not only to a debt but also a part of a debt.

I-8.30. In our view, in the ultimate analysis, it is for the businessman to decide as a matter of commercial expediency what amount he should write off in the Profit and Loss Account in respect of the bad and doubtful debts. Likewise, it is a matter of his judgement whether legal proceedings should be initiated and as to how far the strict legal remedies should be pursued. There is no point in laying down artificial restrictions on the broad principle of commercial accounting for arriving at the true profits and

gains. This, in our view, merely results in increase in work without any significant benefit to the revenue. The provisions of section 41(4) of the Act are also a sufficient safeguard against any possible loss of revenue inasmuch as any subsequent recovery against the allowances made is brought to tax in the year of such recovery. Therefore, any apprehension that profits may be artificially deflated or depressed by exaggerated claims for bad or doubtful debts is unfounded and any such contingency is adequately covered by virtue of the express provisions in section 41(4).

I-8.31. On a consideration of the above circumstances our recommendations in regard to the allowance for bad, doubtful or irrecoverable debts are as under :—

- (i) The allowance in respect of debts estimated to be bad, doubtful or irrecoverable should be on the basis of the amount written off by the assessee in the profit and loss account of the relevant previous year. Where such a write-off relates to debts which fell due within a period of two years preceding the date of the write-off the taxpayer may be called upon to justify the write-off. In any case, the taxpayer should be entitled to freely write-off debts which are not recovered for a period of two years from their original due date.
- (ii) The existing provisions for subjecting to tax any recovery out of the amounts written off should continue as a necessary safeguard in the interests of revenue.
- (iii) The write-off of the debt to the profit and loss account may be made either by a corresponding credit entry to the debtor's account or by passing a credit entry in another appropriate account, such as "provision for bad and doubtful debts accounts".

I-8.32. We may incidentally point out that an Explanation appearing below sub-section (4) of section 41 refers to the expressions "moneys payable" and "sold" and in terms applies to sub-section (2) and sub-section (3); it has no relevance to the provisions of sub-section (4). A similar Explanation also appears after sub-section (2A). We recommend that the explanation appearing after sub-section (4) of section 41 should be placed either at the end of the entire section or after sub-section (3) and should, with the necessary change in the language, cover sub-section (2). Sub-section (2A) and sub-section (3).

I-8.33. Contributions to approved funds—section 36(1)(iv) and (v) : Clauses (iv) and (v) of section 36(1) provide for specific deduction of any amounts paid by an employer by way of contribution, to a recognised provident fund, an approved superannuation fund or an approved gratuity fund. The expression "paid" in the case of a taxpayer who adopts the mercantile system of accounting includes a provision which may be made in the accounts having regard to section 43(2) of the Act. There are several complaints that employers have been defaulting in the payment of their contributions to these funds. Any remedial action by way of withdrawal of approval or recognition

would adversely affect the interests of the employees. In order to prevent employers from obtaining the benefit of deduction for purposes of taxation even without effecting payment of contributions to these funds, it will be desirable to fix a time limit for actual payment of the contributions. We, accordingly, recommend that in clauses (iv) and (v) of section 36(1), a specific provision should be made that if the contributions are not paid within a period of three months from the end of the previous year, the deduction shall not be allowed in the computation of business profits of that year. However, in cases of delayed payments the deduction should be allowed in the year of actual payment.

I-8.34. Rule 14 in Part A of the Fourth Schedule makes provisions, which are substantive in nature, applicable to the assessment of the employer. Similarly, rule 5 in Part B of the Fourth Schedule and rule 7 in Part C of the Fourth Schedule also contain substantive provisions affecting the employer. These provisions should appropriately be placed in the substantive law along with the provisions relating to computation of income from business rather than in the rules laying down the procedure for grant of approval to provident funds, superannuation funds and gratuity funds.

I-8.35. *Entertainment expenditure—Section 37 (2A)* : The deduction on account of entertainment expenditure is, under the present provisions, limited to a maximum of Rs. 30,000 in the case of any assessee. The amount which is to be allowed in any case is, however, to be determined by the application of certain percentages (ranging from $\frac{1}{2}$ per cent to $\frac{1}{8}$ per cent) to the profits and gains of the business of profession and limited to the upper ceiling of Rs. 30,000 which is reached when the profits and gains exceed Rs. 1.70 crores. In the representations received by us, it has been urged that these limits are too low, particularly, in the case of businesses having large overseas ramifications requiring extensive and continuing contact with customers and other business houses. Apart from this, the main difficulty in administering these provisions arises on account of the conflicting judicial pronouncements regarding the scope of the expression "entertainment expenditure". Considering these and other practical problems arising in this connection. We recommend that the ceiling for allowance of entertainment expenditure may be raised to Rs. 1 lakh from the existing Rs. 30,000. This may be achieved by suitably increasing the rates and the length of the slabs so as to arrive at the ceiling of Rs. 1 lakh where the profits and gains of the business exceed Rs. 2.80 crores, on the following lines :—

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|---|---|
| (i) On the First Rs. 20 Lakhs of the Profits and Gains | : At the Rate of 1% or Rs.10,000 whichever is higher. |
| (ii) On the next Rs. 60 Lakhs of the Profits and gains | : At the Rate of $\frac{1}{2}$ % |
| (iii) On the next Rs. 2 Crores of the Profits and gains | : At the Rate of $\frac{1}{4}$ % |
| (iv) On the Balance | : Nil |

I-8.36. *Travelling expenses—Section 37(3)* : In the matter of expenditure on travelling by an employee or any other person for the purposes of the business, certain restrictions are placed on the admissible amount of such expenditure under rule 6D of the Income-tax Rules, prescribed in pursuance of section 37(3). Rule 6D lays down the following limits for deduction in respect of daily allowance paid to an employee for the period spent by him outside his headquarters :—

- | | |
|---|------------------------------------|
| (i) in respect of an employee whose salary is Rs. 1000 or more. | : Rs. 100 per day or part thereof. |
| (ii) in respect of any other employee. | : Rs. 50 per day or part thereof. |

The aforesaid rates are to be increased by 50 per cent if the stay outside headquarters is at Bombay, Calcutta or Delhi. The figures originally fixed were Rs. 80 and Rs. 40, which were increased to Rs. 100 and Rs. 50 with effect from 1st April, 1976. Thereafter, the rates charged by hotels, including hotels run by the India Tourism Development Corporation (a Government company) have been revised upwards. While it is true that luxurious and ostentatious expenditure on travel needs to be discouraged, the rule should not result in legitimate business expenditure of a normal character being disallowed. The maximum allowance could appropriately be related to the rates charged for a single room by the hotel of the highest grade run by the India Tourism Development Corporation in the city concerned, apart from the charges for normal refreshments and meals. To enable easy administration of the law, it is ideal that the amount is quantified in the Income-tax Rules itself rather than being related to any yardstick for comparison. The latter course may lead to difficulties in accurately obtaining the rates as also determining the figures in cities where comparable hotels may not be available. From that point of view and having regard to the present rates, it appears to us that the actual expenditure, subject to a ceiling of around Rs. 400, in the cities of Bombay, Calcutta and Delhi would be realistic. The ceiling would be correspondingly lower in the case of the other cities. At the same time it should be remembered that this figure of the ceiling has relationship to the present tariffs of India Tourism Development Corporation run hotels in the city of Delhi. If these tariffs are revised upwards it is appropriate that the ceilings be also raised correspondingly. We, accordingly, recommend that the ceilings of Rs. 100 and Rs. 50 mentioned in rule 6D be increased to Rs. 250 and Rs. 125 respectively. It would follow from this recommendation that in the cities of Bombay, Calcutta and Delhi, the revised ceiling would be Rs. 375 and Rs. 187.50 respectively. We further recommend that these monetary ceilings should be revised periodically having regard to the tariffs of hotels run by the India Tourism Development Corporation.

I-8.37. *Amounts payable outside India, etc.—Section 40(a)* : Clause (a) of section 40 contains certain provisions for the disallowance, in computing business profits, of payments by way of salary or interest outside India unless tax has been deducted at source from

such payments. Under another provision in the same section any payment to a provident fund or any other fund established for the benefit of employees of the assessee, shall not be deductible unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payment made from the fund which is chargeable to tax as salary. As regards the former provision, we are of the view that having regard to the specific requirements of the law in the matter of deduction of tax at source from all income—payments to non-residents and the stringent provisions relating to charge of interest, levy of penalty or prosecution for infringement of those requirements, there is no need to have a provision for disallowance of such payments in the assessment of the payer. Apart from this, no remittance of any amount to any person outside India is possible without the express permission of the Reserve Bank of India and such permission would not ordinarily be accorded unless tax has been deducted at source from the concerned remittance. In the circumstances we recommend that the provisions in sub-clause (i) and (iii) of clause (a) of section 40 should be deleted.

I-8.38. As regards the provision in sub-clause (iv) of section 40(a), there is no provision spelling out the arrangements which would be considered effective for the purpose of this provision. While we agree that the provision for disallowance of payments to provident and other funds should stay, at the same time, we recommend that the nature of the arrangements that would be considered as effective for the purpose of section 40(a)(iv) should be spelt out in the rules.

I-8.39. *Remuneration, benefit or amenity to director etc.—Section 40(c) and 40A(5)* : Clause (c) of section 40 provides for disallowance of excessive or unreasonable expenditure incurred by a company on the payment of any remuneration or the provision of any benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of such director or such person. There is also a monetary ceiling on the deductible amount of such expenditure. There are corresponding provisions in section 40A(5) for the disallowance of salary and perquisites to employees in excess of certain monetary limits. The monetary ceiling under both these sets of provisions is Rs. 72,000 for a year or Rs. 6,000 per month. We have noticed a certain lack of uniformity between these provisions on the one hand and the approach adopted by the Department of Company Affairs in granting approval to such salary and perquisites to directors, on the other. Quite often, the Department of Company Affairs has approved salaries and perquisites to a director of a company on a scale higher than those specified in section 40(c). We recommend that this dichotomy should be avoided, by making a specific provision to the effect that the monetary ceiling laid down in section 40(c) and in section 40A(5) will not apply in any case where the salary and perquisites of the director or other person, etc., have been approved by the Government of India in the department of company affairs, and that the test of whether the payment is excessive or unreasonable will also not apply in such cases. We further recommend that the provisions of section 40(c) should operate in

a mutually exclusive area from section 40A(5) and accordingly section 40A(5) should be rendered inapplicable to cases of persons who are covered by section 40(c). We may, however, clarify that the items of expenditure like provident fund contributions etc., which are excluded from disallowance under section 40A(5) should likewise continue to be excluded from disallowance under section 40(c).

I-8.40. Another aspect in which the existing provision in section 40A(5) may result in hardship is the matter of retirement benefits paid to employees, such as gratuity, etc. At present, such payment would be reckoned as included in the term "salary" and the limit of Rs. 5,000 per month or Rs. 60,000 per year will apply to the deduction admissible to the employer in respect of expenditure on payment of salary to the employees upto the date of his retirement, taken together with the gratuity paid to him. Although retirement benefits such as gratuity would generally be paid out of an approved gratuity fund set up by the employer and the contributions made to the gratuity fund are to be excluded from the term "salary" for the purposes of applying the monetary limit by virtue of the second proviso to section 40A(5)(a), there may be cases where the employer does not have an approved gratuity fund but pays the gratuity to retiring employees out of his own resources and claims the same as a revenue deduction in the year of payment. In order to avoid hardship in such cases, we recommend that it may be clarified that any payment by way of gratuity to retiring employees (computed in accordance with a scheme applicable to all the employees) will be excluded from the scope of salary for the purposes of the limit specified in section 40A(5) and correspondingly in section 40(c).

I-8.41. *Cash payments in respect of business expenditure—Section 40A(3)* : Section 40A(3), introduced by the Finance Act, 1968, provides for the disallowance of any expenditure in a business or profession for which payment in an amount exceeding Rs. 2,500 is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft. Simultaneously with the making of these provisions, power was given to the Board to prescribe, in the rules, the cases and circumstances in which the disallowance will not be made. These cases and circumstances are spelt out in rule 6DD of the Income-tax Rules. The limit of Rs. 2,500 which was fixed in 1968 would in the circumstances of today be a very low limit. It should bear a reasonable relationship to the general levels of costs and prices and the size of business transactions. While we agree that the provision in section 40A(3) should be kept on the statute book with a view to encouraging transactions through banks, we recommend that the limit of Rs. 2,500 may be raised to Rs. 10,000.

I-8.42. *Interest on deposits in the case of companies other than banking and financial companies—Section 40A(8)* : Sub-section (8) of section 40A which was introduced by the Finance Act, 1975, provides for the disallowance of 15 per cent of the interest paid by a non-banking company on deposits received by it. The objective of disallowing a part of the interest was to

increase the cost of borrowing in the form of such deposits and thereby discourage the acceptance of deposits by companies in the non-banking sector. It should be observed that the Income-tax Act should not aim at controlling various aspects of corporate enterprise. The acceptance of deposits is now well regulated by rules framed under the provisions of section 58A of the Companies Act, 1956. The Department of Company Affairs is, therefore, actively seized of the problem of regulating the acceptance of such deposits by companies.

I-8.43. The partial disallowance of the interest under section 40A(8) was justified on the ground that deposits from the public had become more attractive as a result of the levy of tax on interest received by scheduled banks on their borrowings, under the Interest Tax Act, 1974. That tax had the effect of increasing the cost of borrowings from scheduled banks by about 1 per cent. The Interest Tax Act has since been repealed and scheduled banks have also been directed to restructure their rates of lending so that the benefit of such repeal is passed on to the borrowers. It would therefore, follow that the artificial disincentive introduced by way of disallowance of interest on public deposits should likewise be discontinued.

I-8.44. The system of public deposits has been in vogue for several years. A large number of depositors place their funds in deposits with companies with a view to earning a reasonable amount of interest. To the companies also such deposits provide a convenient source of short-term finance for working funds. As such deposits are unsecured and do not involve any elaborate formalities, companies are in a position to readily accept such monies for the purposes of their business. By and large, the rates of interest paid on such deposits are also lower than the rates of interest charged by banks on working capital advances. It has not been suggested that rates of interest on such deposits were unduly high or unreasonable. After the enforcement of the rules under the Companies Act, the terms for acceptance of deposits are required to be properly publicised and the general trend indicates a well regulated pattern in most companies. In fact, with the reduction in the rates of interest charged by scheduled banks consequent upon the abolition of the Interest Tax Act, several companies have also correspondingly reduced the rates of interest offered by them on public deposits.

I-8.45. In such a situation, the disallowance of 15 per cent of the interest on deposits is harsh. Courts of law have, in construing the provisions for allowance of interest against business income under section 36(1)(iii), emphasised that the real test to be applied is to ascertain whether the money has been borrowed for the purposes of business. If that test is satisfied and interest is paid on such money, there is no warrant for disallowing any portion of the interest on subjective or objective grounds. (See *The East India Industries (Madras) Ltd. v. CIT* 31 ITR 803 and *CIT v. Bombay Samachar Ltd.* 74 ITR 723). The emphasis in the matter of allowance of interest is, therefore, on the borrowings being effected for the purposes of the business. So long as capital is borrowed for business purposes it contributes to the business activity, and to

provide for an artificial disallowance even on funds legitimately used for the purposes of business is to needlessly distort the determination of true and commercial profits. We, therefore, recommend that the provisions in section 40A(8) should be deleted along with the tenth schedule to the Income-tax Act, which pertains to those provisions.

I-8.46. *Computation of income from insurance business*—Section 44 : Section 44 of the Act makes a special provision and directs the computation of profits and gains of insurance business in accordance with the rules contained in the First Schedule. To the extent that computation is required to be made as per the rules in the First Schedule, such computation overrides anything to the contrary contained in the Act relating to computation of income under the heads "Interest on securities", "Income from house property", "Capital gains", "Income from other sources", as well as anything to the contrary contained in section 199 and sections 28 to 43A. It is clear from a plain reading of section 44 that the process of computation under the schedule would prevail even if there is anything contrary in the other provisions referred to earlier.

I-8.47. The First Schedule consists of three parts. Part A deals with the computation of income from life insurance business. This part has been considerably simplified under the Finance Act, 1976, and it therefore, does not require any comment.

I-8.48. Part B of the First Schedule contains rules for the computation of the profits of general insurance business. Rule 5 provides that such profits shall be computed on the basis of the annual accounts furnished to the Controller of Insurance. The whole scheme of computing the income under the five separate heads is, therefore, modified by adopting the profits from the annual accounts filed pursuant to the Insurance Act, 1938. The rule provides for three adjustments to such profits. The first adjustment relates to specific disallowances of expenditure as contained in sections 30 to 43A of the Act. To that extent, therefore, those provisions are to be given effect to. The second adjustment is in relation to transfers for depreciation or appreciation in the investments held. The rule expressly allows the deduction of any amount written off or reserved in the accounts to meet depreciation or loss on realisation of investments. The allowance is, however, subject to a proviso which requires the Income-tax Officer to be satisfied about the reasonableness of the write off. In the context of the public ownership of all general insurance business in our country, we consider that disputes between the Department and the general insurance companies in the public sector would be merely academic. No worthwhile purpose would, therefore, be served by continuing the proviso. We, accordingly, recommend the deletion of the proviso to clause (b) of rule 5 of the First Schedule. The third adjustment relates to the reserve for unexpired risks as prescribed under rule 6E of the Income-tax Rules.

I-8.49. After such adjustments are made the figure of profits determined from the annual accounts is to be taken as the profits and gains from the general insurance business. This, however, is not the end of the exercise of determination of total income which is to be subjected to tax. In order to compute the total

income, the further steps of computation under Chapter VIA would have to be given effect to. Accordingly, from the profits and gains as determined under the First Schedule, deductions would specifically be allowable for items such as donations (under section 80G), intercorporate dividends (under section 80M), etc.

I-8.50. Our attention has been drawn to a view taken that the deductions under Chapter VIA are not to be allowed and that the computation made under the First Schedule is final by itself. Such a view, to our thinking, is clearly opposed to the express terms of section 44, which provides that by this process what is determined is the profits and gains of the insurance business. It does not provide that such profits and gains would constitute the total income. There is nothing to the contrary contained in Chapter VIA to warrant the exclusion of those provisions in the case of a general insurance business. We, therefore, recommend that this clear position in law should be reiterated by suitable instructions to the assessing officers.

I-8.51. Our attention has also been drawn to a view that section 44 has the effect of overriding section 199 with the result that credit for taxes deducted at source is not to be allowed in the case of a general insurance business. The reference to section 199 in section 44 is clearly to give effect to the modified treatment of taxes deducted at source as contained in rule 4 of the First Schedule. That rule has no relevance for the

purposes of general insurance business. There is nothing in rule 5 which even suggests that section 199 shall be rendered nugatory or inoperative. The provision in section 44 is only to override anything to the contrary contained in section 199. When, however, rule 5 of the First Schedule is totally silent and makes no provision at all in relation to the treatment of taxes deducted at source, the question of overriding anything to the contrary in section 199 does not arise at all. Without doing extreme violence to the language of section 44, credit for taxes deducted at source cannot be denied in the case of a general insurance business. Again, as pointed out elsewhere in our Report, section 199 has also to be read in the context of the entire scheme of deduction of tax at source under Chapter XVII and more particularly section 198 and section 205. No demand based on denial of credit for taxes deducted at source can be enforced against the taxpayer in view of the clear provisions in section 205. We, accordingly, recommend that suitable instructions may be issued to the assessing officers clarifying the position in law and setting at rest the needless controversy based upon the erroneous construction of section 44.

I-8.52. There are certain deductions available from the gross total income which are relevant to the computation of income under the head "Profits and gains from business or profession". In this regard attention is invited to our comments in Chapter 13.

CHAPTER 9

CAPITAL GAINS

I-9.1 Part E of Chapter IV of the Income-tax Act, comprising sections 45 to 55A, contains the substantive provisions relating to computation of income chargeable under the head "Capital gains". Under section 45 profits and gains arising from the transfer of a capital asset effected in a previous year are chargeable to income-tax under the head "Capital gains" as income of that previous year. The expression "transfer" in relation to a capital asset, is defined in section 2(47) of the Act, to include the sale, exchange or relinquishment of the asset or the extinguishment of any right therein or the compulsory acquisition thereof under any law.

I-9.2. The expression "capital asset" has been defined in section 2(14) of the Act. This definition is comprehensive in the sense that it includes property of any kind held by an assessee. The definition expressly excludes certain items, namely :

- (1) stock-in-trade ;
- (2) personal effects held for personal use of the assessee or his family, except jewellery ;
- (3) agricultural land situated in India outside urban areas ; and
- (4) certain Gold Bonds issued by the Central Government.

I-9.3. The scheme of section 45 is to bring about the charge of tax on capital gains in entirety in the year in which the transfer of the capital asset is effected. Conversely, no liability to tax on capital gains arises until the capital asset in question is transferred within the meaning of that expression.

I-9.4. The quantum of the capital gains is determined in accordance with section 48 of the Act. This broadly aims at treating the excess realisation over the cost of acquisition of the assets as the capital gain. The cost of acquisition represents the actual cost of acquiring the asset and the cost of effecting improvements thereto. In certain circumstances this cost may be substituted by the fair market value as on 1st of January, 1964, under section 55 of the Act.

I-9.5. Certain types of transactions are not regarded as transfer under section 47 of the Act. The objective underlying section 47 is to exempt from charge of tax the capital gains arising on the transactions specified therein, notwithstanding the change in ownership of the asset. Correspondingly, section 49 provides that the cost of acquisition of the asset to the transferee in such cases would be the cost to the previous owner. Accordingly, when such a transferee subsequently transfers the capital asset by any one of the non-excepted modes, capital gains would be charged on the sale proceeds realised less the cost of acquisition to the previous owner.

I-9.6. Apart from the categories of transfers which are excluded from the incidence of tax on capital gains, there are other specific exemptions conferred by law. Section 53 confers an exemption in relation to capital gains arising on transfer of house property where the sale value does not exceed Rs. 25,000. Section 54 confers an exemption where his residential house is sold by a taxpayer and another house is acquired by him for his residence. Section 54B exempts the capital gains on the sale of agricultural land used by the taxpayer for cultivation where another agricultural land is purchased for similar use. Section 54D exempts capital gains arising on compulsory acquisition of lands and buildings of an industrial undertaking which is followed by acquisition of fresh land or building for the purpose set out therein.

I-9.7. Section 54E, which has been introduced by the Finance (No. 2) Act, 1977, confers exemption where the sale proceeds of capital assets are reinvested in approved forms of financial assets.

I-9.8. Certain difficulties have arisen in regard to the operation of these provisions. The charge is attracted under section 45 when the transfer is effected. It has been held by the Supreme Court in several cases that "transfer" means an effective transfer of title. In *Alapati Venkataramiah v. CIT*, 57 ITR 185, the Court has observed that "transfer must mean effective conveyance of the capital asset to the transferee". Delivery of possession of immovable property cannot by itself be treated as equivalent to conveyance of the immovable property. The Court also negated the argument based on section 53A of the Transfer of Property Act under which the assessee could never have got back possession of the properties. The Court held that it was only on the effective conveyance and transfer of title that the tax can be levied.

I-9.9. This position can lend itself to hardship in particular cases. It is a common practice for immovable property to be sold under an agreement of sale but the actual conveyance may be drawn up and registered several years after the finalisation of the transaction. This may be due to various factors sometimes beyond the control of the parties. In cities like Bombay where properties are being developed for construction of multi-storeyed buildings, the builder who constructs the building for the purchasers of the property, does not effect the transfer of title until the property is constructed and a co-operative society of the flat owners is formed. In such cases due to delay in the formation of the co-operative society, the actual transfer is not effected until the expiry of several years after the original transaction of sale. It follows that in such cases the original seller of the immovable property is not taxed on the Capital gains until the year when the actual conveyance takes place. By this time he may well have lost or spent away the consideration

arising on the sale of the property and rendered himself unable to pay the tax. Difficulties also arise in cases where the interregnum between the agreement to sell and the execution of the conveyance of sale may witness a steep appreciation in the value of the property thereby giving rise to the question of applicability of section 52(2) of the Act (on its narrow construction) with reference to the market value as on the date of the conveyance. On the one hand, the Department's attempt to apply section 52(2) to such cases would be unjustified when the difference is attributable to appreciation in the value of the property between the date of the agreement to sell and the execution of the deed of conveyance. On the other hand, the attempt to apply section 52(2) in a case of understatement may also be frustrated by antedating the agreement to sell. The provision for bringing the gain to tax at the point of conveyance in relation to immovable property, therefore, creates these complications.

I-9.10. Suggestions have been made to the effect that the meaning of the term "sale" in relation to immovable property should be varied and related to the point of time where possession of property is parted with and the sale consideration received by the seller. We have considered these suggestions very carefully. We are of the view that any radical change in the meaning of the word 'sale', having regard to the scheme of transfer of title under the Transfer of Property Act, would create additional problems and distortions. At the same time we have to take into account the difficulties arising in relation to the operation of the taxing provisions particularly sections 45 and 52(2) pointed out above.

I-9.11. It would not be appropriate to totally alter the meaning of the expression 'transfer' in all cases. However, in cases where all incidents of ownership are virtually transferred to the purchaser it would be appropriate to advance the stage of assessment to tax. No useful purpose would be served in delaying the levy of the tax until the actual transfer of title in a legal sense under the provisions of the Transfer of Property Act. In several cases, evidence of transfer of incidents of ownership could be easily established. There may for example, be a written agreement to sell between the parties, handing over possession of the premises or property by the seller to the buyer and payment of the whole or substantially the whole of the consideration by the buyer to the seller. These features would be present in a large number of transactions relating to sale of immovable property in the principal cities of the country. The situation would be very similar to that contemplated under section 53A of the Transfer of Property Act where in the circumstances specified in the section, the transferor is debarred from enforcing any claim in respect of the property against the transferee. We, accordingly, recommend that in relation to transfer of immovable property by way of sale, where the agreement to sell is evidenced by an instrument in writing, where possession of the immovable property has been handed over to the purchaser and the whole or substantially the whole of the consideration has been received by the transferor, the capital gains

should be chargeable at such point of time when these requirements are fulfilled. Where the gain is brought to charge in these circumstances it should not again be deemed to arise in the previous year when the instrument of conveyance is executed and registered.

I-9.12. The second issue for consideration in relation to the charge of tax on capital gains is whether self-generated assets like goodwill fall within the expression 'capital assets'. The Madras High Court in CIT v. Rathnam Nadar, 71 ITR 433, held that the scheme of tax on capital gains did not envisage the inclusion of self-generated assets, like goodwill, as a capital asset. The Gujarat High Court in CIT v. Mohanbhai Pamabhai, 91 ITR 393, has taken the opposite view. There are several decisions of other High Courts following the Madras view. However, in CIT v. Srinivasa Setty, 96 ITR 667, the Karnataka High Court while following the Madras view, has drawn support from the fact that the Department's appeal to the Supreme Court against the Madras judgment was dismissed as not pressed. There is, however, no direct ruling or judgment of the Supreme Court on the issue. It is desirable to settle this issue in the law itself. The judgments of the courts have been arrived at on a construction of the relevant provisions dealing with the levy of tax on capital gains. Apart from such a construction, it should be emphasised that a gain realised on a self-generated asset contributes to the capacity of the taxpayer to pay tax as much as a gain realised from any other asset. In the circumstances there is no particular merit in not subjecting to tax the capital gains on self-generated assets. We, therefore, recommend that the provisions of law should be suitably amended so as to expressly include self-generated assets within the meaning of capital assets and thereby bringing to tax the capital gains on the transfer of such assets. This recommendation is conditional upon the further recommendation for determination of cost of acquisition of such asset in the following paragraphs.

I-9.13. The recommendation set out in the earlier paragraph is intended to bring to tax only the element of gain. It is not suggested that the tax should be levied on the total sale consideration. This was, in fact, one of the difficulties encountered in the course of cases which went before the courts. If the provisions as they stand led to the levy of tax on the gross sale price it was clearly beyond the scheme of tax on the gain. We appreciate that the determination of the cost of acquisition of self-generated assets can lead to several practical difficulties and disagreement between the taxpayer and the Income-tax Department. It is possible to determine the cost of such assets by elaborate arguments and calculations supported by principles of accounting. There is, however, need for simplification of this process so as to render the same easily workable. The situation could be taken care of by deeming the cost of acquisition as an *ad hoc* percentage of the sale proceeds. A percentage which would vary depending upon the number of years for which the asset is held would be by and large fair whilst at the same time leading to an easy determination of the gain. We, accordingly, recommend that the cost of acquisition of self-generated assets may be

deemed to be a percentage of the sale proceeds as under the following formula :—

The cost of acquisition will be :

1. Where the asset is held by the assessee for not more than five years before its transfer : 20 per cent of the sale proceeds.
2. Where the asset is held for more than five years but not more than ten years : 40 per cent of the sale proceeds.
3. Where the asset is held for more than ten years but not more than fifteen years : 60 per cent of the sale proceeds.
4. Where the asset is held for more than fifteen years : 80 per cent of the sale proceeds.

I-9.14. The determination of the cost of acquisition would thus be made on a fixed percentage basis having regard to the length of time during which the asset is held. As this method is an *ad hoc* determination primarily aimed at simplification of the law, it would follow that the question of substitution of such cost by the fair market value as on 1st January, 1964 would not arise. Providing for such right of substitution would defeat the very basis of simplification as it would lead to protracted litigation on the determination of the fair market value as on 1st January, 1964. It would, no doubt, mean that if a self-generated asset had achieved a higher market value in the past and thereafter is disposed of at a lower market value, the assessee would be denied the benefit of claiming a capital loss. We, are however, of the view that such situation would be exceptional and such a difficulty should not necessitate a change in the simplified method of determining the capital gains suggested by us. We, accordingly, recommend that in case of self-generated assets the taxpayers should not have the right of substitution of the fair market value as on 1st January, 1964.

I-9.15. Another area of controversy in regard to the taxation of capital gains relates to transactions between a taxpayer and a firm in which he is a partner. It is now well settled that where transactions by way of sale, exchange, etc., take place between a firm and a partner, the tax consequences would be the same as in the case of a sale to an outsider. However, where a division of partnership assets takes place on the dissolution of the firm, the transfer of such capital assets to the partners is expressly excluded under section 47(ii) of the Act. The Supreme Court has held that the adjustment of partnership accounts could take place by handing over partnership assets at a valuation and/or by payment of cash—CIT v. Bankey Lal Vaidya, 79 ITR 594. Correspondingly, section 49(1)(iii)(b) provides that the cost of acquisition of such assets in the hands of the partner would be the cost to the previous owner. Both sections 47 and 49 refer to a distribution of capital assets on the dissolution of a firm. In several cases, the parties may not bring about an actual dissolution of a firm when one or more partners retire and the continuing partners either by themselves or with others continue to carry on the business of the partnership. The settlement of accounts of a partner retiring from

the firm is similar to the settlement of accounts on a dissolution of a firm. This is because the retirement of a partner virtually amounts to a dissolution of the firm *qua* the retiring partner. Our attention has been drawn to the fact that sections 47 and 49 are not being applied to the settlement of accounts on the retirement of a partner. We recommend that the position should be suitably clarified to include the payment of his share to a partner retiring from a firm and to apply section 47(ii) and section 49(1)(iii)(b) to such cases as well.

I-9.16. Apart from the specific exemption under section 47(ii) in regard to distribution of assets on the dissolution of a firm, the Supreme Court has held that where a partner introduces capital assets belonging to him as his share of capital contribution in a firm, there is no sale—CIT v. Hind Construction Ltd., 83 ITR 211. The Kerala High Court in a full bench decision, A. Abdul Rahim, Travancore Confectionery Works v. CIT, 110 ITR 595, has applied the definition of “transfer” under section 2(47) to the case where a partner introduced his own assets in a firm as his capital. The question in that case was whether this operation amounted to a sale or transfer of an asset on which development rebate was allowed, thereby entailing the loss of the development rebate. The Court held that there was an extinguishment of the rights of full ownership on the property becoming the asset of the firm and that there was a transfer within the meaning of section 2(47). It is, of course, true that the decision of the Supreme Court referred to earlier was not cited before the Kerala High Court; but it may be stated that the Supreme Court held on the facts of that case that there was no sale. The Court had no occasion to construe the provisions of section 2(47) as examined by the Kerala High Court.

I-9.17. It should be pointed out that the general concept of relationship between a partner and the firm as applicable under the Indian Partnership Act, 1932, acquires a particular significance under the provisions of the income-tax law. The line of division between a partner and the firm as obtaining under the partnership law need not necessarily be the same as under the income-tax law. Under the income-tax law a firm is deemed to be a person and a taxable entity in its own right apart from the partners constituting the firm. The expression “transfer” may, therefore, acquire a special connotation in the circumstances of such operations between a partner and the firm. Our attention has been drawn to several cases of partners introducing assets into partnership firms at enhanced valuations. In that context, therefore, it would be appropriate to deem such transactions of introduction of assets into the firm as a transfer within the meaning of section 2(47). When a partner's account is credited at an enhanced valuation, it bears the characteristics of a transfer in a broad sense. Even under the partnership law once an asset becomes the property of the firm, the partner cannot claim to have any identifiable right or interest over that particular asset. There is, therefore, a change in the characteristics of ownership of the assets from the individual when such asset is introduced as the property of the firm. We accordingly,

recommend that where a partner introduces capital assets into the partnership firm, it should be deemed to be a transfer under section 2(47) of the Act subject to the recommendation in the next paragraph.

I-9.18. The recommendation, made in the preceding paragraph would block an avenue of avoidance of tax on capital gains. However, whenever fictions are introduced into a taxing statute, it is absolutely essential to clearly demarcate and restrict the area of operation of the fiction. Failure to do so may lead to unintended hardships. It should in that context be recognised that introduction of assets into a firm need not always be motivated by considerations of capital gains. There may be several circumstances where for genuine business necessity such transactions may be effected. It would be wholly unfair, therefore, to apply a fiction suggested in the preceding paragraph generally to all cases. In the first place, it is appropriate to clarify that the provisions of section 52 would not be invoked in such cases. This is to ensure that what is brought to charge is only actual profit and not a notional profit. In the second place, difficulty would be created where business assets are introduced and the partner concerned does not really obtain money or money's worth as consideration. The mere credit to his account by itself would not place him in the position of one who is effecting a real transfer of a capital asset. On the same parity of reasoning of the subsequent recommendation in the following paragraph, the fiction should only be applied at the point of time when the taxpayer in question realises the value in money or money's worth. **We accordingly, recommend that the fiction of transfer on introduction of capital assets into partnership by a taxpayer should apply in the year when the taxpayer concerned realises the consideration for such introduction, in money or the equivalent of money, or when the firm transfers such assets, whichever is earlier.**

I-9.19. Somewhat similar to the operation of introducing assets into partnership is another operation where an assessee may revalue his assets prior to the realisation thereof. A mere revaluation does not by itself give rise to any income chargeable to tax. It is well settled that a taxpayer cannot make profit out of himself. However, such revaluation may arise in the course of the conversion of capital assets into trading assets such as stock-in-trade and the subsequent realisation of such assets as trading assets. Such an operation would entitle the taxpayer to claim as the cost of the assets for the purposes of determination of business profits, the market value of those assets on the date of conversion. To the extent, therefore, that there has been an appreciation in the value of the capital asset with reference to the cost as at the time of its acquisition and the market value as at the time of its conversion into a trading asset, no tax liability is attracted. The tax liability is totally avoided because at the stage of conversion the assessee cannot be taxed and at the stage of realisation it is only the difference between the realisation and the market value on the date of conversion which is brought to tax. This position follows from the decision of the Supreme Court in *CIT v. Shirin-*

bai Kooka, 46 ITR 86. There is no adequate justification for a complete avoidance of tax on the appreciation between the original cost and the market value on the date of conversion having regard to the general scheme of the tax on capital gains. At the same time it would not be appropriate to tax a mere notional appreciation at the point of conversion of the asset from a capital asset into a trading asset. The fact, however, remains that where the assessee transfers an asset which originally was a capital asset but it ceased to be a capital asset on its conversion into a trading asset, there is an element of capital gains actually realised at the point of sale which escapes tax. In order to prevent this escapement of tax. **We recommend that where an asset which was at any time a capital asset is subsequently realised as a trading asset, the element of capital gains should be brought to tax. For this purpose, the consideration realised at the point of ultimate transfer less the amount assessable as profits and gains from business should be deemed to be the full value of the consideration for determination of the capital gains. In other words, the difference between the value at which the asset is taken into the business as a trading asset and the cost of acquisition would represent the capital gains liable to tax, at the point of time when the asset is actually transferred.**

I-9.20. The effect of the above recommendation is, firstly, to create a fiction of transfer of a capital asset at the point of time when the trading asset is realised in the course of business. The second fiction which is created is to regard the full value of the consideration as the sale proceeds of the asset less the amount which is assessable as profits and gains from business. These fictions are necessary because at the point of transfer the asset has ceased to be a capital asset and there is an escapement of tax on capital gains. The escapement which is to the extent of the difference between the value at which the asset is taken into the business and the cost of the asset, should be brought to tax. It should not be brought to tax at the point of mere conversion of the capital asset into trading asset, but at the later stage when it is realised in the course of the business.

I-9.21. Once the charge of tax on capital gains arises as outlined in the preceding paragraph all the other provisions for determining the charge of the tax would apply. Thus, if the deemed consideration is reinvested under section 54E in approved forms of investments, the taxpayer would qualify for the exemption of tax on capital gains.

I-9.22. It is possible to come across situations which represent a combination of the two types of operations referred to in the preceding paragraphs. An assessee may first revalue his capital assets and thereafter introduce such assets at the revalued figure in a partnership firm. It would follow from the recommendations made by us earlier that in such a case there would be no liability to tax on the mere revaluation of the asset. However, the subsequent introduction of the asset into the partnership firm would be deemed to be a transfer and tax on capital gains would be attracted in the manner recommended in para I-9.18 above.

I-9.23. Section 47 also excludes from the scope of taxation, capital gains arising on the transfer of capital assets between a holding company and its wholly-owned subsidiary company where the transferee-company is an Indian company. The justification for such an exemption is that a wholly-owned subsidiary is virtually part and parcel of the parent company itself. On the principle that a person cannot make profit out of himself, the transaction between the parent company and its 100 per cent subsidiary is exempted from tax on capital gains. This provision has, however, lent itself to various devices for tax avoidance. In the first place, when the asset changes its character from a capital asset in the hands of the holding company into a trading asset in the hands of the subsidiary company, there is avoidance of tax. The provision in section 49 requiring the adoption of the cost to the previous owner in the hands of the subsidiary becomes inoperative because the asset itself changes its character and becomes a trading asset. Again there is no prohibition on the de-linking of the holding-subsidary relationship within any period of time after the transfer of the assets to the subsidiary company. These aspects have led to a large number of transactions being ostensibly put through between the parent company and its wholly-owned subsidiaries formed for the purposes of tax avoidance. Ordinarily, depreciable capital assets would be transferred only at the book values because the actual cost and written down value of the asset to the transferee-company is to be taken as the same as that to the transferor-company. However, the exemptions under section 47(iv) and (v) have led to operations designed to avoid the levy of tax on capital gains. It is appropriate, therefore, that the abuse of the exemption provision should be prevented. This could be achieved by ensuring that the intent underlying the exemptions is not frustrated by the mere form of the transaction. Provision may, therefore, be made that the exemption under section 47(iv) and (v) shall be deemed to be wrongly allowed where within a period of 5 years after the transfer :

- (a) the relationship of holding company and wholly-owned subsidiary is altered, or
- (b) the subsidiary company does not, or ceases to, hold the capital asset as a capital asset.

As a consequence, the assessment would render itself open to rectification. We, accordingly, recommend that the exemptions under clauses (iv) and (v) of section 47 should be conditional upon fulfilment of the above stated requirements for a period of 5 years from the date of transfer.

I-9.24. Under the provisions of section 47, a transfer by way of gift and a transfer under a will does not attract tax on capital gains. Correspondingly, section 49 provides that in such cases and in cases of inheritance the cost of acquisition to the transferee shall be the cost to the previous owner. It has been represented that these transfers attract other forms of taxation, viz., gift-tax under the Gift-tax Act and estate duty under the Estate Duty Act. Both these taxes are levied with reference to the market value of the assets at the point of transfer. It

has, therefore, been urged that in case of subsequent transfers, the base for taxation should be such market value as adopted for the gift-tax assessment or the estate duty assessment, as the case may be. We are not in agreement with this suggestion inasmuch as the levy of gift-tax and estate duty cannot be equated to the scheme of taxation of capital gains. It is not a case of double taxation because the purpose of the gift-tax and the estate duty is to bring to tax the operations of transfer of wealth. The levy of tax on capital gains is to bring to tax the appreciation in the value of assets with reference to the cost of acquisition. The transfer at the point of gift or death does not attract a tax on capital gains though there is a change in ownership. The levy of tax on capital gains is thus held in abeyance until such time as the asset is realised by a transfer within the meaning of section 2(47). There is, therefore, a mere postponement of the liability to tax on the capital gains. There is, however, a case for grant of relief having regard to the incidence of gift-tax and estate duty. The tax in the form of gift-tax or estate duty being merely in the nature of a levy on the capital value of the property which is the subject of transfer falls directly or indirectly on the beneficiary. To that extent it is in the nature of a cost incurred by him so as to be left with that capital asset in his ownership. We, accordingly, recommend that the cost of acquisition of assets under a gift or by way of inheritance should continue to be the cost to the previous owner, which, however, should be increased by the proportionate amount of gift-tax or estate duty attributable to such asset so however that such increase does not result in the cost exceeding the value adopted for the purposes of gift-tax or estate duty. The proportionate part of the gift-tax or estate duty should in such cases be attributed on the basis of the average rate of tax.

I-9.25. Another difficulty to which our attention has been drawn is that the fiction of section 49 is in certain cases being applied literally. Where assets are acquired by way of gift, there could yet be situations under which the donee is required to incur certain expenditure either by way of improvements or obtaining possession of the asset. Typical instances may relate to freight and transportation charges necessary to bring the asset to the premises of the donee. It may be argued that such expenditure does not constitute cost of improvement. Such a technical view is divorced from the realities of the situation and should be discouraged. To place the matter beyond doubt we recommend that the cost of improvement as defined in section 55(1)(b) and referred to in sections 48 and 49 should include all expenditure incurred by a taxpayer in obtaining possession of the asset and establishing or completing full title thereto.

I-9.26. In a large number of cases transfers of capital assets may actually be effected at a value lower than the full market value of the asset, based largely on considerations of exigencies of business and not motivated by avoidance of tax on capital gains. In that context a fear of possible application of the provisions of section 52(1) or section 52(2) may be voiced. As regards section 52(1) the scope of the

operation of that provision has been clearly laid down by the Madras High Court in *Sundaram Industries Pvt. Ltd. v. CIT*, 74 ITR 243. In order to bring this section into operation there must be an object of avoidance or reduction of tax liability. This would not be the case where the transaction is *bona fide* and the consideration stated is genuine.

I-9.27. As regards the operation of section 52(2) it has been held by the Karnataka High Court in *Addl. CIT v. M. Ranga Pai and others*, 100 ITR 413, that the section does not aim at perfectly *bona fide* transactions where the full value of the consideration received has been correctly declared by the assessee. The section is aimed at transactions where the figure declared is lower than what is actually received. The section, therefore, cannot be literally construed and applied in the case of a genuine transaction. It has further been observed that the provision to section 52(2) which was added in 1965 is otiose. It appears to proceed on the incorrect assumption that the sub-section can be applied even to honest transactions where the real consideration is fully disclosed. In order to reiterate the correct position in law. We recommend that the assurance given by the Finance Minister in the Lok Sabha at the time of insertion of section 52(2) be incorporated in the section itself. Section 52(2) should apply to cases of understatement of the consideration which actually passes and should not apply to cases where nothing more than the declared consideration is received by or accrues to the assessee. Such an express clarification in the section on account of a contrary view being possibly taken on a literal construction of the section would give effect to the real motive underlying the provision. It would also be necessary in view of the fictional extension suggested by us in the earlier paragraphs to treat certain transactions as transfers though they are not transfers under general law.

I-9.28. The recommendation made above in regard to section 52(2) of the Act would also obviate another hardship to which our attention has been drawn. Under the present provisions, no capital gain is chargeable on a transfer by way of gift. The expression "gift" as used in section 47 may be construed to mean a gift as defined under the Transfer of Property Act, that is to say, a transfer of property without consideration. It may not, extend to gift as defined under section 4 of the Gift-tax Act. A transfer for inadequate consideration is deemed to be a gift for the purposes of levy of gift-tax. A taxpayer who sells his property at a lower consideration with a view to benefit the transferee would be regarded as having made a gift to the extent of the shortfall in the consideration. He would accordingly be liable to pay gift-tax. It could simultaneously be urged in the light of the position explained above that such a transaction does not fall within the exception in section 47(iii) and that, accordingly, the taxpayer is simultaneously liable to pay tax on the capital gains. Insofar as the tax on the capital gains is levied on the difference between the consideration realised and the cost of acquisition of the asset, there could be no injustice inasmuch as the levy is on the

actual capital gains realised. If, however, an attempt is made to invoke section 52(2) on a literal construction of the section and the difference between the fair market value and the declared consideration is brought to tax as deemed capital gains, this would be a case of hardship. It is, of course, arguable that the same amount cannot be fictionally treated as a gift for the purposes of the Gift-tax Act and also be fictionally treated as a capital gain for the purposes of the Income-tax Act. The majority decision of the full bench of the Kerala High Court in *ITO v. K. P. Varghese*, 91 ITR 49, is to the effect that both the levies could be sustained. A different view was, however, expressed by the Chief Justice in his dissenting judgment. The controversy arising in the matter would be set at rest by the recommendation made by us earlier. If section 52(2) is not applied to *bona fide* transactions, in cases where the document of transfer expresses the clear intention of gift or concession, there would be no case of invoking that provision and bringing to tax fictional capital gains. We, accordingly, recommend that where evidence of a gift or a deemed gift is available in relation to the transfer of a capital asset, the question of applying the provisions of section 52(2) should not arise. This would follow upon our earlier recommendation in regard to the scope of the operation of section 52(2).

I-9.29. Capital gains are brought to tax either in relation to short-term capital assets or long-term capital assets. As regards short-term capital gains, there is no special method for determination of the tax liability thereon. As regards long-term capital gains, the Income-tax Act provides for a concessional treatment. In the case of companies, a concessional rate of tax is provided for in section 115. The rate is thus not determined by the Finance Act. At present the rate of tax is 50 per cent in respect of capital gains relating to immovable properties and 40 per cent for other capital gains. These rates are lower than the general rates of tax applicable to companies. In the context of differential rates of tax between widely-held companies, closely-held industrial companies, closely-held non-industrial companies, etc., the adoption of flat rates for taxation of capital gains largely involves the same burden on all these different classes of companies. The differential rates of incidence of tax as applicable to their other incomes is not reflected in the incidence of tax on long-term capital gains.

I-9.30. In the case of non-corporate assessees, however, the Act does not lay down the rates of tax but provides for a deduction from the income under section 80T. In effect section 80T provides for a deduction of Rs. 5,000 plus 25 per cent of the capital gains relating to immovable properties or 40 per cent in the case of other capital assets. By this method whatever be the differentials in the rates of tax between different non-corporate taxpayers they get automatically reflected in the incidence of tax on the long-term capital gains too.

I-9.31. There is no particular merit in this different treatment between companies and other taxpayers, we recommend that the scheme for allowing deduc-

tion of a portion of the long-term capital gains should be applied both to corporate taxpayers and non-corporate taxpayers.

I-9.32. There are specific provisions in sections 53, 54, 54B, 54D and 54E for grant of exemption from tax on capital gains. The exemption under section 53 relates to capital gains arising from the transfer of house properties with lands appurtenant thereto. If the consideration for the transfer does not exceed Rs. 25,000 and the aggregate fair market value of all house properties belonging to the assessee prior to the transfer does not exceed Rs. 50,000, the transfer does not attract tax on capital gains. These monetary limits for grant of exemption have been fixed several years back. Since then there has been a fall in the value of the rupee as also a steep increase in the market value of house properties. In the Budget for the year 1977-78 it has been recognised that over a length of time in a world of rapid and continuing inflation, capital gains tend to be, to a great extent, illusory in nature. There is, therefore justification for enhancing these monetary limits to more realistic levels. We, accordingly, recommend that the limits of Rs. 25,000 and Rs. 50,000 specified in section 53 should be doubled to Rs. 50,000 and Rs. 1,00,000 respectively.

I-9.33. The concession under section 54 of the Act is intended to exempt capital gains arising on the sale of a residential property where there is re-investment in another residential property. The section provides for conditions to be satisfied in relation to the use of the property for the purposes of the residence of the taxpayer or the taxpayer's parents, in the two years preceding the date of transfer. A construction that has been placed on this condition is that the property need not have been in use as a residence for a period of two years and it was adequate if the residential use was for any time in the two-year period. A literal construction of the language of the section in this manner would defeat the underlying intention of the concession. The very basis of the concession is that where a taxpayer is the owner of his residential premises, he should not be charged to tax on the capital gains when he disposes of this residence and acquires another property for his own residence. The requirement of user may be stipulated as the full period of 365 days preceding the transfer.

I-9.34. Other difficulties in relation to the operation of the concession have also been brought to our attention. A view has been expressed that the section applies only to individuals and not to other assessees such as Hindu undivided families. The practice of residential properties being owned by Hindu undivided families and members of the family residing therein is quite prevalent in the country. Denial of the concession to Hindu undivided families would be unwarranted. Another issue which arises is where the new house is acquired for the purposes of residence of parents of the taxpayer. The section at present permits a reinvestment only for the purposes of the taxpayer's own residence. It would be appropriate to extend the concession to the repurchase of a house for the residence of the taxpayer's parents.

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I-9.35. Still another difficulty to which our attention has been drawn is that the section refers to buildings, the income of which is chargeable under the head "Income from house property". Under section 27 of the Act, the income of ownership flats in co-operative societies is chargeable in the hands of the members and a member is fictionally considered as the owner of that part of the building. It is appropriate that in cases where buildings cannot be owned by taxpayers, the fiction as contained in section 27 should also be extended to section 54, as the underlying condition in that provision relates to such property the income of which is chargeable under the head "Income from house property". We, therefore, make the following recommendations in regard to section 54 :

- (1) The house property in respect of transfer of which exemption from tax on the capital gains is provided should have been used by the taxpayer or his parents throughout a period of 365 days preceding the date of transfer. The user for residence should not require the physical occupation in all the days of the year but it should suffice if the property is retained for their occupation in contradistinction to its being let out.
- (2) It should be clarified that the benefit under the section is not to be restricted only to individuals but is available to Hindu undivided families as well.
- (3) It should be clarified that residential units in Co-operative Societies also qualify for the benefit under Section 54 and the fiction in Section 27 should be read into Section 54. In the light of our observations in Chapter 7 of this report regarding buildings owned by Companies similar to housing Co-operative Societies, residential units in such buildings should also qualify for the benefit under Section 54.
- (4) The new Acquisition may be made either for the Taxpayer's own residence or for that of his parents.
- (5) The period within which the new Asset has to be constructed or acquired may be allowed to be extended by the Commissioner in appropriate cases where he is satisfied that the delay is caused for reasons beyond the control of the Assessee.

I-9.36. The exemptions under the sections 54B and 54D are also conditional upon acquisition of fresh assets within a stipulated period. To overcome genuine cases of hardship occasioned by delay in compliance for just and sufficient cause we recommend that the Commissioner should have the power to extend the time limit for acquiring the new Asset for purposes of the exemptions provided in Sections 54B and 54D.

I-9.37. Section 54E which was introduced in the law from the 1st April, 1978, makes a special provision for exemption from tax of long-term capital gains if the sale proceeds are invested in any of the

specified modes laid down in the section. In order to qualify for full exemption the section requires the reinvestment of the full value of the consideration in approved assets. It can be appreciated that this concession is granted where there is a change of the holding from one form of capital asset to another form, the latter being within the specified category. To that extent it is logical that it does not merely require the reinvestment of the capital gains but requires reinvestment of the sale proceeds. It should, however, be noted that under section 48 it has been expressly recognised that from the full value of the consideration a deduction should be permitted for expenditure incurred wholly and exclusively in connection with the transfer. There could be cases where such expenditure is incurred by the seller and he would thus not be in a position to reinvest the full sale proceeds. There would be partial denial of the concession in his case. This appears to be clearly unintended. We, accordingly, recommend that the requirement of reinvestment should be with reference to the full value of the consideration less expenditure incurred wholly and exclusively in connection with the transfer.

I-9.38. It may be noticed that section 54 of the Income-tax Act provides for concessions in relation to capital gains realised on the sale of residential properties where there is reinvestment in another residential property. Under section 54E the exemption is conferred on any capital gains where the sale proceeds are reinvested in specified assets. A taxpayer may realise his capital assets with the objective of acquiring a house for the purposes of his own residence. Such a situation would fall outside the present exemptions under section 54 and 54E. We have already recognised that there should be a general encouragement to taxpayers to own accommodation. The exemption under section 54 only operates when a taxpayer already owns a residential accommodation. It is desirable that a taxpayer who converts his capital assets for the purpose of acquiring a residential accommodation should likewise be entitled to exemption from tax on capital gains. This can be achieved by the inclusion of one residential house for the purpose of the residence of the taxpayer or his parents, as one of the approved categories of assets enumerated in section 54E. We, accordingly, recommend that specified Assets in Section 54E for the purpose of reinvestment should include one residential house for the use of the taxpayer or his parents.

I-9.39. Section 54E also lays down certain restrictions in regard to the non-transferability of the new assets. The objective is to limit the concession only to cases where the consideration is utilised in approved categories of investment to be held for a minimum period of three years. There may be cases where this condition may have to be breached. A taxpayer who has effected such reinvestment may die and his legal heir may have to realise the assets for payment of estate duty. Again, a taxpayer may have to realise a part of the investments for any sudden or unexpected eventualities. We, accordingly, recommend that where the realisation is made for

the purposes of payment of estate duty on the death of a taxpayer, it should not involve liability to tax on capital gains. Further it may be suitably clarified that realisation of a part of the new Assets would entail taxation of only proportionate amount of capital gains originally exempted from tax.

I-9.40. Apart from the circumstances set out in the preceding paragraph, the death of a taxpayer would result in succession to the capital assets by his legal heirs. Such succession should not by itself be regarded as a breach of the condition of holding the specified assets for the period of three years. In such cases, if the successor by inheritance continues to hold the assets for the balance duration of the term, there should be no liability to tax on capital gains. We, accordingly, recommend that the passing of the specified assets to the legal heirs in the case of death of a taxpayer should not entail consequences of Sub-section (2) of Section 54E provided such legal heirs continue to fulfil the condition of holding the specified Assets as would have applied to the taxpayer were he alive.

I-9.41. Still another area of difficulty in relation to section 54E is the requirement of the reinvestment within a period of six months from the transfer. There are several transactions particularly in relation to immovable properties or large holdings of other capital assets where the payment of the price may be deferred. In such cases, the taxpayer would not have the requisite funds in his possession to make the reinvestment. The denial of the benefits in such cases is not justified, particularly as the condition of reinvestment laid down is, in the circumstances, impossible of fulfilment. We recommend that the Commissioner of Income-tax should be given discretion to extend the time limit for reinvestment in the specified Assets where the receipt of the consideration for the transfer of the original Assets is deferred.

I-9.42. The section requires the investment in the specified assets to be made by the "assessee". A doubt may arise in regard to the operation of this condition where the capital gain may require to be clubbed in the hands of another person by virtue of the operation of section 64. The sale proceeds can in such cases only be reinvested by the vendor of the capital asset and not by the person in whose hands the capital gains would be includible for taxation. We, therefore, recommend that the position may be clarified by suitable instructions to the effect that where the vendor of the capital Asset reinvests the sale proceeds in compliance with the provisions of Section 54E, the benefit of the exemption under that section should be available, and accordingly, the operation of the clubbing provisions under Section 64 would be subject to such exemption.

I-9.43. The provisions of section 54E were designed to reduce the inequitable nature of the tax on capital gains. A reference has already been made to the observations of the Finance Minister that in times of continuing inflation, capital gains tend to be largely illusory. Lord Shawcross, the eminent

jurist who was the Attorney General of the United Kingdom, has characterised the levy of tax on capital gains as the greatest fraud in the history of fiscal legislation if the tax is levied without taking into account the depreciation in the value of currency. The phenomenon of progressive erosion in the value of the rupee is one which is inevitable and has come to stay. The injustice is to some extent mitigated by advancing the right of substitution of the cost of acquisition by the fair market value, from that as on 1st January, 1954, to that as on 1st January, 1964. Such adjustments tend to be ad hoc because absolute stability in the value of the currency is an ideal difficult to achieve. The appropriate measure to meet the needs of the situation would be to determine the date of such substitution not on a fixed basis but on a moving basis which may be, say, ten years preceding the last day of the previous year on which the transfer takes place. This suggestion has relevance because the continued existence of section 54E on the statute book cannot necessarily be assumed. It is, therefore, appropriate and fair that capital gains are measured in a realistic manner quite apart from the reliefs which may be available to prevent the tax on capital gains becoming in essence a tax on capital. We, accordingly, recommend that the right of substitution of the cost of Acquisition should not be with reference to the market value on 1-1-1964 but should be with reference to the market value on the day ten years preceding the last day of the previous year in which the transfer takes place.

I-9.44. The definition of the expression "capital asset" has been varied from time to time. Agricultural lands were totally outside the definition until a few years back when the exclusion was restricted to agricultural lands outside urban areas. Cases may also arise where assets originally exempted from the definition of capital asset subsequently fall within the definition. In such cases it is appropriate that the asset which originally did not attract liability to tax on capital gains should not subsequently attract full liability to such tax. The Gujarat High Court in *Ranchhodbhai Patel v. CIT*, 81 ITR 446, has held that where agricultural land was converted into non-agricultural land, the capital gains should be determined with reference to the cost of acquisition of the agricultural land. The assessee was denied the right to deduct the market value of the land on the date of its conversion into non-agricultural land. The effect of this denial is to bring to tax even the portion of the appreciation as relates to the period when the asset did not attract any liability to tax on capital gains at all. Had the asset been disposed of as agricultural land in the past, the appreciation to that extent would not have been taxed. The denial of such exemption is, therefore, a hardship caused to taxpayers. We recommend that a specific provision should be made to ensure that when an Asset which fell outside the definition of Capital Asset when acquired but which later comes within the scope of the definition, is transferred, the cost of acquisition of the Asset to the taxpayer should be taken to be the fair market value of the

Asset as on the date when it fell within the definition. The effect of this recommendation would be to protect the exemption available in respect of the appreciation in the value of the asset during the period when it was outside the definition of "capital asset". As a corollary to this recommendation, we recommend that for determination whether the Asset is a short-term or long-term Asset, the date of reckoning should be the point of time when the Asset came within the definition of Capital Asset.

I-9.45. Under section 55(2)(v) in the cases of restructuring of capital enumerated therein the cost of acquisition of shares and stocks are to be calculated with reference to the cost of acquisition of the original shares and stocks. Shares in the capital of a company may be consolidated or sub-divided or converted from one kind into another. In all such cases the resultant share that is held may constitute a separate asset from the original share from which it was derived. It is appropriate in all such cases to treat the capital asset as one and the same, viz., the original asset from which the new asset has been derived. Whilst this is the position for the purposes of determining the cost of acquisition, a corresponding provision is not contained in section 2(42A) for determining the holding period of the asset. It is appropriate that the determination of the short-term or long-term character of such assets should also be determined with reference to the original shares or stocks from which the asset is derived. We recommend that a clarificatory amendment should be made in Section 2(42A) to include the contingencies contemplated in Section 55(2)(v) for determining the period for which such Capital Assets are held by the taxpayer.

I-9.46. Another concession available in regard to the taxation of capital gains is that contained in section 280ZA of the Act. That section is part of Chapter XXIIB dealing with tax credit certificates. The other provisions in that Chapter have become largely defunct as the entitlement to tax credit certificates under other circumstances no longer exists. Section 280ZA provides for relief in the form of tax credit certificates with reference to the tax on the capital gains arising on the sale of land and buildings used for the business of an industrial undertaking in an urban area pursuant to shifting the undertaking to any other area. The entire tax liability on such capital gains is refunded through tax credit certificates on the basis of the proportion between the expenditure on acquisition of lands and buildings in the other area and shifting the undertaking thereto and the quantum of the capital gains. In the process of determination of the capital gains liable to tax it would not be appropriate to provide for the grant of tax credit certificates or refund of taxes. However, the concession can be effectively built into the computation provisions themselves on a parallel with section 54D of the Act. Section 54D provides for a relief with reference to reinvestment of compensation money arising out of compulsory acquisition of business undertakings. The same benefit could be extended to the capital gain on the sale of land and buildings in the urban area and relating it to the cost of the new assets in any other area

as well as the cost of shifting the undertaking. We, accordingly, recommend that the tax credit Certificates Scheme under Section 280ZA may be discontinued and the capital gain arising in the circumstances mentioned therein be accorded similar treatment as under Section 54D of the Act.

I-9.47. Under extensive amendments made through the Finance Act, 1978, situations arising out of grant of additional compensation with reference to compulsory acquisition of capital assets or receipt of additional consideration, as a result of enhancement by any court etc., have been dealt with. Because of the charging provision under section 45, the grant of additional compensation by any court, tribunal or other authority would attach to the transfer and be notionally chargeable with reference to the year of transfer. This, accordingly, necessitates rectification of the original assessment for which provisions have been made in section 155. The position is further complicated if the taxpayer has availed of any of the advantages for exemption under section 54, 54B, 54D or 54E. The delayed receipt of additional compensation or consideration may leave the taxpayer with no remedy to utilise the additional amount in the manner contemplated in the exempting sections. The law has made express provision to grant further opportunity to the taxpayer to avail of the exemptions with reference to the additional amount.

I-9.48. The entire complication in these provisions can be attributed to the scheme of taxing the capital gains in the year of transfer. The same effect could have been achieved in a much simpler manner. The law could have expressly provided that in cases where the capital asset was transferred by way of compulsory acquisition, the additional compensation or consideration received in a later year could be brought to tax in such later year. Such a modification would obviate the revision of completed assessments after several years. Similarly the concessions originally availed of under sections 54, 54B or 54D need not be disturbed. It would have been appropriate to confer the exemption for reinvestment of the additional compensation in accordance with section 54E. This would have made the law simpler and easier of application. **We recommend that additional compensation or consideration received with reference to compulsory acquisition of Capital Assets, should be deemed to be the Income of the year in which it is received and not of the year of transfer of the Capital Asset. The taxpayer should be entitled to the exemption under Section 54E with reference to the date of receipt of such additional compensation. These provisions should likewise apply to cases where consideration originally determined by the Central Government or the Reserve Bank is subsequently enhanced.**

I-9.49. The discussion in the preceding paragraphs relates to cases of enhancement of compensation. The possibility of the reverse situation must also be recognised. We understand that there are several instances where, in subsequent proceedings, apart from enhancement of compensation there may,

in fact, be a reduction of the compensation. It is, therefore, appropriate in the scheme of things that if enhancement is brought to tax, in like manner, reduction should result in relief in tax. **We, accordingly, recommend that where compensation referred to in the preceding paragraphs is subsequently reduced, specific provision should be made to correspondingly rectify the relevant past assessment.**

I-9.50. We have in the course of our recommendations suggested the curtailment of the exemptions under clauses (iv) and (v) of section 47. The observations made earlier would ensure that transfers of capital assets between holding and wholly-owned subsidiary companies which are motivated by genuine business considerations would not attract any adverse consequences in regard to the incidence of tax on capital gains. Likewise they would not artificially distort the allowance by way of depreciation in the hands of the transferee-company. The Income-tax Act likewise has a series of provisions which ensure that amalgamations of companies effected under the provisions of company law do not result in any adverse tax consequences under the Income-tax Act. Express provisions contained in clauses (vi) and (vii) of section 47, clause (2) of the Explanation to section 32(1)(iii), sub-section (5) of section 32A etc., ensure that no tax on capital gains is levied, no balancing charge is made and no withdrawal of investment allowance is effected consequent to amalgamation. The law on the contrary makes express provision for conferring the benefit of unabsorbed investment allowance to a transferee company under a scheme of amalgamation by virtue of sub-section (6) of section 32A. The apprehension of the risk of deemed dividend being brought to tax under section 2(22) in respect of a scheme of amalgamation of a wholly-owned subsidiary company with the holding company has been allayed by a circular of the Central Board of Direct Taxes. Recently, in recognition of the need to promote amalgamation of sick units, section 72A has been enacted to further expressly allow benefits available to the sick units to the amalgamated company which, but for such provision, would have lapsed. In our Interim Report we have referred to the provisions of this section 72A (vide Chapter 4). It has been represented to us that similar to amalgamation of companies, there may be instances of reorganisation or reconstruction of businesses which is necessitated by economic consideration similar to considerations which motivate an amalgamation. Again under section 27 of the Monopolies and Restrictive Trade Practices Act, division of large-sized industrial undertakings may be compulsorily effected by the Central Government in the circumstances mentioned therein. Section 54D of the Income-tax Act recognises that the levy of tax on capital gains arising out of compulsory acquisition of capital assets should be mitigated and provides for exemption from tax on capital gains where the capital gain is reinvested in setting up another industrial undertaking.

I-9.51. The provisions relating to amalgamation as contained in the Income-tax Act are largely aimed at overcoming tax obstacles which may prevent amalgamations brought about for economic considerations. Such economic considerations would have equal force in other forms of reorganisation which may involve

separation of business units from companies or other similar structural reorganisations. Where such reorganisations are effected in the public interest to the satisfaction of the Central Government or alternatively, where such reorganisations are effected on the specific directions of the Central Government, it is appropriate that the provisions corresponding to the provisions applicable to amalgamation of companies should be made in the Income-tax Act. This could be achieved by first defining the concept of "scheme of reconstruction" to include any scheme or arrangement involving the division of any undertaking or any part or parts thereof which is either carried out under the directions of the Central Government or which has the approval of the Central Government as being in the public interest. Having defined the expression, the provisions corresponding to the scheme of amalgamation contained in section 32, section 32A, section 33, section 33A, section 34, section 43, section 47 and section 49 should be made applicable to such schemes of reconstruction. The administrative circular so far as it applies to section 2(22) *quâ* amalgamations should be expressly extended to schemes of reconstruction. There should be no question of taxing any deemed dividend under any of the clauses of section 2(22) and to that effect express provision would have to be made. The clarificatory provision in section 45 of the Gift-tax Act should also be likewise extended to schemes of reconstruction. At the present stage, however, we are not in favour of extending any corresponding provisions as under section 72A to schemes of reconstruction as no case has yet been made out for conferring tax benefits to promote schemes of reconstructions as distinct from removing the obstacles in the way of schemes of reconstruction in public interest. All these provisions are necessary because schemes of reconstruction may involve one or more of the following :

- (a) the transfer or vesting of property, rights, liabilities or obligations ;

- (b) the adjustment of contracts either by discharge or reduction of any liability or obligation, or otherwise ;
- (c) the creation, allotment, surrender or cancellation of any shares, stock or securities ;
- (d) the payment of compensation ;
- (e) the formation, or winding up of an undertaking, or the amendment of the memorandum and articles of association or any other instruments regulating the business of any undertaking ;
- (f) the continuation, with such changes as may be necessary, of parties to any legal proceeding ;
- (g) the adjustment of the rights of shareholders or creditors or any class of shareholders or creditors ;
- (h) the dissolution of any company.

Inasmuch as one or more of these features may involve adverse consequences under the tax law in the form of levy of tax on capital gains, levy of balancing charge, withdrawal of investment allowance, etc., it is necessary to make express provisions in the Act. The interests of revenue would be adequately safeguarded because, by definition, a scheme of reconstruction which would qualify for consideration under these provisions would be only such as is either directed by the Central Government or approved by the Central Government on grounds of public interest. We, accordingly, recommend that provisions broadly corresponding to the removal of obstacles in relation to amalgamation of companies under the income-tax act should be extended to schemes of reconstruction as defined under the income-tax act. Accordingly, in relation to such schemes of reconstruction the law should expressly provide that there should be no tax liability of any kind and that the relevant allowances shall continue.

CHAPTER 10

INCOME FROM OTHER SOURCES

I-10.1. Part F of Chapter IV of the Income-tax Act, comprising sections 56 to 59, deals with computation of income under the head 'Income from other sources'. This head of income is intended to be a residuary head to include all items of income which are not chargeable to tax under the earlier five heads. However, under section 56(2)(i) income by way of dividends is specifically chargeable under this head. This provision has the effect of over-riding the earlier general provision. The effect of this clause is that all dividends are taxable under this head even if they are derived from shares held as stock-in-trade.

I-10.2. We do not see any particular merit in affording such a special treatment for the taxation of income by way of dividends. Earlier we have recommended that the separate head "Interest on securities" should be dropped and income now falling under that head should be charged under the residuary head. We have in that context expressly suggested that if the income is such as is chargeable under the head 'business' it should be charged under that head and not under the residuary head. This is because of the general consideration that what is clearly and truly business income should appropriately be computed under the specific head of profits and gains from business and a reclassification of such income under another head would be artificial. On the same ground we are of the view that where dividends are in the nature of profits and gains of business (as in the case of a taxpayer who receives dividends on shares held by him as stock-in-trade), such dividends should be computed along with the business income under the head "Profits and gains of business or profession". It is only in cases where dividend does not constitute business income that it should fall to be assessed under the residuary head. We, accordingly, recommend that the provision in section 56(2)(i) bringing dividends to tax under the head 'income from other sources' in all cases should be deleted.

I-10.3. It would follow from the recommendation made in the preceding paragraph that dividend income would be business income in a set of cases and income from other sources in other cases. Where income is in the nature of business income it would be more appropriate and convenient if such income is computed in accordance with the method of accounting regularly employed by the taxpayer. The ascertainment of business profits would ordinarily be made under one of the well recognised methods of accounting which are supported by commercial practices. In these circumstances it is necessary to reconsider the provisions in section 8 of the Income-tax Act which provide for a fiction in regard to the year in which dividend income is to be included in the total income. So far as interim dividends are concerned, the present provision in sec-

tion 8(b) would be appropriate as it follows the law laid down by the Supreme Court in *J. Dalmia vs. C.I.T.*, 53 ITR 83. However, as regards section 8(a) which deals with dividends other than interim dividends, some modification would be necessary. Historically, such dividend was includible when it was paid, credited or distributed. The present section provides for inclusion of dividend when it is declared, distributed or paid.

I-10.4. There appears to be no particular merit in adopting the date of declaration of dividend as the test for determining the year in which it should be subjected to tax. It may lead to difficulties in the matter of obtaining credit for tax deducted at source under section 199 to which a reference has been made in Part II of this Report. The scheme for deduction of taxes at source is correlated with the dates of payment. Again the provisions in regard to distribution of dividends have been considerably rationalised under the Companies Act, 1956. There is now a mandatory requirement to effect distribution of dividends within 42 days from the date of declaration. The deletion of the reference to declaration in section 8(a) would, therefore, not make any material difference and the only consequence would be that the year of chargeability of a dividend would be reckoned with reference to distribution or payment. In marginal cases it may result in a shift of the year of taxability from one year to another.

I-10.5. A further point to be noted is that when dividend income is charged as business profits, the taxation of the dividend as income of the year in which it is declared would needlessly interfere with the method of accounting. From this point of view also the deletion of the reference to declaration in section 8(a) would be appropriate. We, accordingly, recommend that dividend income other than interim dividends should be taxable in the year in which the dividend is distributed or paid.

I-10.6. Taxpayers who maintain regular books of account would thus offer the dividend for tax whether as business or as income from other sources, in accordance with their method of accounting. Such method of accounting would ordinarily take credit for the dividend with reference to the distribution or payment and the fiction of treating it as income of the year of declaration would, therefore, be unnecessary.

I-10.7. Section 58 of the Income-tax Act draws reference to certain sections of the Act dealing with computation of business income and specifically extends the application of these sections to the computation of income under the head "income from other sources". Our observations in Chapter 3 and Chapter 8 of this

Report on those sections would, therefore, correspondingly apply even in relation to computation of income under this head.

I-10.8. The proviso to section 57 expressly disallows the claim of expenditure against income by way of

dividends earned by a foreign company. There is no justification for disallowance of such expenditure and taxing the gross receipt particularly when income-tax is a tax on income and not on gross receipt. We, therefore, recommend that the proviso to section 57 should be deleted.

CHAPTER 11

INCOME OF OTHER PERSONS INCLUDED IN ASSEESSEE'S TOTAL INCOME

I-11.1. Chapter V of the Income-tax Act, comprising section 60 to 65, deals with situations where income of other persons is to be included in the total income of a taxpayer. The provisions relating to such inclusion with reference to revokable transfers of assets as contained in section 60 to 63 are well settled and do not call for any further modification.

I-11.2. As regards the provisions of section 64, they are principally aimed at clubbing the income of a spouse or minor child of the taxpayer in the circumstances specified therein. Under the amendments made by the Taxation Laws (Amendment) Act, 1975, the clubbing has been extended, in certain circumstances, to the income of the son's wife or the son's minor child, apart from further tightening up of the provisions for clubbing the income of the spouse or minor child. It has been recognised that one of the methods of tax avoidance is the diversion of income to the spouse or minor children by taxpayers. With a view to preventing such avoidance, section 64(1) enumerates seven different contingencies for clubbing the income. One of the suggestions made to us was that these provisions could be considerably simplified by the introduction of the concept of a family comprising of husband, wife and minor children, as a taxable unit. The concept of the family as a unit of assessment has been discussed for almost the last ten years, when a suggestion to this effect was contained in the budget speech. We have carefully examined this suggestion. This concept, in our view, has far-reaching implications and repercussions on the independent status of women and their right to hold property and earn income under our law. It may also be detrimental to the interests of a large number of middle class families where women have to work to supplement the family income. It may be urged that these aspects could be taken into consideration if provisions were made to exclude various categories of income from particular sources and incomes from what is popularly known as "streedhan" from the scope of joint tax liability. Any such scheme to our mind would be far from simple in operation and would not be a better alternative to the scheme of clubbing of income in specified circumstances as contained in the present section 64(1). Moreover, in the context of the Hindu undivided family being a separate taxable unit, further complications would arise in evolving yet another separate taxable unit. It would considerably distort the law in regard to the Hindu undivided family as a taxable unit where the law has evolved and is now reasonable well settled by several judicial pronouncements. In view of these and other considerations We are not in

favour of substituting the present provisions for clubbing of incomes under section 64(1) by the adoption of a family as a unit of assessment.

I-11.3. One of the circumstances under which the income of a minor child is clubbed with that of its parent is the income from the admission of the minor to the benefits of partnership in a firm. Prior to the amendment made in 1976, such clubbing only operated if the minor was admitted to the benefits of a partnership in which either parent was a partner. It was observed that the advantage of admitting minors to the benefits of partnership had unfortunately been misused widely. It was even suggested at one stage that the Partnership Act should be amended to prevent the admission of minors to the benefits of partnership. It was also observed that the clubbing provision was easily avoided by the admission of minors to the benefits of partnerships in which neither parent is a partner. Having observed the large-scale misuse of this facility, section 64 was amended to provide for clubbing of the income of the minor from admission to the benefits of any partnership with the income of the parent irrespective of whether or not either parent was a partner in the same firm.

I-11.4. Our attention has been drawn to instances where the new provisions are being circumvented by the interpolation of a trust for the benefit of minors and the trustees of such trusts entering into partnerships. According to this device, a trust is created for the benefit of minors with express power to the trustees to utilise the trust funds by way of investment in business enterprises and partnerships. The legal position under partnership law is that the partnership is the relationship between the persons who are named as partners and the fact that a partner is in turn accountable for his share of income to any third party is irrelevant to the partnership. The introduction of a trust takes advantage of this position under the partnership law and seeks to avoid the clubbing under section 64(1). It is appropriate that the adoption of such a device is countered and the underlying provisions of the section are given proper effect. We, accordingly, recommend that where a minor receives income as a beneficiary under a trust and such income is derived from the profits and gains of business carried on by the trustees in partnership with others, such income of the minor should be added to the income of the parent. The clubbing provision in section 64 should be extended to cover such cases.

I-11.5. It would follow from the recommendations made in the earlier paragraph that the device of a

trust which is used to avoid the clubbing of the income of a spouse under the circumstances presently contained in section 64 should likewise be countered. Accordingly, we recommend that if the spouse is a beneficiary under a trust and the trustees join in partnership with the individual, the clubbing provisions as presently contained in section 64(1)(i) and explanation 1 should become applicable.

I-11.6. The provisions for aggregating income of the spouse under clause (i) of section 64(1) has led to a dispute in regard to the treatment of losses which may fall to the share of the spouse from the partnership. The Gujarat High Court in *Dayalbai Vadera vs. CIT* (60 ITR 551) has ruled that the section contemplates inclusion of income and, accordingly, the share of loss arising to the spouse cannot be set off against the total income of the other spouse. The Karnataka High Court in *Kapadia vs. CIT* (87 ITR 511) has dissented from this view and has held that income in this section includes a loss. On general principles, income from membership in a firm would include a loss and the context of clause (i) of sub-section (1) does not warrant the contrary construction. The liability to assessment cannot alternate from year to year between the individual and the spouse depending on whether there is a profit or a loss. Besides, in the absence of other income, the right to carry forward the loss in a running business would be completely lost if the individual is to be vicariously liable when there is a profit and the loss is to remain a dead loss in the assessment of the spouse. Apart from the construction of the existing provisions, in the interest of equity as well, it is appropriate that income referred to in section 64 should include losses. Accordingly,

if the income which is subject to clubbing under the section is negative amount, such negative amount should be available for set off in the income of the individual in whose hands the clubbing has to be given effect to. We, accordingly, recommend that income referred to in section 64(1) of the act should include loss.

I-11.7. Sub-section (2) of section 64 deals with another situation of clubbing in regard to Hindu undivided families. Where an individual, being a member of such a family, converts his separate property into property belonging to the family and thereby diverts income to the family, the section provides for the inclusion of such income in the hands of the individual. The section applies to cases where such conversion takes place through the act of impressing separate property with the character of family property or throwing it into the common stock of the family. Recently in the case of *C.I.T. vs. J. G. Shah*, the Supreme Court has held that the section is inapplicable where the conversion takes place by a direct gift. As the effect of gift is essentially not different from the other forms of conversion referred to in the section, the circumvention of the provisions of section 64(2) by adopting the form of a gift, should be prevented. The intention underlying section 64(2) is to cover the cases of conversion and the diversion of income and wealth achieved thereby. We, recommend that section 64(2) should apply to all cases of conversion of individual property into joint family property by a member otherwise than for adequate consideration whether by the act of impressing the property with the character of family property or by throwing it into the common stock of the family or by gift.

CHAPTER 12

SET OFF AND CARRY FORWARD OF LOSSES

I-12.1. Sections 70 to 80, in Chapter VI of the Income-tax Act, deal with the provisions for carry forward and set off of losses. The scheme of the law, at present, is reasonably clear and well settled by judicial pronouncements. Within the same assessment year a taxpayer has the right to set off losses under any source under any head against his profits from any other source under the same head, and to set off the remaining loss, if any, under that head against income under any other head. This is, however, subject to the special treatment in respect of long-term capital losses, speculation losses, and certain types of casual losses referred to in section 74A where the right of such set off is restricted. As regards the unabsorbed losses of one year, the law confers a limited benefit of carrying forward such losses for set off against the income of a subsequent year or years. This benefit is only available in respect of business losses, losses under the head "Capital gains", short-term and long-term, and losses of a casual nature referred to in section 74A. Losses under the other heads of income are not eligible for being carried forward to a subsequent assessment year.

I-12.2. Various representations have been made to us to further rationalise these provisions. The first suggestion is that losses relating to income from house property and other sources which are not allowed to be carried forward to subsequent years under the present law should be allowed the facility of carry forward. The representation is to the effect that the charge for income-tax should be on positive income, whatever may be the method of computation, and if a taxpayer has suffered a loss in any year, his true chargeable income cannot be properly reflected unless such losses are first allowed to be set off. This point is of particular validity where the incidence of tax may operate at rates exceeding 50 per cent. It is also pointed out that tax laws of some progressive countries do not make any distinction between business losses and other forms of losses in the matter of carry forward and set off against income in subsequent years. It may be urged, on the other hand, that income-tax is an yearly tax levied with reference to a given year's income. Though the income-tax is an yearly tax, one cannot lose sight of the long-term aspects of its incidence over a period of years, particularly where some of these years result in a positive income and some others in a loss.

I-12.3. The incomes in the nature of business income, capital gains, and certain casual incomes are definitely susceptible to fluctuations and on that count may entitle the assessee to the benefit of carry forward. At the same time, incomes from house property as well as from other sources, which may not be exposed to fluctuations between years, may still

involve a deficit in one or more years to the taxpayer. So long as there is a valid deficit, computed in accordance with the rules of computation contained in the Income-tax Act, the fact that it is not brought about by cyclical changes is no justification for the denial of the right of carrying forward such loss. With a view to securing a broad measure of equity over a period of time it is only fair that losses of one year should be allowed to be adjusted against income of subsequent years. This principle of equity would equally apply to other categories of income such as income from house property and interest or dividend. There may be a case or circumstance where income from salary would result in a loss having regard to the scheme of taxation as recommended by us. We accordingly, recommend that losses relating to any source under any head should qualify for the benefit of carry forward and set off against income of subsequent years.

I-12.4. The next provision on which representations have been made to us is in regard to the carry forward of business losses. At present, this right of carry forward is subject to the condition that the business in respect of which the loss was sustained continues to be carried on in the subsequent year. This condition is a relic of the 1922 Act under which carry forward and set off of business loss was allowed only against the income from the same business in the subsequent years. When this provision was liberalised under the 1961 Act, so as to allow set off against income from any business (including the one in which the loss was incurred) the said condition was imposed. There is no stipulation in the section that the business should continue to be carried on at the same level of activity. Such a condition may not be sustainable on economic grounds, insofar as it compels the taxpayer to continue a losing business merely for the sake of qualifying for the set off of loss. There may be circumstances where it is impossible to rehabilitate a business and to make it a viable proposition. The condition has further led to considerable litigation to determine whether the loss-making business was in fact in existence or not and was continued to be carried on in the subsequent year. Various tests are required to be applied to determine whether the same business is in fact also carried on in the subsequent year. In our view, the fundamental decision whether a loss-making business should be kept alive or not is one to be taken purely on business or commercial considerations. Such a decision should not be linked with the eligibility for a set off of losses for tax purposes. Such a set off in any event, is a proper deduction for arriving at the true profits of the taxpayer.

I-12.5. Another reason which may be advanced in justification of the condition is that, in its absence, loss-making business would be freely transferred or

losses may be built up in businesses and they may be quietly discontinued in later years. This apprehension, to our mind, is exaggerated. The Income-tax Officer has sufficient powers to determine the true profits or losses of a business carried on by the taxpayer. It is far fetched to imagine that a person would like to buy a concern which has been showing losses and which may not be viable, merely to reduce the tax on his other income. Such reduction is only possible if factually a loss is incurred by the taxpayer. The set off of such loss against taxable income does not result in recoupment of the whole of the loss from the Government out of tax revenues and a portion of such loss necessarily falls on the taxpayer. The law also does not enable a successor otherwise than by inheritance to claim the carry forward of the losses of the predecessor. In view of the considerations mentioned above. **We recommend that the carry forward and set off of business losses should be allowed without any condition that the business or profession in which the loss was sustained should continue to be carried on by the taxpayer in the subsequent years.**

I-12.6. The recommendations made in the preceding paragraphs would entail the carry forward of losses under the heads salary, house property, business and other sources. All these losses as well as short-term capital losses are to some extent similar in nature and interchangeable. The grounds which justify the carry forward of all such losses necessarily lead to the conclusion that there is no particular merit in limiting the set off of such losses against income under the respective heads in the subsequent year. The basic justification is that the true concept of taxable income cannot be derived unless and until losses suffered by the taxpayer are first set off. On this principle, the losses under the head salary, house property, business or profession, or other sources or short-term capital losses should be allowed to be carried forward and set off against the income in the subsequent year under any head. Such treatment cannot, however, be extended to losses on long-term capital assets and losses of a casual nature referred to in section 74A inasmuch as, such losses are of an exceptional or non-recurring nature. Again, the treatment of speculation losses, whether in the same year or in any subsequent year, should necessarily continue to be separate as at present. Barring the special treatment to such categories of losses, viz., long-term capital losses, losses from casual incomes under section 74A and speculation losses, all other losses may be carried forward in one lot and set off against future incomes without distinction. Such right of carry forward should be limited to a period of eight years following the year in which the loss is incurred. It would follow that when short-term capital losses are carried forward they would also form part of the consolidated loss alongwith losses under the other heads of salary, house property, business or profession and other sources and qualify for set off against other income. The present provision restricting the right of set off of short-term capital losses carried forward from earlier years only against short-term capital gains is not justified. **We, accordingly, recommend that losses relating to salary house property, business or profession, other sources, and short-term capital assets (but excluding losses in speculation business, long-term capital losses and losses referred to**

in section 64(A) should be allowed to be carried forward to subsequent years and set off against income of those years under the same head or any other head in the eight years following the year in which the loss is incurred.

I-12.7. Another suggestion received by us relates to the need for a provision in the income-tax law to permit a taxpayer to carry back current business losses and to have the same set off against his income of earlier years which has already suffered tax. This claim is sought to be justified on the ground that losses in a business cycle could be legitimately set off against profits earned during the earlier periods, just as a right is already conferred to set off such losses against profits of subsequent periods. It is further sought to be justified on the ground that taxation laws of some other countries like the United States of America confer such a benefit on the taxpayer. We have recommended in Chapter 8 of this Report that such a benefit should be extended to industrial undertakings which have suffered damage or destruction as a result of natural calamities, civil disturbances, etc., as contemplated in section 33B. We are, however, not in favour of making a general provision in this regard and extending the benefit to business undertakings in general. The position of an undertaking which is destroyed and which is in need of reconstruction, revival or re-establishment is different from losses occasioned in a normal business undertaking. The need in the former case is to replenish the resources of the business to facilitate the re-establishment, reconstruction or revival. So far as businesses in general are concerned, the risk of loss is inherent in them and the facility for set off of such losses against income of future years (extended in the manner recommended) is adequate to ensure that the levy of the tax is fair and reasonable. There is no sufficient justification for refunding taxes already collected in respect of profits already earned by the business. Such a procedure would, to some extent, distort the revenue projections of the Central Government and may also lend itself to hazardous or other similar operations by a taxpayer who has already paid large taxes on good business profits in earlier years. Again, a provision to this effect would create practical difficulties in implementation more particularly, as it would involve the revision of assessments which have been completed and refund of taxes already paid and accounted by the Government. The introduction of any such facility would also interfere with the smooth working of the scheme for general acceptance of returns and making of summary assessments which we have recommended in the Interim Report. For these and other reasons, **we are not in favour of providing for a general right to carry back business losses.**

I-12.8. The provisions of the law relating to losses of registered firms have led to certain practical difficulties. The losses of such firms are required to be apportioned amongst the partners in their loss-sharing proportions and it is the partners alone who have the right to set off such losses or carry forward such losses in their personal assessments. Such a provision is simple and logical so long as there is no separate incidence of tax on the firm. The provisions have, however, become inequitable in the context of the levy of the separate tax on registered firms. In our Interim

Report we have recommended that the separate tax on the registered firms should be discontinued. If such tax is not discontinued for any reason, it is essential that, to determine the levy of the tax on the registered firm, the loss incurred by the firm should be carried forward and set off for the limited purpose of determining the tax on the registered firm against its income in the subsequent years, without disturbing the other provisions of carry forward and set off of losses. Failure to do so would result in a registered firm being called upon to pay tax on profits of the subsequent period even though there would, really and in substance, be no profits or smaller profits, if the effect of the losses incurred in the earlier years were taken into account. We, accordingly, recommend that during such time as a separate tax is levied on registered firms, the losses incurred by a registered firm should be carried forward and set off against the firms's income in the subsequent years, only for the purpose of ascertaining the tax payable by the firm. The existing provisions regarding apportionment of the loss amongst the partners with the corresponding rights of the partners to set off such loss or carry forward such loss in their personal assessments should continue. It would follow that the apportionment of the share of income/loss of the firm (as reduced by the registered firm's tax) among the partners in the subsequent year would have to be the income/loss without the set off of the past loss because such loss was already apportioned among the partners in the earlier year. To that extent the total income on which the registered firm's tax is charged in the subsequent year would be different from the income which is apportioned among the partners for separate assessment in their cases. To this extent, two sets of calculations would be involved until such time as there is a separate levy of tax on the income of the registered firm.

