INCOME TAX ENQUIRY REPORT, 1936.

Submitted to the Government of India as a result of the investigation of the Indian Income-tax System conducted by Khan Bahadur J. B. Vachha, C.I.E., Commissioner of Income-tax, Bombay and Messrs. C. W. Ayers and S. P. Chambers of the Board of Inland Revenue in the United Kingdom.

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INTRODUCTION.

We were appointed in October 1935 to make an investigation of the Indian Income Tax system in all its aspects and to report upon both the incidence of the tax and the efficiency of its administration. For this purpose, we made an extensive tour throughout British India, during which we made a detailed examination of the organisation and work of the Department.

Chambers of Commerce and other public bodies were invited to make written representations to us and many of them availed themselves of the opportunity given them in the course of our tour of supplementing these by informal discussion. A list of those bodies which assisted us in this manner is contained in Appendix 1.

The first part of our Report deals with those provisions of the Income Tax Act which relate to the scope of the tax and the quantification of liability, while in the second part, we examine the statutory provisions for assessment and appeal procedure and the administration of the Act generally.

Our recommendations are designed to secure the fairest possible treatment of the honest tax-payer and at the same time to strengthen the Department in dealing with fraudulent evasion and what is known as "legal avoidance". It cannot be too strongly emphasised that many of these recommendations are inter-related and should be read together, rejection or modification of one necessitating rejection or modification of others.

Our thanks are due to the various members of the Department of all ranks for the ready assistance and valuable co-operation which they afforded us and we wish to make special mention of our able Personal Assistant Mr. Motiram D. Advani who spared himself no effort to assist us in the preparation of this Report.

CHAPTER I.—SCOPE OF THE TAX.

SECTION 1.—RESIDENTS IN BRITISH INDIA—INCOME ARISING ABROAD.

(a) *Basis of liability.*—Foreign income of a resident in British India is at present assessable only to the extent to which it has been received in or brought into British India. The substitution of the basis of income arising or accruing in place of the remittance basis has been under discussion for some years past and unsuccessful attempts have been made to amend the Income-tax Act accordingly.

The principal objections to the accrual basis are—

(i) the administrative difficulties involved in determining the profits assessable in the case of foreign business and

(ii) the inequity of subjecting to taxation in British India the home income of a person whose permanent home is outside British India and who comes to British India merely for the purposes of business or employment.

We are not much impressed by the first objection as it is a matter of complaint on the part of officers of the Department that they find it extremely difficult in many cases to decide what is the amount of the remittances, if any, from a foreign branch business. Prior to the amendment of Section 4(2) of the Act in 1933, foreign business profits were liable only when brought into British India within three years of their accrual and it was therefore necessary on the occasion of each remittance to ascertain the actual profits for three years. Books from which no clear inference as to remittances can be drawn are often, nevertheless, of great value in determining the amount of profits and we think that the difficulties would be lessened rather than increased by a change to the basis of the profits arising.

There is more force in the second objection. It does seem at first sight inequitable to subject to taxation income that has no connection in origin or otherwise with British India because it belongs to a person who, however long his stay, does not intend to make his home in British India. Proposals have been made to meet this type of case by restricting the accrual basis to persons domiciled as well as resident in British India. This, however, was objected to on the grounds that it would amount in practice to discrimination in favour of Europeans and residents domiciled in an Indian State, and the proposal for the accrual basis modified by the domicile qualification was rejected by the Legislature. We may point out that there is, for the majority of cases, a definite reply to the plea of hardship in that there are reciprocal arrangements for double taxation relief.

The Objections to the existing system, apart from the administrative difficulties already referred to, are as under:—

(i) opportunity is afforded for fraudulent evasion and legal avoidance of tax of which we have seen several examples.

(ii) Encouragement is offered to investment abroad by wealthy persons who can afford to refrain from having the income remitted to British India. Not only is no tax payable on that

part of the resident's income, but there are possibly adverse effects upon the supply of capital for Indian industry. There is no reason in equity why investment of money abroad, as contrasted with home investment, should be given immunity from taxation.

(iii) The profits attributable to the sale of goods by foreign branches of British Indian concerns are held by some Provincial High Courts to arise abroad and to be non-assessable unless remitted, even though the profits may be said to arise primarily from the higher management and control which are situate in British India.

(iv) A resident in British India earning large profits by speculation in foreign markets by issuing orders from an office in British India to brokers abroad at present escapes tax thereon as long as such profits are not brought into British India.

Having regard to all these considerations, we recommend that foreign income of residents in British India should be dealt with on the basis of the whole income arising. Incidentally, this would provide for the allowance of foreign business losses.

The only modification of this general rule that we recommend is that salaries earned abroad should only be chargeable where the recipient is absent from British India for the purpose of his employment for a period not exceeding 6 months.[1]

We also recommend that remittances received by a wife out of such part of her husband's income as is not liable to assessment in his hands should be deemed to be income arising to her and assessable in her hands.

(b) *Residence*.—The foregoing necessitates a definition of "residence" and in this connection reference may usefully be made to clauses 6 and 7 of the draft Income-tax Bill appended to the Report of the United Kingdom Income Tax Codification Committee presented to Parliament in April 1936.[2]

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[1] Some objections to this proposal are met by the proposed definition of "residence".

[2] These clauses read as follows :—

6.—(1) An individual shall be treated as being resident in the United Kingdom in a year of charge if he—

(*a*) is in the United Kingdom in the year of charge for a period or periods amounting in all to one hundred and eighty-two days or more; or

(*b*) maintains or has maintained for him a dwelling place in the United Kingdom for a period or periods amounting in all to ninety-one days or more in the year of charge, and is in the United Kingdom for any time in the year of charge; or

(*c*) is in the United Kingdom for any time in the year of charge with the intention of setting up a dwelling place therein, and in that or the following year of charge sets up such a dwelling place; or

(*d*) having within the four years preceding the year of charge been in the United Kingdom for a period of, or for periods amounting in all to, three hundred and sixty-five days or more, is in the United Kingdom for any time in the year of charge otherwise than on an occasional or casual visit.

Individuals.—Clause 6(1), suitably adapted, is in our opinion generally appropriate to Indian conditions and to the basis of charge which we have recommended. We consider, however, that sub-clauses (b) and (c) import an invidious distinction between the newcomer who at once sets up a dwelling house and the newcomer who takes less permanent accommodation, and we therefore suggest that sub-clause (c) be not adopted and that sub-clause (b) be adapted by the substitution of 182 days for 91 days. Clause 6(2) we do not recommend for adoption as it provides for distinctions on the basis of domicile. etc., which we have examined and rejected earlier in this section. In adapting the clause, the conditions constituting residence should have reference to the 'previous year' and not to the year of charge, since in British India, the assessment is an assessment of the profits of the previous year, whilst in the United Kingdom, the previous year's profits are normally used only as a measure of the profits of the subsequent year.

Companies.—In view of our suggested basis of assessment for foreign income, and of our suggestion that the whole profits of a business carried on by a company should be assessable when the company is controlled in British India, clause 7 is too wide for the purpose and we therefore suggest a definition on the following lines:—

"A company shall be treated as resident in British India if it is controlled in British India at any time during the year in which the profits sought to be assessed arise."

As to what constitutes 'control' there is, we consider, sufficient guidance in the numerous decided cases.

SECTION 2.—NON-RESIDENTS: INCOME ARISING IN BRITISH INDIA.

(a) *Income from Trade.*—It is not clear from a comparison of sections 4 and 42 of the Act with paragraph 111 of the Income-tax Manual, and various cases taken to the Courts, how far it is intended to tax profits arising from trading in or with British India by a non-resident.

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(2) An individual who in a year of charge is resident in the United Kingdom but is not resident solely therein—

(*a*) shall be treated as being principally resident in the United Kingdom, if, in the year of charge—

(i) he maintains or has maintained for him a dwelling place or a place of business in the United Kingdom, but neither a dwelling place nor a place of business elsewhere; or

(ii) he neither maintains nor has maintained for him a dwelling place or a place of business in any country, but is domiciled in the United Kingdom;

(*b*) shall, in a case to which paragraph (*a*) does not apply, be treated as being principally resident in the United Kingdom if he appears in view of all the circumstances of his case to be so resident, regard being had in particular to his domicile, nationality and habits of life.