I-12.9. The existing provisions in regard to carry forward of business loss expressly provide that when business losses under section 72 and depreciation under section 32(2) are both carried forward, the set off of business losses should take precedence over the set off of unabsorbed depreciation. This provision is aimed at protecting the interests of the taxpayers insofar as business losses are carried forward only for a limited period of eight years whereas unabsorbed depreciation is carried forward indefinitely. It has, however, been represented to us that a similar restriction of eight years applies to investment allowance, yet such allowance is set off after the unabsorbed depreciation. Again, it has been pointed out that current depreciation takes precedence over past losses. The tax holiday concession also operates after the set off of all the brought forward allowances and losses. Representations have, therefore, been made that the law should expressly provide for the order of set off of carried forward benefits in order to ensure that the taxpayer obtains the maximum benefit under the tax laws. We are not in favour of any artificial provision in this regard. The simplified scheme of depreciation as recommended in our Interim Report should to a large measure meet the various conflicting situations to which our attention has been drawn. There is, therefore, in our opinion, no need to make any further specific provisions in the Law in regard to the order of set off of various allowances and losses

I-12.10. We have in the observations made in the preceding paragraphs clarified that the changes recommended by us do not apply to speculation losses. We are in full agreement with the present provisions in the income-tax law which isolate speculation losses and permit a taxpayer to set off such losses only against speculation profits either in the same year or in the subsequent years. Speculation profits, however, are brought to tax on par with other business profits. A loss from a non-speculation business can be set off against income from any business including speculation profits. There may thus be situations where a speculation loss as well as a non-speculation loss are carried forward from an earlier year and the claim for set off against speculation profit may arise in a subsequent year. It should logically follow that the first claim for set off against the speculation profit should be that of the speculation loss in view of the restrictive right of setting off such losses as contained in section 73. Section 72 deals with business losses in general while section 73 deals with the special category of losses in speculation business. Therefore, where both the provisions of sections 72 and 73 are simultaneously applicable, effect should first be given to the provisions of the special nature viz., section 73. Such a construction would resolve the difficulty in regard to the question as to which loss should take priority in the set off against the speculation profit. The Central Board of Direct Taxes have issued administrative instructions to the effect that unabsorbed speculation losses should first be set off against subsequent speculation profit and it is only if a balance of speculation profit is left that it should be utilised for set off of non-speculation business losses. In order that the instructions regarding set off of speculation losses are not overlooked, we recommend that this matter may be suitably clarified in the act itself.

I-12.11. An essential provision in regard to the scheme for carry forward and set off of losses is that contained in section 80 of the Act. This is in the nature of an overriding condition that unless a loss is determined in pursuance of a return filed under section 139, the taxpayer would not be entitled to carry forward his loss. Such a provision is salutary inasmuch as it safeguards the interests of revenue against claims for set off of losses relating to past years raised at the time of subsequent assessments purely with a view to escapement of taxes. The Supreme Court in *C.I.T. v. Kulu Valley Transport Co. Ltd.*, 77 ITR 518, has held that even a belated return is a valid return under section 139 and, accordingly, it would confer a right on the taxpayer to carry forward the loss as may be determined on the basis of that return. A return of loss may thus be filed even after the expiry of the statutory period allowed under section 139(1) read with section 139(3) thus the right to file such return continues till an assessment is made as provided in section 139(4). In the Interim Report we have stressed the need for timely compliance on the part of the taxpayers in filing returns of income in order that the scheme for summary assessments could be effectively operated. It is, therefore, necessary that the filing of loss returns should be restricted within a specified time and that the general provision under section 139(4) should not be applied to a loss return.

The returns of losses should ordinarily be filed before the 30th of June as in the case of other returns. The taxpayer may, however, obtain extension of time for filing the loss return, from the Income-tax Officer, upto the end of the assessment year. For delay beyond the end of the assessment year, time for filing the return may be granted by the Commissioner of Income-tax for just and sufficient reason. These aspects are discussed in Part II of this Report. **We recommend that returns of loss filed after the 30th June or such exten-**

ed time before the end of the assessment year as allowed by the Income-tax Officer or such extended time thereafter as allowed by the commissioner of Income-tax, should not confer on the taxpayer the right of carry forward of losses under the provisions of Chapter VI of the Act. It may, however, be clarified that the taxpayer's right to file a revised return under section 139(5) should extend even to a loss return which has originally been filed within the time allowed for filing the loss return.

CHAPTER 13

DEDUCTIONS TO BE MADE IN COMPUTING TOTAL INCOME

I-13.1. Chapter VIA of the Income-tax Act, comprising sections 80A to 80VV, contains a number of provisions for the deduction of certain amounts in computing the total income for the purpose of tax. The scheme of the Act is to determine the gross total income as defined in section 80B(5) which necessitates the application of all the provisions of the Act other than those contained in Chapter VIA. The Scheme of the Chapter is to start with such gross total income and make deductions therefrom for the various purposes as provided in the different sections of the Chapter so as to arrive at the total income on which the tax has to be charged. Gross total income is thus the aggregate of incomes from the different sources computed under the different heads of income specified in section 14. It also requires giving effect to the provisions for set off and carry forward of losses as provided in sections 70 to 80 of the Act.

I-13.2. This Chapter has been on the statute book in the present form from 1st April, 1968, although some of the provisions included in it have been part of the law since 1st April, 1965. The Chapter came into existence as a step in the simplification of tax laws. Instead of calculation of rebates at average rates of tax for various purposes, the Chapter aims at securing more or less the same tax benefit by making straight deductions of appropriate amounts in computing the total income. Having regard to the genesis of this Chapter, express provision is made in section 89A(2) to the effect that the aggregate of the deductions provided under the various sections does not exceed the gross total income.

I-13.3. The deductions provided in the Chapter broadly fall into two categories. The first category comprises deductions in respect of certain outgoings from the income, by way of expenditure or savings, irrespective of the component of the income from which the outgoings are met. Deductions falling in the second category relate specifically to certain components of the gross total income. Therefore, whilst one set of deductions deals broadly with outgoings, the other set of deductions deals with components of the income. Some of these provisions have come up before the courts for interpretation as to their scope and meaning. The largest amount of controversy centres round section 80J, whilst by and large the other provisions have given rise to few disputes.

I-13.4. We have considered the representations for liberalisation of some of the deductions provided under this Chapter. We consider that a certain amount of re-arrangement or re-positioning of some of these provisions will be justified in the interest of rationalisation and simplification. In Chapter 1 of this Report we have already commented about the need to delete the spe-

cial definition of the term "relative" contained in section 80B(8). We now proceed to examine some of the provisions in this Chapter individually.

I-13.5. Section 80C provides for a deduction in respect of long-term savings effected by the taxpayer in specified media while computing his taxable income. This deduction is available to individuals, Hindu undivided families and a limited category of associations of persons or bodies of individuals. The form of savings qualifying for the deduction are broadly, life insurance premiums, contributions to provident funds and superannuation funds and certain Cumulative Time Deposits in Post Offices. The quantum of the deduction has been increased from time to time and the ceiling over the savings qualifying for the deduction has also been similarly increased. At present, the deduction under this section is allowed to the extent of the whole of qualifying long-term savings upto Rs. 5,000 plus 50 per cent of the next Rs. 5,000 plus 40 per cent of the balance of such savings. The aggregate of the savings qualifying for the deduction is limited to Rs. 30,000 or 30 per cent of the gross total income, whichever is less.

I-13.6. One of the suggestions made to us is that the deposits with public sector banks for a specified number of years should also qualify for the deduction under section 80C. The principle underlying this section being the investment of funds largely at the control of the Government and for a reasonable length of time of at least 10 years, the concession should be extended to savings which satisfy these principles. Savings with public sector banks for a duration of 10 years or more would merit inclusion. Likewise, a taxpayer may desire to pay a lump sum to the Life Insurance Corporation by way of single premium on a life insurance policy, without committing himself for a recurring obligation for 10 years. This would enable savings to be placed with the Life Insurance Corporation as well, provided there are adequate safeguards such as (a) the policy on the life of the assessee having a minimum maturity period of 10 years, and (b) the policy not enjoying any cash surrender value. Such a scheme would entitle taxpayers to make single premium payments and avail of the benefits of insurance largely within the safeguards as applicable to the other forms of savings. We, accordingly, recommend that the following types of savings should be included for the purposes of the deduction under section 80C :—

- (a) Deposits or cumulative time deposits with public sector banks for a period of not less than 10 years with facilities in the matter of borrowings and encashment broadly comparable to those available in the case of 10-year or 15-year cumulative time deposits accounts in Post Offices;

- (b) **Single premium paid on a policy of insurance on the life of the taxpayer, where the duration of the policy is for a minimum period of 10 years or life, without any option to obtain a cash payment by surrender or commutation in the intervening period.**

I-13.7. Section 80D allows a deduction in respect of expenditure incurred by the assessee on the medical treatment, etc., of a handicapped dependent relative, upto Rs. 2,400 where such treatment is provided in an institution and Rs. 600 in any other case. It has been represented that these limits have become unrealistic having regard to the present day cost of such treatment. We recommend that the ceilings of Rs. 2,400 and Rs. 600 laid down in section 80D may be doubled to Rs. 4,800 and to Rs. 1,200 respectively.

I-13.8. The need for medical attention for taxpayers in general needs no emphasis. It is in recognition of this necessity that administratively no perquisite value is attributed to ordinary medical expenses provided by an employer to his salaried employees. Some form of medical benefits are also available to employees who are covered under the Employees State Insurance Scheme. Taxpayers in the non-salaried class are compelled to incur such expenditure out of their income which has suffered tax. In view of the need to enhance the efforts of the taxpayers in increasing income and to be reasonably free of the worry of the cost of medical attention it is appropriate to provide for a deduction from the taxable income for medical expenses. We, accordingly, recommend that taxpayers who are not otherwise eligible to medical perquisites be entitled to a deduction of actual medical expenses incurred on themselves and members of their family dependent on them upto a limit of 10 per cent of the gross total income or Rs. 5,000 per annum, whichever is lower.

I-13.9. Section 80E provides for deduction of premium payments under an annuity contract for securing a life annuity in old age subject to a ceiling on the premium of Rs. 5,000 per annum. The deduction is presently allowed to partners of registered professional firms. It is not available in cases where the taxpayer has income in the nature of unearned income referred to in sub-section (6) of Rs. 10,000 in the aggregate. The representations received by us in regard to this provision seek relaxation of the present restrictions. It has been urged that the limit of Rs. 5,000 should be increased to Rs. 10,000 in view of the fall in the value of the rupee. It has further been urged that the concession is an extension of the benefits under section 80C. The additional advantage under this section is a 100 per cent deduction of the premium as against the graded deduction under section 80C but correspondingly the benefits under this form of saving are less attractive. The principle underlying the concession being the purchase of a deferred annuity policy which involves deferment of the tax, the restriction with reference to the unearned income referred to in sub-section (6) has no particular validity. The premium paid to the Life Insurance Corporation accumulates with interest to a capital sum in comparison to which the annuity provided barely represents a reasonable

rate of interest. The corpus or the capital sum remains with the Corporation in perpetuity. Again, the restriction of the concession to partners of registered firms only is also not fully warranted. We, accordingly, recommend that the benefit of section 80E should be extended to all taxpayers rendering professional services mentioned therein. The monetary limit of deduction should be increased to Rs. 10,000 per annum. The condition that the unearned income referred to in sub-section (6) should not exceed Rs. 10,000 to qualify for the benefit should be deleted.

I-13.10. Section 80FF provides for a concession in respect of education expenses of the children or dependants of taxpayers. Here again, the various conditions prescribed by way of limitations serve to restrict the benefit to a very limited number of taxpayers. The deduction is available only where the individual's gross total income does not exceed Rs. 12,000. The deduction is limited to Rs. 1,000 per year for degree or post-graduate courses and Rs. 500 per year for diploma courses. It is further limited to two dependants. These restrictions render the concession illusory. We recommend that the limit of Rs. 12,000 in respect of the gross total income should be increased to Rs. 25,000. The limits of Rs. 1,000 and Rs. 500 should also be increased to Rs. 2,000 and Rs. 1,000 respectively.

I-13.11. Section 80G provides for deduction in respect of donations to charitable institutions and certain funds of national importance. The section also covers donations for renovation or repair of notified places of public worship. The quantum of the deduction is 50 per cent of the qualifying donations.

I-13.12. One of the suggestions made in regard to this provision is that minimum limit of Rs. 250 for the deduction under this section should be reduced to Rs. 100 or be removed. We are not in agreement with this suggestion as it would needlessly increase the administrative work without significant benefit to the taxpayers. Another suggestion was that in regard to contributions to national funds like the National Defence Fund, the Prime Minister's Drought Relief Fund and the Prime Minister's National Relief Fund, the deductions should not be limited to 50 per cent but should be increased to 100 per cent. In view of the fact that these funds are national in character and are administered by the Central Government the grant of an additional incentive by way of tax would be justified. We recommend that the quantum of deduction under section 80G should be raised to 100 per cent of donations to funds of a National character as specified at present in the section or as may be notified by the Government from time to time.

I-13.13. Explanation 3 to section 80G excludes from the term "charitable purpose" purposes which are substantially of a religious nature. It is generally recognised that spreading of religious thought and learning is as useful as any other formal scheme of education. It is an object of general public utility and in recognition thereof income which enures for the benefit of public religious purposes qualifies for tax exemption under section 11 of the Act. Section 80G

already contains a salient restriction to the effect that the institution or fund in question should not be expressed to be for the benefit of any particular religious community or caste. Thus, so long as donations are made to public trusts which are engaged in public religious activities and which by their terms are not restricted to any particular religious community or caste, there seems to be no justification for denial of the deduction under section 80G. The effect of Explanation 3 is to allow the deduction only to non-religious trusts. Again, the need for contributions for places of public worship is already recognised under section 80G and donations made for renovation or repair of places of worship do qualify for exemption in appropriate cases. The Explanation, therefore, introduces a needless refinement between trusts which qualify for exemption under section 11 and trusts the donations to which qualify for deduction under section 80G. Apart from the considerations mentioned above, even for the sake of simplification such a distinction could conveniently be dropped. We, accordingly, recommend that explanation 3 to section 80G be deleted.

I-13.14. The departmental practice at present is for the Commissioner of Income-tax to issue a certificate at the request of a charitable trust for the purposes of section 80G. Such a certificate *prima facie* entitles the donor to the benefit of the deduction under this section. Delays in the matter of obtaining such certificates have been pointed out with the consequent adverse effect on the collection of donations by charitable trusts. It appears to us that the procedure for grant of such certificates could be streamlined. We recommend that certificates under section 80G should be issued by the Income-tax Officer having jurisdiction over the Charitable Trust. The certificate should be granted within a period of three months from the date of application. The grant of the certificate should continue to be merely a measure of administrative convenience and not to be made a pre-condition for grant of deduction under section 80G. The order of the Income-tax Officer refusing to grant the certificate should be made appealable in the normal course. Once a certificate is granted its withdrawal or cancellation should not disqualify donations made prior to the withdrawal or cancellation for deduction under this section.

I-13.15. The provisions of section 80G are aimed at encouraging donations for public institutions and charitable causes. In recent times there are many institutions which are engaged in promotion of scientific research in various fields. The income of such of these institutions as are approved under the Act qualifies for exemption under section 10(21). Contributions made to such institutions are allowable as a deduction under section 35 of the Act only to those taxpayers who have income under the head "Profits and gains of business or profession". As the provisions stand at present, a person who has no income under that head cannot obtain the benefit of deduction in respect of the contributions made to approved scientific research institutions. The encouragement of scientific research would warrant that the benefit of deduction under section 35 should be available in respect of contributions by all classes of taxpayers. To that

extent it is an extension of the principle underlying section 80G where all classes of taxpayers can make donations to funds and charitable institutions and qualify for tax exemption. We, accordingly, recommend that subject to the exception mentioned below a new section should be inserted after section 80G to allow full deduction of contributions which any taxpayer may make to approved scientific research institutions.

The benefits under the new section should be on similar terms as presently available under sections 35(1)(ii) and 35(2)A. The deduction under this section would only be available to assessee who do not have any income under the head "Profits and gains of business or profession". Accordingly, sums which have been claimed as a deduction under section 35 would not qualify for a further deduction under the new section.

I-13.16. On the same parity of reasoning taxpayers in general should be entitled to deductions of amounts contributed to approved institutions for rural development programmes under section 35CCA. We recommend that the above new section should, therefore, extend also to contributions by taxpayers to institutions referred to in section 35CCA.

I-13.17. Section 80GG was introduced with effect from 1st April, 1976, with a view to providing relief to a taxpayer who does not receive a house rent allowance from an employer. The deduction is with reference to the rent for his residential accommodation as is in excess of 10% of the total income. It is, however, limited to Rs. 300 per month or 15 per cent of the gross total income, whichever is less. The deduction is not available where any residential accommodation is owned by the taxpayer or his spouse or minor children or the Hindu undivided family of which he is a member. There is need to increase the limit of Rs. 300 to correspond to the increased limit of Rs. 400 as applicable to house rent allowance for the purposes of the exemption under section 10(13A). Again, the mere fact of ownership of residential accommodation should not result in denial of the concession particularly, by reason of the employment or business. We, accordingly, recommend that the limit of Rs. 300 in section 80GG should be raised to Rs. 400. We also recommend that the deduction should not be denied where the residential accommodation owned by the individual, his spouse, minor children or the Hindu undivided family is situated at a place other than the one where the taxpayer resides or conducts his business or profession.

I-13.18. Section 80V allows a deduction in respect of interest paid by a taxpayer on money borrowed for payment of income-tax. A specific provision to this effect was necessary because such interest does not constitute an allowable deduction against income computed under the Act. The question of allowing payment of interest may also arise where taxpayers borrow money for the purpose of acquiring a residential house.

Borrowings effected for creation of income-earning assets qualify for deduction under the appropriate computation provisions. Under the present law borrowings for acquisition of house property are allowable as a deduction in the computation of income from property. We have in Chapter 7 recommended that income from one residential house used by the taxpayer for the purposes of his own resident should be exempted from tax. In such circumstances there would be no computation of income from such a property and the result would be to deny the taxpayer the deduction for expenditure by way of interest incurred on borrowings for acquisition of such residential house. As the recommendation for exemption of the notional income of one residential house is an extension of the concession in the Act for self-occupied residential property, the concession should not result in denial of a relief already available to the taxpayer. It is also appropriate that interest expenditure of this nature should be allowed as a deduction from the gross total income of the taxpayer but within a reasonable limit. We, accordingly, recommend that section 80V should be extended to cover interest upto a limit of Rs. 10,000 per year paid by a taxpayer on borrowings from banks or financial institutions for acquiring, constructing, repairing, renovating or reconstructing one residential house property used for the purpose of the taxpayer's own residence.

I.13.19. Section 80VV was introduced in the law with effect from 1st April, 1976. It provides for deduction of expenditure incurred by the taxpayer in tax proceedings for determination of the liability under the Act. A ceiling of Rs. 5,000 has been fixed for the deduction. The section is also referred to in section 37 with a view to excluding such expenditure from the operation of section 37. This has led to the position, that the limit of Rs. 5,000 is also applied to taxpayers having business income. In such cases, it has been clearly held that expenditure of the nature referred to in section 80VV constitutes allowable business expenditure without any limit. We do not consider it necessary to place such an artificial limitation on such expenditure and also on the freedom of a taxpayer to have his case properly represented for determination of his tax liability. We, therefore, recommend that the reference to section 80VV in section 37 should be omitted. The deduction under section 80VV should operate in the case of assessee having no income chargeable under the head "profits and gains of business or profession".

I.13.20. Apart from the recommendation made in the preceding paragraph, we are of the view that an artificial limit of Rs. 5,000 placed in section 80VV can result in practical hardships. It has now been well settled that expenditure incurred in tax proceedings is allowable to a taxpayer even against his income under the head "Income from other sources". The deduction in any case is restricted only to the actual expenditure incurred and it is not in the nature of a standard deduction. The artificial ceiling may prove inequitable because a taxpayer would necessarily have to defend himself against wrongful assessments. His costs in such circumstances may be beyond his control particularly if the Department carries the matter higher. In such situations, the limit of Rs. 5,000 could result

in an arbitrary disallowance. By the very nature of tax proceedings, a monetary limit is impractical because the sum of Rs. 5,000 may be excessive in a large number of cases whilst it may be a pittance in some other case. We are of the view that there is no justification for a monetary limit on a category of expenditure like that referred to in section 80VV which is otherwise allowable in computation of income. We, accordingly, further recommend that the monetary limit of Rs. 5,000 referred to in section 80VV should be removed.

I.13.21. Deductions of the second category, provided under Chapter VIA, are those in respect of specific components of the gross total income. Wherever such deduction relates to a particular head of income it would be more appropriate to provide for such deduction in the process of computation of the income under that head to the extent it does not disturb the general scheme of the Act. Accordingly, the deductions under sections 80R and 80RRA should be grouped with in the sections dealing with computation of income under the head "salaries". Sections 80HH, 80HHA, 80J, 80JJ, 80QQ and 80RR which relate to income from business or profession should more appropriately be placed along with the sections dealing with computation of profits and gains, from business or profession. As regards sections 80K, 80L, 80MM, 80N, 80O and 80P they should be placed along with the sections dealing with computation of profits and gains from business or profession. They should correspondingly be applied to the computation of income from other sources wherever the income in question is assessed under that head, on the lines of the present provisions of section 59. We, accordingly, recommend that deductions pertaining to specific heads of income should be placed along with the computation sections relating to the relevant heads of income.

I-13.22. We are aware that the regrouping of the sections as suggested by us will accelerate the operation of those provisions in precedence over the provisions for carry forward and set off of loss under Chapter VI of the Act. Further, such regrouping would also take those sections out of the overall limit under section 80A(2) and the deductions would not be limited to the quantum of gross total income. However, having regard to the scheme of the Act, where deductions are allowed as and by way of incentive, it is appropriate that they should be allowed to operate in full so as not to restrict the benefit to the taxpayer. The rationalisation and simplification resulting from the change are also a further justification for the suggestion, having regard to the litigation resulting from the present provisions. Where, however, the deductions under Chapter VIA are designed to reduce the effective rate of tax applicable to the income, such provisions should continue in the same Chapter as deductions from gross total income, and they have accordingly not been included in the aforesaid suggestion for regrouping.

I-13.23. By far the most important provision contained in Chapter VIA is that in section 80J which provides for a deduction in respect of profits and gains derived from a new industrial undertaking or a ship or a hotel. The scheme for allowance of the deduction

is reasonably clear and it provides for a deduction upto a fixed percentage of the capital employed from the qualifying profits. Adequate provision is made for the carry forward of the deficiency pertaining to any year to the future years upto the eighth year from the commencement of production.

I-13.24. There was considerable controversy on the question whether an industrial undertaking is a new undertaking so as to qualify for the deduction under this section. The controversy has been substantially set at rest by the decision of the Supreme Court in *Textile Machinery Corporation Ltd. v. CIT*, 107 ITR 195. The effect of the Supreme Court's decision is to substantially reiterate the position as contained in the Board's Circular of 1948.

I-13.25. The concession is available to industrial undertakings, hotels and ships. A similar deduction is not available in respect of an aircraft used by an Indian company for the purposes of the business of transporting passengers or cargo. There is really no significant difference between the business of operating ships and the business of operating aircraft. Under section 32A, ships and aircraft have been treated on par. **We, therefore, recommend that the deduction under section 80J should be extended to aircraft in like manner as in the case of a ship.**

I-13.26. One of the qualifying conditions stipulated in the section is the commencement of operations within a specified period following the 1st April, 1948. At present this period is fixed at 33 years, thereby making the benefit available to activities commenced before 1st April, 1981. This period has been extended from time to time at five-year intervals. If projects are to be planned at present, it is quite possible that the commencement may extend beyond 31st March, 1981. It is desirable to provide for the benefit with a reasonable degree of certainty and continuity in the interests of industrial development. **We recommend that the provision in section 80J should be continued without any time limit and the condition regarding commencement of operations before a prescribed date should be deleted.**

I-13.27. The next point of controversy is the provision in section 80J fixing the quantum of the deduction at a percentage per annum of the capital employed. The expression "6 per cent per annum" (or "7½% per annum" in certain cases) has been construed to refer to a full benefit for each assessment year. In other words, the quantum of the benefit is to be calculated at the full percentage of 6 per cent or 7½% as the case may be for the assessment year irrespective of the period during which the industrial undertaking may have actually carried on operations during the first year. Recently, however, a contrary view seems to have been expressed by the Central Board of Direct Taxes and officers have been directed to apply the percentage to a full year and reduce it in proportion to the number of days during which the undertaking is in operation so far as the first year is concerned. This would lead to a permanent loss to the taxpayer inasmuch as the tax holiday period is only five assessment years and there is no provision for a spillover into the sixth year so as to allow the deduction for an aggregate period of 60 months or five years of operation. We are not in

agreement with the view that the section requires the percentage to be applied on a proportionate basis in the first year. The directions of the Board proceed on a wrong interpretation of the section and would result in a further spate of litigation and an unstable position in the law. In consonance with the underlying intention of the provision, **we recommend that in regard to the deduction under section 80J the percentage should be applied in full for each assessment year irrespective of the days of operation of the industrial undertaking and to this effect directions should be issued by the board.**

I-13.28. There has been protracted litigation on the provisions for computation of the "capital employed" in the new industrial undertaking. The legislature has left computation of capital employed to be prescribed by the rules under the Act, whilst providing expressly in the section that the benefit of the concession is limited to a percentage of the capital employed computed in the prescribed manner. Formerly, rule 19 of the Income-tax Rules provided for the capital to be ascertained by the process of determining the assets and liabilities, making due allowance for the additions to the assets in the course of the computation period on a *pro rata* basis. The provisions were, however, liberalised under rule 19A when certain categories of borrowings were not required to be deducted in the process of determination of the capital employed. As a measure of simplification, it was provided that the assets should be ascertained as on the first day of the computation period. Thereafter, the provisions have been further amended and all borrowings and liabilities are required to be deducted from the assets to determine the capital employed. The Calcutta High Court in two judgements both in the case of *Century Enka Ltd. v. Income-tax Officer*, 107 ITR 123, and 107 ITR 909, has held that rule 19A was *ultra vires* the rule-making power of the Board. The first judgement dealt with the adoption of the assets on the first day of the computation period without making adjustments for increases during the year. The second judgement dealt with the exclusion of borrowed capital otherwise than from the approved sources expressly mentioned in the rule. The gist of these judgements is that the expression "capital employed" is used by the legislature and borrowed money employed as capital in a new industrial undertaking cannot be artificially excluded from the quantum of capital employed, by a rule-making authority. In dealing with a significant benefit like the one under consideration, it would be appropriate that the quantum of the tax concession is clearly specified by the legislature itself. If the method of determining the capital employed were part of the provisions of section 80J itself instead of the rules, the challenge on the grounds urged before the Calcutta High Court may not have been made. It may be mentioned that the provisions as of the Surtax Act themselves prescribed the method of determining the capital. **We, therefore, recommend that the method of computing the capital employed should be laid down in the section itself.**

I-13.29. We may now deal with the merits of the representations made to us that capital employed should include all forms of capital including borrowed capital. The scheme of section 80J is to grant an incentive to taxpayers to undertake new industrial enterprises.

The incentive is provided by exempting certain part of income which would otherwise have attracted tax. In order to afford a yardstick for determining the amount of income to be exempt, a certain percentage of the capital employed has been adopted. This is a fair yardstick because the return on the capital which is deployed in the business will determine the extent of the exemption. Capital which is deployed in establishing an industrial enterprise is not only the owner's own capital but also capital provided by other agencies, either by way of contributions to share capital or by way of loans. Capital raised through borrowings has ultimately to be repaid in any event. The yardstick by which the exemption is measured should not, therefore, make a distinction between the source of capital, whether as equity or as loans. The power of the Board to frame rules is to be exercised to give effect to the legislative intent and not to defeat it by an artificial mode of capital computation where the resultant sum is wholly unrelated to the real capital during the relevant year. In the absence of a statutory definition the expression "capital employed" may be taken in its legal sense or its dictionary meaning or its popular or commercial sense. But in none of these senses can the true capital employed exclude all borrowed moneys or ignore the reality of the funds used during the entire year except its first day. It could not have been intended that affluent taxpayers who are able to employ their own capital should be favoured against the indigent entrepreneurs who have to borrow funds to finance their undertaking. The source of capital is, therefore, not entirely relevant when the question is of exempting from tax, profits which have been appropriately computed and which, but for the exemption, would have suffered tax. There may even be situations where the proprietor's own equity funds may not be deployed in the undertaking and may represent monies not required for the purposes of the undertaking. In such cases the adoption of the equity alone, irrespective of its use, may distort the concept of capital employed. What is, therefore, necessary is to determine fairly, what can in an accounting and commercial sense, be regarded as capital employed, as a relevant yardstick for determining the exemption underlying section 80J. When the legislature has conferred the power on the Central Board to prescribe the method of determining capital employed, it is incumbent on the Board to frame such rules that the result approximates closest to the capital employed from the rational accounting point of view. The Board cannot in exercise of its rule-making power abridge or modify a concession or exemption conferred on the taxpayer by the legislature.

I-13.30. Our attention has been drawn to the following observations in the speech of the then Finance Minister in May, 1971 :

At present, in the case of *new industrial undertakings*, ships and approved hotels, profits upto 6 per cent of the capital employed are entitled to tax exemption for a period of five years. Since debentures and long-term borrowings do not in any manner represent risk capital and interest thereon is in any case deducted, it was generosity on the part

of the Government to extend the tax holiday provision even to such constituents of capital. I now propose that in calculating the limit of 6 per cent of the capital for purposes of tax-exemption, debentures and long-term borrowings will be excluded. This single measure will provide the exchequer with Rs. 10 crores during the current year ; the yield for a full year will be of the order of Rs. 14 crores."

I-13.31. No proposal to amend the provisions of the Act was contained in the Finance Bill in pursuance of the aforesaid observations in the budget speech. Apparently, it was then felt that the proposal of the Finance Minister could be given effect to by more amendment of the rules. We have in the preceding recommendation observed that the concept of capital employed should be a part of the Act itself and not left to the rules. The amendment of the provisions to abridge or extend a tax concession should more appropriately be effected by amendment to the Act so that the *vires* of the rule are not brought into question.

I-13.32. Quite apart from the aspect of legality of the rule-making power, we are of the view that the allowance of interest on borrowings is by itself not a relevant question for the exemption of the nature underlying section 80J. The whole principle underlying that section is to grant a concession after taxable profits are determined. The allowance of interest is in the nature of an allowance of expenditure incurred wholly and exclusively for the purposes of business and it should in any manner abridge the quantum of profit eligible for the exemption. The exemption is with reference to profits which, but for the exemption, would have attracted tax.

I-13.33. Again on the question of risk, it is true that, historically risk capital has been equated with capital provided by the proprietors of an undertaking. It is such capital which is regarded as bearing the ultimate risk of the success or failure of an enterprise. Other forms of capital, whether long-term or short-term, are provided, in a traditional sense, with a reduced risk on the part of the lender inasmuch as, such capital ranks for repayment in priority to the equity of the enterprise. In recent times, however, it should be recognised that the establishment of industrial enterprises in a developing economy necessarily involves the deployment of loan funds to a significant extent. Where capital is scarce, it has been recognised that funds have to be mobilised from all available sources and the Government has also to promote and foster enterprises through public financial institutions. Some of the funds provided by such agencies also involve a convertibility clause which entitles the lender to opt for conversion of the whole or part of the amount into equity. To that extent, borrowed funds so provided assume a character similar to the equity of the enterprise. The measure of the risk attaches to borrowed funds and the enterprise which is set up with such funds also ultimately carries the risk of such funds. The borrower pledges in a sense his credit and assumes the risk for the due repayment of borrowed funds in priority to his own equity in the enterprise.

I-13.34. Further object of section 80J is to encourage rapid industrialisation of the country, and not to compensate the taxpayer for bringing in risk capital. In principle, it should make no difference in the achievement of this object whether an enterprise is conducted with the taxpayer's own funds or with borrowed funds. For the aforesaid reasons it appears to us that the case for exclusion of borrowed funds from the capital employed, sought to be made out in the budget speech referred to above, is not correct or justifiable. We, accordingly, recommend that the provisions for determination of capital employed made as part of the income-tax Act, should be so enacted as to approximate closest to the concept of capital employed from the rational accounting point of view. For this purpose, what is relevant to determine is not the source of funds but whether the funds in question are utilised for the purposes of the industrial undertaking or are outside the undertaking as in the form of investments or surplus bank deposits, etc. The capital employed should be truly reflective of the realities of the enterprise and should, therefore, make due provision for increases and decreases therein in the course of the computation period. In order to facilitate the work of the income-tax officer we recommend that the capital employed in the industrial undertaking should be certified by an accountant as defined in the explanation below section 288(2) of the Act.

I-13.35. Notwithstanding the aforesaid recommendations we still visualise that the determination of the capital employed may involve certain practical difficulties. By and large, in the case of new entities setting up new industrial undertakings, computation of the capital employed would be reasonably simple. However, in the case of existing companies or taxpayers setting up a new industrial undertaking within the same taxable entity, the capital employed for the new industrial undertaking would require to be separately determined. Such separate determination may not be very difficult in cases where separate books of account with adequate details are maintained. However, this may not always be the case. We, therefore, recommend that where the determination of the capital employed in a separate undertaking presents undue difficulty, it may be ascertained on a pro rata basis by adopting the proportion of the net fixed assets of the new undertaking to the total net fixed assets of the taxpayer and by applying such percentage to the total capital employed in the business.

I-13.36. It has been suggested that the measure of the concession under section 80J is grossly inadequate. It has been pointed out that in some of the tax systems the exemption from tax on profits of new industrial enterprises is total for the initial years of operation. In a developing economy where high rates of profitability cannot wholly be attributed to the success of an industrial enterprise, it would not be appropriate to grant total exemption of the profits of new industrial enterprises. At the same time, however, the rate of concession which has been fixed at 6 per cent per annum (7-½ per cent in certain cases of companies) requires reconsideration. The increased rate of 7½ per cent in the case of companies is not in the real sense an increase in the concession but it was enacted by the

Finance Act, 1975, to compensate for the removal of the concession under section 80K in the hands of the shareholders in respect of dividends relating to new industrial enterprises commencing operations after 31st March, 1976. The rate of concession of 6 per cent per annum has continued ever since the enactment of the concession in 1949. A concession of this nature cannot be determined in isolation but should have relevance and correlation to the prevalent interest structure and expectations of yield in the economy. The rate of 6 per cent was appropriate at a time when the bank rate was 3 per cent. In the present context when the bank rate is 9 per cent, the rate of the concession should necessarily be appropriately adjusted. We, accordingly, recommend that the rate of concession should be increased to 10 per cent per annum, which rate should be correspondingly adjusted as and when the bank rate is changed upwards or downwards.

All our above recommendations contained in paras I-13.26 to I-13.36 apply equally to ships and hotels and to aircraft as recommend in para I-13.25.

I-13.37. Section 80JJ provides for the deduction of one-third of the profits and gains from the business of live-stock breeding, or poultry or dairy farming, subject to a minimum of Rs. 10,000. Prior to the introduction of the provision, income from these activities was totally exempt from tax under section 10(27). It cannot be denied that activities of the type enumerated in section 80JJ require encouragement. The tax concession is aimed at providing an incentive for the growth of such activities. However, it is appropriate to note that great emphasis is presently being laid on the development of industries in rural areas. Sections 80HH and 80HHA of the Income-tax Act are also designed to promote industrial development in relatively backward districts and rural areas. It has further been recognised that not all industries may be suitable for establishment in rural areas. Activities such as those referred to in section 80JJ would more appropriately and conveniently be established in rural areas and from that point of view the continuance of the incentive for such activities in urban areas may not be advisable. The incentive should, therefore, be restricted in its operation to such activities carried on in rural areas. We, accordingly, recommend that the deduction under section 80JJ should be specifically confined to cases where such activities are carried on in a rural area as defined in section 35CC.

I-13.38. There is also a need to effect a measure of control in the determination of profits from the business of live-stock breeding involving race horses. In order to encourage these activities in a more regulated manner, it is appropriate that the tax concession should only be available where the race horses bred are sold at public auction, which is open to members of the public generally. We, accordingly, recommend that the grant of tax concession under section 80JJ in regard to the profits and gains of the business of live-stock breeding involving race horses should be restricted only such of the race horses as are sold at public auctions.

I-13.39. Section 80M provides for the total exemption of dividends received by a domestic company from

another domestic company which is formed and registered after 28th February, 1975, and is engaged in specified industries, and for partial exemption of dividends from any other domestic company. There have been disputes as to whether the deduction is available with reference to the gross income by way of dividends or with reference to the net income. If it is allowed with reference to the gross income it may in certain cases result in a deduction exceeding the quantum of the income included for tax purposes. We recommend that the deduction under section 80M should be allowed with reference to the net income from dividends coming within the scope of this section (i.e., after allowing expenses actually incurred for earning and realising the dividend income).

I-13.40. Section 80MM provides for partial exemption of income by way of royalties, commission, fees, etc., received by an Indian company, from any person carrying on a business in India, in consideration for the provision of technical know-how or the rendering of technical services. The technical know-how coming within the scope of the section may relate even to installation or erection of machinery and plant before commencement of the business. Doubts may arise as to whether the deduction is available with reference to the fees received for the provision of such technical know-how or for the rendering of technical services in such a case. We, recommend that income exempt under section 80MM should be the net income (i.e., after deduction of expenses incurred for the earning of that income) which is included in the gross total income, and not the gross receipts. We also recommend that a clarificatory amendment should be made in the section to secure that the deduction will be allowed even where the technical know-how or services are supplied or rendered in connection with the setting up of the business.

I-13.41. The deduction under section 80MM is available only where the agreement for the provision of technical know-how or the rendering of technical services is approved by the Board on an application made before the 1st October of the relevant assessment year. While we agree that the present provision for the approval of the agreement by the Board should continue. We recommend that the Board's refusal to grant such approval under section 80MM should be made appellable to the Central Tax Court recommended by us in part II of this report, and pending the establishment of the Central Tax Court the appeals against Board's orders should lie to the Delhi High Court. We also recommend that the Board should have the power to admit an application for approval after the first of October where sufficient reason is shown for the delay.

I-13.42. Section 80N provides for complete exemption of dividends received by an Indian company on shares in a foreign company allotted to it in consideration of the provision of technical know-how or the rendering of technical services by it to the foreign company. As in the case of sections 80M and 80MM we recommend that the deduction under section 80N should also be allowed only with reference to the net income by way of such dividend and not the

gross amount. We also recommend that the deduction should not be confined to dividend on the shares originally allotted to the Indian company as mentioned in this section but should cover also the dividends pertaining to any bonus shares subsequently allotted with reference to the original holding. As recommended by us in connection with section 80MM, there should be a provision for condonation of delay in the making of the application to the Board for the purpose of section 80N and for appeal to the Central Tax Court or the Delhi High Court against the Board's order refusing such approval.

I-13.43. Section 80-O provides for complete exemption of royalties, commission, fees etc., received by an Indian company from a foreign Government or a foreign enterprise in consideration for the provision of technical know-how or the rendering of technical services. We recommend that as in the case of section 80MM and section 80N, there should be provision for condonation of delay in making the application to the Board for approval of the agreement for the purpose of section 80-O and for appeal to the Central Tax Court or the Delhi High Court against the Board's order refusing approval. We further recommend that the deduction under this section should also be allowed only with reference to the net income and not the gross receipts.

I-13.44. Section 80P exempts the income of certain categories of cooperative societies. The income of a co-operative society which is engaged in the marketing of agricultural produce of its members is wholly exempted from tax. The co-operative movement sometimes functions by the formation of an apex society for channelising the activities of a group of co-operative societies. In such situations while the individual co-operative societies obtain full exemption from tax on their income under section 80P(2) (a), the apex society itself does not qualify for the tax exemption. It is appropriate that the apex society also qualifies for the same tax concession as is available to the primary societies. We, accordingly, recommend that where the income of co-operative societies is wholly exempted from tax under the provisions of section 80P(2) (a) in relation to the activities of the society vis-a-vis its members, the same exemption should also be extended to an apex society which itself consists of a group of co-operative societies whose income is exempt under this section.

I-13.45. Section 80RR allows a deduction of 25 per cent of the income received in or brought into India in foreign exchange by an author, playwright, artist, musician or actor, where the income is derived by him in the exercise of his profession from a non-resident. The section is aimed at promoting the earning of foreign exchange by the exercise of cultural skills and thereby promoting the development of the cultural arts of India in the international field. It is, therefore, appropriate that other forms of cultural activities, as for example, the promotion of studies into the rich Indian heritage are similarly encouraged. Sometimes disputes arise as to whether certain cultural activities are art. To illustrate, there is a growing recognition outside India of the benefits of study and practice of

Yoga, but a question has been raised, whether Yoga is an art. Again, learned professions practised by Indian residents are also being increasingly recognised in the international field. If the rendering of professional services in the learned professions also leads to the earning of foreign exchange, it should be encouraged, at least to the limited extent under section

80RR, if not in the form of total exemption as available for technological skills under section 80-O. We, accordingly, recommend that section 80RR should be extended to members of learned professions as referred to in section 10(23A) as also persons engaged in such cultural activities of the nature notified by the Central Government.

CHAPTER 14

INCOMES FORMING PART OF TOTAL INCOME ON WHICH NO INCOME-TAX IS PAYABLE AND OTHER PROVISIONS OF THE ACT

I-14.1. Chapter VII of the Income-tax Act, comprising sections 86 and 86A, contains provisions for exemption from tax of certain types of income whilst at the same time including such income in the total income for determining the rate of tax to be charged on the remaining income. The method of computing the tax in such cases is explained in sections 66 and 110 of the Act. Such incomes do not enjoy total exemption from tax as in the case of incomes stipulated in section 10. These are items of income which are to be included in the total income but which at the same time entail reduction of the incidence of tax thereon at the average rate of income-tax. Many of the sections formerly included in this Chapter were deleted consequent upon the introduction of Chapter VIA as a result of which these reliefs were allowed by way of straight deductions from the gross total income. There are, however, two items of such income which continue in section 86 apart from another provision contained in section 86A. We do not wish to make any observations in regard to the provisions of section 86A. However, as regards the two items of income included under section 86, there is need to alter the provisions in the light of our other recommendations.

I-14.2. Clause (iii) of section 86 provides that the share of income of a partner of an unregistered firm should be treated as income on which no income-tax is payable by the partner. In our Interim Report we have made several recommendations in regard to the registration of firms, *vide* Chapter 8. The sum total of these recommendations is that any partnership firm would ordinarily qualify for registration without any process of inquiry or investigation. To obtain registration there would be need for fulfilment of only a procedural formality of submitting the particulars of the firm to the Commissioner of Income-tax. To that extent registration would be automatic.

I-14.3. It would follow from those recommendations that the category of unregistered firms would be exceptional. This category would only comprise of such partnership firms as :—

- (a) fail to comply with the procedure for registration, or
- (b) where particulars furnished for registration are inaccurate or false.

The recommendation is further coupled with the suggestion to impose a deterrent rate of tax on unregistered firms. The levy of tax at 65 per cent is aimed at safeguarding the interests of revenue where despite the simplified procedure a taxpayer would seek to be

assessed in the status of an unregistered firm. In the aforesaid scheme, registration ceases to be a privilege conferred by the Income-tax Act and is converted into a right which every taxpayer-firm could enforce against the tax Department. It necessarily, therefore, implies that the cases where the deterrent rate of tax is applied would be such where the taxpayer foregoes this right and not cases where there is any denial of a privilege to him.

I-14.4. The rate of tax of 65 per cent suggested by us is almost equivalent to the present maximum rate of tax. It would result in a punitive levy which may even equate to 100 per cent of the tax incidence where the average rate of tax otherwise applicable would have been around say, 30 per cent. The recommendation has referred to this rate which is at present in force in section 164 in the case of discretionary trusts. In such cases, the aim is to collect the tax at a single point and to counter deliberate measures of avoidance of tax by persons who are at the highest levels of income. It is in that context that the rate of 65 per cent was adequately justified and in the light of our specific recommendations it would not result in any hardship to the normal taxpayer and more particularly, the taxpayer in smaller income groups. The levy of tax at the flat rate under section 164 does not entail any further double taxation by inclusion of the income of the discretionary trusts once again in the hands of a beneficiary who may actually receive a distribution by the exercise of the discretion vested in the trustees. This is because tax at the flat rate from a revenue point of view almost equals the highest marginal incidence of tax. On the same principle, therefore, in our view, there would be no occasion once again to include the share from an unregistered firm in the hands of a partner even for the limited purpose of determining the rate of tax. We, accordingly, recommend that clause (iii) of section 86 should be deleted. As under the existing law, share of loss of a partner in an unregistered firm would not be apportioned to him and would not be available for set off against his other income.

I-14.5. In the Interim Report the flat rate of 65 per cent has been referred to, having regard to the rate at present in force under section 164 in the case of discretionary trusts. In Chapter 2 of this Report we have, whilst examining the structure of income-tax rates, recommended that the maximum rate of tax be fixed at 60 per cent. Any measure which proposes a flat rate of tax with the objective of countering tax avoidance, must necessarily have relationship to the maximum rate of tax with reference to which there could have been the possible avoidance of tax. In our

view, therefore, the levy of tax at the flat rate should be determined at 60 per cent in place of the rate of 65 per cent. We have suggested that the flat rate enacted in section 164 itself should be reduced to 60 per cent and correspondingly, therefore, the rate of tax to be applied to the unregistered firms should also be at 60 per cent. This revision in the rate of tax arises as a direct and consequential result of our recommendations on the rate structure and the appropriate maximum rate of tax.

I-14.6. Clause (v) of section 86 is a corresponding provision which deals with the share of the income of a taxpayer as a member of an association of persons or body of individuals which has been separately assessed and which is not a Hindu undivided family, a company or a firm. In Chapter 1 of this Report we have made recommendations in regard to the definition of the concepts of 'association of persons' and 'body of individuals'. From the discussion set out therein it would follow that the status of association of persons or body of individuals would only arise where income is earned by a group of persons by some deliberate activity as distinguished from the mere receipt of income jointly without anything further. The circumstances which would involve this status of association of persons or body of individuals are such that they flow from a motivated activity of earning income. The distinguishing feature between these two categories is that in the case of association of persons, the parties consciously come together to form the association whereas in the case of body of individuals they may have been thrown together by factors outside their control.

I-14.7. The status of association of persons, therefore, involves a group of persons who join in a common purpose or common action with the object of producing income. To a large extent, therefore, the rights and relationships of the parties would be similar to those of partners in a partnership firm barring the test of agency, which is the crucial test of a partnership. The test of agency is not a material test for the purposes of the income-tax law where the primary purpose is to tax income where it is earned. Our attention has been drawn to the fact that the status of association of persons is being subjected to a degree of abuse by persons in the higher income brackets forming such loose associations for generating income and having such income taxed separately at the appropriate rates. In many cases the identity of the persons constituting the association of person is not divulged or adequately established and the provisions contained in section 86(v) rendered incapable of application. It is necessary to ensure that the adoption of such a status by a calculated scheme does not result in avoidance of tax. It has also been pointed out that the provisions of section 86(v) are being construed to mean that the Department is required to choose between taxing an association of persons on its income or, in the alternative, taxing a member of the association in respect of his share. Any proceedings leading to an assessment in one of these two alternatives may lead to the Department being denied the right of resorting to the other alternative later. Such a position has also led to considerable amount of litigation.

I.14.8. In order to meet the various situations outlined above, it is our considered view that the taxation

of associations of persons should closely follow the pattern of taxation of firms. An association of persons should be required to declare to the Department the constitution of the association and the individual shares of the members so that the income could be taxed directly in the hands of the members. For this purpose, the procedure for registration of firms as suggested by us in the Interim Report should *mutatis mutandis* be made applicable. Likewise, it should follow that where an association of persons avoids such registration and where in similar circumstances a firm would be treated as an unregistered firm, the association of persons should be taxed separately and the flat rate of tax of 60% be applied on its income. The taxation of association of persons in this manner would be totally parallel to the taxation of firms under the Income-tax Act. Here again, the declaration of the individual shares of the members constituting the association for separate taxation in their hands would be in the nature of a right of the taxpayer and it would not constitute a privilege. The levy of tax at a punitive rate of 60% equal to the maximum rate of tax would only arise where there is a deliberate attempt on the part of the taxpayer to seek assessment in the status of association of persons. We, accordingly, recommend that an association of persons should not be separately taxed on its income where it registers particulars of its constitution and the profit-sharing ratios of the members under a procedure similar to that of registration of firms outlined in our interim Report. In circumstances where a firm would have been treated as an unregistered firm, an association of persons should be separately assessed and be taxed on its income at the flat rate of 60%. For the reasons explained earlier, the provisions in sub-clause (v) of section 86 should be deleted. The loss of an association of persons which is registered or which is separately assessed should likewise be treated similarly as the loss of a registered firm or an unregistered firm, respectively.

I-1.9. The provisions set out above in relation to an association of persons cannot be fully applied to a body of individuals. In that case, it is essential to remember that such status cannot be brought about by design or voluntary act on the part of the taxpayer. The status of body of individuals, no doubt, involves the engagement in a profit-earning activity (as distinguished from mere co-ownership) but it is brought about by persons being thrown together by accident or factors outside their control. For this reason, it would not lend itself to the mechanisms of tax avoidance as in the case of association of persons. It should, therefore, be continued to be taxed as at present as a separate taxable entity at the appropriate slab rate of tax.

I-14.10. The observations in the preceding paragraph to tax the body of individuals as a single entity at the appropriate slab rate may lead to injustice and hardship in many cases. For example, where a widow and minor children inherit a business and continue to carry on the business activity, the taxation of the income in the hands of a single assessable entity would impose a higher burden of tax than if such income were apportioned between the widow and the minor children. If the facility of declaring the constitution and obtaining separate assessments is available to

partnership firms as well as to associations of persons, there is no justification for denial of the same facility to bodies of individuals. It is appropriate that a body of individuals should be entitled to register particulars of its constitution and the shares of income of the different individuals constituting the body and following upon such declaration the income should be assessed in the hands of the individuals separately and not under the status of body of individuals. We, accordingly, recommend that a body of individuals should not be taxed as a unit on its income where it registers particulars of its constitution and profit-sharing ratios of the individuals constituting the body, under a procedure similar to that recommended in the case of association of persons. In circumstances similar to those where an association of persons would be separately assessed and taxed at the flat rate of 60%, the body of individuals should be separately assessed as a unit but not at the flat rate of 60% but at the appropriate slab rate of tax. The loss of the body of individuals which is registered and one which is separately assessed as a unit should likewise be treated similarly as the loss of an association of persons which is registered and one which is assessed as a unit, respectively. Where a body of individuals is assessed as a unit, the individual members should not be again assessed in respect of any income falling to their share in the income of the body.

I-14.11. A similar situation would arise in the case of trustees of a trust where the shares of the beneficiaries are definite and known. In the scheme of the income-tax law, particularly, sections 160 to 167 of the Act, such trustees are only assessable in a representative capacity and tax would be leviable upon and recoverable from them in like manner and to the same extent as it would be leviable upon and recoverable from the beneficiaries. It is possible that an assessment may be sought to be made in the status of body of individuals, taking the beneficiaries collectively, in cases where the trustees carry on a business. The recommendation made in the preceding paragraph would ensure that in such cases also the tax is appropriately charged in the hands of the respective beneficiaries rather than on the body of individuals as a single independent entity, as the beneficiaries could comply with the formalities of declaration. Alternatively, if the assessment is made on the trustees, they would only be representative assesseees and thus be assessed in like manner and to the same extent as the beneficiaries in relation to their respective shares.

I-14.12. Another situation which would be relevant is in relation to a body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu. Our recommendation for separately assessing the income of body of individuals which registers its constitution, may result in such a body of individuals obtaining a disproportionate benefit. In such cases, the income is largely generated by the husband, but under the operation of the old Portuguese law, the wife has an interest in such income. The apportionment of the income between the husband and wife through the process of declaration would substantially

reduce the incidence of tax notwithstanding the fact that the income is essentially earned by an individual. It is, therefore, appropriate that the right to declare the constitution and seek separate assessment should not extend to a body of individuals consisting only of husband and wife governed by the system of community of property in force in the said Union Territories. The income-tax law has made a departure from other social laws, as in the case of Hindu undivided families where artificial clubbing provisions are introduced under section 64(2). The suggestion to exclude such a body of individuals from the scheme of declaration of constitution and separate assessment would, therefore, not be unjustifiable. We accordingly, recommend that the right to declare the constitution of the body of individuals and seek separate assessment should not extend to the members of the body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu, if they are otherwise assessable as a body of individuals.

I-14.13. The collective effect of our recommendations in the matter of taxing a group of persons constituting a firm or an association of persons or a body of individuals is that the income would appropriately be assessed in the hands of the persons ultimately entitled to the income, as a matter of right, by mere compliance with procedural formalities under the Income-tax Act. Non-compliance with such formalities, which as pointed out earlier would be exceptional, would result in assessment as a single assessable entity and levy of tax at the flat rate of 60% in the case of a firm or an association of persons, (where the presumption necessarily to be drawn is that such non-compliance is deliberate and intentional), and at the appropriate slab rates in the case of body of individuals, having regard to the fact that a body of individuals is brought about not by volition of the parties, but otherwise.

I-14.14. Our recommendation for deletion of section 86(iii) and 86(v) and the scheme of taxation of a group of persons constituting a firm, an association of persons or a body of individuals will largely simplify the assessment of income and levy of tax in such cases. In the scheme outlined by us, there would be no question of any option to the Department in such cases of taxing either the persons individually or the group as a single unit. The whole issue of the taxability of the persons will be dependent upon compliance with the formalities for declaration of the constitution of such groups. In such circumstances, the old controversy of double assessment of the same income and the question of choice being exercised by the Department would not arise. The scheme would ensure that the doctrine of no double taxation is duly observed.

I-14.15. However, situations may arise where the group is assessed as a single unit under the scheme outlined by us and yet, one or more members may also be assessed on the share declared by them. Further, after the group is assessed, the income distributed

may be sought to be taxed in the hands of the individual recipients. To prevent such double taxation, it is eminently desirable that a clear provision is made that the same income which is once taxed shall not be taxed over again. This principle is to some extent enacted in Explanation 2 to section 5; but the provision to prevent double taxation should be all-comprehensive and exhaustive. We recommend that an express statutory provision should be made that once a firm, association of persons or body of individuals is assessed, the income in question cannot again be assessed in the hands of the constituents of the firm, association of persons or body of individuals. Likewise, if the individual members are first assessed, it should not be construed that the formalities of registration are automatically complied with and the Department should not be prevented from framing an assessment on the firm, association of persons or body of individuals, as the case may be, in the circumstances where such an assessment would lie. However, in such a situation the prior assessment of assessment on the one hand or the individual members should be appropriately rectified as a mistake apparent from the record, and the tax, if any, collected should be duly refunded. In other words, the procedure of assessment ceases to be a matter of choice for the Department and it is only according to the clear circumstances as outlined by us that assessment would be made either on the firm, association of persons or body of individuals as a unit of assessment on the one hand or the individual members thereof on the other.

I-14.16. Apart from such a specific provision to prevent double assessment, a general provision to prevent double assessment should be enacted, preferably in the charging section itself.

I-14.17. The scheme for individual assessment of the persons constituting the association of persons and body of individuals enables division of income amongst the members and separate levy of tax thereon. To that extent the position is similar to that obtaining in the case of a firm. It should be remembered that minors can be members of an association of persons. Likewise, the spouse of an individual may be a member along with the individual in an association of persons or a body of individuals. Our attention has also been drawn to attempts to form associations of persons to circumvent the provisions of section 64. It is appropriate that the provisions for clubbing incomes as obtained in relation to a firm under section 64(1)(i) and (iii) to prevent avoidance of tax, should be extended to the corresponding situations in relation to an association of persons which is engaged in a profit earning activity. However, in view of our observations in para 14.9 above, it would not be appropriate to extend these provisions to the body of individuals. We, accordingly, recommend that the provisions for clubbing incomes of the spouse of an individual and of a minor child of the individual as obtaining in relation to a firm under section 64(1)(i) and (iii) should be enacted correspondingly in relation to an association of persons which is engaged in a profit-earning activity but not in relation to a body of individuals.

I-14.18. The observations and recommendations made in the preceding paragraphs of this Chapter necessarily deal with situations where an association of persons is a taxable entity in its own right and individual members constituting the association are entitled to the income of the association of persons. It is in such circumstances that the provisions of section 86 arise for consideration. We are aware that the status of association of persons may arise under certain special cases as under Chapter XV of the Act as at present in the case of executors, legal representatives, trustees of a trust in writing, etc. In such cases the observations contained hereinabove would be inapplicable and the question of fastening tax at the punitive rate of 60 per cent or requiring declaration of constitution, etc., would not arise. The entire discussion relates to an association of persons which derives income as group and which has a primary liability (as distinct from a vicarious liability) for payment of tax under the Act. Moreover, the question of fastening tax at the maximum rate would also not arise for the reason that we have recommended in Chapter I that such persons should be assessed in the status of individual.

I-14.19. Chapter VIII of the Income-tax Act relating to relief in respect of income-tax, at present comprises only one section, namely section 89. Sub-section (1) has been dealt with in Chapter 5 and sub-section (2) in Chapter 6, of this report.

I-14.20. Chapter XI of the Income-tax Act, which comprises sections 90 and 91, deals with provisions for double taxation relief. These provisions would continue without any modification.

I-14.21. Chapter X of the Income-tax Act, comprising sections 92 to 94 of the Act, deals with special provisions relating to avoidance of tax. We have already recommended the continuance of section 94 in the course of our observations in Chapter 6 of this Report. The other sections in the Chapter should also necessarily be continued.

I-14.22. Chapter XI which at present comprises sections 104 to 109 deals with the additional income tax on undistributed profits. This subject has been dealt with in our Interim Report.

I-14.23. Chapter XII of the Income-tax Act, comprising sections 110 to 115B, deals with determination of tax in certain special cases. We have referred to the provisions of section 115 in Chapter 13 and those of section 115A in Chapter 3 of this Report.

I-14.24. The rest of the Chapters and sections in the Income-tax Act deal with the procedural provisions of law and are discussed in Part II of our Report. We may, however, refer to certain specific provisions of a substantive character.

I-14.25. Section 164 of the Act provides for the charge of tax in the case of a trust where the shares of the beneficiaries are indeterminate or unknown. The section provides for the tax to be charged at the flat rate of 65 per cent or at the appropriate rates applicable to an association of persons, whichever

course would be more beneficial to the revenue. Having regard to our recommendation in the matter of the maximum rate of income-tax as contained in Chapter 2 of this Report, we recommend that the flat rate of tax to be charged under section 164 should be 60 per cent in place of 65 per cent. As this rate of 60 per cent is the maximum, the question of applying the alternative higher rate applicable to an association of persons would not arise.

I-14.26. Chapter XVIII of the Act, comprising sections 236 and 236-A, deals with relief in respect of tax on dividends in certain cases. The first section is a relic of the old scheme of grossing up dividends and granting credit to the shareholders for a portion of the tax paid by the company. As cases to which the

section would apply would have been more or less exhausted by now, it is appropriate that the section be deleted.

I-14.27. Section 236A provides for a relief to a charitable trust with reference to its income by way of dividends from a company in which 75 per cent or more of the capital is held by the trust. The relief is to be computed in relation to the tax payable by the company with reference to the dividends distributed by it. Such 'dividend tax' which was levied under the Finance Acts of some past years is no longer in existence. The provisions of section 236A are, therefore, inoperative. We, therefore, recommend that sections 236 and 236A should be deleted.

CHAPTER 15

THE COMPANIES (PROFITS) SURTAX ACT, 1964

I-15.1. The Companies (Profits) Surtax Act, 1964, (hereinafter referred to as the Surtax Act) was introduced in substitution of the Super Profits Tax Act, 1963. According to the Finance Minister's Budget speech for 1963-64, the Super Profits Tax Act was introduced with the idea that at that juncture (when India was subjected to territorial aggression) the corporate sector like the rest of the community must bear its share of the increased national responsibility. The measure was also justified (in the same speech) on the ground that there was no correlation between the rate of tax and the percentage of profits in the system of corporate taxation and it was hoped that the tax would act as a disincentive to excessive profits and would help to keep down the prices. Even at that stage it was felt that the super-imposition of a separate tax was a better alternative than revising the system of corporate taxation in general.

I-15.2. When Surtax was introduced in the year 1964, after the discontinuance of the levy of the super profits tax, it was aimed at meeting the considerable criticism in respect of the super profits tax and the uneven nature of its effect on industry as a whole. It was stated to have produced a psychological resistance and had, to some extent, affected industrial growth. The levy of super profits tax was, therefore, discontinued from the assessment year 1964-65 and in its stead, a surtax on profits of companies was introduced from that year.

I-15.3. It has been represented that the surtax has in effect amounted to a tax on efficiency and that it should be scrapped altogether. The Bhoothalingam Committee as well as the Wanchoo Committee had advocated abolition of this tax. These recommendations had, however, not been accepted by the Government. The Surtax Act has been introduced not purely as a revenue raising measure of the Government. It has certain socio-economic objectives to serve. As a revenue measure it accounts for a substantial collection to the tune of nearly Rs. 50 crores annually although the process of assessments is limited to a comparatively small number of cases. There have, therefore, to be compelling circumstances to warrant the abolition of the levy of surtax.

I-15.4. As regards the justification for the levy of surtax, namely, the absence of any correlation between the rate of corporation tax and the profit earning ability of a company, it may be observed that such a view is not wholly appropriate. Under the scheme of corporate taxation presently in force, the entire tax paid by a company is treated as the company's liability to tax and no part of the tax is allowed against the personal assessment of the shareholders. Again, on the dividends distributed (which are necessarily

dependent upon the level of profits in the company), tax is once again attracted in the hands of the shareholders at the progressive rates of tax. The combined incidence of the personal tax on the dividends as well as the tax on the companies brings about an adequate measure of progression in the matter of the levy of tax on corporate profits.

I-15.5. The basic objective underlying a levy like surtax is to mop up the excess profits of corporate enterprises. In a developing economy, and more so in a planned economy, such as ours, there are certain sectors where unduly large profits are generated. This is particularly so in some of the more sophisticated industries which may be developed and established through the system of licensing and operate in a protected and, virtually, captive market. This large level of profits cannot wholly be said to be brought about by mere efficiency in the management of the corporate enterprise or in the management of the funds of the corporate enterprise. The high return on capital employed in such industries is to some extent fortuitous in that it is brought about not so much by any positive effort of the management as by the general economic climate resulting from Governmental policies. A characteristic feature which is observed is that the level of profits itself is subject to wide fluctuations. An additional tax on such extra profits would, therefore, cater to the needs of social justice but it should at the same time not affect the efficiency of the organisation. If and to the extent the surtax has had an adverse impact on efficiency as a result of its operation for the past several years, that could be effectively remedied by suitable modifications in the scheme of the levy rather than by a total abolition of the levy. The nature of the levy of surtax has necessarily to be of an exceptional character which would not be applicable to the large majority of corporate assesseees. We are, therefore, not in favour of merging the levy of surtax with the income-tax on companies. We, accordingly, recommend the continuance of the levy of surtax under the Surtax Act. We are, however, indicating the specific areas where the levy needs to be modified in order that it may not impair the efficiency of corporate enterprises.

I-15.6. The substantive provisions which determine the levy of surtax are almost exclusively contained in the three Schedules to the Act. The First Schedule lays down the mechanism for the computation of chargeable profits. The Second Schedule lays down the rules for the computation of the capital of the company. The Third Schedule lays down the rates of tax to be applied.

The First Schedule :

I-15.7. The starting point for the levy of surtax is the total income of the company as determined under the Income-tax Act. Certain adjustments as provided in rules 1, 2 and 3 of the First Schedule have to be made to such total income for arriving at the chargeable profits. Stated briefly, these rules stipulate the following adjustments :

- (a) rule 1 enumerates those items of income, profits and gains which have to be excluded from the assessed total income of the company ;
- (b) rule 2 provides for deduction of the various taxes payable by the company ;
- (c) rule 3 mentions the items which have to be added to the assessed total income.

The aforesaid three rules have given rise to certain disputes and differences in the actual operation of the law.

I-15.8. The items spelt out in rule 1 of the First Schedule have to be excluded from the total income as defined in section 2(45) of the Income-tax Act and not from the gross total income as defined in section 80B(5) of the Income-tax Act. A controversy has arisen in regard to the scope of the adjustment under items (viii) and (ix) of rule 1 which provide for deduction of income by way of dividends and royalties. These items of income are entitled to certain reliefs by way of deductions under Chapter VIA of the Income-tax Act. Dividends qualify for full or partial deduction under section 80M, while royalties from Indian sources qualify for partial deduction under section 80MM. The question that has arisen is whether in making the adjustment under rule 1 the whole of the dividends and royalties should again be deducted, or the deduction should be only of such part of the dividends or royalties as stand included in the total income. Our attention has been drawn to a possible view that the wording of clauses (viii) and (ix) of rule 1, literally construed, may entitle the taxpayer to the deduction of the gross amount of dividends and royalties. A decision to this effect of the Kerala High Court is also reported in 110 ITR, 515 (A. V. Thomas & Co. v. CIT). This would lead to the anomalous result that the income by way of dividends and royalties which already enjoys a total or partial deduction under Chapter VIA in computing the total income, can for the purposes of surtax, once again be deducted to the extent of the gross amount of such dividend and royalty. Such a construction leads to a double deduction, which could not have been intended.

I-15.9. Apart from the deductions under Chapter VIA, the items of income referred to in rule 1 may also have been arrived at after deduction of expenditure incurred for the purposes of earning such income. As for example, income by way of dividends would be arrived at after providing for the expenditure to be allowed under section 57 of the Act. If the items in rule 1 are to be construed as providing for a deduction of the gross amount of dividends (as was, indeed, held by the Kerala High Court in the case cited earlier), here again it would amount to the ano-

maly of double deduction. The expenditure incurred for earning dividends would already have been allowed against the dividend income in determining the total income. The deduction now from the total income of the gross amount of dividends would result in excluding from the total income once again the expenditure which itself does not form part of the total income. With a view to clarifying the situation under the First Schedule. We recommend that the deductions to be made from the total income should necessarily be restricted to the net amounts, if any, which remain included in the total income as computed under the Income-tax Act.

I-15.10. Clause (xii) of rule 1 provides for the exclusion of the amount of any deduction from the income-tax, granted under the annual Finance Act in connection with exports. The provisions of this clause have become redundant for and from the assessment year 1968-69 as the scheme for grant of rebates in income-tax under the Finance Act with reference to exports has been discontinued. We, accordingly, recommend that clause (xii) should be deleted from Rule 1 of the First Schedule.

I-15.11. After the total income has been reduced by excluding the items specified under rule 1, the next step in the computation of chargeable profits is to deduct income-tax liability, in accordance with rule 2. In respect of the liability under the Income-tax Act, the provision is that the actual tax liability (other than that under section 104) is to be deducted, that is to say, the net tax after making due allowance for reliefs and rebates under the Income-tax Act and the Finance Act. One of the components of this tax which is expressly required to be ignored under clause (b) of rule 2(i) is the amount of income-tax payable with reference to "the relevant amount of distributions of dividends". The levy of tax under the Finance Act with reference to the distributions of dividends excluding as specified percentage of the capital of the company has been discontinued with effect from the Finance Act, 1969. The provision in sub-clause (b) of clause (i) of rule 2 is, therefore, redundant and we recommend that this provision should be deleted.

I-15.12. The third and final step in the computation of chargeable profits is contained in rule 3 which authorises the Income-tax Officer to add back expenditure by the company on account of commission, entertainment and advertisement to the extent such expenditure is considered by the Income-tax Officer to be excessive. This provision has become redundant after the enactment of section 40A(2) of the Income-tax Act and in view of the provisions in section 37 of that Act under which the allowance of expenditure on entertainment and advertisement is now statutorily limited. There would, therefore, be no justification for any further add back under rule 3. As regards commission, though there are no specific statutory limits, it can only be allowed in the determination of the total income if it satisfies the legal test of eligibility, viz., of having been incurred wholly and exclusively for the purposes of business. Once expenditure of the nature of commission, entertainment and advertisement is only allowed in conformity with the provisions of section 37 of the Act in the computation of total income, there is no warrant for a further provision under the

Surtax Act for disallowance in the determination of chargeable profits. We, therefore, recommend the deletion of Rule 3 of the First Schedule.

The Second Schedule :

I-15.13. The Second Schedule deals with the rules for computing the capital of a company for the purposes of surtax. The quantum of the capital affects the quantum of statutory deduction available under the Surtax Act and has, therefore, a direct bearing on the quantum of tax. At present, the rules provide for determination of the capital as the aggregate of paid-up share capital and the reserves of the company. Such capital is required to be determined as on the first day of the previous year, with appropriate adjustment for any increase or reduction in the paid-up share capital in the course of the year. The Second Schedule contains five rules and five Explanations. These provisions have led to considerable litigation and it is, therefore, necessary to resolve some of these problems.

I-15.14. The reserves of the company which are to form part of the capital under rule 1 are exclusive of the amounts, if any, credited to reserves which have been allowed as a deduction in computing the total income. The Explanation to rule 1 clarifies that any amount standing to the credit of an account being of the nature of items (5), (6) or (7) under the heading "Reserves & Surplus" or any item under the heading "Current liabilities and provisions" in the "Form of Balance-sheet" given in Part I of Schedule VI to the Companies Act, 1956, will not be regarded as a reserve. The expressions "provisions" and "reserve" are not defined under the Surtax Act. Part III of Schedule VI to the Companies Act defines these expressions. The absence of a precise definition of "reserve" under the Surtax Act has given rise to many disputes. The executive instructions issued by the Board on 11th November, 1974, direct the departmental officers to critically examine the reserves in the company's balance-sheet to determine their eligibility for inclusion in the capital on the ground that some of the items may not really be in the nature of free reserves. For the purposes of the Surtax Act the distinction between free reserves and other reserves has no relevance. The only requirement under rule 1 is that the amount credited to the reserves should not have been allowed as a deduction in computing taxable income. A committed reserve in contradistinction to a free reserve would still qualify for inclusion in the capital under rule 1 to the extent no part of the reserve has been allowed as a deduction in computing the taxable income. We recommend that the two terms, "reserve" and "provision", should be defined under the Surtax Act by adopting for that purpose the corresponding provisions in Part III of Schedule VI to the Companies Act, 1956.

I-15.15. Rule 2 of the Second Schedule requires that the company's capital as computed under rule 1 shall be diminished by the excess of A over B as hereinbelow :—

A. the cost of the assets, the income from which consists of :

- (i) profits and gains of any life insurance business ;
- (ii) interest on tax free Government securities ;
- (iii) dividends from an Indian company or a company which declares and pays dividends in India ;

B. the aggregate of :

- (i) the amount of any outstanding borrowings as on first day of the previous year ; and
- (ii) the amount of any fund, any surplus and any such reserve as is not taken into account in computing the capital under rule 1.

I-15.16. In the application of rule 2, the following difficulties have been pointed out to us :—

- (a) The rule refers to the cost of the specified assets. The expression "cost" has not been defined. It may constitute the original cost of the assets. However, in certain cases such original cost may not be reflected in the balance-sheet which may show the asset at its depreciated or appreciated value, according to the company's practice. This would particularly be the case where investments are held as trading assets and shown on the basis of a valuation determined in accordance with the method of accounting. The adjustments between the cost and the book value of the assets would invariably have been correspondingly reflected in the reserves of the company. The adoption of the cost in such cases would, therefore, lead to distortions.
- (b) Difficulties have arisen in the construction of clause (ii) of rule 2 which requires the setting off of the amount of any fund, any surplus and any such reserve as is not taken into account in computing the capital under rule 1. A provision appearing in the balance-sheet does not constitute a surplus or a reserve. A provision for taxation could however, be construed as a "fund", as held by the Calcutta High Court in *Duncan Brothers & Co. v. CIT 111 ITR 885*. The use of the word "fund" in rule 2(ii) has, therefore, led to ambiguity and may lead to anomalies in the making of the adjustment. Clause (ii) is also silent in regard to the day as at which the amount referred to therein is required to be determined. The main part of the rule 2 and clause (i) of the rule refer specially to the first day of the previous year. It would apparently follow that clause (ii) of rule 2 should also relate to the first day of the previous year.

I-15.17. In order to resolve the difficulty of interpreting the expression "any fund, any surplus and any such reserve as is not to be taken into account" appearing in rule 2(ii), it should be clarified that these words refer to :

- (a) items of reserves which do not form part of capital by reason of the reserve representing

- amounts allowed as a deduction in computing the total income of the company; and
- (b) amounts in the nature of items 5, 6 and 7 under the heading Reserves and Surplus in the form of balance-sheet given in Part 1 of Schedule VI to the Companies Act.

The aforesaid two amounts represent credits made to reserves which under rule 1 are excluded from the computation of the capital. It is appropriate that in making a deduction from the reserves under rule 2 these items should be treated on par with moneys borrowed and outstanding on the first day of the previous year. It would, therefore, be appropriate if rule 2(ii) specifically draws attention to reserves not taken into account as a result of rule 1(iii) and items (5), (6) or (7) referred to in the Explanation to rule 1.

I-15.18. As regards the other difficulty pointed out above, as the computation of capital proceeds with reference to the balance-sheet, the adjustments should also necessarily proceed with reference to the values as shown on the face of the balance-sheet. It would, therefore, be appropriate to make the adjustment with reference to the book value of the specified assets and not the actual cost. We, accordingly, recommend that rule 2 of the Second Schedule should be amended to the following effect :—

- (a) The adjustment with reference to Assets, the income whereof is excluded should be made on the basis of the book value of the said assets.
- (b) Rule 2(ii) should only refer to amounts excluded in computing the capital under rule 1(iii) and items (5), (6) and (7) referred to in the Explanation to Rule 1.
- (c) Rule 2(ii) should relate to the position as on the 1st day of the previous year.

I-15.19. Explanations 1, 2 and 3 appearing after rule 2 do not appear to be correctly placed. The provisions of these three Explanations extend to the rules for computation of capital in general, including rule 3. We, accordingly, recommend that explanations 1, 2 and 3 should be placed at the end of the second schedule, expressly clarifying that they apply to all the rules of the second schedule.

I-15.20. Rule 3 provides for the adjustments to be made for increases or reductions in the paid-up share capital in the course of the year. These adjustments are to be made on a proportionate basis with reference to the number of days for which the increase or reduction remains effective. A practical difficulty has been brought to our attention in connection with the operation of this rule when one company amalgamates with another. Schemes of amalgamation of companies necessarily provide for a date with reference to which the assets and liabilities of the transferor company vest in the transferee-company. Such date normally coincides with the last day of the accounting year of the transferor-company, so that the assets and liabilities as appearing in the audited statements of account are incorporated into the books of the transferee-company after receipt of the orders sanctioning the scheme. The consideration of the amalga-

mation is generally discharged by the transferee-company making an allotment of shares in the transferee-company to the shareholders of the transferor-company. The transferor-company is normally dissolved without a winding up under the orders sanctioning the scheme. The effect of such schemes, therefore, is to vest the assets and liabilities and consequently the working results of the transferor-company as from the effective date which is considerably earlier than the actual date when the allotment of shares and the increase in capital of the transferee-company takes place. The transferee-company is thus exposed to the inclusion of the profits of the transferor-company for the full period as from the date of vesting whereas the capital under rule 3 may only be reckoned proportionately from the number of days after the actual allotment. This would clearly be inequitable. In such cases the allotment of shares, in effect, dates back to the effective date of the amalgamation, namely, when the assets and liabilities vest in the transferee-company. It would be appropriate if the capital is also correspondingly adjusted in the transferee-company in the same manner as the profits so that the comparison of the chargeable profits with the capital is made on a like to like basis. We, accordingly, recommend that the application of rule 3 in cases of amalgamation of two companies should entitle the amalgamated company to reckon the increase in the paid-up share capital as from the date from which the amalgamation is effected and not only from the date of actual allotment.

I-15.21. Rule 4 of the Second Schedule provides that where a company has got any income, profits and gains which are not includible in its total income as computed under the Income-tax Act, its capital as ascertained in accordance with rules 1, 2 and 3 has to be diminished proportionately. This diminution is required to be effected with reference to the proportion of the exempted profits on the total profits. Much of the litigation under the Surtax Act has revolved around this provision. The main controversy centres around the expression "not includible in its total income" occurring in the rule. There can be no dispute that there are incomes, profits and gains which are not includible in the total income under the Income-tax Act by virtue of section 10 in Chapter III of that Act. There are also incomes which fall outside the scope of the charge by virtue of section 5 of the Income-tax Act. There can be no controversy that insofar as the capital of a company is deployed for generation of such income as well, there is justification in reducing the capital on a proportionate basis under rule 4.

I-15.22. However, the controversy which has arisen is with reference to the construction sought to be placed on the rule in certain quarters that incomes with reference to which a deduction is allowed in computing the total income under Chapter VIA of the Income-tax Act are also to be regarded as incomes "not includible in its total income". An illustration of such income would be the tax holiday profits under section 80J of the Income-tax Act. If literally construed, the argument would extend even to dividends which are excluded under section 80K or 80M and thereby lead to the anomalous position of a further diminution in the capital once under rule 2 and again under rule 4.

I-15.23. The controversy under rule 4 has assumed significance from the assessment year 1968-69 onwards. As already pointed out, the provisions of Chapter VIA were recast as from 1st April, 1968, subsequent to the enactment of the Surtax Act. Whilst some changes have been made in the Surtax Act corresponding to the provisions of Chapter VIA when amended in April, 1968, the position has not been clarified under rule 4. There is of course a clear distinction between an item which is not "includible" in the total income and a deduction from total income. Rule 4 cannot obviously refer to items which are first included in the gross total income and then allowed as deduction in computing the total income. The High Courts of Karnataka, Madras and Bombay have construed the provisions of rule 4 in this sense in *I.T.O. v. Stumpp, Schuele & Somappa Pvt. Ltd.* 106 I.T.R. 399, Addl. C.I.T. v. *Bimetal Bearings Ltd.* 110 I.T.R. 131 and *C.I.T. v. Century Spg. & Mfg. Co. Ltd.* 111 I.T.R. 6. A reference has, however, been made to the possible ambiguity in the provision and the need to resolve the ambiguity in favour of the taxpayer.

I-15.24. Apart from the judicial pronouncements, a reference to the historical development of the income-tax law would also clarify the position. Tax relief on certain components of the total income, with reference to which deductions are provided under Chapter VIA, were earlier allowed by way of a rebate in tax, the items themselves being included fully as part of the total income. Thus, prior to the assessment year 1968-69, when Chapter VIA in its present form came into effect, no part of the capital of the company could have been reduced under the provisions of rule 4. The mere change in the mode of allowing tax relief by replacing rebates in tax by straight deductions from income, cannot, in our view, warrant a diminution in the capital for purposes of surtax, with reference to the same categories of income. In order to settle the controversy on the subject we recommend that an Explanation should be added to rule 4 clarifying that no diminution under rule 4 is to be made with reference to the items of income in relation to which the company has been allowed deductions under Chapter VIA of the income-tax Act. As this would be a clarificatory Explanation for the removal of doubt, it would follow that it would settle the law as from its inception, viz., assessment year 1968-69 as from which date the scheme of straight deductions from income under Chapter VIA came into effect.

The Third Schedule :

I-15.25. The last stage in the determination of the liability to surtax is the application of the rates of surtax under the Third Schedule. The Third Schedule lays down the rates of surtax which are to be applied to the "chargeable amount" i.e. the chargeable profits as reduced by the statutory deduction, which is at present as amount equal to 15 per cent of the capital of the company or Rs. 2 lakhs, whichever is greater. As specified in section 4, the liability to surtax arises only when the chargeable profits exceed the statutory deduction. The rates are applied in two slabs : the first slab representing so much of the chargeable amount as does not exceed 5 per cent of the capital is taxed at 25 per cent, while for the balance, if any,

of the chargeable amount the rate is 40 per cent. There is also a provision which limits the aggregate incidence of income-tax and surtax to 70 per cent in the cases and in the circumstances specified in the proviso; in such cases, the surtax is appropriately reduced so as to keep down the aggregate to 70 per cent.

I-15.26. We have carefully examined the impact of the levy of surtax on the basis set out in the Third Schedule and in the context of the observations made by us in the beginning of this Chapter. We are of the view that certain modifications in regard to the operation of the levy are necessary to overcome the deterrent nature of the tax as a tax on efficiency.

I-15.27. The first feature on which this tax needs modification arises from the absence of a provision for carrying forward a deficiency. By its very nature, the tax is intended to be a tax on surplus profits. A true measure of surplus profits cannot be ensured unless the results are considered over a reasonable period of time. There are seasonal and cyclical variations in several industries. The abnormal profits of a single year may not, therefore, properly reflect the measure of surplus profits and the ability to bear the burden of a surtax. The period of a single accounting year need not necessarily form a reasonable base for measuring surplus profits, particularly as contractual obligations and liabilities, bonus claims and other settlements effected or quantified in a given year may relate to more than one accounting period. For these reasons we are of the view that there should be a provision for determining the deficiency in profits with reference to the standard deduction and allowing the set off of such deficiency in subsequent years. This period of time should not be so long as to unduly complicate the assessment procedures. In our view, a period of three subsequent years would be fair and reasonable. We are not in favour of a provision for carrying back the deficiency in profits and, consistent with the scheme of charging total income under the Income-tax Act, the right should only be to carry forward the deficiency to subsequent years. We, accordingly, recommend that the deficiency relating to a year should be allowed to be carried forward and set off in the following three years before the determination of profits which attract surtax liability.

I-15.28. The principle of allowance of deficiency is not unknown to legislation dealing with the levy of tax on surplus profits like the surtax. The Super Profits Tax Act, 1963, contained a provision for the carry forward of deficiency. Under the Excess Profits Tax Act, 1940, and the Business Profits Tax Act, 1947, too, deficiency was permitted to be carried forward or backward. The levy of surtax on a continuing basis can also be justified only if the surplus profits are correctly determined after due provision for the set off of deficiency of earlier years. For ascertainment of the deficiency it would follow that a return of deficiency should be submitted and the deficiency ascertained in the course of assessment. Such ascertainment in every assessment year may generate considerable amount of work-load which might not ultimately prove fruitful. The carry forward of deficiency would have a meaning only in cases where ultimately

such deficiency is claimed as a set off. If the right to carry forward the deficiency is strictly limited to the timely filing of a return it may lead to undue hardship and a larger number of companies filing such returns and keeping the deficiency merely in reserve. In order to reduce such unnecessary paper work, it would be adequate if the taxpayer company is entitled to file a return of deficiency at the point of time when it actually earns surplus profits which attract surtax liability and finds the necessity for set off of the deficiency. It would, therefore, follow that while ordinarily the returns for the purposes of surtax should be required to be filed by a specified date, in common with other tax returns, returns claiming the determination of a deficiency may be allowed to be filed even beyond the end of the relevant assessment year right until even the fourth year in which the set off of deficiency may be required to be claimed. Appropriate recommendations in this regard are made in Part II of our Report.

I-15.29. The next feature in regard to the levy is the quantum of the statutory deduction. The statutory deduction was originally fixed at 10 per cent of the capital employed or Rs. 2 lakhs, whichever is greater, in the year 1964. The capital employed included, *inter alia*, long-term borrowings which were largely obtained at the rates of interest below 10 per cent. By the Finance Act, 1976, the statutory deduction was raised from 10 per cent to 15 per cent of the capital, and, simultaneously, the capital base was curtailed to comprise only the paid-up capital and reserves, but excluding all borrowings. The objective in prescribing the statutory deduction is to determine the level of profits which cannot be said to be abnormal and which accordingly should not attract the levy of surtax. In the matter of fixation of fair prices of essential commodities and regulated industries, Government has recognised that the fair rate of return should bear a reasonable relationship to the level of interest rates prevalent in the economy. A minimum rate of 12 per cent of the net worth after tax has been considered to be reasonable, which has to be suitably adjusted having regard to the risk factor and other considerations as applicable to particular industries. Apart from this measure of regulated profits or controlled profits in other industries, it should be recognised that there is the normal objective of the management towards maximisation of profits as the ultimate test of efficiency of the enterprise. In the determination of the level of surplus profits, therefore, there should be a reasonable measure of return which could be attributed to the management's efforts towards profit maximisation and which would thus, legitimately, fall within a level of profits which should not be considered as abnormal. The criticism that surtax operates as a tax on efficiency would be largely met if the minimum level of profits which do not attract surtax, that is to say, the threshold, is fixed at a reasonable level so as not to dampen the initiative of management. For these considerations, we are of the view that in the present context the threshold should be fixed at 20 per cent of the capital of the company. Needless to say, this rate of 20 per cent would be appropriately adjusted upwards or downwards having regard to the normal rates of return, interest rate structure, etc. as prevalent in the economy from time to time. We, accordingly, recommend that the statutory deduction

under the surtax act should be increased from 15 per cent to 20 per cent of the capital.

I-15.30. As pointed out earlier, at present there are two rates of surtax, one of 25 per cent and the residual rate of 40 per cent applicable to two slabs of the chargeable amount. The rate of 25 per cent operates in the slab of chargeable profits representing a return between 15 per cent and 20 per cent of the capital having regard to the fact that the statutory deduction is 15 per cent. Once it is accepted that the objective underlying the levy of surtax is to mop up the surplus profitability not reasonably attributable to management effort, the existence of two separate rates applicable to two slabs is an unnecessary refinement in the levy. It also provides an unnecessary complication in the process of determination of the tax, which could be avoided if surtax were to operate at a flat rate. For these and other considerations, as also in view of the earlier recommendation for increasing the threshold from 15 per cent to 20 per cent, we recommend that surtax should be levied at the flat rate of 40 per cent.

I-15.31. Another criticism in regard to the levy of surtax is that it leads to wasteful and unproductive expenditure particularly because it steps up considerably the marginal rates of tax on corporate profits. The combined incidence of income-tax and surtax can take the marginal rates of tax to 74.65 per cent, 77.80 per cent, 80.95 per cent and 84.1 per cent depending upon whether a company is one in which the public are substantially interested, or a closely-held industrial company, or a closely-held non-industrial company or a foreign company. It has to be recognised that such a steep marginal rate of tax, more particularly when the ceilings on personal income-tax are considerably lower, may have a dampening effect on the management of corporate enterprises. The Surtax Act already provides for a ceiling of 70 per cent on the total incidence of both income-tax and surtax in recognition of the need for a ceiling on such incidence. However, this ceiling operates only if the following conditions are satisfied :—

- (a) it applies only to an Indian company or a company which has made the prescribed arrangements for payment of dividends in India ;
- (b) the company is one which is referred to in section 108 of the Income-tax Act ; and
- (c) the paid-up share capital subscribed for in cash as on the last day of the previous year is not less than 25 per cent of the capital of the company, as computed for surtax.

There appears to be no particular justification for the third condition. On the contrary there is no justification for discouraging a company which builds up its capital by the process of retention of reserves. Whether capital is subscribed in cash or augmented through the process of retention of reserves (after payment of taxes), there should be really no particular distinction. We are, therefore, not in favour of the continuation of any artificial condition about the composition of the capital as computed for surtax and we recommend that the third condition should be deleted.

I-15.32. The present provision recognises the need for a ceiling in the case of a widely-held company. As regards the category of closely-held companies which in terms of number constitute the preponderant majority of companies operating in India, at present there is no such ceiling. Even companies are already under the additional obligation of paying a higher rate of basic income-tax. Even within that class of companies, the industrial companies are subjected to a slightly lower rate of tax. It cannot be denied that such companies are also engaged in economic activity and if they generate a level of profits which attracts an undue incidence of surtax there is equally a justification for limiting the total incidence of tax. Such a limit, apart from its economic justification, would also reduce the impact of very high rates of marginal incidence pointed out above and remedy still another objectionable feature of the levy. At the same time we recognise that through the process of a ceiling the justification for a differential incidence of tax between a widely-held company and a closely-held company should not be nullified. We are of the view that a ceiling of 75 per cent on the total incidence of income-

tax and surtax in the case of other companies would meet with the observations made earlier. A ceiling on the total incidence of taxes would enable companies to retain a portion of the surplus profits for augmenting the internal resources of the company. Again, the ceiling of 70 per cent at present would operate only in very exceptional cases. We, accordingly, recommend that the provision for a ceiling on the total incidence of surtax and Income-tax should be made as under :—

- (a) A ceiling of 70 per cent on the total incidence should apply in the case of domestic companies which are widely held (section 108) ;
- (b) A ceiling of 75 per cent on the total incidence should apply in the case of all other companies ;
- (c) As stated above, the ceiling should not be made conditional upon fulfilment of any requirement about the composition of the capital as computed for the purposes of surtax.

CHAPTER 16

WEALTH-TAX

I-16.1. The Wealth-tax Act, 1957, has been in operation for over two decades, during which period it has undergone amendments on a few occasions. As in the case of the other direct tax laws, the Wealth-tax Act also contains certain provisions of a substantive nature and certain other provisions of a procedural nature. We have recommended in Part II of this Report that the procedural provisions of all the direct tax laws should be consolidated. Accordingly, those provisions would form part of the proposed Direct Taxes Management and Administration Act. In this Chapter, some of the substantive provisions of the Act, contained in Chapters I and II of that Act, are examined.

I-16.2. The first feature to be noticed in the Wealth-tax Act is that the levy is made with reference to the net wealth. The expression "net wealth" is defined in section 2(m) of the Act broadly to correspond to the excess of assets over liabilities. Provision is, accordingly, made for deductions to be allowed from the assets in respect of debts owed by the taxpayer. Three categories of debts are, however, not to be allowed as a deduction. There is no particular hardship pointed out in regard to the disallowance of the first category of debts, namely, debts outside India under section 6 of the Act. The second category of debts which are disallowed comprises those which are "secured on, or which have been incurred in relation to, any property in respect of which wealth-tax is not chargeable under this Act". This provision has been the subject of considerable litigation between taxpayers and the Department. The provision lends itself to the view that a debt raised on the security of an exempt asset cannot be deducted from the net wealth though the funds raised thereby may have been used for acquisition of taxable assets. Thus, where a taxpayer raises a loan on an insurance policy before its maturity and utilises the amount of the loan for acquiring an asset on which wealth-tax is payable, he will be called upon to pay wealth-tax on such asset without obtaining deduction for the debt incurred for acquiring the asset, on the ground that the debt is secured on an exempt asset, viz., the insurance policy.

I-16.3. The words reproduced above also lead to the construction that debts incurred in relation to exempt assets are not to be allowed as a deduction. Thus, where a loan has been raised on the security of a chargeable asset, but such loan is used for acquiring an exempt asset, the loan will not qualify for deduction on the ground that the debt has been incurred "in relation to" an exempt asset. The logic of this provision is understandable insofar as debts which are raised for acquiring exempt assets cannot be deducted from the other wealth of the taxpayer.

The asset in question itself does not attract wealth-

tax and, therefore, the source of the funds used for acquiring that asset cannot be allowed as a deduction against other assets.

I-16.4. In our opinion, the appropriate test for deciding whether a debt should be allowed or not is the purpose for which the moneys represented by the debt are utilised. The test based upon the property on which the debt is secured, is inappropriate. It would be perfectly legitimate to disallow a debt which has been incurred for the purposes of acquiring an exempt asset. It is, however, illogical to disallow a debt incurred for acquiring taxable assets, merely on the ground that the debt has been secured on an exempt asset. We, therefore, recommend that debts which are utilised for acquiring property on which wealth-tax is not charged (either because such property falls outside the definition of 'assets' or it is specifically exempted from charge by virtue of section (5) should alone be disqualified from deduction in determining the net wealth.

I-16.5. The debts in the third category which do not qualify for deduction are :

tax, penalty or interest payable in consequence of an order passed under the direct tax laws—

- (a) which is disputed in appeal, revision, etc., by the taxpayer, or
- (b) which though not disputed is outstanding for a period of more than 12 months as on the valuation date.

There does not appear to be adequate justification for disallowing disputed tax demands outstanding on the valuation date. Where tax, penalty or interest has been demanded in consequence of an order passed under a law, it cannot be said that the debt is frivolous or non-existent merely because it is disputed in appeal. A taxpayer should be entitled to take remedies expressly provided in law in the matter of demands which in his view require interference by the appellate authorities. Such disputed demands are necessarily taken into account by a prospective purchaser of a business undertaking if the demands relate to the business undertaking. The Controller of Capital Issues also takes into consideration such disputed tax liabilities for the purposes of computations made by him. The debt arising out of an order under a direct tax law is very much a reality until it is adjusted through appellate proceedings. As on the valuation date it should, therefore, go to reduce the net wealth of the taxpayer. A demand arising on an order of a statutory authority is a crystallised statutory liability

and does not partake of the nature of a contingent claim. We are, therefore, of the view that the restriction under item (a) of section 2(m)(iii) is not justified. However, if as a result of appellate proceedings the debt is either scaled down or cancelled, the effect of the appellate order would in fact alter the amount of the debt in question and it would then be appropriate to amend the wealth-tax order as containing a mistake apparent from record. We, accordingly, recommend that disputed demands for tax, penalty or interest under direct tax laws should be allowed as a debt on the valuation date so, however, that if the demand is altered as a result of appellate proceedings or otherwise, the assessment in question shall be appropriately rectified under section 35 of the Act.

I-16.6. The other disallowance is in respect of taxes, penalty and interest under the direct tax laws which though undisputed, have remained outstanding for more than 12 months. This provision is also not justifiable. Taxes may remain outstanding for more than 12 months for valid reasons. They may, in fact, have been expressly permitted by the tax authorities to be paid over a deferred period. The blanket denial of deduction in such cases is unwarranted. Again, if this measure is aimed at discouraging delay in payment of taxes it cannot be said to be really logical as the marginally higher incidence of wealth-tax by reason of the non-deduction of such tax liability, by itself, is not likely to be an effective deterrent. If a taxpayer has possession of assets sufficient to attract the levy of wealth-tax, there is nothing to prevent the Department from taking appropriate remedial steps to recover the outstanding taxes. Again, the principles laid down by the Supreme Court in *Kesoram Industries and Cotton Mills Ltd. v. C.W.T.*, (59 ITR 767), in the matter of allowing deduction of debts under section 2(m), is that the liability should be to pay an ascertainable sum of money *in praesenti* or *in futuro*. This legal dictum recognises the right of the taxpayer to claim deduction even in respect of future liabilities. For all these reasons, we do not consider the denial of deduction of such debts to be justified. We, accordingly, recommend the deletion of the provision in item (b) of sub-clause (iii) of clause (m) of section 2.

I-16.7. The concept of net wealth requires the ascertainment of assets belonging to the taxpayers on the valuation date. It should be appreciated that this concept postulates rights of ownership of the taxpayer over the assets. There are situations where certain assets may be of a contingent nature. This is particularly so in cases where assets have been compulsorily acquired by the Government and a certain compensation is awarded by the appropriate authority. Invariably, the quantum of compensation is the subject of challenge by the erstwhile owner and he would be taking appropriate proceedings for enhancing the amount of compensation. The recent amendments in the Income-tax Act in relation to capital gains to which a reference has been made earlier, contemplate a situation where additional amounts of compensation are awarded at some later stage. By its very nature the additional amount of compensation cannot be predicated with any amount of certainty or with reasonable accuracy. In such circumstances, the nature of the interest of the taxpayer in the additional compensa-

tion amount which is likely to be awarded is wholly contingent upon the outcome of the proceedings for enhancement of compensation. Until these proceedings reach some stage of finality it cannot be said that the contingent interest of the taxpayer in the claim for enhanced compensation constitutes an asset owned by him on the valuation date. Our attention has been drawn to the attempts are made to include the amount of claims preferred by taxpayers for additional compensation as part of the net wealth. Such attempts are contrary to the concept of assets belong to the assessee, which is the essential feature of net wealth before it can attract charge to wealth-tax. We recommend that suitable administrative instructions should be issued so as not treat as an asset claims for enhanced compensation which are not finally decided as at the valuation date. In the alternative a clarificatory explanation may be inserted in section 2(m) of the Act.

I-16.8. Section 4 of the Wealth-tax Act provides for the inclusion of certain assets in the net wealth of an individual though such assets do not legally belong to the individual on the valuation date. Sub-section (1) covers assets transferred by the individual to his spouse, minor children, etc. Sub-section (1A) covers separate property of the individual, which is converted by him into Hindu joint family property. These provisions correspond to those contained in section 64 of the Income-tax Act to deal with the clubbing of income under the Income-tax Act. The objective underlying the provisions is identical, namely, to check the avoidance of tax. Sub-section (1A), at present, refers only to conversion of the separate property of the individual into property belonging to the Hindu undivided family through the act of impressing such separate property with the character of family property or throwing such property into the common stock of the family. In line with the recommendation made by us whilst dealing with section 64(2) of the Income-tax Act, we recommend that sub-section (1A) of section 4 should be amended to cover property gifted by the individual to the Hindu undivided family.

I-16.9. Sub-section (3) of section 4 provides for deduction of debts referable to the assets which are clubbed, as also for the allowance of the exemptions under section 5 in respect of such assets. The purpose of the provision is to take the fiction of clubbing to its logical conclusion. Thus, if assets of the spouse, minor child, etc., are included in the net wealth of the individual in the circumstances mentioned in section 4(1), it is appropriate that the individual should be entitled to deduction of the debts referable to such assets and also to the exemption appropriate to such assets under section 5. A specific provision to this effect is, however, not to be found insofar as the clubbing operates under section 4(1A) in regard to separate property converted into Hindu joint family property. The provision in sub-section (3) is, of course, only of a clarificatory nature. Nevertheless, it may lead to an erroneous conclusion that, in the absence of a specific provision, the deductions and exemptions are not admissible in respect of assets which are clubbed under section 4(1A). We, therefore, recommend that the provisions of sub-section (3) of section 4 may expressly be made applicable

to assets included in the net wealth of the taxpayer under section 4(1A).

I-16.10. Sub-section (5A) of section 4 deals with gifts of money made by means of book entries. It is well settled that transfers by way of gift can be effectively made by entries in books of account. The sub-section is aimed at checking such transactions where the book entries are not accompanied by actual delivery of money. The consequence of the provision is to ignore such gifts for the purposes of the Wealth-tax Act and to club such gifts in the net wealth of the donor. The provision may be justifiable from the point of view of preventing fictional gifts, for which the only evidence is that contained in the book entries. The desired result could have been achieved by recognising the gift only at the point of time when there is physical transfer of money or money's worth. The provision, however, recognises the gift by book entries only if there was actual delivery of the money at the time the entries were made. This requirement of the delivery of the money being simultaneous with the book entries is, to our mind, unjustified and might lead to hardships where the gift is completed by the physical transfer of money at a subsequent date. Further, while the provision in sub-section (5A) will result in the assets being clubbed in the assessment of the donor for purposes of wealth-tax, under the Gift-tax Act, the donor would be assessable to gift-tax in respect of the gift even though there was no actual delivery of the money. This is because there is no corresponding provision made under the Gift-tax Act. To that extent the provision is not defensible, particularly, because the scheme of direct taxes in India is an integrated one. We, accordingly, recommend that the provision in sub-section (5A) of section 4 should correspondingly be reflected in the Gift-tax Act as well, where also such a transaction should not be regarded as a gift. We further recommend that on the delivery of money or money's worth, the gift should be regarded as effective so as to attract gift-tax and to warrant exclusion from the net wealth of the donor subject to the other clubbing provisions. We recommend that such amendment should be made with retrospective effect from 1st April, 1976, when sub-section (5A) came into force.

I-16.11 In line with our observations in Chapter 14 of this Report in relation to the Income-tax Act, it is appropriate to enact a general provision in the Wealth-tax Act that the same wealth will not be subject to double assessment. Thus, where assets are clubbed artificially in the net wealth of a taxpayer, the same assets should not form part of the net wealth of the legal owner. Such a provision is specifically made in the proviso to sub-section (1A) of section 4 but as it deals with only a restricted category, it may lead to an inference that in other cases double assessment is warranted. We recommended that an express provision against double assessment should be made in the charging section.

I-16.12. Section 5 of the Wealth-tax Act provides for exemption of certain assets from the charge to wealth-tax. Under sub-section (1), the exempted assets are not liable to wealth-tax and they are not to be

included in the net wealth. Sub-section (2), however, envisages a category of exemptions for investments (by way of deposit or in any security) with the Government etc. as may be notified. The sub-section, however, provides for the inclusion of such assets in computing the net wealth so as to allow the exemptions at the average rate of wealth-tax in the manner specified in rule 1 of Part II of Schedule I. This seems to be a needless refinement and runs counter to the trend of simplification of tax calculations. The concept of average rate of wealth-tax is not very significant in terms of revenue impact and on the grounds of simplification as well, it appears that a total exemption would be more appropriate. We, accordingly, recommend that reliefs under the Wealth-tax Act should be by way of straight deductions without any provisions for reliefs at the average rate of tax.

I-16.13. It would also be of general assistance to the taxpayer if exemption of the nature which are granted from time to time by notification or which may otherwise be granted under the terms of other governmental schemes, are specifically set out in a Schedule to the Wealth-tax Act so that they are readily available for reference. In that event, specific powers may be conferred on the Central Government to add to or alter the assets specified in such Schedule. It would also be appropriate to point out that, under sub-section (1) of section 5, certain exemptions are provided by Government notifications as specified in clause (xv). Such notifications may be issued from time to time and as they do not form part of either the Act or the Rules they may not be readily available for reference to the taxpayer. Absence of general publicity in this regard may also result in taxpayers not availing of the tax concession and the objectives of the Government in promoting such schemes remaining unfulfilled. We recommend that exemptions left to notifications should be consolidated in a Schedule to the Wealth-tax Act which may be altered by the Central Government under a specific authority conferred by the Act.

I-16.14. Representations have been made to us in regard to the position of taxability of outstanding fees in the case of professionals. A professional person is liable to wealth-tax in the same manner as any other taxpayer in respect of his net wealth under section 3 of the Wealth-tax Act. This section provides that wealth-tax shall be charged for every assessment year in respect of the net wealth on the valuation date, of every individual, Hindu undivided family, etc. Wealth-tax is charged on the net wealth and "net wealth" as defined under the Act means the amount by which the aggregate value, computed in accordance with the provisions of the Act, of all the assets belonging to the taxpayer on the valuation date exceeds the liabilities owing by the taxpayer. The expression "assets" has been defined in section 2(e) to include property of every description, movable or immovable.

I-16.15. Section 7 of the Wealth-tax Act lays down the rule for valuing the assets of the taxpayer. It states that the value of any asset shall be estimated to be the price which it would fetch if sold in the open market on the valuation date. However, sub-section (2) of section 7 states that where the taxpayer is carrying on a business for which accounts are main-

tained by him regularly, the Wealth-tax Officer may, instead of determining separately the value of each asset held by him in the business, determine the net value of the assets of the business as a whole having regard to the balance-sheet of such business as on the valuation date and make such adjustments as may be prescribed. The said section and the rules framed thereunder are strictly not applicable to a profession. However, the underlying principle of the section is a global valuation where a balance-sheet drawn up under a recognised method of accounting is available.

I-16.16. Normally speaking, professional persons who are assessed to wealth-tax, maintain their books of account on cash basis which are accepted by the Income-tax Department for the purpose of income-tax. A regular profit and loss account and balance-sheet may also be drawn up. Therefore, the question of valuing any assets in the nature of fees due by clients in respect of work done by the taxpayer would not arise because such fees would be accounted for first as income and thereafter the net result of the fees received after deducting the expenses would be added to the capital of the professional.

I-16.17. The cash method of accounting is one of the recognised methods of accounting. It is statutorily recognised for the purposes of income-tax and if such a method is regularly employed by a taxpayer, the profits and gains of the business or profession must be computed in accordance with that method (section 145 of the Income-tax Act). The Wealth-tax Act also contemplates determination of the wealth on the basis of a balance-sheet which is drawn up from books regularly maintained for a business. The Income-tax Appellate Tribunal has held that the adoption of such a balance-sheet for wealth-tax purposes with the permitted adjustments cannot empower the wealth-tax authorities to wholly rewrite the accounts to a mercantile system and thus treat the outstandings as assets. This would amount to an arbitrary change of the method of accounting regularly employed by the taxpayer.

I-16.18. As the accounts are maintained by many professional persons on cash basis, consistent with this method of accounting, the fees outstanding from clients would not constitute an asset in the accounts till they are received and therefore, such fees are not assets under the Wealth-tax Act. However, on this point a doubt has been raised because of the decision of the Calcutta High Court in *Dipti Kumar Basu v. C.W.T.* 105 ITR 450. The Calcutta High Court has dissented from the decision of the Orissa High Court in *C.W.T. v. V. B. Raju* 79 ITR 330. An approach was made on behalf of legal practitioners who represented that fees due to them by clients which remain outstanding and which are not disclosed in their accounts mainly because they maintain their books of account on cash basis should not be treated as assets for the purpose of the Wealth-tax Act. The Government had accepted this representation of the legal practitioners and introduced an amendment in the Wealth-tax Act

through the Finance Act, 1976, to the following effect :—

“5(1)
wealth-tax shall not be payable by an assessee in respect of the following assets”

... ..
... ..

(xa) the amount of any fee due to the assessee in respect of services rendered by him as a legal practitioner within the meaning of the Advocates Act, 1961 (25 of 1961).”

I-16.19. In enacting this provision it has been stated that outstanding fees in the case of pleading advocates and senior advocates who are briefed by junior advocates are not legally recoverable. It is to be recognised that it is not as if the legal bar on recovery applies to all lawyers and solicitors. This legal bar applies only in certain cases. The other more important reason given is that the ascertainment of the outstanding fees presents practical difficulties. The practical difficulties which are envisaged would relate not only to determination of the gross quantum of the outstanding fees but also to the imponderables involved in the quantum of recoveries, the quantum of expenditure which would constitute a charge against such fees and, last but not the least, the quantum of inbuilt income-tax liability which would necessarily arise as soon as these fees are recovered. Again, there is a clear distinction between a business and a profession and the underlying philosophy in a profession is the concept of service to society. Professionals normally treat their fees as debts of honour and do not resort to legal remedies for recovery thereon even in cases where such a remedy may theoretically exist.

I-16.20. Thus, insofar as legal practitioners are concerned, the fees outstanding and due to them from their clients is not treated as an asset for the purpose of wealth-tax from the assessment year 1975-76. It is, therefore, suggested that in case of all professionals the amount of any fee due to them in respect of services rendered by them should not be treated as an asset so long as they maintain their books of account on cash basis.

I-16.21. The proposition to treat outstandings as the assets of a professional is in conflict with the concept of assets, having regard to the method of accounting regularly followed by the taxpayer. In the mercantile system of accounting it is not only appropriate but also necessary that the year-end assets or stock-in-trade are valued. But on the cash basis of accounting there is no question of bringing the year-end stock-in-trade into account because they do not constitute assets. This proposition has been fully considered by the Court of Appeal in England in the case of *Mason v. Innes*, 70 ITR 491. That was a case of a professional author who had disposed of his rights in a book and the revenue sought to tax the author with reference to the value of the work. The court has drawn a clear distinction between a trader who maintains his books on the mercantile system (in whose case the question of

taxation could arise on the basis of an earlier judgment) and a professional who proceeds on the cash basis of accounting. In the latter case there is no asset to be recorded because the stage of recording only arises with reference to receipt. Lord Denning in the course of his judgment observed that professional men such as authors, artists and advocates usually "do not keep accounts on an 'earning basis'. They keep them on a 'cash basis', by which I mean that on one side of the account they enter the actual money they expend and on the other side the actual money they receive. They have no stock-in-trade to bring into the accounts. They do not bring in debts owing by or to them, nor work in progress. They enter only expenses on the one side and receipts on the other . . . a professional man comes within the general principle that, when nothing is received, there is nothing to be brought into account"

I-16.22. The above referred judgment, though rendered with reference to taxation of income, clearly postulates that debts or outstandings in the case of a professional do not constitute an asset. It would follow that bringing to charge such outstandings to wealth-tax would be against the fundamental basis of the charge under the Wealth-tax Act. The fact that the manner of taxation of income of a trader in such circumstances may be distinguishable under the English law and the Indian law (based upon pronouncements of the Supreme Court in India) is not relevant to the limited issue as to whether the outstandings or stock-in-trade constitute an asset in the case of a professional maintaining accounts on a cash basis. Apart from the fact that the Calcutta High Court has dissented from the decision of the Orissa High Court, the learned Judges had no occasion to consider the true effect of the final decision of the Court of Appeal in the case cited above as the attention of the court does not appear to have drawn to that case. The decision in such circumstances is, it is submitted with respect, open to review.

I-16.23. The enactment of section 5(1)(xa) has also not achieved the purpose of settling the controversy. Our attention has been drawn to the fact that the amendment is being construed as an express sanction for levying wealth-tax in respect of years prior to the assessment year 1975-76. This has further aggravated the problem and rendered the plight of several eminent professional men intolerable as pointed out to us by a former Attorney General of India. For the reasons set out above, we are of the view that outstanding fees in the case of a professional who maintains his books on cash basis cannot constitute an asset and much less the wealth belonging to the professional for the purposes of the Wealth-tax Act.

I-16.24. In order, therefore, to settle the whole controversy, quite apart from the position in law as explained above, we recommend that section 5(1)(xa) be amended as under :

"The amount of any outstanding fee in respect of professional services rendered by the assessee as a lawyer, solicitor, Chartered Accountant, Architect, Engineer, Medical Practitioner or such other professional service as may be notified in this behalf by the Central Government in the official Gazette, where the books of account are regularly maintained on the cash system of accounting."

I-16.25. Such a provision should be made operative retrospectively from the date the Wealth-tax Act came into force, as it is largely clarificatory and it is also intended to settle the controversies in a large number of assessments which are unsettled.

I-16.26. The entities liable to charge of wealth-tax under the Wealth-tax Act are individuals, Hindu undivided families and companies. As from 1st April, 1960, no wealth-tax is charged in respect of the net wealth of companies. Section 19A was specifically enacted with effect from 1st April, 1965, to sustain an assessment on executors and by a fiction they are treated as an individual for the purposes of the Wealth-tax Act. There has been considerable litigation on the scope of the charge on individual under the Wealth-tax Act and courts have decided that bodies like State Financial Corporations, State Road Transport Corporations, etc., which are strictly not companies as defined under the Wealth-tax Act are also liable to wealth-tax. The position had, therefore, to be remedied by a retrospective amendment of the definition of the term 'company' under section 2(h) of the Act. Certain sports and recreation clubs also which are not registered as companies, but registered as societies or constituted as associations may be regarded as liable to wealth-tax. The charging section does not seem to intend to cover such a wide field. Under specific provisions in section 10(23) of the Income-tax Act, total exemption from income-tax is provided to sports associations or institutions as a measure of encouragement of such activities. It is appropriate that all bodies which enjoy exemption from taxation on income under the provisions of section 10 of the Act should correspondingly enjoy exemption from taxation of wealth under the Wealth-tax Act. We, accordingly, recommend that a specific provision be introduced in section 5 of the Wealth-tax Act to exempt from tax the net wealth of all such bodies, associations or institutions as enjoy exemption from Income-tax on their income under the provisions of section 10 of the Income-tax Act.

CHAPTER 17

GIFT-TAX

I-17.1. The provisions of the Gift-tax Act were enacted as part of an integrated scheme of taxation of income, wealth, expenditure and gifts. These provisions operate for the purpose of levy of a tax on gifts notwithstanding the position that both under the Income-tax Act and under the Wealth-tax Act there are provisions for clubbing of incomes and wealth in certain circumstances. Thus though the effect of certain gifts is ignored for the purposes of income-tax and wealth-tax, yet under the Gift-tax Act a provision is made for the levy of gift-tax. The basic objective underlying the Gift-tax Act is to ensure that transfers of wealth which are effected during the lifetime of a taxpayer, attract liability to tax similar to the levy of estate duty on property which passes on the death of a taxpayer.

I-17.2. We had considered the feasibility of integration of the Gift-tax Act with the Income-tax Act. The point for examination was whether the levy of a separate tax through another legislation could be avoided and the same objective achieved by levying income-tax on the donee by treating the gift as his income. Such a course of action could have been justified on the ground that income under the Income-tax Act is a concept of the widest connotation. It has been enlarged to include even capital appreciation when realised in the form of capital gains. Recent legislation for inclusion of casual gains and windfalls as income has also to be taken note of. On the same basis, if gifts received by a person are treated as accretion of income and brought to tax in the hands of the donee under the Income-tax Act, the need for a separate Gift-tax Act would cease to exist. Consistent with the nature of such fictional income, the scheme would necessarily have to provide for liberal exemption similar to the deductions under section 80T in relation to long-term capital gains. Such a measure would have the added attraction of eliminating the fictional provision for clubbing income and wealth.

I-17.3. However, after careful consideration of the various implications of the scheme outlined above, we are of the view that the benefits that might be derived by the process of integration are outweighed by the disadvantages. The present provisions for taxing income, wealth and gifts separately are now well settled in the minds of the taxpayers. The inclusion of gifts as deemed income would be a revolutionary concept and would considerably remove the stability achieved over the past two decades of the operation of the Gift-tax Act. Various other complications would also result in the income-tax law which would outweigh the advantages of integration. We are, therefore, not in favour of treating gifts as income under the Income-tax Act and recommend the continuation of the Gift-tax Act in its present form.

I-17.4. One feature on which we would like to comment is that concepts which are common to the direct tax laws should, as far as possible, bear the same connotation under all the laws. Necessity of a common definition also arises because of certain concepts which are relevant for both the Income-tax Act and the Gift-tax Act, as for example, transfers by way of gift to which a reference has been made in Chapter 9 of this Part of our Report, dealing with "capital gains". We are making this observation in the context of the definition of 'company' in section 2(vii) of the Gift-tax Act. The definition is different from the definitions under the Income-tax Act and the Wealth-tax Act. There does not appear to be any justification for such variations in the definition for the different enactments. We recommend that the definition of 'company' as contained in the Income-tax Act should be made applicable for the purposes of the Gift-tax Act, too.

I-17.5. The expression 'charitable purpose' is defined in section 2(va) of the Gift-tax Act, in terms similar to the definition in section 2(15) of the Income-tax Act. Our recommendation in the Interim Report for amendment of the definition for the purposes of the Income-tax Act would correspondingly apply to the definition in section 2(va) of the Gift-tax Act.

I-17.6. The recommendations made by us in Chapter 18 of this Report in regard to the valuation of the interest of a partner in the assets of the partnership serve another useful purpose. At present, there is considerable uncertainty in regard to the question of gift when there are changes in the constitution of a partnership firm either by the introduction of new partners or by the readjustment of the profit-sharing proportions of the partners *inter se*. Where such reconstitution is made out of love and affection, there is clearly evidence of gift as held by the Supreme Court in *C.G.T. v. Dr. George Kuruvilla*, 77 I.T.R. 746. In such cases the only issue would be the quantification of the value of the gift. The interest of a partner in the firm includes his right to receive the share of profits of the firm and to receive the share of the assets of the firm in the event of dissolution as per the terms of the partnership agreement. The right to receive a share of income is itself in the nature of property. Cases of reconstitution which are not expressly out of love and affection raise the issue as to whether they involve an element of gift at all. This is largely a question of fact to be determined in the circumstances of each case. Two provisions of the Gift-tax Act are, however, relevant to determine this question. A reconstitution by itself would not be a gift to the extent it is not a transfer without consideration. It may, however, fall within the definition of "transfer of property" in section 2(xxiv). The other provision which has a bearing on the question is section

5(1)(xiv), which exempts a gift made in the course of carrying on a business, profession or vocation to the extent to which the gift is proved to the satisfaction of the Gift-tax Officer to have been made *bona fide* for the purpose of such business, profession or vocation. The exemption under this section can only operate if the transaction clearly satisfies the terms of the clause, viz., that the gift is, firstly, in the course of carrying on the business or profession and, secondly, it is made *bona fide* for the purpose of such business or profession. These tests have been considered by the Supreme Court in the case cited above and they are necessarily restricted by the express terms of the section. The development of partnership businesses necessarily involve periodical admission and retirement of partners and reconstitution of profit-sharing proportions. These are largely based upon subjective evaluations of the contributions by the partners concerned. It should be noted that in the case of learned professions, the scope of making gifts through reconstitution of the partnership is largely restricted because such professional firms must necessarily comprise persons who possess the requisite professional qualifications. There is in our view, therefore, no justification for invoking the provisions of section 2(xxiv) of the Gift-tax Act in the case of the learned professions mentioned in section 10(23A) of the Income-tax Act, viz., the professions of law, medicine, accountancy, engineering or architecture or such other profession as may be notified by the Central Government. **We, therefore, recommend that an Explanation should be added at the end of section 2(xii) clarifying that where there is a bona fide change in the constitution of a firm engaged in one of the learned professions, it shall not be regarded as a gift.**

I-17.7. In case of business difficulty arises because the Supreme Court has in the case cited above disapproved the construction placed by the Kerala High Court on section 5(1)(xiv) and has not decided the question whether the test of commercial expediency is strictly appropriate to the claim for exemption under section 5(1)(xiv). As a result of the observations of the Court the position in law can be said to be uncertain and disputes and differences are likely to arise between the taxpayers and the Department. There are also decisions of High Courts where cases have been held either to fall outside or within section 5(1)(xiv). It is our view that where a *bona fide* reconstitution of a firm takes place and it is justified on grounds of commercial expediency, there cannot really be said to be any gift. The case should more appropriately fall outside section 2(xiv) rather than fall for consideration under the exempting provision of section 5(1)(xiv). **We, accordingly, recommend that another Explanation should be added at the end of section 2(xii) clarifying that where a bona fide change in the constitution of a firm carrying on any business is made on grounds of commercial expediency, it shall not be regarded as a gift.**

I-17.8. One of the vexed questions of dispute between the taxpayers and the Department is the treatment of premium paid under policies taken out by a taxpayer for the benefit of the members of his family under the Married Women's Property Act. Such poli-

cies are *ab initio* settled under an irrevocable trust and the taxpayer has no control over the monies. It is in recognition of this position that under the state duty law such policies are regarded as a separate estate and not aggregated with the other property of the deceased. Premiums paid under such policies are designed to cover the risk of life under a contract of insurance. It is harsh and inequitable to bring to tax either the premium or any other notional sum as a gift in the hands of the taxpayer. There is need to encourage this form of thrift, more particularly in the absence of social security schemes of general applicability. We understand that the Appellate Tribunal has also held that payment of such premium does not constitute a gift. Apart from the legal position in this regard it is appropriate that no attempt should be made to tax the premium or any other amount as gift in respect of policies issued by the Life Insurance Corporation of India expressly under the Married Women's Property Act. **We recommend that no part of the premium paid on a Life Insurance Policy effected under the Married Women's Property Act should be regarded as a gift.**

I-17.9. Section 4(2) of the Gift-tax Act prescribes the manner of computation of taxable gift where a person impresses his individual property with the character of property belonging to the Hindu undivided family of which he is a member or throws his individual property into the common stock of the family. In such cases by a fiction the value of the property so impressed or thrown, excluding the share of the individual on a notional partition thereof, is deemed to be a gift. As pointed out in the corresponding provisions under the Income-tax Act (section 64(2)) and the Wealth-tax Act (section 4(1A)), the provisions do not cover a direct gift by the individual to his Hindu undivided family. We are of the view that the direct gift to the family should for the purposes of gift-tax also be treated on par with the deemed transfer to the Hindu undivided family by the act of impressing or throwing. **We, accordingly, recommend that a transfer by way of gift by an individual to the Hindu undivided family of which he is a member should, in section 4(2) of the Gift-tax Act, be treated in like manner as property impressed with the character of joint family property or thrown into the common stock of the Family.**

I-17.10. Section 18 of the Gift-tax Act provides for a rebate with reference to gift-tax paid in advance. The section was amended in April, 1976, in order to secure that the rebate is computed in a manner which will ensure that the tax paid in advance, together with the rebate, would cover the gift-tax liability on final assessment. The need for granting the rebate by way of refund on final assessment was thus obviated.

I-17.11. The provisions as they stand at present indicate the requirement of making payment of the tax due on the gift calculated at the rates specified in the Schedule. Another provision contained in section 18A of the Act allows a deduction of the stamp duty on the instrument of gift against the gift-tax liability. The provisions of section 18 may be so construed as not to entitle the taxpayer to set off the stamp duty under section 18A against the gift-tax liability at the

time of advance payment. On such construction a higher amount of tax than ultimately due would become payable in advance. The taxpayer also does not enjoy any additional rebate under section 18 on the extra payment, because, the quantum of the rebate is limited to 10 per cent of the gift-tax due. Such cases would, therefore, necessitate refund of tax on completion of assessment and defeat the intention underlying the amendment of 1976.

I-17.12. We were informed that the Central Board of Direct Taxes has issued a circular clarifying that the taxpayer may take into account the rebate on stamp duty under section 18A for the purpose of the advance payment under section 18. This circular of the Board is in conformity with the intention underlying the section as well as the provisions thereof. It is, however, desirable that statutory effect be given to the circular to prevent the denial of the rebate on an erroneous construction of section 18. We recommend that section 18 of the Gift-tax Act should expressly permit the taxpayer to compute the advance gift-tax by taking into account the rebate on stamp duty under section 18A.

1-17.13. Section 18A allows deduction for stamp duty paid on an instrument of gift of property in respect of which the gift-tax payable exceeds Rs. 1,000. As the provisions stand, no relief under the section is available until the gift-tax exceeds Rs. 1,000. Thereafter deduction is allowed for the whole of the stamp duty but it is limited to 50 per cent of the gift-tax in excess of Rs. 1,000. Full relief for the stamp duty paid is, therefore, at present available only where gifts exceed the limit of Rs. 30,000 or so. The principle of allowing credit for one form of tax against another form of tax is a healthy principle as the State should not be entitled to a double source of revenue in respect of a single transaction. As the stamp duties are in the nature of revenue to the Government, it is appropriate that this duty is allowed as a deduction against the gift-tax in full. There is no particular justification for limiting the relief in the manner at present provided in section 18A and full relief should be afforded at all levels. Such full relief would not involve any significant addition to the administrative work because the determination of the gift-tax liability is effected in a single proceeding. We, accordingly, recommend that the provisions of section 18A should be amended to allow full credit for the stamp duty paid on an instrument of gift against the gift-tax payable in every case without any limitation.

CHAPTER 18

VALUATION OF ASSETS

I-18.1. The valuation of assets has relevance for the various direct taxes acts. Problems of valuation arise under the Income-tax Act for the levy of tax on capital gains, and under the Wealth-tax Act, Gift-tax Act and Estate Duty Act for the levy of these taxes. The general principle of valuation enunciated in section 7 of the Wealth-tax Act, section 6 of the Gift-tax Act and section 36 of the Estate Duty Act is that the value of any property shall be estimated to be the price which it would fetch if sold in the open market. Difficulties and disputes, however, arise in the application of this seemingly simple principle to specific situations.

I-18.2. In order to reduce the area of controversy, the Central Board of Direct Taxes has framed rules under these enactments for determination of the value of certain specific assets. There are thus specific rules under the Wealth-tax Act, vide rules 1A to 1D and rules 2 to 2-I. Rules 10 and 11 of the Gift-tax Rules prescribe the methods for valuation of assets for the purposes of gift-tax. The provisions under the Estate Duty Act are somewhat different in view of certain special features of that Act which are separately dealt with in Part III of this Report. As a general proposition it appears to us that there is no reason why the value of assets by and large should be determined differently under the Wealth-tax Act from that under the Gift-tax and Estate Duty Acts. If the attempt is to determine what corresponds to the open market value on a fair basis, the guiding principles should necessarily be the same under similar circumstances. There is, therefore, need for evolving, as far as possible, a uniform system of valuation under these laws in view of the fact that the basic concept of the price in the open market is common. There are certain specific situations, however, which may require different method of valuation of certain assets, e.g., shares in a controlled company for estate duty purposes. Apart from such exceptional cases (which are separately dealt with in Part III of this Report) there should not be any departure from the uniform principles for valuation applicable under the three enactments.

I-18.3. The general principles in regard to valuation of shares in a limited company for wealth-tax purposes have been examined by the Supreme Court in *C.W.T. v. Mahadeo Jalan & Ors.* 86 ITR 621. While setting out the principles normally applicable, the Court observed that these were not hard and fast rules, and that, ultimately, the facts and circumstances of each case would necessarily have to be taken into account. The principles set out by the Court in this regard are as follows :—

- (1) Where the shares are of a public company and are quoted on the stock exchange and there are dealings in them, the price prevail-

ing on the valuation date is the value of the shares.

- (2) Where the shares are of a public company which are not quoted on a stock exchange or of a private company, their value is determined by reference to the dividends, if any, reflecting the profit-earning capacity on a reasonable commercial basis. But if the profits are not reflected in the dividends which are declared and a low earning yield is shown by the company, which is unrealistic on a consideration of the financial affairs disclosed for the relevant year, the Wealth-tax Officer can, on an examination of the balance-sheet, ascertain the profit-earning capacity of the concern, and on the basis of the potential yield, fix the valuation. In other words, the profits which the company has been making and should be making will ordinarily determine the value. The dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the profit-earning capacity. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of the profits.
- (3) In the case of a private company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield.
- (4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set-back is temporary then it is perhaps possible to take the estimate of the value of the shares before set-back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.
- (5) Where the company is ripe for winding up then the break-up value determines what would be realised by that process.
- (6) Valuation by reference to the assets would be justified where the fluctuations of profits and uncertainty of conditions at the date of the valuation prevent any reasonable estimation of prospective profits and dividends.

I-18.4. It would follow from the aforesaid principles that where regular quotations in the open market are available, as in the case of shares of public

companies quoted on the stock exchange, the quoted prices would represent the proper value for tax purposes. This principle is applicable for all the direct taxes because there is factual evidence of the market value of the asset. Share market quotations in relation to shares which are freely quoted on the stock exchange are generally accepted as the best evidence of market value and there is no suggestion that for the three different direct taxes, such value needs any adjustment. This value would be directly applicable wherever the market value has to be determined for the purposes of wealth-tax, gift-tax or estate duty.

I-18.5. The problem which arises, however, is the determination of the market value where such direct evidence of the value is not available. As already pointed out, the requirement of the law is to determine the open market value for the purposes of all the three statutes. The process by which such market value is sought to be determined could, therefore, appropriately be the same for all the three statutes. It is well recognised that valuation cannot necessarily be determined with certainty or mathematical accuracy. Every valuation involves determination of the subject matter of the valuation, viz., the property which has to be valued, and the purpose for which the valuation is to be made. Both these fundamentals of valuation are the same whether it be the Wealth-tax Act or the Estate Duty Act or the Gift-tax Act. **We recommend that any rules which may be framed for determining the market value of assets should as far as possible be made applicable to all the direct tax statutes.**

I-18.6. The type of property which is common in most assessments, and in relation to the valuation of which considerable controversy exists, is unquoted equity shares of a company. At present, under the Wealth-tax Act such shares are divided into two categories for purposes of valuation. The first category comprises shares of investment companies and managing agency companies as defined in rule 1A, of the Wealth-tax Rules. For such shares, no method of valuation has been prescribed in the Rules, and the valuation is left to circulars issued by the Board, by way of executive instructions.

I-18.7. In respect of the second category of unquoted equity shares, that is to say, shares of companies other than investment companies and managing agency companies, rule 1D of the Wealth-tax Rules lays down the procedure for determining the value of these shares for wealth-tax purposes. Some amount of controversy has arisen even in the matter of determining the value on the simplified formula contained in rule 1D. We understand that references are pending against the decision of the Appellate Tribunal that on a construction of rule 1D the determination of the value of the share has to be worked out by excluding the advance tax appearing as an asset in the balance-sheet and also reducing the provision for taxation shown as a liability in the balance-sheet. This indicates that even an attempt to simplify the process of valuation can lead to difficulties in interpretation.

I-18.8. It should, further, be noted that rule 1D proceeds on the basis of determining the value of the unquoted equity shares with reference to the net assets of the company. At the time when the rule was framed the principles laid down by the Supreme Court

in 86 ITR 621, cited above, were not available. It would be noticed that the adoption of a single method of valuing the shares on the net asset basis uniformly in all cases, is not in conformity with the principles enunciated by the Supreme Court. The valuation should ordinarily proceed on the basis of the profit earning capacity on a reasonable commercial basis. The earning power or yield method of valuation of shares should be the method generally used, while a valuation by reference to the assets or the break-up method would be justified only under certain exceptional circumstances, as mentioned by the Court. The inequities arising out of rule 1D could be clearly demonstrated if they were to be applied to some of the companies whose shares are quoted on the stock exchange; the value whereof determined under rule 1D may be widely divergent from the market quotations.

I-18.9. The rules for valuation of unquoted shares as framed today may be open to challenge as being *ultra vires*. The power of the Central Board to frame rules has necessarily to be limited in a manner as to result in a value which is the equivalent of the market value. It cannot extend to framing rules under which the value fixed does not approximate or equate to the market value. The opening words of section 7—"subject to any rules made in this behalf"—cannot destroy the concept of open market value, which is of the essence. The legislature can only delegate matters of procedure and administrative detail and not any matters of substance or essence. If, for example, the Central Board had notified rules which were on the face of them destructive of the concept of market value, as for instance determining the value of a share on the basis of total assets without deducting liabilities, such a rule would have been totally repugnant to the scheme of the Act. The power to make rules can, therefore, only be exercised within the framework of the scheme of the Act and within the overriding considerations of open market value which are essential for the charge of wealth-tax under section 3 read with section 7 of the Act.

I-18.10. There is, therefore, need to modify the procedures laid down in rule 1D and to evolve a method by which the value of unquoted equity shares can be determined on a more realistic basis so as to obviate unnecessary litigation. Any such basis would only be appropriate, if and to the extent the value determined thereunder would approximate to the fair market-value i.e. the price paid by a willing buyer and a willing seller in the open market. We are of the view that though as a general principle valuation would be required to be determined on the basis of the yield or earning power, there would necessarily be differences in the actual application of the method to various facts and circumstances. The determination of the value in the case of manufacturing companies need not necessarily be the same as in the case of service companies. There cannot be a single set of rules which could apply uniformly to all classes of companies irrespective of the facts and circumstances of the case. However, in the interest of uniformity on a broad basis, appropriate methods could be devised for companies falling under different classes such as industrial companies, investment companies, trading companies and others including service companies. These norms could generally be applied to companies falling in these categories and the ultimate value derived by a valuer. It would

be inherent in the scheme of valuation that the valuer may be required to make such adjustments as may be warranted by the facts and circumstances of the case.

I-18.11. With a view to reducing the area of difference between the taxpayer and the Department, we are of the view that the general guidelines for determination of the valuation should be evolved by a professional body like the Institute of Chartered Accountants of India. The affairs of this statutory body are governed by an elected council in which the Government nominates representatives from the interests concerned with the accounting profession, such as the Department of Company Affairs, the Central Board of Direct Taxes, the Office of the Comptroller and Auditor General of India, representative of labour interests, and representative of national trade chambers. Guidelines evolved by this council may be notified by the Government in the rules framed under the direct tax laws for valuation of unquoted shares.

I-18.12. In order to ensure that such valuations are readily determined, it would be appropriate if the valuation is required to be furnished in the form of a statement attached to the annual statements of account of the company. This statement should be drawn up by the auditors of the company, who would be required to express their professional opinion in conformity with the rules which are based on the guidelines framed by the Institute. The suggestion to have the statement of valuation attached to the annual accounts is to ensure that the process of determining the value is self-evident from the statement itself and to expose the statement to the public gaze. A document drawn up in this form would assume the character of a public document and would thus acquire a reasonable evidentiary value. The assessing officer could then adopt the value as contained in the statement of valuation subject to his right to adjust the same if and to the extent he considers the valuation to be not in conformity with the rules. Such a right would vest with the assessing authority as there may still be some areas where a genuine difference of opinion could arise. This would, however, be exceptional and over a period of time a reasonable stability in the matter of valuation of unquoted equity shares could be expected to be attained. As it is, in the case of corporate assessee the audited statements of account generally form the basis and the starting point for determination of income. The utility of the audited statements of account for framing assessments has been evolved over several years and in the same manner the statement of share valuation would also in due course provide the necessary basis for a fair valuation which should be acceptable to the taxpayer and the Department. For the purposes of valuation of unquoted equity shares of companies we recommend that :—

- (a) Rule 1D of the Wealth-tax Rules should be deleted and in its place fresh rules should be notified by the Government after consultation with the Institute of Chartered Accountants of India who may evolve guidelines for valuation.
- (b) The rules/guidelines should be framed separately for companies in four different categories, viz., (i) industrial, (ii) invest-

ment, (iii) trading, and (iv) others including service companies.

- (c) The auditors of the companies whose shares are not quoted should be required to furnish a statement, to be attached to the audited statements of account, showing the valuation of the shares of the company as at the balance-sheet date with an opinion to the effect that the value has been determined in accordance with the rules framed under the direct tax laws.
- (d) The statement of valuation should be reasonably explicit so that the figures adopted in the statement are readily verifiable with reference to the audited statements of account and the process by which the value of the share determined is reasonably clear. Adjustments which may be made by the auditor should be clearly reflected in the statement.
- (e) The value as determined in the statement of valuation by the company's auditor should be adopted by the assessing officer for all the direct tax laws unless the officer is of the opinion that the value needs to be modified to the extent the valuation is not in conformity with the rules notified under the act.
- (f) The value to be adopted on the basis of the aforesaid statement should relate to the date of the balance-sheet either coincident with or immediately preceding the valuation date.

I-18.13. Rule 10(2) under the Gift-tax Rules provides for the valuation of shares in a private company. This rule would become redundant in the scheme of valuation of unquoted shares recommended by us. Similarly the provision in rule 10(4) requiring the value of any other property to be determined by the Board would also be redundant in the light of our recommendation that the set of rules framed for determination of market value of assets should apply to all direct tax laws. We, accordingly, recommend that rules 10(2) and 10(4) of the Gift-tax Rules should be deleted.

I-18.14. Rule 1C of the Wealth-tax Rules prescribes the method for determining the market value of unquoted preference shares. The method, in brief, is to determine the value with reference to the actual yield on the preference shares by assuming a yield of 8 per cent to be normal. The rule also provides for a downward adjustment in cases where there are arrears of preference dividend. The rate of 8 per cent stipulated in the rule may have had relevance to conditions obtaining at the time when the rule was framed. Under the Capital Issues (Control) Act, the rate of preference dividend is revised from time to time. The Capital Issues (Exemption) Order does not itself stipulate the rate but refers to the rate which may be notified by the Controller of Capital Issues from time to time. At present, the rate of preference dividend notified by the Controller of Capital Issues is 11 per cent per annum. This is the rate applicable to preference shares of public companies. If preference shares of public com-

panies are available at par on the basis of a yield of 11 per cent, it is unrealistic to determine the value of unquoted preference shares with reference to a norm of 8 per cent. The rule should, therefore, not be framed in this inflexible manner and either the rate should be periodically revised as and when the rates are revised by the Controller of Capital Issues or, in the alternative, the rule itself should refer to such rate as may be notified under the Capital Issues (Control) Act and Rules. A discounting factor for non-negotiability should also be provided for, as the property to be valued is an unquoted preference share. The allowance for restricted negotiability can be made by providing for the normal yield to be 1 per cent higher than the rate notified under the Capital Issues (Exemption) Order by the Controller of Capital Issues. Thus, in present circumstances when the notified rate for public companies is 11 per cent, it would be reasonable to determine the value of unquoted preference shares on the basis of a yield of 12 per cent. **We recommend that rule 1C(1) of the Wealth-tax Rules should be amended to provide for the normal yield on reference shares to be 1 per cent over the rate notified by the controller of Capital Issues under the Capital Issues (Exemption) Order.**

I-18.15. Another asset which figures in a large number of wealth-tax cases is life interest in property. Rule 1B of the Wealth-tax Rules provides a simplified formula for determining the value of interest. The rule provides for the adoption of a rate of interest of 6½ per cent per annum. While this rate may have had relevance to the circumstances prevailing at the time when the rule was framed, it is out of date today. It must be recognised that the rate cannot be static. As in the case of the yield from all other forms of investments or assets, the rate should bear a reasonable relationship to the prevailing level of return and the interest rate structure. It would, therefore, be appropriate not to prescribe the rate in the rule itself but to direct the adoption of the rate of interest equal to the interest allowed by nationalised banks on long term fixed deposits of 5 years or more. The method of determining the value of life interest under the rule should be applicable to all the direct tax laws where the value of life interest is required to be taken into account. **We recommend that the rate of interest under clause (c) of the Explanation to rule 1B(1) of the Wealth-tax Rules should be equivalent to the rate of interest allowed by nationalised banks on long term fixed deposits of 5 years or more.**

I-18.16. As regards the valuation of reversions and interests in expectancy, we recognise that it would not be practicable to reduce such valuations to a mere arithmetical exercise. The rules at present also, therefore, do not provide the method of determining the values of such assets. These values would be determined by the valuers possessing the requisite qualifications as an actuary under rule 8A(2) of the Wealth-tax Rules.

I-18.17. Agricultural lands and coffee, tea, rubber and cardamom plantations also constitute important assets for the purposes the direct tax statutes. Agricultural lands and connected assets have been brought within the purview of the Wealth-tax Act from the assessment year 1970-71 onwards. The rules have not prescribed any specific method of valuation of agricul-

tural lands. The determination of the open market value could, therefore, be made either by comparing the prices of similar lands in the neighbourhood or in the alternative by the process of capitalisation of income. Instances of sales in the same or similar locality may not always be available and may also not be comparable having regard to various factors like soil classification, irrigation facilities, vicinity to marketing centres, topographical conditions, prevailing cropping pattern, etc. The determination of the fair market value by this process would, therefore, largely become arbitrary and lead to differences. Based upon the general principles established over the years, the appropriate method would be to derive the value by the process of capitalisation of income. Taxpayers who are liable to wealth-tax or gift-tax would ordinarily be liable to income-tax as well. Some evidence of the income from agricultural land would, therefore, be available on the records of the tax department. It would, therefore, be appropriate to determine the valuation of the agricultural land by capitalising the estimated agricultural income (having regard to the particulars shown in the income-tax return, if any) on the basis of the rates of capitalisation which may be notified by the Central Board of Direct Taxes in the rules from time to time. These rates may be notified at intervals of three years under normal circumstances unless there is any major restructuring of the interest rates in the economy. The purpose of leaving the rates of capitalisation to the rules is to allow for due consideration of the reasonable rates of expectancy of return from assets of this type during the relevant period.

I-18.18. The same method would correspondingly be also applicable in the case of agricultural lands used for coffee, tea, rubber and cardamom plantations. Here again, particulars of the agricultural income may be available with the Income-tax Department. Particulars of the agricultural income would in any event be also available in assessments under the State Agricultural Income-tax laws. In any event a reasonable estimate could be made of such income. The income basis being so available, the valuation could appropriately be made by the process of capitalisation of income. The Central Board of Direct Taxes could notify in the rules the appropriate rates of capitalisation once every three years as suggested in the preceding paragraph and in doing so, they may consult the specialised Boards constituted by the Government like the Tea Board, the Coffee Board, etc., who are actively concerned with the regulated development of the plantations industry. **We, accordingly, recommend that agricultural lands including plantations may be valued by capitalisation of the income therefrom at rates to be notified by the Central Board.**

I-18.19. In the Interim Report, we have suggested that the valuation of house properties should be made on the basis of capitalisation of the return. This method should be applicable for all the direct tax laws. Such house properties would include the land appurtenant thereto and thus the capitalisation would provide the valuation of the entire property. Our attention has been drawn to the fact that in some of the properties the land appurtenant has not been fully exploited. The land would entitle the owner to build up additional area on the basis of the floor space index (F.S.I.) as in

force from time to time. We are aware that the capitalisation of the income from the property as constructed would not attribute any separate value to this potential development. The levy of taxes under the direct tax laws should be based on the actual possession of the assets and not on theoretical potentialities. The further development which may be possible in the case of constructed properties would ordinarily not have a transferable value and, therefore, that cannot be separately assessed. As and when the property is further developed, it would automatically result in an increase in the income return and the process of capitalisation of the increased return would take into account the value of the property as developed.

I-18.20. The above principle would, however, not apply in the case of immovable properties held as open lands without construction. This would also not apply to land which is surplus to the house property and upon which separate building units could be constructed according to the prevalent regulations. Such surplus lands are also on par with open lands though such lands may be contiguous to the land on which a structure has been put up. Open land and surplus land of this nature will not lend themselves to valuation based upon the income capitalisation method. Land in such circumstances could be valued with reference to the comparable rates for similar land in the same or adjoining locality. Instances of recent transactions in comparable plots would form the basis of valuation. No further rules would, therefore, be necessary for valuation of such vacant lands or surplus lands and the basic provision contained in the Act viz., estimating the open market value, is, therefore, sufficient. The adoption of comparable instances would automatically taken into account the potentiality of developing such open lands. **We, accordingly, recommend that house property should be valued on the basis of capitalisation of income as recommended in the interim report for all direct tax laws. No separate valuation of potential development of the property should be made. However, open land and surplus land should be separately valued on the basis of estimation of the open market value.**

I-18.21. Another important asset for the purposes of the Wealth-tax Act, as also for the other direct tax laws, is jewellery. The general principles of valuation set out above would be inapplicable in the case of an asset like jewellery because it does not generate income. It would, therefore, be inappropriate and cumbersome to prescribe any rules for the purposes of valuation of jewellery. Items of jewellery have necessarily to be valued on the basis of the valuer's judgment of what the item would fetch if sold in the open market. The existing form of the report of valuation of jewellery in Form O—8 under rule 8D of the Wealth-tax Rules provides sufficient details to be certified by the registered valuer and based thereon the Wealth-tax Officer would be able to form a broad idea of the reasonableness of the valuation. We, therefore, do not recommend any special rules for the valuation of jewellery.

I-18.22. By far the most important asset which poses major problems in the matter of valuation is the asset in the form of interest in a business organisation including the interest of a partner in a partnership firm or the interest of a member of an association of persons. Section 7(2)(a) of the Wealth-tax Act has been

expressly enacted to enable the Wealth-tax Officer to make, what may be commonly called, a 'global valuation'. The section contemplates that ordinarily wealth would be determined by estimating the market value of the assets. However, where a business is carried on and accounts are regularly maintained, the section suggests that a different approach may be adopted, which is to value the business as a whole from the balance-sheet. The whole purpose underlying this provision is that where a business is carried on, its income would be assessable under the Income-tax Act in accordance with the method of accounting regularly employed by the taxpayer, and thus the profits and loss account and the balance-sheet of the business would form the basis of the income-tax assessment. In such cases, it is logical and appropriate that the wealth-tax assessment is also founded on the same basis and the value of the business determined as a whole from the balance-sheet. The valuation of an interest in a business must necessarily proceed on the basis of the business as a going concern inasmuch as the business undertaking is primarily set up for the purpose of earning profits. The undertaking would be constituted of the assets, rights and obligations of a going concern, all of which form an integral part of the undertaking. The section recognises that in such circumstances it is the valuation of the business undertaking as a unit which has to be made because the aggregate value of the components is not necessarily the value of the entirety of a unit of property, especially when the property is a going concern as an organised business. These principles in relation to the valuation of a business undertaking are contained in the observations of the Supreme Court in *R.C. Cooper v. Union of India* 40 Company Cases 325. Similarly attempts of the Department to value an individual asset like goodwill of a business undertaking in a gift-tax case, *C.G.T. v. P. Gheevarghese, Travancore Timbers and Products*, 83 ITR 403, were not upheld by the Supreme Court. Individual components of the business undertaking cannot be valued divorced of the undertaking, particularly, when an asset, like goodwill, is an integral part of the functioning of the business undertaking as a going concern. On the basis of these observations we are of the view that the provisions in rules 2A to 2G which deal with the global valuation under section 7(2)(a) of the Wealth-tax Act are inappropriate. The basic principle underlying section 7(2)(a) is to proceed with reference to the balance-sheet drawn up in accordance with the method of accounting regularly employed by the taxpayer. The section authorised the Wealth-tax Officer initially to make such adjustments to the balance-sheet "as the circumstances of the case may require", which expression was changed to "as may be prescribed" by the amendment of 1964. This change of expression cannot, however, be destructive of the essence of the provision, as pointed out earlier in this Chapter, while commenting on rule 1D of the Wealth-tax Rules. In the process of a global valuation there may be circumstances which require adjustments to be carried out. As for example, the taxpayer may have adopted a method of writing off assets such as capital assets for scientific research, etc. The circumstances of the case may require such write offs to be adjusted in the process of proper determination of the value of the business as a unit. Likewise, in a going concern there may be several inbuilt liabilities like gratuity, retrenchment, compensation and other claims of the workers

connected with the continuity of their service. In many cases, the proprietors of the business and more particularly partners in a partnership firm would not have access to the assets which are an integral part of the business. The provisions of rules 2A to 2F are therefore almost destructive of the global valuation which is contemplated as an alternative to the valuation by determining the individual values of the assets separately and aggregating the same. It is, therefore, appropriate that business undertakings which are to be valued as a going concern on a global basis should be valued by reference to the balance-sheet which is drawn up on the basis of the method of accounting regularly followed by the taxpayer. In a recurring tax like the wealth-tax, the determination of the value of the business with reference to the balance-sheet from year to year would necessarily even out distortions and abnormalities in a business as a going concern. The acceptance of a method of accounting for assessing income is also based on this principle that the business operations would get reflected in the books of account over a period of time and the matter should not be viewed narrowly only with reference to a single year. In the same way, from the point of view of wealth-tax which is charged from year to year, minor differences in the form of exclusions of certain assets or claims which may arise in accordance with the method of accounting would get evened out when these items are reflected in accordance with the method of accounting. As for example, a business concern may reckon its export incentive on a cash basis instead of the full mercantile basis. Such practices within the framework of the method of accounting regularly employed are common and there is no loss of revenue involved because ultimately the items are brought into account in one year or the other. In the integrated scheme of direct taxes, a practice which is accepted for the levy of income-tax need not be disturbed for a marginal effect which may arise under the Wealth-tax Act. It is, therefore, appropriate that the balance-sheet which is drawn up as per the method of accounting should not be disturbed for the purposes of determining the levy of wealth-tax from year to year. There is also no justification to disturb the value that may be placed on individual assets merely because there may be a differential of 20 per cent between the market value and the book value of a particular item of asset. The objective being to determine the value of a business undertaking as a unit, such individual adjustments should not be resorted to. The reason why this is suggested is that, apart from the facility arising from the adoption of the balance-sheet from year to year as the basis for wealth-tax, attempts to disturb individual valuations tend to distort the concept of value of the business as a unit. If such adjustments are to be made, the adjustments which would be necessary cannot be confined to upward revisions for individual assets and correspondingly various other revisions and evaluations of intangibles, labour liabilities on the basis of continuity of service, etc., would have to be taken into account. The adoption of such an exercise would open innumerable areas of difference and dispute between the tax-payer and the Department which would not be justified for a levy like the wealth-tax which operates from year to year. The only adjustments to be made should be those which the circumstances of the case may require, as for example, a write off of assets like capital expenditure on scientific research or excessive write down of other assets having

regard to the depreciation allowable under income-tax law, etc. It would be logical to adjust the net assets of the business by bringing back such assets to a corresponding book value. So far as gratuity, bonus, labour claims, etc., are concerned, these would necessarily have to follow the method of accounting adopted for determination of the business profits. Unprovided gratuity liabilities where gratuity is accounted for on cash basis would thus not qualify for any adjustment to the net asset from the balance-sheet.

I-18.23. In the same manner, the issue arises about assets not disclosed in the balance-sheet. In cases where the cash system of accounting in contrast to the mercantile system of accounting is adopted, the value of unrealised income would not appear as an asset. The income-tax law recognises that true profits can be determined for the purposes of income-tax assessment even on the basis of cash system of accounting. It is inherent in this system that having regard to the nature of income receipts, it would be appropriate to account for the income only on the basis of actual receipt and likewise, correspondingly, to account for the expenditure on the basis of actual disbursement. We have discussed this aspect in detail in Chapter 16 of this Report. The observations made earlier indicate that in an integrated scheme of direct taxes there should be a reasonable correlation between the Income-tax Act and the Wealth-tax Act, more particularly where section 7(2)(a) of the Wealth-tax Act imports a concept of the method of accounting regularly employed which is the basis for determining business income under section 145 of the Income-tax Act. The inclusion of outstanding income as an asset not reflected in the balance-sheet is not, in our view, an adjustment which the circumstances of the case would warrant. The adjustments should not be such as are destructive of the method of accounting and virtually amount to a total change in the method of accounting.

I-18.24. At the same time we do recognise that there are instances where the media of business undertakings or partnership firms are used for the purpose of holding non-business assets with a view to reduction of the incidence of wealth-tax. This is particularly in evidence where investments in shares of companies which appreciate over a period of time are held in partnership firms by constituting such assets as the property of the firm. In many cases these investments are really held as long-term investments in companies under the management of the partners or their associates. If assets are so held, the global valuation on the method outlined by us would not necessarily reflect true wealth of the partners. Such cases should necessarily be distinguished from other cases where the assets are genuinely held as part of a business, as for example, where share investments are held as stock-in-trade in case of a business of dealing in shares. Where the stocks are genuinely part of the business, they would have to be valued according to the method of accounting and there would be no justification for disturbing such value. However, the same would not be true in the case of investments which are not part of the true business assets. In order that there is no avoidance of wealth-tax by this procedure, the provisions contained in rule 2G should continue to operate. Such assets as do not really pertain to the business should be excluded from the global valuation and should be

valued in a direct manner as any of the other assets of the taxpayer. We, accordingly, recommend that rules 2A to 2F of the Wealth-tax Rules should be substituted by rules which provide for the valuation of a business concern as a whole on the basis of the balance-sheet drawn up in accordance with the method of accounting and the determination of the excess of assets over liabilities as per such balance-sheet. The only adjustments which need be made should be those which the circumstances of the case may require, such as adjustments of departure from the method of accounting, or straight write offs of assets like capital assets for scientific research or excessive write off of depreciation beyond that permitted under the tax laws. No adjustments of hypothetical nature or adjustments to individual items as at present contemplated in rules 2A to 2F should be made. The taxpayer should also not be entitled to deductions for liabilities like gratuity, bonus, etc., which remain unprovided in accordance with the method of accounting. In particular, no adjustments which amount to a change in the method of accounting with reference to which income is computed should be made. However, assets which do not really pertain to the business should be separately valued as under rule 2G.

I-18.25. The approach suggested in the preceding paragraphs for determining the value of business on the basis of the balance-sheet drawn up under the method of accounting regularly employed would bring about considerable simplification in the determination of the value of such assets. Such a simplification is necessary particularly where the value has to be determined from year to year in the case of large number of wealth-tax payers. This would, no doubt, mean that attempts to determine market value of individual assets, or to determine the value of intangible assets and benefits like goodwill, not reflected in the balance-sheet, and attempts to evaluate inbuilt disadvantages and liabilities, etc., would be unnecessary and the whole area of differences between the taxpayers and the Department would be eliminated. This cannot have any significant impact on the revenue from wealth-tax and the advantages that would flow from the simplification would fully justify the reform.

I-18.26. The provisions of section 7(2) and Rules 2A to 2G framed thereunder are appropriate to the valuation of business undertakings. There is a distinction between a profession and a business. On a proper construction, section 7(2) would be inapplicable to the valuation of interest in a professional organisation. However, for the purpose of determining the interest on a global basis, the approach set out above should be equally applicable, if the profession concerned maintains accounts regularly under a recognised method of accounting. Our observations and recommendations in the preceding paragraph should, therefore, be regarded as applicable to the case of the learned professions as well and the global valuation as contemplated in section 7(2) (a) should likewise be expressly made applicable to such professions.

I-18.27. It should further be recognised that such a simplified procedure which may be warranted for the levy of a tax on a large number of wealth-tax payers from year to year may not necessarily be justified in

the context of the exceptional levies like gift-tax and estate duty. We have already indicated earlier that the principles of valuation of the same property and for the same purpose should be the same and, therefore, there should be no occasion for a different approach between wealth-tax, gift-tax and estate duty. However, in the case of a complex asset like interest in a business, we have suggested an approach for wealth-tax which is largely justified on grounds of simplification and the recurring nature of the levy whereby the yardstick of the method of accounting would, over a period of time, lead to fairness and reasonableness. Such justification may not necessarily apply with equal force in the case of gift-tax or estate duty which are by their nature non-recurring. There have been several cases where interests in business have been transferred either by the process of gift or by the process of death and succession. In fact it would almost be the normal sequence of events for a taxpayer to divest himself of his interest in business to his family members in the same manner as he divests himself of other items of wealth like shares, jewellery, immovable property, etc. In such cases it would not be appropriate to merely adopt a simplified measure of valuation which may lead to large scale avoidance of gift-tax and estate duty. In these exceptional circumstances it would be appropriate that both the taxpayer and the Department exert themselves in the direction of making a more accurate estimate or assessment of the value of a business as a unit and thereby measure the extent of transfer in value that may be achieved. There is, therefore, ample justification for a limited exception to the general rule explained by us earlier. This exception would be justified having regard to the complexity of the asset. We would, however, emphasise that the appropriate method for the valuation of such a complex asset is the global method and not a method of attempting individual valuations of the various components of the business undertaking. A global evaluation based upon the approach of capitalisation of income would automatically take into consideration the sum total of the tangible and intangible assets, advantages, and obligations which constitute the integral part of the business unit. This would be the method which would lead to the nearest approximation of a value based on commercial principles. There are, however, a large number of factors which are peculiar to the valuation on this approach which may not necessarily have the same force or impact when dealing with a regulated organisation like a company. The capitalisation of income approach suggested by us for the valuation of unquoted shares of companies can be reasonably adopted on a year to year basis having regard to the nature of the corporate entity. The same considerations would however, not directly be applicable to other forms of business organisations. In the evaluation of the business in the non-corporate sector, the valuer would necessarily have to give considerable weightage to the personal involvement of the parties constituting the business, the factor of uncertainty and lack of perpetual succession to the business organisation, the incidence of personal taxation, the assessment of a fair compensation for managerial effort, the factor of risk and appropriateness of the anticipated rate of return, etc. These factors are illustrative of the complexities of the valuation of a business in the non-corporate sector. It should further be remembered that the valuation of a share in a company based on the

earning power is quite different from valuation of a business undertaking directly which is held by the owners of the business in the non-corporate sector. These complexities can be gone into by the taxpayer and the Department. In the exceptional circumstances of gift-tax and estate duty which by their nature are not recurring levies. Needless to say, the valuation made on the basis of capitalisation of the income would necessarily have to be tested with the realities of the given situation so as to equate it with what a willing buyer would be prepared to pay for such a business undertaking. The willing buyer who makes such an investment would necessarily take into account the number of years over which he could recoup the cost of the purchase as is in excess of the net value of the tangible assets making due allowance for interest on the capital outlay, recoupment of income after meeting tax liabilities, share of labour, etc. We, therefore, recommend that the valuation of interest in business for the purposes of gift-tax and estate duty should be on the basis of capitalisation of the income. In our view, it would not be possible to lay down rules for determining the income and for determining the rates of capitalisation having regard to the wide complexities which prevail in individual business in the non-corporate sector. The valuation would, therefore, necessarily have to be made on a case to case basis as and when the occasion arises having regard to the facts and circumstances of each case. The rule should, however, provide that the value shall be determined on the global valuation basis by capitalisation of the income of the business leaving the actual computation of the income as well as the rate of capitalisation to the valuer and the assessing officer. In no case, however, the value of the business should be taken at a figure below the value of the net tangible assets as shown in the balance-sheet, the justification being that in making the valuation, negative value of intangibles should be ignored.

I-18.28. The above recommendations for valuation of business undertakings would apply to sole proprietors, partnerships and associations of persons. In the case of associations of persons and partnerships it is to be noted that the property to be valued is the property in the form of interest of the taxpayer in the association of persons or the firm. Such interest should be determined by a rule which corresponds to the present rule 2 of the Wealth-tax Rules and rule 10(3) of the Gift-tax Rules. In other words, the determination of the value of the business conducted by the partnership or the association of persons would be made on the global basis, the non-business assets would be separately valued in accordance with the applicable rules and the interest of the taxpayer in the total value so determined would be ascertained on the basis of a notional dissolution of the firm or the association of persons.

I-18.29. The rule in regard to the valuation of interest of a partner in a firm under the Wealth-tax Rules has led to a controversy on the scope of the exemptions under section 5. Certain approved types of assets like shares of companies, bank deposits, etc., qualify for exemption in the hands of taxpayers to the extent of Rs. 1,50,000. It is possible that such assets

may be held by a partnership firm. The question which arises, in such circumstances, is whether the exemption should be made while determining the net wealth of the firm or it should be made in the individual assessments of the partners constituting the firm. This controversy arises because rule 2 requires the net wealth to be first determined in the hands of the firm. An extreme view would be to allow a deduction up to Rs. 1.5 lakhs for such assets in the hands of the firm and disallow any further benefit in the hands of the partners. As against this view, the other extreme view would be to allow the deduction upto Rs. 1.5 lakhs in the hands of the firm and also separately allow a deduction upto Rs. 1.5 lakhs in the assessment of each of the partners. Both these views are not in conformity with the intention underlying the exemption under section 5. A partner may hold qualifying assets in his own hands and he also has an interest in such assets which are held by the firm. If the firm holds the qualifying assets as the property of the firm, legally such assets cannot be said to be the assets of the partner and on this ground, the benefit may be denied to the partner. On the other hand, if the totality of the interest of the partner in the firm is included in his net wealth, it would be unfair to deny the partner the benefit of the exemption insofar as he has a proportionate interest, in the ultimate analysis, in the assets of the firm. This is all the more so because rule 2 proceeds on the basis of a notional dissolution and in such notional dissolution logically the interest of each partner should be regarded as proportionately represented by the different assets of the firm. The objective of promoting investments in qualifying assets would, therefore, be achieved if the interest of the partner is computed inclusive of the proportionate interest in the qualifying assets held by the firm. The partner should then be granted the exemption together with other qualifying exemptions under section 5 of the Wealth-tax Act with reference to the aggregate of qualifying assets directly held by him and his proportionate interest in the qualifying assets held by the firm. The question of allowing a deduction in the computation of the net wealth of the firm has no relevance because the firm is itself not liable to pay wealth-tax. This computation is made for the limited purpose of allocating the total wealth of the firm to the partners. The above observations in relation to a firm and its partners are equally applicable to an association of persons and its members. We recommend that Rule 2 of the Wealth-tax Rules should clarify that in allocating the interest in the net wealth of a firm among the partners, the interest of each partner would be deemed to comprise of the qualifying assets and the other assets on a proportionate basis the same procedure should also apply in allocating the interest in the wealth of an association of persons among its members. To illustrate, if there are two persons A and B having equal profit sharing proportions in a firm, the net wealth of the firm shall first be determined without allowing any exemption in the firm's computation. Assuming such net wealth is Rs. 3 lakhs and it is apportioned between A and B in accordance with rule 2 as Rs. 2 lakhs to A and Rs. 1 lakh to B, and if the firm has qualifying assets of Rs. 90,000, then the share of A in the qualifying assets shall be deemed to be Rs. 60,000 and the share of B shall be deemed to be Rs. 30,000. Thus, the interest of A in the firm would be Rs. 2 lakhs inclusive of Rs. 60,000 of quali-

fyng assets and Rs. 1,40,000 of other assets. These qualifying assets of Rs. 60,000 together with the other qualifying assets owned by A would qualify for exemption in the assessment of A. Likewise, the sum of Rs. 30,000 would qualify for exemption in the personal assessment of B, together with the other qualifying assets owned by B. Under the recommendation made by us, there will not result any additional benefit to the taxpayer. In each case, the totality of the qualifying assets would be ascertained and the exemption would be limited to the ceiling of Rs. 1,50,000. The recommendation ensures that there is no double counting of the same qualifying assets, nor a double benefit in the course of computation of the net wealth of the firm and its partners of the association of persons and its members.

I-18.30. The valuation of policies of insurance before the monies due thereon become payable has relevance for the purposes of gift-tax. Such property is not liable to Wealth-tax in view of the specific exemption in section 5. **The present Rule 10(1) under the Gift-tax Rules which prescribes the cash surrender**

value as the value of the policy, is fair and reasonable.

I-18.31. Rule 11 of the Gift-tax Rules deals with the valuation of a revocable gift which is peculiar to the provisions of the Gift-tax Act. The value is required to be determined by capitalising the income for the number of complete years for which the gift is not revocable. One incidental effect of this provision is that where the gift is not revocable for a period of less than one complete year, its value will be nil. This would go against the specific provision in section 6(2) of the Gift-tax Act which provides that the value of the property gifted shall be the capitalised value of the income from the property gifted during the period for which the gift is not revocable. Where the gift is not revocable for less than a completed year, it would be appropriate to capitalise the income for the broken period even though the year is not complete. **We, accordingly, recommend that where the period for which the gift is not revocable is less than one year, the actual income for the period upto the date of revocation should be discounted for determining the present value of the gift.**

CHAPTER 19

CONCLUSION

I-19.1. Two of the terms of reference of the Committee call for comment and discussion. The first is the advisability of consolidating the four laws relating to income-tax, surtax, wealth-tax and gift-tax into one Act and the other is the preparation of the draft of the Bills for being presented before Parliament.

I-19.2. The terms of reference referred to above recognise that the provisions of estate duty law are distinct from the other four direct taxes and the question of consolidating the estate duty law with the other laws was not practicable. In respect of both the substantive provisions and the procedural provisions of the law, as also in the matter of valuation, there are several unique features which are peculiar to the provisions of levy of estate duty. Accordingly, we have dealt with the whole subject of Estate Duty separately and are of the view that the **Estate Duty Act should be a comprehensive legislation by itself.**

I-19.3. In regard to the other four direct tax laws, it is commonly known that each of such laws has two broad compartments; one dealing with the charging or substantive provisions of the law and the other dealing with the administration or procedural provisions of the law.

I-19.4. We have examined the desirability of consolidating the charging and substantive provisions of the four direct tax statutes. Though in the case of income-tax, surtax and wealth-tax the levy of tax is on an year to year basis and continuous, yet, even between these three laws there is a material difference in the scope of the charge, in the base, in the rates and in the principles relating to exclusions and exemptions. In Chapter 15 of this Report on surtax (which is itself a tax in the nature of an extension of the levy of income-tax), we have explained the reasons why surtax should continue as a separate charge and should not be integrated with income-tax. A total consolidation of the four direct tax laws in the sense of reducing all of them to a single charge is neither feasible nor desirable. We are, however, of the view that as each of the laws dealing with surtax, wealth-tax and gift-tax would comprise of relatively smaller number of sections dealing with the respective area of charge, it may be appropriate to have a single enactment in the ultimate analysis of all these provisions along with the Income-tax Act.

I-19.5. There are three possibilities regarding the question of consolidation of the substantive and the procedural provisions pertaining to the four direct taxes—income-tax, surtax, wealth-tax and gift-tax :

- (1) the substantive as well as the procedural provisions pertaining to the four direct taxes may be dealt with by separate Acts, as they are today ;

- (2) the substantive as well as the procedural provisions pertaining to all the four taxes may be consolidated into a single Act ;

- (3) the substantive provisions pertaining to the four taxes may continue to be the subject-matter of separate Acts as at present, but the procedural provisions regarding all the four taxes may be consolidated into a new, separate, single Act.

I-19.6. An ideal solution of the problem would be to have a single new Act, which may be called "Direct Taxes Act". This Act could contain both the substantive as well as the procedural provisions pertaining to the four taxes which are the subject-matter today of four separate Acts. But having regard to the fact that such total consolidation into a new enactment would be time consuming, we do not think it right to recommend such consolidation immediately.

I-19.7. The less time consuming attempt at consolidation would be to keep the substantive provisions of the four taxes as the subject-matter of four separate Acts as they are today but to consolidate the procedural provisions pertaining to the four taxes into a single new enactment. We have recommended this course of action in Part II of our Report and the whole of that Part proceeds upon the basis that there is to be such consolidation of all the procedural provisions pertaining to the four taxes. However, we should like to make it clear that it would be patently against the public interest to hold up the implementation of the first Part of our Report by treating both the Parts as requiring simultaneous implementation. The substantive provisions of the four direct tax laws are a matter of substance, while the consolidation of their procedural provisions is purely a matter of form. The substantive provisions require to be attended to urgently, with a view to eliminating the various injustices which are inherent in the present laws—injustices to the taxpayer in some cases and injustices to the exchequer in others, as we have pointed out in this Part I of our Report. These substantive injustices cry out for urgent redress, while the form can wait and the job of consolidating the procedural provisions as set out in Part II of our Report can wait.

I-19.8. While there is no inter dependence between the two parts of our Report and the consolidation of the procedural provisions into a new enactment can brook delay, we would desire to emphasise that this Part of our Report has to be read and taken as a whole, if justice is to be done between the State and the citizen. It would be a distortion of our recommendations, if such of them as are in favour of the taxpayer were to be implemented without an attempt to implement the others which are in favour of the

Revenue. It would be an equal distortion of our recommendations to pick out only those which are in favour of the Revenue while ignoring the others which seek to do justice to the taxpayer. We earnestly hope that the Government would see its way to implement the recommendations impartially in a spirit of fairness and justice without reference to the question whether the beneficiary of the reforms would be the State or the citizen. Fairness breeds fairness and equity is never a one-way street. A feeling among taxpayers that they are fairly treated by the State would go a very long way towards inculcating a sense of responsibility and obligation in the minds of the citizens towards the exchequer.

I-19.9. The last term of reference requires the Committee to prepare drafts of the Bills for being presented before Parliament. The Finance Minister had indicated that separate legislation to give effect to the main recommendations contained in our Interim Report as are acceptable to the Government is to be introduced in Parliament. As mentioned earlier in the Introduction to this Report, some of the amendments effected through the Finance Act, 1978 have taken into consideration a few points made out in the Interim Report. The task before the Committee was first and foremost to deal with some of the more urgent problems which accordingly have been discussed in the Interim Report. The Committee had then to address itself to the task of examining hundreds of issues which were posed by responsible sections of the public both in the written memoranda and in the oral representations. Apart from these, the Committee had also to deliberate upon several problems which had come to light in the course of operation of the direct tax laws. It was thus of highest priority to analyse all these issues and come to conclusions thereon. The energy of the Committee and its secretariat was thus geared towards formulating its observations and recommendations on all these issues.

I-19.10. It was only after the Committee had come to definite conclusions on the issues, that the question of preparation of legislative Bills could arise for consideration. The task of drawing up Bills cannot by the very nature of the assignment be progressively attempted as the scheme of the laws involves interrelation of various concepts and provisions.

I-19.11. Having regard to the large number of recommendations, some of which involve questions of

policy, we recognise that the contents of our Report would require to be processed by the Government. It is for this reason that even the recommendations contained in the Interim Report have not yet been moved as a Bill for consideration of the legislature. Accordingly at the time of discussions the Chairman and one of our Members had with the Finance Minister, we have been advised that the contents of our Report would be processed by the Government and draft Bills to give effect to the recommendations would be prepared by the Government in different stages of priorities. In that context, preparation of comprehensive Bills to cover all our recommendations would be rendered unnecessary at this stage. We have, however, agreed to the request to be available for discussion with the Government in the course of implementation of the Report.

I-19.12. Lord Herschell said the law would be imperfect even if it is made by a committee of archangels. Despite such a limitation we have attempted to set a tone for healthy change fully realising that our Report cannot produce a magic formula: A tax law perfect in all its parts will remain in the realm of idealism. We have concentrated on major areas of importance brought before us within the constraints of time. Our approach has consistently been to objectively assess these issues in the light of our experience of the working of the tax laws, divorced of ideological considerations of any type.

(C. C. CHOKSHI)
Chairman

(S. P. MEHTA)
Member

(HARNAM SHANKAR)
Member

(C. C. GANAPATHI)
Member

(T. S. R. NARASIMHAM)
Member

(D. N. PATHAK)
Secretary

September 1978

**PART I—SUMMARY OF OBSERVATIONS
AND RECOMMENDATIONS**

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

INTRODUCTION

1. The problem of simplification and rationalisation of tax cannot be considered in the abstract and divorced from the background of the economic activity in which the tax laws are required to operate.

(Para I-0.5)

2. The administration is in a position to ensure fair play and justice as also equity in the tax laws.

(Para I-0.7)

3. Tax laws cannot be reduced to a plane of total or absolute simplicity.

(Para I-0.8)

4. Artificial distortions lead to complexities in the law as well as increased administrative difficulties.

(Para I-0.9)

5. The errant taxpayer should not expect nor be shown any indulgence under the law.

(Para I-0.13)

6. A climate of mutual trust and fair-play should be fostered so as to make for better voluntary compliance with the tax laws on the part of the taxpayers.

There is need for a clear statement that measures like disclosure scheme would not be repeated and that errant taxpayers would necessarily be dealt with in accordance with the due process of law.

(Para I-0.14)

7. The need for continuous fiscal research embracing various aspects of the tax provisions needs no emphasis.

(Para I-0.6)

8. Continuous fiscal research undertaken by an independent autonomous body will be to public finance what a well established scientific research institution is to technology.

(Para I-0.7)

9. There is no particular merit in or necessity for clothing the budget proposals relating to the tax laws with an undue air of secrecy.

(Para I-0.8)

10. In the circumstances prevailing in our country at present, where the requirement of rapid economic

development is paramount, an experiment in re-structuring the base for levy of tax, from income to consumption would be unwise and the cost to the nation would be incalculable and unjustifiable. It would be more prudent to extend the area of saving out of income qualifying for tax relief, than change the fundamental yardstick of income as the base for charge of tax.

(Para I-0.21)

11. The concept of income as a base for tax cannot be artificially confined to a single accounting year and there should be a reasonable flexibility in the law to take into account adjustments which are not necessarily or strictly confined to a single year.

(Para I-0.22)

12. If the phenomenon of inflation had continued unabated and the value of the rupee further eroded we would have examined the need for introducing the concept of indexation in our taxing statutes.

(Para I-0.25)

CHAPTER 1—DEFINITIONS

13. It would be appropriate that the amendments arising out of our recommendation are all brought into force at one and the same time and that too with effect from a specified assessment year, say, assessment year 1980-81.

(Para I-1.1)

14. The expression 'amalgamation' may be defined to mean the merger of one or more companies with another company, or the merger of two or more companies to form one company, under a scheme sanctioned by the court under section 394 of the Companies Act, 1956, or ordered by the Central Government under section 396 of the said Act.

(Para I-1.5)

15. An amendment may be made in the definition of capital asset to expressly include therein self-generated assets like goodwill. The recommendation in this regard is, however, conditional upon the acceptance of the other recommendation contained in Chapter 9 to allow the cost of acquisition of such asset determined in the manner explained in that Chapter.

(Para I-1.7)

16. The definition of a "company in which the public are substantially interested", should be simplified in the manner suggested.

(Para I-1.12)

17. It is appropriate that sub-clause (e) of clause 22 of section 2 is excluded from operation in cases where the payment in question is made in such circumstances or for such a brief duration that it cannot in substance be treated as falling within the intent of that sub-clause.

(Para I-1.17)

18. An explanatory definition of the term "education" should be introduced with retrospective operation to the effect that "education shall not be restricted to scholastic instruction only".

(Para I-1.21)

19. The artificial definition of "interest" in section 2(28A) is unnecessary and not called for and may hence be deleted.

(Para I-1.24)

20. Sub-clause (v) of section 2(31) defining "person" should be divided into two parts as follows :

"(v) an association of persons whether incorporated or not ;

(va) a body of individuals whether incorporated or not but not including a combination of individuals who merely receive income jointly without anything further."

(Para I-1.26)

21. Sub-clause (i) of the definition of "person" in section 2(31) should refer to "an individual including individuals who do not fall within sub-clauses (v) or (va)".

(Para I-1.27)

22. The definition of "relative" in section 2(41) should apply for all the provisions of the Income-tax Act and the extended definition in other provisions, viz., section 13 and section 80B, should be deleted.

(Para I-1.30)

23. A definition of a new expression "scheme of reconstruction" should be enacted in section 2.

(Para I-1.31)

24. The following recommendations are made in relation to "Previous year" :

(1) The general rule that previous year means the financial year immediately preceding the assessment year should continue with regard to taxpayers who do not have income from a business or profession and those who do not maintain accounts. This will not unduly disturb revenue collections and will also facilitate the assessments of the salary-earner class.

(2) In respect of companies, including statutory corporations, there should be a uniform previous year coinciding with the calendar year which should be applicable to all cases. Banks and insurance companies already maintain accounts on the calendar year basis

as required by law. This recommendation would necessitate a change in the accounting period by those companies which follow periods other than the calendar year. In the case of companies which now follow the financial year, i.e., year ending 31st March, the transition year will consist of only 9 months, while those which follow accounting periods ending on 'diwali', 30th September, 30th June, etc., will have the transition year covering a period longer than 12 months. There should be no special method of computation of the tax liability in such cases in order to compensate for the variation in the length of the transition year from a period of 12 months.

(3) A non-corporate taxpayer who carries on a business or profession, who maintains accounts for any source of income and claims the benefit of the exception to the normal rule in regard to previous year, should be required to choose one previous year according to his individual requirement, which would, then, be the previous year in respect of his income from all sources other than share from a firm dealt with in item (5) below.

(4) In the case of a taxpayer who has chosen, under recommendation (3) above, a year other than the calendar year or the financial year to be his previous year, any change in the previous year in future should be allowed only if he wishes to adopt the calendar year or the financial year and not any other period. Any such change should be allowed without any condition.

(5) In the case of a partner of a firm, his share of income from the firm will continue to be assessed on the basis of the previous year of the firm as at present. This could result in such a taxpayer having a previous year for his share of income from the firm or as many different previous years as the number of firms in which he is a partner, assuming that these firms choose different previous years for the closing of their accounts and a separate previous year for his other income.

(6) The operation of the new provisions based on the above recommendations may be reviewed in due course. If it is observed that the medium of firms is being resorted to with the objective of perpetuating the multiplicity of previous years in the case of non-corporate taxpayers, the previous year for firms in general could also be standardised at a later stage as in the case of companies.

(Para I-1.40)

CHAPTER 2—BASIS OF CHARGE

25. The rates of income-tax should be specified in a schedule to the substantive enactment imposing the tax, instead of being laid down from year to year in a separate Act of Parliament.

(Para I-2.2)

26. The rate structure of income-tax should provide for a maximum marginal rate of tax of 60 per cent which should be applicable on income exceeding Rs. 2 lakhs, with an appropriately smooth and even progression at all levels below Rs. 2 lakhs.

(Para I-2.9)

27. Surcharges on income-tax should be abolished and in any event, the maximum marginal rate of income-tax of 60 per cent should be inclusive of surcharges if any.

(Para I-2.10)

28. The revenue presently being derived by the Centre through the scheme of integration of agricultural income with non-agricultural income should not be forgone and the scheme should continue to operate.

(Para I-2.20)

29. If the consensus arising out of the dialogue and discussion between the Central Government and the State Governments is that agricultural income-tax should also be imposed under a Central Act, it would be more appropriate to do so by a direct amendment of the Constitution than by amending the definition of 'agricultural income' in the Income-tax Act or by resorting to the provisions of Article 252(1) of the Constitution.

(Para I-2.32)

30. If the Centre is not to levy income-tax on agricultural incomes the following measures are suggested for the consideration of the Government.

- (a) States which do not have any law for taxation of agricultural income at present may be advised by the Central Government to introduce such legislation at an early date.
- (b) The pattern of the legislation may as far as possible be uniform in all the States.
- (c) The uniformity should extend to the levy of the tax on all categories of agricultural income, whether from plantations, cash crops, or food crops.
- (d) As far as possible, the principle of progression, with a graded rate structure, should be adopted, broadly conforming to the minimum exemption limit and the maximum rate under the Central income-tax law.
- (e) With a view to facilitating administration and eliminating the process of elaborate determination through books and records, the law could provide for a scheme of composition of the tax. This composition scheme could provide for a flat determination of the income having regard to the category of the land and the nature of agricultural activity carried out thereon. The composition scheme contained in section 67 of the Karnataka Agricultural Income-tax Act could provide a useful model. Needless to say, the composition scheme should not be available to or-

ganised bodies like companies and co-operative societies which are required by law to maintain proper books of account.

- (t) The scheme of integration of agricultural income for determining the tax on non-agricultural income under the Finance Act should have a complementary provision incorporated in the State laws for the determination of the tax on agricultural income. In other words, the State law should provide for taking the non-agricultural income of a taxpayer into account for determining the rate of tax applicable to his agricultural income. This will be a necessary ingredient of the progression in the rate structure of agricultural income-tax.

(Para I-2.33)

31. No change is required in the concept of "not ordinarily resident" or in the tests for determining whether a person is "not ordinarily resident".

(Para I-2.38)

32. The test in section 6(1)(b) for determination of residence with reference to the maintenance of a dwelling house should be deleted.

(Para I-2.39)

33. Section 6(1)(c) should be amended and the words 'sixty days' be replaced by the words 'ninety days'. The Explanation to section 6(1) should be deleted.

(Para I-2.40)

34. No basic change in the scope of tax liability, by linking residential status with citizenship, is necessary.

(Para I-2.41)

35. No change is necessary in regard to the scope of total income as contained in section 5 of the Act.

(Para I-2.42)

CHAPTER 3—TAXATION OF NON-RESIDENTS ON INCOME DEEMED TO ACCRUE IN INDIA

36. The threat of an assessment based upon business connection of every foreigner dealing with India has to a large extent been reduced as a result of the tests laid down by the Supreme Court.

(Para I-3.2)

37. Clause (v) of section 9(1) should be deleted and income by way of interest should be deemed to accrue or arise in India in the circumstances specified in section 9(1)(i) prior to its amendment in 1976.

(Para I-3.4)

38. It is eminently in the national interest that some machinery should be devised for making the incidence of tax on foreigners both certain and foreseeable, and at the same time, equitable.

(Para I-3.6)

39. The tax sought to be imposed on the non-resident collaborator in industrial ventures in India, in effect, falls on the Indian participant and ultimately,

enters into the cost of products manufactured under such collaboration.