7. A company shall be treated as resident in the United Kingdom in a year of charge if it is controlled in the United Kingdom, or if it maintains in that year an established place of business in the United Kingdom and any substantial part of the activities of the company, whether administrative or other, is conducted in the United Kingdom, but a company shall not be treated as so resident by reason only of the fact that it has a registered office in the United Kingdom at which is transacted such administrative business only as is necessary to comply with the requirements of Company Act, 1929.

Section 42 appears to cover all profits arising from the sale in British India of goods produced abroad, irrespective of the circumstances in which or of the means by which such sales are effected. Similarly, it appears to cover the profits arising from the sale, wherever effected, of goods produced in British India.

Paragraph 111(c) of the Manual states, however, that it is not desired, in practice, that liability to assessment should be enforced except where something in the nature of a branch or agency exists and that in particular, no attempt should be made to tax the profits of 'consignment business pure and simple merely because the non-resident consignor habitually uses a particular resident as his agent'. Repeated representations have been made to us to the effect that the quoted phrase, taken in conjunction with the remainder of the paragraph including the examples, makes it virtually impossible to determine with certainty whether any specific case of consignment or agency business is or is not intended to be assessed. These instructions are such that in practice it is only possible to levy tax in a few cases of sale of goods in British India by non-residents. In one Province, recently a special staff was engaged specially on this type of case, but it was found that in view of these instructions, in only 2 per cent. of the cases handled could liability be established.

Before it is possible to make any recommendations on this subject, it is necessary to find answers to the following questions:—

(1) Is it the clear intention only to assess the profits of trading *in* British India as contrasted with the profits of trading *with* British India and if so, what is the test to be applied to determine what constitutes trading in and not merely with British India?

(2) What part of the profits of such trading is sought to be assessed?

(1) It seems clear from paragraph 111 of the Manual that mere trading *with* India is not sought to be assessed, notwithstanding the fact that under Section 42 it is liable. This view, moreover, is in harmony with the practice of other countries, notably the United Kingdom, and we proceed on the assumption that this is the considered intention of the Government of India.

The finding of a test which will operate consistently to bring into the tax net all cases sought to be assessed, whilst excluding the cases of casual operations not intended to be made liable to taxation, is a matter of some difficulty. The existing instructions in the Manual suggest two alternatives, the positive criterion of agency and the negative criterion of 'consignment business pure and simple', but in practice neither of these criteria has proved to be entirely satisfactory. In the United Kingdom, liability is confined to the case where the non-resident is represented by a regular agent who actually sells his principal's goods in the United Kingdom, but exemption is granted in the case where the regular agent acts as such in the course of his business of broker or commission agent and a claim for the same exemption was put forward by some representative bodies. It may be pointed out that the Royal Commission on Income-tax in 1920 recommended that any regular agent, whether or not in business as a broker or commission agent, should be assessable in respect of the profits arising to his non-resident principal from transactions in the United Kingdom.

In our view, the non-resident on whose behalf goods are *regularly* sold in British India should be made assessable in respect of the profits arising therefrom, whatever may be the type of representative employed. We consider that it would be undesirable to attempt to tax the profits arising where an agent only receives casual consignments and does not regularly act for the consignor.

It has been strongly represented that considerable hardship results when an agent is assessed in respect of the profits of his foreign principal at a date when he has in his hands none of his principal's monies and so is unable to recover the tax. To meet this difficulty, we recommend that statutory power be given to an agent, acting regularly for a non-resident principal, to retain a sum equal to the estimated tax liability and that in a case where there is disagreement between the principal and the agent upon the question of the reasonableness of the amount retained, the certificate of the Income-tax Officer as to a reasonable amount should be sufficient authority for retention of such an amount pending final ascertainment of the liability.

Later in this Report, we recommend (a) that persons liable to assessment should be required by the Act to make returns whether or not individual notices have been served upon them and (b) that the time limit for additional assessment should be extended to six years. Neither of these recommendations, we consider, should be applied to the case of the income of a non-resident assessable in the name of a resident agent.

(2) As regards the second question there is a widespread convention that the profit arising when goods are sold is attributable in part only to the operations of sale;[1] and that in the case of trading in a country by a non-resident, only the profit attributable to the operations performed in that country is assessable therein. In our opinion, this convention is essentially sound and the country that does not honour it would appear to be in the position of taxing the foreign profits of a non-resident.