(Para I-3.11)

40. In giving the prior determination about taxability of payments under collaboration arrangement, Government would take into account the guiding principles already enunciated namely :

- (1) consideration for transfer of know-how outside India against payment outside India will not attract any tax in India ;
- (2) payment for engineering and technical services performed outside India will not attract tax in India ;
- (3) services rendered in India will result in income accruing or arising in India which will be liable to tax in India but only after deduction of all expenditure wholly and exclusively incurred for the purpose of earning such income ;
- (4) royalties paid in consideration for the use of know-how in India will be liable to tax in India subject to deduction of expenditure incurred for the purpose of earning such royalties ;
- (5) where composite services are rendered, partly in India and partly outside, the income deemed to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India.

(Para I-3.13)

41. Clauses (vi) and (vii) of section 9(1) should be deleted and the deeming of royalties and technical service fees as income in India should be restored to the position obtaining prior to the amendments of 1976. At the point of time when collaboration arrangements are approved by the Central Government a determination should be made by the Central Government of the quantum of fee which is deemed to accrue or arise in India and the quantum of income component therein (that is to say fees less expenses attributable thereto).

(Para I-3.16)

42. Section 44D should be deleted and in its place a provision should be made for allowance of expenditure against royalties and fees for technical services of only such amount and in such manner as may be determined by the Central Government while approving the terms of collaboration.

(Para I-3.18)

43. The provisions of section 44C should be amended to allow a uniform deduction of 5 per cent of the adjusted total income as defined in the Explanation thereto in respect of head office expenditure in the case of non-residents.

(Para I-3.21)

CHAPTER 4—EXEMPTIONS

44. The various exemptions and exclusions contained in section 10 may be rearranged as follows :

- (a) all exclusions relating to computation of income under the head "Salaries" should be grouped together ; exemptions which are merely designed to spell out the diplomatic immunities and privileges enjoyed under international law by citizens of a foreign country rendering services to their Government in India, should be placed together as at present ;
- (b) exemptions applicable to institutions of various kinds, either in respect of their entire income or in respect of only specified items of their income, should be grouped together distinctly and separately from other exemptions which are operative without reference to the status of the recipient;
- (c) the remaining exemptions, which are either based on the nature of the receipt or which are of a miscellaneous character not capable of a rational classification, may be enumerated separately from the exemptions relating to institutions referred to in item (b).

Exemptions which are now scattered over the Finance Acts and other enactments, exempting from tax for all time or for limited periods) the income of certain corporations and other bodies such as the Unit Trust, of India, the Industrial Development Bank of India, etc., or which make special provisions (short of total exemption), as in the case of the Industrial Finance Corporation of India, State Financial Corporations and the Agricultural Refinance Corporation, may also be incorporated in the Income-tax Act either *in extenso* or by way of reference to the relevant provision of the concerned enactment in a schedule, in future, it should be ensured that, whenever any such exemption or special provision is enacted, it is specifically mentioned in the Income-tax Act.

(Para I-4.5)

45. Appropriate instructions should be issued by the Board to the officers not to deny any exemption or deduction which an assessee may claim merely on the basis that it is open to him to claim exemption under some other provisions of the Act.

(Para I-4.6)

46. The exemption under section 10(4A) in respect of interest on Non-resident (External) Accounts should be made available to all assesseees who are non-residents for the purposes of the Foreign Exchange Regulation Act and not only to "non-residents" under the Income-tax Act.

(Para I-4.7)

47. The law may be amended to vest power in the Central Government to extend the period of 90 days mentioned under section 10(6)(vi) in appropriate cases.

(Para I-4.8)

48. The stipulation in section 10(6) (viiia) that the technician should be employed in a capacity in which his specialised knowledge and experience are actually utilised, in order that he may be entitled to the exemption under that provision, is a superfluity and this requirement should be deleted.

(Para I-4.10)

49. It should be clarified that the exemption from tax under section 10(6)(viiia) will be available even if the foreign technician is employed in connection with a business to be commenced later.

(Para I-4.11)

50. The condition under section 10(6)(viiia), that the technician should not have been resident in India in any of the four financial years immediately preceding the year of his arrival in India, should be deleted.

(Para I-4.12)

51. A clarificatory amendment should be made to the effect that "remuneration", for the purpose of section 10(6)(viiia), shall not include allowances, such as daily allowance or travelling allowance, which are eligible for exemption from tax under any other provision of the law.

(Para I-4.13)

52. Payments of the nature of contributions towards retirement and social security benefits made by the foreign employer in the home country of the foreign technicians should be specifically excluded from liability to tax in India.

(Para I-4.14)

53. The Period of full exemption from tax of the remuneration of a foreign technician under section 10 (6) (viiia) may be raised to 36 months, with exemption for a further period of 36 months where the employer pays to Government the tax on the technician's salary.

(Para I-4.15)

54. Daily allowances paid by Indian concerns to foreigners working in India for temporary periods, as in the case of technician referred to in section 10 (6) (vi) or section 10 (6) (viiia), should not be liable to tax and should be exempted under section 10 (14) if such daily allowances have been approved by the Reserve Bank of India or the Central Government.

(Para I-4.16)

55. The provision in section 10 (7) exempting allowances and perquisites paid or allowed as such outside India from liability to Indian tax, should be extended to all Indian citizens whether they render services to Government or to any public sector corporation or other Indian employer.

(Para I-4.17)

56. No. useful purpose would be served by having a specific clause in section 10 of the Act to exempt receipts under life policies which by their very nature are capital receipts and not income.

(Para I-4.18)

57. Section 10 (14) may be amended to exempt from tax city compensatory allowances upto the maximum monetary limit applicable in the case of employees of the Central Government as specified stations.

(Para I-4.21)

58. Approval granted by the Central Government to the agreement relating to the borrowing of money abroad for industrial development in India should be adequate for the purpose of the exemption from tax of the interest payable thereon, under section 10(15) (iv). The further requirement, under that provision, of approval of the rate of interest should be deleted.

(Para I-4.22)

59. The approval of a scientific research association, for the purpose of various tax concessions, should have a currency of only three years at a time.

(Para I-4.24)

60. Section 10 (21) may be clarified to provide, firstly, that in the case of a scientific research association approved for the purpose of section 35 (1) (ii) which has scientific research as its only object, the whole of its income will be exempt from tax and, secondly, that in the case of an institution which has scientific research as one of its several objects, and which is approved for the purposes of section 35 (1) (ii), its income will be eligible for exemption from tax to the extent it is applied for the purposes of scientific research or set apart for application to such purposes.

(Para I-4.25)

61. The exemption in clause (23A) of section 10 may be extended to cover all income, from whatever source derived, in the case of an association or institution referred to therein.

(Para I-4.27)

62. The condition under section 10 (23B) that the institution referred to therein should not exist for the purpose of profit should be deleted.

(Para I-4.28)

63. Section 296 may be suitably amended to require notifications issued by the Central Government under section 10 (23C) (v) also to be laid before Parliament.

(Para I-4.29)

64. Section 10 (29) may be amended to make it clear that it applies specifically to State Warehousing Corporations.

(Para I-4.30)

CHAPTER 5—COMPUTATION OF INCOME UNDER THE HEAD 'SALARIES'

65. The various provisions relating to the computation of income under the head "Salaries" and deductions therefrom should be grouped together in the sections dealing with computation of income under the head "Salaries".

(Para I-5.4)

66. Amending the definition of salary so as to have a uniform definition for different purposes, is not desirable as the benefit of simplification would be more than off-set by the complications and inequities that would result by adoption of a single norm for different objectives.

(Para I-5.6)

67. The standard deduction under section 16 (i) may be calculated at the uniform rate of 20 per cent at all levels of salary and the monetary ceiling may be increased from Rs. 3,500 to Rs. 5,000.

(Para I-5.9)

68. In the case of an employee having the use of a conveyance, the limit over the deduction under section 16(1) should be raised to Rs. 2,500 from the present limit of Rs. 1,000. Further, in the case of an employee who is in receipt of a conveyance allowance, the ceiling should be fixed at Rs. 5,000 as reduced by the amount of conveyance allowance not qualifying for exemption under section 10 (14) or Rs. 2,500, whichever is higher.

(Para I-5.10)

69. The standard deduction should be allowed also to a person in receipt of a pension from a former employer, at half the normal rate, i.e., at the rate of 10 per cent subject, however, to a ceiling of Rs. 1,000 per year.

(Para I-5.11)

70. Section 16 (i) which provides for the standard deduction should give an option to the salary-earner to claim, in place of the standard deduction, a deduction of the actual expenditure incurred out of the remuneration wholly, necessarily and exclusively for the purposes of employment.

(Para I-5.12)

71. Though section 16 may empower a salary-earner to claim the actual expenditure in lieu of the standard deduction, deduction of tax at source should be effected by the employer after allowing only the standard deduction.

(Para I-5.13)

72. In determining the perquisite value of residential accommodation under rule 3 of the Income-tax Rules, the addition in respect of the excess of the fair rental value over 20 per cent or 30 per cent, as the case may be, of the salary, should be subject to a limit of 15 per cent of the employee's salary. This limit should, however, not apply in respect of residential accommodation where the annual cost to the employer is not less than Rs. 36,000 per annum. The annual cost should necessarily include not only the direct cost of the accommodation but also incidental costs such as interest, maintenance, depreciation, etc.

(Para I-5.15)

73. No requisite value should be attributed to the provision of a mere transport facility to an employee from his residence to the office and back.

(Para I-5.16)

74. The existing administrative instructions regarding the perquisite value of domestic help should continue where the employer directly meets the costs of such services. Where, however, such services are engaged by the employee and in turn the employer pays the employee a cash amount by way of reimbursement, the perquisite value should be determined at 50 per cent of the amount paid by the employer, without any upper monetary limit.

(Para I-5.17)

75. Despite the observations of the Madras High Court in some cases, no attempt should be made to tax employees on an imputed benefit by virtue of loans granted by the employer under the schemes of loans to employees. The present practice of not taxing any imputed benefit should continue. If necessary, administrative instructions may be issued to that effect. It would, however, follow that where loans or advances made show abuse of power, the Department should, of course, be entitled to take appropriate action in bringing to tax the value of the benefit enjoyed.

(Para I-5.18)

76. As long as expenditure on medical benefits to employees is within the reasonable bounds of commercial expediency, no attempt should be made to draw any distinction between ordinary medical treatment and other medical treatment and consequently no attempt should be made to bring to tax any such facility in the hands of the employees as perquisites. In other words, the administration should continue to be liberal in the matter of determination of perquisite in relation to medical facilities.

(Para I-5.19)

77. Section 89 (1) should be recast so as to allow that section to be applied at the time of calculating the tax to be deducted at source from payments of salary in the circumstances referred to in that section. The provision of section 192, relating to deduction of tax at source from salary payments, should also be amended to enable the employer to take into account the provisions of section 89 (1) while calculating the tax to be deducted at source.

(Para I-5.25)

78. For the purpose of the relief under section 89 (1), wherever the arrears of salary relate to a period exceeding 5 years, the arrears should be spread equally over five years inclusive of the year of payment. The amount so included should be added to the total income of each of these years and the tax determined accordingly. A provision on these lines should be incorporated in section 89 itself.

(Para I-5.27)

79. For the purpose of the relief under section 89 (1), payments of gratuity, compensation, etc., may be spread over the last 5 years equally including the year of retirement. The amount allotted to each year may be added to the total income of such year and tax determined accordingly. This formula should likewise be incorporated in the Act itself and not left to the Income-tax Rules.

(Para I-5.29)

80. Rule 6 in Part A of the Fourth Schedule should be amended to provide that only contributions of the employer in excess of 10 per cent of the salary of the employee will be deemed to be employee's income and that no part of the interest credited to the employee's account shall be deemed to be his income. (Para I-5.30)

81. Provisions of a substantive nature, at present, contained in the rules in the Fourth Schedule in so far as they relate to the taxation of certain amounts as income of the employer should be included in the sections of the law dealing with the computation of income under the head "Salaries". (Para I-5.34)

82. The provisions for bringing to tax non-exempt portions of payments from an approved superannuation fund should be clearly enacted. (Para I-5.35)

83. Provisions of rule 72 of the Income-tax Rules should find their place in the substantive law and not in the rules framed by the Board. (Para I-5.36)

CHAPTER 6—INTEREST IN SECURITIES

84. The category of income at present assessable under a separate head "Interest on securities" should more appropriately be assessed either under the head "Profits and gains of business or profession" where the income partakes of the character of business income or under the residuary head "Income from other sources" where it is not derived from a business activity. The existing provisions in sections 18, 19, 20 and 21 will, then, no longer be necessary. (Para I-6.4)

85. Section 57 is wide enough to cover the two items of deductions at present allowable under section 19 of the Act. (Para I-6.5)

86. Interest on securities should be subjected to tax in accordance with the method of accounting regularly employed by the taxpayer and, in the absence of accounts, such interest should be subjected to tax as income of the year in which it is received. (Para I-6.7)

87. It is not necessary to continue the provisions of section 89 (2) for allowing relief where interest on securities is received in arrears. (Para I-6.8)

88. The provisions of section 94 should be continued. (Para I-6.9)

CHAPTER 7—INCOME FROM HOUSE PROPERTY

89. The concept of owner under section 22 should be consistent with the observations of the Supreme Court and should not be unduly strictly construed in the manner done by the Calcutta and Bombay High Courts. In other words where actual income is received by a person other than the legal owner then he alone should be assessed and no concurrent assessment

should be made on the legal owner under section 22 of the Act. In all such cases, the beneficial owner should be assessed on such income under the head "Income from house property". (Para I-7.5)

90. One house property used by the taxpayer for his own residence should be exempt from tax under section 22 of the Act. (Para I-7.11.)

91. The recommendation made in para I-7.11. should be in addition to the concession available to the taxpayer under section 23(3). (Para I-7.13.)

92. The condition connected with the allowance for the first five years in respect of new residential units under section 23(1) that the income of such units is in no case a loss should be deleted. (Para I-7.14.)

93. Amounts recovered from its members by a Co-operative Housing Society to meet various charges should be expressly allowed as a deduction in the computation of income from property in the hands of the members, so however, that where any part of such amounts is already allowable in the computation under any specific provision of the law, no double deduction of the same item should be made. (Para I-7.15.)

94. The income under the head "Income from house property" should be computed after allowance in respect of repairs on the basis of 1/6th of the annual letting value under section 24(1)(i) as at present, with a right to the taxpayer to claim the actual expenditure if it is in excess of the deduction on the basis of 1/6th. To determine such excess, the comparison should not be limited to a single previous year but should extend to the previous year relevant to the year of assessment and the five previous years immediately preceding it. (Para I-7.16.)

95. Section 24 should expressly provide for a residuary item of deduction in respect of other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning income under the head "Income from house property". (Para I-7.17.)

96. If the rents are in arrears for a period of two years, the taxpayer should be entitled to the deduction of the same under section 24(1)(x) without any further requirements as at present stipulated in rule 4 of the Income-tax Rules. (Para I-7.18.)

97. A provision should be made for bringing to tax amounts subsequently realised out of amounts allowed as deduction under section 24(1)(x) in the year of realisation, so that the relaxation in the conditions for allowance does not result in an undue benefits to taxpayers. (Para I-7.18.)

98. The fiction in section 27(iii) of treating each member of a co-operative society as the owner of a portion of the property, should be extended to the members of a limited company owning house property possession of which is divided among the several members. (Para I-7.19.)

CHAPTER 8—PROFITS AND GAINS OF BUSINESS OR PROFESSION

99. The distinction between an adventure in the nature of trade and a capital or casual transaction has, to some extent, lost its significance in the context of the present scheme of the Income-tax Act where income from casual transactions as well as gains from certain capital transactions are brought to tax.

(Para I-8.3)

100. The law should recognise the peculiar nature of income derived from professional activity by the exercise of intellectual skill which should be encouraged by suitable incentives in the computation of the chargeable income.

(Para I-8.5.)

101. The Supreme Court has laid great emphasis on the computation of business profits and gains in accordance with the ordinary principles of commercial accounting.

(Para I-8.6.)

102. Section 28 should be extended to cover income of a business or profession which is discontinued, which is, at present dealt with in section 176(3A) and section 176(4). All the deductions as available to a continuing business should be allowed to the closed business in the computation of the income as discussed in para I-8.11.

(Para I-8.7.)

103. Expenditure incurred in the course of the trade, which is unremunerative is, none the less, a proper deduction as expenditure wholly and exclusively incurred for the purposes of the trade.

(Para I-8.8.)

104. The general provision in section 37(1) should have primacy in the scheme of computation of income from business or profession and should come immediately after sections 28 and 29.

(Para I-8.9.)

105. The sole test for allowance of business expenditure should be that laid down in section 37(1), namely, whether the expenditure is laid out or expended wholly and exclusively for the purposes of the business or profession, not being in the nature of capital expenditure or personal expenses.

(Para I-8.9.)

106. All expenditure incurred wholly and exclusively for the purposes of the business or profession, other than personal expenditure of the taxpayer, should be allowed as a deduction in computing the profits and gains. If the expenditure is in the nature of revenue expenditure it should be allowed in the year in which it is incurred or actually met, in accordance with the method of accounting followed by the taxpayer. If the expenditure is of the nature of capital expenditure, it should still be allowable in the process of computation of taxable profits through allowances such as depreciation or amortisation as explained in the Interim Report, paras 3.30 and 3.31.

(Para I-8.10.)

107. Expenditure which would have been allowable had the business continued should be allowed even after the closure of business and profit or loss should be computed accordingly. The expenditure arising out

of the closure of the business should also be regarded as expenditure incurred for the purposes of the business.

(Para I-8.11.)

108. At least for the future, artificial disallowance of business expenditure should be kept at the minimum and the Government should accept the concept of real income as evolved by courts of law over the years.

(Para I-8.12.)

109. Where any incentive or extra deduction for a particular expenditure is desired to be granted, the intention should be expressly and clearly spelt out in the law.

(Para I-8.13.)

110. Where the Income-tax Officer disallows an item of expenditure in the assessment for any year as not pertaining to that year, he should simultaneously be required to determine the year to which such expenditure relates. If it relates to a past year then he should be required to simultaneously revise the assessment of the past year and allow the deduction. If it relates to a future year, the assessment order should record a finding in regard to the year to which it relates and such a finding should be binding on the Income-tax Officer or his successor in so far as the assessment for such subsequent year is concerned.

(Para I-8.14.)

111. All situations warranting deduction of business expenditure cannot be legislated upon and much would depend upon an enlightened approach in the administration of the law based on considerations of equity and justice.

(Para I-8.17.)

112. Where the asset qualifying for investment allowance under section 32A is acquired or installed in one previous year but brought into use in any subsequent previous year, not necessarily the previous year immediately following the year of acquisition/installation of the asset, the investment allowance should be granted in the year in which the asset is first put to use for the purposes of the business.

(Para I-8.19.)

113. Provisions corresponding to those in subsections (6) and (7) of section 32A entitling the successor to the investment allowance should be made also in the following types of cases involving a change of ownership of assets qualifying for investment allowance :—

- (a) where an individual proprietor of a business expires and his successor inherits the business ;
- (b) where the change in ownership takes place as a result of partition of the property of a Hindu undivided family which is carrying on the business ;
- (c) where a sole proprietor converts his business into a partnership and continues as a partner for the unexpired portion of the mandatory holding period of the asset. (Para I-8.20)

114. The Explanation to section 32A(4) should suitably clarify that it covers not merely cases of inadequacy of the reserve but also absence of any reserve under similar circumstances. (Para I-8.21.)

115. In the case of assessee engaged in the business of operation of ships or aircraft, investment allowance should also be granted in respect of any new plant and machinery installed for the purposes of such business. (Para I-8.22.)

116. In the circumstances mentioned in section 33B of the Income-tax Act, the taxpayer should be entitled to carry backward business losses and other admissible allowances and deductions to the three years immediately preceding the year in which the business was disrupted, to be set off against the profits assessed for those years. If there is still any loss or other amount which remains unabsorbed by such set off, such loss, etc., may be allowed to be carried forward for future set off in the same manner as at present. Such right to carry backward and set off losses should, however, be allowed only if the taxpayer satisfies the Income-tax Officer at the time of assessment that he has taken adequate steps for the revival, re-establishment or reconstruction of the disrupted business. (Para I-8.25.)

117. In the case of patents and copyrights, the cost of acquisition should be amortised over a ten-year period. (Para I-8.26.)

118. The first proviso to section 36(1) (ii), which limits the allowance in respect of bonus paid to employees to the amount payable under the Payment of Bonus Act should be deleted. (Para I-8.27.)

119. In regard to the allowance for bad, doubtful or irrecoverable debts, the law should be amended on the following lines :—

(i) The allowance in respect of debts estimated to be bad, doubtful or irrecoverable should be with reference to the amount written off by the assessee in the profit and loss account of the relevant previous year. Where such write off relates to debts which fell due within a period of two years preceding the date of the write off the taxpayer may be called upon to justify the write off. In any case, the taxpayer should be entitled to freely write off debts which are not recovered for a period of two years from their original due date.

(ii) The existing provisions for subjecting to tax any recovery out of the amounts written off should continue as a necessary safeguard in the interests of revenue.

(iii) The write off of the debt by debit to the profit and loss account may be made balanced either by a corresponding credit entry to the debtor's account or by passing a credit entry in another appropriate account, such as "Provision for bad and doubtful debts account". (Para I-8.31.)

120. The *Explanation* appearing after sub-section (4) of section 41 should be placed either at the end of the entire section or after sub-section (3) and should, with the necessary change in language, cover sub-section (2), sub-section (2A) and sub-section (3) (Para I-8.32.)

121. In clauses (iv) and (v) of section 36(1), relating to deduction of amounts paid by the employer by way of contributions to a recognised provident fund, approved superannuation fund or approved gratuity fund, a specific provision should be made that, if the contributions are not paid within a period of three months from the end of the previous year, the deduction shall not be allowed in the computation of the business profits of that year. However, in cases of delayed payments, the deduction should be allowed in the year of actual payment. (Para I-8.33.)

122. The ceiling for allowance of entertainment expenditure may be raised to Rs. 1 lakh from the existing Rs. 30,000. This may be achieved by suitably increasing the rates and the length of the slabs so as to arrive at the ceiling of Rs. 1 lakh where the profits and gains of the business exceed Rs. 2.80 crores, on the following lines :—

(i) on the first Rs. 20 lakhs of the profits and gains.	at the rate of 1% or Rs. 10,000 whichever is higher;
(ii) on the next Rs. 60 lakhs of the profits and gains	at the rate of $\frac{1}{2}$ %;
(iii) on the next Rs. 2 crores of the profits and gains.	at the rate of $\frac{1}{4}$ %;
(iv) on the balance	Nil

(Para I-8.35.)

123. The ceilings of Rs. 100 and Rs. 50 mentioned in rule 6D may be increased to Rs. 250 and Rs. 125 respectively. These monetary ceilings should be revised periodically having regard to the tariffs of hotels run by the India Tourism Development Corporation. (Para I-8.36.)

124. The provisions in sub-clauses (i) and (iii) of clause (a) of section 40 should be deleted.

(Para I-8.37.)

125. The nature of the arrangements that would be considered as effective for the purposes of section 40(a) (iv) should be spelt out in the rules.

(Para I-8.38.)

126. A specific provision should be made to the effect that the monetary ceiling laid down in section 40(c) and in section 40A(5) will not apply in any case where the salary and perquisites of the director or other person etc., have been approved by the Government of India in the Department of Company Affairs, and that the test of whether the payment is excessive or unreasonable will also not apply in such cases. The provisions of section 40(c) should operate in a mutually exclusive area from those of section 40A(5) and accordingly section 40A(5) should be rendered inapplicable to cases of persons who are covered by section 40(c). The items of expenditure like provident fund contributions, etc., which are excluded from disallowance under section 40A(5), should continue to be excluded from disallowance under section 40(c). (Para I-8.39.)

127. Any payment by way of gratuity to retiring employees (computed in accordance with a scheme applicable to all the employees) should be excluded from the scope of 'salary' for the purposes of the limit specified in section 40A(5) and in section 40(c).

(Para I-8.40.)

128. The provision in section 40A(3) should be kept on the statute book with a view to encouraging transactions through banks, but the limit of Rs. 2,500 may be raised to Rs. 10,000.

(Para I-8.41.)

129. The provision in section 40A(8) should be deleted along with the Tenth Schedule to the Income-tax Act, which pertains to those provisions.

(Para I-8.45.)

130. The proviso to clause (b) of rule 5 of the First Schedule should be deleted.

(Para I-8.47.)

131. The view that the deductions under Chapter VIA are not to be allowed in the computation made under the First Schedule is clearly opposed to the express terms of section 44. The clear position in law should be reiterated by suitable instructions to the assessing officers.

(Para I-8.50.)

132. Suitable instructions may be issued to the assessing officers clarifying the position in law and setting at rest the needless controversy based upon the erroneous construction of section 44 regarding credit for taxes deducted at source.

(Para I-8.51.)

CHAPTER 9—CAPITAL GAINS

133. In relation to transfer of immovable property by way of sale, where the agreement to sell is evidenced by an instrument in writing, where possession of the immovable property has been handed over to the purchaser and the whole or substantially the whole of the consideration has been received by the transferor, the capital gains should be chargeable at such point of time when these requirements are fulfilled. Where the gain is brought to charge in these circumstances it should not again be deemed to arise in the previous year when the instrument of conveyance is executed and registered.

(Para I-9.11.)

134. The provisions of law should be suitably amended so as to expressly include self-generated assets within the meaning of "capital assets" and thereby bringing to tax the capital gains on the transfer of such assets. This recommendation is conditional upon the further recommendation for determination of the cost of acquisition of such asset.

(Para I-9.12.)

135. The cost of acquisition of self-generated assets may be deemed to be a percentage of the sale proceeds as under the following formula :—

- | | |
|--|----------------------------|
| (1) Where the asset is held by the assessee for not more than five years before its transfer | 20 % of the sale proceeds. |
|--|----------------------------|

(2) where the asset is held for more than five years but not more than ten years	40% of the sale proceeds.
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(3) where the asset is held for more than ten years but not more than fifteen years	60% of the sale proceeds.
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(4) where the asset is held for more than fifteen years	80% of the sale proceeds.
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(Para I-9.13.)

136. In case of self-generated assets, the taxpayer should not have the right of substitution of the fair market value for the cost of acquisition. (Para I-9.14.)

137. Distribution of capital assets in payment of his share to a partner on his retiring from a firm should be brought within the purview of section 47(ii) and section 49(1) (iii) (b).

(Para I-9.15.)

138. Where a partner introduces capital assets into a partnership firm, it should be deemed to be a transfer under section 2(47) of the Act, subject to the recommendation in the next paragraph.

(Para I-9.17.)

139. The fiction of transfer on introduction of capital assets into a partnership by a partner should apply in the year when the taxpayer concerned realises the consideration for such introduction, in money or the equivalent of money, or when the firm transfers such assets, whichever is earlier.

(Para I-9.18.)

140. Where an asset which was at any time a capital asset is subsequently realised as a trading asset, the element of capital gains should be brought to tax. For this purpose, the consideration realised at the point of ultimate transfer less the amount assessable as profits and gains of business should be deemed to be the full value of the consideration for determination of the capital gains. In other words, the difference between the value at which the asset is taken into the business as a trading asset and the cost of acquisition would represent the capital gains liable to tax at the point of time when the asset is actually transferred.

(Para I-9.19.)

141. The exemptions under section 47(i) and (v) should be deemed to be wrongly allowed where within a period of 5 years after the transfer :

- (a) the relationship of holding company and wholly-owned subsidiary is altered, or
- (b) the transferee company does not or ceases to hold the transferred asset as a capital asset.

(Para I-9.23.)

142. The cost of acquisition of an asset under a gift or by way of inheritance should be the cost to the previous owner as increased by the proportionate amount of gift-tax or estate duty attributable to such asset, so however that such increase does not result in the cost exceeding the value adopted for the purposes of gift-tax or estate duty.

(Para I-9.14.)

143. The cost of improvement, as defined in section 55(1)(b) and referred to in sections 48 and 49, should include all expenditure incurred by a taxpayer in obtaining possession of the asset and establishing or completing full title thereto. (Para I-9.25.)

144. The assurance given by the Finance Minister in the Lok Sabha at the time of insertion of section 52(2) should be incorporated in the section itself. Section 52(2) should apply to cases of understatement of the consideration which actually passed and should not apply to cases where nothing more than the declared consideration is received or accrues to the taxpayer. (Para I-9.27.)

145. Where evidence of a gift or a deemed gift is available in relation to the transfer of a capital asset, the question of applying the provisions of section 52(2) should not arise. (Para I-9.28.)

146. The provision for allowing deduction of a portion of the long-term capital gains under section 80T should be applied both to corporate taxpayers and non-corporate taxpayers and no separate rate of tax on long-term capital gains in the case of companies need be specified in section 115. (Para I-9.31.)

147. The limits of Rs. 25,000 and Rs. 50,000 specified in section 53 should be doubled to Rs. 50,000 and Rs. 1,00,000 respectively. (Para I-9.32.)

148. The following amendments should be made to section 54 :

- (1) the house property in respect of the transfer of which exemption from tax on the capital gains is provided should be required to be used by the taxpayer or his parents for his or their residence throughout the period of 365 days preceding the date of the transfer. The condition of user for residence should not require physical occupation throughout the year but it should suffice if the property is retained for occupation in contradistinction to its being let out ;
- (2) it should be clarified that the benefit under the section is not to be restricted only to individuals but is available to Hindu undivided families as well ;
- (3) it should be clarified that residential units in co-operative societies also qualify for the benefit under section 54 and the fiction in section 27(iii) extended to cover members of companies, as recommended in Chapter 7, should be made applicable for the purpose of section 54.
- (4) the new acquisition may be made either for the taxpayer's own residence or for that of his parents ;
- (5) the period within which the new asset has to be constructed or acquired may be allowed to be extended by the Commissioner in appropriate cases where he is satisfied that the delay was caused by factors beyond the control of the taxpayer. (Para I-9.35.)

149. The Commissioner should have the power to extend the time-limit for acquiring the new asset for the purposes of the exemptions provided in sections 54B and 54D as well. (Para I-9.36.)

150. The requirement of reinvestment under section 54E should be with reference to the full value of the consideration less expenditure incurred wholly and exclusively in connection with the transfer. (Para I-9.37.)

151. Assets specified in section 54E for the purpose of reinvestment should include one residential house for the use of the taxpayer or his parents. (Para I-9.38.)

152. Where realisation of the assets acquired in conformity with the requirements of section 54E is made for the purposes of payment of estate duty on the death of the taxpayer, it should not entail liability to tax on capital gains as a breach of the section. Further, it may be suitably clarified that realisation of a part of the new asset (otherwise than as stated above) would entail taxation of only the proportionate amount of capital gains originally exempted from tax. (Para I-9.39.)

153. The passing of the specified assets to the legal heirs in the case of the death of the taxpayer should not entail consequences under sub-section (2) of section 54E, provided such legal heirs continue to fulfil the same condition of holding the specified assets as would have applied to the taxpayer were he alive. (Para I-9.40.)

154. The Commissioner should be given discretion to extend the time-limit for reinvestment in the specified assets where the receipt of the consideration for the transfer of the original assets is deferred or delayed. (Para I-9.41.)

155. The right of substitution of the market value for the cost of acquisition should not be with reference to the market value as on 1-1-1964 but should be with reference to the market value on the day ten years preceding the last day of the previous year in which the transfer takes place. (Para I-9.42.)

156. A specific provision should be made to secure that, when an asset which fell outside the definition of capital asset when it was acquired by the assessee but which later came within the scope of the definition, is transferred, the cost of acquisition of the asset to the taxpayer should be taken to be the fair market value of the asset as on the date when it came within the definition. For determining whether the asset is a short-term or long-term asset, the period of holding should be reckoned from the point of time when the asset came within the definition of capital asset. (Para I-9.43.)

157. A clarificatory amendment should be made in section 2(42A) to include the contingencies contemplated in section 55(2)(v) for determining the period for which such capital assets are held by the taxpayer. (Para I-9.44.)

158. The provision for grant of tax credit certificates under section 280ZA may be discontinued and the capital gain arising in the circumstances mentioned therein be accorded treatment similar to that under section 54D of the Act. (Para I-9.45.)

159. Additional compensation or consideration received with reference to compulsory acquisition of capital assets should be deemed to be the income of the year in which it is received and not of the year of transfer of the capital asset. The taxpayer should be entitled to the exemption under section 54E with reference to the date of receipt of such additional compensation. These provisions should likewise apply to cases where the consideration originally determined by the Central Government or the Reserve Bank is subsequently enhanced. (Para I-9.47.)

160. Where compensation for the compulsory acquisition of a capital asset is subsequently reduced, specific provision should be made to rectify the relevant past assessment. (Para I-9.48.)

161. Provisions broadly corresponding to the removal of obstacles in relation to amalgamation of companies under the Income-tax Act should be extended to schemes of reconstruction as defined under the Income-tax Act. Accordingly, in relation to such schemes of reconstruction the law should expressly provide that there should be no tax liability of any kind and that the relevant allowances shall continue. (Para I-9.50.)

CHAPTER 10—INCOME FROM OTHER SOURCES

162. It is only in cases where dividend does not constitute business income that it should fall to be assessed under the residuary head. The provision in section 56(2)(i) bringing dividends to tax under the head 'Income from other sources' in all cases should be deleted. (Para I-10.2.)

163. Dividend income other than interim dividends should be taxable in the year in which the dividend is distributed or paid. (Para I-10.5.)

CHAPTER 11—INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

164. It is not advisable to substitute the present provisions for clubbing of incomes under section 64(1) by the adoption of the family as a unit of assessment. (Para I-11.2.)

165. Where a minor receives income as a beneficiary under a trust and such income is derived from the profits and gains of a business carried on by the trustees in partnership with others, such income of the minor should be added to the income of the parent. The clubbing provisions in section 64 should be extended to cover such cases. (Para I-11.4.)

166. If the spouse is a beneficiary under a trust and the trustees join in partnership with the individual the clubbing provisions at present contained in section 64(1)(i) and *Explanation 1* thereto should become applicable. (Para I-11.5.)

167. Income referred to in section 64(1) of the Act should include loss. (Para I-11.6.)

168. Section 64(2) should apply to all cases of conversion of individual property into joint family property by a member otherwise than for adequate consideration whether by the act of impressing the property with the character of family property or by throwing it into the common stock of the family or by gift. (Para I-11.7.)

CHAPTER 12—SET OFF AND CARRY FORWARD OF LOSSES

169. Losses relating to any source under any head should qualify for the benefit of carry forward and set off against income of subsequent years. (Para I-12.3.)

170. The carry forward and set off of business losses should be allowed without any condition that the business or profession in which the loss was sustained should continue to be carried on by the taxpayer in the subsequent years. (Para I-12.5.)

171. Losses relating to salary, house property, business or profession, other sources, and short-term capital assets (but excluding losses in speculation business, long-term capital losses and losses referred to in section 74A) should be allowed to be carried forward to subsequent years and set off against income of those years under the same head or any other head in the eight years following the year in which the loss is incurred. (Para I-12.6.)

172. Provision of a general right to carry back business losses is not favoured. (Para I-12.7.)

173. During such time as a separate tax is levied on registered firms, the losses incurred by a registered firm should be carried forward and set off against the firm's income in the subsequent years, only for the purpose of ascertaining the tax payable by the firm. The existing provisions regarding apportionment of the loss amongst the partners with the corresponding rights of the partners to set off such loss or carry forward such loss in their personal assessments should continue. It would follow that the apportionment of the share of income/loss of the firm (as reduced by the registered firm's tax) among the partners in the subsequent year would have to be of the income/loss without the set off of the past losses because such losses would have been already apportioned among the partners in the earlier years. (Para I-12.8.)

174. There is no need to make any further specific provisions in the law in regard to the order of set off of various allowances and losses. (Para I-12.9.)

175. The Board's instructions regarding the order of set off of speculation losses and other losses against profits from speculation business may be suitably clarified in the Act itself. (Para I-12.10.)

176. Return of loss filed after the 30th of June or such extended time as may be allowed by the assessing authority or the Commissioner should not confer on the taxpayer the right of carry forward of losses under the provisions of Chapter VI of the Act. (Para I-12.11.)

CHAPTER 13—DEDUCTIONS TO BE MADE IN COMPUTING TOTAL INCOME

177. The following types of savings should be included for the purposes of the deduction under section 80C :—

(a) Deposits or cumulative time deposits with public sector banks for a period of not less than 10 years with facilities in the matter of borrowings and encashment, broadly comparable to those available in the case of 10-year or 15-year cumulative time deposits accounts in post offices.

(b) Single premium paid or a policy of insurance on the life of the taxpayer where the duration of the policy is for a minimum period of 10 years or life, without any option to obtain a cash payment by surrender or commutation, in the intervening period.

(Para I-13.6.)

178. The ceiling of Rs. 2400 and Rs. 600 laid down in section 80D should be doubled to Rs. 4800 and Rs. 1200 respectively.

(Para I-13.7.)

179. Taxpayers who are not otherwise eligible to medical facilities provided by an employer should be entitled to a deduction of actual medical expenses incurred on themselves and members of their family, dependent on them upto a limit of 10 per cent of the gross total income or Rs. 5,000 per annum, whichever is lower.

(Para I-13.8.)

180. The benefit of section 80E should be extended to all taxpayers rendering professional services mentioned therein. The monetary limit of deduction should be increased to Rs. 10,000 per annum. The condition that the unearned income referred to in subsection (6) should not exceed Rs. 10,000 to qualify for the benefit, should be deleted.

(Para I-13.9.)

181. The limit of Rs. 12,000 in respect of the gross total income in section 80FF should be increased to Rs. 25,000. The limits of Rs. 1,000 and Rs. 500 in the said section should also be increased to Rs. 2,000 and Rs. 1,000, respectively.

(Para I-13.10.)

182. The quantum of deduction under section 80G should be raised to 100 per cent of donations to funds of a national character as specified at present in the section or as may be notified by the Government from time to time.

(Para I-13.12.)

183. *Explanation 3* to section 80G should be deleted and thus charitable purpose for the purposes of section 80G should not exclude religious purposes.

(Para I-13.13.)

184. Certificates under section 80G should be issued by the Income-tax Officer having jurisdiction over the charitable trust. The certificate should be granted within a period of three months from the date of application. The grant of the certificate should continue to be merely a measure of administrative convenience and not be made a pre-condition for grant

of the deduction under section 80G. The order of the Income-tax Officer refusing to grant the certificate should be made appealable in the normal course. Once a certificate is granted its withdrawal or cancellation should not disqualify donations made prior to the withdrawal or cancellation for the purpose of the deduction under the section.

(Para I-13.14.)

185. A new section should be inserted after section 80G to allow full deduction of contributions which any taxpayer may make to approved scientific research institutions. The deduction under this section should only be available to assessee who do not have any income under the head "Profits and gains of business or profession."

(Para I-13.15.)

186. The new section as recommended in para I-13.15 should cover also contributions by taxpayers to institutions referred to in section 35CCA.

(Para I-13.16.)

187. The limit of Rs. 300 in section 80GG should be raised to Rs. 400. The deduction should not be denied where the residential accommodation owned by the individual, his spouse, minor children or the Hindu undivided family is situated at a place other than the one where the taxpayer resides or conducts his business or profession.

(Para I-13.17.)

188. Section 80V should be extended to cover interest upto a limit of Rs. 10,000 per year paid by a taxpayer on borrowings from banks or financial institutions for acquiring, constructing, repairing, renovating or reconstructing one residential house property used for the purposes of the taxpayer's own residence.

(Para I-13.18.)

189. Reference to section 80VV in section 37 should be omitted. The deduction under section 80VV should operate in the case of assessee having no income chargeable under the head "Profits and gains of business or profession".

(Para I-13.19.)

190. The monetary limit of Rs. 5,000 referred to in section 80VV should be removed.

(Para I-13.20.)

191. Deductions pertaining to income under specific heads should be placed along with the computation sections relating to the relevant head of income.

(Para I-13.21.)

192. Where, however, the deductions under Chapter VIA are designed to reduce the effective rate of tax applicable to the income, such provisions should continue in the same Chapter.

(Para I-13.22.)

193. The deduction under section 80J should be extended to aircraft in like manner as in the case of a ship.

(Para I-13.25.)

194. The provisions of section 80J should be continued without any time limit and the condition regarding commencement of operations before a prescribed date should be deleted.

(Para I-13.26.)

195. In regard to the deduction under section 80J, the percentage should be applied in full for each assessment year irrespective of the days of operation of the industrial undertaking etc., and directions to this effect should be issued by the Board. (Para I-13.27.)

196. The method of computing the capital employed for the purpose of the deduction under section 80J should be laid down in the section itself.

(Para I-13.28.)

197. The provisions for determination of capital employed for the purpose of the deduction under section 80J should be so devised as to approximate closest to the concept of capital employed from the rational accounting point of view. In order to facilitate the work of the Income-tax Officer the capital employed in the industrial undertaking should be certified by an accountant as defined in the *Explanation* below section 288(2) of the Act.

(Para I-13.34.)

198. Where the determination of the capital employed in a separate undertaking for the purposes of the deduction under section 80J presents undue difficulty, it may be ascertained on a *pro rata* basis by ascertaining the proportion of the net fixed assets of the new undertaking to the total net fixed assets of the taxpayer and by applying such proportion to the total capital employed in the business.

(Para I-13.35.)

199. The quantum of the deduction under section 80J should be increased to 10 per cent per annum of the capital employed, and this rate should be correspondingly adjusted as and when the bank rate is changed upwards or downwards. All the recommendations contained in Paras I-13.26 to I-13.36 apply equally to ships, hotels and to aircraft as recommended in Para I-13.25.

(Para I-13.36.)

200. The deduction under section 80JJ should be specifically confined to cases where the activities referred in that section are carried on in a rural area as defined in section 35CC.

(Para I-13.37.)

201. The grant of tax concession under section 80JJ in regard to the profits and gains of the business of live-stock breeding involving race horses should be restricted to only such of the race horses as are sold at public auctions.

(Para I-13.38.)

202. Deduction under section 80M should be allowed with reference to the net income from dividends coming within the scope of this section (i.e., after allowing expenses which are actually incurred for earning and realising the dividend income).

(Para I-13.39.)

203. Income exempt under section 80MM should be the net income (i.e., after deduction of expenses incurred for the earning of that income) which is included in the gross total income, and not the gross receipts. A clarificatory amendment should be made in the section to secure that the deduction will be allowed even where the technical know-how or services are supplied or rendered in connection with the setting up of the business.

(Para I-13.40.)

204. The Board's refusal to grant approval under section 80MM should be made appealable to the Central Tax Court recommended in Part II of this Report, and pending the establishment of the Central Tax Court the appeals against Board's order should lie to the Delhi High Court. The Board should have the power to admit an application for approval after the first day of October where sufficient reason is shown for the delay.

(Para I-13.41.)

205. The deduction under section 80N should also be allowed only with reference to the net income by way of dividend referred to in that section and not the gross amount. The deduction should not be confined to dividend on the shares originally allotted to the Indian company as mentioned in that section but should cover also the dividends pertaining to any bonus shares subsequently allotted with reference to the original holding. There should be a provision for condonation of delay in the making of the application to the Board for the purpose of section 80N and for appeal to the Central Tax Court or the Delhi High Court against the Board's order refusing such approval.

(Para I-13.42.)

206. As in the case of section 80MM and section 80N, there should be provision for condonation of delay in making the application to the Board for approval of the agreement for the purpose of section 80-O and for appeal to the Central Tax Court or the Delhi High Court against the Board's order refusing approval. The deduction under this section should also be allowed only with reference to the net income and not the gross receipts.

(Para I-13.43.)

207. Where the income of co-operative societies is wholly exempted from tax under the provisions of section 80P(2) (a) in relation to the activities of the society *vis-a-vis* its members, the same exemption should also be extended to an apex society which itself consists of a group of co-operative societies whose income is exempt under this section.

(Para I-13.44.)

208. Section 80RR should be extended to members of learned professions as referred to in section 10(23A) as also persons engaged in such cultural activities of the nature notified by the Central Government.

(Para I-13.45.)

CHAPTER 14—INCOMES FORMING PART OF TOTAL INCOME ON WHICH NO INCOME-TAX IS PAYABLE AND OTHER PROVISIONS OF THE ACT

209. Clause (iii) of section 86 should be deleted and share of profit of a partner in an unregistered firm should not be included in the total income of the partner in his assessment. As under the existing law share of loss of a partner in an unregistered firm should not be apportioned to him and should not be available for set off against his other income.

(Para I-14.4.)

210. An association of persons should not be separately taxed on its income where it registers particulars of its constitution and the profit-sharing ratios of the

members under a procedure similar to that of registration of firms outlined in the Interim Report. In circumstances where a firm would have been treated as an unregistered firm, an association of persons should be separately assessed and be taxed on its income at the flat rate of 60 per cent. As a corollary the provision in sub-clause (v) of section 86 should be deleted. The loss of an association of persons which is registered and the loss of one which is separately assessed should, likewise, be treated similarly to the loss of a registered firm and the loss of an unregistered firm, respectively. (Para I-14.8.)

211. A body of individuals should not be taxed as a unit on its income where it registers particulars of its constitution and profit-sharing ratios of the individuals constituting the body, under a procedure similar to that recommended in the case of an association of persons. In circumstances similar to those where an association of persons would be separately assessed and taxed at the flat rate of 60 per cent, a body of individuals should be separately assessed as a unit but not at the flat rate of 60 per cent but at the appropriate slab rates of tax. The loss of the body of individuals which is registered and the loss of one which is separately assessed as a unit should likewise be treated similarly to the loss of an association of persons which is registered and the loss of one which is assessed as a unit, respectively. Where a body of individuals is assessed as a unit, the individual members should not be again assessed in respect of any income falling to their share in the income of the body. (Para I-14.10.)

212. Where property is held in trust, and the trustees carry on a business, if an assessment is made in the status of body of individuals, taking the beneficiaries of the trust collectively. The recommendation made in the preceding paragraph would ensure that the tax is appropriately charged in the hands of the respective beneficiaries rather than on the body of individuals as a single independent entity. If the assessment is made on the trustees, they would only be representative assesses and thus be assessed in like manner and to the same extent as the beneficiaries in relation to their respective shares. (Para I-14.11.)

213. The right to declare the constitution of the body of individuals and seek separate assessments of the members should not extend to the members of the body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu, if they are otherwise assessable as a body of individuals. (Para I-14.12.)

214. An express statutory provision should be made that once a firm, association of persons or body of individuals is assessed, the income in question cannot again be assessed in the hands of the constituents of the firm, association of persons or body of individuals. However, if the individual members are first assessed, it should not be construed that the formalities of registration are automatically complied with and the Department should not be prevented from framing an assessment on the firm, association of persons or body

of individuals, as the case may be, in the circumstances where such an assessment would lie. However, in such a situation the prior assessment that may have been made on any of the individual members should be appropriately rectified as a mistake apparent from the record, and the tax, if any, collected should be duly refunded. In other words, the procedure of assessment ceases to be matter of choice for the Department and it is only according to the clear circumstances as outlined earlier that assessments would be made either on the firm, association of persons or body of individuals as a unit of assessment on the one hand or the individual members thereof on the other.

(Para I-14.15.)

215. Apart from such a specific provision to prevent double assessment, a general provision to prevent double assessment should be enacted, preferably in the charging section itself. (Para I-14.16.)

216. The provisions for clubbing incomes of the spouse of an individual and of a minor child of the individual, as obtaining in relation to a firm under section 64(1)(i) and (iii), should be enacted correspondingly in relation to an association of persons which is engaged in a profit earning activity but not in relation to a body of individuals. (Para I-14.17.)

217. The flat rate of tax to be charged under section 164 should be 60 per cent in place of 65 per cent. As this rate of 60 per cent is the maximum rate recommended, the question of applying the alternative higher rate applicable to an association of persons would not arise. (Para I-14.25.)

218. Sections 236 and 236A should be deleted. (Para I-14.27)

CHAPTER 15—THE COMPANIES (PROFITS) SURTAX ACT 1964

219. The levy of surtax should not be merged with the income-tax on companies. The levy of surtax under the Surtax Act may be continued. (Para I-15.5.)

220. The deductions to be made from the total income under rule 1 of the rules for computing chargeable profits in the First Schedule should necessarily be restricted to the net amounts, if any, which remain included in the total income as computed under the Income-tax Act. (Para I-15.9.)

221. Clause (xii) should be deleted from rule 1 of the First Schedule. (Para I-15.10.)

222. The provision in sub-clause (b) of clause (i) of rule 2 of the First Schedule is redundant and this provision should be deleted. (Para I-15.11.)

223. Rule 3 of the First Schedule should be deleted. (Para I-15.12.)

224. The two terms, "reserve" and "provision", should be defined under the Surtax Act by adopting for that purpose the definitions in Part III of Schedule VI to the Companies Act, 1956. (Para I-15.14.)

225. Rule 2 of the Second Schedule should be amended to secure that :—

- (a) the adjustment with reference to assets the income whereof is excluded is made on the basis of the book value of the said assets ;
- (b) rule (2) (ii) refers only to amounts excluded in computing the capital under rule 1 (iii) and items (5), (6) and (7) referred to in the *Explanation* to rule 1 ;
- (c) rule 2(ii) relates to the position as on the 1st day of the previous year. (Para I-15.18.)

226. *Explanations* 1, 2 and 3 appearing after rule 2 of the Second Schedule should be placed at the end of the Second Schedule, expressly clarifying that they apply to all the rules of the Second Schedule.

(Para I-15.19.)

227. The application of rule 3 of the Second Schedule in cases of amalgamation of two companies should entitle the amalgamated company to reckon the increase in the paid up share capital as from the date from which the amalgamation is effected and not only from the date of actual allotment.

(Para I-15.20.)

228. An *Explanation* should be added to rule 4 of the Second Schedule clarifying that no diminution under rule 4 is to be made with reference to the items of income in relation to which the company has been allowed deductions under Chapter VIA of the Income-tax Act.

(Para I-15.24.)

229. The deficiency in chargeable profits with reference to the standard deduction relating to a year should be allowed to be carried forward and set off in the following three years before the determination of the chargeable profits which attract surtax liability.

(Para I-15.27.)

230. The statutory deduction under the Surtax Act should be increased from 15 per cent to 20 per cent of the capital.

(Para I-15.29.)

231. Surtax should be levied at the flat rate of 40 per cent on the amount by which the chargeable profits exceed the standard deduction.

(Para I-15.30.)

232. Continuation of any artificial condition about the composition of the capital as computed for surtax for the purposes of the proviso in the Third Schedule, is not favoured ; the third condition in the said proviso, that paid-up capital subscribed in cash should be not less than 25 per cent of the 'capital', for applying the ceiling of 70 per cent, should be deleted.

(Para I-15.31.)

233. The provision for a ceiling on the total incidence of surtax and income-tax should be amended as under :—

- (a) a ceiling of 70 per cent on the total incidence should apply in the case of domestic companies which are widely-held (section 108) ;

- (b) a ceiling of 75 per cent on the total incidence should apply in the case of all other companies ;

- (c) the ceiling should not be made conditional upon fulfilment of any requirement about the composition of the capital as computed for the purposes of surtax. (Para I-15.32.)

CHAPTER 16—WEALTH-TAX

234. Debts which are utilised for acquiring property on which wealth-tax is not charged either because such property falls outside the definition of 'assets' or it is specifically exempted from charge by virtue of section 5 should alone be disqualified from deduction in determining the net wealth.

(Para I-16.4.)

235. Disputed demands for tax, penalty or interest under direct tax laws should be allowed as a debt on the valuation date so, however, that if the demand is altered as a result of appellate proceedings or otherwise, the assessment in question shall be appropriately rectified under section 35 of the Act.

(Para I-16.5.)

236. The provision in item (b) of sub-clause (iii) of clause (m) of section 2 should be deleted and the restriction on allowing tax demands remaining outstanding for more than 12 months should be removed.

(Para I-16.6.)

237. Suitable administrative instructions should be issued so as not to treat as an asset, claims for enhanced compensation which are not finally decided as at the valuation date. In the alternative a clarificatory *Explanation* may be inserted in section 2(m) of the Act.

(Para I-16.7.)

238. Sub-section (1A) of section 4 should be amended to cover property gifted by the individual to the Hindu undivided family.

(Para I-16.8.)

239. Sub-section (3) of section 4 may expressly be made applicable to assets included in the net wealth of the taxpayer under section 4(1A) to allow deduction of debts referable to such assets.

(Para I-16.9.)

240. The provision in sub-section (5A) of section 4 regarding gifts by book entries should correspondingly be reflected in the Gift-tax Act as well, where also such a transaction should not be regarded as a gift. On the delivery of money or money's worth, the gift should be regarded as effective so as to attract gift-tax and to warrant exclusion from the net wealth of the donor, subject to the other clubbing provisions. Such amendment should be made with retrospective effect from 1st April, 1976, when sub-section (5A) came into force.

(Para I-16.10.)

241. An express provision against double assessment should be made in the charging section.

(Para I-16.11.)

242. Reliefs under the Wealth-tax Act should be by way of straight deductions and not by way of rebate at the average rate of tax.

(Para I-16.12.)

243. Exemptions left to notifications should be consolidated in a schedule to the Wealth-tax Act which may be altered by the Central Government under a specific authority conferred by the Act.

(Para I-16.13.)

244. Section 5(a)(xa) should be amended as under .

“The amount of any outstanding fee in respect of professional service rendered by the assessee as a lawyer, solicitor chartered accountant, architect, engineer, medical practitioner or such other professional service as may be notified in this behalf by the Central Government in the Official Gazette, where the books of account are regularly maintained on the cash system of accounting”. (Para I-16.24.)

245. Such a provision should be made operative retrospectively from the date the Wealth-tax Act came into force, as it is largely clarificatory and it is also intended to settle the controversies in a large number of assessments which are unsettled. (Para I-16.25.)

246. A specific provision should be introduced in section 5 of the Wealth-tax Act to exempt from tax the net wealth of all such bodies, associations or institutions as enjoy exemption from income-tax on their income under the provisions of section 10 of the Income-tax Act. (Para I-16.26.)

CHAPTER 17—GIFT-TAX

247. Treating gifts as income under the Income-tax Act is not favoured ; the Gift-tax Act should continue in its present form. (Para I-17.3.)

248. Concepts which are common to the direct tax laws should, as far as possible, bear the same connotation under all the laws. The definition of ‘company’ as contained in the Income-tax Act should be made applicable for the purposes of the Gift-tax Act, too. (Para I-17.4.)

249. An *Explanation* should be added at the end of section 2(xii) clarifying that where there is a *bona fide* change in the constitution of a firm engaged in one of the learned professions, it shall not be regarded as a gift. (Para I-17.6.)

250. Another *Explanation* should be added at the end of section 2(xii) clarifying that where a *bona fide* change in the constitution of a firm carrying on any business is made on grounds of commercial expediency, it shall not be regarded as a gift. (Para I-17.7.)

251. No part of the premium paid on a life insurance policy effected under the Married Women’s Property Act should be regarded as a gift. (Para I-17.8.)

252. A transfer by way of gift by an individual to the Hindu undivided family of which he is a member should, be treated in like manner as property impressed with the character of joint family property or thrown into the common stock of the family under section 4(2) of the Gift-tax Act. (Para I-17.9.)

253. Section 18 of the Gift-tax Act should expressly permit the taxpayer to compute the advance gift-tax by taking into account the rebate on stamp duty under section 18A. (Para I-17.12.)

254. The provisions of section 18A should be amended to allow full credit for the stamp duty paid on an instrument of gift against the gift-tax payable in every case without any limitation. (Para I-17.13.)

CHAPTER 18—VALUATION OF ASSETS

255. There is no reason why the value of assets by and large should be determined differently under the Wealth-tax Act from that under the Gift-tax and Estate duty Acts. There is need for evolving, as far as possible, a uniform system of valuation under these laws in view of the fact that the basic concept of the price in the open market is common. (Para I-18.2.)

256. Any rules which may be framed for determining the market value of assets should as far as possible be made applicable to all the direct tax statutes. (Para I-18.5.)

257. For the purposes of valuation of unquoted equity shares of companies ;

- (a) rule 1D of the Wealth-tax Rules should be deleted and in its place fresh rules should be notified by the Government after consultation with the Institute of Chartered Accountants of India who may evolve guide-lines for valuation ;
- (b) the rules/guide-lines should be framed separately for companies in four different categories, viz., (i) industrial, (ii) investment, (iii) trading and (iv) others, including service companies ;
- (c) the auditors of the companies whose shares are not quoted should be required to furnish a statement, to be attached to the audited statements of accounts, showing the valuation of the shares of the company as at the balance-sheet date with a certificate to the effect that the value has been determined in accordance with the rules framed under the direct tax laws ;
- (d) the statement of valuation should be reasonably explicit so that the figures adopted in the statement are readily verifiable with reference to the audited statements of account and the process by which the value of the share determined is reasonably clear ; adjustments which may be made by the auditor should be clearly reflected in the statement ;
- (e) the value as determined in the statement of valuation by the company’s auditor should be adopted by the assessing officer for all the direct tax laws unless the officer is of the opinion that the value needs to be modified to the extent the valuation is not in conformity with the rules notified under the Act ;

- (f) the value to be adopted on the basis of the aforesaid statement should relate to the date of the balance-sheet either coincident with or immediately preceding the valuation date. (Para I-18.12.)

258. Rules 10(2) and 10(4) of the Gift-tax Rules should be deleted. (Para I-18.13.)

259. Rule 1C(1) of the Wealth-tax Rules should be amended to provide for the normal yield on preference shares to be 1 per cent over the rate notified by the Controller of Capital Issues under the Capital Issues (Exemption) Order. (Para I-18.14.)

260. The rate of interest under clause (c) of the Explanation to rule 1B(1) of the Wealth-tax Rules should be equivalent to the rate of interest allowed by public sector banks on long term fixed deposits of more than 5 years duration. (Para I-18.15.)

261. Agricultural lands including plantations may be valued by capitalisation of the income therefrom at rates to be notified by the Board. (Para I-18.18.)

262. House property should be valued on the basis of capitalisation of income as recommended in the Interim Report, for all direct tax laws. No separate valuation of development potential of the property should be made. However, open land and surplus land should be separately valued on the basis of estimation of the open market value. (Para I-18.20.)

263. Rules 2A to 2F of the Wealth-tax Rules should be substituted by rules which provide for the valuation of a business concern as a whole on the basis of the balance-sheet drawn up in accordance with the method of accounting and the determination of the excess of assets over liabilities as per such balance-sheet. The only adjustments which need be made should be those which the circumstances of the case may require, such as adjustments for any departure from the method of accounting, or straight write offs of assets, like capital assets for scientific research or excessive write off of depreciation beyond that permitted under the tax laws. No adjustments of hypothetical nature or adjustments to individual items as at present contemplated in rules 2A to 2F should be

made. The taxpayer should also not be entitled to deductions for liabilities like gratuity, bonus, etc., which remain unprovided in accordance with the method of accounting. In particular, no adjustments which amount to a change in the method of accounting with reference to which income is computed should be made. However, assets which do not really pertain to the business should be separately valued as under rule 2G. (Para I-18.24.)

264. Recommendations in the preceding paragraph should be regarded as applicable to the case of the learned professions as well and the global valuation as contemplated in section 7(2)(a) should likewise be expressly made applicable to such professions. (Para I-18.26.)

265. The valuation of interest in business for the purposes of gift-tax and estate duty should be on the basis of capitalisation of the income. The value should be determined on the global valuation basis by capitalisation of the income of the business leaving the actual computation of the income as well as the rate of capitalisation to the valuer and the assessing officer. In no case, however, the value of the business should be taken at a figure below the value of the net tangible assets as shown in the balance-sheet, the justification being that in making the valuation, negative value of intangibles should be ignored. (Para I-18.27.)

266. Rule 2 of the Wealth-tax Rules should clarify that in allocating the net wealth of a firm among the partners, the interest of each partner would be deemed to comprise of the assets qualifying for exemption under section 5(1) of the Wealth-tax Act and other assets on a proportionate basis. The same procedure should also apply in allocating the net wealth of an association of persons or body of individuals among its members. (Para I-18.29.)

267. Rule 10(1) of the Gift-tax Rules which prescribes the cash surrender value as the value of a policy of insurance is fair and reasonable. (Para I-18.30.)

268. Where the period for which a gift is not revocable is less than one year, the actual income for the period upto the date of revocation should be discounted for determining the present value of the gift. (Para I-18.31.)

PART II

DIRECT TAX LAWS COMMITTEE

FINAL REPORT—PART II

INTRODUCTORY

II-0.1. We now turn to the procedural and administrative aspects of the direct tax laws. In Part I of this Report, while examining the feasibility of consolidating the laws relating to income-tax, wealth-tax, gift-tax and surtax on company profits into one enactment in accordance with one of the terms of reference, we have expressed the view that though the ideal solution would be to have a single new Act consolidating both the substantive and procedural provisions relating to the four taxes as the consolidation of the substantive law would be time-consuming, only the procedural provisions relating to the four direct taxes should be consolidated into a single enactment while keeping the substantive provisions in separate Act as they are today. The consolidation of the procedural provisions relating to these four taxes is not likely to present any serious problem as, not only the administrative authority is the same for all the four taxes but the broad framework of the procedures is also common to them. The proceedings are set in motion through a return followed by a process of assessment and quantification of the base and the tax. The procedures for appeals, rectifications, revisions, collection of taxes, levy of penalties, etc., are also the same. The position is, however, materially different in the case of estate duty where the charge is attracted with reference to the event of death and the assessment process is also different. For this reason we are of the view that estate duty legislation should remain as a self-contained statute embracing both the substantive law and the procedural law.

II-0.2. Our study of the taxation laws and procedures of some of the developed countries like U.K., U.S.A. and Japan shows that, while there are several taxes, some direct and some indirect levied in those countries the procedure for the levy and management of these taxes is common and is spelt out in a common code. We are of the view that, in our country also, introduction of a uniform procedure for the administration of the four Central direct taxes is a reform overdue.

II-0.3. We are of the view that an integrated procedure for the administration of income-tax, wealth-tax and surtax on companies would go a long way in ensuring uniformity in their administration and removing the various minor disparities in procedure, which often lead to mistakes in assessments. Above all, this would facilitate better voluntary compliance by taxpayers with their obligations under all these tax laws. We accordingly recommend the enactment of a consolidated code laying down one uniform procedure for the management and administration of the four Direct Taxes namely, Income-tax, Wealth-tax, Gift-tax and Surtax on company profits.

II-0.4. While separating the procedural and administrative aspects of the direct tax laws from the substantive provisions, we have given serious thought to some of the provisions which are on the borderline between the two. We have generally approached this task on the basis that any provision of the law which casts a substantive liability on the taxpayer or gives him a substantive right should be considered as a substantive provision, whereas provisions which are auxiliary or merely assist in enforcing the rights and duties of the taxpayer should be regarded as procedural in character. In borderline cases, where the substantive provisions are interwoven with the procedures, or where procedures by themselves generate certain rights or liabilities, we have classified the provisions either as substantive or procedural, keeping in view the legislative intent underlying them and facility in administration.

II-0.5. In conformity with this approach, we have divided the procedural and administrative aspects of the tax laws into the following Chapters for the purposes of the separate enactment :—

- Chapter 1 : Preliminary
- Chapter 2 : Administration
- Chapter 3 : Pre-assessment payment of taxes
- Chapter 4 : Assessment procedure
- Chapter 5 : Penalties
- Chapter 6 : Appeals, references and revisions
- Chapter 7 : Settlement of cases
- Chapter 8 : Payment and refund of taxes
- Chapter 9 : Recovery of taxes
- Chapter 10 : Liability in special cases
- Chapter 11 : Registration of firms, and association of persons and bodies of individuals
- Chapter 12 : Offences and prosecutions
- Chapter 13 : Miscellaneous provisions
- Chapter 14 : Approvals under the tax laws

These Chapters will cover the procedural provisions contained in Chapters I, XI, XIII, XIV, XV, XVI, XVII, XIX, XIXA, XX, XXI, XXII and XXIII of, and the Second, Third and Fourth Schedules to, the

income-tax Act, and the corresponding provisions of the Wealth-tax Act, Gift-tax Act and Companies (Profits) Surtax Act. We shall in the following Chapters of this Report, deal with each one of these aspects in detail and indicate our thinking as to the steps necessary for integrating the procedures for all direct taxes and also for streamlining the present provisions in regard to these matters so as to make the administration of these taxes simpler, more purposeful and convenient to tax-payers and the Department.

II-0.6. In recommending the integration of the procedural and administrative provisions relating to these direct taxes into a common code, it is not our intention that there should be common proceedings for the levy of these taxes in any given case. As the

substantive provisions relating to the computation of the tax base and the application of the tax rates under the different tax laws are different, the proceedings for the levy of these taxes may have to be independent of one another. What is aimed at is a common nomenclature for the authorities who administer these taxes, a common assessment procedure, a common appellate procedure, a common procedure for recovery of the taxes and other ancillary matters. Thus, while leaving open the question of having a common proceeding for the assessment and collection of the four direct taxes, we recommend that the proceedings for the assessment and collection of these taxes in any given case should, as far as possible, be taken up and completed simultaneously, so as to save the time of the Department as also of the taxpayer.

CHAPTER 1

PRELIMINARY

II-1.1. The opening Chapter of the consolidated enactment for the management and administration of the direct taxes will deal with the title of the enactment, its commencement, its scope and application and also the definitions which would be relevant to its various provisions.

Title

II-1.2. As regards the title of the enactment, we recommend that the proposed Act may be titled "The Direct Taxes Management and Administration Act". This title would, in our opinion, indicate that the provisions of the proposed Act would not merely contain the procedural provisions governing the assessment and collection of the direct taxes but also specify the authorities responsible for administering the laws and their powers and functions, and also deal with defaults and offences under these laws, penalties for such defaults and prosecution for such offences. We shall for the sake of brevity, refer to the proposed enactment as the "Management Act" in this Report.

Commencement

II-1.3. When the Indian Income-tax Act, 1922, was replaced by the Income-tax Act, 1961, elaborate transitional provisions were set out in section 297 of the latter Act with the intention of smoothening the process of transition and reducing the area of doubts, disputes and litigation. These transitional provisions, however, led to considerable problems and litigation which could not be totally obviated or resolved even by the exercise of the power to remove difficulties vested in the Central Government under section 298. In the light of the experience gained in the working of these provisions, we are of the view that the old laws should continue upto and inclusive of a specified assessment year, say, 1979-80. All proceedings relating to assessments for the assessment years upto and inclusive of the assessment year 1979-80 would be taken under the old law irrespective of the time when such proceedings are initiated, carried out or concluded. The new law would only apply for and from the immediately following assessment year, i.e., 1980-81. For all proceedings relating to the assessment year 1980-81 and subsequent years, the new law would operate. Such an approach would eliminate controversies in regard to the questions whether a change in the statute relates to substantive law or to procedural law. The principle of applying the law as in force on the first day of the assessment year is now well-recognised and is, in fact, generally applied whenever amendments are made to the law.

II-1.4. At the same time, it is not our desire to keep the old and new provisions in totally watertight compartments. If it is found that it is desirable to apply the new procedures even in respect of assessments relating to earlier years, this could still be achieved by moving amendments to the old Act. By way of illustration, when the Central Tax Court, recommended by us elsewhere in this Report, is established, it would be desirable to transfer all pending references, etc., from the High Courts to the Central Tax Court even though they may relate to earlier assessment years. This could be achieved by specific amendments to the old law. Likewise, appeals against orders of the Tribunal arising after the constitution of the Central Tax Court would have to be referred to the Central Tax Court irrespective of the year of assessment to which they relate. Here also necessary provision could be incorporated in the old law.

II-1.5. We accordingly recommend that the provisions of the old law should continue upto and inclusive of a specified assessment year, say, assessment year 1979-80. The new provisions based on our recommendations should apply for and from the immediately following assessment year, i.e., 1980-81. Whenever the Government desires to adopt the new procedure even for earlier assessment years, this should be achieved by appropriate amendments to the old law.

Scope and Application

II-1.6. We are of the view that the scope and application of the Management Act should be clearly spelt out in the "Preliminary" Chapter of that Act. We, accordingly, recommend that there should be a specific provision in the Management Act making it applicable to the assessment and collection of the following direct taxes, namely:—

- (i) Income-tax ;
- (ii) Wealth-tax ;
- (iii) Gift-tax ; and
- (iv) Surtax on Company Profits.

If, in future, the Government considers it necessary to levy any other direct tax, the procedure for the assessment and collection of such tax should also be governed by the Management Act.

Definitions

II-1.7. The preliminary Chapter will also contain definitions of various terms which are relevant for

the purposes of the Management Act. We recommend that there should also be a specific provision that words which are not defined in the Management Act but are defined in the substantive enactment will have the same meaning for the purposes of the Management Act and, correspondingly, there should be a similar provision in the substantive enactment to the effect that words which are defined in the Management Act but not in the substantive enactment will have the same meaning for the purposes of the substantive enactment also. On present indications, we are of the view that the following terms should be defined in the definitions section of the Management Act :—

1. Appellate Tribunal.
2. Approved gratuity fund.
3. Approved provident fund.
4. Approved superannuation fund.
5. Assessment.
6. Assistant Commissioner.
7. Board.
8. Commissioner.
9. Commissioner (Appeals).
10. Deputy Commissioner.
11. Director of Inspection.
12. Director, manager, etc.
13. Direct Taxes Act.
14. Direct Taxes Officer.
15. Excutor.
16. Inspector of Direct Taxes.
17. Legal representative.

18. Prescribed.
19. Principal officer.
20. Public servant.
21. Reassessment.
22. Regional Commissioner.
23. Registered association.
24. Registered body of individuals.
25. Registered firm.
26. Registered valuer.
27. Regular assessment.
28. Settlement Commission.
29. Tax.
30. Tax Court.
31. Tax return.
32. Unregistered association.
33. Unregistered body of individuals.
34. Unregistered firm.

Some of the above definitions already find place in the existing direct tax laws. They are proposed to be incorporated in the definitions section of the Management Act as they have greater relevancy for the purposes of the procedural provisions of the tax laws. Apart from these, some new definitions are also required to be added. Some of these are necessitated by the integration of the procedural provisions of the various direct tax laws. Others are consequential to the suggestions made in our Interim Report and this Report for the rationalisation or simplification of the procedural laws.

CHAPTER 2

ADMINISTRATION

Direct Taxes Authorities

II-2.1. Chapter 2 of the Management Act will incorporate the provisions at present contained in Chapter XIII of the Income-tax Act and corresponding provisions of the other direct tax laws. These provisions specify the authorities who are empowered to exercise the powers and perform the functions under different direct tax laws, their appointment and span of control, their jurisdiction, powers and duties, and also the procedures for disclosure of information relating to taxpayers. Under the existing provisions, the Central Board of Direct Taxes heads the hierarchy of tax authorities, followed by Directors of Inspection, Commissioners of Income-tax/Wealth-tax/Gift-tax, Assistant Commissioners of Income-tax/Wealth-tax/Gift-tax, Income-tax Officers/Wealth-tax Officers/Gift-tax Officers and Inspectors of Income-tax/Wealth-tax/Gift-tax. Once the procedural provisions of the different direct tax laws are integrated, common designations will have to be evolved for the authorities responsible for administering such tax laws.

Designations of Officers

II-2.2. In this context, we have considered it desirable to review the appropriateness of the present designations of the officers of the Income-tax Department at various levels. The present cadre of Income-tax Officers consists of Class I Officers in the Senior Scale and Junior Scale and Class II Officers. The Income-tax Act and other direct tax enactments do not make any distinction, as regards the powers and functions, between one class of Income-tax Officers and another, or between a Senior Scale Income-tax Officer and a Junior Scale Income-tax Officer in the Class I cadre. Although efforts were made from time to time to classify the charges of Income-tax Officers as Senior Scale charges, Junior Scale charges, or Class II charges, and have these manned by officers of appropriate status, in practice, these attempts have not been successful. The reasons are partly technical, viz., difficulties in creating homogeneous charges which can be definitely classified as a Senior Scale charge, or a Junior Scale charge or a Class II charge, and partly administrative, viz., difficulties in finding an officer of the appropriate status to be posted to a particular charge. The result has been that it is not uncommon to find an Income-tax Officer, Class II, holding a charge with high revenue potential and containing important cases requiring investigation, such as a Companies Circle or a Central Circle, while a Class I Income-tax Officer may sometimes be in charge of a comparatively unimportant Circle. This situation has naturally given rise to a grievance among the Class II Officers, on the one hand, in that they are asked to perform functions of an onerous character without

appropriate compensation, and among the Class I Officers, particularly those in the Senior Scale, on the other, in as much as they bear the same designation as other officers who are much junior to them in the service and who draw much lower emoluments.

II-2.3. We have taken note of the recommendations made by the Wanchoo Committee and also the suggestions made by the Working Group on Central Direct Taxes of the Administrative Reforms Commission. The Wanchoo Committee had, in its Final Report, recommended a change of designation for certain income-tax authorities. That Committee had expressed the view that in any administrative set-up, designations had an important place, as these broadly indicated the grade and level of responsibility of an officer and provided an index for comparing positions in different departments; and further, a change of designation was indicative of advancement in official career and, as such, had a considerable effect on the morale of the officers. That Committee accordingly recommended redesignation of Income-tax Officers Class I Senior Scale as Assistant Commissioners and redesignation of Assistant Commissioners as Deputy Commissioners. Although the Government accepted one part of this recommendation, namely, the redesignation of Assistant Commissioners as Deputy Commissioners, and incorporated an amendment to that effect in the Taxation Laws (Amendment) Bill, 1973, the Select Committee considered it unnecessary to change the existing designations of officers, with which the tax-paying public were familiar.

II-2.4. In the context of integrating the procedural provisions of the different tax laws, redesignation of the authorities administering them has become inevitable. We are of the view that this is the opportune time for rationalising the designations of the authorities functioning under the direct tax laws. We recommend that the existing cadre of assistant commissioners should be redesignated as deputy commissioners and that Income tax Officers, Class I, in the senior scale, should be designated as assistant commissioners. This would bring the designations of the officers of the Income-tax Department on par with the designations of the corresponding levels of officers in the sister revenue service of Customs and Central Excise.

II-2.5. We also recommend that suitable provisions be made in the law so as to enable assistant commissioners (new designation) to perform all the functions and exercise all the powers of the assessing authority.

II-2.6. The redesignation of officers in Class I Senior Scale as Assistant Commissioners, as recommended by us in an earlier paragraph, will accentuate the need for classifying the assessment charges Senior Scale Charges and others. The existing difficulties in posting

officers of the appropriate status to various charges may, however, still persist. The Wanchoo Committee had recommended in para 6.69 of its Final Report that, where a Class II Officer is required to hold a charge meant for a Senior Class I Officer, he should be compensated for the higher responsibilities that he would be required to shoulder by the grant of an officiating or charge allowance of Rs. 150 per month, in addition to his grade pay in Class II. This decision has not so far been implemented by the Government. We are of the view that there is urgent need for redressing the just grievances of Class II Officers. We, accordingly, recommend that the classification of charges into senior scale charges and other charges should be brought about and, where a class II officer is required to hold a senior scale charge, he should be appropriately compensated for the higher responsibility that he is required to shoulder.

First Appellate Authority

II-2.7. In the existing cadre of Assistant Commissioners, there are two categories, namely, Inspecting Assistant Commissioners and Appellate Assistant Commissioners. Inspecting Assistant Commissioners exercise administrative control and supervision over the work of Income-tax Officers. They may also be vested with powers of making assessments where specifically directed by the Commissioner. Appellate Assistant Commissioners constitute the first appellate authority over the orders of Income-tax Officers. Recently, an additional first appellate authority has been created at the level of Commissioner (Appeals), to whom appeals against specified orders of the Income-tax Officer would lie, while appeals against the remaining orders of the Income-tax Officer would continue to lie to the Appellate Assistant Commissioner. This dichotomy at the first appellate level has been brought about pursuant to the changes introduced in the assessment procedure on the recommendations of the Wanchoo Committee, according to which assessments involving additions to returned income exceeding Rs. 1 lakh (or any other limit, not below Rs. 25,000, which may be notified by the Board) are to be made by the Income-tax Officer after issuing a draft assessment order to the assessee and after the assessee's objections, if any, thereto are heard and directions given by the Inspecting Assistant Commissioner. We have, elsewhere in this Report, recommended the discontinuance of this practice, without, however, detracting from the Inspecting Assistant Commissioner's powers of being associated continuously in the process of assessment in important cases. In our view, the association of the Inspecting Assistant Commissioner in the process of assessment through all its stages is necessary not only in important cases, but also in all scrutiny cases in the interest of efficient collection of revenue. When scrutiny is limited only to important cases and a small percentage of other cases, and such scrutiny is made in depth under the close supervision and guidance of senior officers, the appeals arising therefrom are bound to raise important issues of law and fact meriting consideration by more experienced and senior officers. In this background, it would be appropriate to vest all powers of the first appellate authority in officers of the Commissioner's rank. This would ensure better consideration of disputed issues by the first appellate authority and thereby

reduce the number of appeals which go up to the Tribunal. Apart from this reduction in the appeals going to the Tribunal and improvement in the quality of the appeal decisions at the first appellate level itself, such a step would also reduce the confusion which the present provisions create in the minds of the assesseees, in that the first appeal lies to the Commissioner (Appeals) in respect of some orders and to the Appellate Assistant Commissioner in respect of other orders even in the same case. We, accordingly, recommend that appeals against orders of the direct taxes officer, assistant commissioner and deputy commissioner (new designations) should lie to the commissioner (appeals).

II-2.8. According to the information furnished to us the sanctioned strength of Inspecting Assistant Commissioners and Appellate Assistant Commissioner is 294 and 197, respectively. Recently, 80 posts of Appellate Assistant Commissioner have been abolished and 70 posts of Commissioner (Appeals) and 10 posts of Commissioner have been created. Under the scheme suggested by us, the remaining posts of Appellate Assistant Commissioner will have to be converted into posts of Inspecting Assistant Commissioner. This would enable the Department to tighten up supervision of the work of the assessing officers. In accordance with the recommendations made in our Interim Report, only a small proportion of the total number of cases need be subjected to scrutiny every year. These scrutiny assessments will be made under the close guidance and supervision of senior officers who would associate themselves in the process of assessment continuously. We can then expect that the number of appeals filed will fall substantially. The recommendations which have been made in our Interim Report for streamlining the appellate procedures and for introducing a system of the Board giving advance rulings when approached by taxpayers, will also tend to reduce unproductive litigation. We are of the view that, for dealing with the lesser load of appellate work that will arise in future, it would not be necessary to make any large scale augmentation of the strength of Commissioners (Appeals) even if all first appeals are entrusted to them.

Deputy Commissioners

II-2.9. We would like to make it clear that implementation of the above recommendation should not result in any reduction in the cadre of Assistant Commissioners (proposed to be redesignated as Deputy Commissioners). As the appeals pending with the present Appellate Assistant Commissioners will stand transferred to Commissioners (Appeals), the officers so released from appellate work should be utilised for giving better direction to, and supervision of, the work of the assessing officers in order to achieve better quality of assessments, better quality of investigation, all-round improvement in the collection work and reduction in disputes and litigation. We, therefore, recommend that deputy commissioners should be deployed exclusively on supervising, guiding and directing the work of assessing officers.

Additional Commissioners

II-2.10. The cadre of Additional Commissioners has become defunct and it is not necessary to retain it as one of the tax authorities.

Regional Commissioners

II-2.11. With the increase in the number of Commissioners in recent years for administrative and technical work, several Commissioners have come to be stationed at the same place and they share common cadres of officers and staff. This position obtains even where Commissioners are stationed at different towns in a state. With the appointment of Commissioners (Appeals), the concentration of officers of the rank of Commissioner at various stations has increased. The seniormost Commissioner has to devote considerable time to administrative matters relating to the entire staff of the charge, covering recruitment, training, departmental examinations, confirmations, promotions, transfers, postings, etc. He has also to co-ordinate the statistical and management reporting systems, besides for the whole charge. He has also the over-all responsibility for the revenue and expenditure accounting work for all house-keeping functions including accommodation (both for offices and residence of officers and staff), furniture and other equipment, stationery, printing, publicity, etc. Moreover, the seniormost Commissioner in the metropolitan cities of Delhi, Bombay, Calcutta and Madras are empowered by the Board to perform the functions of a Director of Inspection for the entire charge for the limited purpose of authorising searches. In this sphere of their functions, these Commissioners control the activities of the officers of the intelligence wing who function for the charge as a whole.

II-2.12. The Wanchoo Committee considered a suggestion for the creation of an intermediate level authority, designated as Regional Commissioner, with a view to ensuring closer control and co-ordination of the functions of the Commissioners and relieving the Board of much of the routine work. However, that Committee did not approve of the suggestion mainly for the reason that it might contribute to delays by adding one more level at which references from the field to the Board will be processed or through which directions from the Board to the field will be routed. We have considered the matter from all its aspects in the light of the position as it has developed after the Wanchoo Committee made its Report. We are of the view that there is urgent need for the creation of an intermediate level of Regional Commissioner, with a higher status and carrying higher emoluments than the Commissioners in general. For the entire country, it would be necessary to have 5 such Regional Commissioners who may be stationed, one each, at the metropolitan cities of Bombay, Calcutta, Delhi and Madras, and the fifth at a central place, say, Hyderabad. They should be responsible for the administrative work relating to both officers and staff in their respective regions and for co-ordinating the work of the Commissioners in the matter of statistical and management reporting, accounting and house-keeping functions. The Commissioners, in the respective Regions, should be subordinate to the Regional Commissioner in all matters except their statutory functions. The fears of the Wanchoo Committee that the Regional Commissioner would act as a further bottle-neck in the flow of communications in either direction do not appear to be justified, as the communications on technical and statutory matters can flow

directly between the Board and the Commissioners concerned in both directions. The administrative, statistical and accounting matters are even now being routed through the seniormost Commissioner. At present, the administrative inspections of the Appellate Assistant Commissioner's offices and monitoring of their performance are being done by the concerned Commissioners. Since the appellate work would, under our recommendation, be entrusted to Commissioners (Appeals), the inspections of their offices and the monitoring of their performance will necessarily have to be done by an officer at a higher level. The Regional Commissioners should, therefore, be made responsible for the administrative inspection of the charges of the Commissioners under their control including the Commissioners (Appeals). The Regional Commissioners may also exercise the powers of Director of Inspection to the same extent as these powers are now being exercised by the senior-most Commissioner in the four metropolitan cities. We, accordingly, recommend the creation of a cadre of regional commissioners, having the status of additional secretary to the Government of India. Regional Commissioners will be responsible for administratively controlling, co-ordinating and supervising the work of the Commissioners in their respective regions and will be accountable to the Board for the overall performance of their regions. This would relieve Members of the Board of their administrative work of supervising various aspects of the work in their zones, which, at present, interferes with the effective performance of their functions as Members of the Board.

Central Board of Direct Taxes

II-2.13. The Central Board of Direct Taxes functions as the apex body of the Revenue Service. The Wanchoo Committee had considered various aspects of the Board's functioning and had recommended several reforms with a view to making the Board an autonomous body, independent of the Ministry of Finance, with the Chairman and Members of the Board enjoying status equivalent to those of a Secretary to the Government of India and Additional Secretaries to the Government of India, respectively, as in the case of the P & T Board. They had also recommended that the Board should function as a body instead of each Member functioning in a watertight compartment, and further that the Board should enjoy financial autonomy and be independent of the Ministry of Finance. Some of these recommendations have been implemented.

II-2.14. We have in our Interim Report, recommended that the Board should give advance rulings on specific issues at the request of the taxpayers. Elsewhere in this Report, we have recommended that the work of granting approval for the various purposes under the direct tax laws should be handled by the Board even where such approval is to be granted by the administrative Ministry concerned of the Central Government. We have also recommended in this context that such approval should be granted within 120 days of the receipt of the application in that behalf, failing which the approval will be deemed to have been granted. All these recommendations, when implemented, will add considerably to the quantum of technical work in the Board's office. The need for staffing of the Board's office with adequate personnel

with the necessary technical background and experience is, therefore, imperative.

II-2.15. As regards the status of the Chairman of the Board, we would like to point out that, in pursuance of our recommendation in the Interim Report, the status of the Chairman of the Settlement Commission has been raised to that of a Secretary to the Government of India. In this background, we consider that the Chairman of the Board should have a similar status as recommended by the Wanchoo Committee.

II-2.16. In the light of the foregoing discussions, We recommend, firstly, that the Chairman of the Central Board of Direct Taxes should have the status of a Secretary to the Government of India and, secondly, that the Board should have adequate staff assistance and should be provided with personnel having necessary technical background and experience.

Valuation Officers

II-2.17. The institution of Valuation Officers has invoked considerable criticism. Under the present law, the assessing officer may refer the question of valuation of any property to the Valuation Officer under certain circumstances. Thereupon, the Valuation Officer, functioning as a statutory authority, proceeds to value the property referred to him and his valuation is binding on the assessing officer. The Valuation Officer has also been given certain statutory powers to help him carry out his functions effectively. Though the valuation made by the Valuation Officer is binding on the assessing officer, it can be challenged in appeal before the Appellate Assistant Commissioner and then before the Appellate Tribunal.

II-2.18. We have, in our Interim Report, recommended that, in the case of let-out house property, the market value should be determined by the method of capitalisation of the return actually received or which could be reasonably expected from such property and that the rates of capitalisation should be notified by the Board from year to year. The Wealth-tax Act has been recently amended to provide that, in the case of property occupied by the owner for his own residence, the market value as on 31st March, 1971 (or the date of its acquisition by the assessee, if later) should be adopted in the wealth-tax assessments for all subsequent years. In our Interim Report, we have recommended that the method of determining the market value by capitalisation of the reasonable yield should be available even in the case of owner-occupied properties. These recommendations will have the effect of considerably reducing the area of disputes in the matter of valuation.

II-2.19. The present provisions relating to valuation divide the responsibility for assessment between the assessing officer and the Valuation Officer, each functioning independently of the other. This causes considerable inconvenience to the taxpayer. Besides, some Valuation Officers are prone to

making unduly high valuation which are considerably reduced in appeal and this tendency has created dissatisfaction among the taxpayers. We have, in Part I of this Report, discussed the problems relating to valuation of properties in detail and have made certain recommendations. If these recommendations are implemented, it will be no longer necessary to have Valuation Officers functioning as a statutory authorities under the direct tax laws. We, therefore, recommend that the Institution of Valuation Officers as statutory authorities under the Direct Tax Laws should be done away with. If necessary, the services of Valuation Officers may be utilised by the Government in a purely advisory capacity in suitable cases.

II-2.20. To sum up, the executive cadre of the Income-tax Department will, according to our recommendations, comprise the following authorities :—

- (1) Central Board of Direct Taxes.
- (2) Regional Commissioners.
- (3) Directors of Inspection.
- (4) Commissioners of Direct Taxes.
- (5) Commissioners (Appeals).
- (6) Deputy Commissioners of Direct Taxes.
- (7) Assistant Commissioners of Direct Taxes.
- (8) Direct Taxes Officers.
- (9) Inspectors of Direct Taxes.

Other Administrative Matters

II-2.21. The tax authorities have necessarily to be assisted in the discharge of their functions by administrative and technical staff. Complaints have been voiced by many of the witnesses who appeared before us that the inadequate staff assistance provided to the officers in the Department leads to considerable delays and neglect of several areas of work. In the course of our visits to some of the Income-tax offices, we ourselves found physical evidence of such delays and neglect. We also found shortage of space and lack of essential equipment impeding the work in the tax offices. We recommend that the manpower assistance to the officers at various levels in the department should be adequately augmented and that they should be provided with adequate office space, storage space, equipments and aids.

Appointment and Control of Direct Tax Authorities

II-2.22. The existing provisions relating to the issue of instructions by the Board to subordinate authorities, in section 119 of the Income-tax Act, will require modification in the light of the recommendation in our Interim Report (para 11.10) that there should be a specific provision 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 prescribed fees. When such an advance ruling is given by the Board in the case of any assessee, the

Board should have the power to issue instructions to the subordinate authorities to ensure compliance with such advance ruling. This will necessitate omission of clause (a) of the proviso to section 119(1).

II-2.23. Another area in which the Board's power to issue instructions will require modification is the provision in section 119(2)(b) which, at present, empowers the Board to authorise the Commissioner or the Income-tax Officer to admit an application or claim for any exemption, deduction, refund or any other relief, after the expiry of the period specified for the making of such application, claim, etc. Instances have been brought to our notice where, although the applications of the assessee were made within the stipulated time, they were not disposed of within the time limit specified in the law for this purpose due to administrative lapses. Although, the general principle of law is that no authority can take advantage of its own wrong and therefore, the relief due to the assessee cannot be denied in such cases, in order to place the matter beyond doubt or dispute, we recommend that the Board should issue directions to subordinate authorities for granting relief even after the expiry of the statutory time limit in cases where the claim for any exemption, deduction, refund or any other relief is made by the Assessee within the specified time limit and, for this purpose, the law may be amended, if necessary, to empower the Board to do so.

II-2.24. While section 119(2)(b) empowers the Board to authorise the Commissioner of Income-tax or the Income-tax Officer to admit claims for reliefs after the period of limitation, it is strange to find that the Board has no such power to waive the time limit for making an application to itself. There are several provisions under which the Central Government or the Board is required to give its approval to agreements, contracts of service, etc., for the purposes of certain tax benefits, such as those contained in sections 10(6)(vii), 80J(6), 80MM, 80N, 80-O, etc. Some of the provisions laid down certain time limits within which applications for such approval have to be made. On the analogy of the provisions in section 119(2)(b), we recommend that the Central Government and the Board should have the power to condone the delay in making an application to them for approval, etc., under various provisions of the tax laws.

Jurisdiction

II-2.25. Sections 120 to 124 of the Income-tax Act set forth the scope of the jurisdiction of various income-tax authorities. Under the scheme of the Income-tax Act and other direct tax laws, the function of making assessments is vested in the Income-tax Officer and the corresponding functionaries under the other Acts. Jurisdictions of Income-tax Officers are demarcated, generally with reference to specified areas, but, not infrequently, with reference to persons or class of persons or incomes or class of incomes or cases or class of cases. There are additional provisions in section 125, 125A and 127, which permit functional distribution of work concurrently among Income tax Officers or between

the Income-tax Officer and the Inspecting Assistant Commissioner.

II-2.26. We have examined certain suggestions for making a radical change in the existing pattern or jurisdiction so as to vest in the Board the overall jurisdiction for assessment and collection of taxes, with the authorities at the lower levels functioning as delegates of the Board. This is the pattern obtaining in some of the foreign countries, such as, U.S.A. and Canada. After careful thought, we feel that the change as suggested would not result in any particular advantage, but might, on the other hand, lead to confusion resulting in inconvenience to taxpayers and delays in disposal of work.

Powers

II-2.27. The powers of tax authorities have been considerably augmented from time to time and, recently, the relevant provisions have been amended on the basis of the recommendations of the Wanchoo Committee. We do not consider any major change in these powers necessary.

II-2.28. Misgivings have been expressed in regard to the provision in section 125(1)(b) which enables the Commissioner to authorise an Inspector of Income-tax or any member of the ministerial staff to exercise the powers of an Income-tax Officer. The only limitation on the Commissioner in delegating such powers to such lower level functionaries is that he has to obtain the authority of the Board before making such delegation in respect of the functions of the Income-tax Officer under certain sections of the Act enumerated in the proviso. The sections so enumerated cover search and seizure, issue of summons for examination of witnesses, assessments and reassessments and certain other matters. While we see the logic of delegating some powers to some lower functionaries in suitable cases, in the interest of expeditious completion of work which does not involve much revenue, we feel that there is no justification for delegating the executive functions to any member of the ministerial staff. Further, the power to summon and examine witnesses, and also that relating to search and seizure and consequential proceedings arising out of these, should not be delegated to lower functionaries at all. We, accordingly, recommend that the Commissioner's power to delegate the functions of the Income Tax Officer should be limited so as to restrict such delegation to an Inspector of Income-tax only and not to any member of the Ministerial Staff; and, further, the Commissioner should have no power to delegate functions under Sections 131, 132, 132A and 132B even to Inspectors.

II-2.29. Another provision which also came on the statute book in recent years is that enabling the Board to empower a Deputy Director of Inspection or an Inspecting Assistant Commissioner to exercise the power to authorise a search. With the increase in the number of Commissioners performing administrative functions, we do not consider it necessary or desirable to vest the power to authorise a search in Officers of the level of Assistant Commissioners. We, therefore, recommend that the provision enabling

the Board to delegate the power to authorise a search to a Deputy Director of Inspection or an Inspecting Assistant Commissioner should be deleted.

II-2.30. Under the present law, powers of search are available only under the Income-tax Act and the Wealth-tax Act but not under the Gift-tax Act. We would like to make it clear that, while integrating the procedure for all the direct taxes, it is not our intention that the powers of search should be extended for the purposes of gift tax also. We recommend that powers of search should not be extended for the purposes of Gift-tax.

II-2.31. There has been considerable grievance among taxpayers about the inordinate delay in the disposal of applications under section 132(11) against the summary orders passed by the Income-tax Officers under section 132(5) pursuant to the seizure of money, bullion, jewellery or other valuable assets in the course of a search. The delay in the disposal of such applications results in inconvenience to, and harassment of, the taxpayer, inasmuch as the valuables so seized are retained by the Department under the impugned order for a considerable time even though, when the application gets finally decided, such retention might turn out to be unjustified. We, therefore, recommend that there should be a time limit of, say, six months for the disposal of applications under Section 132(11) by the notified authority. Such applications are now to be heard by the Commissioner concerned. With the increase in the number of Commissioners, it should be possible for them to decide such applications within the period of six months mentioned above.

II-2.32. Section 133 of the Income-tax Act empowers certain authorities to call for information. Similar provisions are contained in section 38 of the Wealth-tax Act and section 37 of the Gift-tax Act. These provisions may be integrated and incorporated in the Management Act.

II-2.33. Section 133A confers the powers of survey on the Officers of the Department. The provisions of this section may be included in the Management Act and made uniformly applicable to all direct taxes. Similarly, the provisions of section 134 conferring the power to inspect registers of a company may be included in the Management Act.

II-2.34. Section 135 authorises the Director of Inspection, Commissioner and Inspecting Assistant Commissioner to exercise all the powers of making enquiries vested in the Income-tax Officer. This provision duplicates the provisions in other sections and is likely to cause confusion. This can be taken care of while drafting the various provisions conferring powers on different direct taxes authorities and it will not be necessary to retain this section as such in the Management Act.

II-2.35. Section 136, deeming proceedings before the Income-tax authorities as judicial proceedings for certain purposes, may be included in the Management Act so as to apply uniformly to all direct taxes.

Similarly, the provision in section 138 of the Income-tax Act, and its counterparts in section 42B of the Wealth-tax Act and 41B of the Gift-tax Act, may be integrated and a provision broadly based on the provisions in the Income-tax Act may be included in the Management Act.

II-2.36. Sections 285A and 285B provide for the furnishing of certain information. These provisions fall in the same category as those of section 133 of the Income-tax Act, with the difference that, under section 133, the Income-tax Officer is entitled to call for information whereas, under sections 285A and 285B, the statute itself requires certain persons to furnish information as required therein *suo motu*. These sections may, therefore, be placed in this Chapter of the Management Act.

II-2.37. Sections 285A and 285B provide certain penalties for failure to furnish the requisite information. While the penalty under section 285A is by way of a fine to be levied by the Commissioner and is dealt with in section 285A itself, the penalty for failure to comply with the requirements of section 285B is dealt with in section 272A in the Chapter dealing with penalties. We recommend that all penalties such as those under Sections 285A and 285B should be dealt with in the Chapter on penalties and, further, that the designated officer to whom this information is required to be furnished should be empowered to levy the penalty.

II-2.38. The statement under section 285B is required to be furnished within 30 days from the end of the financial year to which it relates or within 30 days from the date of completion of the production of the film, whichever is earlier. To avoid confusion and uncertainty, we recommend that the material date for the purpose of Section 285B should be the date of expiry of 30 days from the end of the Financial Year to which the statement relates or 30 days from the date of grant of the Certificate of Fitness for Public Exhibition of the Film by the Board of Film Censors, whichever is earlier. This section requires particulars to be furnished of all payments over Rs. 5000 in the aggregate made to any person engaged in the production of the film as employee or otherwise. It is difficult to say that persons engaged in auxiliary activities like publicity, etc. are engaged in the production of the film. To make matters clear, we recommend that information should be required to be furnished in respect of all expenses debitable to the cost of production of the film. We further recommend that the limit of Rs. 5,000 should be raised to Rs. 10,000 and information should be required to be furnished of all payments in respect of such expenses, aggregating to Rs. 10,000, made to any person during a Financial Year.

II-2.39. The statement to be furnished under section 285B is required to be given in form No. 52A. Some changes in the format of the statement is necessary to make the requirements of the section clearer. For example, the heading of column 2 should be "nature of services for which payment is made" and not merely "Nature of payment." Columns 3 and 4 should be further split up to facilitate showing the

date on which payment was due and the amount which was due and also the date on which payment was made and the amount actually paid.

II-2.40. Elsewhere in this Report, we have recommended that the several statements required at present to be furnished by persons responsible for paying interest or dividends should be replaced by a consolidated provision in the Chapter dealing with deduction of tax at source. Sections 285 and 286 need not then be included in this Chapter of the Management Act even though, like sections 285A and 285B, they deal with furnishing of information.

II-2.41. While on the subject of powers of tax authorities, we find that section 287 (which appears in the Miscellaneous Chapter of the Income-tax Act but, in our view, should rightly find a place in this Chapter) gives power to the Central Government to publish the names of the assessee and any other particulars relating to any proceedings or prosecution under the Act in respect of such assessee. Such publication is made from year to year by the respective Commissioners of Income-tax under the authority of the Central Government. The only safeguard against premature or unjustified publicity under this provision is that in the case of penalty, the name of the assessee shall not be published until the stage of first appeal is over. Penalties sustained at the first appeal level often get deleted by the Tribunal, but, in the meanwhile, the adverse publicity would have caused damage to the reputation of the concerned assessee. With a view to avoiding such a situation, we recommend that the publication of names of Assessee on whom penalties have been imposed should be made only after the penalty has been upheld by the tribunal or it has otherwise become final, and not earlier.

II-2.42. Section 294A deals with the Central Government's power to make exemption, etc., in relation to certain Union Territories. This provision may be omitted if it is no longer necessary to retain it for rescinding any such exemption, reduction or modification already made. If it is considered necessary to retain the provision, it may be included in this Chapter of the Management Act.

II-2.43. Sections 295 and 296 deal with the Board's powers to make rules for the various purposes of the

Income-tax Act. Similar provisions are contained in the other direct tax laws as well. In the Management Act, a consolidated provision authorising the Board to frame rules for the various purposes of the direct taxes should be incorporated and included under this Chapter of the Management Act. Thus, all rules will be framed by the Board by virtue of the powers conferred under the Management Act. It should not, however, be construed that merely because the rules are framed under the Management Act they would necessarily be procedural and could be made retrospective in application. We recommend that care should be taken, while drafting the rules having substantive implications, to ensure that they apply only prospectively.

II-2.44. Another point which we would like to emphasize is that frequent amendments to the Income-tax Rules create difficulty in keeping track of the various changes and tend to unsettle the smooth administration of the Act. Between the years 1969 and 1978 the Income-tax Rules have been amended several times each year. There were six amendments in 1969, five in 1970, four in 1971, four in 1972, three in 1973, six in 1974, five in 1975, seven in 1976 and nine in 1977. In the current year the Rules have been amended not less than eight times till date. In order to ensure the smooth working of the law, we recommend that amendments to the Income-tax Rules should be made only once a year and notified by September so as to operate from the first of April of the following year. Where, however, an Interim Amendment becomes absolutely unavoidable, it should be fully justified with adequate reasons as to why the change could not be made part of the Annual Amendment to the Rules. This alone would serve as an adequate restraint on the rule-making authority from resorting to frequent and piecemeal amendments of the Rules. The present provisions in section 296 of the Income-tax Act requiring the placing of the Rules before the Houses of Parliament by themselves do not seem to have served as an adequate measure of restraint as is evident from the large number of amendments annually made to the Rules in the recent past.

II-2.45. Section 298 relates to the power of the Government to remove difficulties. This provision should appropriately be placed in this Chapter of the Management Act.

CHAPTER 3

PRE-ASSESSMENT PAYMENT OF TAXES

II-3.1. This Chapter will include provisions relating to deduction of tax at source from the various categories of payments which are at present set forth in Chapter XVII-B of the Income-tax Act and those relating to advance payment of tax in Chapter XVII-C. These provisions are relevant only for the purpose of income-tax as there are no similar provisions for wealth-tax, gift-tax or surtax. The only exception is the provision in section 18 of the Gift-tax Act for advance payment of gift-tax which entitles the assessee to a rebate.

Deduction of tax at source

II-3.2. Deduction of tax at source is, at present, required to be made from payments of salaries, interest on securities, dividends on shares in companies, other types of interest payable to residents, winnings from lotteries or cross-word puzzles, payments to contractors and sub-contractors, payment by way of insurance commission, and all categories of income payments to non-residents. In pursuance of the recommendations in our Interim Report, the Finance Act, 1978 has inserted a provision for deduction of tax at source also from winnings from horse-racing. Thus, these provisions already cover a wide area. It is neither necessary nor advisable to extend their area of operation any further.

Salaries

II-3.3. On the other hand, some of the existing provisions need rationalisation so as to reduce infructuous work and avoid inconvenience to taxpayers. One of these relates to deduction of tax at source from salary payments. Where salary is received in arrears or in advance, relief is admissible to the assessee by way of limiting the tax payable by him to the tax that would have been payable if the payments had been received in the years to which they related. However, under the existing provisions, such relief can be allowed only when the income has been 'assessed'. Elsewhere in this Report, we have expressed the view that considerable infructuous work can be avoided if the relief is allowed without waiting for the income to be assessed. We, accordingly, recommend that specific provision should be made enabling the employer to take into account the relief to which the employee is entitled while deducting tax at source from payments on account of arrears of salary.

II-3.4. The existing provisions relating to deduction of tax at source from salary payments also do not, in terms, expressly permit the employer to take into account the deduction to which the employee is entitled in respect of payments made by way of life insurance premiums, contributions to provident funds,

etc. (section 80C) or the deduction admissible with reference to donations to certain funds, charitable trusts, etc. (section 80G). The administrative practice has, however, been to allow these deductions to be taken into account to a limited extent while calculating the tax to be deducted at source. We recommend that the administrative practice of taking into account the deduction under section 80C and the deduction under section 80G with reference to contributions to the National Defence Fund, Jawaharlal Nehru Memorial Fund, the Prime Minister's Drought Relief Fund or The Prime Minister's National Relief Fund, while deducting the tax at source from salaries, should be given statutory recognition by suitably amending the relevant provision.

II-3.5. Under the existing provisions, tax is to be deducted from salary at the time when the payment is made. Rule 6 in Part A of the Fourth Schedule deems certain amounts credited to the account of an employee participating in a recognised provident fund as income deemed to have been received by the employee in the year in which the amounts are so credited. This rule is in the nature of a substantive provision and we have discussed it in detail in Part I of this Report. We recommend that the element of salary income referred to in the rule as modified in the light of our suggestions in Part I, should be clearly brought within the purview of deduction of tax at source by making an appropriate provision in section 192.

Payments to Contractors

II-3.6. The provision in section 194C, relating to deduction of tax at source from payments made to contractors and sub-contractors, requires such deduction to be made where the consideration for the contract exceeds Rs. 5,000. As the rate of deduction is two per cent in the case of principal contracts and one per cent in the case of sub-contracts, and, as the deduction is to be made from each individual payment, the limit of Rs. 5,000 for the value of the contract is unduly low, in that it entails accounting for tax deductions of comparatively petty amounts. We recommend that the limit for deduction of tax under section 194C should be raised to Rs. 25,000.

Insurance Commission

II-3.7. Section 194D requires tax to be deducted at source from every payment by way of insurance commission irrespective of its amount. This also, in our view, proliferates infructuous work by necessitating accounting of comparatively small amount of tax, and by increasing the number of refund claims from persons receiving insurance commission. We recommend that deduction of tax from payments by way of insurance commission should be required to be made only where

the payment to any one person during a financial year exceeds Rs. 1,500/-.

Time limits for remittance of tax

II-3.8. The Income-tax Rules prescribe different time limits for payment of the tax deducted at source to the credit of the Central Government. While in certain cases of interest payments to residents, payments to contractors and payments by way of insurance commission, the tax has to be paid to the credit of the Central Government within two months from the end of the month in which the person making the payment closes his account, in certain other cases the amount has to be paid to the credit of the Central Government within one week from the end of the month in which the deduction is made or within one week of the deduction or within one week of the date of receipt of the challan. The rule authorises the Income-tax Officer to permit, in special cases, the remittance of the amounts deducted at quarterly intervals. We feel that these provisions laying down different dates and time limits for payment of the tax deducted at source to the credit of the Central Government are capable of being streamlined. We, accordingly, recommend that the time limit for payment of the tax deducted at source to the credit of the Central Government should uniformly be prescribed as one month following the end of the month in which the deduction is made, without linking it to the date of obtaining the challan for making the remittance. In cases where interest payment to a resident or payment to a contractor or sub-contractor or payment by way of insurance commission is credited to the account of the payee in the books of the payer, being a person carrying on a business or profession, the existing provision permitting payment of the tax deducted within two months of the close of the payer's accounting year, should be allowed to continue. We also recommend that the facility now allowed in certain cases to remit the tax deducted at source at quarterly intervals may be withdrawn.

Credit for Tax Deducted at Source

II-3.9. Our attention has been drawn to certain practical difficulties and anomalies arising out of the provisions of section 199. This section entitles the taxpayer to the credit for taxes deducted at source in the assessment made for the *immediately following assessment year*. It is quite likely that the income which is the subject of deduction may be assessable in an earlier year or a later year. The present provisions create difficulties in giving credit for the tax deducted at source in the assessment year in which the relevant income is brought to tax. To obviate such difficulties we recommend that credit for the deducted at source in respect of any income should be allowed in the assessment year in which such income is subjected to tax. In a case where the deduction of tax is made in a year later than that in which the income is subjected to tax, the credit should be allowed by rectification of the assessment within the normal period of limitation or within one year from the end of the financial year in which the tax is deducted, whichever is later.

Monitoring of deductions

II-3.10. The existing arrangements for keeping a watch over the deductions made from various categories of payments and the remittance of the amounts deducted to the credit of the Central Government, also need improvement to make them more effective. At present, the work of monitoring deductions of tax from salary payments, particularly, in the metropolitan cities where there is a large concentration of employers, is centrally organised and the returns furnished by the employers are also processed on the computer. However, there is no such centralised monitoring in the case of deductions of tax from other categories of payments such as dividends, interest, payments to contractors, etc. The existing statutory provisions also stand in the way of such centralisation as they require the relevant returns to be furnished to the several Income-tax Officers assessing the payers. The time and periodicity for furnishing such returns also vary from one type of payment to another. In the case of certain types of payments like dividends and interest other than interest on securities, there are more than one return to be furnished by the payer. With a view to making this work more effective in checking defaults and to preventing leakage of revenue, we recommend that Central Monitoring should be extended to cover all deductions of tax at source. We further recommend that statutory returns, including those required under sections 285 and 286, should be required to be submitted only at yearly intervals on the existing pattern of salary returns and the necessary changes should be made in the law to require such returns to be submitted to a designated income-tax Officer instead of to the several Income-tax Officers assessing the payers. We also recommend that suitable arrangements should be made for Government Departments, both at the Centre and the States, to submit returns of tax deducted at source from payments of salaries, payments to contractors, payments of interest, lottery winnings, etc., and arrangements should be made for checking these centrally as in the case of returns furnished by payers other than Government.

Refund of excess payments

II-3.11. Situations sometimes arise where payment on account of tax deducted at source is found to be in excess of the amount actually deducted. There is no express provision in the law enabling the person making such payment to claim refund of the excess payment. We, therefore, recommend that suitable provision should be made in the law to enable the person responsible for deducting tax at source to obtain refund of any excess payment made by him to Government on this account from the Income-tax Officer dealing with this subject, independently of his own assessment. This should, of course, be subject to certain safe-guards, namely, that the person claiming the refund has not recovered the tax paid in excess from the recipients of the amounts and has not issued any tax deduction certificates in respect of such amounts.

Advance payment of tax

II-3.12. In our Interim Report, we had recommended that advance payment of tax should be left to

voluntary compliance by taxpayers and that taxpayers should be required to furnish estimates of advance-tax before the due date for the first instalment only on the basis of the last completed assessment in their case or the return filed for a later year. We had also recommended that the existing provisions in sub-section (3A) of section 212 requiring taxpayers to furnish upward estimates of advance-tax payable in certain circumstances should be deleted. We had also made several other recommendations intended to simplify the procedures for calculation of interest in relation to advance-tax payment. We find that, instead of replacing the existing provisions relating to payment of advance-tax by provisions on the lines recommended by us, a new section 209A, incorporating only a part of our recommendations has been

superimposed on the existing provisions of the law. This seems to have created avoidable confusion and dissatisfaction among the taxpayers. We would only like to stress the importance of the law being properly amended to bring out the real intention behind the recommendations contained in our Interim Report which is to simplify the procedures relating to payment of tax and eliminate unproductive work.

II-3.13. The Gift-tax Act also contains a provision for payment of tax in advance within 15 days of the taxpayer's making the gift. Such payment would entitle the taxpayer to an additional credit at the time of assessment equal to 1/9 of the amount so paid in advance but limited to 1/10 of the tax due on the gift. This provision may be included in this Chapter of the Management Act without change.

CHAPTER 4

ASSESSMENT PROCEDURE

II-4.1. This Chapter will cover the provisions at present contained in Chapter XIV of the Income-tax Act and the corresponding provisions of the Wealth-tax Act, Gift-tax and Companies (Profits) Surtax Act. In addition, we feel that the provisions relating to refunds contained in Chapter XIX of the Income-tax Act and the corresponding provisions of the other Acts should also be integrated with the assessment procedure, as the two are essentially similar and an assessment may culminate in either demand or refund. In the process of integrating the procedures for assessment and refund under the different direct tax laws, any variations in the procedure would get eliminated and a uniform procedure will become applicable for the purposes of all the taxes.

Tax Return

II-4.2. The starting point for the process of assessment under all the Acts is the filing of a return. We recommend that, in the Management Act, a "tax return" should accordingly be defined as referring to a return of income or a return of Wealth or return of Gifts or a return of chargeable profits or any combination of two or more of such returns. Such a definition will facilitate consolidation of the returns if, at a later date, this is considered feasible and desirable.

II-4.3. The provisions in the Income-tax Act relating to the filing of returns are very elaborate and cover voluntary returns, returns filed in response to a notice, returns showing a loss, returns showing non-taxable income for the purpose of claiming refund, returns for the purpose of claiming the exemption available to charitable or religious trusts, belated returns and revised returns. The existence of these distinctions has created considerable amount of confusion and given rise to disputes and litigation. Doubts arise as to whether a voluntary return showing non-taxable income is at all valid and whether an assessment determining tax liability on the basis of such a return is sustainable; whether a loss return furnished beyond the specified time limit is valid and requires the Income-tax officer to compute the loss; whether a charitable or religious trust filing a belated return is entitled to exemption from tax; whether an assessee filing a belated return is entitled to revise it, etc. In our view, it is not necessary to have different provisions dealing with various types of returns, as these are essentially similar in character. We, accordingly, recommend that there should be a single provision in the law requiring the filing of a tax return if the total income or the net wealth or the taxable gifts or the chargeable profits of a person exceed the maximum amount which is not chargeable to tax, or if a person desires to have an assessment made

of his total income, net wealth, taxable gifts or chargeable profits or to have any loss, unabsorbed allowance or deficiency computed and carried forward to future years or to avail of the exemption provided in the case of charitable or religious trusts or to claim refund of any pre-assessment tax paid by him or on his behalf.

Time Limit for Filing Return and Consequences of Delay in Filing Tax Returns.

II-4.4. The existing provisions also lay down statutory time limits for the filing of returns, which vary according to the purpose for which the return is filed. Here also, there is considerable confusion as to the correct position under the law. Statutory time limits are important inasmuch as their non-observance entails certain consequences like liability to pay interest or penalty, prosecution, etc. While the taxpayer should suffer these consequences if he fails to furnish the returns within the time limits specified in the statute, we are of the view that the non-observance of the time limit should not by itself invalidate the return. We, accordingly, recommend that the law should make the following provisions in regard to the filing of tax returns :

- (1) In order to ensure uniformity, tax returns should be required to be filed by 30th of June in each year. The rate of one per cent per month on the tax payable as at present provided in section 139(8). In para 7.18 of our Interim Report we had recommended that the cost of 'buying time' should be one per cent per month calculated on the gross tax payable so as to provide a sufficient deterrent against delay in filing returns. It has been represented before us that the concept of 'buying time' implies for payment of a price by way of interest for the delay in remitting the taxes which are to be paid on self-assessment whilst filing the return and that by its very nature interest can only attach to unpaid sums, and not to amounts which have already been paid over. It has been further submitted that charging of interest on taxes which have already been paid to the Government, would be a contradiction in terms and interest should only be levied with reference to unpaid sums. We feel that these submissions are reasonable and, therefore, we recommend that the cost of buying time should be calculated with reference to the net tax in the light of our recommendations relating to 'previous year' contained in Part I of this Report, undue hardship is not

likely to be created by fixing the time limit for filing tax returns at 30th of June of the Assessment year in all cases.

- (2) The Law should specifically provide that returns filed after 30th June will nevertheless be valid in law. Subject to the consequences laid down in the law, the taxpayer should have the right to file a tax return at any time before an assessment is made for the relevant year without any outer time limit. The process of issue of notice by the assessing authority need not be a pre-condition for the filing of a belated return beyond the end of the assessment year or even beyond the time limit for the completion of assessment.
- (3) For the delay in filing the tax return beyond the 30th of June and until 30th of September, the taxpayer should be required to 'buy time'. This should be on payment of interest at and the rate of interest should be one per cent per month. This would ensure that refund cases and cases involving large taxes which have been substantially paid in advance, do not involve payment of any cost for delay in filing returns from June to September. To relieve any possible hardship in other cases we have elsewhere recommended that the Commissioners should be empowered to waive or reduce any interest payable on this account.
- (4) Where a return is filed after 30th September of the assessment year, the assessment should not ordinarily be made without scrutiny of accounts. However, such a return may be accepted as correct without scrutiny if the Commissioner so directs provided the return is filed before the last day of the assessment year. If a return is filed after the close of the assessment year, it should invariably be subjected to scrutiny.
- (5) Where the return is delayed beyond the 30th September of the assessment year, the taxpayer should become liable to pay penalty in the circumstances stated in the chapter on penalties.
- (6) If the return is not furnished before the close of the assessment year, the assessee should also become liable to prosecution, in the circumstances stated in the chapter on offences and prosecutions.
- (7) The assessee should forfeit the right to carry forward of loss, unabsorbed allowances, deficiency, etc., if the return is not furnished before the expiry of the assessment year. Similarly, an assessee claiming exemption from tax, available to charitable or religious trusts, etc., should also be rendered ineligible for such exemption if the return is not filed before the expiry of the assessment year. The Commissioner should, however, be empowered to relax this condition in appropriate cases.

An exception will have to be made in the case of a return for the purpose of surtax where the company wants to claim the set-off of a deficiency against the chargeable profits for a subsequent year. The company should be required to file a return of such deficiency only when it makes sufficient profits which attract liability to surtax in a subsequent year and not earlier.

- (8) An assessee who claims refund of pre-paid taxes should be eligible for such refund only if the return is filed within a period of two years from the end of the relevant assessment year. The existing powers of the Board to authorise admission of belated claims should continue.

Exemption from obligation to file return

II-4.5. Under section 139(1A), which was inserted by the Finance Act, 1974, persons having salary income not exceeding Rs. 18,000/- for the year are relieved of the obligation to furnish a return of income, subject to the satisfaction of certain conditions. These conditions are, firstly, that in the case of an employee of a company, he was not a director of the company at any time during the previous year and did not hold beneficial ownership over equity shares carrying 20 per cent or more of the voting power; secondly, that his salary, exclusive of benefits or amenities in kind, did not exceed Rs. 18,000; thirdly, that he did not have any other income except income not exceeding Rs. 3,000/- from financial assets eligible for the deduction under section 80L; and lastly, that the tax has been correctly deducted at source from his salary income. While we appreciate the purpose underlying this concession to salaried taxpayers, we are of the view that the continuance of this concession would not be compatible with the new scheme for filing of returns and buying of time as recommended by us in the Interim Report and in the preceding paragraphs. Under our recommendations, the assessing officer will be expected to issue notices calling for returns of income in the case of all taxpayers on his register who do not furnish returns voluntarily latest by 30th September of the assessment year. The assessing officer will not be in a position to know from his records whether the omission on the part of a taxpayer to furnish his return by 30th September was on account of his availing of the benefit of this concession or it was a case of real default. Most of the salaried employees falling in this group, will in any event, have to come to the Department for obtaining some refund of tax deducted at source in excess or even to get their records complete with a view to avoiding disputes and difficulties in a later year. Hence, the discontinuance of this concession is not likely to cause any undue hardship nor is the continuance of the concession likely to reduce the work of the Department to any significant extent. We accordingly, recommend that sub-section (1A) of section 139 may be deleted on our recommended scheme of acceptance of tax returns being brought into force.

Permanent Account Numbers

II-4.6. The system of assigning a Permanent Account Number to every taxpayer in the country, which

will attach to him for life, was introduced in the law through the Taxation Laws (Amendment) Act, 1975, with the intention of improving maintenance of records in the case of taxpayers by linking all correspondence, returns, challans and other papers promptly with the existing file, on the one hand, and using this system to match information received from various sources with the returns and other statements furnished by the taxpayer so as to check tax evasion on the other. There is a penalty upto Rs. 500/- for failure on the part of the taxpayer to comply with the requirements of the law in this regard. In fact, the system of allotment of Permanent Account Numbers was instituted in 1972 even before the statutory provisions were made. Although a good beginning was made in this regard by allotment of numbers to all existing taxpayers borne on the registers of the Department at that time, and directories of taxpayers were also got printed, there have been deficiencies in keeping these directories upto date and also in the allotment of Permanent Account Numbers to taxpayers who have come on to the registers in later years. Although the law requires the taxpayers to quote his Permanent Account Number in all his returns and correspondence with the Income-tax Department, and all challans for payment of taxes, quite often, it is seen that the Department continues to send communications to the taxpayer without quoting his Permanent Account Number but using the old General Index Register Number. **We recommend that the working of the system of permanent account numbers should be improved. Numbers should be allotted to all taxpayers who have so far applied for them and there should be arrangement for prompt allotment of such numbers to those who apply for them in future; the Directories of taxpayers should be updated; the department should ensure that all communications sent to the taxpayer carry his permanent account number; and, lastly, the penalty for non-compliance should not attach to minor defaults such as failure to quote the permanent account number on routine correspondence like reminders, etc. sent by the taxpayer to the Department.** Although the Board has the power to specify the transactions for which the Permanent Account Number should be quoted in all the relevant documents, this power has so far not been utilised. In our view, the power should be utilised, but only after the administrative apparatus for the allotment and use of these numbers is made effective and its deficiencies removed and proper arrangements are made for digesting and making use of the large volume of information which would pour in when these numbers are required to be quoted on documents pertaining to various transactions which may be prescribed by the Board. Only when this process is completed can the objective of this system to check tax evasion be fully realised.

Signing of the Return

II-4.7. The provisions in section 140 of the Income-tax Act, specifying the person who is authorised to sign the return of income in the case of different categories of taxpayers, were amended through the Taxation Laws (Amendment) Act, 1975, on the recommendations of the Wanchoo Committee. The objective of

the amendments was to remove some of the unsatisfactory features of the earlier provisions and fix responsibility for furnishing false returns on the appropriate persons with a view to prosecuting them for such offences. However, the provisions as they have emerged after the amendment still leave certain grey areas where genuine hardship and ambiguities continue to exist.

II-4.8. Thus, in the case of a company, the return is required to be signed and verified by the managing director or, where for any unavoidable reason the managing director is not able to sign and verify the return, or where there is no managing director, by any director of the company. The provision does not specify who should sign the return in case all the directors including the managing director, happen to be away from the country or where there is no such director stationed in the country, as in the case of a foreign company carrying on business through a branch in India, the business being managed by the holder of a power-of-attorney. Again, the provision is silent as to who should sign the return in the case of a company in liquidation when the board of directors ceases to have any voice in the management of the affairs of the company by virtue of section 491 of the Companies Act, 1956, and the liquidator becomes empowered to exercise all the powers of the board of directors. To meet these situations, **we recommend that the existing provisions should be modified to permit the tax return in the case of a Company being signed by the holder of a power-of-attorney in a case where there is no managing director or other director stationed in India, or by the liquidator in the case of a company in liquidation.**

II-4.9. In the case of a Hindu undivided family, the Karta is required to sign the return, but if he is absent from India or is mentally incapacitated from attending to his affairs, any other adult member of the family can sign the return. The provision is silent as to who should sign the return where there is no other adult member in the family but there are only minor children for whom a guardian is appointed by the court or where some relative manages the affairs of the family. **We recommend that suitable alternative provisions should be made to permit the return being signed by any other person who manages the affairs of the family.**

Form of Return

II-4.10. There are, at present, separate forms of return prescribed under the different direct tax laws. We have considered the feasibility of integrating the returns for the different taxes. We are of the view that there will be no particular advantage in doing so. While the number of income-tax payers is about 40 lakhs, the number of wealth-tax payers and gift-tax payers is very much less. Prescribing a single return for all the taxes would only lead to waste of stationery and cause confusion in the minds of taxpayers who may not be liable to wealth-tax or gift-tax.

II-4.11. The format of the return and the particulars to be furnished therein vary from year to year, depending upon the substantive law applicable for the

particular assessment year. Although return forms, particularly for income-tax, are revised year after year to keep pace with changes in substantive law, the practice at present is to make the revised form applicable not only to the particular assessment year for which the amendments are relevant, but also to earlier assessment years in cases where returns are furnished after the date on which the revised form comes into force. The reason for this practice appears to be that it would be difficult to maintain stocks of forms relating to various past years with all the Income-tax offices for being supplied to assessees who desire to furnish returns for those years. As against this aspect, it has to be kept in view that, when the return form is amended to bring it in line with the law applicable for a later assessment year, it would be inappropriate for use for an earlier assessment year when the law was different. The use of such an inappropriate form might cause the assessee to make mistakes either in furnishing details of their income, wealth, etc., or in claiming various deductions which were available for the earlier year but which may have either ceased to be available altogether or may have undergone change in form or content in a later year. Apart from this, the practice also entails waste of stationery, in that the stocks of forms of returns which were in force earlier become obsolete and have to be disposed of as waste paper.

II-4.12. With a view to rationalising the position in this regard, we recommend that return forms pertaining to a particular assessment year should be used only for that assessment year and not for any earlier assessment year, and the assessment year to which the particular form pertains should be printed in bold figures on the first page of the form so as to facilitate easy identification. We understand that this is the position prevailing in some of the countries like U.K. and U.S.A.

II-4.13. We have already recommended in our Interim Report that the particulars to be furnished in the return should be clearly indicated in a manner intelligible to the taxpayer (para 7.9) and that there should be provision in the law for treating an incomplete return as invalid (para 7.11). Another recommendation in the Interim Report is that an assessment should be deemed to be completed on the assessing officer signing the tear-off slip attached to the return and returning it to the assessee (para 7.13). While devising the form of return, these aspects will have to be kept in view and the tear-off slip will have to be provided.

Self-assessment

II-4.14. At present, there is a provision for payment of tax on self-assessment under the Income-tax Act and Wealth-tax Act, but none under the Gift-tax Act or the Surtax Act. Instead, there is a provision in the Surtax Act for the making of a provisional assessment by the assessing officer on the basis of the return or even in the absence of a return. A provisional assessment is also contemplated under the Wealth-tax Act even though there is a provision for the payment of tax on self-assessment. In order to bring uniformity in this regard in respect of all direct taxes, we recommend that payment of tax on self-assessment

before the furnishing of the return should be extended to Gift-tax and the Surtax and the existing provisions in the Wealth-tax and the Surtax Act for the making of a provisional assessment should be deleted. In all cases, the challan for payment of taxes on self-assessment should be required to be attached to the relevant tax return in the absence of which the return should be considered to be invalid. Further, as recommended in our interim report (para 7.18). Interest payable for delay in furnishing the tax return beyond 30th June should be required to be paid alongwith the tax on self-assessment.

Provisional assessment for refund

II-4.15. The Income-tax Act now provides, in section 141A, for the making of a provisional assessment in a case where the tax deducted at source taken together with the advance tax paid, if any, exceeds the tax payable on the basis of the return and the assessee claims refund of such excess. The section provides that the Income-tax Officer should make a provisional assessment and grant the refund within a maximum period of six months from the date of receipt of the return unless he makes the regular assessment itself within that period. While we consider that this provision should continue to remain on the statute book, the provision should be amended to bring it in line with the new concept in regard to charging of interest for short payment of advance tax which we have set out in our Interim Report (Chapter 9). We, accordingly, recommend that interest on excess payment of advance tax should be calculated with reference to the tax payable on the basis of the income returned and only upto the date of furnishing the return or 30th June of the assessment year, whichever is earlier. At the same time, with a view to expediting the refund of excess advance tax paid, we recommend that for any delay in granting the refund beyond three months from the end of the month in which the return is filed or 1st October of the assessment year, whichever is later, interest at 12 per cent per annum should be allowed upto the end of the month preceding the month in which the refund voucher is actually issued to the assessee.

II-4.16. Any tendency on the part of taxpayers to understate their income in the return so as to receive a larger refund of the advance tax paid will be effectively checked by the recommendation in paragraph 9.19 of our Interim Report for charging of interest at the rate of 1 per cent per month on the difference between the tax eventually assessed and the tax payable on the basis of the return, from the date of filing of the return upto the date of the assessment made after due scrutiny.

Pre-assessment enquiry

II-4.17. Section 142 of the Income-tax Act contains provisions enabling the assessing authority to make pre-assessment enquiries. There are similar, though non identical, provisions in the other direct tax laws. Section 142 has also been amended recently to empower the tax authorities to get the accounts of any assessee audited by a chartered accountant. These

provisions are necessary for enabling the tax authorities to make proper assessment and should be incorporated in the Management Act and made applicable on a uniform basis to all direct taxes.

Assessment by Acceptance of Return

II-4.18. Under the existing provisions of section 143 of the Income-tax Act, the process of assessment on the basis of the return falls into two broad categories, namely, summary assessment, virtually accepting the return filed by the assessee, and scrutiny assessment after examining account books and other material. We have, in our Interim Report, (Chapter 7) already dealt with both these aspects of the assessment procedure. The only further change that we would recommend is that the process of assessment by acceptance of returns should be extended also for the purpose of Wealth-tax and Gift-tax. This would, no doubt, be subject to guide-lines to be issued by the Board for identifying the cases in which the procedure for acceptance of returns should be adopted. We would like to make it clear that cases marked for scrutiny including those picked up on random sampling basis should be kept apart and tear-off slips sent only in those cases which are not required to be scrutinised. So far as surtax assessments are concerned, there is no question of acceptance of returns, considering that the income-tax assessment itself will be made in the case of a company after scrutiny of accounts.

Assessment after Scrutiny

II-4.19. The procedure for examination of accounts and other material before completion of an assessment is also common to all the direct taxes. While incorporating these provisions in the Management Act, any minor disparities in the existing provisions will be removed and a uniform procedure will be made applicable for all the taxes.

Ex parte Assessment

II-4.20. In cases where there is failure on the part of the taxpayer to furnish the return of income, wealth, etc., the law provides for completion of the assessment to the best judgement of the assessing officer. Such an assessment can be made also in cases of certain other defaults on the part of the assessee, namely, his failure to furnish accounts or other material called for by the assessing officer or his failure to attend before the assessing officer either in person or through an authorised representative for the purpose of pre-assessment enquiry. These provisions are also common to all the direct taxes and will be incorporated in the Management Act.

Reopening of ex parte Assessment

II-4.21. The Income-tax Act at present contains a provision for the reopening of an *ex parte* assessment by the Income-tax Officer himself on the application of the assessee, followed by the making of a fresh assessment. The law also lays down a statutory time limit of 90 days for disposing of the application of the assessee in this regard. Although this time limit was intended to speed up the proceedings and safeguard the interests of the taxpayer, we understand that

in practice, it has not operated in that fashion but perhaps, in a contrary way, in that, having allowed the application to lie over for more than 90 days, the officers often express inability to deal with the application due to the expiry of the time limit. While considering this matter in our Interim Report, we had recommended that the relevant provision should be modified to provide that, if the Income-tax Officer fails to dispose of the application for reopening of an *ex parte* assessment within the stipulated period of 90 days, the assessment shall be deemed to have been cancelled and the proceedings reopened (para 7.26).

II.4.22. In the Wealth-tax Act and Gift-tax Act, there is no similar provision for reopening an *ex parte* assessment by the assessing officer on the application of the assessee. The remedy in such cases is the filing of an appeal before the appellate authority. Under the Income-tax Act, on the other hand, where an *ex parte* assessment has been made, and the application for reopening the assessment is rejected by the Income-tax Officer, the assessee may file an appeal against such rejection. An appeal may also be filed challenging the content of the assessment though not the justification for making it *ex parte*. Thus, there is unnecessary duplication of proceedings, leading to delays and inconvenience to the taxpayers. We have considered the matter from all its aspects and we recommend that the provision for the reopening of an *ex parte* assessment by the Income-tax Officer on the application of the assessee need not be incorporated in the management Act.

Issue of Directions by Inspecting Assistant Commissioner

II-4.23. Sections 144A and 144B were inserted in the Income-tax Act through the Taxation Laws (Amendment) Act, 1975, on the basis of the Wanchoo Committee's recommendation, with the object of securing closer and more intimate association of the Inspecting Assistant Commissioner in the process of assessment in important cases.

II-4.24. Section 144A permits issue of directions by the Inspecting Assistant Commissioner to the Income-tax Officer on various matters pertaining to the assessment in specific cases, either on the request of the Income-tax Officer or at the instance of the assessee or on the Inspecting Assistant Commissioner's own motion. We recommend that these provisions should be made uniformly applicable to all Direct Taxes.

II-4.25. Section 144B introduces a new concept of issue of a draft order by the Income-tax Officer to the assessee setting forth the additions which he proposes to make to the returned income, followed by consideration of the assessee's objections and issue of directions to the Income-tax Officer by the Inspecting Assistant Commissioner. The impression which we have gathered from our discussions with the departmental officers and assesseees is that this section has merely resulted in delays in completion of assessments and duplication of proceedings without substantially curbing highpitched assessment or reducing the scope for litigation. We have, elsewhere in this Report, recommended that the Inspecting Assistant Commissioner should be closely associated in the process of

assessment on a continuing basis in all scrutiny cases. Implementation of that recommendation would render the existing procedure for issue of draft orders and consideration of the assessee's objections by the Inspecting Assistant Commissioner unnecessary. Besides, section 144A itself (with some amendments if necessary) can effectively achieve the purpose of section 144B. We, accordingly, recommend that the provisions of section 144B may be deleted. We would like to make it clear that, in recommending the deletion of the procedure for issue of a draft order, it is not our intention to detract in any way from the existing well-established legal position that the assessing officer, who exercises quasi-judicial functions, should act fearlessly and without bias, conduct himself in accordance with the principles of justice, equity and good conscience and give sufficient opportunity to the assessee to place his case before the Department. Further, the Income-tax Officer cannot rely on any material in arriving at his conclusions, without first placing it before the assessee and giving him a reasonable opportunity of controverting it. If these principles are scrupulously kept in mind by all assessing officers and followed while completing assessments, an assessee can have no cause for grievance.

Valuation Procedure

II-14.26. Section 16A of the Wealth-tax Act lays down the procedure for referring the valuation of any asset to a Valuation Officer, who exercises statutory powers and performs statutory functions. These provisions are applicable for the purpose of gift-tax and tax on capital gains also. We have, elsewhere in this Report, recommended that the Valuation Officer should not function as a statutory authority under the Wealth-tax Act or the other direct tax enactments but that his role, wherever necessary, should be merely advisory. We recommend that the provisions of section 16A of the Wealth-tax Act and connected provisions in all the Direct Tax Laws should be deleted.

Notice calling for return

II-4.27. A notice calling for a return can, at present, be issued by the assessing officer only before the expiry of the assessment year, under the Income-tax Act, Gift-tax Act and Surtax Act, but this restriction does not seem to be operative under the Wealth-tax Act. If such a notice has not been issued before the end of the assessment year under the Income-tax Act, gift-tax or Surtax Act, then a return can be called for only by invoking the powers under sections 147 and 148 of the Income-tax Act or the corresponding provisions of the other two Acts. Where such notice is to be issued after the expiry of four years but within eight years from the end of the assessment year, the previous approval of the Commissioner is necessary for the purposes of income-tax. We do not see the need for the assessing officer to invoke different provisions of the law according as he calls for a return within the assessment year or after its expiry. We, therefore, recommend that the assessing officer should be empowered to issue a notice calling for a return for the purpose of income-tax, wealth-tax and gift-tax in cases where such return has not been furnished by the assessee by 30th September of the assessment year. We further recommend that

such a notice may be issued at any time upto the expiry of eight years from the end of the relevant assessment year, without the need to obtain the approval of the commissioner in this behalf.

II-4.28. At present, a notice calling for a return of income can be issued beyond the period of eight years and upto sixteen years from the end of the assessment year, only with the approval of the Board and only in cases where the income has escaped assessment is estimated by the Income-tax Officer at Rs. 50,000/- or more. However, under the Wealth-tax Act and Gift-tax Act, there is no similar provision for calling for returns beyond the period of eight years. In the interest of uniformity, We recommend that the assessing officer should have the power to call for a return for the purpose of income-tax, wealth-tax or gift-tax even after the expiry of eight years but before the expiry of sixteen years, after obtaining the board's approval. The minimum limit for the issue of such notices after the eight-year period should remain at Rs. 50,000/- for the purposes of income-tax, and it may be placed at Rs. 5 lakhs for purposes of wealth-tax and Rs. 50,000/- for the purposes of gift-tax.

II-4.29. For the purposes of surtax, however, some modification will be necessary inasmuch as the assessing officer will be able to identify the case of a company liable to surtax only after completing the income-tax assessment. There is also no advantage in the assessing officer issuing a notice calling for a return in a routine manner. We, accordingly, recommend that the assessing officer should have the power to call for a return for the purposes of surtax at any time before the expiry of eight years from the end of the relevant assessment or one year from the end of the financial year in which the assessment or re-assessment of the company for the purposes of income-tax is completed or such assessment is modified as a result of appeal, revision or rectification, whichever is later. The monetary limit of Rs. 50,000/- and the requirement of the board's approval should not apply even in a case where such notice is issued after the expiry of eight years from the end of the relevant assessment year.

Reassessment

II-4.30. The Income-tax Act at present contains a variety of provisions for reassessment of escaped income of a past year after an assessment had already been made for such year. The corresponding provisions in the Wealth-tax Act and Gift-tax Act are less elaborate although they also have the same objective in view, namely, reassessment of escaped wealth or gifts. In addition, under the Income-tax Act, in cases where a summary assessment has been made by virtually accepting the return of the assessee, there is provision for reopening the proceedings with a view to making a fresh assessment after scrutiny of the accounts and other material. This is permissible either on the request of the taxpayer or on the Income-tax Officer's own volition, subject to his obtaining the approval of the Inspecting Assistant Commissioner.

II-4.31. The time limits within which action for reopening of completed assessments can be initiated extend upto 16 years under the Income-tax Act and 8 years under the Wealth-tax Act and Gift-tax Act.

Where the reopening is necessitated on the basis of information, without there being any default on the part of the assessee, the time limit is 4 years under all the four Acts, including the Surtax Act. Under the Surtax Act, however, there is no time limit whatever where the reopening is necessitated by the default of the assessee. In the context of integration of the procedural provisions relating to all the four direct taxes. We recommend that the time limits for initiating action for reopening of completed assessments should be on the pattern of the existing provisions in the Income-tax Act and should uniformly apply to Wealth-tax and Gift-tax as well.

II-4.32. In respect of surtax, however, the liability, if any, determined in the assessment made earlier may require recomputation in consequence of a reassessment of the company for the purpose of income-tax or even as a consequence of any modification of the income-tax assessment of the company as a result of appeal, revision or rectification. The existing provision in section 14 of the Surtax Act authorises the consequential revision of the surtax assessment already made in pursuance of the modification of the income-tax assessment as a result of appeal, revision or rectification, but it does not cover consequential revision of the surtax assessment in pursuance of a reassessment of the company for the purpose of income-tax. We see no reason why these two situations should be treated differently. We, accordingly, recommend that, while incorporating the existing provision in section 14 of the Surtax Act in the management Act, it should be extended to cover a case where the surtax assessment needs modification in consequence of a reassessment of the company for the purposes of income-tax. We further recommend that, in line with our recommendations elsewhere in this report, the period of four years for such modification should, in all cases, be reckoned from the last day of the financial year in which the event necessitating the modification of the surtax assessment happened. The provisions for reopening a surtax assessment independently of the income-tax assessments should be on par with the corresponding provisions applicable in respect of other direct taxes as discussed in this chapter.

II-4.33. Action for reassessment of income can now be initiated by the assessing officer on his own motion in certain cases but, in certain other circumstances, he has to obtain the previous approval of the Inspecting Assistant Commissioner or the Commissioner or the Board. The approval of the Inspecting Assistant Commissioner is at present required where the assessment made by accepting the return is to be reopened for scrutiny of accounts. We have, in para 4.18 above, recommended that cases meant for scrutiny including those picked up on random sampling basis should be kept apart and tear-off slips should be issued in the remaining cases only. When the assessment is deemed to have been completed by sending the tear-off slip, any reopening of the assessment should be not only under the normal provisions governing reopening of closed assessments. We recommend that the provisions in section 143(2) of the Income-tax Act which enable the Income-tax Officer to reopen an assessment completed by accepting the return with the approval of the Inspecting Assistant

Commissioner or on the request of the taxpayer should be deleted. We do not think that there will be any difficulty in reopening such assessments on the basis of the information available in the return and in the accompanying statements and documents or other information becoming available subsequently. However, to place the matter beyond doubt or dispute, and to ensure that the acceptance of his return does not confer on the tax evader all-time immunity from being subjected to reassessment proceedings, we recommend that a suitable explanation may be added to the provision dealing with reopening of completed assessments on the basis of information, clarifying the scope of the word "information".

II-4.34. Under the present law, the approval of the Commissioner is required for reopening a completed assessment under the Income-tax Act after the expiry of four years but within eight years from the end of the assessment year, *inter alia*, on the ground that there was failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment of his income. This provision for approval is meant to be a safeguard against indiscriminate reopening of closed assessments. We recommend that these provisions should continue and apply uniformly for Wealth-tax and Gift-tax as well, even though at present there is no such provision for the purpose of those taxes.

II-4.35. For reopening closed assessments after the expiry of 8 years from the end of the assessment year on similar grounds of non disclosure of material facts, the previous approval of the Board is required under the Income-tax Act. Such reopening is permissible only where the escaped income of Rs. 50,000/- or more. There is no provision for reopening of closed assessment beyond the 8-year period under the Wealth-tax Act and Gift-tax Act, while under the Surtax Act, such reopening may be made at any time without the approval of any higher authority and without any monetary limit. With a view to bringing uniformity in the procedures, we recommend that in cases of failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment, there should be a provision for initiating proceedings for reassessment of escaped income, wealth or gifts beyond eight years upto a period of 16 years, subject to the approval of the Board and also subject to the minimum monetary limit of Rs. 50,000/- in respect of escaped income or taxable gifts and Rs. 5 lakhs in respect of escaped wealth.

II-4.36. Another direction in which the existing provisions can be rationalised is in the matter of submission of a return by the taxpayer in response to a notice of reassessment. While we agree that such a return is necessary in cases where no return has been filed already, we are of the view that, where a return has already been furnished and assessment has been made on the basis of such return, there is no need to insist on the submission of a fresh return by the taxpayer for the purpose of making a reassessment of the escaped income, wealth, etc. While it is necessary that the assessing officer should issue a notice to the assessee intimating his intention to make a reassessment so as to bring to charge the escaped income, wealth, etc., it should be left to the assessee to furnish or not to furnish a fresh return according to his

choice. Further, as the law stands today, when the notice of reassessment is issued, the assessee is kept in dark as to the reason for the proposed reassessment. We, therefore, recommend that in cases where proceedings are initiated for reassessment of escaped income, wealth etc., there should be no insistence on the submission of a fresh return but the assessee should be given the right to file a return at any time before the reassessment is completed if he so wishes. Further, the Assessing Officer should intimate to the assessee clearly the reasons for reassessment and give the assessee a reasonable opportunity to state his objections, if any, to the reopening of the assessment the assessee should, for this purpose, be allowed a minimum time of 30 days.

II-4.37. Section 150 of the Income-tax Act permits the initiation of action for assessment, reassessment or recomputation to give effect to any finding or direction contained in an order passed in appeal, reference or revision, without any time limit. Although, this is a salutary provision for taking consequential action to bring escaped income to assessment, in the interest of definiteness and expeditious completion of such actions. We recommend that for initiating such action there should be a time limit of one year from the end of the financial year in which the order in appeal, reference or revision is received by the Assessing Officer.

II-4.38. Section 152(1) of the Income-tax Act provides that in an assessment, reassessment or recomputation made under section 147, the tax shall be chargeable at the rate or rates at which it would have been charged, had the income not escaped assessment. This provision does not appear to add anything to the statutory position that income pertaining to a particular assessment year should be charged to tax at the rates applicable to that year or that reassessment means integrating the escaped income with the income already assessed. There is no similar provision in the Wealth-tax Act or Gift-tax Act. We recommend that the provision in section 152(1) need not be repeated in the Management Act.

II-4.39. Section 152(2) authorises the taxpayer to claim that proceedings initiated against him under section 147(b), i.e., on the basis of information coming to the notice of the Income-tax Officer, without there being any default on the part of the taxpayer in furnishing his return of income or in disclosing all the material particulars necessary for the assessment, should be dropped under certain circumstances. We recommend that this provision should be made applicable to all types of reassessments under all the four acts on a uniform basis. We further recommend that this right should be available to the assessee notwithstanding that he might have filed an appeal against the original assessment provided that such appeal has since been disposed of, and the matter has become final.

II-4.40. The existing provisions of the Income-tax Act, Wealth-tax Act and Gift-tax Act lay down certain time limits for completion of assessments and reassessments. The time limit for completing an assessment under the Income-tax Act is two years from the end of the relevant assessment year, whereas under the Wealth-tax Act and Gift-tax Act, it is

four years. There is no time limit for completion of assessments under the Surtax Act. In the context of integration of the procedural provisions of the four direct tax laws, we recommend that a uniform time limit of two years should be laid down in the management act for all the taxes. In respect of surtax, however, an alternative time limit of one year from the end of the financial year in which the income-tax assessment is completed, if later, will have to be provided. To obviate undue burden on the department in having to deal with a large number of pending assessments made under the Wealth-tax Act and Gift-tax Act getting barred by time in one year, the reduction of the time limit from four years to two years should be staggered suitably. Similarly, in respect of surtax where there is no time limit at present for completion of assessments, suitable staggering should be provided while imposing the time limit recommended by us.

II-4.41. At present, extended time limits apply for completion of assessments and reassessments under the Income-tax Act, Wealth-tax Act and Gift-tax Act in certain circumstances. Firstly, an assessment is permitted to be completed within a period of one year from the date of filing of the return or a revised return even if such period expires after the stipulated time limit of two years or four years, as the case may be. Secondly, under the Income-tax Act, an assessment is allowed to be completed before the expiry of eight years from the end of the assessment year in a case where penalty for concealment of income is attracted. This latter provision has, in practice, been of little use because of vagueness. In the interest of certainty, uniformity and ease in keeping track of limitation, we recommend that, for all the four direct taxes, extended time limit with reference to the date of filing the return should be available upto the last day of the financial year following that in which the return is filed. Such extension should be available only with reference to the date of filing the first return and not any revised return. Further, there should be no extension of time limit with reference to the consideration whether or not the case attracts penalty for concealment.

II-4.42. The time limit for completion of assessment, reassessment or recomputation in pursuance of proceedings initiated by issue of a notice under section 148 on the basis of fresh information, without there being any default on the part of the assessee in furnishing the return or in disclosing material facts, is at present one year from the date of service of the notice or four years from the end of the assessment year, whichever is later. Here also, in the interest of certainty and ease in keeping track of limitation, we recommend that the extended period of limitation of one year should be counted from the last date of the financial year in which the notice is served.

II-4.43. There is at present a time limit under section 153(2A) for completing assessments/reassessment, reassessment or recomputation in pursuance of finding or direction contained in an order in appeal, revision, etc., of two years from the end of the financial year in which the order in appeal was received by the Commissioner or the order in revision was passed

by the Commissioner. This time limit should continue. There is now no time limit at all for making an assessment on a partner of a firm in consequence of an assessment made on the firm under section 147. We recommend that, in such a case, there should be an extended time limit of one year from the end of the year in which the assessment on the firm was made.

II-4.44. Explanation 1 to section 153 enumerates certain situations in which the period of limitation gets extended by the exclusion of certain periods. Under clause (i), in a case where there is a change in the incumbent of the office of the assessing authority, the time taken in reopening the whole or any part of the proceedings or in giving an opportunity to the assessee to be reheard, on his demand, is to be excluded in computing the period of limitation. This provision creates uncertainty about the period of limitation. We accordingly recommend that, where the assessee claims in writing that the whole or any part of the proceedings should be reopened and he should be reheard by the successor in office because of the change in incumbent, the limitation should expire on the last day of the financial year following that in which such claim is made by the assessee.

II-4.45. Under clause (ii) of Explanation 1 to section 153, in a case where the assessment proceeding is stayed by an order or injunction of any court, the period of limitation gets extended by the period for which the proceedings are so stayed. It often happens that stay orders are obtained by assessee towards the fag end of the period of limitation and when such stay orders are ultimately vacated after the lapse of several years, the assessing officer gets hardly a few days' time to complete the proceedings even under the extended time limit. The position becomes greatly aggravated where there has been a change in the assessing officer dealing with the case in the meanwhile, and the successor has to familiarise himself with the facts before he can make an assessment. With a view to obviating these difficulties and imparting certainty and ease in keeping track of the date of limitation in such cases, we recommend that the period of limitation should expire on the last day of the financial year following that in which the stay order is vacated.

II-4.46. Clause (iii) of Explanation 1 to section 153 deals with the situation where a special audit of the assessee's accounts is carried out at the instance of the Income-tax Officer. Clause (iv) deals with the situation where a draft assessment order has been issued and the objections of the assessee to the proposed additions have been referred to the Inspecting Assistant Commissioner for his directions. Clause (v) deals with the situation where an application made before the Settlement Commission by the assessee is rejected by it or is not allowed to be proceeded with. In the light of our recommendation for deletion of the provisions in section 144B for the issue of a draft order, we recommend that the provision in clause (iv) of Explanation 1 to section 153 should be deleted. As regards clauses (iii) and (v), in line with our earlier recommendations, we recommend that the time limit should get extended upto the last day of the financial year next following that in which the

report of audit is furnished by the assessee or, as the case may be, the decision of the settlement commission rejecting the application, etc., is received by the Commissioner.

II-4.47. In the matter of time limit for completion of assessment, an exception will have to be made in respect of assessment of deficiency for surtax purposes as, otherwise, a large number of companies, who may have no liability to surtax, will have to file deficiency returns and get the deficiency determined by formal assessment orders to meet the remote eventuality of their becoming liable to surtax at a later date. We have, elsewhere, recommended that deficiency returns for the purpose of surtax may be filed at the time when set off of such deficiency is claimed in an assessment. We recommend that, similarly, the assessment of deficiency for surtax purposes may be made simultaneously with the surtax assessment in which the deficiency is required to be set off.

Method of Accounting and Maintenance of Accounts

II-4.48. Section 145 of the Income-tax Act provides that income from a business or profession or income from other sources shall be computed in accordance with the method of accounting regularly employed by the assessee. Under section 44AA introduced by the Taxation Laws (Amendment) Act, 1975, pursuant to the recommendations of the Wanchoo Committee, persons engaged in specified professions and also persons carrying on a business or a profession other than those specified, who have income, gross receipts or turnover exceeding specified limits, are statutorily required to maintain such books of account and other documents as may enable the Income-tax Officer to compute their total income for the purpose of tax. Further, the Board is authorised to prescribe the books of account and other documents that will have to be maintained by such persons. The provisions in section 145 and section 44AA should go together and find place in the Management Act in this Chapter. Draft rules have been notified by the Board sometime back, seeking to prescribe the account books and other documents to be maintained by professional men, such as doctors. The draft rules require that a person carrying on medical profession should maintain a daily case register in the prescribed form, an inventory of the stock of drugs, medicines and other consumable accessories used for the profession, a daily cash book, a journal, if the accounts are maintained on the mercantile system, a ledger, duplicate copies of machine-numbered bills and receipts issued by the person and original bills and receipts in respect of expenditure incurred by him.

II-4.49. Several professional associations have represented before us that the draft rules are unduly onerous and interfere with their professional work and might even compel them to violet professional confidence of their clients which would be contrary to the ethics of their profession. We have given earnest consideration to these and other objections to the draft rules. While we do not fully agree with the views expressed that maintenance of accounts by professional persons such as doctors would seriously

interfere with their professional work, we agree that the draft rules do unduly burden them with avoidable clerical and accounting work. In particular, we see no justification for requiring doctors to maintain inventories or drugs, medicines and other consumable accessories or to have machine-numbered bills and receipts. We recommend that persons carrying on a profession may be required to maintain only certain basic records such as a professional case diary, a fee register, a cash book (which may not necessarily be balanced daily), a journal if the accounts are maintained on mercantile basis and a ledger. In conjunction with the bank pass book, etc., these records should provide quite sufficient material for the computation of their income for purposes of assessment.

II-4.50. Section 44AA, at present, authorises the Board to prescribe by rules not only the types of books of account and other documents to be maintained by taxpayers carrying on any business or profession but also the period for which such books of account and other documents should be retained. In the context of our recommendation in para 4.32, that when an assessment is completed by acceptance of return any reopening of such assessment should be done only under the normal procedure governing the reopening of closed assessments, we recommend that books of account and other documents relating to any business or profession coming within the scope of section 44AA should be required to be retained for a minimum period of eight years.

Assessment of additional Income-tax on closely held companies

II-4.51. Chapter XI of the Income-tax Act contains provisions for the levy of additional income-tax on a closely-held company for its failure to distribute dividends upto the required percentage of its distributable income. Some of these provisions are substantive in character while the others are procedural. The procedural provisions of that chapter should be incorporated in the management act in this Chapter.

II-4.52. At present, there is no statutory provision for the issue of a notice to the company before the Income-tax Officer invokes the provision for levy of additional tax. We recommend that the Management Act should provide for the issue of a notice by the Assessing Officer to the company before starting the proceedings for the levy of additional tax. Such notice should be issued by the Assessing Officer soon after the completion of the relevant assessment or reassessment of the company.

II.4.53. Section 105, which spells out the circumstances in which liability to the additional tax would not be attracted, is largely substantive, although it includes certain procedural formalities to be observed by the company or to be taken by the assessing officer. This provision should find a place alongwith section 104 in the substantive law. The existing provisions in section 106 lay down a time limit of two years from the end of the relevant assessment year for levy of the additional tax, subject to an alternative limit of one year from the end of the financial year in which the assessment or reassessment of the

income of the company is made. These time limits can remain unchanged and should be incorporated in the Management Act. Section 107, which requires approval of the Inspecting Assistant Commissioner before the Income-tax Officer makes an order levying the additional tax, is purely procedural and should be incorporated in the Management Act. Section 107A enables a company, other than an investment company, to approach the Board for relaxation of the requirement of distribution of dividends. In para 6.11 of our Interim Report, we have recommended that the provisions relating to levy of additional income-tax should be restricted in their application to closely-held investment companies only. In the light of that recommendation, the provisions of section 107A would become otiose. We, therefore, recommend that section 107A should be deleted.

Rectification of mistakes

II-4.54. Section 154 of the Income-tax Act contains provisions empowering the tax authorities to rectify mistakes in their orders which are apparent from the record. The Income-tax Appellate Tribunal is also given similar powers under a different section, namely section 245(2) of the Income-tax Act. Section 35 of the Wealth-tax Act and section 34 of the Gift-tax Act apply not only to the tax authorities but also to the Appellate Tribunal. It is also seen that section 154 of the Income-tax Act and section 35 of the Wealth-tax Act do not confer any power of rectification on the Inspecting Assistant Commissioner whereas in the Gift-tax Act, the Inspecting Assistant Commissioner's power to rectify certain penalty orders passed by him is retained. When an Inspecting Assistant Commissioner makes an assessment by virtue of his exercising the powers of the Income-tax Officer, he can no doubt, resort to section 154 in exercise of the same powers. However, there are other orders, such as those under section 131(2) or section 272A of the Income-tax Act where the Inspecting Assistant Commissioner acts by virtue of his own powers. It is desirable to confer specific powers of rectification on the Inspecting Assistant Commissioner also. We recommend that the powers of rectification of all tax Authorities and the tribunal should be made uniform and applicable to all orders passed by them. We further recommend that the existing provisions laying down the time limit for rectificatory action, at four years from the date of passing of the order sought to be rectified, should, in the interest of uniformity, certainty and ease in keeping track of dates of limitation, be amended so as to permit rectification within a period of four years from the end of the financial year in which the order sought to be rectified was passed.

II-4.55. The provisions in section 154 are supplemented by the provisions in section 155 which provide for amendment of orders in specified circumstances by bringing them within the scope of rectification of mistakes and by providing extended time limits for that purpose. Here also, We recommend that the extended time limit of four years provided in the various sub-sections of section 155 should be made to expire at the end of four years from the last day of the financial year in which the event which attracts the amendment happens.

CHAPTER 5

PENALTIES

II-5.1. This Chapter of the Management Act will incorporate the provisions at present contained in Chapter XXI of the Income-tax Act relating to penalties for various defaults, and the corresponding provisions of the Wealth-tax Act, Gift-tax Act and Surtax Act. The provisions in the Management Act will apply uniformly to defaults under all the four direct tax laws and the differences which exist in the present provisions as between one Act and the other will get eliminated in the process of integration.

II-5.2. The most important provisions relating to levy of penalty in Chapter XXI are those contained in section 271 which deals with several categories of defaults. Sub-section (1) of section 271 prescribes the penalty for (a) defaults in furnishing returns of income, (b) defaults in complying with certain notices calling for accounts, etc., issued by the assessing authority, and (c) concealment of income. Sub-section (4) deals with wrong distribution of profits of a registered firm. Combining the provisions relating to these various defaults, which are essentially independent of one another and indicate different degrees of culpability, seems to be a historical accident. We, therefore, recommend that penalties for the above different types of defaults should be dealt with in separate sections of the Management Act.

Default in furnishing the return

II-5.3. At present, under section 271 of the Income-tax Act, a penalty of 2 per cent of the "assessed tax" is leviable for every month during which the default in furnishing the return of income continues, subject to an overall limit equal to twice the amount of the assessed tax. This limit is applicable to the aggregate penalty for failure to furnish the return of income and the penalty leviable by deeming such failure beyond the time allowed for furnishing a voluntary return to be concealment of income. In our Interim Report, we have recommended that taxpayers should be allowed to buy time for furnishing the return on payment of interest, upto a maximum period of 3 months expiring on 30th September of the assessment year, and that any delay in furnishing the return after that date should attract penalty (para 7.20). Accordingly, we recommend that any delay in furnishing the tax return beyond 30th September of the assessment year should attract penalty at the rate of one per cent of the gross tax, i.e. tax determined on assessment without giving credit for prepaid taxes, for every month of default. We further recommend that there should be no ceiling on the amount of penalty payable for delaying the tax return so that a person who fails to furnish the tax return for several years may be required to pay an adequate price for his delinquency. We also recommend that the

penalty provisions should apply uniformly to all the four direct taxes.

II-5.4. *Explanation 3* to section 271 seeks to induce a sense of responsibility in taxpayers by deeming failure to furnish the return of income within the time allowed for furnishing a voluntary return, to be concealment of income. We have, elsewhere in this Report, recommended that there should be no time limit, as such, for furnishing a tax return on the taxpayer's own volition. In view of that recommendation and the recommendation in the last para that there should be no upper limit on the penalty for default in furnishing a tax return, we recommend that *explanation 3 to section 271* may be deleted.

II-5.5. Under the existing law, no penalty is leviable in a case where the income of the taxpayer exceeds the exemption limit by less than Rs. 1,500. Considering the increased emphasis on voluntary compliance by taxpayers and acceptance of returns in the large majority of cases without scrutiny of accounts, we are of the view that there should be no exception even in the case of persons with incomes exceeding the exemption limit by a small amount. We, therefore, recommend that the existing exception in section 271(3)(a) should be omitted.

II-5.6. In a case where a taxpayer, to whom a notice calling for a return has been issued by the assessing authority, proves that he has no income liable to tax at all, the present law provides that the penalty leviable shall not exceed Rs. 25. *Ex hypothesi*, in a case like this, the penalty leviable is *null* and hence the provision that it shall not exceed Rs. 25/- seems to have no significance. What is, perhaps, intended is that a token penalty not exceeding Rs. 25/- may be levied on a taxpayer who does not comply with a notice calling for the return even if it ultimately turns out to be a case of no taxable income. We, accordingly, recommend that the provision in section 271(3)(b) should be re-drafted to make the intention clear.

II-5.7. In the case of a charitable or religious trust which does not have any tax liability in view of the exemptions provided in sections 11 and 12, the law provides that failure to furnish the return of income should be visited with a penalty at the rate of one per cent of the total income computed under the Act, without giving effect to the provisions of sections 11 and 12, for each year or part thereof. Several witnesses before us described this provision as unduly harsh on charitable trusts. They have also pointed out that the penalty on trusts which are exempt often works out to be more than the penalty leviable on trusts which become taxable by virtue of the provisions of section 13. While we

appreciate the need for compelling persons claiming exemption from tax under sections 11 and 12 to file their returns in time, we feel that the penalty for default should not be so stiff. Elsewhere in this Report, we have recommended that eligibility for the exemption under sections 11 and 12 should be conditional upon the furnishing of the return before the close of the assessment year. In this context, we recommend that, while the present scale of penalty leviable for default in furnishing return of income by a Trust which is entitled to exemption under sections 11 and 12 may continue, the quantum of the penalty should be limited to Rs. 500. This limit should, however, apply only to cases where, after applying the provisions of sections 11, 12 and 13, the trust does not have a taxable income.

II-5.8. The existing provisions for levy of penalty for default in filing the return of income have been interpreted by the courts to mean that a penalty cannot be levied unless the Department proves deliberate intent on the part of the taxpayer to escape tax liability. Recently, a Full Bench of the Kerala High Court has held in *Commissioner of Income-tax vs. Gujarat Travancore Agency* (103 I.T.R. 149) that the mere use of the expression "without reasonable cause", in section 271(1)(a), cannot import a mental element or *mens rea*. Here again, in the light of the approach adopted by us in the Interim Report, that all taxpayers should be induced to comply voluntarily with the tax laws fully and promptly and that the Department should also place faith in the taxpayers and accept the returns in the large majority of cases, we recommend that the law should clearly provide for levy of penalty for default in furnishing the return of income more or less as a matter of course except where the taxpayer proves that he was prevented by sufficient cause from furnishing the return. In other words, the principle enunciated by the Kerala High Court should be spelt out clearly in the statute.

Defaults in complying with notices for production of Accounts, etc.

II-5.9. Another type of default for which section 271 provides a penalty is default in complying with notices issued by the assessing authority calling for accounts, documents and other material. The penalty for such defaults, at present, ranges from 10 per cent to 50 per cent of the tax which would have been avoided if the income returned by the assessee had been accepted as the correct income. The penalty in such cases is, thus, linked to the tax on the additions made to the returned income. In order to make the penalty really effective, we are of the view that the penalty should be independent of the quantum of the assessment and the tax liability determined thereby. In this connection, it should be noted that in the case of non-compliance with summons under section 131 for production of evidence, etc., there is a fine of Rs. 500 for each default, which, according to our recommendation in a later paragraph, should be increased to Rs. 1,000. The defaults at present dealt with in

section 271(1)(b) are essentially similar to defaults under section 131 and the penalty should also be similar. We accordingly, recommend that, for defaults in complying with notices issued by the Assessing Authority calling for production of Account Books, documents and other material, the penalty should be a lumpsum not exceeding Rs. 1,000 for each default. We further recommend that, while drafting the provisions, it should be made clear that the onus of showing sufficient cause for failure to comply with the notices will be on the taxpayer. We also recommend that the penalties for such defaults should be levied without waiting for the completion of the relevant Assessment proceedings.

Penalty for concealment

II-5.10. The third type of penalty provided under section 271 is that for concealment of particulars of income or furnishing inaccurate particulars of income. The quantum of penalty in such cases is subject to a minimum equal to the tax sought to be avoided and a maximum equal to twice such amount. Under the corresponding provisions of the Wealth-tax Act, the minimum is the same, but the maximum is 5 times that amount. Under the Gift-tax Act, the minimum penalty for concealment is 20 per cent of the tax sought to be avoided and the maximum is 1-1/2 times such tax. Under the Surtax Act, there is no minimum for such penalty but the maximum is the amount of surtax sought to be avoided. In line with our approach that there should be uniform provisions applicable for all the direct taxes, we recommend that the provisions in the Management Act relating to penalty for concealment of Income, Wealth, etc., should uniformly apply to all the four direct taxes. There should be no minimum penalty and the Assessing Officer's discretion in this regard should be unfettered. The maximum penalty should be twice the amount of the tax sought to be avoided.

Authorities empowered to Levy Penalty

II-5.11. The present provision in section 27(1) confers the power to levy penalty for different types of defaults on the Income-tax Officer, Appellate Assistant Commissioner and Commissioner (Appeals). The corresponding provisions of the Wealth-tax Act and Gift-tax Act confer such power on the Commissioner and the Appellate Tribunal also, in addition to the assessing authority and the first appellate authority. Under the Surtax Act, however, the Income-tax Officer is the only authority competent to levy penalty. While defaults in furnishing the return of income or in complying with notices calling for books of account, documents and other material can occur only in proceedings before the assessing authority, concealment may be detected by the assessing authority or the first appellate authority or even by the Commissioner in the course of revision proceedings. We have elsewhere in this Report, recommended that the Tribunal, which is the final appellate authority on facts, should not have the power to enhance the assessment as at present provided in the Wealth-tax Act and the Gift-tax

Act. In the light of the recommendation and in the context of integration of the procedure for all direct taxes, we recommend that the power to levy penalty for various defaults detailed in the preceding paragraphs should not be available to the Appellate Tribunal. We further recommend that the penalty for defaults in furnishing tax returns or in complying with notices issued by the Assessing Authority should be leviable only by the Assessing Authority and not by any other authority. The power to levy penalty for concealment should, however, be available uniformly to the first Appellate Authority and also to the Commissioner, in addition to the Assessing Authority, in respect of all the four direct taxes.

Penalties on Registered Firms

II-5.12. Section 271(2) provides that, in the case of a registered firm, the penalty for different defaults shall be computed with reference to the tax which would have been imposed on the firm had it been treated as an unregistered firm. The effect of this provision is that, although the tax payable by the registered firm may be a comparatively small amount, the penalty for delay in furnishing the return of income even for a short period of a month or two can exceed the tax payable by the firm. This provision is no doubt intended to act as a positive deterrent on partners of a registered firm against delaying the return of income of the firm, and then claiming that as the excuse for delaying their own personal returns. Several witnesses who appeared before us described these provisions as harsh and pleaded for mitigation. In this connection, we would like to refer to the recommendation in our Interim Report (para 8.18) that the separate tax on a registered firm should be discontinued altogether. If that recommendation is accepted and implemented by the Government, then the existing provisions for calculating penalty for default of a registered firm in furnishing the return of Income should continue unchanged. If, however, the separate tax on registered firm continues to be charged, we recommend that the penalty for default in furnishing return of Income should also be calculated with reference to the tax payable by the registered firm itself and not on the Notional Tax which would be chargeable if it had been assessed as an Unregistered Firm. We do not, however, recommend any change in the existing method of calculation of penalty for concealment of Income in the case of Registered Firms.

II-5.13. Elsewhere in this Report, we have recommended that the procedure for registration of firms should be extended to associations of persons and bodies of individuals as well, and that a registered association of persons or body of individuals should not be assessed to tax on its income as a single unit but that the shares of the numbers in the income of the association or body should be subjected to tax in their hands. In this context, we recommend that the penalty leviable in the case of a Registered Association or Registered Body of Individuals for defaults in furnishing returns of Income and also for concealment of Income should be calculated

with reference to the tax that would have been payable if the Association or Body had been subjected to tax on its Income as a single unit.

II-5.14. Section 271(4), providing for the levy of penalty on a registered firm, which distributes its profits otherwise than in accordance with the shares of the partners as shown in the instrument of partnership, is virtually a dead letter inasmuch as any wrong distribution of profits would entitle the Income-tax Officer to refuse registration to the firm and assess it as an unregistered firm and should be deleted.

Failure to keep books of accounts, etc.

II-5.15. Section 271A prescribes the penalty for failure to keep, maintain or retain books of accounts, documents, etc., as required under section 44AA or the rules made under that section. At present, this penalty is linked with the tax which would have been avoided if the income returned by the assessee had been accepted as correct, and ranges from a minimum of 10 per cent to a maximum of 50 per cent of the tax. The scale of penalty can be meaningful only if failure to maintain books of accounts as required by section 44AA leads to additions to the income returned by the assessee, and not otherwise. Further, the penalty for such failure can be levied only after the assessment has been finalised. These two features make the penal provision uncertain and even illusory. With a view to making the penalty serve the purpose underlying it, we recommend that the penalty for failure to keep, maintain or retain books of Accounts, Documents, etc., as required under Section 44AA, should be a lump-sum not exceeding Rs. 5,000.

Defaults Relating to advance tax

II-5.16. Section 273 of the Income-tax Act deals with penalties leviable for defaults relating to payment of advance-tax. The section contemplates, three types of defaults, namely:—

- (a) furnishing an underestimate of the advance tax payable;
- (b) failure to furnish an estimate of the advance tax payable; and
- (c) failure to furnish an upward estimate of the advance tax payable under section 212(3A).

II-5.17. In our Interim Report, we have recommended that the obligation to submit an upward estimate of the advance tax payable should be discontinued (para 9.10). Apart from this, we have also recommended that all assessees, including those who are already assessed to tax in the past, should be required to pay advance tax on the basis of their own estimate without waiting for a notice from the Income-tax Officer (para 9.5). This latter recommendation has been accepted by the Government and implemented through the Finance Act, 1978. Another recommendation in our Interim Report is that, where the advance tax paid falls short of 75

per cent of the tax payable on the basis of the returned income, interest should be charged with reference to the shortfall from the tax on the returned income, at the rate of 1 per cent per month, upto the date of furnishing the return of income (paras 9.13 and 9.14). We have further recommended that penalty should be leviable on a taxpayer who has failed to make payment of advance tax which is due or where 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.

II-5.18. As a further step towards simplification, we recommend that, the levies by way of interest and penalty may be merged and the interest to be charged for non-payment of advance tax or on short payments of advance may be fixed at 18 per cent per annum of the tax payable on the basis of the return or, as the case may be, of the shortfall from such tax. Once this is done, it will be unnecessary to have separate penal provisions for this purpose and Section 273 may be omitted.

Miscellaneous defaults

II-5.19. Apart from the penalty provisions discussed above, there are a number of other provisions prescribing penalties for various other defaults. These are contained in sections 270, 272, 272A and 272B in Chapter XXI of the Income-tax Act. Besides these, there are certain other provisions for levy of fines, in sections 131(2) and 285A(2). Out of these various provisions, those in section 272A cover a number of defaults, namely, refusal to answer questions, sign statements, allow inspections, etc., failure to furnish various returns or statements, mentioned in sections 133, 206, 285, 285B and 286; failure to furnish certificate of the tax deducted at source, as required by section 203; and so on. For refusal to answer and sign statements, the penalty is a lumpsum upto Rs. 1,000, while for the other defaults referred to in section 272A, it is Rs. 10 for every day during which the failure continues. Section 270 prescribes a penalty upto Rs. 500 for failure to furnish information in respect of securities, called for by the Income-tax Officer, with a further penalty of like amount for every day during which the default continues. Section 272 prescribes a penalty for failure to give notice of discontinuance of business or profession as required by section 176(3), and the amount of penalty may vary from a minimum of 10 per cent of the tax subsequently assessed in respect of the business or profession upto the date of its discontinuance, to a maximum equal to such tax. Section 272B prescribes a penalty upto Rs. 500 on a person who fails to obtain a Permanent Account Number and quote it on all returns, correspondence, challans, documents, etc. addressed by him to the Department or fails to inform the Department of any change in his address or in the name and nature of his business as required under section 139A. The fine for failure to comply with a summons under section 131 may extend upto Rs. 500, while the fine on a contractor who fails to furnish information about the contract, as required

under section 285A(1), may be upto Rs. 50 for every day during which the contravention continues, subject to a ceiling of 25 per cent of the value of the contract.

II-5.20. All the defaults enumerated in the various sections referred to in the preceding paragraph are technical defaults and there should be a certain degree of uniformity in the penalties leviable for such defaults. After considering the comparative importance of the relevant provisions and the gravity of the defaults, we recommend as follows :—

- (1) Penalty for failure to respond to summons under section 131 should be brought on par with the penalty leviable under section 272A(1) for refusal to answer the questions and sign statements, and the necessary provision in this behalf should be made in the latter section.
- (2) Penalty for not complying with the provisions under section 139A for obtaining a permanent Account Number and quoting it should also be covered under the provisions of section 272A(1), subject to the exclusion of failure to quote the permanent Account Number on routine correspondence for which no penalty should be levied.
- (3) The penalties provided under sections 270, 272 and 285A(2) should be integrated with the penalty for various defaults enumerated in section 272A(2) and the amount of the penalty should be fixed at a maximum of Rs. 20 for every day during which the failure or contravention continues.
- (4) The penalties for the corresponding defaults under the Wealth-tax Act, Gift-tax Act and the Surtax Act should be brought in line with these penalties.

II-5.21. The procedure for the levy of various penalties, as detailed in Chapter XXI of the Income-tax Act, is spelt out in section 274, while the time limits for the passing of relevant orders are laid down in section 275. There are corresponding provisions in the Wealth-tax Act and Gift-tax Act. Certain aspects of the procedure are incorporated in section 271 itself. Essentially, under all the four direct tax laws, the previous approval of the Inspecting Assistant Commissioner is required to be obtained before the Income-tax Officer can levy penalty in respect of certain defaults, subject to certain monetary limits. Thus, under the Income-tax Act, a penalty in respect of concealed income of more than Rs. 25,000 can be levied by the Income-tax Officer only after getting the previous approval of the Inspecting Assistant Commissioner. The provision under the Wealth-tax is similar while, under the Gift-tax Act, the Inspecting Assistant Commissioner's approval is required where the minimum penalty imposable for concealment exceeds Rs. 1,000. Under the Surtax Act, the Inspecting Assistant Commissioner's previous approval is required for the levy of penalties not only for concealment but also for default

in furnishing the return of chargeable profits or in producing documents, statements, etc. required by notice, and there is no minimum limit.

II-5.22. In the context of integration of the procedures for all the four taxes, we recommend that all procedural aspects in regard to levy of penalties should be uniform for the purpose of all the direct taxes, and the Inspecting Assistant Commissioner's approval should be required to be obtained for levy of penalty for concealment where the penalty exceeds Rs. 5,000. We further recommend that all orders levying penalty should be in writing. Although this is the practice at present, there is no specific requirement under the law to this effect. Further, the law should specifically provide that, where any Authority other than the Assessing Officer levies any penalty, a copy of the order shall be sent to the Assessing Officer who shall thereupon issue a notice of demand and proceed to recover the amount.

II-5.23. Section 275 of the Income-tax Act and the corresponding provisions of the Wealth-tax Act, prescribe the time limits for the completion of penalty proceedings. We recommend that a uniform time limit should apply for all the four direct taxes and, further that the extension of these time limits in specified circumstances should be so fixed as to expire on the 31st March of the Financial year next following that in which the event justifying the extension happens. This will make it easier for the Department to keep track of such time limits and take necessary action before their expiry.

II-5.24. Section 273A gives powers to the Commissioner to reduce or waive certain penalties or interest in certain circumstances. There are corresponding provisions in the Wealth-tax Act but not in the Gift-tax Act or the Surtax Act. We have also considered similar powers conferred on the

concerned authorities by section 102¹ of the U.K. Taxes Management Act, 1970. Our recommendations in regard to these provisions are as follows :—

- (1) These should be uniformly applicable for all the four Taxes.
- (2) The provisions in this behalf should be placed in the Chapter dealing with the Commissioner's powers of revision in the Management Act, rather than in the Chapter relating to penalties.
- (3) The existing requirement of obtaining the Board's approval before the Commissioner reduces or waives under section 273A(1) any penalty or interest exceeding the specified limit should be deleted.
- (4) The provision in section 273A(3) should be amended to make it clear that it applies only to the exercise of the power under sub-section (1).
- (5) The power of the Commissioner to waive or reduce penalty on the ground of hardship, under sub-section (4), should be extended to cover interest, including interest for delay in payment of tax, and its scope should be enlarged so as to empower the Commissioner to waive or reduce any penalty or interest even in cases not involving hardship but where for any other reason he considers such a course to be desirable or expedient.
- (6) Powers similar to those under sub-section (4) should be given to the Board also, so that in case where the Assessee does not get the necessary relief at the Commissioner's level, he should be in a position to approach the Board.

¹Section 102 of the U.K. Taxes Management Act, 1970, reads as follows :—

“S. 102. Mitigation of penalties: The Board may, in their discretion, mitigate any penalty or stay or compound any proceeding for the recovery thereof, and may also, after judgment, further mitigate or entirely remit the penalty.”

CHAPTER 6

APPEALS REFERENCES AND REVISIONS

II-6.1. This Chapter of the Management Act will incorporate the provisions at present contained in Chapter XX of the Income-tax Act, Chapter VI of the Wealth-tax Act and Chapter VI of the Gift-tax Act, besides the provisions contained in sections 11, 11A, 12, 16 and 17 of the Surtax Act. The Commissioner's power to reduce or waive penalty or interest, at present contained in section 273A of the Income-tax Act and the corresponding provisions of the Wealth-tax Act, will also be incorporated in this Chapter of the Management Act.

II-6.2. In our Interim Report, we have already considered the provisions relating to appeals, references and revisions and made several recommendations for rationalisation and simplification of these provisions with a view to obviating or reducing litigation, accelerating disposal of appeals, references, etc., and generally streamlining these provisions in the interest of securing speedier justice and better collection of revenue. These recommendations should be taken into account while drafting this Chapter of the Management Act. In the following paragraphs, we deal with some of the aspects relating to appeals, references and revisions which had been left over for consideration in the Final Report or where, on further examination, we consider it necessary to make modifications in some of the provisions already dealt with in the Interim Report.

First Appeals

II-6.3. In para 11.20 of the Interim Report, we have recommended that the powers of the Appellate Assistant Commissioner/Commissioner (Appeals) to set aside or remand a case should be taken away and that he should be required to decide the issues raised in the appeal finally after himself conducting any further enquiry that he may consider necessary for the purpose. In para 4.22 of this Part, we have recommended that the provision in section 146 of the Income-tax Act, for reopening an *ex parte* assessment by the assessing officer on the application of the assessee should be discontinued. This means that appeal against an *ex parte* assessment of the assessing officer will go to the first appellate authority in regard to both the justification for making the assessment *ex parte* and the details of the computation of income made in such assessment. If the appellate authority, after hearing the assessee, comes to the conclusion that the assessment should not have been made *ex parte*, it should be in a position to remit the matter back to the assessing officer for making a fresh assessment after giving further opportunity to the assessee. The appellate authority can do this only if it has the power to set aside the assessment. Apart from this, the rules

relating to admission of fresh evidence at the appellate stage also require that the appellate authority should give the assessing officer an opportunity to examine the evidence or documents or to cross-examine the witnesses produced by the appellant. Further, section 250(5) itself permits the appellate authority to allow an appellant to go into fresh grounds of appeal, not specified originally, in certain circumstances. With a view to meeting these situations and ensuring justice both to the taxpayer and to the revenue, we recommend that the first appellate authority's power to set aside an assessment or remand it to the assessing authority for further enquiry should remain but it should be limited to the following situations :

- (a) Where the assessment was made *ex parte* and the appellate authority comes to the conclusion that it should not have been so made ;
- (b) Where the appellate authority admits any fresh ground of appeal not originally specified ;
- (c) Where the appellate authority admits any fresh evidence produced by the appellant at the stage of appeal; and
- (d) Where any of the grounds of appeal relates to a matter which has not been considered by the assessing authority.

II-6.4. In Additional Commissioner of Income-tax, Gujarat, vs. Gurjargravures Pvt. Ltd. (111 ITR 1) the Supreme Court has held that, under the existing law, the appellate authority is not competent to admit a ground of appeal relating to a point which had not been raised before the assessing authority and which had therefore not received its consideration at the time of assessment. We feel that this is a situation which requires to be remedied in order to avoid any unintended hardship to the taxpayer who may, through inadvertence or ignorance or on the basis of the then prevailing law, omit to make a claim for any deduction, allowance or relief to which he is legitimately entitled. We, therefore, recommend that the first appellate authority should be specifically empowered to admit, in its discretion, any ground even if it had not been raised before the assessing authority and considered by the latter, subject to the safeguard that, where any such ground is admitted, the assessing authority should be allowed an opportunity to examine the matter on merits and make a report to the appellate authority setting forth the results of such examination. We further recommend that similar power should be given to the Appellate Tribunal to admit any ground not raised before any lower authority, subject to a similar safeguard.