We recommend, therefore, that only the proportion of profits attributable to the operations carried out in British India should be assessable. Thus in the case of sale of goods imported into British India by a non-resident, his liability should correspond to the profits that would normally be made by a resident if he imported such goods and dealt with them in a similar manner. Similar considerations apply to the case of the non-resident purchasing goods in British India for resale abroad.

Apart from these basic considerations, there are three further matters to be examined.

(i) There is an anomaly in Section 42, in that sub-section (2) provides for the case where the relationship between the resident and the non-resident is so close and matters are so arranged that the profits arising to the resident are less than might ordinarily be expected to arise. This sub-section does not apply, however, where the non-resident is a British subject. The British subject is left to be dealt with under the much wider provisions of sub-section (1). Since the remedy prescribed by sub-section (2) in the conditions mentioned is merely the assessment of the amount by which the *resident's* profits are estimated to have fallen short, it seems clear that the case of the British non-resident is more severely dealt with

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1 This convention is applied in the case of Tea Companies in British India in which case only 40 per cent. of the total profit is deemed to arise from manufacture and sale as opposed to agriculture.

than the case of the non-British. This may be remedied quite simply by the deletion from the sub-section of the words: "and not being a British subject or a firm or company constituted within His Majesty's dominions or a branch thereof."

(ii) Representations have been made calling our attention to the provisions of section 43 of the Act by which the Income-tax Officer has a very wide choice of persons whom he may treat as agents of non-residents and to the omission of any right of appeal against the Income-tax Officer's decision. The only recommendation that we can make is that there should be the same right of appeal as against other orders of the Income-tax Officer.

(iii) We further recommend that for the words "shall be chargeable to income-tax in the name of the agent" in Section 42(1), there be substituted the words "shall be chargeable to income-tax either in the name of the non-resident or in the name of the agent" in order to leave no doubt that such income is also directly assessable.

(b) *Other Income.*—We feel that income payable to non-residents arising in a primary sense from British Indian sources should be subjected to British Indian taxation. Pensions originating in British India are considered in Section 6 of this Chapter and interest payable on securities is considered in Section 7. There are other payments such as interest (other than interest on securities), patent royalties and rents. We recommend that all these should be brought within the scope of the Indian Income-tax Act by an amendment to Section 42(1) substituting the words "or money lent at interest, or property or any other asset" for the words "or property". (In Chapter X, Section 4, we recommend deduction of tax at source in such cases).

Section 3.—Religious and Charitable Exemptions.

The existing exemption of income applied, under a trust or other legal obligation, to religious and charitable purposes has the sanction of long tradition and it is not thought necessary for us to examine the basic principle, but it is necessary to see whether the Act does secure the intended result.

The cases taken to the High Courts have resulted in definitions of "property" and "wholly for religious or charitable purposes", much narrower than obtain in the practice of the Department. Thus "property" is in practice treated, not according to the restricted meaning it bears in Section 9 of the Act, but in its wider sense to include securities, a business or a share in a business. It seems, therefore, that there is no desire on the part of the Government of India to restrict the existing exemptions. If, however, any limitation is desired, we suggest (i) that private religious trusts which do not enure to the benefit of the public should not be exempt, and (ii) that business carried on by the trustees of a religious or charitable trust should be exempt only when the business activities are in themselves the primary purpose of the charity, or when the work in connection with the business is mainly carried on by the beneficiaries. (See Section 24, United Kingdom Finance Act, 1927.)

We have considered various suggestions for amending the definition of 'charitable purpose' at the end of Section 4 of the Act, these all having the effect of narrowing the exemption, but in view of the general attitude of the Government of India to this matter, we do not recommend the adoption of any of these suggestions.

Section 4.—Agricultural Income.

(a) *General Exemption.*—A number of representations were made to us, some in favour of the exemption and others not, but in view of Sections 100 and 138 of the Government of India Act, 1935, consideration of the existing exemption of agricultural income would be out of place in our investigation.

(b) *Effect of agricultural income upon taxability of other income.*—We have been impressed by the fact that the tax payable in respect of non-agricultural income in the hands of an agriculturist is not at all affected by the existence of his agricultural income. Thus a person with Rs. 1,500 of assessable income pays no tax even though he has agricultural income of a considerable amount. On the principle of "ability to pay", we find, as did the Taxation Enquiry Committee of 1924-25, that "there is ample justification in theory for the proposal that income from agriculture should be taken into account for the purpose of determining the rate at which the tax on the other income should be assessed."