II-6.5. Under the existing law, an Assistant Director of Inspection can exercise the powers of issuing summons, etc., under section 131, under certain circumstances, and he can levy a fine for non-compliance with such summons. At present, there is no clear provision indicating the authority to whom appeal against the order imposing such fine will lie. We, therefore, recommend that the appeal against the order of an Assistant Director of Inspection levying a fine under section 131(2) should lie to the Commissioner (Appeals) having jurisdiction over the Income-tax circle in which the assessee or the other person on whom the fine is imposed is assessable to tax.

Second Appeal

II-6.6. Section 252 of the Income-tax Act deals with the constitution of the Appellate Tribunal. It appears to be a historical accident that the Tribunal is a body constituted under the Income-tax Act itself. With the enactment of other direct tax laws, the appellate functions of the Tribunal have been extended to those taxes as well. For ensuring the independence of the Appellate Tribunal, the administrative control over the Appellate Tribunal has now been vested with the Law Ministry instead of with the Ministry of Finance under which the Income-tax Department functions. We see no reason why the Appellate Tribunal should continue to remain a creation of the Income-tax Act. The Central Board of Direct Taxes which is the apex authority of the Income-tax Department is constituted not under the Income-tax Act but under a separate enactment, namely, the Central Boards of Revenue Act. We, therefore, recommend that section 252 of the Income-tax Act should be deleted and a separate statute should be enacted to deal with the constitution and composition of the Appellate Tribunal.

II-6.7. Under section 253 of the Income-tax Act, appeals lie to the Appellate Tribunal against orders of the Appellate Assistant Commissioner, Commissioner (Appeals) and the Commissioner. Clause (b) of sub-section (1) of that section also provides an appeal to Appellate Tribunal against an order of the Inspecting Assistant Commissioner under section 154. This latter provision appears to have been allowed to remain in the section to provide an appeal against an order by an Inspecting Assistant Commissioner rectifying a mistake in an order of penalty passed by him under section 271(1)(c) of the Income-tax Act as it existed before the amendment made by the Taxation Laws (Amendment) Act, 1975. The continuance of the provision is likely to create the impression that, while appeals against various orders of the Inspecting Assistant Commissioner would lie to the Commissioner (Appeal), appeal against an order under section 154 would alone lie to the Appellate Tribunal. We recommend that, in order to make the provision clear section 253 may be reworded to provide that appeal will lie to the Appellate Tribunal against all final orders of the Commissioner (Appeals) and the Commissioner and that the reference to orders under section 154 passed by the Inspecting Assistant Commissioner should be omitted.

II-6.8. Under section 24(5) of the Wealth-tax Act and section 23(5) of the Gift-tax Act, the Appellate Tribunal has been specifically empowered to enhance

an assessment or penalty after giving the taxpayer an opportunity of showing cause against such enhancement. Under the Income-tax Act, the Tribunal does not have such specific power. As the Tribunal is the final authority on facts, any enhancement of the assessment or penalty by it would leave the taxpayer without any remedy except on points of law. In actual practice also, we understand that the powers of enhancement under the Wealth-tax Act and Gift-tax Act have, very wisely, not been used by the Tribunal. In the interest of uniformity in all the direct taxes and for the reasons set out above, we recommend that the Tribunal should not have the power to enhance the assessment or penalty under any of these Acts.

II-6.9. The existing provisions relating to the Appellate Assistant Commissioner/Commissioner (Appeals), as also the Appellate Tribunal, require that, where the valuation of any asset is objected to in appeal, the appellate authority shall give an opportunity of being heard to the Valuation Officer who made the valuation, or who may be nominated for the purpose by the assessing officer. Before the provisions for exercise of statutory functions by the Valuation Officer were introduced in the law, there was a provision for arbitration in respect of the value of any asset at the stage of appeal to the Appellate Tribunal by two valuers, appointed, one each, by the appellant and the Department, and in the case of disagreement between these valuers, by a third valuer. We have, elsewhere in this Report, recommended that Valuation Officers should not have statutory functions under the direct tax laws and that their role, if any, should be merely advisory. While making the appropriate consequential drafting changes in the provisions relating to appeals, it is not our intention to revive the earlier system of arbitration of the value by two valuers at the stage of appeal to the Appellate Tribunal. The appellate authority will consider whatever expert evidence is produced by either party before it in the matter of valuation.

Central Tax Court

II-6.10. In paragraph 11.30 of our Interim Report, we had expressed 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, and had left the matter for consideration in greater detail in our Final Report. We have since examined the matter from all aspects.

II-6.11. The problem of tax litigation in India has assumed staggering proportions in recent years. From the statistics supplied to us, it is seen that, as on 30th June, 1977, there were as many as 10,500 references under the direct tax laws pending with the various High Courts, the largest pendency being in Bombay, Calcutta, Madras, Karnataka and Madhya Pradesh. The number of references made to the High Courts in India under all the tax laws is of the order of about 3,300 in a year, whereas the annual disposals of such references by all the High Courts put together amount to about 600 in a year. In addition to these references, about 750 writ petitions on tax matters are also filed before the High Courts every year. Under the existing practice of each High Court having only

a single bench for dealing with tax matters and that too not all round the year, there is obviously no likelihood of the problem being brought down to manageable proportions at any time in the future, but, on the other hand, it is likely to become worse. Even writ petitions seeking urgent remedy against executive action take several years for disposal. The Wanchoo Committee, which had considered this problem, recommended the creation of permanent Tax Benches in High Courts and appointment of retired Judges to such Benches under Article 224A of the Constitution to clear the backlog. Although more than 6 years have passed since that recommendation was made, the position of arrears in tax matters has shown no improvement but, on the other hand, it has worsened. In this connection, it would be worth noting that the Wanchoo Committee considered an alternative course for dealing with the problem through the establishment of a Tax Court but they desisted from making any recommendation to that effect as, in their opinion, that would involve extensive amendments to law and procedures. We have directed our attention to this matter in the context of the mounting arrears of tax cases before the courts.

II-6.12. The pendency of cases before the courts in tax matters has also a snow-balling effect all along the line of appellate hierarchies inasmuch as proceedings in hundreds of cases are initiated and kept pending, awaiting the law to be finally settled by the Supreme Court after prolonged litigation in some other cases. This obviously adds considerably to the load of infructuous work in the Department and clutters up the files of appellate authorities at all levels, with adverse consequences on their efficiency. According to the figures supplied to us, out of tax arrears amounting to Rs. 986.53 crores as on 31st December, 1977, Rs. 293.26 crores (30 per cent) were disputed in proceedings before various appellate authorities and courts.

II-6.13. Apart from the delays which are inherent in the existing system, the jurisdiction pattern of the High Courts also seems to contribute to the generation of avoidable work. At present, High Courts are obliged to hear references on matters falling within their jurisdiction notwithstanding that references on identical points have been decided by other High Courts. The decision of one High Court is not binding on another High Court even on identical issues. Finality is reached only when the Supreme Court decides the issue which may take 10 to 15 years.

II-6.14. Tax litigation is currently handled by different Benches of the High Courts constituted on an *ad hoc* basis. The absence of permanent benches also accounts for the delay in the disposal of tax cases by High Courts.

II-6.15. The answer to these problems, in our view, is the establishment of a Central Tax Court with all-India jurisdiction to deal with such litigation to the exclusion of High Courts. Such a step will have several advantages. In the first place, it would lead to uniformity in decisions and bring a measure of certainty in tax matters. References involving common issues can be conveniently consolidated and disposed of together, thereby accelerating the pace of disposal.

Better co-ordination among the benches would make for speedy disposal of cases and reduce the scope for proliferation of appeals on the same issues before the lower appellate authorities, which in its turn will reduce the volume of litigation going up before the Tax Court as well. Once a Central Tax Court is established, the judges appointed to the Benches thereof will develop the requisite expertise by continuous working in this field. This would facilitate quicker disposal of tax matters and would also help in reducing litigation by ensuring uniformity in decisions.

II-6.16. In the light of the foregoing discussions, we recommend that the Government should take steps for the early establishment of a Central Tax Court with all-India jurisdiction to deal exclusively with litigation under the direct Tax laws in the first instance, with provision for extending its jurisdiction to cover all other Central Tax laws, if considered necessary in the future. We suggest that such a court should be constituted under a separate statute. As the implementation of this recommendation may necessitate amendment of the constitution, which is likely to take time, we further recommend that Government may, in the meanwhile, consider the desirability of constituting special Tax benches in the High Courts to deal with the large number of Tax cases by continuous sitting throughout the year. The Judges to be appointed to these special benches may be selected from among those who have special knowledge and experience in dealing with matters relating to direct Tax laws so that, when the Central Tax Court is established at a later date, these judges could be transferred to that Court.

II-6.17. The Central Tax Court should have Benches located at important centres. To start with, it may have Benches at the following seven places, *viz.*, Ahmedabad, Bombay, Calcutta, Delhi, Kanpur, Madras and Nagpur. Each Bench should consist of two judges. Highly qualified persons should be appointed as judges of the Central Tax Court, from among persons who are High Court judges or who are eligible to be appointed as High Court judges. In the matter of conditions of service, scales of pay and other privileges, judges of the Central Tax Court should be on par with the High Court judges.

II-6.18. The Supreme Court and, following it, the High Courts have held that the Tribunal and the tax authorities, being creatures of the Act cannot pronounce on the constitutional validity or vires of any provision of the Act; that; therefore, such a question cannot arise out of the order of the Tribunal and cannot be made the subject matter of a reference to the High Court and a subsequent appeal to the Supreme Court; and that such a question of validity or vires can be raised only in a suit or a writ petition. While an income-tax authority or the Tribunal cannot decide upon the validity or vires of the sections under which they are appointed or vires of the sections under which their powers and functions are derived, there seems to be no reason why they should be debarred from considering the validity of vires of the other provisions of the law. We recommend that the powers of the Central Tax Court in this regard should be clarified in the law itself by specifically giving it the right to go into questions of validity of the provisions of the Tax Laws or of the rules framed thereunder.

II-6.19. Another important matter, in which we consider that the present position needs improvement, is the nature of the Court's jurisdiction in tax matters. Under the present law, the High Court's jurisdiction in such matters is merely advisory on questions of law. For this purpose, the Appellate Tribunal has to draw up a statement of the case and refer the same to the High Court for its opinion. After the High Court delivers its judgment on the reference, the matter goes back to the Tribunal, which has then to pass such orders as are necessary to dispose of the case conformably to such judgment. Under this procedure, the aggrieved party before the Tribunal has to file an application seeking a reference to the High Court on specified questions of law arising out of the Tribunal's order. The hearing of such application by the Tribunal, followed by the drawing up of the statement of the case to the High Court, delays the consideration of the issues by the High Court for a considerable time. Where the Tribunal refuses to state the case as sought by the applicant, then again, the law provides for a direct approach to the High Court for issue of directions to the Appellate Tribunal to state the case to the High Court on the relevant question of law. This process also delays the consideration of the matter by the High Court for quite some time. In addition to these types of delay, there will be further delays after the High Court decides the matter, as the Tribunal has to pass consequential orders disposing of the case, before the relief, if any due, can be granted to the assessee.

II-6.20. In our view, the disposal of tax litigation can be speeded up considerably by vesting jurisdiction in the proposed Central Tax Court to hear appeals against the orders of the Tribunal on questions of law arising out of such orders. We, accordingly, recommend that the jurisdiction of the Central Tax Court should be Appellate and not advisory. We also recommend that appeals before the Central Tax Court should be heard by a Bench of two judges. Where, however, the judges do not agree, the appeal should be heard by a full Bench of three judges. The judgment of a division Bench should be binding on other division Benches of the Tax Court unless it is contrary to a decision of the Supreme Court or of a full Bench of the Tax Court.

II-6.21. In the matter of appeals before the Central Tax Court, it would be necessary to make a special provision for enabling Chartered Accountants to appear on behalf of appellants or respondents to argue the appeals before it. Legal practitioners would, in any event, be entitled to appear before the Central Tax Court. In addition, any other person, who may be permitted by the Court to appear before it, may also represent the appellant or the respondent in tax matters.

II-6.22. Our recommendation for setting up of a Central Tax Court may not be interpreted to be only a modified version of the concept of administrative and other tribunals authorised to be set up for various purposes under the amendments effected by the 42nd Amendment of the Constitution. The Central Tax Court, which we have in view, will be a special kind of High Court with functional jurisdiction over tax matters and enjoying judicial independence in the

same manner as the High Courts. The controversy generated by the 42nd Amendment to the Constitution should not, therefore, be held to militate against the proposal for the establishment of a Central Tax Court to exercise the functions of a High Court in tax matters.

Revision of Orders by Commissioner

II-6.23. Section 263 of the Income-tax Act at present empowers the Commissioner to revise the orders of the Income-tax Officer within a period of two years. There are corresponding provisions in the Wealth-tax Act, the Gift-tax Act and the Surtax Act. The time limit of two years at present runs from the date of the orders sought to be revised. This means that the date of limitation for revising orders passed at different times during any given year will expire on different dates, necessitating exercise of continuous vigilance throughout the year. In conformity with our recommendations for streamlining the provisions relating to limitation for various purposes under the tax laws with a view to securing certainty and ease in keeping track of limitation. We recommend that the time limit under section 263 should be two years from the end of the financial year in which the order sought to be revised is served on the taxpayer.

II-6.24. Section 263 at present authorises the Commissioner to revise orders of the Income-tax officer only and not of other subordinate authorities. Section 125 provides for delegation of some of the functions of the assessing officer to an Inspector of Income-tax or any member of the ministerial staff, subject to certain conditions and restrictions. The provisions of section 263, as they stand at present, may not cover orders passed by such lower authorities. Doubts may also arise whether orders passed by the Income-tax Officer in conformity with the directions of the Inspecting Assistant Commissioner or after obtaining his prior approval, orders passed by an Inspecting Assistant Commissioner exercising the powers and functions of an Income-tax officer, can be revised by the Commissioner. In order to set at rest these controversies, we recommend that the Commissioner should be given the power under this provision to revise the order of any authority subordinate to him. As we have elsewhere recommended that the first appellate authority should in all cases be of the rank of Commissioner, there will be no question of the Commissioner revising the orders of any appellate authority under this power.

II-6.25. At present, a Commissioner is not empowered to revise under section 263 an order of reassessment made under section 147 of the Income-tax Act. This restriction has apparently been provided because, formerly, all reassessment proceedings involving some default on the part of the taxpayer used to be initiated with the approval of the Commissioner. Even under the existing law, proceedings beyond four years are initiated with the approval of the Commissioner while, beyond eight years, they are initiated with the approval of the Board. The prohibition against revision of such a reassessment order should therefore continue. The Commissioner's power under section 263, however, now extends to revision of orders of fresh assessments passed under section 143(3)

after reopening an assessment made earlier under section 143(1). We have elsewhere recommended that an assessment deemed to be completed by issue of a 'tear-off slip' should be reopened only under the provisions dealing with reopening of closed assessments corresponding to the provisions presently contained in section 147 of the Income-tax Act. For ensuring that all such reassessments do not entirely go outside the scope of the Commissioner's revisionary powers, we recommend that the powers of revision under section 263 should extend to reassessments made in pursuance of proceedings initiated without the previous approval of the Commissioner or the Board.

II-6.26. Sub-section (3) of section 263 removes the time limit of two years in cases where the revision is necessitated to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court. In line with our recommendation made elsewhere in this Report for introducing an element of uniformity and certainty in the matter of limitation, we recommend that this provision in section 263(3) should be amended to secure that an order of revision under the circumstances mentioned therein may be passed at any time upto the end of the financial year next following that in which the order of the Appellate Tribunal, the High Court or the Supreme Court was received by the Commissioner.

II-6.27. The *Explanation* to section 263 provides for the exclusion of the time taken in giving an opportunity of rehearing to the assessee under the proviso to section 129 and of any period during which any proceeding for revision is stayed by an order or injunction of any court in computing the time limit of two years provided for the revision of orders. We have, elsewhere in this Report, recommended that similar provisions in connection with time limits for completion of assessments should be amended to provide that the time limit in such cases will expire on the last day of the financial year next following that in which the assessee's request for rehearing under the proviso to section 129 is received by the assessing authority or the year in which the order of stay or injunction of the court is vacated. In line with that recommendation, we recommend that for the purpose of revision of orders by the Commissioner, in a case where the assessee demands rehearing on account of a change of incumbent of the office of the Commissioner, the limitation should expire on the last day of the financial year next following that in which the demand of the assessee is received by the Commissioner. Similarly, we recommend that, in a case where the proceedings before the Commissioner are stayed by an order or injunction of any court, the limitation should expire on the last day of the financial year next following that in which the order of stay or injunction is vacated by the Court.

II-6.28. The time limit for making an application for revision to the Commissioner under section 264 is, at present, one year from the date on which the order in question was communicated to the assessee. The time limit within which the Commissioner is empowered to revise the order of a subordinate authority on his own motion under that section is one year from the date of the order. In line with our recommendations in regard to revision by the Commissioner under section 263, we recommend that the time limits under section 264(2) and section 264(3) should be increased from one year to two years and further that this period should be reckoned from the end of the financial year in which the order was communicated to the assessee.

Giving effect to orders in appeal, revision etc.

II-6.29. At present, there is no specific provision in the law requiring the assessing authority to pass a formal order giving effect to the order of the appellate authority or the Commissioner in revision although, in practice, such an order is passed by the assessing officer and communicated to the assessee. There are instances where, in the process of giving effect to an order in appeal or revision, the assessing officer misinterprets such order and the intention underlying such order gets distorted thereby. There is no clear provision in the law laying down the remedy available to the assessee in such a situation. With a view to bringing certainty in the position, we recommend that a specific provision should be made in the law requiring the assessing authority to pass an order in writing giving effect to the order in appeal, revision, etc., and also enabling the taxpayer to represent his case through a miscellaneous petition filed within 60 days of his receiving such order to the appellate authority in case he is aggrieved by the manner in which that authority's order has been given effect to by the assessing authority. The appellate authority should also be required to dispose of such an application in the same manner as if it were an appeal presented before it. We also recommend that the law should specify a time limit of six months from the end of the month in which the appellate or revisional order is received by the assessing authority for giving effect to it by passing an order under this provision.

II-6.30. There may also be cases where an altogether new point arises out of the order of the assessing authority giving effect to an order of the appellate or revisionary authority. Such a point cannot be considered as merely one arising through misinterpretation of the appellate or other order and hence it would not be appropriate to cover such a situation through a miscellaneous petition as suggested in the preceding paragraph. We recommend that an order giving effect to an order in appeal or revision should be made appealable on any new point arising out of it, in the same manner as other final orders of the assessing authority.

CHAPTER 7

SETTLEMENT OF CASES

II-7.1. This Chapter of the Management Act will incorporate the provisions at present contained in Chapter XIXA of the Income-tax Act and Chapter VA of the Wealth-tax Act. At present, the Gift-tax Act and Surtax Act do not contain provisions for settlement of cases. In the interest of uniformity, we recommend that the provisions in the Management Act relating to settlement of cases should apply to all the four taxes.

II-7.2. We have examined the provisions relating to settlement of cases in detail in Chapter 10 of our Interim Report and made several recommendations for amendment of those provisions. These recommen-

dations may be kept in view while drafting this Chapter of the Management Act. We would particularly invite attention to para 10.5 of our Interim Report wherein we had recommended 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. To enable the Settlement Commission to function effectively, we recommend that all restrictions on its powers to entertain cases in its discretion should be removed. The Settlement Commission should be authorised to admit applications even when the matter is pending before the High Court or the Supreme Court provided the taxpayer withdraws the reference to the High Court or the appeal to the Supreme Court.

CHAPTER 8

PAYMENT AND REFUND OF TAXES

II-8.1. This Chapter of the Management Act will incorporate some of the provisions at present contained in Chapter XVII-D of the Income-tax Act relating to payment in pursuance of various orders passed under that Act levying a tax or a penalty, and charge of interest for delay and levy of penalty for default in making such payment. This Chapter will also include provisions relating to defaults in deduction of tax at source and in payment of advance tax demanded under a notice issued by the assessing authority, and consequent charge of interest and levy of penalty. The Chapter will also include provisions relating to grant of interest on delayed refunds due to assesseees and provisions relating to tax clearance certificates. Thus, this Chapter will cover the provisions at present contained in sections 156, 201, 218, 220, 221, 230, 230A, 234, 241, 243, 244 and 245 of the Income-tax Act. We recommend the provisions in the Management Act in respect of these matters should apply uniformly to all the direct taxes.

Notice of Demand and Intimation of Refund

II-8.2. The Chapter will open with a provision for the issue of a demand notice whenever a demand for payment of any tax, penalty, interest or other sum arises as a result of an order passed by any direct tax authority. This provision will also require an intimation to be sent when any such order results in a refund payable to the assessee.

Assessee in default

II-8.3. The existing provision that a person on whom a notice of demand has been served for payment of any tax, penalty, interest or any other sum, and who does not make payment of the same within the time allowed for the purpose, shall be regarded as an assessee in default, will be made applicable, under the Management Act, not only to demands arising as a result of an assessment, imposition of penalty, etc., but also to demands in respect of advance tax under a notice issued by the assessing officer and in relation to tax deductible at source where the person responsible for the deduction either fails to deduct or having made the deduction, fails to pay the tax deducted to the credit of the Central Government within the stipulated period. In respect of any tax, etc., payable under a notice of demand, the assessee will be regarded as an assessee in default from the day next following the last date specified in such notice for making the payment or any later date up to which the time for payment is extended. In respect of tax deductible or deducted at source, the person responsible for making the deduction will be regarded as an assessee in default from the date on which he is so

held by an order of the concerned authority. The effect of regarding such persons as assesseees in default will be that the coercive processes of recovery will be set in motion.

Charge of interest on delayed payments

II-8.4. Under the present law, the liability for charge of interest for non-payment of the taxes demanded commences from the date of expiry of the time originally allowed for payment in the notice of demand. In respect of tax deductible or deducted at source, interest is, at present, chargeable from the date on which it was deductible. However, no interest is now chargeable in respect of defaults in payment of any advance tax instalment due under a notice issued by the Income-tax Officer or under an estimate made by the taxpayer. With a view to streamlining the existing provisions and facilitating interest calculations, we recommend that interest for delay in payment of tax, including advance tax, payable under a notice of demand should be reckoned from the first day of the month next following the month in which the amount was payable under such notice. In respect of tax deductible or deducted at source, the interest should be reckoned from the first day of the month following that in which it was deductible. In all cases, the interest should be charged up to the last day of the month in which the amount is paid. The existing rate of interest of 12% per annum will continue.

II-8.5. The existing rules require that interest on outstanding tax demands should be calculated at the end of every financial year and that a demand notice should be issued to the assessee for such interest. This has resulted in a certain amount of infructuous work inasmuch as, where the assessment is under appeal, the addition of interest on the disputed demand from year to year merely results in unduly inflating the arrears without any collection being made so long as the original demand itself is in dispute. After the appeal is decided, the original demand may get reduced and the interest calculations have also to be revised. Secondly, after the issue of a demand notice for interest, the view is held that interest becomes chargeable even on such interest. This is opposed to the provision in the law that *simple interest* at 12% per annum is chargeable on tax arrears. In order to remove all these practical difficulties and eliminate unproductive work, we recommend that interest should be calculated and recovered only after the tax demand has become final and it has been fully paid or recovered. It is also desirable that the taxpayer is furnished with a formal order showing how the interest is worked out and a demand notice issued for the amount of interest. The law should also make it

clear that interest should be charged only on outstanding tax and not on penalty, interest or any other sum.

Penalty for non-payment of tax

II-8.6. As regards penalty for non-payment of tax, we recommend that the provision in the Management Act should make it clear that an assessee will be liable to pay penalty for default in payment of regular tax, for default in making deduction of tax at source or in paying the tax deducted to the credit of the Central Government, and for default in payment of advance tax demanded by a notice issued by the assessing authority. Under the existing law, no penalty is leviable in respect of default in payment of penalty, interest or any other sum. The existing provision for giving an opportunity to the defaulter to be heard before levy of penalty and the discretion of the assessing authority not to levy a penalty if he is satisfied that the default is for good and sufficient reason, will continue. However, we recommend that the relevant provision in the Management Act should make it clear that the onus of establishing the existence of good and sufficient reasons will be on the assessee.

II-8.7. Section 221(2) of the Income-tax Act at present provides for cancellation of the penalty levied for non-payment of tax in a case where the tax in question is wholly reduced as a result of appeal, etc. There is no provision for proportionate reduction of the penalty in a case where the tax is only partly reduced. The absence of such a provision compels the assessee to go in appeal against the penalty whenever the assessment is disputed in appeal. In order to eliminate such infructuous appeals and to secure justice to the taxpayer, we recommend that there should be a provision for proportionate reduction of the penalty in cases where the tax with reference to which the penalty was imposed is partly reduced as a result of appeal, revision, etc.

Grant of interest on delayed refunds

II-8.8. In the matter of grant of interest on delayed refunds, the existing provisions in the Income-tax Act make a distinction between cases of taxpayers having income consisting solely of interest on securities or dividends or both, on the one hand and other taxpayers, on the other. In the former type of case, interest becomes payable to the assessee if the refund is not granted within a period of three months from the end of the month in which the claim for refund is made whereas, in any other case, eligibility for interest arises only if the refund is not granted within three months from the end of the month in which the total income is determined by making an assessment. In the context of our approach in the Interim Report that assessments in the large majority of cases should be completed by acceptance of returns and that assessee should be required to file, all tax returns by 30th June and buy time thereafter upto 30th September on payment of interest, the existing provision for allowing interest in cases where refund is not granted within three months from the end of the month in which the claim for refund is made, will cease to have any significance. In the circumstances, we recommend that the provision for grant of interest

on delayed refunds should, in all cases, take effect only if the refund is not granted within three months from the end of the month in which the assessment is completed. In any event, there should be no question of the Government paying interest on refunds due to the assessee for any period prior to 1st October of the assessment year.

II-8.9. The existing provisions in regard to refunds arising as a result of assessment on the one hand, and refunds arising as a result of orders in appeal, revision etc., on the other, contemplate the grant of interest upto the date of the "order granting the refund" in the former case and the date on which the "refund is granted" in the latter case. There are doubts and disputes about the significance of these two terms. With a view to introducing certainty in the matter and ease in interest calculations, we recommend that, in all cases where interest becomes payable to the assessee on a delayed refund, the same should be reckoned upto the last day of the month preceding the month in which the refund voucher or cheque is issued to the assessee. As the date upto which the interest runs would thereby become ascertainable, we further recommend that the appropriate amount of interest should be added to the refund of tax, etc., in the same refund voucher or cheque. The format of the refund voucher or cheque should provide for showing the amount of interest separately from the amount of tax or other sum which is being refunded.

Form of refund voucher

II-8.10. The form of refund voucher at present is a formidable document containing various certificates to be signed by the assessing authority justifying the grant of refund. In our view, these certificates are not relevant or of any interest to the taxpayer but are required only for the purpose of the Department's records. We, accordingly, recommend that the refund order should be, broadly, in the form of a cheque, whereas the certificates etc., may be incorporated in the counterfoil to be retained with the department.

II-8.11. Under section 245, any refund due to an assessee may be set off against any other sum remaining payable by him under the Act. We recommend that the provisions of this section should be extended to cover amounts payable under other direct tax laws also and the assessee should also be given the right to ask for adjustment of refunds against demands payable and, in that event, the date of receipt of the request from the assessee should be taken to be the date of adjustment for the purpose of calculating interest payable or receivable. Where any refund is adjusted by the Income-tax Officer against demand, the date of passing the order for adjustment should be taken to be the date of payment of tax and grant of the refund.

Tax accounts

II-8.12. Suggestions have been made that a system of "Tax Accounts" with public sector banks may be introduced, with a view to simplifying the procedures involved in payment of taxes and the maintenance of records relating to the same. Under this system, a taxpayer will have a tax account, identified by his Permanent Account Number, in a public sector bank,

which will be used exclusively for recording his tax transactions with the Department. Taxes due will be paid into this account by the account-holder through challans as at present. The amounts paid into this account will be held by the bank to the credit of the Central Government and the account-holder will have no further control over such amounts. The advantage of this system will be that all the tax payments by a particular assessee will get recorded in a single account. The bank will transmit the payments to the Reserve Bank from time to time. When refunds are due to the taxpayer on the basis of an assessment or an order in appeal, etc., the bank will be advised to that effect by the assessing authority and it will encash the refund cheque given to the assessee through his tax account. Thus, all refunds will also get recorded in the tax account of the assessee. The bank will send periodical statements showing the state of the tax account to the taxpayer as well as to the Department to serve as proof of the tax payment to the former in addition to the challan receipt, and to the Departments as a running account of tax payments and refunds pertaining

to a particular taxpayer. Such a system will have several advantages. The taxpayer will be in a position to ascertain the payments he has made from time to time towards taxes and the refunds he has received, as these would be recorded in his tax account chronologically, separately from his other financial transactions. From the point of view of the Department, the system will provide a record of all payments made by a taxpayer and refunds allowed to him at one place. The tax account will ensure proper accounting of tax payments and the taxpayer will be saved the trouble of retaining receipts for such payments with him as protection against possible future demands for non-existent tax liabilities. We recommend that Government may consider the introduction of a system of tax accounts in public sector banks, on a compulsory basis in the case of companies and other big taxpayers and on a voluntary basis in the case of other taxpayers. This would, however, require discussion with the Reserve Bank of India and the public sector banks to enlist their co-operation in drawing up a scheme which can be successfully and effectively implemented.

CHAPTER 9

RECOVERY OF TAXES

II-9.1. This Chapter of the Management Act will incorporate all the provisions of the Income-tax Act dealing with coercive recovery processes, which now appear in sections 222 to 229, 231 and 232 of, and the Second and Third Schedules to, the Income-tax Act. These provisions in the Management Act will apply uniformly to all the four direct taxes.

Tax Recovery Officers

II-9.2. The existing provisions in section 222 envisage the issue of a recovery certificate by the Income-tax Officer to another functionary known as the Tax Recovery Officer, specifying the amount of taxes, etc., due from the assessee in default. Thereupon, the Tax Recovery Officer becomes seized of the matter and he is expected to realise the outstanding amount by the processes set out in detail in the Second Schedule. These provisions for recovery of taxes by Tax Recovery Officers were introduced in the law to facilitate the Department taking over the recovery functions from the State Governments which were formerly handling this work through their revenue recovery machinery. The institution of Tax Recovery Officers has now been in existence for more than a decade but the process of recovery of outstanding taxes cannot be said to have been speeded up or improved significantly.

II-9.3. There are several reasons for this situation, most of which are organisational in nature, in that the issue of recovery certificates by the assessing officers and the process of recovery by the Tax Recovery Officers on the basis of such certificates have generated an enormous amount of unproductive work. There is also lack of co-ordination between the two wings of the Department, resulting in inflated arrears being certified to the Tax Recovery Officers, causing harassment and inconvenience to a large number of taxpayers who have already paid up their taxes. The procedure has also generated a degree of indifference on the part of the assessing officers who tend to neglect the recovery work once the certificate has been issued to the Tax Recovery Officer. The Tax Recovery Officers have to duplicate the records maintained by the Income-tax Officers, such as demand and collection registers, in all cases in which certificates have been received by them and they have to issue various notices which are also largely a duplication of the demand notices already issued by the Income-tax Officers. Due to the communication gap between the two functionaries, recoveries made by one do not get recorded in the registers of the other. This results in harassment of the innocent and law abiding taxpayers. At the same time, owing to the large volume of infructuous work, the Tax Recovery Officers do not have the time to pursue the hardened tax dodgers.

II-9.4. We have given careful consideration to all the aspects of this problem and we are of the view that it is now time to integrate the recovery functions with the assessment functions and end the present dichotomy between the assessing officer and the Tax Recovery Officer. We accordingly recommend that the institution of Tax Recovery Officers should be done away with. The provisions in the Management Act corresponding to section 222 should authorise the assessing officer himself to issue a show cause notice to the defaulter and, thereafter, proceed to recover the taxes by applying the various methods set forth in that section and in the Second Schedule. We also recommend that the rules for recovery of taxes in the Second Schedule should be included as sections in this chapter of the Management Act with appropriate drafting changes to enable the assessing officers to exercise these powers instead of the Tax Recovery Officers.

II-9.5. There may, no doubt, be cases in which the properties of the defaulter are scattered in the jurisdiction of different assessing officers or even in different States. In a few hardened cases, it may also be necessary to devote concentrated attention to the recovery work through attachment and sale of movable and immovable properties, appointment of a receiver or even by arresting the defaulter and committing him to civil prison. The existing provisions in the law relating to jurisdiction of assessing officers are sufficiently flexible to allow functionalisation of the recovery work in such cases with selected officers according to needs.

II-9.6. Rules 86 and 87 of the Second Schedule provide for appeal against and review of orders of the Tax Recovery Officer. We recommend that these provisions should continue, with appropriate modifications and the appeal against the order of the assessing officer in recovery matters should lie to the Commissioner to whom he is subordinate, and not to the Commissioner (Appeals). The order of the Commissioner in such appeal should be final.

Limitation for Commencement of Recovery

II-9.7. Section 231 lays down the time limit for commencement of recovery proceedings. At present, this is one year from the end of the financial year in which the demand is made or in the case of a person who is deemed to be an assessee in default from the end of the year in which he is deemed to be an assessee in default. Although there are provisions which extend the period of limitation in specified circumstances, the tendency on the part of the assessing officers

is to issue recovery certificates in the month of March in respect of all demands for which demand notices were served during the preceding financial year. This is also responsible for the large number of certificates with Tax Recovery Officers on which they could ordinarily take no action due to the pendency of appeals, rectification claims, etc. In order to obviate such infructuous and unproductive work, it is necessary to ensure that the issue of the show-cause notice to the defaulter by the assessing officer himself is not required to be made until the tax demands have attained a reasonable state of finality. **We accordingly recommend that the notice of commencement of recovery proceedings should be permitted to be issued at any time before the expiry of three years from the end of the financial year in which the demand was made or in which the person concerned is deemed to be an assessee in default.**

II-9.8. The law provides for the extension of the period of limitation for commencement of recovery proceedings, in cases where such proceedings have been stayed by an order of a court. This provision does not, however, cover stay of recovery proceedings

by the Appellate Tribunal. This lacuna in the law necessitates the issue of recovery certificate even though the recovery has been stayed by the Tribunal. In the context of the changes suggested by us for elimination of infructuous work, we recommend that the provision for extension of time in cases where recovery proceedings are stayed by any court should be made applicable also to the stay of such proceedings by the appellate Tribunal.

Miscellaneous

II-9.9. Section 281 of the Income-tax Act deems certain transfers to be void where these are made during the pendency of any proceedings under that Act or during the interval between the completion of such proceedings and before the service of a notice for recovery of taxes by the Tax Recovery Officer. Section 281B of the Income-tax Act provides for provisional attachment of assets of any person to protect the revenue. Both these provisions are intimately connected with the recovery of taxes. **We, therefore, recommend that these provisions should be incorporated in this chapter of the Management Act with appropriate changes.**

CHAPTER 10

LIABILITY IN SPECIAL CASES

II-10.1. This Chapter will incorporate the procedural provisions contained in Chapter XV of the Income-tax Act and the corresponding provisions in the other direct tax laws. Some of the provisions in Chapter XV of the Income-tax Act are substantive in nature, such as sections 164 and 165 relating to taxation of discretionary trusts. These provisions will form part of the substantive law, and should not be included in the Management Act. Section 171, relating to assessment after partition of a Hindu undivided family, is essentially procedural in character even though some of its provisions may be regarded as substantive. However, as the procedural provisions are not severable, the whole of section 171 should be incorporated in the Management Act. Section 172 is partly procedural and partly substantive. The substantive portion, which is severable from the rest, should be incorporated in the substantive law, along with the special provision in section 44B of the Income-tax Act which deals with the same subject matter. The rest of section 172 should be incorporated in the Management Act. Section 180 is also substantive in nature and should be grouped with sections 44 to 44D in the substantive law. The same remarks apply to section 181 which imposes a tax liability on the State Government in respect of income-tax on the interest on a tax-free security issued by it.

Representative Assessee

II-10.2. Section 160 defines "representative assessee" for the purposes of the Income-tax Act. While incorporating these provisions in the Management Act, it should be ensured that these provisions apply uniformly to Wealth-tax, Gift-tax and Surtax as well. Another aspect to be kept in view in this connection is the status of a trustee under an oral trust. The provision, as it stands at present, covers only a trustee appointed under a trust declared by a duly executed instrument in writing. In order to ensure certainty and completeness, we recommend that this provision may be enlarged to cover a trustee appointed under an oral trust also.

Assessment of executors

II-10.3. Sections 168 and 169 of the Income-tax Act deal with the assessment of executors. The corresponding provisions in the Wealth-tax Act are contained in section 19A. Under the Wealth-tax Act the executor or executors are to be assessed in the status of an "individual", even though there are two or more executors, whereas, under the Income-tax Act, the assessment will be in the status of an individual, if there is only one executor, but that of an association of persons, if there are two or more executors. The provision in the Wealth-tax Act is more

rational and in keeping with the legal position of executors under the general law. Accordingly, we recommend that the provision in the Management Act corresponding to section 168 should be so drafted as to ensure that, even where there are two or more executors, the assessment will be made in the status of an "Individual" both for Income-tax and Wealth-tax.

Assessment after partition of Hindu undivided family

II-10.4. Section 171 of the Income-tax Act deals with the assessment after partition of a Hindu undivided family. Sub-section (1), as it is worded, comes into operation only in the case of a family which has been assessed as undivided at any time in the past and then goes on to provide that such a family will continue to be assessed as a Hindu undivided family, except where and insofar as a finding of partition has been recorded by the Income-tax Officer. This causes practical difficulties in assessing a Hindu undivided family which has successfully evaded assessment for any year and it is found (after the family has disrupted) to have had taxable income for such past year. To remove this lacuna, we recommend that the provision in the Management Act corresponding to section 171 may be made applicable to a Hindu undivided family assessable as such for any year, whether or not the family had actually been so assessed at any time in the past, and it may be provided that the status of Hindu undivided family will continue as such, except where and insofar as a finding of partition is recorded by the assessing authority.

Discontinued Business or Profession

II-10.5. Section 176 of the Income-tax Act deals with assessment of a discontinued business or profession. Sub-section (3A) and sub-section (4) of the section are substantive in character, inasmuch as, under these sub-sections, any sum received after the discontinuance of a business or profession is deemed to be the income of the recipient and charged to tax in the year of receipt if such sum would have been included in the total income of the person who carried on the business or profession had it been received before such discontinuance. In Part I of this Report, we have recommended that these provisions should be made part of section 28 in the substantive law and that a specific provision should be made for the allowance of expenses incurred for the recovery of the outstanding sums in arriving at the taxable income. Sub-sections (3A) and (4) may, therefore, be omitted while incorporating the provisions of section 176 in the Management Act. The provision in sub-section (5) of section 176 is merely a duplication of the provision contained in section 284 relating to service of notice.

As the latter section is more comprehensive and will be incorporated in Chapter 13 of the Management Act, it is not necessary to repeat the provision in the present Chapter.

Liability of Directors of Private Company

11-10.6. Section 179 casts a liability in respect of tax due from a private company on its erstwhile directors. The section was substantially amended and enlarged in its scope recently in pursuance of the recommendations of the Wanchoo Committee. Under this provision, while every person who was a director of a private company at any time during the relevant previous year will be jointly and severally liable for the payment of any tax due from the private company in respect of that previous year which could not be recovered from the company such liability will not attach to any director who proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. This implies that every

director should be given an opportunity to show cause why the liability in respect of the company's tax arrears which could not be recovered from the company should not be enforced against him, before such liability is actually enforced. The section, however, is silent on this procedural aspect. The section is also silent on the question of any time limit for fastening of the liability on the erstwhile director. To avoid controversy and in the interest of natural justice, we recommend that a specific provision should be made requiring the assessing authority to give an opportunity of being heard to any director of a private company before the latter is fastened with the tax liability of the company which could not be recovered from it and also requiring such authority to pass a formal order holding such director to be liable for such tax (where justified) and specifying the amount for which he is so liable. We also recommend that such an order should be made appellable. We further recommend that a time limit of two years from the end of the financial year in which the tax due from the company is found to be not recoverable from it, should be laid down for passing an order holding the director to be liable for such tax.

CHAPTER 11

REGISTRATION OF FIRMS, ASSOCIATIONS OF PERSONS AND BODIES OF INDIVIDUALS

II-11.1. This Chapter will incorporate the provisions at present contained in Chapter XVI of the Income-tax Act and will be relevant for the purpose of income-tax only. These provisions have already been reviewed by us in the Interim Report wherein we have made several recommendations for streamlining these provisions so as to make them simpler in operation and remove some of the existing lacunae and bottlenecks.

II-11.2. Elsewhere in this Report, we have recommended that the scope for evasion or reduction of tax liability by forming association of persons to carry on profit-making activities, in preference to partnership firms, should be curbed by imposing a high flat rate of tax on an association of persons, in the same manner as in the case of an unregistered firm, unless it satisfies certain conditions. At the same time, we have recommended that the income of an association

of persons which registers itself with the tax authorities in the prescribed manner should be subjected to tax only in the hands of its members at the appropriate rate of tax applicable to their total incomes and not at the high flat rate.

II-11.3. In the case of a "body of individuals", we have recommended elsewhere that no tax should be levied on the 'body' as such and the members should be taxed on their shares in the income of the body provided the body gets itself registered in the same way as applicable in the case of firms and associations of persons and that the income should be assessed by treating the body of individual as a unit of assessment only where it does not so register itself.

II-11.4. We accordingly recommend that the procedure for registration of partnership firms on the lines recommended by us in our interim report should be made applicable, mutatis mutandis, to registration of association of persons and bodies of individuals also.

CHAPTER 12

OFFENCES AND PROSECUTIONS

II-12.1. This Chapter of the Management Act will incorporate the provisions at present contained in Chapter XXII of the Income-tax Act and the corresponding provisions in sections 35A to 35N and section 36A of the Wealth-tax Act, sections 35 to 35C of the Gift-tax Act and sections 20 to 23 of the Surtax Act. The provisions relating to prosecution in the Income-tax Act and Wealth-tax Act have been extensively amended pursuant to the recommendations of the Wanchoo Committee so as to increase their deterrent effect in combating tax evasion. While integrating the provisions relating to offences and prosecutions so as to make them apply uniformly for all direct taxes, care should be taken to ensure that the provisions in 275A, dealing with prosecution for contravention of an order under section 132(3) prohibiting the person concerned from removing books of accounts, etc., are confined in their operation to income-tax, wealth-tax and surtax only and do not extend to gift-tax. Sections 276A and 276B are relevant only for the purpose of Income-tax, and the corresponding provisions in the Management Act should therefore apply accordingly.

Failure to furnish Tax return

II-12.2. Under section 276CC of the Income-tax, prosecution for failure to furnish the return of income would lie only if the tax payable on the total income determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source exceeds Rs. 3,000/-. Having regard to the prevailing circumstances, we recommend that this limit may be raised to Rs. 5,000/- and that the increased limit may be applied uniformly for the purpose of all the direct taxes.

Failure to Produce Accounts, etc.

II-12.3. Section 276D of the Income-tax Act prescribes rigorous imprisonment upto one year or a monetary fine or both, for failure to produce accounts, documents, etc., called for by notice and for failure to get the accounts audited where so directed by the assessing authority. The punishment provided under the corresponding provision in section 35C of the Wealth-tax Act is similar. However, under the Gift-tax Act and Surtax Act there is only a monetary fine for such defaults. In the context of integration of the procedural provisions of the four direct taxes, we recommend that the provision in the Income-tax Act and Wealth-tax Act in this respect may be made uniformly applicable to all the four taxes.

False Statement in verification by person seeking registration as registered valuer.

II-12.4. Section 35E of the Wealth-tax Act provides for the prosecution of a person seeking registration as a registered valuer for making a false statement in a verification in the application for registration. Although, elsewhere in this Report, we have recommended that Valuation Officers should not exercise statutory functions but that their role, if any, should be merely advisory, the institution of registered valuers should continue. Such registered valuers are concerned with matters relating to valuation under the Income-tax Act, the Wealth-tax Act and the Gift-tax Act. The provisions of section 35E of the Wealth-tax Act should be incorporated in the Management Act.

Conditions for launching prosecution

II-12.5. Section 279 provides that prosecution should be at the instance of the Commissioner and that the Commissioner should have the power to compound any offence before or after launching prosecution. The Wealth-tax Act, the Gift-tax Act and the Surtax Act contain similar provisions. These provisions should be incorporated in the Management Act. The Income-tax Act and the Wealth-tax Act also provide that no prosecution should be launched in a case where penalty for concealment has been reduced or waived. The power to waive or reduce penalty extends to various other types of defaults in respect of which the law provides for prosecution as well. We recommend that no prosecution should be launched for any default in respect of which the penalty levied or leviable has been waived or reduced.

Disclosure of particulars by public servants

II-12.6. Section 280 of the Income-tax Act authorises prosecution of a public servant for disclosing information in contravention of the provisions of section 138(2). There are no corresponding provisions in the other direct tax laws. In the context of the integration of the procedural provisions, including those relating to disclosure of information, and their application uniformly to all the four direct taxes, we recommend that the provision in section 280 should also be included in the Management Act and made applicable to unauthorised disclosure of information relating for all direct taxes.

Other Provisions

II-12.7. Sections 291, 292 and 292A, appearing in Chapter XXIII—Miscellaneous, of the Income-tax Act, relate to prosecutions for tax offences, and should more appropriately be included in this Chapter of the Management Act. These provisions, with their counterparts in the Wealth-tax Act and Gift-tax Act, should apply uniformly for all direct taxes.

Fraudulent removal, etc., of property with intent to thwart recovery of taxes

II-12.8. Rule 89 of the Second Schedule to the Income-tax Act provides that whoever removes, conceals, transfers, etc., property to thwart recovery proceedings shall be deemed to have committed an offence punishable under section 206 of the Indian Penal Code. This provision, in our view, should be replaced by a provision in the Management Act for the prosecution of such a person, under the Management Act

itself instead of under the Indian Penal Code. This provision is similar to that contained in section 275A of the Income-tax Act for the prosecution of a person who removes, parts with or deals with the assets covered by a prohibitory order issued under section 132(3). Accordingly we recommend that the provision in the Management Act, corresponding to rule 89 of the second schedule to the Income-tax Act, should form part of this chapter and that the punishment for such an offence should be the same as provided under section 275A.

CHAPTER 13

MISCELLANEOUS PROVISIONS

II-13.1. This Chapter of the Management Act will incorporate such of the provisions at present contained in Chapter XXIII of the Income-tax Act, Chapter VIII of the Wealth-tax Act and Chapter VIII of the Gift-tax Act, as do not appropriately fall within the purview of the other Chapters of the Management Act or are not specifically recommended by us for being placed in any other Chapter. We have already recommended, elsewhere in this Report, that sections 281 and 281B should be placed in Chapter 9 dealing with recovery of taxes. The provisions in sections 281A, 288A and 288B are relevant for the purposes of assessment and should be included in Chapter 4—Assessment procedure.

Service of Notice

II-13.2. Section 282 deals with service of notices generally and, in the main, provides that a notice or requisition under the Act may be served on the person named therein either by post or as if it were a summons issued by a court under the Code of Civil Procedure. The rules governing services in the Code of Civil Procedure are thus made applicable for the purposes of service under the Income-tax Act. However, rules in the Code of Civil Procedure are liable to amendment and it may happen that such amendments do not come to the knowledge of the assessing officers immediately and, in the absence of such knowledge, service of a notice, which would have been valid under the old procedure, may turn out to be invalid because of the amendment. To avoid such situations and to impart certainty and definiteness to the service of notices under the direct tax laws, we recommend that the relevant rules in the civil procedure Code may be incorporated in the Management Act.

II-13.3. We have, in Chapter 3—'Pre-assessment payment of taxes' recommended that returns in respect of deductions of tax at source from various categories of income subject to such deductions should be required to be furnished at yearly intervals on the lines of the existing annual salary returns. Sections 285 and 286 which require submission of returns in respect of payments by way of interest other than interest on securities and by way of dividends, respectively, will be covered by the general provisions as suggested, and should not therefore be included in this Chapter of the Management Act. Sections 285A and 285B, which require submission of information by contractors and by producers of cinematograph films, respectively, should, more appropriately, be incorporated in the Chapter—Administration, along with other provisions empowering the assessing officer to elicit information on various matters relevant for tax purposes. Similarly, section 287 authorising publication of information, should also find a place in that Chapter

along with the provisions relating to disclosure of information.

Appearance by Registered Valuer

II-13.4. Section 287A provides for the appearance by a registered valuer to represent an assessee before any income-tax authority or the Appellate Tribunal in connection with the valuation of an asset. There are detailed provisions in sections 34AA, 34AB, 34AC and 34AD of the Wealth-tax Act regulating the registration of valuers and their appearance on behalf of taxpayers before the tax authorities and the Appellate Tribunal, and placing certain restrictions on their practice. These provisions are applicable for the purposes of income-tax and gift-tax also. We recommend that the provisions relating to registered valuers in the three acts should be incorporated in a single section and placed in this chapter of the Management Act.

Appearance by authorised representative

II-13.5. Section 288 of the Income-tax Act regulates appearance by authorised representatives on behalf of assessee in tax proceedings. These provisions have been made applicable to wealth-tax, gift-tax and surtax as well. While incorporating these provisions in the Management Act and making them applicable uniformly for all the direct taxes, we would suggest certain modifications therein, as detailed in the following paragraphs.

II-13.6. Sub-section (2) of section 288 lays down the qualifications of an authorised representative. It has been represented to us that experience for a number of years as an income-tax authority should be acceptable as adequate qualification to represent an assessee in tax proceedings. The system of recruitment of officers to the Income-tax Service and their training ensure that even those coming into the service from disciplines other than law or commerce, get adequate training and experience in law and accounts. We do not see any reason why such persons, particularly after practical experience in administering the tax laws for a number of years, should not be regarded as competent to represent taxpayers after leaving government service, even if they do not have a degree in law or commerce. We, accordingly, recommend that a person who has a minimum of 10 years' service as an Income-tax authority not below the rank of a Direct Taxes Officer should be declared eligible to represent an assessee before any tax authority or the appellate tribunal, after leaving the service.

II-13.7. Sub-section (3) of section 288 places a two-year ban on practice by a person who resigns or retires after having served for a minimum period of

three years as an Income-tax Officer or in any higher position in the Department. Representations have been made before us that this restriction is irrational. It has been pointed out that judges, after resignation or retirement, are allowed to practise as advocates without any break. Even High Court Judges are allowed to practice before other High Courts. Section 288(3) does not apply to a person who retires after having served as a member of the Appellate Tribunal. The present provision merely encourages clandestine practice by ex-Income-tax authorities taking shelter behind relations or friends already in the profession. We, accordingly, recommend amendment of section 288(3) to secure that a person who has retired or resigned from service as a direct taxes authority, not below the rank of a Direct Taxes Officer, shall not be entitled to practise for two years at any station where he had served at any time during the two years preceding the date of his leaving the service without placing any such restriction against his practising at any other station. We further recommend that even this restriction should not apply for appearance before the appellate tribunal

II-13.8. Section 289 of the Income-tax Act provides that a receipt shall be given for money paid or recovered under the Act. There is no such provision

in the other direct tax laws. Having regard to the state of records in the Income-tax Department, we feel that such a statutory requirement is necessary. We recommend that section 289 of the Income-tax Act should be incorporated in the Management Act and made uniformly applicable to all the four direct taxes.

II-13.9. As regards the remaining sections in the Miscellaneous Chapter of the Income-tax Act, sections 291, 292 and 292A should more appropriately be placed in the Chapter—Offences and prosecutions, in the Management Act. Section 292B, saving returns, etc., from being invalidated on technical grounds, should find a place in the Chapter—Assessment procedure. Section 293, barring civil suits in revenue matters, should find a place in the Chapter—Appeals, references and revisions. Section 294 is a substantive provision relevant for the purpose of rates of tax and has no place in the Management Act. Sections 294A, 295, 296 and 298 should more appropriately, be placed in the Chapter—Administration. We have elsewhere recommended that transitional provisions of the type contained in section 297 of the Income-tax Act will not have any particular advantage and have recommended that all the new provisions should commence with effect from a particular assessment year.

CHAPTER 14

APPROVALS UNDER THE TAX LAWS

II-14.1. This Chapter will lay down the procedures for grant of approval, for the several purposes of the tax laws, by the Central Government, the Board, the Commissioner or any other specified authority. In particular, this Chapter will incorporate the provisions at present contained in the Fourth Schedule to the Income-tax Act relating to recognition of provident funds and approval of superannuation funds and gratuity funds and will also include the more important provisions relating to these matters at present contained in the Income-tax Rules.

Approval by Central Government Board, etc.

II-14.2. There are several provisions in the Income-tax Act which require approval of the Central Government, the Board, the prescribed authority or the Commissioner, before certain tax concessions or benefits become available. Such provisions include approval of agreement for supply of technical know-how or rendering of technical services; contract of employment of foreign technicians in Indian concerns, contract of service of professors, teachers and research workers of foreign nationality in India; sports associations; professional institutions; universities and other research institutions, hotels catering to tourists; scheme of amalgamation of companies; agreement relating to borrowing of money from foreign sources for industrial development in India; awards for literary, etc., work; gallantry awards; etc. Where such approval is required to be accorded by the Central Government, this is interpreted to mean approval by the administrative Ministry dealing with the subject. Thus, hotels catering to tourists are approved by the Ministry of Tourism, agreements for supply of know-how for rendering of technical services are approved by the Ministry of Industrial Development or the Ministry of Steel or the Ministry of Petroleum and Chemicals, etc., universities and research institutions are approved by the Secretary in the Department of Science and Technology, the Indian Council of Medical Research, the Indian Council of Social Science Research, the Indian Council of Agricultural Research, etc. Under many other provisions, the approval is required to be granted by the Board. Ordinarily, where the administrative Ministry grants an approval which carries a tax benefit with it, the matter is processed in consultation with the Board; where the Board is the approving authority and the matter relates to a subject dealt with by any other Ministry, the Board consults that Ministry before according approval. With a view to ensuring uniformity of approach and certainty in the availability of tax benefits if the prescribed procedures are followed by taxpayers, we recommend that applications for approval of agreements, contracts, schemes, etc. for various purposes under the direct tax laws should invariably be submitted to the board even where the

approval is to be granted by the administrative Ministry concerned. The Board can then process the matter in consultation with the administrative Ministry, where necessary, and have the approval of the Central Government accorded by such Ministry. Such a procedure will ensure that the taxpayer has to deal only with the Board and not with the Ministries or other authorities for approval. We further recommend that the procedures for making such applications, the forms to be used and the guidelines which would regulate such approvals, should be laid down in the rules.

II-14.3. There are often undue delays in the grant of approvals by the Government or the Board which cause considerable inconvenience to taxpayers and leave them in a state of uncertainty. We recommend that a provision should be made in the law whereby such approval will be deemed to have been given if an application is not finally disposed of within a period of 120 days from the date of receipt of the application by the Board.

Provident and other funds

II-14.4. The Fourth Schedule to the Income-tax Act contains rules governing the recognition of provident funds, approval of superannuation funds and approval of gratuity funds. These rules are contained in Parts A, B and C, respectively, of the Fourth Schedule and are supplemented by the rules in Parts XII, XIII and XIV of the Income-tax Rules. The use of the term "recognition", in relation to provident funds and a different term "approval", in relation to superannuation funds and gratuity funds, seems to be a historical accident. In the interest of uniformity in terminology, we recommend that the term "approval" may be used in relation to all the three categories of funds.

II-14.5. The rules in the Fourth Schedule and in the Income-tax Rules in this behalf display several minor variations in matters of detail, which do not have any rationale or significance. Thus, in respect of provident funds, the application for recognition is required to be made to the Commissioner through the Income-tax Officer, whereas, in respect of superannuation funds and gratuity funds, the application for approval is required to be made to the Income-tax Officer, although in these cases too, the approval is ultimately to be granted by the Commissioner. Again, the rules relating to the procedure for making the application are contained in the Income-tax Rules in the case of provident funds but in the Fourth Schedule in the case of superannuation funds and gratuity funds. In the case of provident funds, there are specific provisions in rule 74 of the Income-tax Rules, governing

maintenance of accounts and furnishing of certified copies thereof to the Commissioner. There are no corresponding provisions in relation to superannuation funds or gratuity funds. Even in the case of provident funds for which maintenance of accounts is required by the rules, there is no requirement that such accounts should be audited. In the matter of the date from which the recognition or approval is to take effect, while in the case of provident funds, the Commissioner has the authority to make the recognition effective from the 1st April of the financial year in which the application is received, there is no specific provision in this regard in the case of superannuation funds and gratuity funds and the Commissioner is apparently free to accord approval from any date of his choice. Although there are provisions for the withdrawal of recognition in respect of all the three funds, there is no effective machinery to exercise control over the funds and ensure their compliance with the requirements of the rules.

II-14.6. In the interest of uniformity and certainty and with a view to enabling the Department to ensure that approved funds continue to comply with the requirements of the rules in this behalf, we make the following recommendations in this regard :—

- (1) The provisions in the Management Act Governing the grant of approval to all the three funds should specify certain general rules applicable to all the three funds, followed by special rules applicable to each type of fund. The general rules should cover such matters as procedure for making the application; requirements regarding maintenance of accounts and audit of such accounts; investment of fund moneys; grant of approval and withdrawal of approval; date from which approval is to take effect; appeal against refusal or withdrawal of approval; and amendments to the rules of an approved fund.
- (2) As the approval of these funds carries important tax benefits, both to the employer and to the employees, particularly for the later who are large in number and whose assessments are generally centralised in salary circles, the applications for approval should in all cases, be required to be addressed to the commissioner having jurisdiction over the salary circle and routed through the specified assessing officer of such circle. This will have the advantage that the work of scrutinising the application can be handled by officers, specialising in such work, thereby ensuring uniformity in approach and speed in disposal, while the work of granting approval will be centralised with one Commissioner, instead of being with a number of Commissioners in big cities like Bombay, Calcutta, etc. The work of monitoring the approved funds and ensuring that they continue to observe the rules, will also be rendered easier.
- (3) All funds which have been granted approval should be required to maintain proper ac-

counts containing essential particulars specified in this behalf and get these audited every year. The auditors should be required to certify that the fund in question continues to satisfy the conditions of approval. Copies of accounts, along with auditor's certificate should be required to be furnished to the designated income tax officer by a specified date every year, together with such other particulars as may be prescribed. It may also be laid down that the accounts should be maintained in India and all fund money should be invested in India.

- (4) There should be uniform provisions governing the investment of fund moneys in the case of all the three categories of funds. Under the present rules, keeping moneys in a savings account or short-term deposit in a Bank is not permitted. This disability should be removed and fund moneys may be permitted to be invested in short-term deposits with the public sector Banks. The investment pattern of fund moneys should be brought on par with that under the employees' provident fund scheme.

II-14.7. The present rules governing the recognition or approval of funds do not permit the constitution of a common fund for the benefit of employees belonging to a group of companies which are connected with one another. As such a common fund would secure economy in administrative costs and facilitate movement of employees from one concern to another within the same group, we recommend that a common fund may be allowed to be set up, subject to whatever safeguards are considered necessary to prevent misuse. Side by side with these provisions, in order to meet a situation where a company in the group having a common fund wishes to separate from the group for any reason, there should be a provision for splitting up the common fund, subject to suitable safeguards.

II-14.8. While rules relating to provident funds in Part A of the Fourth Schedule permit transfer of the accumulated balance from one recognised provident fund to a similar fund maintained by another employer, when the employee changes his employment, there is no similar provision for the transfer of the balance or the accrued benefits from an approved superannuation fund or an approved gratuity fund to another similar fund maintained by the new employer. In the present day world, there is increasing mobility of personnel from one employment to another, particularly in the managerial cadres. There are also many instances of transfer of employees *en masse* when industrial units are transferred from one ownership to another. The rules do not, in terms, provide for the transfer of the interest of the employee in an approved superannuation fund to another approved superannuation fund when he changes his employment, voluntarily or otherwise. The Board have recently issued instructions that approval to a superannuation fund should not be refused merely on the ground that its rules provide for payment of annuity to an employee or the transfer of his equitable interest to another approved superannuation fund when the employee leaves the service voluntarily before he attains the specified age

for retirement and that approval should be granted to such a fund if it complies with the rules and conditions set out in Part B of the Fourth Schedule and the relevant rules in the Income-tax Rules. In order to place the matter beyond doubt or dispute, we recommend that there should be uniform provisions for transfer of the balance or accrued benefits from one approved fund to another approved fund of the same type, in respect of all the three categories of funds whenever an employee changes his employment. Further, an employer company may be permitted to make contribution to the account of an employee in a gratuity fund maintained by it after taking into consideration the past service of the employee under the former employer. Where, however, the new employer does not maintain a superannuation fund or where the employee does not take up another employment, we recommend that the former employer should be required to purchase from the Life Insurance Corporation out of the balance in the superannuation fund account of the employee a non-surrenderable deferred annuity policy in favour of the employee under which payments would be made to the employee on his attaining the normal age of superannuation or on his prior incapacitation or to his widow, children, dependents or nominees if he dies before attaining such age.

II-14.9. There are some provisions in the Fourth Schedule to the Income-tax Act and in the Income-tax Rules which are substantive in nature and should really be part of the substantive law relating to computation of salary income or business income or to exemptions, e.g., rules 6, 8 and 9 of Part A, rules 5 and 6 of Part B and rule 7 of Part C of the Fourth Schedule to the Income-tax Act and rule 72 of the Income-tax Rules. These provisions have been discussed in Part I of this Report. As the provisions are not procedural in nature, they should not be incorporated in the Management Act.

II-14.10. Rule 76, 92 and 105 of the Income-tax Rules make certain provisions which are in the nature of penalty. Under these rules, if any employee assigns or creates a charge upon his beneficial interest in a recognised provident fund, approved superannuation fund or approved gratuity fund, the Income-tax Officer is empowered to treat the consideration received by the employee for the assignment or charge as his income liable to tax in the year in which the fact becomes known to the Income-tax Officer. These rules impose a substantive liability to tax, and are intended to be in the nature of penal provisions. The rules, as they stand, assume that an employee assigning or charging his beneficial interest in such a fund would, in all cases, be receiving a monetary consideration for such assignment or charge. The rules are silent as to the penalty, if any, applicable to a case where the employee has not received any such consideration and the assignment or charge is created out of social obligation or necessity. We recommend that in place of the existing rules treating the consideration received as income, provision should be made in the chapter relating to penalties for the imposition of a suitable monetary penalty on the employee in such a case. Such monetary penalty may be expressed as a percentage of the consideration, if any, received for such

assignment or charge subject to an alternative minimum amount which should be applicable where no consideration is received by the employee.

II-14.11. Rule 68 of the Income-tax Rules, laying down the circumstances in which the withdrawal from a recognised provident fund may be permitted, rule 69, laying down the conditions for such withdrawals, and rule 75, laying down limits for contributions, show some variations from similar rules in the Employees' Provident Fund Scheme. As the Employees' Provident Fund and provident funds recognised under the tax law overlap over a very wide area of industrial employees and their objects are also similar. We recommend that the provisions in the Management Act and the rules thereunder, Governing Provident Funds should be brought in line with those in the employees' Provident Fund Scheme.

II-14.12. Under rule 3 in Part B of the Fourth Schedule, the benefits from an approved superannuation fund can be availed of by the employee himself or by his widow, children or dependents. In the case of provident funds and gratuity funds, rules 67A and 101A, respectively, of the Income-tax Rules provide for the nomination by the employee of one or more persons belonging to his family who should have the right to receive the benefits from the fund in the event of the employee's death, and such nomination may be in favour of any person where the employee does not have a family. In the case of a superannuation fund, on the other hand, there is no specific provision for the nomination of beneficiaries although, where an annuity policy is effected with the Life Insurance Corporation, the beneficiaries will, presumably, have to be named in the policy. Further, in the rules relating to approval of superannuation funds there is no provision for payment of annuity to the widower in a case where the employee is a married woman. Later in this Chapter, we have recommended that an option may be given to an employee participating in an approved superannuation fund either to have the payment of annuity secured by taking out an annuity policy with the Life Insurance Corporation or to receive the annuity directly from the trustees. In these circumstances, we recommend that the provisions in this behalf should be made uniform for all the three types of funds and necessary amendments may be made to the rules relating to approval of superannuation funds to bring these on par with rules 67A and 101A of the Income-tax Rules.

II-14.13. Section 10(10A) of the Income-tax Act exempts from tax the commuted value of 1/3 of the pension in the case of an employee in receipt of gratuity and 1/2 of the pension in any other case. Rule 90 of the Income-tax rules, however, allows commutation of the annuity from an approved superannuation fund only to the extent of 1/4 of such annuity where the employee is in receipt of a gratuity or 1/3 of the annuity in any other case. In the interest of uniformity, and to avoid invidious distinctions, we recommend that the provisions in rule 90 may be brought in line with those in section 10(10A).

II-14.14. Rule 3 in Part B of the Fourth Schedule provides that a superannuation fund will be entitled to receive and retain approval if, *inter alia*, the fund has for its sole purpose the provision of annuities for employees in the trade or undertaking on their retirement at or after a specified age or on their becoming incapacitated prior to such retirement, or for the widows, children or dependents of persons who are or have been such employees on the death of these persons. Rule 89 of the Income-tax Rules stipulates that, for the purpose of providing annuities for the beneficiaries, the trustees of an approved superannuation fund shall either enter into a scheme of insurance with the Life Insurance Corporation or accumulate the contributions in respect of each beneficiary and purchase an annuity from the Life Insurance Corporation at the time of retirement or death of each employee or on his becoming incapacitated prior to retirement. Two matters arise for consideration in connection with these two provisions. Firstly, there is no definition of the term annuity in the rules. With a view to placing the matter beyond doubt, we recommend that the term annuity in this context may be defined to mean an annuity payable for a period of not less than 10 years and may even extend to the life time of an employee.

II-14.15. The second matter arises in the context of the requirement in rule 89 that the benefits out of the superannuation fund must in all cases be provided through purchase of an appropriate annuity policy from the Life Insurance Corporation. Representations have been made to us that the compulsion to purchase annuity from the Life Insurance Corporation in all cases indirectly denies to the employees the benefit of administrative economies in the

management of the fund. When an annuity policy is purchased from the Life Insurance Corporation, the amount of annuity which is yielded by a given capital sum or by a given annual premium depends upon the Life Insurance Corporation's expense-ratio. It has been claimed that, superannuation funds being managed largely by the employees themselves who contribute their time and services virtually free of charge, in the common interest, the expense of managing a given fund would be considerably less than the expense-ratio of the Life Insurance Corporation. If the trustees of the fund are permitted to pay annuities to retiring employees or to their beneficiaries directly instead of taking out annuity policies from the Life Insurance Corporation, the employees will be able to receive a higher benefit for a given contribution than when the policy is effected with the Life Insurance Corporation. We see the justice of this claim. We would, therefore, recommend that option may be given to an employee participating in an approved superannuation fund either to have the payment of annuities secured by taking out annuity policies with the Life Insurance Corporation or to receive the annuities directly from the trustees.

II-14.16. The provisions in Part C of the Fourth Schedule relating to approval of gratuity funds differ in certain respects from those in the Payment of Gratuity Act, e.g., the definition of the words "family" and "wages". To avoid any conflict with the provisions of the Payment of Gratuity Act, which are mandatory, we recommend that the provisions applicable to approval of gratuity funds for the purpose of taxation should be brought in line with those under the payment of Gratuity Act.

CHAPTER 15

CONCLUSION

II-15.1. In the foregoing Chapters of this Part, we have dealt with the various changes which we consider necessary in the existing procedural provisions of the direct tax laws. In formulating our recommendations, we have had due regard to our terms of reference, particularly those relating to suggesting ways and means of improving the administration of direct tax laws and the consolidation of the four laws relating to income-tax, surtax, wealth-tax and gift-tax into one Act.

II-15.2. The enactment of a single Management Act on the lines of our recommendations would go a long way in improving the administration of the direct tax laws. This is because the procedures for determination of the tax base and the quantum of tax, the procedures for recovery of the tax, consequential procedures relating to penalty and prosecution, the appellate machinery and procedures, etc., are all so similar that the provisions relating to them can be conveniently and appropriately consolidated into a single legislative enactment. In our view, a major advantage which would flow from such consolidation will be to bring about uniformity in procedures under the four laws. We have deliberately refrained from recommending the integration of all proceedings relating to different taxes into a single proceeding. While the proceedings in respect of the levy of income-tax, sur-tax, wealth-tax and gift-tax would follow a common pattern, they would still remain separate proceedings.

II-15.3. While framing our recommendations, we have placed greater emphasis on the timely submission of returns by all classes of taxpayers without any exception, including those taxpayers who would be entitled to refunds or whose ultimate tax liability may be minimal. This emphasis, together with the corresponding measures for ensuring compliance, is largely a corollary of the scheme of acceptance of a substantial majority of the returns. At the same time, the interests of revenue are safeguarded by our recommendations for streamlining and simplifying the procedures for reopening of closed assessments. While finality in the matter of assessments is desirable as a measure of stability to both the taxpayer and the Department, the summary assessment procedures should necessarily entitle the administration to take appropriate remedial action wherever the interests of speed have led to loss of revenue or under assessment.

II-15.4. Another area of simplification suggested by us relates to the time limits for initiation and completion of various proceedings under the tax laws. Our attempt has been to prescribe the last day of the financial year, viz., 31st March, as the date of limitation for various purposes to the extent possible. The existence

of different dates of limitation for initiation or completion of proceedings leads to a disturbance of the smooth functioning of the Department. Our recommendations may, no doubt, result in an extension of the time limits within which the Department may initiate or complete action in certain cases and to that extent may appear to water down the privileges at present enjoyed by the taxpayers, but such marginal extension of time should not be considered as detrimental to the interests of the taxpayer. On the contrary, this would go a long way to reduce peremptory or hurried action which may be necessitated by attempts to beat time limits scattered over different dates throughout the year.

II-15.5 In the matter of the levy of interest and penalties, our recommendations may lead to some of these levies becoming more or less automatic. We have not disturbed the basic principle that consequences of tax evasion would follow where the intent and motive of evasion is adequately established. However, in matters of procedural failures and delinquencies, certain consequences should necessarily follow as a matter of course. This is the logical conclusion to the approach where greater emphasis is placed on voluntary compliance by the taxpayer. In the changed atmosphere of mutual trust and goodwill, which must follow upon the recommendations made by us, some of the procedures which hitherto were regarded as cumbersome or irksome would gradually come to be followed by the taxpayers voluntarily and as a matter of course.

II-15.6. Our approach in the matter of improving the administration of tax laws has been to concentrate on the area of interaction of the administration with the taxpaying public. The emphasis in our approach is on expeditious assessment and expeditious grant of reliefs under the appellate and other procedures. Our terms of reference do not envisage any study into the internal administrative problems of the Department and, naturally our recommendations do not cover them either. We are however glad to note that, in our discussions with the persons at the highest levels in the Department, we found an awareness of the problems facing the Department and the need to meet them in good time.

II-15.7. Some of the observations made by us on the need for raising the status of the Chairman of the Central Board of Direct Taxes, strengthening the supervisory functions through Regional Commissioners, merging recovery functions with the assessment functions, re-designating the senior level of assessing officers, elevating the level of the first appellate authority, etc., are all part of a package of proposals, which should

go a long way in improving the administration of the tax laws. Many of the difficulties experienced by the taxpayers in their dealings with the administration could be effectively countered under the improved procedure suggested by us.

II-15.8. The various suggestions for improving the administration of the tax laws, particularly in the area of levy, collection and recovery of the direct taxes should, in our view, lead to a better climate of understanding between the taxpayers and the taxgatherers. We would once again emphasise that the rigours of a taxing statute can be largely mitigated and made

acceptable to the public by an enlightened and fair administration.

(C. C. CHOKSHI)
Chairman

(S. P. MEHTA)
Member

(HARNAM SHANKAR)
Member

(C. C. GANAPATHI)
Member

(T. S. R. NARASIMHAM)
Member

(D. N. PATHAK)
Secretary.
Bombay,
September, 1978.

**PART II—SUMMARY OF OBSERVATIONS
AND RECOMMENDATIONS**

SUMMARY OF OBSERVATIONS AND RECOM-
MENDATIONS

FINAL REPORT—PART II

INTRODUCTORY

1. A consolidated code should be enacted laying down uniform procedures for the management and administration of the four direct taxes, viz., income-tax, wealth-tax, gift-tax and surtax on company profits. Estate duty legislation should, however, continue to remain separate as a self-contained statute.

(Paras II-0.1 to 0.3)

2. Integration of the procedural and administrative provisions of direct tax laws does not mean that there should be common proceedings for the levy of these taxes in any given case. While the proceedings for the assessment and collection of these taxes in any given case should remain separate, they should as far as possible be taken up and completed simultaneously, so as to save the time of the Department as also of the taxpayer.

(Para II-0.6)

CHAPTER 1 : PRELIMINARY

3. The title of the proposed enactment consolidating the procedural provisions of the direct tax laws should be "The Direct Taxes Management and Administration Act".

(Para II-1.2)

4. When the Indian Income-tax Act, 1922 was replaced by the Income-tax Act, 1961, the transitional provisions led to considerable problems and litigation which could not be totally obviated or resolved even by the exercise of the power to remove difficulties vested in the Central Government under section 298. To avoid such difficulties, the old law should continue upto and inclusive of a specified assessment year, say, assessment year 1979-80. The new provisions should apply for and from the immediately following assessment year, i.e., 1980-81. Whenever the Government desires to adopt the new procedure even for old proceedings, e.g., provision of appeal to the Central Tax Court, this should be achieved by appropriate amendments to the old law.

(Paras II-1.3 to 1.5)

5. There should be a specific provision in the Management Act spelling out the scope of the Act and making it applicable to the assessment and collection of the following direct taxes, namely :—

- (1) Income-tax ;
- (2) Wealth-tax ;
- (3) Gift-tax ; and
- (4) Surtax on company profits.

If, in future, the Government considers it necessary to levy any other direct tax, the procedure for the assessment and collection of such tax should also be governed by the Management Act.

(Para II-1.6)

6. The preliminary Chapter of the Management Act should contain definitions of various terms having relevancy for the purposes of the procedural provisions of the tax laws. There should also be a specific provision that words which are not defined in the Management Act, but are defined in the substantive enactment would have the same meaning for the purposes of the Management Act and, correspondingly, there should be a similar provision in the substantive enactment to the effect that words which are defined in the Management Act but not in the substantive enactment will have the same meaning for the purposes of the substantive enactment also.

(Para II-1.7)

CHAPTER 2—ADMINISTRATION

7. In the context of integrating the procedural provisions of the different tax laws, redesignation of the authorities administering them has become inevitable. This is the opportune time for rationalising the designations of the various direct taxes authorities. The existing cadre of Assistant Commissioners should be redesignated as Deputy Commissioners and Income-tax Officers, Class-I, in the Senior Scale, should be designated as Assistant Commissioners. Suitable provisions should be made in the law so as to enable Assistant Commissioners (new designation) to perform all the functions and exercise all the powers of the assessing authorities.

(Paras II-2.4 & 2.5)

8. The classification of assessment charges into senior-scale charges and other charges should be brought about and where a Class-II Officer is required to hold a senior-scale charge, he should be appropriately compensated for the higher responsibility that he is required to shoulder.

(Para II-2.6)

9. The association of the Inspecting Assistant Commissioner in the process of assessment, through all its stages, is necessary not only in important cases, but also in all scrutiny cases. The appeals arising from all such cases are bound to raise important issues of law and fact, meriting consideration by more experienced and senior officers. Appeals against orders of the Direct Taxes Officer, Assistant Commissioner and Deputy Commissioner (new designations) should lie to the Commissioner (Appeals).

(Para II-2.7)

10. Deputy Commissioners should be deployed exclusively on supervising, guiding and directing the work of assessing officers.

(Para II-2.9)

11. It is not necessary to retain the cadre of Additional Commissioners as one of tax authorities.

(Para II-2.10)

12. A cadre of Regional Commissioners should be created having the status of Additional Secretary to the Government of India. Regional Commissioners will be responsible for administratively controlling, co-ordinating and supervising the work of Commissioners in their respective regions and accountable to the Board for the overall performances of their regions. They should also perform the functions of the Director of Inspection and control the activities of the officers of the intelligence wing for the Region.
(Paras II-2.11 & 2.12)

13. The Chairman of the Central Board of Direct Taxes should have the status of a Secretary to the Government of India. The Board should have adequate staff assistance and should be provided with personnel having necessary technical background and experience.
(Para II-2.16)

14. The institution of Valuation Officers as statutory authorities under the direct tax laws should be done away with. If necessary, the services of Valuation Officers may be utilised by the Government in a purely advisory capacity in suitable cases.
(Para II-2.19)

15. The executive cadre of the Income-tax Department should comprise the following authorities :—

- (1) Central Board of Direct Taxes,
- (2) Regional Commissioners,
- (3) Directors of Inspection,
- (4) Commissioners of Direct Taxes,
- (5) Commissioners (Appeals),
- (6) Deputy Commissioners of Direct Taxes,
- (7) Assistant Commissioners of Direct Taxes,
- (8) Direct Taxes Officers,
- (9) Inspectors of Direct Taxes. (Para II-2.20)

16. The manpower assistance to the officers at various levels in the Department should be adequately augmented and they should be provided with adequate office space, storage space, equipments and aids.
(Para II-2.21)

17. When an advance ruling is given by the Board in the case of any assessee, the Board should have the power to issue instructions to the subordinate authorities to ensure compliance with such advance ruling. This will necessitate the omission of clause (a) of the proviso to section 119(1).
(Para II-2.22)

18. The law should be amended, if necessary, to enable the Board to issue directions to subordinate authorities for granting relief even after the expiry of the statutory time limit in cases where the claim for any exemption, deduction, refund or any other relief is made by the assessee within the specified time limit.
(Para II-2.23)

19. The Central Government and the Board should have the power to condone the delay in making an application to them for approval, etc., under various provisions of the tax laws.
(Para II-2.24)

20. It is not desirable to make any radical change in the existing pattern of jurisdiction so as to vest in the Board the overall jurisdiction for assessment and collection following the pattern obtaining in USA and Canada.
(Para II-2.26)

21. No major changes are necessary in the powers of tax authorities.
(Para II-2.27)

22. The Commissioner's power to delegate the functions of the Income-tax Officer should be limited so as to restrict such delegation to an Inspector of Income-tax only and not to any member of the ministerial staff. Further, the Commissioner should have no power to delegate functions under sections 131, 132, 132A and 132B even to Inspectors.
(Para II-2.28)

23. The provision enabling the Board to delegate the power to authorise a search to a Deputy Director of Inspection or an Inspecting Assistant Commissioner should be deleted.
(Para II-2.29)

24. The powers of search should not be extended for the purposes of gift tax.
(Para II-2.30)

25. There should be a time limit of, say, six months for the disposal of applications under section 132(11) by the notified authority.
(Para II-2.31)

26. The provisions relating to the power of calling for information under section 133, powers of survey under section 133A and powers of inspection under section 134 may be incorporated in the Management Act.
(Para II-2.33)

27. The provisions of section 135 authorising the superior authorities to exercise the power of making enquiries vested in the Income-tax Officer duplicate provisions in other sections and need not be retained in the Management Act.
(Para II-2.34)

28. Section 136 deeming proceedings before the Income-tax authorities as judicial proceedings for certain purposes and section 138 relating to disclosure of information may be included in the Management Act so as to apply uniformly to all direct taxes.
(Para II-2.35)

29. Sections 285A and 285B of the Income-tax Act, prescribing certain information returns may be incorporated in the Chapter—"Administration" in the Management Act.
(Para II-2.36)

30. All penalties such as those under sections 285A and 285B should be dealt with in the Chapter on penalties and, further, the designated officer, to whom such information is required to be furnished, should be empowered to levy the penalty.
(Para II-2.37)

31. The material date for the purposes of section 285B should be the date of expiry of 30 days from the end of the financial year to which the information relates or 30 days from the date of grant of the certificate of fitness for public exhibition of the film by the Board of Film Censors, whichever is earlier.
(Para II-2.38)

32. Information under section 285B should be required to be furnished in respect of expenses debitable

to the cost of production of the film. The limit of Rs. 5,000 should be raised to Rs. 10,000 and information should be required to be furnished of all payments in respect of such expenses, aggregating to Rs. 10,000, made to any person during a financial year. (Para II-2.38)

33. The format of the statement required to be furnished under section 285B, prescribed under rule 121A (form No. 52A) should be changed to make the requirements of the section clearer. (Para II-2.39)

34. Once the several statements required at present to be furnished by persons responsible for paying interest or dividends are replaced by a consolidated provision in the Chapter dealing with deduction of tax at source, it will not be necessary to include the provisions of sections 285 and 286 in the Chapter—"Administration". (Para II-2.40)

35. Publication of names of assesseees on whom penalties have been imposed should be made only after the penalty has been upheld by the Tribunal or it has otherwise become final, and not earlier. (Para II-2.41)

36. The provision in section 294A may be omitted if it is no longer necessary to retain it for rescinding any exemption or modification already made. If it is considered necessary to retain the provision it may be included in the Chapter—"Administration" in the Management Act. (Para II-2.42)

37. A consolidated provision authorising the Board to frame rules for the various purposes of the direct taxes may be incorporated in the Management Act. Care should be taken, while drafting the rules having substantive implications, to ensure that they apply only prospectively. Frequent amendments to the Income-tax Rules unsettle the smooth administration of the Act. All amendments to the rules should be made only once in a financial year and notified by September so as to operate from the first April of the following year. Where an interim amendment becomes unavoidable, it should be fully justified with adequate reasons as to why the change could not be made part of the annual amendments to the Rules. (Paras II-2.43 & 2.44)

38. Section 298 dealing with the power of the Central Government to remove difficulties should be placed in the Chapter—"Administration". (Para II-2.45)

CHAPTER 3—PRE-ASSESSMENT PAYMENT OF TAXES

39. The provisions for deduction of tax at source already cover a wide area and it is not necessary to extend the area of their operation any further. (Para II-3.2)

40. Where salary is paid in arrears, specific provision should be made enabling the employer to take into account the relief to which the employee is entitled while deducting tax at source from payments on account of arrears of salary. (Para II-3.3)

41. The administrative practice of taking into account the deduction under section 80C and that under

section 80G, with reference to contributions to certain specified funds, while deducting the tax at source from salaries, should be given statutory basis by suitably amending the relevant provision. (Para II-3.4)

42. The element of salary income referred to in rule 6 in Part A of the Fourth Schedule, as modified in the light of the suggestions in Part I of the Report, should be clearly brought within the purview of deduction of tax at source by making an appropriate provision in section 192. (Para II-3.5)

43. The limit for deduction of tax under section 194C should be raised from Rs. 5,000 to Rs. 25,000. (Para II-3.6)

44. Deduction of tax from payments by way of insurance commission should be required to be made only where the payment to any one person during a financial year exceeds Rs. 1,500. (Para II-3.7)

45. The time limit for remittances of the tax deducted at source to the credit of the Central Government may uniformly be prescribed as one month following the end of the month in which the deduction is made, without linking it to the date of obtaining the challan for making the remittance. In cases where interest payments to residents, payments to contractors and payments by way of insurance commission are credited to the account of the payee in the books of the payer, being a person carrying on a business or profession, the existing provision permitting remittance of the tax deducted within two months of the close of the payer's accounting year, may be allowed to continue. The facility now allowed in certain cases to remit the tax deducted at source at quarterly intervals should be withdrawn. (Para II-3.8)

46. Credit for tax deducted at source in respect of any income should be allowed in the assessment year in which such income is subjected to tax. In a case where deduction of tax is made in a year later than that in which the income is subjected to tax, the credit should be allowed by rectification of the assessment within the normal period of limitation or within one year from the end of the financial year in which the tax is deducted, whichever is later. (Para II-3.9)

47. The existing arrangements for keeping a watch over deductions from various categories of payments and the remittance of the amounts deducted to the credit of the Central Government need improvement to make them more effective. Central monitoring should be extended to cover all deductions of tax at source. Statutory returns including those required under sections 285 and 286, should be required to be submitted only at yearly intervals on the existing pattern of salary returns and the necessary changes should be made in the law to require such returns to be submitted to a designated Income-tax Officer instead of to the several Income-tax Officers assessing the payers. Suitable arrangements should be made for Government departments, both at the Centre and the States, to submit returns of tax deducted at source from payments of salaries, payments to contractors, payment of interest, lottery winnings, etc., and arrangements should be made for checking these centrally as in the case of returns furnished by payers other than Government. (Para II-3.10)

48. Suitable provision should be made in the law to enable the person responsible for deducting tax at source to obtain refund of any excess payment made by him to Government on this account from the Income-tax Officer dealing with this subject, independently of his own assessment, subject to necessary safeguards. (Para II-3.11)

49. The law should be properly amended to bring out the real intention behind the recommendations relating to the provisions for payment of advance tax, contained in the Interim Report, which is to simplify the procedures relating to payment of such tax and elimination of unproductive work. (Para II-3.12)

50. The provision in the Gift-tax Act for payment of tax in advance within 15 days of the taxpayer's making the gift may be included in the Management Act without change. (Para II-3.13)

CHAPTER 4—ASSESSMENT PROCEDURE

51. By integrating the procedures for assessment and refund under the different direct tax laws, any variations in the procedure would get eliminated and a uniform procedure will become applicable for the purposes of all the direct taxes. (Para II-4.1)

52. In the Management Act, a tax return should be defined as referring to a return of income or a return of wealth or a return of gifts or a return of chargeable profits or any combination of two or more of such returns. (Para II-4.2)

53. There should be a single provision in the law requiring the filing of a tax return if the total income/net wealth/taxable gifts/chargeable profits of a person exceeded the maximum amount which is not chargeable to tax or if a person desires to have an assessment made of his total income, net wealth, taxable gifts, or chargeable profits or to have any loss, unabsorbed allowance or deficiency computed and carried forward to future years or to avail of the exemption provided in the case of charitable or religious trusts or to claim refund of any pre-assessment tax paid by him or on his behalf. (Para II-4.3)

54. Statutory time limits are important inasmuch as their non-observance entails certain consequences by way of interest, penalty, prosecution, etc. While the taxpayer should suffer these consequences if he fails to furnish the return within the time limits specified in the statute, the non-observance of the time limit should not by itself invalidate the return. The law should make the following provisions in regard to filing of tax returns :

- (1) In order to ensure uniformity, tax returns should be required to be filed by 30th of June in each year.
- (2) The law should specifically provide that returns filed after 30th June will nevertheless be valid in law. Subject to the consequences laid down in the law, the taxpayer should have the right to file a tax return at any time before an assessment is made for the relevant year without any outer time limit.

- (3) For delays in filing the tax return beyond the 30th of June and until 30th of September, the taxpayer should be required to 'buy time'. The cost of buying time should be calculated with reference to the net tax and the rate of interest should be one per cent per month.
 - (4) Where a return is filed after 30th September of the assessment year, the assessment should not ordinarily be made without scrutiny of accounts. However, such a return may be accepted as correct without scrutiny if the Commissioner so directs provided the return is filed before the last day of the assessment year. If a return is filed after the close of the assessment year, it should invariably be subjected to scrutiny.
 - (5) Where the return is delayed beyond the 30th September of the assessment year, the taxpayer should become liable to pay penalty in the circumstances stated in the Chapter on penalties.
 - (6) If the return is not furnished before the close of the assessment year, the assessee should also become liable to prosecution in the circumstances stated in the Chapter 'Offences and prosecutions'.
 - (7) The assessee should forfeit the right to carry forward of loss, unabsorbed allowances, deficiency, etc., if the return is not furnished before the expiry of the assessment year. Similarly, an assessee claiming exemption from tax available to charitable or religious trusts, etc., should also be rendered ineligible for such exemption if the return is not filed before the expiry of the assessment year. The Commissioner should, however, be empowered to relax this condition in appropriate cases.
- An exception will have to be made in the case of a return for the purpose of surtax where the company wants to claim the set-off of a deficiency against the chargeable profits for a subsequent year. The company should be required to file a return of such deficiency only when it makes sufficient profits which attract liability to surtax in a subsequent year and not earlier.
- (8) An assessee who claims refund of pre-paid taxes should be eligible for such refund only if the return is filed within a period of two years from the end of the relevant assessment year. The existing powers of the Board to authorise admission of belated claims should continue. (Para II-4.4)

55. Sub-section (1A) of section 139 exempting certain categories of salaried taxpayers from the obligation to file returns should be deleted. (Para II-4.5)

56. The working of the system of permanent account numbers should be improved. Numbers should be allotted to all taxpayers who have so far applied for them and there should be arrangement for prompt allotment of such numbers to those who apply for them in future; the directories of taxpayers should be

updated; the Department should ensure that all communications sent to the taxpayer carry his permanent account number; and, lastly, the penalty for non-compliance should not attach to minor defaults such as failure to quote the permanent account number on routine correspondence like reminders, etc., sent by the taxpayer to the Department. (Para II-4.6)

57. The existing provisions of section 140 should be modified to permit the tax return in the case of a company being signed by the holder of a power-of-attorney in a case where there is no managing director or other director stationed in India or by the liquidator in the case of a company in liquidation. (Para II-4.8)

58. Suitable alternative provisions should be made to permit the return being signed by any other person who manages the affairs of a Hindu undivided family in a case where there is no adult member of the family. (Para II-4.9)

59. Return forms pertaining to a particular assessment year should be used only for that assessment year and not for any earlier assessment year, and the assessment year to which the particular form pertains should be printed in bold figures on the first page of the form so as to facilitate easy identification. (Para II-4.12)

60. Provisions for payment of tax on self-assessment before the furnishing of the return should be extended to gift-tax and surtax and the existing provisions in the Wealth-tax Act and Surtax Act for the making of a provisional assessment should be deleted. In all cases, the challan for payment of taxes on self-assessment should be required to be attached to the relevant tax return, in the absence of which the return should be considered to be invalid. Further, as recommended in the Interim Report (para 7.18) interest payable for delay in furnishing the tax return beyond 30th June should be required to be paid along with the tax on self-assessment. (Para II-4.14)

61. Interest on excess payment of advance-tax should be calculated with reference to the tax payable on the basis of the income returned and only upto the date of furnishing the return or 30th June of the assessment year, whichever is earlier. At the same time, with a view to expediting the refund of excess advance-tax paid, for any delay in granting the refund beyond three months from the end of the month in which the return is filed or 1st October of the assessment year whichever is later, interest at 12 per cent per annum should be allowed upto the end of the month preceding the month in which the refund voucher is actually issued to the assessee. (Para II-4.15)

62. The provisions of section 142 of the Income-tax Act should be incorporated in the Management Act and made applicable on a uniform basis to all direct taxes. (Para II-4.17)

63. The process of assessment by acceptance of returns should be extended also for the purpose of wealth-tax and gift-tax subject to guidelines to be issued by the Board. (Para II-4.18)

64. The procedure for examination of accounts and other materials before completion of an assessment should apply uniformly to all the taxes. (Para II-4.19)

65. The provisions relating to *ex-parte* assessments should be incorporated in the Management Act. (Para II-4.20)

66. The provision for the reopening of an *ex-parte* assessment by the Income-tax Officer on the application of the assessee need not be incorporated in the Management Act. (Para II-4.22)

57. The provisions of section 144A should be made uniformly applicable to all direct taxes. (Para II-4.24)

68. The provisions of section 144B should be deleted. (Para II-4.25)

59. The Valuation Officer should not function as a statutory authority under the Wealth-tax Act or the other direct tax enactments but his role, wherever, necessary, should be merely advisory. The provisions of section 16A of the Wealth-tax Act and connected provisions in the other direct tax laws should be deleted. (Para II-4.26)

70. The assessing officer should be empowered to issue a notice calling for a return for the purpose of income-tax, wealth-tax and gift-tax in cases where such return has not been furnished by the assessee by 30th September of the assessment year. Such a notice may be issued at any time upto the expiry of eight years from the end of the relevant assessment year, without the need to obtain the approval of the Commissioner in this behalf. (Para II-4.27)

71. The assessing officer should have the power to call for a return for the purpose of income-tax, wealth-tax or gift-tax even after the expiry of eight years, but before the expiry of sixteen years, after obtaining the Board's approval for the purpose. The minimum limit for the issue of such notice after the eight year period should remain at Rs. 50,000 for the purpose of income-tax and it may be placed at Rs. 5 lakhs for the purpose of wealth-tax and Rs. 50,000 for the purposes of gift-tax. (Para II-4.28)

72. The assessing officer should have the power to call for a return for the purposes of surtax at any time before the expiry of eight years from the end of the relevant assessment year or one year from the end of the financial year in which the assessment or reassessment of the company for the purposes of income-tax is completed or such assessment is modified as a result of appeal, revision or rectification whichever is later. The monetary limit of Rs. 50,000 and the requirement of the Board's approval should not apply even in a case where the notice is issued after the expiry of eight years from the end of the relevant assessment year. (Para II-4.29)

73. The time limits for initiating action for reopening of completed assessments should be on the pattern of the existing provisions in the Income-tax Act and should uniformly apply to wealth-tax and gift-tax as well. (Para II-4.31)

74. While incorporating the existing provision in section 14 of the Surtax Act in the Management Act, it should be extended to cover a case where the surtax assessment needs modification in consequence of a reassessment of the company for the purposes of income-tax. The period of four years for such modification

should in all cases, be reckoned from the last day of the financial year in which the event necessitating the modification of the surtax assessment happened. The provisions for reopening a surtax assessment independently of the income-tax assessment should be on par with the corresponding provisions applicable in respect of other direct taxes. (Para II-4.32)

75. The provisions in section 143(2) of the Income-tax Act which enable the Income-tax Officer to reopen an assessment, completed by accepting the return, with the approval of the Inspecting Assistant Commissioner or on the request of the taxpayer should be deleted. A suitable *Explanation* may be added to the provision dealing with the reopening of completed assessments on the basis of information, clarifying the scope of the word "information". (Para II-4.33)

76. The existing provision, requiring the approval of the Commissioner for reopening a completed assessment under the Income-tax Act after the expiry of four years but within eight years from the end of the assessment year, on the ground that there was failure on the part of the assessee in disclosing fully and truly all material facts necessary for the assessment of his income, should continue and apply uniformly for wealth-tax and gift-tax as well even though at present, there is no such provision for the purposes of those taxes. (Para II-4.34)

77. There should be a provision for initiating proceedings for reassessment of escaped income, wealth or gifts beyond eight years upto a period of 16 years, on the ground of the taxpayer's failure to disclose fully and truly all material facts necessary for assessment subject to the approval of the Board and also subject to the minimum monetary limit of Rs. 50,000 in respect of escaped income or taxable gifts and Rs. 5 lakhs in respect of escaped wealth. (Para II-4.35)

78. In cases where proceedings are initiated for reassessment of escaped income, wealth, etc., there should be no insistence on the submission of a fresh return but the assessee should be given the right to file a return at any time before the reassessment is completed if he so wishes. Further, the assessing officer should intimate to the assessee clearly the reasons for reassessment and give the assessee a reasonable opportunity to state his objections, if any, to the reopening of the assessment. The assessee should, for this purpose, be allowed a minimum time of 30 days. (Para II-4.36)

79. For initiating action for assessment or reassessment in the circumstances mentioned in section 150, there should be a time limit of one year from the end of the financial year in which the order in appeal, reference or revision is received by the assessing officer. (Para II-4.37)

80. The provision in section 152(1) need not be repeated in the Management Act. (Para II-4.38)

81. The provisions of section 152(2) should be made applicable to all types of reassessments under all the four Acts on a uniform basis. The right under this section should be available to the assessee notwithstanding that he might have filed an appeal against the original assessment provided that such appeal has

since been disposed of and the matter has become final. (Para II-4.39)

82. A uniform time limit of two years for completion of assessments should be laid down in the Management Act for all the taxes. In respect of surtax, however, an alternative time limit of one year from the end of the financial year in which the income-tax assessment is completed, if later, will have to be provided. To obviate undue burden on the Department in having to deal with a large number of pending assessments under the Wealth-tax Act and Gift-tax Act getting barred by time in one year, the reduction of the time limit from four years to two years should be staggered suitably. Similarly, in respect of surtax where there is no time limit at present for completion of assessments, suitable staggering should be provided while imposing the time limit recommended. (Para II-4.40)

83. For all the four direct taxes, extended time limit with reference to the date of filing the return should be available upto the last day of the financial year following that in which the return is filed. Such extension should be available only with reference to the date of filing the first return and not any revised return. There should be no extension of the time limit with reference to the consideration whether or not the case attracts penalty for concealment. (Para II-4.41)

84. For completion of assessment, reassessment or recomputation in pursuance of proceedings initiated by issue of a notice under section 148 on the basis of fresh information, without there being any default on the part of the assessee in furnishing the return or in disclosing material facts, the extended period of one year from the date of service of the notice should be counted from the last day of the financial year in which the notice is served. (Para II-4.42)

85. The time limit under section 153(2A) for completing assessments/reassessments in consequence of or to give effect to any finding or direction contained in any order in appeal, revision, etc., should remain as at present. For completing a partner's assessment on the basis of the assessment of the firm under section 147 there should be an extended time limit of one year from the end of the financial year in which the assessment of the firm was made instead of there being no time limit as at present. (Para II-4.43)

86. Where the assessee claims in writing that the whole or any part of the proceedings should be reopened and he should be reheard by the successor in office because of the change in incumbent, the limitation under clause (i) of *Explanation 1* to section 153, should expire on the last day of the financial year following that in which such claim is made by the assessee. (Para II-4.44)

87. In a case where the assessment proceeding is stayed by an order or injunction of any court, the limitation under clause (ii) of *Explanation 1* to section 153 should expire on the last day of the financial year following that in which the stay order is vacated. (Para II-4.45)

CHAPTER 5—PENALTIES

88. In the light of the recommendation for the deletion of section 144B, the provision in clause (iv) of *Explanation 1* to section 153 should be deleted. The time limits under clause (iii) and (v) of the said *Explanation* should get extended upto the last day of the financial year next following that in which the report of audit is furnished by the assessee or, as the case may be, the decision of the Settlement Commission rejecting the application, etc., is received by the Commissioner. (Para II-4.46)

89. The assessment of deficiency for surtax purposes should be made simultaneously with the surtax assessment in which the deficiency is required to be set off. (Para II-4.47)

90. Persons carrying on a profession should be required to maintain only certain basic records such as a professional case diary, a fee register, a cash book (which may not necessarily be balanced daily), a journal, if the accounts are maintained on mercantile basis, and a ledger. In conjunction with the bank pass book, etc., these records should provide quite sufficient material for the computation of their income for purposes of assessment. (Para II-4.49)

91. Books of account and other documents relating to any business or profession coming within the scope of section 44AA should be required to be retained for a minimum period of eight years. (Para II-4.50)

92. The procedural provisions of Chapter XI of the Income-tax Act relating to levy of additional income-tax on a closely-held company should be incorporated in the Management Act in the Chapter dealing with assessment procedure. (Para II-4.51)

93. The Management Act should provide for the issue of a notice by the assessing officer to the company before starting the proceedings for the levy of additional tax. Such notice should be issued by the assessing officer soon after the completion of the relevant assessment or reassessment of the company. (Para II-4.52)

94. In the light of the recommendation in the Interim Report (Para 6.11) that provisions relating to levy of additional income-tax should be restricted in their application to closely-held investment companies only, the provisions of section 107A will be otiose and may be omitted. (Para II-4.53)

95. The powers of rectification of all tax authorities and the Tribunal should be made uniform and apply to all orders passed by them. The existing provisions laying down the time limit for rectificatory action at four years from the date of passing of the order sought to be rectified, should in the interest of uniformity, certainty and ease in keeping track of dates of limitation, be amended so as to permit rectification within a period of four years from the end of the financial year in which the order sought to be rectified was passed. (Para II-4.54)

96. The extended time limit of four years provided in the various sub-sections of section 155 should be made to expire at the end of four years from the last day of the financial year in which the event which attracts the amendment happened. (Para II-4.55)

97. Penalties for different types of default should be dealt with in separate sections of the Management Act. (Para II-5.2)

98. Any delay in furnishing the tax return beyond 30th September of the assessment year should attract penalty at the rate of one per cent of the gross tax, i.e., tax determined on assessment without giving credit for prepaid taxes, for every month of default. There should also be no ceiling on the amount of penalty payable for delaying the tax return so that a person who fails to furnish the tax return for several years may be required to pay an adequate price for his delinquency. The penalty provisions should apply uniformly to all the four direct taxes. (Para II-5.3)

99. In view of the recommendations that there should be no time limit, as such, for furnishing a return on the taxpayer's own volition, and also that there should be no upper limit on the penalty for default in furnishing a tax return. *Explanation 3* to section 271 may be deleted. (Para II-5.4)

100. Considering the increased emphasis on voluntary compliance by taxpayers and acceptance of returns, the provision in section 271(3)(a) exempting from penalty a taxpayer whose income exceeds the exemption limit by less than Rs. 1,500, should be omitted. (Para II-5.5)

101. The provision in section 271(3)(b) should be redrafted to make the intention clear and provide for the levy of a token penalty not exceeding Rs. 25 where a person, to whom a notice calling for a return has been issued and who fails to comply with it, proves that he had no income liable to tax. (Para II-5.6)

102. In the context of the recommendation that the eligibility for the exemption under sections 11 and 12 should be conditional upon the furnishing of the return before the close of the assessment year, the maximum penalty leviable for default in furnishing return of income by a trust which is entitled to exemption under section 11 and 12 should be limited to Rs. 500. This limit should, however, apply only to cases where, after applying the provisions of sections 11, 12 and 13, the trust does not have a taxable income. (Para II-5.7)

103. The law should clearly provide for levy of penalty for default in furnishing return of income more or less as a matter of course except where the taxpayer proves that he was prevented by sufficient cause from furnishing the return. (Para II-5.8)

104. For default in complying with notices issued by the assessing authority calling for production of account books, documents and other material, the penalty should be a lump sum not exceeding Rs. 1,000 for each such default. While drafting the provision, it should be made clear that the onus of showing sufficient cause for failure to comply with the notices will be on the taxpayer. The penalties for such defaults should be levied without waiting for the completion of the relevant assessment proceedings. (Para II-5.9)

105. The provisions in the Management Act relating to penalty for concealment of income, wealth, etc., should uniformly apply to all the four direct taxes. There should be no minimum penalty and the assessing officer's discretion in this regard should be unfettered. The maximum penalty should be twice the amount of tax sought to be avoided. (Para II-5.10)

106. The power to levy penalty for various defaults under section 271 should not be available to the Appellate Tribunal. The penalty for defaults in furnishing tax returns or in complying with the notices issued by the assessing authorities, should be leviable only by the assessing authority and not by any other authority. The power to levy penalty for concealment should, however, be available uniformly to the first appellate authority and also to the Commissioner, in addition to the assessing authority, in respect of all the four direct taxes. (Para II-5.11)

107. If the recommendation in the Interim Report (para 8.18) that the separate tax on a registered firm should be discontinued altogether is accepted and implemented by the Government, then the existing provisions for calculating penalty for default of a registered firm in furnishing the return of income should continue unchanged. If, however, the separate tax on registered firms continued to be charged, the penalty for default in furnishing the return of income should also be calculated with reference to the tax payable by the registered firm itself and not on the notional tax which would be chargeable if it had been assessed as an unregistered firm. No change in the existing method of calculation of penalty for concealment of income in the case of a registered firm is called for. (Para II-5.12)

108. In the context of the recommendation that the procedure for the registration of firms should be extended to association of persons and bodies of individuals as well and that a registered association of persons or body of individual should not be assessed to tax on its income as a single unit but that the shares of the members in the income of the association or body should be subjected to tax in their hands, the penalty leviable in the case of a registered association of persons or registered body of individuals for defaults in furnishing returns of income and also concealment of income should be calculated with reference to the tax that would have been payable if the association or body had been subjected to tax on its income as a separate unit. (Para II-5.13)

109. Section 271(4) which provides for the levy of penalty on a registered firm which distributes its profits otherwise than in accordance with the shares of the partners is virtually a dead letter and should be deleted. (Para II-5.14)

110. With a view to making the penalty for failure to keep, maintain or retain books of accounts, documents, etc., as required under section 44AA serve the purpose underlying its levy, the penalty should be a lump sum not exceeding Rs. 5,000. (Para II-5.15)

111. In regard to defaults in payment of advance-tax, instead of having a separate provision for levy

of interest and for levy of penalty for the same type of default, it would be sufficient if the interest to be charged for non-payment of advance tax or on short payments of advance tax is fixed at 18 per cent per annum of the tax payable on the basis of the return or, as the case may be, of the shortfall from such tax. Once this is done, it will be unnecessary to have separate penal provisions for this purpose and section 273 may be omitted. (Para II-5.18)

112. There should be a certain degree of uniformity in the provisions for the levy of penalties for the defaults enumerated in sections 270, 272, 272A and 272B and the provisions for the levy of fines in sections 131(2) and 285(2), which are of a technical nature. These provisions should be modified as under :

- (1) Penalty for failure to respond to summons under section 131 should be brought on par with the penalty leviable under section 272A(1) for refusal to answer questions and sign statements, and the necessary provision in this behalf should be made in the latter section.
- (2) Penalty for not complying with the provisions for obtaining a Permanent Account Number or quoting it under section 139A, should also be covered under the provisions of section 272A(1), subject to the exclusion of failure to quote the Permanent Account Number on routine correspondence for which no penalty should be levied.
- (3) The penalties provided under sections 270, 272 and 285A(2) should be integrated with the penalty for various defaults enumerated in section 272A(2) and the amount of penalty should be fixed at a maximum of Rs. 20 for every day during which the failure or contravention continues.
- (4) The penalties for the corresponding defaults under the Wealth-tax Act, Gift-tax Act and Surtax Act should be brought in line with these penalties. (Para II-5.20)

113. All procedural aspects in regard to levy of penalties should be uniform for the purpose of all the direct taxes. The Inspecting Assistant Commissioner's approval should be required to be obtained for levy of penalty for concealment, where the penalty exceeds Rs. 5,000. All orders levying penalties should be in writing. The law should also specifically provide that, where any authority other than the assessing officer levies a penalty, a copy of the order shall be sent to the assessing officer who shall thereupon issue a notice of demand and proceed to recover the amount. (Para II-5.22)

114. The time limits for completion of penalty proceedings should apply uniformly for all the four direct taxes and, further, that the extension of these time limits in specified circumstances should be so fixed as to expire on the 31st March of the financial year next following that in which event justifying the extension happens. (Para II-5.23)

115. Section 273A which gives powers to the Commissioners to reduce or waive certain penalties or interest in certain cases should provide as under :—

- (1) These should be uniformly applicable for all the four taxes.
- (2) The provisions in this behalf should be placed in the Chapter dealing with the Commissioner's powers of revision in the Management Act, rather than in the Chapter relating to penalties.
- (3) The existing requirement of obtaining the Board's approval before the Commissioner reduces or waives, under section 273A(1), any penalty or interest exceeding the specified limit should be done away with.
- (4) The provisions in section 273A(3) should be amended to make it clear that it applies only to the exercise of the power under sub-section (1).
- (5) The power of the Commissioner to waive or reduce penalty on the ground of hardship under sub-section (4) should be extended to cover interest including interest for delay in payment of tax, and its scope should be enlarged so as to empower the Commissioner to reduce or waive any penalty or interest even in cases not involving hardship but where, for any other reason, he considers such a course to be desirable or expedient.
- (6) Powers similar to those under sub-section (4) should be given to the Board also so that, in case where the assessee does not get the necessary relief at the Commissioner's level, he should be in a position to approach the Board. (Para II-5.24)

CHAPTER 6 : APPEALS REFERENCES AND REVISIONS

116. The first appellate authority's power to set aside an assessment or remand it to the assessing authority for further enquiry should remain but it should be limited to the following situations :—

- (a) Where the assessment was made *ex parte* and the appellate authority comes to the conclusion that it should not have been so made ;
- (b) Where the appellate authority admits any fresh ground of appeal not originally specified ;
- (c) Where the appellate authority admits any fresh evidence produced by the appellant at the stage of appeal ; and
- (d) Where any of the grounds of appeal relates to a matter which has not been considered by the assessing authority. (Para II-6.3)

117. The first appellate authority should be specifically empowered to admit, in its discretion, any ground even if it had not been raised before the assessing authority and considered by the latter, subject to the safeguard that, where any such ground is admitted, the

assessing authority should be allowed an opportunity to examine the matter on merits and make a report to the appellate authority setting forth the results of such examination. Similar power should also be given to the Appellate Tribunal to admit any ground not raised before any lower authority, subject to a similar safeguard. (Para II-6.4)

118. Appeal should be provided against the order of an Assistant Director of Inspection, levying a fine under section 131(2), to the Commissioner (Appeals) having jurisdiction over the Income-tax Circle in which the assessee or the other person on whom the fine is imposed is assessable to tax. (Para II-6.5)

119. Section 252 of the Income-tax Act should be deleted and a separate statute enacted to deal with the constitution and composition of the Appellate Tribunal. (Para II-6.6)

120. Section 253 may be reworded to provide that appeal will lie to the Appellate Tribunal against all final orders of the Commissioner (Appeals) or the Commissioner and the reference to orders under section 154 passed by the Inspecting Assistant Commissioner should be omitted. (Para II-6.7)

121. The Tribunal should not have the power to enhance an assessment or penalty under any of the direct tax laws. (Para II-6.8)

122. While abolishing the institution of Valuation Officers performing statutory functions, the earlier system of arbitration of the value by two Valuers at the stage of appeal to the Appellate Tribunal should not be revived. (Para II-6.9)

123. The Government should take steps for the early establishment of a Central Tax Court with all-India jurisdiction to deal exclusively with litigation under the direct tax laws in the first instance, with provision for extending its functions to cover all other Central tax laws, if considered necessary, in the future. Such a court should be constituted under a separate statute. In the meanwhile, the desirability of constituting special tax benches in the High Courts to deal with the large number of tax references by continuous sitting throughout the year may be considered. (Para II-6.16)

124. The Central Tax Court should initially have benches located at Ahmedabad, Bombay, Calcutta, Delhi, Kanpur, Madras and Nagpur. Each bench should have two judges. Judges of the Tax Court should be appointed from among High Court Judges or persons who are qualified to be appointed as High Court Judges and should be on par with High Court Judges in the matter of conditions of service, scales of pay and other privileges. (Para II-6.17)

125. The Central Tax Court should have the right to go into questions of the validity of the provisions of the tax laws or of the rules framed thereunder. (Para II-6.18)

126. The jurisdiction of the Central Tax Court should be appellate and not advisory. The appeals should be heard by a bench of two judges. Where, however, the judges do not agree, the appeal should

be heard by a full bench of three judges. The judgment of a division bench should be binding on other division benches unless it is contrary to a decision of the Supreme Court or of a full bench of the Tax Court. (Para II-6.20)

127. In addition to legal practitioners, Chartered Accountants and also such other persons as may be permitted by the Court to appear before it may also represent the appellant or the respondent in tax matters before the Central Tax Court. (Para II-6.21)

128. The time limit under section 263 should be two years from the end of the financial year in which the order sought to be revised is served on the taxpayer. (Para II-6.23)

129. The Commissioner should be given the power under section 263 to revise the order of any authority subordinate to him. (Para II-6.24)

130. The powers of revision under section 263 should extend to reassessments made in pursuance of proceedings initiated without the previous approval of the Commissioner or the Board. (Para II-6.25)

131. The provision in section 263(3) may be amended to secure that an order of revision under the circumstances mentioned therein may be passed at any time upto the end of the financial year next following that in which the order of the Appellate Tribunal, High Court or Supreme Court was received by the Commissioner. (Para II-6.26)

132. For the purpose of revision of orders by the Commissioner under section 263, in a case where the assessee demands rehearing on account of a change of incumbent of the office of the Commissioner, the limitation should expire on the last day of the financial year next following that in which the demand of the assessee is received by the Commissioner. Similarly, in a case where the proceedings before the Commissioner are stayed by an order or injunction of any court, the limitation should expire on the last day of the financial year next following that in which the order of stay or injunction is vacated by the Court. (Para II-6.27)

133. The time limits under section 264(2) and section 264(3) should be increased from one year to two years. This period should be reckoned from the end of the financial year in which the order in question was communicated to the assessee. (Para II-6.28)

134. A specific provision should be made in the law requiring the assessing authority to pass an order in writing giving effect to the order in appeal, revision, etc., and also enabling the taxpayer to represent his case through a miscellaneous petition filed within 60 days of his receiving such order to the appellate authority in case he is aggrieved by the manner in which that authority's order has been given effect to by the assessing authority. The appellate authority may also be required to dispose of such an application in the same manner as if it were an appeal presented before it. The law may also specify a time limit of six months

from the end of the month in which the order in appeal or revision is received by the assessing authority for giving effect to it by passing an order under this provision. (Para II-6.29)

135. An order giving effect to an order in appeal or revision should be made appealable on any new point arising out of it, in the same manner as other final orders of the assessing authority. (Para II-6.30)

CHAPTER 7 : SETTLEMENT OF CASES

136. The provisions in the Management Act relating to settlement of cases should apply to all the four taxes. (Para II-7.1)

137. All restrictions on the powers of the Settlement Commission to entertain cases in its discretion should be removed. The Commission should be authorised to admit an application, even when the matter is pending before the High Court or the Supreme Court provided the taxpayer withdraws the reference or appeal. (Para II-7.2)

CHAPTER 8 : PAYMENT AND REFUND OF TAXES

138. The provisions in the Management Act relating to payment and refund of taxes should apply uniformly to all the direct taxes. (Para II-8.1)

139. The term "assessee in default" will be made applicable under the Management Act, not only to demands arising as a result of an assessment, imposition of penalty, etc., but also to defaults in respect of advance tax and tax deductible at source, so that the coercive process of recovery can be set in motion in all cases. (Para II-8.3)

140. Interest for delay in payment of tax, which should include advance tax payable under a notice of demand, should be reckoned from the first day of the month next following the month in which the amount was payable under such notice. In respect of tax deductible or deducted at source, the interest should be reckoned from the first day of the month following that in which it was deductible. In all cases, the interest should be charged upto the last day of the month in which the amount is paid. (Para II-8.4)

141. Interest should be calculated and recovered only after the tax demand has become final and it has been fully paid or recovered. It is also desirable that the taxpayer is furnished with a formal order showing how the interest is worked out and a demand notice issued for the amount of interest. The law should also make it clear that interest should be charged only on outstanding tax and not on penalty, interest or any other sum. (Para II-8.5)

142. The provision in the Management Act should make it clear that an assessee in default will be liable to pay penalty for default in payment of regular tax as also for default in making deduction of tax at source or non-payment of the tax deducted to the credit of the Central Government, and for default in payment of advance tax demanded by a notice issued by the assessing authority. The relevant provision in the

Management Act in the matter of levy of penalty should make it clear that the onus of establishing the existence of good and sufficient reasons will be on the assessee. (Para II-8.6)

143. There should be a provision for proportionate reduction of the penalty in cases where the tax with reference to which the penalty was imposed is partly reduced as a result of appeal, revision, etc. (Para II-8.7)

144. The provision for grant of interest on delayed refunds should, in all cases, take effect only if the refund is not granted within three months from the end of the month in which the assessment is completed. In any event, there should be no question of the Government paying interest on refunds due to the assessee for any period prior to first October of the assessment year. (Para II-8.8)

145. In all cases where interest becomes payable to the assessee on a delayed refund, the same should be reckoned upto the last day of the month preceding the month in which the refund voucher or cheque is issued to the assessee. As the date upto which the interest runs would thereby become ascertainable, the appropriate amount of interest should also be added to the refund of tax, etc., in the same refund voucher or cheque. The format of the refund voucher or cheque should provide for showing the amount of interest separately from the amount of tax or other sum which is being refunded. (Para II-8.9)

146. The refund order should be, broadly, in the form of a cheque, whereas the certificates, etc., may be incorporated in the counter-foil to be retained with the Department. (Para II-8.10)

147. The provisions of section 245 may be extended to cover amounts payable under other direct tax laws also and the assessee may also be given the right to ask for adjustment of refunds against demands payable and, in that event, the date of receipt of the request from the assessee should be taken to be the date of adjustment for the purpose of calculating interest payable or receivable. Where any refund is adjusted by the Income-tax Officer against demand, the date of passing the order of adjustment should be taken to be the date of payment of tax and grant of the refund. (Para II-8.11)

148. Government may consider the introduction of a system of tax accounts in public sector banks, on a compulsory basis in the case of companies and other big taxpayers, and on a voluntary basis in the case of other taxpayers. (Para II-8.12)

CHAPTER 9 : RECOVERY OF TAXES

149. The institution of Tax Recovery Officers should be done away with. The provisions in the Management Act corresponding to section 222 should authorise the assessing officer himself to issue a show cause notice to the defaulter and, thereafter, proceed to recover the taxes by applying the various methods set forth in that section and in the Second Schedule. The rules for recovery of taxes in the Second Schedule should be included as sections in this Chapter of the

Management Act with appropriate drafting changes to enable the assessing officers to exercise these powers instead of the Tax Recovery Officers. (Para II-9.4)

150. Provisions of rules 86 and 87 of the Second Schedule should continue, with appropriate modifications and the appeal against the order of the assessing officer in recovery matters should like to the Commissioner to whom he is subordinate, and not to the Commissioner (Appeals). The order of the Commissioner in such appeal should be final. (Para II-9.6)

151. The notice of commencement of recovery proceedings should be permitted to be issued at any time before the expiry of three years from the end of the financial year in which the demand was made or in which the person concerned is deemed to be an assessee in default. (Para II-9.7)

152. The provision for extension of time in cases where recovery proceedings are stayed by any court should be made applicable also to the stay of such proceedings by the Appellate Tribunal. (Para II-9.8)

153. Provisions of section 281 and 281B should be incorporated in this Chapter of the Management Act with appropriate changes. (Para II-9.9.)

CHAPTER 10 : LIABILITY IN SPECIAL CASES

154. While incorporating provisions of section 160 which defines "representative assessee" for the purposes of the income-tax Act, in the Management Act, it should be ensured that these provisions apply uniformly to wealth-tax, gift-tax and surtax as well. In order to ensure certainty and completeness, this provision may be enlarged to cover a trustee appointed under an oral trust also. (Para II-10.2)

155. The provisions in the Management Act corresponding to section 168 should be so drafted as to ensure that, even where there are two or more executors, the assessment will be made in the status of an 'individual' both for income-tax and wealth-tax. (Para II-10.3)

156. The provisions in the Management Act corresponding to section 171 should be made applicable to a Hindu undivided family assessable as such for any year, whether or not the family had actually been so assessed at any time in the past, and it may be provided that the status of Hindu undivided family will continue as such, except where and insofar as a finding of partition is recorded by the assessing authority. (Para II-10.4)

157. A specific provision should be made requiring the assessing authority to give an opportunity of being heard to any director of a private company before the latter is fastened with the tax liability of the company which could not be recovered from it and also requiring such authority to pass a formal order holding such director to be liable for such tax (where justified) and specifying the amount for which he is so liable. Such

an order should be made appealable. A time limit of two years from the end of the financial year in which the tax due from the company is found to be not recoverable from it should be laid down for passing an order holding the director to be liable for such tax.
(Para II-10.6)

CHAPTER 11 : REGISTRATION OF FIRMS, ASSOCIATION OF PERSONS AND BODIES OF INDIVIDUALS

158. The procedure for registration of partnership firms on the lines recommended in the Interim Report should be made applicable, *mutatis mutandis*, to registration of associations of persons and bodies of individuals also.
(Para II-11.4)

CHAPTER 12 : OFFENCES AND PROSECUTION

159. The existing limit of Rs. 3,000, under section 276CC, should be raised to Rs. 5,000 uniformly for the purpose of all the direct taxes.
(Para II-12.2)

160. In the context of integration of the procedural provisions of the four direct taxes, the provision of section 276D of the Income-tax Act and section 35C of the Wealth-tax Act should be made uniformly applicable to all the four taxes.
(Para II-12.3)

161. The provisions of section 35E of the Wealth-tax Act should be incorporated in the Management Act.
(Para II-12.4)

162. No prosecution should be launched for any default in respect of which the penalty levied or leviable has been waived or reduced.
(Para II-12.5)

163. The provisions of section 280 of the Income-tax Act should be made applicable to unauthorised disclosure of information relating to all direct taxes.
(Para II-12.6)

164. The provisions of section 291, 292 and 292A of the Income-tax Act should be incorporated in the Chapter on offences and prosecutions in the Management Act.
(Para II-12.7)

165. The provisions of rule 89 of the Second Schedule to the Income-tax Act should form part of the Chapter dealing with offences and prosecutions and the punishment for such an offence should be the same as provided under section 275A.
(Para II-12.8)

CHAPTER 13 : MISCELLANEOUS PROVISIONS

166. The relevant rules in the Civil Procedure Code governing service of notices should be incorporated in the Management Act itself.
(Para II-13.2)

167. The provisions relating to registered valuers in the Income-tax Act, Wealth-tax and Gift-tax Act should be incorporated in a single section.
(Para II-13.4)

168. A person who has a minimum of 10 years' service as an income-tax authority not below the rank of a Direct Taxes Officer should be declared eligible to represent an assessee before any tax authority or the Appellate Tribunal after leaving the service.
(Para II-13.6)

169. Section 288(3) should be amended to secure that a person who has retired or resigned from service as a direct taxes authority, not below the rank of Direct Taxes Officer, shall not be entitled to practise for two years at any station, where he had served at any time during the two years preceding the date of his leaving the service, without placing any such restriction against his practising at any other station. Further, even this restriction should not apply for appearance before the Appellate Tribunal.
(Para II-13.7)

170. Section 289 of the Income-tax Act, requiring grant of a receipt for money paid or received under the Act should be incorporated in the Management Act and made uniformly applicable to all direct taxes.
(Para II-13.8)

CHAPTER 14 : APPROVALS UNDER THE TAX LAWS

171. The applications for approval of agreements, contracts, schemes, etc., for various purposes under the direct tax laws should invariably be submitted to the Board even where the approval is to be granted by the administrative Ministry concerned. The procedures for making such applications, the forms to be used and the guidelines which would regulate such approvals, should be laid down in the Rules.
(Para II-14.2)

172. Provision should be made in the law whereby approval will be deemed to have been given if an application is not finally disposed of within a period of 120 days from the date of receipt of the application by the Board.
(Para II-14.3)

173. Uniform terminology of "approval" should be used in relation to provident funds, superannuation funds and gratuity funds.
(Para II-14.4)

174. The provisions relating to approval of funds should be streamlined as follows :

- (1) there should be certain general rules applicable to all the three funds, followed by special rules applicable to each type of fund ; the general rules should cover such matters as procedure for making the application ; requirements regarding maintenance of accounts ; investment of fund money ; grant of approval ; date from which approval is to take effect ; appeal against refusal or withdrawal of approval ; and amendments to the rules of an approved fund ;
- (2) the applications for approval should in all cases, be required to be addressed to the Commissioner having jurisdiction over the Salary Circle and routed through the specified assessing officer of such circle ;
- (3) any fund which has been granted approval should be required to maintain proper accounts containing essential particulars specified in this behalf and get these audited every year ; the auditors should be required to certify that the fund in question continues to satisfy the conditions of approval ; copies

of the accounts, along with the auditor's certificate, should be required to be furnished to the designated Income-tax Officer by a specified date every year together with such other particulars, as may be prescribed; it should also be laid down that the accounts should be maintained in India and all fund moneys should be invested in India;

- (4) there should be uniform provisions governing the investment of fund moneys in the case of all the three categories of funds, fund moneys should be permitted to be invested in short-term deposits with the public sector banks or kept in savings accounts, the investment pattern of fund moneys should be brought on par with that under the Employees' Provident Fund Scheme.

175. A common fund should be allowed to be set up for the benefit of employees belonging to a group of companies which are connected with one another, subject to whatever safeguards are considered necessary to prevent misuse. This would secure economy in administrative costs and also facilitate movement of employees from one concern to another within the same group. Side by side with these provisions, in order to meet a situation where a company in the group, having a common fund wishes to separate from the group for any reason there should be a provision for splitting up the common fund subject to suitable safeguards. (Para II-14.7)

176. There should be uniform provisions for transfer of the balance or accrued benefits from one approved fund to another approved fund of the same type, in respect of all the three categories of funds whenever an employee changes his employment. Further, an employer company may be permitted to make contribution to the account of an employee in a gratuity fund maintained by it after taking into consideration the past service of the employee under the former employer. Where, however, the new employer does not maintain a superannuation fund or where the employee does not take up another employment, the former employer should be required to purchase from the Life Insurance Corporation out of the balance in the superannuation fund account of the employee a non-surrenderable deferred annuity policy in favour of the employee under which payments should be made to the employee on his attaining the normal age of superannuation or on his prior incapacitation or to his widow children, dependents or nominees if he dies before attaining such age. (Para II-14.8)

177. The provisions in rules 6, 8 and 9 of Part A, rules 5 and 6 of Part B and rule 7 of Part C of the Fourth Schedule to the Income-tax Act and rule 72 of the Income-tax Rules are substantive in nature and should not be incorporated in the Management Act. (Para II-14.9)

178. In place of the existing rules 76, 92 and 105 of the Income-tax Rules, treating the consideration received for the assignment or creation of a charge upon his beneficial interest in a recognised provident fund, approved superannuation fund or an approved gratuity fund, as the employee's income, provision should be made in the Chapter relating to penalties for the imposition of a suitable monetary penalty on the employee in such a case. Such monetary penalty may be expressed as a percentage of the consideration, if any, received for such assignment or charge, subject to an alternative minimum amount which should be applicable where no consideration is received by the employee. (Para II-14.10)

179. The provisions in the Management Act and the rules thereunder governing provident funds should be brought in line with those in the Employees' Provident Fund Scheme. (Para II-14.11)

180. The provisions relating to availing of benefits should be made uniform for all the three types of funds and necessary amendments should be made to the rules relating to approval of superannuation funds to bring these on par with rules 67A and 101A of the Income-tax Rules. (Para II-14.12)

181. In the interest of uniformity and to avoid invidious distinction, the provisions in rule 90 may be brought in line with those in section 10(10A). (Para II-14.13)

182. The term 'annuity', for the purpose of the provisions relating to superannuation funds, may be defined to mean an annuity payable for a period of not less than 10 years and may even extend to the life time of an employee. (Para II-14.14)

183. Option should be given to an employee participating in an approved superannuation fund either to have the payment of annuities secured by taking out annuity policies with the Life Insurance Corporation or to receive the annuities directly from the trustees. (Para II-14.15)

184. The provisions applicable to approval of gratuity funds for the purpose of taxation should be brought in line with those under the Payment of Gratuity Act. (Para II-14.16)

CHAPTER 15 : CONCLUSION

185. The various suggestions for improving the administration of the tax laws, particularly in the area of levy, collection and recovery of the direct taxes should lead to a better climate of understanding between the taxpayers and the tax-gatherers. The rigours of a taxing statute can be largely mitigated and made acceptable to the public by an enlightened and fair administration.

PART III

PART III—ESTATE DUTY

INTRODUCTORY

III-0.1. Death duties have been in vogue in varied forms in different countries of the world. This levy is generally either in the form of estate duty or in the form of an inheritance tax. Each of these forms has advantages as well as disadvantages.

III-0.2. In India, estate duty was brought on the statute book in the year 1953 and was made applicable to estates of individuals dying on or after 15-10-1953. It has thus been in existence for the past twentyfive years. The question as to the best form of a death duty has engaged serious attention of various Committees in the past, both in our country as well as outside. We have also received various representations on the subject of either continuing the Estate Duty Act as such or its consolidation with some other Act and even for its repeal in view of the annual levy on "net wealth" under the Wealth-tax Act, 1957.

III-0.3. Dealing with problems relating to estate duty, Shri Bhoothalingam, while saying that an inheritance tax may be more equitable than the present levy, had suggested the maintenance of the *status quo* on the ground that "at long last, the people are getting accustomed" to this enactment. The Wanchoo Committee, while recommending that there should be a complete integration of gift-tax with estate duty by way of aggregation of the taxable gifts made during lifetime with the property passing on death, had also favoured the preservation of the Estate Duty Act in its present form. The recommendation of that Committee was for aggregation of gifts made during the entire lifetime of the deceased with the estate passing on his death and giving a set-off for the gift-tax paid against the estate duty payable.

III-0.4. More recently, in the year 1975, the Asprey Committee in Australia had examined the question of unification of gift duty with the death duty. That Committee has, in categorical terms, favoured the preservation of a separate death duty. One important suggestion of that Committee is on almost identical lines with that of the Wanchoo Committee. It has observed that an estate duty must fall short of its objective unless the tax base was extended to include gifts made by the

deceased during his lifetime and that the prevailing system of aggregation of only gifts made within the three years preceding the death with the estate led to splitting up of the estate with a view to avoidance of estate duty. That Committee, therefore, recommended a complete integration of estate duty and gift duty, while keeping the two enactments separate.

III-0.5. One country which has so far attempted to consolidate death duty with gift-tax is the United Kingdom. There, a new levy termed as the capital transfer tax has in the year 1975 been ushered in after abolishing the estate duty, which was in existence from the year 1894. In the United Kingdom, there had never been a tax on gifts *inter vivos* prior to the introduction of the capital transfer tax. It was in this background that a combined enactment covering both the lifetime gifts and property passing on death was brought into tax all "chargeable transfers of value". Although comparatively new, this tax has already come in for criticism. It has been termed as a severe and unreasonable import. Among the several unsatisfactory features of this tax, the complexities of the new legislation have been highlighted. It is evident that it would not be easy to unify the Estate Duty Act with the Gift-tax Act without introducing serious complications. Besides, our Estate Duty Act is, in itself, a highly complicated piece of legislation and in case it is sought to be unified with any other Act, the existing provisions are bound to become more cumbersome and complex. **We are, therefore, not in favour of consolidation of the estate duty Act with any other direct tax enactment.**

III-0.6. The other suggestion for scrapping altogether the estate duty levy is, in our view, not justified since estate duty has an essential role to play. A death duty serves two main purposes. Firstly, it serves to support the progressivity of the tax structure and, secondly, it limits the growth of large inherited fortunes and thus caters to a socialistic objective. After fully weighing the pros and cons of the continuation of the present levy or its unification with any other enactment, **we recommend the continuance of the estate duty Act.**

CHAPTER I

DEFINITIONS

III-1.1. Our Estate Duty Act was modelled on the lines of the English statute almost wholly in respect of the substantive law and broadly so in respect of procedural matters. This Act has not undergone many substantial changes for the last several years whereas the other direct tax laws have witnessed major changes. In the interest of simplification and rationalisation, the Estate Duty Act needs to be amended to bring its substantive provisions to be in keeping with Indian conditions and its procedural provisions in line with those in the other direct taxes, apart from other comprehensive amendments on numerous counts, including building in certain basic concepts, which are presently wanting.

III-1.2. We notice that, at present, the Estate Duty Act, 1953 lacks even the fundamental concept of a precisely spelt out dutiable base. A specific definition of "principal value of the estate" is itself absent in the enactment. This is clearly in contrast to the well-defined taxable base like the "total income" under section 2(45) of the Income-tax Act, 1961 and the "net wealth" under section 2(m) of the Wealth-tax Act, 1957. In section 5 of the Estate Duty Act, which is the charging section, there is no clear-cut meaning or definition of the base for charge of duty. The basic concept of subjecting to duty, the sum-total of the market values of all properties passing or deemed to pass on death has to be gathered by reference to other sections such as, section 3 and 34 besides the charging section. We, therefore, recommend that the term "principal value of the estate" may be used to indicate the base for charge of duty and it may be defined to mean the aggregate of the market values of all property, settled or not settled, including agricultural lands, which passes or is deemed to pass on the death of a person as reduced by the debts and incumbrances and after allowance of the admissible deductions. Once this term is given a technical meaning, any similar expression, viz., "principal value", used elsewhere in the act to denote the market value of a single item of the deceased's property as in sections 20A, 34, 36, 39(3) etc., will necessary have to be suitably modified for the sake of clarity.

III-1.3. Corresponding to the definition under section 2(10) of the Income-tax Act, 1961 of the expression "average rate of income-tax", there is no definition of "average rate of duty" in the Estate Duty Act. We are of the view that such a definition is necessary firstly, because the duty payable might be required to be apportioned between different accountable persons on the parcels of estate inherited by them for determination of their individual liability out of the joint

and several liability under section 53(5) of the Estate Duty Act. Secondly, some of the properties, exempt from duty, e.g. agricultural lands in the non-adopting states of West Bengal and Jammu & Kashmir, are aggregable only for determination of the rate of duty. For certain other purposes, such as, calculating the allowance for quick succession or deduction on account of gift-tax, court-fees or income-tax on capital gains from the estate duty, also, it is necessary to compute the estate duty attributable to a part of the principal value of the estate. The rate of duty to be employed for making these calculations has necessarily to be worked out at the average rate. A specific definition of "average rate of duty" will enable working out of the net duty payable in a precise manner. For this purpose; it would first be necessary to define "gross duty payable", as the amount of duty calculated on the "principal value of the estate" in accordance with the rates specified in the second schedule to the estate duty act, 1953 and then to provide that the "Average Rate of duty" means the rate arrived at, by dividing the "gross duty payable" by the principal value of the estate". We accordingly recommend that the terms "gross duty payable" and "average rate of duty" may be defined in the manner indicated.

III-1.4. The Estate Duty Act, at present, does not contain separate definitions of some important authorities like the Assistant Controller and the Deputy Controller of Estate Duty. There is only an inclusive definition in section 2(5) of the term "Controller", which includes the said two functionaries also. Section 4, which spells out the estate duty authorities also does not specify, in clear terms, that the Assistant Controller and the Deputy Controller are also "authorities" for the purposes of the Act. We are informed that by way of an administrative measure, assessment functions have been allotted to the Assistant Controller of Estate Duty, whereas the Controller of Estate Duty and the Deputy Controller of Estate Duty perform only supervisory functions. Under the law as it stands, a Controller of Estate Duty or Deputy Controller of Estate Duty can neither issue binding instructions to Assistant Controllers of Estate Duty nor are the latter statutorily subordinate to the former, as is clearly provided in relation to the corresponding authorities under the Income-tax Act and other direct tax laws. In our view, it is necessary to constitute the Controller of Estate Duty, Deputy Controller of Estate Duty and Assistant Controller of Estate Duty as distinct authorities under the Estate Duty Act with powers and functions similar to their counterparts under the other direct tax laws.

CHAPTER 2

BASIS OF CHARGE OF ESTATE DUTY

III-2.1. Section 5 of the Estate Duty Act is the charging section. It provides for the levy of estate duty on the principal value of all property, settled or not settled, including agricultural lands situated in the territories which immediately before 1.11.1956 were comprised in the States specified in the First Schedule, which passes on the death of a person. By virtue of sub-section (3) of section 3, property passing on death includes property deemed to pass on death. Under section 6 to 17, certain items of property are deemed by law to pass on the death. In actual working, some of these provisions have revealed certain dark corners leading to complications and disputes. In this Chapter, we shall deal with some of these provisions with a view to rationalising and simplifying them.

III-2.2. Under section 6, property, which the deceased was, at the time of his death, competent to dispose of, is deemed as passing on his death. Problems have arisen in the applicability of this section when some property of the deceased is held *benami*. The legal position in regard to the dutiability of such property has been sought to be clarified by judicial pronouncements in *Chawla vs. Assistant Controller of Estate Duty, Allahabad (1973) 90 ITR 68* (Full Bench decision), *Controller of Estate Duty, Punjab vs. Manchanda (1974) 93 I.T.R. 173*, *Aloke Mitra vs. Controller of Estate Duty, Allahabad (1971) 82 ITR 430* and in *Controller of Estate Duty, Uttar Pradesh vs. Kochhar (1973) 89 ITR 216*. In the first case, it was held by the Court that since the deceased had the real title to the property, viz., the beneficial interest in the property and the *benamidar* was having only a nominal title thereto, the property passed under section 5 of the Estate Duty Act on the death of the beneficial owner and was dutiable, although section 6 was inapplicable. In *Manchanda's* case, the Court ruled that since the legal title to the property vested in the *benamidar*, who was, therefore, competent to dispose of it, on the *benamidar's* death, the property would be deemed to pass under section 6 of the Estate Duty Act, notwithstanding the fact that somebody else had the beneficial interest. In the third case of *Aloke Mitra*, it was decided that neither section 5 nor section 6 was applicable. There, the Court held that the beneficial owner has no competency to dispose of the property, which stands *benami*. In *Kochhar's* case too, the revenue's claim to levy duty made under section 6 on the death of the beneficial owner of the property was negated. Apart from this cleavage of judicial opinion, the Department, we understand, makes an attempt to subject to duty the same property both on the death of the real owner as well as of the *benamidar*. This, evidently, leads to avoidable litigation. We feel that it is unfair to charge duty on property on the death of the *benamidar*, who is in the position of a trustee under the general law. We, therefore, recommend

that the law should make it clear that on the death of the real (beneficial) owner, property held *benami*, would pass under section 5 of the Estate Duty Act, 1953 and that on the death of the *benamidar*, section 6 would not be applicable on the mere ground that the *benamidar* was legally competent to dispose of the property.

III-2.3. Section 9 deems property taken under a disposition made by the deceased, purporting to operate as an immediate gift *inter vivos*, whether by way of transfer, delivery, declaration of trust, settlement upon persons in succession or otherwise, within the period of two years before the death of the deceased as passing on the death. (This period is hereinafter referred to as the "statutory period" or the "vulnerable period"). The meaning of the term "disposition" is extended by the two *Explanations* to clause (15) of section 2 defining "property". Further, under clause (b) of sub-section (1) of section 3, a disposition taking effect out of the interest of the deceased is deemed to have been made by him whether the concurrence of any other person was or was not required. Under section 27, a disposition made by the deceased in favour of his relative (as defined in that section) is treated as a gift for the purpose of the Act, unless the disposition was made for full consideration paid to the deceased for his own use or benefit. In case such a disposition was made for partial consideration, the value remaining after deduction of the said consideration from the full value of the property is to be treated as gift. It would thus be seen that the dispositions contemplated by section 9 are fairly wide in their sweep and the question of any extension of the scope of section 9 has, therefore, to be viewed in this perspective.

III-2.4. The enlargement of the vulnerable period of two years specified in section 9 of the Estate Duty Act had earlier come up for consideration by the Wanchoo Committee. In para 3.79 of their Final Report, that Committee had recommended that the principle of aggregation of gifts should be extended further so as to achieve complete integration with estate duty and for this purpose, all taxable gifts made during his life-time by the deceased should be included in the principal value of the estate subject to allowing credit for the gift-tax paid. That Committee had further suggested lowering of exempted threshold of taxable gifts in a year to Rs. 1,000/-, taxing of gifts of a year after aggregating the gifts made earlier and securing of equity between a person who makes gifts in his lifetime and another who leaves his property in its entirety on death to his heirs. We understand that the Government has, in principle, accepted these recommendations with certain modifications. In respect of the recommendations relating to estate duty, the actual modifications under contemplation are,

however, not known to us. We are, all the same, conscious of the fact that in countries like U.S.A. and the U.K., aggregation of whole-life gifts with estate passing on death has been achieved.

III-2.5. Against the above background, we have examined the question as to how far the complete integration of lifetime gifts with the estate passing on death would be practical and rational under our system of taxation. We find that firstly, the pattern of gift-tax rates, in our country, is basically different from that elsewhere. In contrast with the scheme in other countries, our gift-tax rates in the lower slabs are higher than the estate duty rates. This pattern, by itself, tends to inhibit, to a certain extent, a person from making gifts in his lifetime with the ultimate object of avoiding estate duty liability. This is more so after the principle of aggregation of gifts made in the previous four years has been introduced, under the new section 6A of the Gift-tax Act pursuant to the Wanchoo Committee's recommendations (Para 3.76 page 86). Secondly, even in the United Kingdom, the complete unification of the levy on transfers *inter vivos* with those on death was brought about gradually. The principle of aggregation of gifts for estate duty purposes was extended initially from two years to five years and then to seven years and finally to the whole life recently in the year 1975, under the Capital Transfer Tax Act. Thirdly, the principle of aggregation of life-time gifts is likely to result in a practical difficulty for the legal heirs as well as for the Department, viz. of the requirement of going through the records, spread over the entire life-span of 50 to 60 years or more of the deceased, for ascertaining all the gifts made by him and the gift-tax paid thereon. Integration of lifetime gifts with the estate passing on death may also, in some cases, result in genuine hardship where the donee has either lost the property gifted, for reasons beyond his control, or he has converted such property into other assets which have fallen considerably in value while the property originally gifted has not suffered any such depreciation in value or has even appreciated in value. It has also to be kept in view that in the case of gifts to the spouse or to minor children, the income from the gifted property is assessed to income-tax in the hands of the donor and such income-tax over a period of years may aggregate to a substantial amount, thereby reducing the extent of tax avoidance which the donor might have had in view when he made the gift. Similar position obtains in respect of wealth-tax on the gifted property where also it is assessed as the net wealth of the donor, subject to some exceptions, year after year for his lifetime in the case of gifts to his spouse and for a number of years during the minority of the children. On considerations of rationality and of practical working, we would, therefore, favour the aggregation of gifts only upto a period of five years prior to the date of death instead of the gifts made during his entire life by the deceased. We, accordingly, recommend that the statutory period of dutiability under section 9 of the Estate Duty Act may be extended from two years to five years only.

III-2.6. We understand that on the scope of section 9, a controversy has arisen with regard to the dutiability of insurance premia, on a policy under the Married

Women's Property Act, 1874, paid by the deceased within the vulnerable period. The Department, it is learnt, includes such payments in the principal value of the estate on the ground that section 9 read with section 27 is attracted, the payments being regarded as dispositions in favour of a relative, viz., his wife or children. We are unable to appreciate the logic of this stand. The payments of the premia, which are in discharge of the contractual obligation to the insurance company cannot constitute a gift. Apart from this, the policy amount is itself dutiable on the death of the person, although this may be a non-aggregable estate under the provisions of section 34(3). Subjecting to duty both the premia and the policy moneys would, therefore, tantamount to double taxation which would appear to be expressly prohibited under sub-section (5) of section 34. With a view to removing any ambiguity in this regard, we recommend that a clarificatory provision may be made in the law to the effect that payment of any premium by the deceased, for effecting or keeping in force a policy taken out under the Married Women's Property Act, 1874, is not to be regarded as a gift for the purposes of section 9 of the Estate Duty Act.

III-2.7. Section 10 of the Estate Duty Act seeks to extend the liability to duty in relation to gifts even beyond the period specified under section 9, in a case where the donor has not been entirely excluded from possession or enjoyment or where there has been some reservation of benefit to the donor. This provision is intended to prevent avoidance of duty by the donor parting with the property only in form, but retaining for himself the enjoyment of, or substantial benefits from, the property. Outright gifts by the deceased of cash amounts to donees who deposit the monies so received in the business of the firm in which the deceased was a partner have been regarded as attracting duty under section 10 on the death of the donor, whereas gifts by entries in the firm's books, followed by retention of the gifted amounts in the firm's business, have been treated as falling outside section 10, by virtue of the Supreme Court's ruling in Ramchandra Gounder's case (88 ITR 448). In the full Bench decision of the Punjab and Haryana High Court, in the case of Controller of Estate Duty, Punjab vs. Jai Gopal Mehra (1972) 85 ITR 175, it had been held that the subsequent deposit of the gifted amounts with the firm by the donees who were not partners therein did not mean that the partners individually, including the deceased, became possessed of the same, so as to attract the provisions of section 10, since the donees did not lose their hold and the exclusion of the donor-partner remained complete. A subtle distinction has, however, been drawn between gifts made by handing over cash and those made by means of transfer entries, by the Gujarat High Court in the case of Sakarlal Chunilal vs. Controller of Estate Duty, Gujarat (1975) 98 ITR 610, (where both types of gifts were involved) while considering at length and explaining the said Supreme Court ruling. The result is that if the deceased had made a gift by handing over to the donee some cash after withdrawal from the business of the firm in which he was a partner and that amount was subsequently invested in the business of that firm, the gifted amount could still be subjected to duty under section 10. On the other hand,

if the cash was not so withdrawn but the gift was made through book-entries in the accounts, the gift would be regarded to have been made shorn of certain rights and section 10 would not be attracted in view of the Supreme Court's ruling in Ramchandra Gounder's case (Supra). We are of the view that despite the subtle distinction, the two types of gifts, one through book-entries and the other by cash, should be treated on par for purposes of section 10 of the Estate Duty Act. We, therefore, recommend that the law may be suitably amended to provide that where cash gifts received by the donee from the deceased, who was a partner in a firm, are deposited in the business of that partnership, such gifted property would not be liable to duty under section 10 of the Estate Duty Act, 1953, regardless of the position whether the donee is a partner in the firm or not.

III-2.8. In the application of section 10, another problem arises in those cases where the gifted property has been converted into one of a different species. In such cases, even though there may be non-exclusion of the donor from the converted property, the charge under section 10 can be defeated on the view that the converted property is not the "property taken under the gift" and that, insofar as the property originally gifted is concerned, the exclusion of the donor is complete. This is what actually happened in the case of Shamsun Mansur vs. Controller of Estate Duty, West Bengal (1969) 71 ITR 301 and in Estate of late T. D. Kochhar (89 ITR 216), in spite of the extended definition of the term "property" under section 2(15) to include "any property converted from one species into another by any method". The effectiveness of the provisions of section 10 can thus be easily eroded by conversion of the gifted property into another of a different species. A similar situation under the Wealth-tax Act has been set right by defining the expression "property" for the purposes of section 4 which deems certain gifted assets to belong to the individual. We, accordingly, recommend that for the removal of doubts, the definition of the term "property" under section 2(15) of the Estate Duty Act may be expressly made applicable to the provisions of section 10.

III-2.9. The first proviso to section 10 of the Estate Duty Act, refers to the statutory period of two years. This proviso stipulates that even if the donee did not, as from the date of the gift, retain *bona fide* possession and enjoyment of the gifted property to the entire exclusion of the donor or of any benefit to him by contract or otherwise, there could still be immunity from the charge, if it was subsequently enjoyed by the donee, to the donor's entire exclusion or of any benefit to him, for at least two years, prior to the deceased's death. The statutory period in this section is linked with the period specified in section 9, for which we have earlier recommended the increase from two years to five years. In keeping with our recommendation under section 9, we recommend that the statutory period under the first proviso to section 10 should also be increased to five years.

III-2.10. In the working of section 10, one irrationality arises where the provisions thereof become applicable even if the deceased had retained the possession and enjoyment of the gifted property for full or partial consideration. The result is that in case

A makes an absolute gift of his property (say a plot of land) to B, who lets it back to A at a fair and full rent, the charge under this section will nevertheless attach at A's death on the said property. In an actual case, the court was constrained to observe that "the lease, however, gave to the donor possession and enjoyment of the land itself which is a simple negation of exclusion, and brings the case within the statutory liability". The argument that as the rent was for full value, the lessee's possession and occupation were not a benefit was negated by the court on the following that "lease at whatsoever rent, prevents, the entire exclusion of the donor". The injustice caused in such circumstances was recognised in the United Kingdom and remedied by an appropriate amendment of the corresponding provision. [Section 35(2) of the U.K. Finance Act, 1959]. We see considerable substance in this representation and would, therefore, suggest suitable modification of the provisions of section 10. Accordingly, we recommend that an explanation may be added at the end of section 10 to the effect that possession and enjoyment of the gifted property by the donor or any benefit reserved to him therein will not result in the charge to the proportionate extent of the consideration, in money or money's worth paid by the donor to the donee, for such possession and enjoyment or benefit, in other words, if the consideration paid is partial in relation to the fair and full yield, only proportionate exclusion will be available.

III-2.11. Section 11 provides that in case any interest limited to cease on death has been disposed of or has determined, then, if but for the disposition or determination of such limited interest, the property would have passed under section 5 or would have been deemed to have passed under section 7, it will be deemed to pass in case the deceased died within the statutory period of two years or in case he survived that period, he was not excluded from possession and enjoyment of the property in which the interest subsisted or he had reserved to himself a benefit therein. Section 11 is thus primarily meant to counter avoidance of liability to duty either under section 5 or under section 7 by disposing of the limited interest before death. However, a common device popularly known as "grafting", viz., the extension of the life-interest by an assignment to the life-tenant by the reversioner of an interest for a fixed period, which might extend for a short period after the death of the life-tenant, is likely to result in avoidance of duty on the whole of the property. In the United Kingdom, the possibility of this loophole, which was brought to light by the decision of the House of Lords in *Ralli Brothers Ltd. vs. Inland Revenue Commissioners* (1966) A.C. 483, was plugged by section 40 of the U.K. Finance Act, 1966. Thereafter, the dutiability of interest ceasing on death has been recast in a substituted section 2(1)(b), (corresponding to section 7 of our Estate Duty Act), enacted by section 36 of the U.K. Finance Act, 1969, with the result that liability to charge arises in all cases, if at any time, within the statutory period the deceased was entitled to a beneficial interest as a beneficiary or as successor to an interest of a beneficiary under settlement, which determined or was disposed of. With a view to preventing leakage of

revenue through this device and to keep up the efficacy of the provisions of sections 5, 7 and 11, we recommend that a suitable amendment may be made on the lines of section 36 of the U.K. Finance Act, 1969. At the same time, it is necessary that the vulnerable period of two years mentioned in Sub-section (2) of section 11 is increased to five years in line with our recommendation for a similar increase of the period under section 9.

III-2.12. Section 12 deems property passing under any settlement made by the deceased to pass on his death if an interest in such property is reserved for the settlor for life or any period determinable by reference to death or where the settlor has the power to restore to himself absolute interest in such property. The section has two limbs. In the first limb, the application of section 12 relates to the settlements in which the deceased settlor had reserved to himself an interest in the settled property. This part of the provisions will apply however small the interest reserved might be. It has been represented to us that the rigours of section 12 require to be mitigated on the lines obtaining under section 10. It has been pointed out that the main difference between the provisions of section 10 and those of section 12 is that whereas under section 10, the gifted assets are includible only "to the extent" that the deceased was not excluded therefrom, under section 12, the entire value of the settled property is includible, if the deceased was not excluded from any portion thereof. In section 10, the words "to the extent" are rightly intended to provide that in the event of the donee assuming bona fide possession and enjoyment of a part or fraction of the gifted property and thenceforward retaining it to the entire exclusion of the donor or of any benefit to him by contract or otherwise, estate duty is payable not in respect of the whole of the gifted property but only in respect of that part or fraction of the gifted property, from which the donor was not so excluded. However, as far as section 12 is concerned, any reservation of interest howsoever small in the property, settled by the deceased, will result in the whole of the settled property being brought to charge and not merely that part thereof in relation to which the reservation of interest subsisted. The representation, in our view, is well-merited. There is hardly any justification in subjecting to duty the whole of the settled property, if the reservation of interest therein is partial. We, therefore, recommend that section 12 may be amended suitable to limit the charge in proportion to the value of the interest reserved. As in sections 9, 10 and 11, there is a reference to the statutory period of two years also in section 12(1). In keeping with our recommendations in relation to those sections, we recommend that this period may be increased from two years to five years in section 12(1) as well.

III-2.13. Sections 14 to 16 relate to policies kept up for the donee and to annuities or other interests, purchased or provided by the deceased or purchased or provided by any person out of property derived from the deceased. In the application of these provisions, a representation has been made with regard to the dutiability and aggregation of the moneys receivable under personal accident policies. It has been urged that the moneys so receivable should not be subjected to charge or in the alternative not aggregated with the other estate of the deceased. We notice that the dutiability or otherwise of amounts receivable under such policies would depend upon the facts of each case. No doubt, such a policy may not be covered under section 14 since it generally involves payment of a single premium and may not, therefore, be said to be "kept up" by the deceased. But, if there was a right of nomination, the amount would be dutiable under section 6 of the Estate Duty Act by reason of the deceased's power of disposal. The charge under section 15 can also get attracted if the interest was provided or purchased by the deceased. Even section 5 has been held applicable by the Gujarat High Court in *Bharat Kumar Manilal Dalal vs. Controller of Estate Duty, Gujarat* (1975) 99 ITR 179, on the ground that the deceased does have an interest during his life-time in the contract of insurance and the moneys payable thereunder on the happening of the contingency of accident. On the question of total exemption of such policies, therefore, we do not see much justification since much would depend upon the facts of an individual case. However, on the question of non-aggregation of the moneys received under such policies, we find that the representation merits consideration because of the conflicting judgments of the Gujarat and Madras High Courts. Dissenting from the judgment of the Madras High Court in *M. Ct. Muthiah vs. Controller of Estate Duty, Madras* (1974) 94 ITR 323, the Gujarat High Court has held that the moneys payable under a personal accident policy are to be aggregated with other properties of the deceased and are not to be assessed as an estate by itself. We think that the view taken by the Madras High Court is more equitable because the moneys become receivable under a personal accident insurance policy for the first time, the moment after death. With a view to reducing litigation on this issue, we, therefore, recommend that a suitable clarification may be made in the law to the effect that the proceeds of such policies, wherever otherwise passing on death, should not be aggregated with the other property of the deceased.

III-2.14. Sections 17 to 20 of the Estate Duty Act, 1953 contain special provisions relating to property transferred by the deceased to a controlled company. Their main purpose is to defeat avoidance of duty by the mechanism of transferring property to a controlled company. These provisions are deterrent and should, in our view, continue to exist as such.

CHAPTER 3

EXCEPTIONS FROM CHARGE

III-3.1. The provisions relating to exceptions from the charge of duty are contained in Part III of the Estate Duty Act comprising sections 21 to 33. We have deliberated upon these provisions in the light of various representations before us. In this Chapter, we shall deal with these excluding the exemptions under Section 33 which are discussed separately.

III-3.2. Section 21 relates to exclusion of foreign property of the deceased. Clause (a) of section 21(1) exempts from duty all immovable property situated outside India in all cases. Under clause (b) of section 21(1), movable property situated outside India is also not liable to duty except where the deceased was domiciled in India, or in the case of settled property of which the deceased was a life-tenant, the settlor was domiciled in India on the date of the settlement. The nationality and residence of the deceased have thus no bearing on the availability of the exemption in respect of foreign movable property.

III-3.3. We have received suggestions that the concept of "domicile" in section 21 in relation to exemption should be changed to "citizenship". It has been urged that citizenship is a clearer and more stable concept capable of easier verification than domicile and that, therefore, it would be simpler both administratively as well as from the view point of the legal representative to adopt the concept of citizenship. This very question, we find, had been examined by the Select Committee before the Estate Duty Act was enacted in the year 1953. Although that Committee had sought to alter the concept of "domicile" to residence and impose liability on all persons resident in India, their recommendation was not incorporated in the final enactment. We also notice that those countries of the world, which have adopted the concept either of citizenship or residence, have simultaneously cast the tax-net wider by subjecting to duty even the foreign immovable properties of the deceased and then providing for double taxation relief, thereby making the provisions more complicated.

III-3.4. After careful consideration, we are not in favour of the change from the concept of domicile to either citizenship or residence. Such a change would result in introducing avoidable complications in the law. Besides, there are many persons of Indian origin, who, while holding British or other citizenship, are either having a permanent residence in India or would be contemplating their ultimate abode in this country. On the basis of their intention to spend the evening of their lives in India, their domicile could be taken to be Indian and their foreign movable property made liable to duty. If the concept of domicile is given up, it might result in escapement from duty of such

properties. Considering all these aspects, we recommend continuation of the concept of domicile in preference to that of either citizenship or residence, for purposes of section 21 of the Estate Duty Act.

III-3.5. For determining whether a particular piece of property is movable or immovable and whether the same is located in India or outside India, rules 7, 8 and 9 have been framed in the Estate Duty Rules, 1953 for the purposes of section 21. Interest in a partnership is treated as movable property notwithstanding that the firm may own immovable property, in terms of rule 7(c). Similarly, under rule 7(e), the share in a company is movable property even though the company may own immovable property. Rule 7(g) provides that the interest of a beneficiary in an unadministered estate is movable property without stating specifically that it would be so notwithstanding that the unadministered estate includes immovable property. We, therefore, recommend that rule 7(g) of the Estate Duty Rules, 1953 may be amended to make it clear that the interest of a beneficiary in an unadministered estate is moveable property even if the estate includes immovable property.

III-3.6. Section 22 exempts from duty property held by the deceased as a trustee subject to certain conditions. This exemption stands forfeited in the case of a disposition made by the deceased, if the possession and enjoyment of the property was not *bona fide* assumed by the beneficiary at least two years before the death and thenceforward retained by him to the entire exclusion of the deceased or of any benefit to the deceased by contract or otherwise. The said period of two years corresponds to the identical vulnerable period specified in other sections, viz., 9, 10, 11, 12, etc. In line with our recommendation elsewhere in this report for the increase in the statutory period from two years to five years under sections, 9, 10, 11, 12, etc., we recommend that the statutory period stipulated under section 22 of the Estate Duty Act should similarly be increased to five years.

III-3.7. Sections 25 and 29 of the Estate Duty Act, 1953 grant relief from payment of duty in certain cases of husband-wife settlements. Section 25 deals with settlements effected before the commencement of the Act, whereas section 29 deals with cases in which estate duty has been paid on one spouse's death irrespective of when the settlement was made.

III-3.8. Under section 29, if estate duty has been "paid" in respect of any settled property (since the date of settlement) on the death of any one party to a marriage, duty shall not again be payable on the very property on the death of the other party to the marriage provided the surviving spouse was not competent to dispose of the property. In a case where no

duty is "payable" by reason of any exemption, say, under section 33(1)(n) on the death of the first party to the marriage or by reason of the estate being below the dutiable limit, it would mean that the relief cannot be claimed on the death of the other party, since it cannot be said that estate duty was "paid" on the death of the first party. The legal position in the United Kingdom was identical till the law was altered by section 32(2) of the Finance Act, 1954, which provided that for the purposes of the exemption, estate duty will be deemed to have been paid on any property passing on the first death even though it was not actually paid on that death by reason only of the value of the property falling below the dutiable limit. We recommend that the provisions of section 29 may be amended to cover both the situations viz. of a property being exempt as also the estate being below the dutiable limit on the first death, on lines similar to section 32(2) of the U.K. Finance Act, 1954.

III-3.9. Section 29A of the Estate Duty Act exempts certain pensions and annuities payable to the widow and other dependants of the deceased from the charge of duty. It has been brought to our notice that as the word "dependants" has not been defined, the grant of exemption has led to difficulties in certain cases. We find that section 33(1)(k) refers to certain relatives of the deceased, who were "dependant upon him for the necessaries of life". The expression used in section 33(1)(k) is thus more specific. We recommend that the word "Dependants" in Section 29A may be replaced by the expression "relatives of the deceased dependent upon him for the necessaries of life". Another difficulty in the grant of this relief, we understand, is the ascertainment of the market value of dutiable part of the pension or annuity, when it exceeds Rs. 15,000 per annum. The excess pension or annuity has necessarily to be evaluated before being subjected to duty. However, neither the Act nor the Rules lay down any method of valuation. To avoid disputes regarding valuation, which arise in those cases where the deceased was a salaried employee, some formula for capitalisation should be devised as in the case of valuation of life-interest under rule 1B of the Wealth-tax Rules, 1957. We recommend that Jellicoe's formula with a rate of interest equal to that allowed by Nationalised Banks on long-term deposits of more than five years may be prescribed for the purpose of determination of the market value of the dutiable part of the annuity or pension under section 29A.

III-3.10. It has been represented before us that the benefits of section 29A require to be liberalised in the cases of annuities taken out under section 80E of the Income-tax Act, 1961. It has been pointed out that the annuity receivable by the widow or dependants on policies taken out under section 80E of the Income-tax Act, 1961 are not exempt under section 29A of the Estate Duty Act even though in the case of such policies also, the arrangement receives the approval of the Commissioner of Income-tax. The suggestions in this representation are that firstly, similar exemption be provided to the dependants who become beneficiaries under a section 80E policy and, secondly, that for all cases, the figure of Rs. 15,000 under section 29A be enhanced to Rs. 30,000.

III-3.11. To us, it appears that the intention behind allowing relief under section 80E of the Income-tax Act, 1961 was to make available the facility for provision of retirement benefits to those professionals who are partners in a registered firm rendering professional services and who pay a premium under an approved annuity contract which provides to them or to their families a life-annuity in old age. The representation seeks to point out that there is hardly any justification in not extending the benefit available for income-tax purposes to that for estate duty assessment as well. Elsewhere in this Report, we have ourselves highlighted the need for liberalisation of the concessional treatment to which the salaried taxpayers are entitled in the matter of their long-term savings, to the selfemployed persons also. We have accordingly recommended that the benefits under section 80E of the Income-tax Act should not be restricted to partners of registered firms but should be granted even to self-employed professionals. In that background, we find considerable substance in this representation, although we do not see much justification in the suggestion for stepping upwards the exempted ceiling under section 29A of the Estate Duty Act. In keeping with our recommendation, elsewhere in this report, for liberalisation in the provisions of section 80E of the Income tax Act, 1961, we recommend that an annuity payable to the widow or other relatives of the deceased dependent upon him for the necessaries of life, under a contract approved under section 80E of the Income-tax Act, 1961, should be eligible for exemption under section 29A of the estate duty Act, 1953 to the extent of Rs. 15,000 per annum. In making this recommendation, we have taken note of the fact that the annuity under an approved contract under section 80E of the Income-tax Act is normally payable to the individual himself after the superannuation age for his life, in which case no property would pass, or for a specified term, not exceeding ten years, to any other person. With the exempted limit fixed at Rs. 15,000 per annum, such a provision in the Estate Duty Act will, therefore, ensure for the welfare of the family in case of premature death of a professional person, without much sacrifice to revenue.

III-3.12. Section 31 of the Estate Duty Act provides for relief from duty on "the same property", consequent upon deaths taking place in quick succession. At present, the power to grant this relief is vested in the Board. As the relief under section 31 is of a routine nature and the working is on the basis of fixed percentages laid down in the section itself we are of the view that the power to grant this relief can conveniently be delegated to the assessing officer, viz., the Assistant Controller of Estate Duty. Such a step would expedite disposal of these claims.

III-3.13. In the actual computation of the quick succession relief, we find that there are certain practical difficulties which require to be set right so that the areas of dispute can be minimised. The words "the same property" occurring in section 31 had appeared in the U.K. law too and had been judicially interpreted in *Glén v. Inland Revenue* (1926) S.C. 44 in very strict terms. It was held that the proceeds of the sale of a property are not "the same property". The test to be applied, therefore, is that the character of the

property should not have undergone a change. In other words, the property must remain without change of identity between the two deaths. This very narrow meaning given to the words "the same property" was set right in the United Kingdom by an appropriate amendment under the Finance Act, 1958. We recommend that the quick succession relief under section 31 should be allowed if the second deceased has at his death adequate resources to cover what he inherited on the first death without the need for tracing actual dealings with the property through sale and re-investment between the two deaths.

III-3.14. The requirement in the proviso to section 31, viz., that the lower of the two values of "the same property" suffering duty again on the second death "shall be substituted" for calculating the relief is not specific. For example, it is not clear as to whether the lower value is to be substituted in the principal value of the estate of the second deceased for the said purpose of computing the reduction or is to be merely adopted as the amount on which the average rate is to be applied. The ambiguity may be explained by means of an example: Assuming that on A's death, a property P valued at Rs. 2,00,000 passes to B, and that at the time of B's death within two years, suppose that the value of the property P has appreciated to Rs. 2,50,000 and that the principal value of B's estate is Rs. 4,00,000, the relief can be computed in either of two ways as hereunder: Gross Estate Duty payable on B's estate viz. with Principal value of the Estate

Rs. 4,00,000/- will be .. Rs. 47,000 (A)

Estate Duty payable on 'B's estate if the value of Rs. 2,50,000 is substituted by Rs. 2,00,000 viz. the smaller of the two values in the Principal value of the estate (which will stand reduced to Rs. 3,50,000) will be .. Rs. 34,500 (B)

(i) Relief may be worked out from (A) to be :

$$\frac{47,000}{4,00,000} \times \frac{2,00,000}{1} \times \frac{40}{100} = \text{Rs. } 9,400$$

OR

(ii) Relief may be worked out from (B) to be :

$$\frac{34,500}{3,50,000} \times \frac{2,00,000}{1} \times \frac{40}{100} = \text{Rs. } 7,886$$

In our view, the proper computation of the relief should be as indicated at (i) above viz., Rs. 9,400. Since there seems to be a doubt in the manner of computation, having regard to the language of the proviso to section 31, it is necessary to clarify the position. We recommend that a suitable amendment of the proviso to section 31 may be made to make it clear that, where the proviso applies, the reduction in the estate duty payable on the second death will be worked out with reference to the amount of duty calculated on the value of the property as on the first death at the "average rate of duty" on the principal value of the estate computed on the second death.

CHAPTER 4

OTHER EXEMPTIONS AND REBATES

III-4.1. We shall now proceed to deal with other exemptions from charge of duty under section 33, aggregation of property under section 34(1) and rebates under sections 34(2) and 35(3) of the Estate Duty Act. Section 33 contains a series of exemptions under clauses (a) to (p) of sub-section (1) thereof. Most of these exemptions are by way of exclusions from the principal value of the estate except those specified in clauses (a), (b), (f) (g), (h) and (k) where the amounts stand included in the principal value but rebate is admissible thereon in the manner provided under section 34(2). Under section 35(3) relief by way of partial rebate is admissible in the case of estates whose principal value does not exceed Rs. 2 lakhs and which include agricultural lands situated in the States specified in the First Schedule.

III-4.2. In order to simplify the calculations of duty it would be desirable that the system of rebates as far as feasible is replaced by straight deductions as is provided for under Chapter VI-A of the Income-tax Act, 1961. At present, the maximum amounts on which certain rebates are admissible under section 33(1) and under section 35(3) of the Estate Duty Act, are as under :—

(i) Clauses (a) & (b) of section 33(1)	Rs. 4,000/-
(ii) Clauses (f) & (g) of section 33(1)	Rs. 50,000/-
(iii) Clauses (h) & (k) of section 33(1) [taking only one dependent relative for purposes of clause(k)]	Rs. 15,000/-
TOTAL	Rs. 69,000/-

(iv) Section 35 (3), in case the principal value of the estate does not exceed Rs. 2 lakhs and includes agricultural land. 1/4th of the duty attributable to the value of the agricultural land.

We have considered the revenue implications of substituting the present system of rebates by straight deductions. We find that there would not be much sacrifice to revenue, if the rebate under section 35(3) is replaced by a flat deduction to the extent of 10 % of the value of agricultural land and the value of other exempted items, mentioned above, is fully excluded in determining the principal value of estate itself. We, therefore, recommend that the reliefs under clauses (a), (b), (f), (g), (h) and (k) of section 33(1) may be provided for as straight deductions. Further the relief under section 35(3) may be given as a deduction of an amount equal to 10 % of the value of the Agricultural Land. Where the principal value of the estate before such deduction does not exceed Rs. 2 lakhs.

III-4.3. At this stage, we may conveniently refer to the provisions of sections 34(1) (b) and 34(1) (c) relating to aggregation and to the corresponding provisions under section 34(2)(ii) and 34(2)(iii) relating to the grant of rebates. Agricultural lands in the non-adopting States of West Bengal and Jammu & Kashmir are aggregable under section 34(1)(b) with other properties of the deceased only for determination of the rate of duty. Similarly, under section 34(1)(c), the value of the coparcenary interests of all lineal descendants of the deceased is included in the principal value of the estate for rate purposes only. Straight deductions cannot, evidently, be provided for these items. We, however, notice that the rebate thereon is spelt out under the provisions of section 34(2) in a roundabout manner. With the introduction of the concept of "average rate of duty" as recommended elsewhere in this Part of the Report, these and similar provisions can be redrafted in simpler language.

III-4.4. In the matter of the quantum of the exemptions and reliefs, at present admissible under section 33, we have received numerous representations. The Wanchoo Committee too had gone into some of these provisions and had suggested enlargement of their scope. We have given careful thought to all the aspects, including the revenue implications, before making our suggestions in regard to some of these provisions. The provisions and our recommendation are discussed in the paragraphs to follow.

III-4.5. Under clause (a) of section 33(1), those gifts to charity, which are includible having been made in the vulnerable period, are exempt to the extent of Rs. 2,500/-. This limit was prescribed twentyfive years back and is certainly low. We recommend that the limit under section 33(1)(a) be raised to Rs. 5,000. Similarly, clause (b) of section 33(1) exempts gifts for other purposes, to the extent of Rs. 1,500/-. We recommend that the amount here may be increased to Rs. 3,000/- in view of the depreciation in the value of the rupee. We also recommend that the period of two years mentioned in section 33(1)(b) may be raised to five years to bring it in line with our earlier recommendation for increasing the vulnerable period for gifts under section 9 from two years to five years.

III-4.6. At present, clause (c) of section 33(1) exempts upto Rs. 2,500/- household goods, including tools of artisans, agricultural implements or any other tools or implements, as were necessary to the deceased to enable him to earn his livelihood. It has been represented that the ceiling so laid down is neither realistic nor meaningful considering the erosion in the value of the rupee in the last twentyfive years, and the corresponding exemptions under the Wealth-tax

Act. Agricultural tools and implements are altogether exempt under the Wealth-tax Act, by virtue of the provisions of section 5(1)(ix) thereof and other tools and implements, necessary for profession or vocation, are exempt upto Rs. 20,000/- under section 5(1)(x). We are of the view that the present ceiling of Rs. 2,500/- under clause (c) should be enhanced. We, accordingly, recommend that a consolidated exemption may be provided for all kinds of tools and household goods to the extent of Rs. 10,000/- under section 33(1)(c) of the Estate Duty Act.

III-4.7. Clauses (f) and (g) of section 33(1) deal with exemption in respect of insurance policies taken out and moneys deposited for the purpose of eventual payment of estate duty. At present, there is a monetary limit of Rs. 50,000 or the amount actually payable as duty, whichever is lower. We have examined the questions as to whether this straight deduction should be enhanced in monetary terms and/or keep it circumscribed by the outer limit of the duty actually payable. We are of the opinion that both the present limit and the restriction under sections 33(1)(f) and 33(1)(g) should continue. We feel that it is only equitable that the estate gets deduction just for the amount of duty payable and no more.

III-4.8. Clause (h) of section 33(1) provides exemption in respect of moneys payable under one or more policies of insurance effected by the deceased on his life to the extent of Rs. 5,000/-. The Wanchoo Committee had recommended that this limit should be raised from Rs. 5,000/- to Rs. 10,000/- (Para 5.57 Page 118). We too recommend that the exemption under section 33(1)(h) may be raised to Rs. 10,000/- apart from the relief being by way of a straight deduction and not as a rebate in terms of our earlier recommendation in this chapter. Further, we find that for estate duty purposes, the deposits in recognised provident funds are not being treated on par with insurance moneys. Under other enactments, all longterm savings in the form of insurance policies and provident funds are treated, more or less, alike in the matter of tax concessions. In our view, there is no justification for leaving out provident fund deposits from the ambit of exemption under the estate duty enactment. We, therefore, recommend that moneys payable from a recognised provident fund or any provident fund to which the provident funds Act, 1925 applies or a provident fund set up by the central Government and notified under section 80C(2)(a)(iv) of the income-tax Act, 1961 should also be covered by exemption under clause (h) of section 33(1) within the same consolidated monetary limit of Rs. 10,000/-.

III-4.9. It has been brought to our notice that the exemption granted by section 33(1)(j) to drawings, paintings, etc. of the deceased is not very clear in its scope. The ambiguity arises because of the use of the word "other" before "heirloom" occurring therein. The section, as worded, is likely to be interpreted to mean that the exemption extends only to those drawings, paintings and other objects, which have come down from at least one generation, prior to the death of the deceased so that an ancestral quality has got attached to these. Collections of the same varieties,

made by the deceased during his lifetime, might also be intended to pass to the generations to come but would, in this view of the statutory provision, be not eligible for exemption. We see no reason as to why the collections of drawings, paintings, photographs etc., made by the deceased himself, should not be eligible for exemption if these are not intended for sale and other conditions prescribed in the section are satisfied. All works of art and art collections, belonging to an assessee and not intended for sale, enjoy exemption under section 5(1)(xii) of the Wealth-tax Act. We, therefore, recommend that the word "other" appearing before "heirloom" in section 33(1)(j) may be deleted.

III-4.10. The expression 'retained in the family' of the deceased occurring in the clauses (i) and (j) of section 33(1) is also not clear, since the word "family" has no well-defined meaning. We recommend that the expression "retained in the family" in clauses (i) and (j) of section 33(1) may be substituted by the expression "retained by the legal heirs or legatees or donees."

III-4.11. The exemptions under clauses (i) and (j) of section 33(1) are conditional and last so long as the conditions, prescribed by the Board, are satisfied. These conditions are spelt out in rules 11, 12 and 13 of the Estate Duty Rules, 1953. These rules, *inter alia* provide for the contingencies when the exempted assets are sold or where there is any breach of the terms of the undertaking given for availing the exemption. Sub-rule (2) of rule 11 provides for the levy of duty on the sale-proceeds if the assets are sold to a person other than the Government, any University or other public institution. Similarly, sub-rule (2) of rule 13 imposes an additional charge to duty at the rate appropriate to the principal value of the estate, if the undertaking given has not been observed in any material respect. These provisions are substantive in nature and should rightly find their place in the Act itself. In the United Kingdom, similar provisions had been enacted in section 48 of the Finance Act, 1950. Moreover, in the said two rules, the expression, "the rate appropriate to the principal value of the estate" at which the duty gets attracted is not precisely defined. In creating this fresh liability to duty on certain other persons and imposing an additional obligation to file supplementary account, the subordinate legislation, contained in these rules, can be said to be suffering from the vice of excessive delegation. We, therefore, recommend that rules 11, 12 and 13 of the estate duty rules, 1953 may be made a part of the substantive law and that the liability thereunder be spelt out precisely.

III-4.12. Clauses (m) and (mm) of section 33(1) provide exemption in respect of the estate of members of the armed forces, killed in action, during operations against an enemy and of members of the police force, including a border security force, killed in action in protecting the border. The Wanchoo Committee had recommended that a similar exemption should be provided in respect of the estates of all civil servants, who are killed in the course of performance of their duty, such as maintenance of law and order (para 5.60.—page 118 of the Report). Their recommendation was based on the ground that the threats to the

security of the State arise not merely across the border but also from disruptive and anti-social forces within. While endorsing that recommendation, we are of the view that the enlargement of the exemption ought not to be restricted only to the cases of civil servants, since there are other categories of people, such as members of the National Cadet Corps, Territorial Army, Home Guards, etc., whose employment in the national cause is equally hazardous. In this connection, we have taken note of the corresponding provision in the United Kingdom, Section 71 of the (U.K.) Finance Act, 1952, we find, is wider in amplitude and is more explicit. There, the exemption extends to all those cases, where it is certified by the appropriate Government authority that the deceased had died either from a wound inflicted, accident occurring or disease contracted at a time, when the deceased was (a) on active service against an enemy or (b) on other service of a war like nature, or which, in the opinion of the Treasury, involved the same risks as service of a war like nature or where the deceased had died from a disease contracted at some previous time, the death being due to or hastened by the aggravation of the disease due to the said employment. We recommend that the scope of the exemptions under sections 33(1)(m) and 33(1)(mm) should be widened on lines similar to those obtaining under section 71 of the (U.K.) finance Act, 1952. These exemptions should operate not merely where the deceased was killed in action but also where the claim for exemption is supported by a certificate from a prescribed authority.

III-4.13. Section 33(1)(n) provides exemption in respect of a residential house upto Rs. 1 lakh, if such a house is situated in a place with a population exceeding 10,000 and without limit in other cases. It has been represented before us that the ceiling of Rs. 1,00,000/- is highly unrealistic in the present day context of prices of residential houses. Besides, a self-occupied house is being valued by the Departmental officers on the basis that the owner will be willing to give vacant possession. This method of valuation causes great hardship to the legal heirs who, evidently, cannot sell the house, in which they continue to stay with no monetary return and have to pay duty thereon on a notional sale as if vacant possession was available. It has, therefore, been suggested that the value of the property which was used by the deceased for his own residence may either be wholly exempted irrespective of its value or that the value thereof may be frozen at 1971-72 level as in the case of a wealth-tax assessment. Another grievance voiced in this regard is that the unexploited floor space index for such property is being separately valued and added, notwithstanding the fact that no separate and distinct structure is capable of being put up in accordance with the Municipal Regulations and that the exemption is being denied for the servant's/gardener's quarters and garages, if any, attached to the self-occupied property.

III-4.14. After careful consideration, we are not in favour of the suggestion for an increase in the quantum of exemption under section 33(1)(n), which is quite adequate and does not call for any liberalisation. The other suggestions, we find, are basically those relating to the method of valuation. We have dealt with this problem separately under Chapter 18 in Part I of this Report. There, we have emphasized the need for having, as far as possible, a uniform system of valuation under all direct tax laws including estate duty. The principles of valuation of immovable properties, whether fully or partly developed, have been set out by us at length in Chapter 18 relating to valuation of assets in Part I of this Report and in Chapter 14 relating to valuation of house properties, or our Interim Report. These principles will also govern the valuation of self-occupied property of the deceased for purposes of estate duty assessment. In the case of owner-occupied property, we have recommended that in the wealth-tax assessment, apart from the facility of pegging down the value to 1971-72 assessment year as provided under section 7(4) of the Wealth-tax Act, the owner of such a property should be allowed the facility of determining the value of such property coming into being after the assessment year 1971-72 at actual cost or at market rate based on the multiplier method, whichever is lower. We have also recommended that vertical development potentiality of the property should not be taken into account in determining the market value of a property which is not fully developed. We recommend that in valuing that property of the deceased which was exclusively used by him for his own residence, the same principles as recommended by us in Chapter 14 of our Interim Report and Chapter 18 of Part I of this Report should be adopted. We further recommend that the expression "one house" occurring in section 33(1)(n) should be clarified to cover servants' or a gardener's quarters and garage.