Apart from theory, objection has been taken to the proposal on the grounds of administrative difficulty in determining the amount of the agricultural income. Various officers of the Department, however, assure us that there would be no undue difficulty in estimating such income from the land revenue, road cess and other records. They say, moreover, that reasonably close estimation in such cases would be much easier than in many cases of business profits.

We therefore recommend that the agricultural income of an assessee should be taken into account in fixing the amount of tax payable on his other income.

If the 'slab' system of rates of tax be adopted, as suggested in Chapter II, it would be necessary to provide a method for the computation of tax in the class of case under consideration. We suggest that the most suitable method would be one similar to that recommended in the case of non-residents, that is, to charge on the assessable income such proportion of the tax (including super-tax) chargeable on an amount equal to the sum of his "total income" and his agricultural income, as his non-agricultural income bears to the sum thus ascertained. If, however, the present 'step' system be continued, it would be necessary as regards income-tax to enact that the rate of tax should be that applicable to the sum of an assessee's "total income" and his agricultural income, but as regards super-tax, some such method of computation would be necessary as indicated above for the 'slab' system generally.

(c) *Tea and other plantation concerns.*—It is clear from the definition in Section 2 of the Act that production plus ordinary preparation of the produce for market is considered to be agriculture and entitled to exemption under Section 4(3)(viii), provided that the land used pays land revenue to the Government. Where the processes performed go beyond this, it is established, by the cases of the Bhikanpur Sugar Concern (1 I.T.C. 29) and of the Killing Valley Tea Co., Ltd. (1 I.T.C. 54) that some part of the total profit arises from business, although the profits arise primarily from agriculture. This is fully recognised in the case of Tea Companies by Rule 24 which reads as follows:—

> "Income derived from the sale of tea grown and manufactured by the seller in British India shall be computed as if it were

income derived from business, and 40 per cent. of such income shall be deemed to be income, profits or gains liable to tax."

The second proviso to Section 4(2) of the Act provides for the continuance, in spite of the remittance of the profits, of exemption of income from agriculture arising in an Indian State from land for which any annual payment is made to the State. This, it will be observed, puts on the same footing any agricultural income of a resident in British India whether derived from land in British India or in an Indian State.

A complaint, however, has been made that where a tea company in British India has its tea gardens in an Indian State and sells its produce in British India, the whole of its profits are assessed to British India income-tax. The somewhat narrow ground for this treatment is the theory that the profits wholly arise on the sale so that there are no profits which accrue or arise outside British India to which the provisions of Section 4(2) can be applied. The profits on this assumption become therefore profits wholly accruing or arising within British India assessable under Section 4(1). We can see no sufficient reason why, if income arising wholly from agriculture in an Indian State is exempt in British India, there should not be exemption also of the agricultural proportion of the profits where crops are raised in a State and sold in British India.

There is, however, in our opinion, no justification for the existing exemption of agricultural income from land in a State for which any annual payment is made to the State, and we recommend its withdrawal. If, however, this exemption is continued, we consider that the second proviso to Section 4(2) should be read as exempting the profits attributable to agriculture in the type of case referred to above.

(d) *Usufructuary Mortgages.*—It may reasonably be assumed, we think, that it was not the intention of the Legislature, when the exemption of agricultural income was continued by Section 4(3) of the Income-Tax Act, 1922, that income derived from lending money to landowners should be exempted. Various decisions of the Courts show, however, that the wording used in the definition of agricultural income (Section 2 of the Act) does in some cases cover such income where it arises under a usufructuary mortgage, *i.e.*, one giving the mortgagee the right to receive rent from the mortgaged lands in lieu of, or in satisfaction of, mortgage interest.

Whether such a loan is made in the course of a money-lending business or otherwise, we are of opinion that the income therefrom should be assessable to tax, but that when the mortgagee has actually become the proprietor of the land, he is entitled to exemption as is any other landowner. To secure this result, we recommend the addition to the definition in Section 2(1)(a) of words such as: "except when it accrues or arises to, or is received by a usufructuary mortgagee as defined in Section 58(d) of the Transfer of Property Act." and also a suitable modification of clause (c) of the sub-section.