III-4.15. Clause (c) of section 33(1) secures that the property gifted by the deceased to his spouse, son, daughter, brother or sister will not be included in the estate of the donor after five years from the date of the gift provided the property is chargeable to gift-tax under the Gift-tax Act, 1958 for the assessment year 1964-65 or thereafter. The exemption thus operates in respect of those gifts to those relatives, which would otherwise have been caught by the provisions of section 10. The provision is clearly meant to exclude the application of section 10 to property gifted by the deceased to close relatives, if he survives the gift by a period which is set somewhat longer than the vulnerable period under section 9. In the context of the increase in the vulnerable period under section 9 recommended by us elsewhere in this Report from two years to five years. We recommend that the period of five years mentioned under section 33(1)(c) be reconsequentially raised to seven years.

CHAPTER 5

VALUE CHARGEABLE

III-5.1. Under the Estate Duty Act, the value of a property passing on death is determined in accordance with the provisions of sections 36 to 43 in Part V read with rule 14 of the Estate Duty Rules, 1953. Besides, shares and debentures of a controlled company are to be valued under rule 15 of the Estate Duty (Controlled Companies) Rules, 1953. The application of these provisions has given rise to many disputes on the question of determination of the "value chargeable" to duty. Some of these disputes raise general issues relating to valuation which are common to all direct taxes. Elsewhere in this Report, we have emphasised the need for evolving, to the extent possible, a uniform system of valuation under these laws in view of the fact that the basic concept, viz., the price in the open market, is common to them. Generally speaking, our observations with regard to a uniform system hold good even for estate duty purposes, since the cardinal principle of valuation of a property of the deceased, contained in section 36(1) is also the very concept of the price which the property would fetch if sold in the open market at the relevant time. High Courts have, in fact, expressed the view that if the death takes place on or near about the last valuation date relevant for the wealth-tax assessment, it would stand to reason that the same value as determined in the wealth-tax assessment should be the value for the purposes of estate duty also. This reasoning might equally apply for the adoption, in the estate duty assessment, of the value taken for the gift-tax assessment, in respect of the property gifted on or near about the date of death, which is subjected to duty under section 9 of the Estate Duty Act, considering the fact that the corresponding provision relating to valuation, viz., section 6 of the Gift-tax Act, 1958, is in similar terms. **Accordingly, both on considerations of equity as well as of uniformity and for reducing litigation, we recommend that as far as possible, the method of valuation of a property for all Direct Tax Laws including estate duty should be the same as suggested by us in part I of this Report, except where some special or distinguishing features are involved in the estate duty assessment, as hereinafter discussed in this chapter.**

III-5.2. While advocating that the system of valuation should be common to all direct taxes, we may point out that for estate duty assessments, there will have to be some different modes of valuation in certain situations. Thus, goodwill of a business, whether proprietary or partnership, has to be evaluated differently for estate duty purposes. Under sub-rule (b) of rule 2C of the Wealth-tax Rules, 1957, the value of goodwill for the purposes of wealth-tax assessment is to be taken to be the price for which it was purchased or its market value, whichever is lower. On the death of a partner his interest in the goodwill of the firm

may, subject to the terms of the partnership deed, devolve upon either the legal heirs or the surviving partners whose shares may get augmented to that extent, attracting the provisions of section 5 of the Estate Duty Act. In that case, the market value of goodwill must be taken, whether or not the deceased had purchased the goodwill for a price. Again, the value of a revocable gift-tax purposes stands on an altogether different footing as compared to that for estate duty. Although, rule 11 of the Gift-tax Rules, 1958, for capitalisation of average income over the completed years for which the gift is not revocable is a good rule for a gift-tax assessment, that rule will not be appropriate for an estate duty assessment keeping those provisions of the Estate Duty Act in view, according to which the whole of such property is deemed to pass. In the same way, where the deceased had the control of a company, his debenture-holdings or shareholdings therein cannot properly be valued as for wealth-tax purposes, since along with the shares and debentures, what further passes to the legal heirs is the intangible asset in the form of the deceased's "control" over the affairs of the company. The special provision in rule 15 of Estate Duty (Controlled Companies) Rules, 1953, cannot, therefore, be done away with, even though a uniform system of valuation of unquoted shares could be adopted in cases where rule 15 does not apply. Such special provisions must, therefore, be continued for the purposes of estate duty.

III-5.3. Sub-section (2) of section 36 of the Estate Duty Act is a special provision not appearing in the Wealth-tax Act. It provides that in estimating the market value, a lower value is not to be adopted merely on the assumption that the entire property is to be placed in the market at one and the same time. In the case of a large estate, it can be argued that the market value would tend to be depressed, if the entire estate is placed on the market at one and the same time. The special provision expressly secures that this aspect has to be ignored for the determination of the value chargeable for estate duty. Apart from the rationality involved, the provision seeks to avoid unnecessary litigation that would otherwise get generated and thus serves a useful purpose. To this sub-section, there is a proviso, whereunder, if it is proved to the satisfaction of the Controller that the value of the property has depreciated by reason of the death, the depreciation has to be taken into account in fixing its value. There can, evidently, be no such stipulation under the Wealth-tax Act. The proviso too has a useful role to play. Considering the utility and the special purpose served by sub-section (2) of section 36 and its proviso, we recommend that these can be retained as a special feature of estate duty valuation.

III-5.4. In the matter of valuation of unquoted shares, the Estate Duty Act contains certain special provisions which are not to be found in the Wealth-tax Act. Thus, section 37 of the Estate Duty Act provides that, in valuing the shares in a private company whose Articles of Association contain restrictions on the transferability of the shares, the open market value (as referred to in section 36) should be ascertained on the assumption that the purchaser of the shares would be entitled to be registered as the shareholder subject to the Articles and further that the existence of any special buyer who might be prepared to pay a higher price for such shares should be ignored. These provisions in section 37 merely reflect the principles established by court decisions in the UK in the matter of valuation of shares in private companies. Section 37, however, excludes from its scope (and consequently from the scope of section 36) cases of shares in a private company which are required to be valued on the basis of the net assets of the company under the terms of rule 15 of the Estate Duty (Controlled Companies) Rules. That rule applies to the valuation of shares in or debentures of a private company which is a 'controlled company' and was either within the control of the deceased at any time during 3 years ending with his death or certain other circumstances as mentioned in that rule existed during such period. Except in cases where rule 15 applies, the principle of open market value adumbrated in section 36 of the Estate Duty Act will govern valuation of property, in common with the corresponding provisions in other direct tax laws. In fact, the refinement at present found in section 37 of the Estate Duty Act, as mentioned earlier, should be applicable equally for other direct taxes as well.

III-5.5. The provisions of section 37 have, however, given rise to certain controversies as to the exact meaning of the expression "if not ascertainable by reference to the value of the total assets of the company" occurring therein. Having regard to the historical development of this branch of the law in U.K. this expression merely means that in a case where rule 15 of the Estate Duty (Controlled Companies) Rules applies, then the valuation of the shares in question should be made under the terms of that rule and not on the basis of the open market value as envisaged in section 37. That section does not refer in terms to rule 15 for the simple reason that the Estate Duty (Controlled Companies) Rules is subordinate legislation which is made by the Board under powers delegated to it under the Estate Duty Act. Our attention has, however, been drawn to the large number of disputes arising in regard to this matter due to the absence of a specific reference to rule 15 in section 37. In fact, it appears that in accordance with certain Departmental instructions, assessing officers are required to adopt the break-up method to value the total assets of the company and ascertain the value of the shares on the basis of such assets. As observed by us in the chapter dealing with valuation of assets in Part I of this Report, the Supreme Court has, in the case of Mahadeo Jalan (86 ITR 621) clearly held that the break-up method of determination of the value of unquoted shares should be adopted only as a last resort and that the yield basis is the most appropriate one for the valuation of such shares.

III-5.6. In the light of the above discussion, we recommend that the substance of section 37 should be incorporated in section 36 itself and at the same time, the exclusion of cases falling under rule 15 of the Estate Duty (Controlled Companies) Rules from the scope of the General provision in section 36 should be spelt out clearly so as to avoid any controversy or ambiguity. We also recommend that the special provisions at present contained in section 37 should be extended for the purpose of valuation of shares in a private company for the purposes of Wealth-tax and Gift-tax as well. In making this recommendation we do not wish to detract in any manner from the recommendation made in part I of this report that rules should be framed by the Board for the valuation of unquoted shares on the basis of guidelines laid down by the Institute of Chartered Accountants and that such rules should be applicable uniformly for all the Direct Taxes.

III-5.7. All this stage we may usefully refer to the provisions of rule 14(3) of the Estate Duty Rules, 1953. This rule is peculiar only to the Estate Duty law and has thrown up a large number of disputes. It states that in case a property is actually sold "within a short time after the death of the deceased under open market conditions", the gross sum realised shall be taken as its market value. Providing as it does for the compulsory substitution of the sale price in place of the market value on the date of death, the rule appears to override even the principal provision, viz., section 36. The rule can lead to unintended consequences as in the case of quoted shares and investments, which would have a well-defined prevailing market price, on the date of death. If such shares are actually sold within a short span after death, the rule, with its mandatory language, would require that the sale proceeds realised should be substituted in place of the actual market value on the date of death. The same would hold good for any stock-in-trade on the date of death. In the books of account, such stocks would be valued at cost or market price or the lower of the two values. A portion of the stocks may get sold within a "short time" after death. In view of the said rule, a question would arise as to whether or not the sale proceeds realised should be substituted in place of the value adopted for the stock valuation in the books of accounts.

III-5.8. It appears to us that the purpose of the said rule 14(3) is to help ascertainment of market price, where it is not readily available, since the actual sale price can be a proper guide, in such cases. This rule, therefore, seems to have been framed mainly for immovable properties or for such movables, of which the price cannot be determined with accuracy. Sale price is certainly not to be adopted where the prevailing market price is otherwise known. We, therefore, recommend that the provisions in rule 14(3) of the Estate Duty Rules may be clarified to the effect that the rule does not apply to quoted shares, stocks and debentures, or to trading assets, viz., stock-in-trade, consumable stores, spare parts, raw materials and semifinished goods. In respect of trading assets, it may expressly be provided that the value as for the corresponding Income-tax assessment of the deceased will be adopted. Further, the expression "short time"

used in the rule is vague. With a view to bringing about clarity, we recommend that the expression "within a short time after the death" in sub-rule (3) of rule 14 of the estate duty rules should be replaced by "within six months after the death".

III-5.9. Section 39 of the Estate Duty Act contains special provisions for valuation of cesser of coparcenary interest. Under section 7, a property in which the deceased had an interest ceasing on his death is deemed to pass on the deceased's death to the extent to which a benefit accrues or arises by the cesser of such interest, including, in particular, a coparcenary interest in the joint family property of certain types of Hindu families. Section 39 prescribes the method of valuing the benefit accruing or arising from the cesser of this coparcenary interest. A notional partition of the family property having taken place immediately before the death of the deceased is contemplated and then the share that would have, on such partition, been allotted to the deceased is taken as the measure of such benefit. For the purpose of actual valuation, sub-section (3) of section 39 provides that the provisions of the Estate Duty Act, so far as may be, shall apply as they would have applied if the whole of the joint family property had belonged to the deceased. We understand that disputes have arisen in the determination of the principal value of the joint family property under this sub-section as regards the extent of admissible exemptions under section 33 of the Act. The controversy has very vividly been elucidated in the decision of the Madras High Court in *Controller of Estate Duty Vs. Estate of R. Krishnamachari* (113 ITR 200).

III-5.10. The aforesaid controversy is similar to that arising in the valuation of the interest of a partner in a firm under the Wealth-tax Rules, which has to be computed from the "net wealth" of the firm under rule 2 of the Wealth-tax Rules, 1957. In line with our recommendation in chapter 18 of Part I of this Report for valuation of the interest of a partner in a firm for wealth-tax purposes, we recommend that under section 39(3) of the Estate Duty Act, the principal value of the joint family property should be computed without grant of any deduction under section 33 and thereafter the deceased's interest in each of the exempted assets of the family should be projected into the assessment for being taken into consideration for exemption subject to the overall ceiling, if any, under section 33.

III-5.11. Rules 14(5) and 14(6) of the Estate Duty Rules, 1953 relate to the valuation of lands containing minerals and agricultural lands respectively. These rules do not in fact provide any definite basis for valuation of such lands. We recommend that rules 14(5) and 14(6) of the Estate Duty Rules should be deleted and the mode of valuation of lands, whether agricultural or containing minerals, or otherwise, should

for estate duty purposes, be the same as suggested by us for valuation under other direct tax laws.

III-5.12. Before concluding the subject of special provisions relating to valuation for estate duty purposes, we would like to refer to the question of relief in those cases, where the value of certain assets, as assessed for estate duty, falls significantly after death and the accountable person, is, therefore, constrained to sell these at a loss. Such a loss or fall in the value of the assets can give rise to considerable hardship and has been duly recognised in the laws of other countries. In the U.K. law, there are elaborate provisions for granting relief when a loss is suffered on the sale of "qualifying investments", viz., quoted shares, debentures, etc., within a period of 12 months after the death of the deceased. In Australia, the Asprey Committee had gone into this matter and had considered an alternative proposition of giving a choice to the legal representatives in the matter of valuation date viz., either the date of death or the first anniversary of that date. The English law on this subject, we find, is rather complicated since it provides for every possible situation, viz., where there is an exchange of the qualifying investments rather than merely sale, where there is a repurchase of the same investments within two months of the sale/exchange upto the period of 14 months from the date of death, where further call moneys are payable or where there is a reorganisation of the company resulting in consequential changes in the share-holdings like the issue of bonus, shares or right shares, etc. For preventing any abuse of the relief by means of sale/exchange between close relatives, it has also been provided that the sale/exchange price is to be substituted by "best consideration".

III-5.13. While we do not favour an elaborate procedure for grant of relief since that would lead to further complications in our system, we are of the view that there should be some machinery in the law for granting relief in individual cases. We, therefore, recommend that power may be given to the controller of estate duty for granting relief in the duty payable in a case of genuine hardship resulting from the sale (to a person not being a relative) of quoted investments within 12 months of the date of death at a substantially lower value than that adopted in the assessment provided that there is no purchase or repurchase thereof within two years of date of the death by any relative of the deceased. Further, the relief may be granted only after making appropriate adjustments for factors such as issue of bonus shares or right shares, payment of further calls, reorganisation of capital of the company, etc. The relief may be determined with reference to the difference between duty on the assessed value of the estate and that on the value of the estate recomputed by taking the price realised on sale of the quoted investments (as adjusted).

CHAPTER 6

DEDUCTIONS AND RELIEFS

III-6.1. The provisions relating to deductions in computing the principal value of the estate and reliefs from the duty payable are contained in Part VI comprising of sections 44 to section 50B of the Estate Duty Act.

III-6.2. In determining the chargeable value of an estate, section 44 provides for the deduction, with some exceptions of all debts and incumbrances and for reasonable funeral expenses. The deduction for funeral expenses is subject to a ceiling of Rs. 1,000. Representations have been received by us, from various quarters, for a substantial enhancement of this amount. Keeping in view the increase in costs in the last twentyfive years after this limit was originally fixed, **we recommend that the limit of the deduction for funeral expenses over Rs. 1,000 may be raised to Rs. 2,500.**

III-6.3. Clauses (a) to (d) of section 44 place certain restrictions on the debts and incumbrances which are eligible for deduction. Under clause (a), the limitation is in respect of debts incurred by the deceased or incumbrances created by a disposition made by the deceased himself. It is stipulated that an allowance shall not be made for such debts or incumbrances unless these were incurred or created *bona fide* wholly for the deceased's own use and benefit and take effect out of his interest. We understand that gift-tax payable (but not paid) on gifts made by the deceased is not being allowed by the Department as a deduction on the ground that this liability cannot be said to have been incurred for the deceased's own use and benefit and further that since the recovery of gift-tax is possible from the donee's estate under section 21A of the Gift-tax Act, the allowance is otherwise also prohibited under clause (b) of section 44. We are unable to appreciate as to how a statutory liability, like the gift-tax payable, can be so ignored when the income-tax liability of the deceased is being held to be eligible for deduction under these very provisions. A statutory liability can never be said to have been created by the deceased on his own volition and accordingly, under the provisions of section 44 as they exist, there is no case for disallowance of the gift-tax liability either under clause (a) or clause (b) of section 44. **However, since a controversy has already arisen, we recommend that for removal of doubts, a clarificatory explanation may be inserted in section 44 to secure that any liability in respect of gift-tax outstanding against the deceased at the time of his death is not disallowed as falling within the scope of clause (a) or clause (b) of section 44.**

III-6.4. An additional restriction under section 44 on the allowability of debts of the deceased is that any debt or incumbrance is deductible only "from the value of the property liable thereto". This stipulation has given rise to an important controversy, which has been decided in favour of the Department, in the case of Controller of Estate Duty, Mysore vs. Srinivasa Murthy R. R. (1974) 95 I. T. R. 388. In a case where the debts against the free estate of the deceased exceed the value of the free estate itself, such debts have been held to be ineligible for deduction against the value of estate passing under other titles, viz., amounts subjected to duty under the deeming provisions of sections 9, 10, etc. The rationale behind the non-allowance is that such debts cannot be legally enforced against the properties which have been gifted away or transferred by the deceased, in his lifetime. In our view, this rationale ought not to be carried too far so as to deny deduction even where the debts of the free estate have actually been discharged out of the property passing under other titles. Similarly, in a case where a property either partly or wholly exempt under sections 21 to 23 of the Estate Duty Act stands charged with an incumbrance, it would not be proper either to abate it proportionately to the extent of the value exempted or to restrict it for deduction only against the value of that property on the mere ground that under section 44, any such incumbrance can be deducted only "from the value of the property liable thereto". We are told that the Department has been placing an interpretation like this, thereby making the exemptions under sections 21 to 33 meaningless.

III-6.5. Keeping in view the judicial pronouncements on the provisions of section 44, we made the following recommendations :

- (I) **Debts or incumbrances which are in excess of the free estate may be allowed against property passing under other titles, if such debts are actually discharged by the persons to whom such other property has passed, within a specified period of, say, two years following the date of death of the deceased.**

The condition requiring actual payment of such debts will prevent the legal heirs from claiming the benefit of deduction of the deficiency in the free estate against other property for the purpose of estate duty while refusing to pay the creditors on the ground of non-enforceability of such debts against property which had been gifted away or transferred by the deceased during his lifetime. **Such a voluntary discharge of the debts of the deceased by the donees of such gifts should also be exempted from any liability to gift-**

tax in the hands of the donees.

- (II) Debts or incumbrances which are secured on property eligible for exemption from duty e.g. foreign immovable property or residential house in India upto Rs. one lakh, should be considered for deduction from the remaining properties which are dutiable provided such debts are enforceable against such dutiable properties; if there is a deficiency, the same should be allowed against property passing under other titles.

III-6.6. We may elucidate our recommendations in the preceding paragraph with the help of an illustration. A house property which was used by the deceased for his residence, of the market value of Rs. 3 lakhs as on the date of death, stands charged with a mortgage debt, including interest, of Rs. 5 lakhs, the only other property in the free estate being a bank balance of Rs. 1 lakh. The aggregate value of the properties passing under the other titles, say, gifts within the statutory period, is Rs. 10 lakhs. The legal heirs who are also the donees to whom the gifts of Rs. 10 lakhs were made by the deceased, have discharged the mortgage debt on the house property to the extent of Rs. 4,50,000 within 2 years of the death of the deceased. In these circumstances, the computation of the principal value of the estate under the recommendations made in the preceding paragraph should proceed on the following lines :

Free Estate	
Residential house	Rs. 3,00,000
LESS: Amount exempt under section 33(1) (n)	Rs. 1,00,000
Balance	Rs. 2,00,000
Bank Balance	Rs. 1,00,000
Total	Rs. 3,00,000
DEDUCT: Mortgage debt actually discharged within 2 years	Rs. 4,50,000
Deficiency in free estate	Rs. 1,50,000
Property passing under other titles	Rs. 10,00,000
DEDUCT: Deficiency in free estate	Rs. 1,50,000
Principal Value of the Estate	Rs. 8,50,000

III-6.7. Section 46 provides certain further limitations on the allowance of debts and incumbrances. Under sub-section (1) of section 46, broadly speaking a debt due to a person, who had, at any time, within his resources, property derived from the deceased (such a person is hereafter being referred to as a donee creditor), is to be disallowed even though otherwise eligible for deduction under section 44. We find that this section is couched in a highly involved language. Under sub-section (3) of section 46, the expression "property derived from the deceased" has been given the same meaning as in section 16(2). The provisions of section 46, which are themselves in an involved language, require reference to the provision of section 16(2) which are no less involved.

We would recommend that the substance of these provisions may be incorporated in section 46 itself in simple language so as to make it self-contained.

III-6.8. We understand that one question that often crops up in the actual application of section 46 is whether income from the property, derived from the deceased, is also property derived from the deceased. The difficulty, it is learnt, is caused by the extended meaning given to the phrase "subject-matter" in clause (c) of section 16(2) to include "any annual or periodical payment made or payable under on by virtue of the disposition." In a case where the immovable property is settled on trust by the deceased A to his son B and the rents are deposited in A's books by B, the rent deposits due from the deceased to his son, would not be deductible in terms of the provisions of section 16(2)(c) read with section 46. But if the property had been gifted outright by A to B, the position may not be free from doubt, because of the extended definition under section 16(2)(c) of the expression "subject-matter". We recommend that the law may be amended to secure that only in the case of a settlement made by the deceased, the annual or periodical payments would be covered in the definition of "subject-matter" under section 16(2)(c) and that in other cases, the income of the property derived from the deceased is not to be regarded as property derived from the deceased.

III-6.9. We find that section 46(1)(c) is in very wide terms since the section refers to the donee-creditor having been, at any time, entitled to or there being included in his resources, at any time, any property derived from the deceased. In those cases where there is a considerable time-lag between the date of the disposition and the loan taken from the donee-creditor, there would arise a practical difficulty in ascertaining whether or not such loans are allowable, inasmuch as it would require looking into all the previous records of the deceased. The accountable person may, therefore, be called upon to establish events very remote in the past. In many cases, records more than 16 to 20 years old may not have been maintained properly even by the deceased himself. We, therefore, recommend that in respect of transactions beyond 15 years, provisions of section 46 should not be applicable. The words "at any time", occurring in this section, may be substituted by "at any time within 15 years prior to the date of death of the deceased".

III-6.10. In the application of the provisions of section 46, another dispute that sometimes arises is whether these provisions can be invoked simultaneously with the provisions of section 9 or 10 by virtue of which the property, taken under a gift is deemed in certain circumstances to be property passing on death. This controversy would arise in a case in which the deceased might have made a gift so as to attract the provisions of section 9 or 10 and subsequently, the donee might have advanced a loan out of the gifted property and the loan might be outstanding on the date of death. In such a case, the provisions of section 9 or 10 and section 46 would appear to be applicable at the same time. We learn that Departmental instructions have been issued saying that in such cases, the provisions of section 9 or 10 and section 46 can be

invoked simultaneously, provided the conditions mentioned, in the said sections are satisfied. Such a procedure can lead to absurd results in certain cases and hence, simultaneous invoking of the provisions appears to us to be unintended by the Statute. We, therefore, recommend that section 46 should be made expressly inapplicable when the property derived from the deceased is included under the provisions of section 9, 10, etc.

III-6.11. Sub-section (2) of section 46 also refers to the vulnerable period of two years for the purpose of application of the provisions therein. This period is linked with the corresponding period stipulated under section 9, and other relevant sections. In keeping with our recommendation regarding these sections, we recommend that the statutory period under sub-section (2) of section 46 should also be increased from two years to five years.

III-6.12. Section 48 of the Estate Duty Act authorises deduction of "additional" expenses, incurred in administering or realising foreign property, subject to a ceiling of 5 per cent of the value of such property, if the Controller is satisfied that such extra expenditure is necessitated by reason of the property being situate out of India. Since foreign immovable property is not liable to duty, the scope of the section extends only to movable properties located abroad. The use of the adjective "additional" has, however, blurred the scope of this deduction. We understand that the Department has taken the stand that normal expenses in administering or realising the property are not deductible contending that the word "additional" has been used in contradistinction to "nominal". As there is no guidelines for determining the "normal" expenditure in respect of such property and considering the upper limit of 5 per cent of the value over the deduction of the expenses, we recommend the deletion of the word "additional" occurring in section 48.

III-6.13. Section 5 provides for the reduction of the estate duty payable by an amount equal to the court fees "paid", in respect of any property on which estate duty is also leviable. It has been brought to our notice that two disputes have arisen in the application of these provisions:

- (i) Where certain items of property are inappropriately included in the probate application, for payment of the court fees, the proportionate part of the court fees paid is treated as ineligible for relief under section 50.
- (ii) A view has been taken that only the court fees payable on the net value of the assets, after deducting the estate duty liability, qualify for deduction under section 50 so that where the estate duty liability has not been so deducted, excess amount of court fees paid has to be disallowed.

We are unable to appreciate the logic in the aforesaid two views. The word "paid" in section 50 can refer only to the actual payment and not what might be correctly and legally payable. The Assistant Controller of Estate Duty cannot adjudicate upon what the

court has considered proper to collect by way of court fees. Under section 50 of the Estate Duty Act the assessing officer has to grant deduction for whatever amount has been paid as court fees after satisfying himself that in respect of the same property, estate duty too is leviable. We also notice that on the question of deductibility of estate duty payable while levying the court-fees, there have been conflicting judgments, one of the Mysore High Court in Mrs. Blanche Nathalia Pinto (1964) 53 I. T. R. 64 (ED) rendered under the Mysore Court Fees & Suits Valuation Act, 1958 and the other of Madras High Court in the case of Mrs. Constance Lubeck (78 ITR 199) under a corresponding Act. In the latter judgment of the Madras High Court, it has been clearly held that for the purposes of levy of court-fees, estate duty is not to be deducted from the value of the assets. The legal position in section 50 of the Estate Duty Act, in our view, is quite unambiguous on both the issues. The relief under that section is clearly for the amount of court fees paid. With a view to overcoming such controversies, we recommend the making of a clarificatory provision to the effect that the amount of court-fees paid, for the purpose of the deduction under section 50, means the amount paid in pursuance of a determination by the court of the court-fees payable on the application for probate, letters of administration or execution certificate and that neither the assessing authority under the estate duty act nor any other authority under that act will be entitled to question such determination.

III-6.14. Section 50A provides for relief in respect of gift-tax paid on any property. If on the same property both gift-tax and estate duty are leviable, estate duty payable is to be reduced by an amount equal to the gift-tax paid. Thus, as the provision stands, the gift-tax paid is wholly deductible irrespective of the fact that the duty, attributable to the gifted property, may happen to be less. The provisions of the Estate Duty Act, deeming gifted property to pass on death, have been enacted for plugging the avoidance of estate duty through the mechanism of gifts. The law had, evidently, contemplated a situation, whereby the gift-tax might be lower than the estate duty payable on the same property, so that the donor prefers to pay gift-tax for reducing eventual liability to estate duty. In those situations where the gift-tax is greater, it would not have been the intention to allow an amount greater than the proportionate estate duty. While a double levy has certainly to be avoided, there would be no justification for deduction of the greater of the two levies. This question would assume added importance, now that the gifts are to be aggregated under section 6A of the Gift-tax Act and the vulnerable period under section 9 of the Estate Duty Act has also been suggested by us to be enlarged to five years, we would, therefore, recommend that section 50A may be suitably amended to limit the deduction on account of gift tax paid to the proportionate estate duty payable on the same property. This proportionate duty will be calculated at the "average rate of estate duty" on the value of the gifted property, as included in the estate duty assessment. The amount of gift tax paid in respect of any such property for the purpose of section 50A will also need

precise quantification on similar lines, viz., by defining "average rate of gift-tax" and then calculating the gift-tax payment at this average rate on the value of the same property as assessed in the gift-tax assessment.

III-6.15. Section 50B of the Estate Duty Act provides for the deduction from the estate duty payable of any tax paid on capital gains on the transfer of the property of the deceased within two years from the date of death (or within such extended period, as the Board may permit), where the proceeds have been utilised wholly or partly for the payment of estate duty. The power to relax the time-limit under this section is, at present, vested in the Board. We recommend that the power to relax the time-limit specified under section 50B of the Estate Duty Act should be given to the Controller of Estate duty instead its centralised with the board. We also noticed that the expression "transferred" occurring in section 50B has not been defined and may not, therefore, include compulsory acquisition of the deceased's property by the Government. If the compensation received on such acquisition is utilised for payment of estate duty, it would but be equitable to accord relief under section 50B even in such cases without the time limit of two years. Similarly, where the deceased's property is delivered by the accountable person for the adjustment of the price against estate duty liability in accordance with the provisions of section 52 of the Estate Duty Act, it would be fair to grant this relief even after the expiry of the period of two years. We, therefore, recommend that suitable amendments may be made in the law to include transfers by way of compulsory acquisition of any of the properties included in the estate or delivery of any such property by the accountable person to the government for the adjustment of the price against estate duty, for eligibility of relief under section 50B of the estate duty act even beyond the period of two years stipulated thereunder.

III-6.16. For the actual grant of the relief under section 50B, an appropriate part of the tax on capital gains is to be considered by taking the proportion that the estate duty which has been paid out of the proceeds of the transfer bears to the gross proceeds of the transfer. The amount of relief is to be computed in accordance with the following formula :

$$R = \frac{E}{P} \times C$$

where,

R is the reduction in the amount of estate duty;

C is the tax paid on the capital gains;
E is the amount paid towards estate duty out of the proceeds of the transfer; and P is the gross proceeds of the transfer.

It has been brought to our notice that in the actual working of this relief, two practical difficulties arise. Firstly, the quantum of tax on capital gains (item "C" in the formula) is not precisely ascertainable, since the section speaks of such tax paid "in respect of the capital gains". It is thus not clear whether this tax has to be worked out at the average rate of income-tax (inasmuch as in the total income for the concerned assessment year, capital gains will only be one of the components) or has to be worked out by placing the capital gains in the highest bracket or in the lowest bracket of the total income of the concerned assessment year. Secondly, it is also not clear whether "the amount paid towards estate duty", (item "E" in the formula) refers to the gross duty or to the net duty after the relief under section 50B itself and/or other reliefs, say, for court fees under section 50, etc. We are told that a contention has been advanced that any payment of court fees out of the sale-proceeds is also "towards" estate duty and is, therefore, eligible for working out the quantum of this relief. For dispelling these ambiguities, we recommend that the quantum of tax paid on capital gains (item "C" in the formula) may be spelt out to be the amount arrived at by applying the average rate of income-tax (applicable to the total income of the relevant year) to the capital gains forming part of such total income after the deduction provided under section 80T of the income tax Act, 1961, if any. As regards the "amount paid towards estate duty" (item "E" of the formula), it may be clarified that this would mean the estate duty actually paid and any court fees paid out of the proceeds of the transfer of the property.

III-6.17. Another inequity brought to our notice in the working of the relief under section 50B is that the amount paid towards duty is being unjustifiably compared with the "gross proceeds of the transfer" and not with the net proceeds thereof, since any such payment can, evidently, be out of the net proceeds realised, that is to say, gross proceeds less the expenses of transfer including stamp and registration charges, if any. We, therefore, recommend that the words "gross proceeds" under section 50B may be substituted by "net proceeds" viz., the proceeds after the deduction of the expenditure incurred wholly and exclusively in connection with the transfer.

CHAPTER 7

ASSESSMENT, PENALTIES AND PROSECUTIONS

III-7.1. Under section 53(3) of the Estate Duty Act, every accountable person has to deliver an account of the estate in the prescribed form within six months of the date of the deceased's death. The account has to be verified on solemn affirmation before a magistrate or on oath commissioner as required under Rule 20A of the Estate Duty Rules and for the purposes of section 56, it is to be accompanied by the "affidavit of valuation" as defined in section 2(1). It has been represented to us that the requirement of an affidavit or a sworn verification before a magistrate is cumbersome and should be dispensed with. Under other direct tax laws, there is no such stipulation. We are of the view that it is not necessary either to insist on a statement, sworn before a magistrate, from the accountable person or to ask him to put his signature on each Part and accompanying Schedule. We recommend that the account of the property passing on the death, required to be filed by the accountable person, should be made in the same manner as in the case of the other taxes, and further that the verification of an estate duty return should be in the same form and should be made in the same manner as in the case of any other direct tax return and the requirement of a sworn statement before a magistrate or an Oath Commissioner should be removed.

III-7.2. Under Section 53(1)(b) of the Estate Duty Act, every trustee or other person in whom any interest in the property passing or the management thereof is at any time vested is accountable for the whole of the estate duty on the property passing on the death. We have received representations that because of this provision, considerable delay and hardships are being caused in the disbursement by the trustees of the balance in the provident fund account to the family of a deceased employee. This is because the trustees of the provident fund as accountable persons, insist upon the production of an estate duty clearance certificate from the Assistant Controller of Estate Duty before making any such payment. Recognising this hardship in the case of small subscribers, the Board had issued instructions in that year 1967 that payments upto Rs. 5,000/- to the legal representatives of the deceased subscriber could be made without production of the certificate. We understand that this limit has since been increased to Rs. 25,000/-. This measure is, however, merely by way of an administrative concession, which does not absolve the trustees of their statutory liability under section 53(1)(b). To safeguard their position, the trustees have, therefore, still been insisting upon the production of the clearance certificate, we, therefore, recommend that the provisions of section 53(1)(b) may be amended so as to confer immunity from accountability on persons res-

ponsible for making payments out of provident funds referred to in section 80C of the Income-tax Act or gratuity funds approved under the Income-tax Act in those cases where the aggregate amount payable out of such funds to the legal heirs or nominees of the deceased subscriber does not exceed Rs. 25,000/-.

III-7.3. Section 53(3) of the Estate Duty Act requires the filing of the estate duty account by the accountable person, within 6 months of the date of death of the deceased and gives power to the Controller to extend this period in appropriate cases subject to payment of interest. Disputes have arisen on the question whether an account filed after the expiry of the 6 months' period without obtaining an extension of the period from the Controller would be a valid account and whether any interest would be chargeable on the duty in such a case. To remove doubts and disputes in this regard, we recommend that there should be a specific provision for treating an Estate Duty return filed any time before the assessment is completed as a valid return and for charge of interest on the duty from the date of expiry of 6 months from the death upto the date of filing of such return, irrespective of whether or not the accountable person had obtained extension of time from the Controller for filing the return.

III-7.4. In the matter of commencement of assessment proceedings for the first time by the Department or proceedings for reassessment in pursuance of section 59(a) or (b) the present time-limits specified in section 73A are, in our view, neither adequate nor in tune with similar provisions under the other direct tax laws. To bring these provisions in line with the recommendations made by us in this regard in Part II of this Report, we recommend that the time-limit for initiation of assessment proceedings under the Estate Duty Act should be 8 years from the end of the financial year in which the death occurred and 16 years in cases where the principal value of the Estate is likely to be Rs. 5 lakhs or more, subject to the requirement that in the latter type of cases approval of the Board is obtained before the issue of the notice. As regards reopening of completed assessments, the time-limit for commencement of proceedings should be 4 years from the end of the financial year in which the death occurred in cases falling under section 59(b) and 8 years in cases falling under section 59(a), subject to the approval of the Controller in the latter type of cases. There should also be a provision for initiating such proceedings upto 16 years in cases where the value of the estate escaping assessment is likely to be Rs. 5 lakhs or more, subject to the approval of the Board.

III-7.5. Section 73A which specifies the period of limitation for initiation of assessment/reassessment proceedings should, subject to the modifications recommended by us in the preceding paragraph, be placed immediately after section 59 which specifies the circumstances in which proceedings may be initiated for assessment/reassessment.

III-7.6. Under the law at present, there are no time limits for completion of assessments or reassessments. We are of the view that, as under the other direct tax laws, there should be time limits for completion of such proceedings under the Estate Duty Act too. An estate duty assessment can be finalised only after all the income-tax, wealth-tax and gift-tax assessments of the assessee have been completed. Keeping this aspect in view, we recommend that the time limit for completion of an Estate Duty Assessment/Reassessment should be 4 years from the end of the financial year in which the proceedings for such assessment/reassessment were initiated, or 4 years from the end of the financial year in which the return or a supplementary return envisaged under section 53(4) or under section 56 is filed, whichever is later. We further recommend that a specific provision should be made authorising a reassessment on the basis of a supplementary return, envisaged under section 53(4) or under section 56, which is filed after the completion of the assessment, without the need to initiate formal reassessment proceedings. As there is no time-limit for completion of assessment/reassessment at present, the introduction of the time-limits as recommended should be suitably staggered in respect of pending proceedings. We further recommend that the time-limit may be relaxed in cases where :

- (a) The accountable person demands the reopening of the whole or any part of the proceedings consequent on a change in the incumbent of the office of the assessing authority ; or
- (b) The proceedings are stayed by an order or injunction of any court ; or
- (c) The assessment/reassessment has to be made in consequence of, or for giving effect to, any finding or direction of any appellate or revisionary authority ; or
- (d) An application made before the settlement commission (in pursuance of the recommendation made by us elsewhere in this part for the provision of a machinery for settlement of disputes in Estate Duty Matters) is rejected by the commission or is not allowed to be proceeded with by it.

In such situations, the relaxation in the time-limit should be broadly on the lines of the provisions in section 153(3) of the Income-tax Act as suggested to be modified under our recommendations in Part II.

III-7.7. We find that the present provisions relating to provisional assessment under section 57 of the Estate Duty Act, 1953 are deficient in certain respects.

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Although a provisional estate duty demand has to be raised immediately on the basis of the account filed both for prompt recovery as also for the grant of a certificate to the accountable person to meet the requirements of section 56, the recovery thereof cannot be effected against any other accountable person except the one who had delivered the estate duty account, as held by the Supreme Court in the case of Madanlal Lohia (1977) 108 ITR 627. Sub-section (2) of section 57 refers to recovery being enforceable only against "the person so assessed". There is also no provision for charging interest, if the provisional duty is allowed to be paid in instalments. The Patna High Court in the case of Bettiah Estate vs. Union of India (1977) 108 ITR 210 has held that the provisions under section 70 of the Estate Duty Act are not attracted in the case of a provisional demand raised under section 57. Having regard to the judicial pronouncements in 108 ITR 627 and in 108 ITR 210, we recommend that the provisions relating to recovery and charging of interest on a provisional demand raised under section 57 of the Estate Duty Act should be appropriately altered. Sub-section (2) of Section 57 should be amended making provisional demand liable for recovery from any of the accountable persons and not merely from the person assessed provisionally after giving an opportunity to the concerned accountable person of being heard. In other words, the liability for provisional duty under section 57(2) should be enforceable jointly and severally against all accountable persons as laid down in section 53. For levy of interest on a provisional demand which is not paid in time, section 70 should be amended to include reference to a demand raised under section 57.

III-7.8. We now take up consideration of provisions relating to levy and grant of interest under this Act. We notice that the provisions relating to charge of interest under section 70 and rule 42 are more favourable to defaulters who do not seek extension of time for filing the estate duty account or for payment of duty. Under section 70 of the Estate Duty Act, instalments for the payment of estate duty demand may be allowed on receipt of a request from the accountable person subject to charge of interest at a rate not exceeding 4 per cent or any higher interest yielded by the property. Similarly, under rule 42 of the Estate Duty Rules, interest is chargeable on delayed submission of estate duty account in cases where the accountable person makes an application for extension under section 53(3) and complies with other requirements spelt out in that rule. Interest may be charged at 6 per cent or any lower rate as the Controller may, in a particular case, decide in accordance with the Board's general instructions. It may thus be seen that the interest provisions come into play only after the accountable person makes an application for extension of time. We recommend that the provisions of section 70 and rule 42 may be modified so that levy of interest is attracted even if there is no application or if the terms specified are not fulfilled in all cases where there is a delay in filing the Estate Duty account or in the payment of duty, whether regular or provisional.

III-7.9. The observations of the Public Accounts Committee in their 88th Report (paras 4.38 to para

4.49) have been brought to our notice in the matter of rates of interest under section 70 and rule 42. The Public Accounts Committee has suggested that the rates of interest should be brought on par with the rate applicable in the case of other tax laws. We are of the view that Estate Duty Act stands on a different footing since this levy is on a person previously unconnected with the affairs of the estate and very often, either insufficient liquid funds are left behind by the deceased or the assets are not easily saleable. Unlike income-tax, which is an annual charge and an outgoing from the earnings of that year, estate duty is a one-time levy on the entire estate. In our view, the two levies are, therefore, not comparable. Besides, the administration of the deceased's estate can itself consume considerable time for obtaining probate or letters of administration before the properties can be dealt with or operated upon. Besides, the annual income-tax and wealth-tax demands have also to be met out of the funds of the estate. As a general rule, the net return from any estate cannot be expected to be as high as 12 per cent, which is the rate of interest leviable on outstanding taxes under other tax laws. The provisions of charging of interest under the Estate Duty Act, therefore, should not be on par with the provisions under other direct tax laws. In our view, the maximum rate of interest under section 70 and under rule 42 should not exceed 6 per cent.

III-7.10. For mitigating the hardship caused in genuine cases, we recommend that as recommended by us in part II of this report in relation to section 273A of the Income-tax Act, power may be conferred on the controller of estate duty to reduce or waive the interest. This power should be in addition to the discretion, at present, vested under section 70 and under rule 42. The proviso to sub rule (d) of rule 42 which makes the controller's discretion to reduce the rate of interest subject to the general instructions of the Board should also be deleted. In other words, the rate of interest to be actually charged in a given case, either for delay in filing of the account or in the payment of duty, may be wholly left to the discretion of the assessing authority.

III-7.11. In accordance with the provisions of sub-rule (3) of rule 19, interest at the rate of 2 per cent per annum is currently payable by the Government on deposits made under section 33(1)(g) towards the prospective estate duty liability. The rate of 2 per cent in rule 19(3) was fixed as early as the year 1955. It has been represented before us that an upward revision of this rate is necessary. While there is considerable substance in the representation, we notice that the amount paid as deposit is entitled to exemption from duty to the extent specified in that provision. It is also noticed that whereas on an advance payment of income-tax, interest is payable only on the amount in excess of the tax-liability, the deposit under section 33(1)(g) carries interest on the whole amount. Considering these aspects. We recommend an increase in the rate of interest payable under rule 19(3) of the Estate Duty Rules from 2 per cent to 6 per cent. This interest will continue to be calculated from the date of deposit to the date of death as at present. In case the deposit is found to be in excess of the estate duty

liability finally determined, we recommend grant of further interest at the same rate from the date of death to the date when the excess is refunded. At present, there is no provision in this regard.

III-7.12. There is at present no provision in the Estate Duty Act for the payment of interest on a refund arising as a result of an assessment appellate order in case there is delay in granting the refund. On the pattern obtaining in the Income-tax Act, it is desirable to have a similar provision. We recommend that interest may be granted on any amount which is found to be refundable to the accountable person consequent upon any order in assessment, appeal, revision or rectification but which is not refunded within the period of 3 months from the end of the month in which the order is passed. For the sake of uniformity, the rate of interest should also be 6 per cent.

III-7.13. As regards the provisions relating to penalty under the Estate Duty Act, we are of the view that having regard to the special features of that enactment, these provisions need not be brought on all fours with those under the other direct tax laws. However, in regard to certain matters, it is necessary to modify these provisions on the following lines :

- (1) At present section 60 empowers the Controller the Appellate Controller as also the Appellate Tribunal to levy penalties for various defaults as specified in that section. In line with our recommendations in part II in respect of other direct taxes, we recommend that under the Estate Duty Act too, penalties for defaults relating to filing of returns or in complying with notices should be leviable only by the authority before whom such default occurs and not by any other higher appellate or administrative authority. The penalty for concealment may, however, be allowed to be levied by the assessing authority as also by the first appellate authority and the revisionary authority. We further recommend that the appellate Tribunal which is the final authority on facts, should not have the power to levy penalties for any of the defaults.
- (2) As there is no provision at present for remission of penalty under the Estate Duty Act, even if there are extenuating circumstances, We recommend that a provision similar to that in section 273A of the Income-tax Act should be introduced in the Estate Duty Act bestowing powers on the controller to reduce or waive the penalty in appropriate cases.

III-7.14 There is at present no time-limit for completion of penalty proceedings under the Estate Duty Act. We recommend that there should be a time-limit for completion of penalty proceedings, of two years from the end of the Financial Year in which the Assessment Proceedings during which penal action is

initiated are completed. Provisions relating to extension of this time-limit corresponding to those under section 275(a) and explanation thereunder of the Income-tax Act, 1961 as suggested to be modified in Part II of this Report may also be made.

III-7.15. At present, there is no provision in the Estate Duty Act for prosecution for any offence in connection with estate duty proceedings. We have earlier recommended that the estate duty return need not be affirmed or verified before a Magistrate or an

Oath Commissioner. Any false return of estate duty will, no doubt, be serious as it would result in consequential evasion of wealth-tax and income-tax by the legal heirs throughout their lifetime. We, therefore, recommend the making of a provision for prosecution in the case of a false statement in any verification or for delivering an account or statement which is false or which the accountable person either knows or believes to be false or does not believe to be true on the lines of the provision in section 277 of the Income-tax Act, 1961.

CHAPTER 8

APPEAL, RECTIFICATION AND REVISION

III-8.1. We find that procedural matters relating to appeals and rectifications under the Estate Duty Act show wide divergence from those under other direct tax laws. These provisions need to be restructured to bring them in line with the corresponding provisions under other direct taxes.

III-8.2. At present, the first appeal lies to the Appellate Controller of Estate Duty only against specified orders of the assessing authority as listed out in section 62. This list is not exhaustive with the result that there are some orders of the assessing authority against which no appeal lies to the Appellate Controller. Instead of enumerating the various orders of the assessing authority against which an appeal lies to the first appellate authority, we recommend that there should be a general provision to the effect that every final order (which is not in the nature of an administrative order or an interlocutory order) of the assessing authority should be appealable to the first appellate authority. We further recommend that, as recommended by us in Part II of this report in regard to other taxes, the first appellate authority under the Estate Duty Act should be of the rank of Collector.

III-8.3. Section 62(4) (a) of the Estate Duty Act empowers the Appellate Controller to go into any ground not specified in the grounds of appeal, at the stage of hearing of the appeal. This power is more by way of his judicial discretion than a right given to the appellant (Swarnammal vs. Controller of Estate Duty, Madras 88 ITR 366). The language in section 62(4) (a) of the Estate Duty Act is also different from that of the corresponding section 250(5) of the Income-tax Act. We, therefore, recommend that the language of section 62(4) (a) should be brought in harmony with that of section 250(5) of the Income-tax Act as modified in the manner recommended by us in Chapter 6 of Part II of this report, we further recommend that provisions regulating the admission of fresh evidence at the stage of first appeal, on the lines of rule 46 of the Income-tax Rules should be incorporated in Estate Duty Act as well.

III-8.4. The proviso to section 62(1) restricts the right of appeal against any penalty levied for non-payment of duty, "unless the duty is paid before the appeal is filed". A similar provision had existed in the Indian Income-tax Act, 1922 under the proviso to section 30. This restriction was however omitted when the 1961 law was enacted. The provision requiring payment of the full amount of duty before entertaining an appeal against an order of penalty for non-payment of estate duty is unnecessarily harsh inasmuch as the accountable person may not be in a position to operate the bank

account of the deceased or deal with the assets comprised in the estate until he obtains grant of representation. We, therefore, recommend that the proviso to section 62(1) may be deleted so that an appeal against penalty levied for non-payment of estate duty would be competent even if the duty is not paid before the appeal is filed.

III-8.5. Under section 63, in appeals other than those relating to valuation of any property, the Appellate Tribunal can pass such orders as it thinks fit, including an order enhancing the estate duty payable or penalty. But, in appeals, relating to disputed valuation, the Tribunal is bound to refer the question to two arbitrators if the appellant so requires. In that event, the Tribunal has to pass its orders "conformably to the decision of the valuers." Appellate Tribunal is a final fact-finding authority. It is, therefore, not proper to confer on it the power of enhancement, since the taxpayer will be left without further remedy. Even in actual practice, the power of enhancement does not seem to have been exercised by the tribunal. We, therefore, recommend that the power of enhancement given to the Appellate Tribunal under section 63 of the Estate Duty Act, 1953, may be withdrawn.

III-8.6. Section 63(6) of the Estate Duty Act provides for reference of any dispute relating to valuation of a property to the arbitration of two valuers at the stage of appeal before the Appellate Tribunal with a further reference to a third valuer in case of disagreement between the two valuers. The provision also makes the decision of the two valuers or the third valuer as the case may be on the question of value binding on the Appellate Tribunal. Similar provisions which were in existence in the other direct tax laws have since been abrogated when the system of Valuation Officers exercising statutory functions was introduced some years ago. In Part II of this Report, we have recommended that Valuation Officers should cease to be statutory authorities under the other direct tax laws and that the procedure of referring the question of disputed value of an asset to arbitration at the stage of appeal before the Appellate Tribunal should not be revived on that account. In the interest of uniformity in procedures in respect of all direct taxes. We recommend that under the Estate Duty Act also, the procedure for reference of any question of disputed value to arbitration, contained in sub-sections (6), (7) and (8) of section 63, should be deleted. We, further, recommend that the system of Valuation officers as obtaining under other direct tax laws functioning in an advisory capacity as recommended in Part II of the report, as also the system of registered valuers obtaining under the other direct tax laws, should be extended to estate duty as well.

III-8.7. Section 63, at present, does not contain any provision for filing of cross objections, by the other party, when one party has filed an appeal to the Tribunal. In the interest of uniformity, We recommend that a provision for filing of a memorandum of cross objections may also be incorporated in the Estate Duty Act as under other Direct Tax Laws.

III-8.8. In regard to further appeals/references against orders of the Appellate Tribunal, we recommend that the provisions in the other Direct Tax Laws as modified in the manner recommended in Part II of this report should be made applicable for the purposes of estate duty too.

III-8.9. In regard to rectification of mistakes apparent from the record, section 61 stipulates a time limit of 5 years from the date of the order. We recommend that the provisions in this regard should be brought in line with these in the other Direct Tax Laws as modified in the interest of uniformity.

III-8.10. Section 155 of the Income-tax Act, 1961 provides extended time limits for certain special rectifications. There is no corresponding provision in the Estate Duty Act. Rectification of orders passed under the Estate Duty Act becomes necessary for various purposes, such as recomputation of the principal value to give effect to any revision in the income-tax or wealth-tax liability already allowed under section 44, deduction of the duty paid in a non-reciprocating country under section 49; deduction for Court fees under section 50; granting of relief due under section 50A or section 50B with reference to the gift-tax or tax on capital gains, etc. The provisions of section 61 are not quite adequate to deal with these situations where a modification of the assessment may become necessary after the expiry of the time limit specified in

that section. We, therefore, recommend that the provisions of section 61 may be enlarged in line with section 155 of the Income-tax Act, so as to provide extended time limits for various purposes.

III-8.11. Under the Estate Duty Act, there is at present no provision for the revision of an order of a subordinate authority by the Controller, either in favour of the revenue or to give relief to the accountable person, similar to those contained in sections 263 and 264 of the Income-tax Act. Such a power to the Controller to revise orders of a subordinate authority is very desirable, since in many cases neither the revenue nor the accountable person may have other remedies open. We, therefore, recommend that the provisions corresponding to section 263 and 264 of the Income-tax Act may be included in the Estate Duty Act, conferring power on the Controller to revise orders of any subordinate authority. Orders of the Controller revising an order prejudicial to the revenue should be appealable to the Appellate Tribunal, as under the other Direct Tax Laws.

III-8.12. Section 71 of the Estate Duty Act authorises the Board to remit outstanding duty and interest after twenty years from the date of death. It is a special provision which is not found in other direct tax laws. Section 71, however, requires that an unduly long period of twenty years should have expired after the death before this power may be exercised by the Board. An application of the accountable person for write off of the duty and interest or any part thereof cannot, therefore, be acted upon till the said period has expired. The time-limit, so laid down, is not realistic. We accordingly recommend that the power to remit outstanding duty and interest under the provisions of section 71 should be exercisable by the Board any time after the expiry of three years from the date of finalisation of an assessment or reassessment proceeding under the Estate Duty Act.

CHAPTER 10

SETTLEMENT OF ESTATE DUTY CASES

III-10.1. A machinery for settlement of income-tax cases has been provided for in Chapter XIXA of the Income-tax Act and of Wealth-tax cases in Chapter VA of the Wealth-tax Act with effect from 1st April, 1976 by the Taxation Laws (Amendment) Act, 1975, consequent upon the recommendations of the Wanchoo Committee (Paras 2.32 to 2.34). At present, the Estate Duty Act does not contain any similar provisions for settlement of cases. A provision, apparently comparable, relating to the assessments in complicated cases through the intervention of the Central Board of Direct Taxes, exists in section 69 of the Estate Duty Act. Thereunder, the Board can compound the duty or duties payable in respect of certain types of property or interests. This power of composition too can be exercised only if the following conditions are fulfilled in a particular case :

- (a) where it is difficult to ascertain the exact amount of estate duty payable in respect of any property or any interest therein because of,
 - (i) the number of deaths upon which the property has passed, or
 - (ii) the complicated nature of the interest of different persons in the deceased's property, or
 - (iii) from any other cause ;

OR

- (b) where the ascertainment of duty is likely to involve expenses out of proportion to the value of the property or interest.

In the aforesaid circumstances alone, the Board has been empowered to assess such sum on the value of the property or interest as, having regard to the circumstances of the case, appears proper.

III-10.2. A closer look at section 69 shows that this provision cannot be as effective as the settlement

machinery under Chapter XIXA of the Income-tax Act or Chapter VA of the Wealth-tax Act. While the said provision enables the Board to assume jurisdiction for assessment in complicated cases, the discretion vested with the Board to compound the estate duty liability is rather limited. The provisions of Chapter XIXA of the Income-tax Act, 1961, on the other hand, are much wider since, under section 245D(4), the Settlement Commission, can, in accordance with the provisions of the Income-tax Act 1961, pass such order as it thinks fit. Further, section 245I lays down that any such order shall be conclusive as to the matters stated therein. There is no specific provision conferring finality on an order passed by the Board under section 69 of the Estate Duty Act.

III-10.3. In our view, a machinery for settlement of estate duty cases is desirable since this would be advantageous both to the Department and to the accountable person. As estate duty assessment is, in essence, not much different from a wealth-tax assessment and therefore, if a settlement machinery can be useful for wealth-tax proceedings, it would be equally so for estate duty purposes. Vexatious problems of valuation and intricate questions involving application of the law to the facts of a given case can more readily be resolved through such a machinery. Besides, estate duty cases occasionally involve highly disputed questions of fact relating to events that would have taken place in the distant past, e.g. for invoking section 10 covering property taken under a gift whenever made or for application of sections 46(4) and 46(2) pertaining to certain types of debts, whenever contracted, if some property was, at any time, derived from the deceased. Such cases can better be decided through the process of settlement. The machinery for settlement of cases would, therefore, result in considerable savings in cost, reduce litigation and facilitate quick recovery of the estate duty due. After careful consideration, we recommend that a settlement machinery on the lines provided under Chapter XIXA of the Income-tax Act, 1961 may be introduced in the Estate Duty Act also, keeping in view the recommendations in Chapter 10 of our Interim Report.

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- (a) where it is difficult to ascertain the exact amount of estate duty payable in respect of any property or any interest therein because of,
 - (i) the number of deaths upon which the property has passed, or
 - (ii) the complicated nature of the interest of different persons in the deceased's property, or
 - (iii) from any other cause ;

OR

- (b) where the ascertainment of duty is likely to involve expenses out of proportion to the value of the property or interest.

In the aforesaid circumstances alone, the Board has been empowered to assess such sum on the value of the property or interest as, having regard to the circumstances of the case, appears proper.

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machinery under Chapter XIXA of the Income-tax Act or Chapter VA of the Wealth-tax Act. While the said provision enables the Board to assume jurisdiction for assessment in complicated cases, the discretion vested with the Board to compound the estate duty liability is rather limited. The provisions of Chapter XIXA of the Income-tax Act, 1961, on the other hand, are much wider since, under section 245D(4), the Settlement Commission, can, in accordance with the provisions of the Income-tax Act 1961, pass such order as it thinks fit. Further, section 245I lays down that any such order shall be conclusive as to the matters stated therein. There is no specific provision conferring finality on an order passed by the Board under section 69 of the Estate Duty Act.

III-10.3. In our view, a machinery for settlement of estate duty cases is desirable since this would be advantageous both to the Department and to the accountable person. As estate duty assessment is, in essence, not much different from a wealth-tax assessment and therefore, if a settlement machinery can be useful for wealth-tax proceedings, it would be equally so for estate duty purposes. Vexatious problems of valuation and intricate questions involving application of the law to the facts of a given case can more readily be resolved through such a machinery. Besides, estate duty cases occasionally involve highly disputed questions of fact relating to events that would have taken place in the distant past, e.g. for invoking section 10 covering property taken under a gift whenever made or for application of sections 46(4) and 46(2) pertaining to certain types of debts, whenever contracted, if some property was, at any time, derived from the deceased. Such cases can better be decided through the process of settlement. The machinery for settlement of cases would, therefore, result in considerable savings in cost, reduce litigation and facilitate quick recovery of the estate duty due. After careful consideration, we recommend that a settlement machinery on the lines provided under Chapter XIXA of the Income-tax Act, 1961 may be introduced in the Estate Duty Act also, keeping in view the recommendations in Chapter 10 of our Interim Report.

CHAPTER 11

RATES OF ESTATE DUTY

III-11.1. We have received numerous representations to the effect that the rates of estate duty are very high and that these should be considerably lowered. In this connection, it has been pointed out that the income-tax and wealth-tax rates have, in recent years, been rightly slashed down. A further demand voiced is that the threshold of exemption from duty should be substantially raised. We have given serious thought to these representations.

III-11.2. In our view, altogether different considerations have to prevail for determining estate duty rates in contradistinction to the rates under other enactments. The fact that income-tax and wealth-tax rates have been brought down does not necessarily imply that there is a case for similar reduction in the estate duty rates. With the deceased's property subject to first charge under section 74 of the Estate Duty Act, there is almost an assumption that there is a prior claim of the State over that of the legal heirs. Besides, the incidence of this levy is felt the least since inheritance is a mere bounty. Estate duty, which thus stands on a different footing, can play a more significant role in the national goal of achieving a socialistic pattern of society. This would, however, not justify any unrealistic rates since these may cause genuine hardships giving rise to reluctant compliance and ultimately evasion. At the same time, estate duty rates must have a proper correlation with gift-tax rates. Any wide disparity between the two rates might mean offering a choice of selecting one in preference to the other, in our system where the two levies are not completely integrated.

III-11.3. A comparison of death duties in U.S.A., the U.K., and Australia with those in India shows that the maximum rate of estate duty is 70 per cent in U.S.A., 75 per cent in the U.K., and 50 per cent in Australia, whereas, in our country, the maximum rate is 85 per cent. The top rate is reached, in terms of the currency of their own countries, in India and the U.K. at 20 lakhs, in U.S.A. at 50 lakhs and in Australia at 20 lakhs. However, as elsewhere pointed out in this Report, a vital difference between the levy in those countries and that in our country is the system of integration of lifetime transfers with the property passing on death. The ultimate effect of such an integration is that any benefit that a person might derive by transfers during his lifetime is offset by clubbing these with the property passing on death. We have elsewhere expressed ourselves against such integration in our law. In that context, we do not consider it appropriate to bring down the maximum rate of estate duty to the level prevailing in these countries. In our view, the maximum rate in our country can be fixed at 80 per cent. The rates of duty in the initial slabs which compare favourably with those elsewhere being, in fact, much lower, require no change. Only the top slab, where the rise in the rates is very steep, needs to be

broken so as to bring about a more gradual rise in the incidence of duty. Accordingly, we recommend that the rates of duty in the slab of principal value exceeding Rs. 20,00,000 may be altered as under :

Slab of Principal value	Present Rate of duty	Rate of duty recommended
Over Rs. 20 lakhs but not exceeding Rs. 25 lakhs.	85%	60%
Over Rs. 25 lakhs but not exceeding Rs. 30 lakhs	85%	70%
Over Rs. 30 Lakhs	85%	80%

III-11.4. As already stated above, the gift-tax rates and estate duty rates have to be properly correlated so that the two rates structure do not lead into an escape route. We find that the gift-tax rates upto Rs. 3,50,000 are higher than the estate duty rates. Thereafter, the rates are the same upto Rs. 20,00,000. The rate applicable to the topmost slab in respect of gift-tax is 75 per cent and that for estate duty is 85 per cent. As a corollary to the change in the rate structure of estate duty recommended above, the gift-tax rates will also need amendment. We recommend that the rates of gift-tax in the slab of taxable gifts over Rs. 20 lakhs upto Rs. 25 lakhs should be 60 per cent and that in the slab over Rs. 25 lakhs upto Rs. 30 lakhs should be 70 per cent and the existing maximum rate of 75 per cent may operate on taxable gifts exceeding Rs. 30 lakhs.

III-11.5. We may now advert to the question of exempted threshold. The Wanchoo Committee had recommended an increase in the basic exemption limit from Rs. 50,000 to Rs. 2 lakhs. This recommendation has, however, to be viewed in the context of their recommendation in para 5.59 of their Final Report for the withdrawal of the exemption under section 33(1)(n) of the Estate Duty Act for a residential house, owned by the deceased, upto Rs. 1 lakh. As we have not favoured any change in the quantum of exemption under section 33(1)(n), in our view, there is no need for raising the threshold above Rs. 1 lakh, which has already been proposed in the Budget for 1978-79.

III-11.6. Part II of the Second Schedule to the Estate Duty Act prescribes a flat rate of duty of 7-1/2 per cent in respect of the value of shares and debentures in excess of Rs. 5,000 held by the deceased who is an individual not domiciled in India in companies incorporated outside India which are referred to in section

20A. By virtue of rules 7(e) and 8(f) of the Estate Duty Rules, 1953 such shares and debentures are movable property located outside India and cannot, but for this provision, be subjected to duty because of the exemption provided under section 21(1)(b) in the case of a person not domiciled in India. The provision has been rendered virtually redundant due to the change in the test for determining the "residence" of a company under the present Income-tax Act. Since a company incorporated abroad can be "resident" in India only if the control and management of its affairs is situated wholly in India, such an eventuality is very remote. That this section is practically a dead letter is borne out by the fact that no case of charge of duty under section 20A has been reported in the statistics published by the Department. In the circumstances, we recommend that section 20A of the estate duty Act and

Part II of the second Schedule to the Estate Duty Act may be deleted.

(C. C. CHOKSHI)
Chairman

(S. P. MEHTA)
Member

(HARNAM SHANKAR)
Member

(C. C. GANAPATHI)
Member

(T. S. R. NARSIMHAM)
Member

(D. N. PATHAK)
Secretary
Bombay,

September , 1978.

**PART III—SUMMARY OF OBSERVATIONS
AND RECOMMENDATIONS**

SUMMARY OF OBSERVATIONS AND
RECOMMENDATIONS

FINAL REPORT—PART III

INTRODUCTORY

1. Consolidation of the Estate Duty Act with any other direct tax enactment is not favoured. (Para III-0.5)
2. The Estate Duty Act should continue as it serves a socialistic objective. (Para III-0.6)

CHAPTER 1 : DEFINITIONS

3. The term "principal value of the estate" may be used to indicate the base for charge of duty and it may be defined to mean the aggregate of the market values of all property, settled or not settled, including agricultural lands, which passes or is deemed to pass on the death of a person, as reduced by the debts and incumbrances and after allowance of the admissible deductions. Any similar expression used elsewhere in the Act to denote the market value of a single item of the deceased's property as in sections 20A, 34, 36, 39(3), etc., will have to be suitably modified for the sake of clarity. (Para III-1.2)
4. The term "gross duty payable" may be defined to mean the amount of duty calculated on the "principal value of the estate" in accordance with the rates specified in the Second Schedule to the Estate Duty Act, 1953 ; and the term "average rate of duty" may be defined to mean the rate arrived at by dividing the "gross duty payable" by the "principal value of the estate". (Para III-1.3)
5. It is necessary to constitute the Controller of Estate Duty, Deputy Controller of Estate Duty and Assistant Controller of Estate Duty as distinct authorities under the Estate Duty Act with powers and functions similar to their counterparts under the other direct tax laws. (Para III-1.4)

CHAPTER 2 : BASIS OF CHARGE OF ESTATE
DUTY

6. The law should make it clear that, property held *benami* would pass under section 5 of the Estate Duty Act, 1953 on the death of the real (beneficial) owner and that, on the death of the *benamidar*, section 6 would not be applicable on the mere ground that the *benamidar* was legally competent to dispose of the property. (Para III-2.2)
7. Complete integration of lifetime gifts with the estate passing on death would neither be practicable nor rational under our system of taxation. The statutory period under section 9 of the Estate Duty Act

may, however, be extended from two years to five years. Corresponding amendments may be made in sections 10, 11, 12, 22, 33(1)(b) and 46. (Paras III-2.5, III-2.9, III-2.11, III-2.12, III-3.6, III-4.5 and III-6.11)

8. A clarificatory provision may be made in the law to the effect that payment of any premium by the deceased for effecting or keeping in force a policy taken out under the Married Women's Property Act, 1874 is not to be regarded as a gift for the purposes of section 9 of the Estate Duty Act. (Para III-2.6)

9. The law may be suitably amended to provide that where cash gifts received by the donee from the deceased, who was a partner in a firm, are deposited in the business of that partnership, such gifted property would not be liable to duty under section 10 of the Estate Duty Act regardless of the position whether the donee is a partner in the firm or not. (Para III-2.7)

10. The definition of the term "property" under section 2(15) of the Estate Duty Act may be expressly made applicable to the provisions of section 10. (Para III-2.8)

11. An Explanation may be added at the end of section 10 to the effect that possession and enjoyment of the gifted property by the donor or any benefit reserved to him therein will not result in the charge of duty to the proportionate extent of the consideration in money or money's worth paid by the donor to the donee for such possession and enjoyment or benefit. (Para III-2.10)

12. With a view to preventing leakage of revenue through the device of "grafting" and to keep up the efficacy of the provisions of section 5, 7 and 11, a suitable amendment may be made on the lines of section 36 of the U.K. Finance Act, 1969. (Para III-2.11)

13. Section 12 may be amended to limit the charge under that section to a part of the settled property in proportion to the value of the interest reserved. (Para III-2.12)

14. A provision may be made in the law to the effect that moneys receivable under personal accident policies, if otherwise passing on the death, are not to be aggregated with the other property of the deceased. (Para III-2.13)

CHAPTER 3 : EXCEPTIONS FROM CHARGE

15. The concept of domicile of the deceased may continue in preference to that of either his citizenship or residence for purposes of section 21 of the Estate Duty Act. (Para III-3.4)

16. Rule 7(g) of the Estate Duty Rules may be amended to make it clear that the interest of a beneficiary in an unadministered estate is movable property even if the estate includes immovable property. (Para III-3.5)

17. Section 29 of the Estate Duty Act providing for relief from duty in cases where estate duty has been paid in respect of any settled property on the death of the spouse may be amended to secure that the relief will be available even where no duty was in fact paid on the first death due to the estate being below the dutiable limit or the property being exempt under any specific provision of the law. (Para III-3.8)

18. The word "dependants" in section 29A may be replaced by the expression "relatives of the deceased dependent upon him for the necessities of life." (Para III-3.9)

19. The market value of the dutiable part of the annuity or pension for the purposes of section 29A may be determined by the application of Jollicoe's formula with a rate of interest equal to that allowed by nationalised banks on long-term deposits of more than five years. (Para III-3.9)

20. An annuity payable to the widow or other relatives of the deceased dependent upon him for the necessities of life, under a contract approved under section 80E of the Income-tax Act, 1961, should be eligible for exemption under section 29A of the Estate Duty Act to the extent of Rs. 15,000 per annum. (Para III-3.11)

21. The power to grant quick succession relief under section 31 should be delegated to the assessing authority. (Para III-3.12)

22. The quick succession relief under section 31 should be allowed if the second deceased has at his death adequate resources to cover what he inherited on the first death without the need for tracing actual dealings with the property through sale and reinvestment between the two deaths. (Para III-3.13)

23. The proviso to section 31 may be amended to make it clear that, where the proviso applies, the reduction in the estate duty payable on the second death will be worked out with reference to the amount of duty calculated on the value of the property as on the first death at the "average rate of duty" on the principal value of the estate computed on the second death. (Para III-3.14)

CHAPTER 4 : OTHER EXEMPTIONS AND REBATES

24. In order to simplify calculations of duty, the exemptions under clauses (a), (b), (f), (g), (h) and (k) of section 33(1) may be provided by way of straight deductions instead of rebates at the average rate. Relief under section 35(3) in respect of agricultural land in the case of small estates may be given by way of a deduction of an amount equal to 10 per cent of the value of the agricultural land included in the principal value. (Para III-4.2)

25. The amount eligible for exemption under section 33(1)(a) with reference to gifts for charitable purposes may be increased from Rs. 2,500 to Rs. 5,000. The amount eligible for exemption under section 33(1)(b) with reference to other gifts may be increased from Rs. 1,500 to Rs. 3,000. (Para III-4.5)

26. A consolidated exemption may be provided in respect of all kinds of tools and household goods, to the extent of Rs. 10,000, under section 33(1)(c). (Para III-4.6)

27. The present limit and the restriction under sections 33(1)(f) and 33(1)(g) should continue as these are equitable. (Para III-4.7)

28. The limit over the exemption in respect of moneys payable under policies of insurance, under section 33(1)(h), should be raised to Rs. 10,000. Further, moneys payable from any provident fund referred to in section 80C(2) of the Income-tax Act should also be covered by the exemption under section 33(1)(h) within the same consolidated monetary limit of Rs. 10,000. (Para III-4.8)

29. The exemption under section 33(1)(i) in respect of drawings, paintings, etc., should be extended to cover such collections made by the deceased himself if the conditions prescribed in that behalf are satisfied. (Para III-4.9)

30. The expression "retained in the family" of the deceased occurring in the clauses (i) and (j) of section 33(1) may be substituted by the expression "retained by the legal heirs or legatees or donees". (Para III-4.10)

31. Rules 11, 12 and 13 of the Estate Duty Rules, 1953, relating to conditions for grant of exemption under sections 33(1)(i) and 33(1)(j), which create substantive liability to duty and cast statutory obligations on certain persons, may be made a part of the substantive law. (Para III-4.11)

32. The scope of the exemptions under sections 33(1)(m) and 33(1)(mm) should be widened so as to cover the estate of any civil servant and any other person whose employment in the national cause is equally hazardous; and these exemptions should be available not merely where the deceased was killed in action against an enemy but also where the claim for exemption is supported by a certificate from the prescribed authority that the deceased had died either from a wound inflicted accident occurring or disease contracted at a time when the deceased was (a) on active service against an enemy or (b) on other service of a warlike nature or which involved the same risks as service of a warlike nature or where the deceased had died from a disease contracted at some previous time, the death due to or hastened by the aggravation of the disease due to the said employment. (Para III-4.12)

33. In valuing the property of the deceased which was exclusively used by him for his own residence for the purposes of exemption under section 33(1)(n), the same principles as recommended in Chapter 14 of the Interim Report and Chapter 18 of Part I of

this Report should be adopted. Further, the expression "one house" occurring in section 33(1)(n) should be clarified to cover servants' or a gardener's quarters and garage. (Para III-4.14)

34. The period of five years specified in section 33(1)(O), relating to exemption of the property gifted by the deceased to his spouse, son, daughter, brother or sister, should be increased to seven years. (Para III-4.15)

CHAPTER 5 : VALUE CHARGEABLE

35. The method of valuation of property under all direct tax laws including estate duty should, as far as possible, be the same as suggested in Part I of this Report except where some special or distinguishing features of the estate duty law require a different method to be adopted. (Para III-5.1)

36. The substance of section 37 should be incorporated in section 36 itself and at the same time, the exclusion of cases falling under rule 15 of the Estate Duty (Controlled Companies) Rules from the scope of the general provision in section 36 should be spelt out clearly so as to avoid any controversy or ambiguity. Further, the special provisions at present contained in section 37 should be extended for the purpose of valuation of shares in a private company under the Wealth-tax Act and the Gift-tax Act as well. In consonance with the recommendation made in Part I of this Report, rules will have to be framed by the Board for the valuation of unquoted shares on the basis of guidelines laid down by the Institute of Chartered Accountants for uniform application to all the direct taxes including estate duty. (Para III-5.6)

37. The provision in rule 14(3) of the Estate Duty Rules may be excluded from application in respect of quoted shares, stocks and debentures, and trading assets, viz., stock-in-trade, consumable stores, spare parts, raw materials and semi-finished goods. In respect of trading assets, it may be expressly provided that the value as for the corresponding income-tax assessment of the deceased will be adopted. Further, the expression "within a short time after the death" in rule 14(3) may be replaced by "within six months after the death". (Para III-5.8)

38. For the purpose of valuing interest in coparcenary property of a Hindu joint family ceasing on the death of the deceased, the principal value of the joint family property should first be computed without grant of any deduction under section 33 and, thereafter, the deceased's interest in each of the exempted assets of the family should be projected into the assessment for being taken into consideration for exemption subject to the overall ceiling, if any, under section 33. (Para III-5.10)

39. Rules 14(5) and 14(6) of the Estate Duty Rules should be deleted and the method of valuation of lands, whether agricultural or containing minerals, or otherwise, should, for estate duty purposes, be the same as for valuation under other direct tax laws. (Para III-5.11)

40. Power may be given to the Controller for granting relief in the duty payable in a case of genuine hardship resulting from the sale (to a person not being a relative) of quoted investments within 12 months of the date of death of the deceased at a substantially lower value than that adopted in the assessment provided there is no purchase or repurchase thereof within two years of the date of death by any relative of the deceased. The relief may be granted only after making appropriate adjustments for factors such as issue of bonus shares or right shares, payment of further calls, reorganisation of the capital of the company, etc. The relief may be determined with reference to the difference between the duty on the assessed value of the estate and that on the value of the estate recomputed by taking the price realised on sale of the quoted investments (as adjusted). (Para III-5.13)

CHAPTER 6 : DEDUCTIONS AND RELIEFS

41. The limit over the deduction for funeral expenses may be raised from Rs. 1,000 to Rs. 2,500. (Para III-6.2)

42. A clarificatory Explanation may be inserted in section 44 to secure that any liability in respect of gift-tax outstanding against the deceased at the time of his death is not disallowed as falling within the scope of clause (a) or clause (b) of that section. (Para III-6.3)

43. Debts or incumbrances which are in excess of the free estate may be allowed against property passing under other titles, e.g., property gifted by the deceased which is included in the estate, if such debts are actually discharged by the persons to whom such other property has passed, within a specified period of, say, two years following the date of death of the deceased. Such a voluntary discharge of the debts of the deceased by the donees of such gifts should also be exempted from any liability to gift-tax in the hands of the donees. (Para III-6.5)

44. Debts or incumbrances which are secured on property eligible for exemption from duty, e.g., foreign immovable property or residential house in India upto Rs. 1,00,000, should be considered for deduction from the remaining properties which are dutiable provided such debts are enforceable against such dutiable properties; if there is a deficiency the same should be allowed against property passing under other titles. (Para III-6.5)

45. The substance of the provisions in section 16(2) may be incorporated in section 46 itself in simple language so as to make it self-contained. (Para III-6.7)

46. Section 16(2)(c) may be amended to secure that only in the case of a settlement made by the deceased, the annual or periodical payments would be covered in the definition of "subject-matter" under that section and that in other cases, the income of the property derived from the deceased is not to be regarded as property derived from the deceased. (Para III-6.8)

47. Section 46 may be amended to secure that its provisions do not apply with reference to transactions which took place earlier than 15 years prior to the date of death of the deceased. (Para III-6.9)

48. Section 46 should be made expressly inapplicable where the property derived from the deceased is otherwise included in the estate under the provisions of sections 9, 10 or 12. (Para III-6.10)

49. The actual expense of realising or administering foreign property should be allowed upto the limit of 5 per cent of its value, under section 48. (Para III-6.12)

50. Section 50 may be amended to make it clear that the amount of court-fees paid means the amount paid in pursuance of a determination by the court of court-fees payable on the application for probate, letters of administration or succession certificate and that neither the assessing authority nor any other authority under the Estate Duty Act will be entitled to question such determination. (Para III-6.13)

51. Section 50A may be amended to limit the deduction on account of gift-tax paid to the proportionate amount of estate duty payable on the same property. (Para III-6.14)

52. The power to relax the time limit under section 50B should be given to the Controller, instead of being centralised with the Board. (Para III-6.15)

53. Section 50B may be amended to cover transfer by way of compulsory acquisition of any of the properties included in the estate or delivery of any such property by the accountable person to the Government for adjustment of the price against the estate duty even beyond the period of two years stipulated thereunder. (Para III-6.15)

54. For purposes of the relief under section 50B, the quantum of tax paid on capital gains may be spelt out to be the amount arrived at by applying the average rate of income-tax applicable to the total income of the relevant year, to the capital gains forming part of such total income, after the deduction, if any, under section 80T of the Income-tax Act, and the "amount paid towards estate duty" may be clarified to mean the estate duty actually paid taken together with any court-fees paid out of the proceeds of the transfer of the property. (Para III-6.16)

55. The relief under section 50B may be computed with reference to the net proceeds of the transfer of the property i.e., the proceeds after the deduction of the expenditure incurred wholly and exclusively in connection with the transfer, instead of the gross proceeds. (Para III-6.17)

CHAPTER 7 : ASSESSMENT, PENALTIES AND PROSECUTIONS

56. The account of the property passing on the death, required to be filed by the accountable person, should be termed as an estate duty return. Further, the verification of an estate duty return should be in the same form and should be made in the same manner

as in the case of any other direct tax return and the requirement of a sworn statement before a magistrate or an oath commissioner should be removed. (Para III-7.1)

57. The provisions of section 53(1)(b) may be amended so as to confer immunity from accountability on persons responsible for making payments out of provident funds referred to in section 80C of the Income-tax Act, or gratuity funds approved under the Income-tax Act, in those cases where the aggregate amount payable out of such funds to the legal heirs, or the nominees of the deceased subscriber does not exceed Rs. 25,000. (Para III-7.2)

58. There should be a specific provision for treating an estate duty return filed any time before the assessment is completed as a valid return and for charge of interest on the duty from the date of expiry of 6 months after the date of death of the deceased upto the date of filing of such return, irrespective of whether or not the accountable person had obtained extension of time from the Controller for filing the return. (Para III-7.3)

59. The timelimit for initiation of assessment proceedings under the Estate Duty Act should be 8 years from the end of the financial year in which the death occurred and 16 years, in cases where the principal value of the estate is likely to be Rs. 5 lakhs or more, subject to the requirement that in the latter type of cases, approval of the Board is obtained before the issue of the notice. The timelimit for commencement of proceedings for reassessments should be 4 years from the end of the financial year in which the death occurred in cases falling under section 59(b) and 8 years in cases falling under section 59(a), subject to the approval of the Controller in the latter type of cases. There should also be a provision for initiating such proceedings upto 16 years in cases where the value of the estate escaping assessment is likely to be Rs. 5 lakhs or more, subject to the approval of the Board. (Para III-7.4)

60. The timelimit for completion of an estate duty assessment/reassessment should be 4 years from the end of the financial year in which the proceedings for such assessment/reassessment were initiated, or 4 years from the end of the financial year in which the return or a supplementary return envisaged under section 53(4) or under section 56 is filed, whichever is later. Further, a specific provision should be made authorising a reassessment on the basis of a supplementary return envisaged under section 53(4) or under section 56, which is filed after the completion of the assessment, without the need to initiate formal reassessment proceedings. The introduction of the timelimit as stated above should be suitably staggered in respect of pending proceedings. The timelimit may be relaxed in cases where :

- (a) the accountable person demands the reopening of the whole or any part of the proceedings consequent on a change in the incumbent of the office of the assessing authority ; or
- (b) the proceedings are stayed by an order or injunction of any court ; or

- (c) the assessment/reassessment has to be made in consequence of, or for giving effect to, any finding or direction of any appellate or revisionary authority ; or
- (d) an application made before the Settlement Commission (in pursuance of the recommendation elsewhere in this Part for the provision of a machinery for settlement of disputes in estate duty matters) is rejected by the Commission or is not allowed to be proceeded with by it.

In such situations, the relaxation in the timelimit should be broadly on the lines of the provisions in section 153(3) of the Income-tax Act as suggested to be modified under the recommendations in Part II.

(Para III-7.6)

61. Sub-section (2) of section 57 relating to provisional assessment should be amended to make the demand raised on such assessment liable to be recovered from any of the accountable persons and not merely from the accountable person on the basis of whose return the provisional assessment is made, after giving an opportunity to the other accountable persons of being heard. Section 70 should be amended to extend the provision for levy of interest on the demand raised on a provisional assessment under section 57, which is not paid in time.

(Para III-7.7)

62. The provisions of section 70 and rule 42 may be modified so that levy of interest is attracted in all cases where there is a delay in filing the estate duty account or in the payment of the duty, whether on regular assessment or provisional assessment, even if there is no application from the accountable person for extension of time, or the terms subject to which extension is granted are not fulfilled.

(Para III-7.8)

63. The maximum rate of interest under section 70 and rule 42 should not exceed 6 per cent.

(Para III-7.9)

64. As recommended in Part II in relation to section 273A of the Income-tax Act, power may be conferred on the Controller to reduce or waive the interest chargeable under the Act. Further, the proviso to rule 42(d) which makes the Controller's discretion to reduce the rate of interest subject to the general instructions of the Board should be deleted and the rate of interest to be actually charged in a given case, either for delay in filing the account or in the payment of duty, may be wholly left to the discretion of the assessing authority.

(Para III-7.10)

65. The rate of interest payable by Government under rule 19(3) on deposits in respect of estate duty made under section 33(1)(g) may be increased to 6 per cent. This interest should continue to be calculated from the date of deposit to the date of death, as at present. In case the deposit is found to be in excess of the estate duty liability finally determined, further interest may be granted on such excess at the same rate from the date of death to the date when the excess is refunded.

(Para III-7.11)

66. Interest may be granted at the rate of 6 per cent on any amount which is found to be refundable to the accountable person consequent upon any order in assessment, appeal, revision or rectification but which is not refunded within the period of 3 months from the end of the month in which the order is passed.

(Para III-7.12)

67. Provisions relating to penalties under the Estate Duty Act may be modified on the following lines :

(i) Penalties for defaults relating to filing of returns or complying with notices should be leviable only by the authority before whom such default occurs and not by any other higher appellate or administrative authority. The penalty for concealment may, however, be allowed to be levied by the assessing authority as also by the first appellate authority and the revisionary authority. The Appellate Tribunal, which is the final authority on facts, should not have the power to levy penalties for any of the defaults.

(ii) A provision similar to that section 273A of the Income-tax Act should be introduced in the Estate Duty Act bestowing powers on the Controller to reduce or waive the penalty in appropriate cases.

(Para III-7.13)

68. For completion of penalty proceedings under the Estate Duty Act, there should be a timelimit of two years from the end of the financial year in which the assessment proceedings during which penal action is initiated are completed. Provision may also be made for extension of this timelimit on the lines of the provision in section 275(a) of the Income-tax Act and the *Explanation* thereto, as suggested to be modified in Part II of this Report.

(Para III-7.14)

69. A provision may be introduced for prosecution for the making of a false statement in any verification or for delivering an account or statement which is false or which the accountable person either knows or believes to be false or does not believe to be true, on lines of the provision in section 277 of the Income-tax Act.

(Para III-7.15)

CHAPTER 8 : APPEAL, RECTIFICATION AND REVISION

70. Provisions of the Estate Duty Act relating to appeals and rectifications need to be restructured to bring them in line with the corresponding provisions under the other direct tax laws.

(Para III-8.1)

71. Instead of enumerating the various orders of the assessing authority against which an appeal lies to the first appellate authority, there should be a general provision to the effect that every final order (which is not in the nature of an administrative order or an interlocutory order) of the assessing authority should be appealable to the first appellate authority. The first appellate authority under the Estate Duty Act should be of the rank of Controller.

(Para III-8.2)

72. The language of section 62(4) (a) relating to admission of fresh grounds of appeal before the first appellate authority should be brought in harmony with that of section 250(5) of the Income-tax Act as modified in the manner recommended in Chapter 6 of Part II of this Report. Further, provisions regulating the admission of fresh evidence at the stage of first appeal may be introduced on the lines of rule 46 of the Income-tax Rules. (Para III-8.3)

73. The proviso to section 62(1) may be deleted so that an appeal against penalty levied for non-payment of estate duty would be competent even if the duty is not paid before the appeal is filed. (Para III-8.4)

74. The powers of enhancement given to the Appellate Tribunal under section 63 may be withdrawn. (Para III-8.5)

75. The procedure for reference of any question of disputed value to arbitration, contained in sub-sections (6), (7) and (8) of section 63, should be deleted. Further, the system of Valuation Officers obtaining under other direct tax laws, functioning in an advisory capacity as recommended in Part II of this Report, as also the system of registered valuers obtaining under other direct tax laws, should be extended to estate duty as well. (Para III-8.6)

76. A provision for the filing of a memorandum of cross objections may be incorporated in the Estate Duty Act as under other direct tax laws. (Para III-8.7)

77. In regard to further appeals/references against orders of the Appellate Tribunal, the provisions in the other direct tax laws as modified in the manner recommended in Part II of this Report should be made applicable for the purpose of estate duty too. (Para III-8.8)

78. The provisions of section 61 relating to rectification of mistakes apparent from the record should be brought in line with those in the other direct tax laws as modified in the manner recommended in Part II of this Report. (Para III-8.9)

79. The provisions of section 61 may be enlarged in line with the provisions in section 155 of the Income-tax Act so as to provide extended timelimits for various purposes under the Estate Duty Act such as, recomputation of the principal value to give effect to any revision in the income-tax or wealth-tax liability already allowed under section 44; deduction of the duty paid in a non-reciprocating country under section 49; deduction for court-fees under section 50; granting of relief due under section 50A or section 50B with reference to the gift-tax or tax on capital gains, etc. (Para III-8.10)

80. Provisions corresponding to those in sections 263 and 264 of the Income-tax Act may be introduced in the Estate Duty Act conferring power on the Controller to revise orders of any subordinate authority. Orders of the Controller revising an order prejudicial

to the revenue should be appealable to the Appellate Tribunal, as under the other direct tax laws. (Para III-8.11)

81. Section 71 of the Estate Duty Act, which authorises the Board to remit outstanding duty and interest, may be modified so that the power under that section is exercisable by the Board any time after the expiry of three years from the date of finalisation of an assessment or reassessment proceeding under the Estate Duty Act. (Para II-8.12)

CHAPTER 9 : RECOVERY OF DUTY

82. The present procedure for collection and recovery of estate duty demands has not proved effective in tackling the problem of mounting arrears. (Para III-9.1)

83. The procedures for recovery of income-tax and other direct taxes, modified in the manner recommended in Part II of this Report, should be made applicable for the purposes of estate duty also. As this would entail the Department taking over the recovery matters already referred to the State Government authorities and pending with them, suitable transitional provisions will have to be made for such take-over. (Para III-9.2)

84. Section 52 of the Estate Duty Act, which provides for payment of duty by transfer of a property comprised in the estate to the Government at a price to be agreed upon, may be amended to secure that, when a property comprised in the estate is offered by the accountable person in payment of the estate duty, it should be obligatory on the Government to accept the offer; where there is a dispute about the price in such a case, the Government should be obliged to pay the value which has been finally adopted for the purpose of assessment. (Para III-9.3)

CHAPTER 10 : SETTLEMENT OF ESTATE DUTY CASES

85. A machinery for settlement of cases may be introduced in the Estate Duty Act on the lines of the provisions in Chapter XIXA of the Income-tax Act, keeping in view the recommendations in Chapter 10 of the Interim Report. (Para III-10.3)

CHAPTER 11 : RATES OF ESTATE DUTY

86. The maximum rate of estate duty should be fixed at 80 per cent and the rates of duty in the slab of principal value exceeding Rs. 20,00,000 altered as under :

Slab of principal value	Present rate of duty	Rate of duty recommended
Over Rs. 20 lakhs but not exceeding Rs. 25 lakhs	85%	60%
Over Rs. 25 lakhs but not exceeding Rs. 30 lakhs	85%	70%
Over Rs. 30 lakhs	85%	80%

(Para III-11.3)

87 With a view to ensuring proper correlation between the gift-tax rates and the estate duty rates, the rate of gift-tax in the slab of taxable gifts over Rs. 20 lakhs upto Rs. 25 lakhs should be 60 per cent ; that in the slab over Rs. 25 lakhs upto Rs. 30 lakhs should be 70 per cent ; and the existing maximum rate of 75 per cent should operate on taxable gifts exceeding Rs. 30 lakhs. (Para III-11.4)

88. Section 20A of the Estate Duty Act imposing liability to estate duty in respect of shares and debentures in a foreign company held by a deceased not domiciled in India, in certain cases, and Part II of the Second Schedule specifying the rate of duty for the purpose of section 20A may be deleted.

(Para III-11.6)

Sale Price : *Inland* : Rs. 11.25
Foreign : £ 1.32 or \$ 4.05