We should add that any such amendment of the definition of agricultural income would need the prior sanction of the Governor General under Section 141 of the Government of India Act, 1935.

SECTION 5.—LOCAL AUTHORITIES.

We observe that in contrast with the practice in the United Kingdom, Local Authorities in British India are specifically exempted from tax. Since such bodies may be engaged in trading activities, we suggest that the extent of their trading be investigated with a view, if necessary, to the reconsideration of the existing exemption.

SECTION 6.—EXEMPTIONS UNDER SECTION 60 (1).

(a) *Governor General's Powers of granting exemption and of revoking exemptions.*—Representations have been made to the effect that the power given to the Governor General under this section is inconsistent with the principles of the Government of India Act, 1935 and out of harmony with the practice in other countries in taxation matters, and should be abolished, leaving any exemption to be specifically enacted. We can, of course, offer no comments upon a constitutional matter such as this, but we are of opinion that the complaints in the main arose out of the specific exemptions dealt with in the following sub-paragraphs.

(b) *Pensions.*—By Notifications under the Section in question, exemption is allowed in respect of—

(i) the pensions of officers of Government residing out of India drawn from any Colonial Treasury or paid in the United Kingdom, whether such pensions are paid in sterling or by means of negotiable rupee drafts on a bank in India, and

(ii) the pensions paid in the United Kingdom or in a Colony to officers of local authorities or employees of companies or of private employers, such officers or employees being resident out of India.

The obvious point is taken that these pensions are earned in British India and paid out of Indian revenues or out of profits arising in British India and should therefore be subject to British India taxation.

So far as certain Government pensions are concerned, the matter is, of course, concluded by Section 272 of the Government of India Act, 1935, which definitely exempts such pensions from taxation imposed by the existing Income Tax Act or any future taxing Act. This exemption is also made applicable to future entrants to the services.

As regards other Government pensions and pensions paid by commercial concerns, etc., there is no such statutory bar against making them liable to tax and the major consideration that pensions earned in British India should pay British Indian tax should in our opinion prevail. If our recommendation be accepted, liability should not depend upon the accident of the place at which the pension may be made payable, but should extend to all pensions earned in British India. It may be pointed out that broadly this recommendation would not, by virtue of the double taxation provisions, increase the total tax payable by a resident in the United Kingdom (the normal case).

To secure the collection of the tax on all such pensions, it would be necessary to enact that any person resident in British India who pays, either directly or through any agent, a pension, whether legally exigible or otherwise, to any person not resident in British India shall deduct tax therefrom at the standard rate and account therefor to the Revenue.

Provision should be made for the deduction of tax to apply only to pensions exceeding Rs. 2,000 per annum and for deduction at a lower rate in appropriate cases on the certificate of the Income Tax Officer as in the case of interest on securities under the proviso to Section 18 (3). The recipient of a pension taxed by deduction should, of course, be entitled to claim small income relief as a non-resident (See Chapter II, Section 1).

(c) *Leave allowance or salary paid outside British India.*—Exemption is allowed in respect of—

(i) the allowance or salary paid in the United Kingdom to officers of Government on leave or duty in that country whether such allowance or salary is paid in sterling in the United Kingdom or by means of negotiable rupee drafts on a bank in India;

(ii) the leave allowance or salary drawn from any Colonial Treasury by officers of Government on leave or duty in the Colony; and

(iii) leave salaries or leave allowances paid in the United Kingdom or in a Colony to officers of local authorities, or to the employees of companies or of private employers, on leave in the United Kingdom or in such Colony.

It has been urged by various bodies, even more strongly than in the case of pensions, that there is no justification for the exemption of any part of the remuneration earned by service in India. We understand that the exemption was granted at a time when, there being no double taxation relief, it was thought that leave pay would otherwise be fully taxed in both British India and the home country. The exemption therefore was intended to restrict taxation to the home country only, but it is common knowledge that in almost every case, leave is so arranged that no liability attaches to the leave pay even in the country where received. This seems to be an almost unique example of income not taxed in either the country of origin or the country of receipt. Not only is leave pay thus totally exempted but the rate of tax is seriously reduced in respect of the salary that is assessable in India in a year when leave is taken. The argument that this exemption is an existing right tantamount to a contractual condition of service has, in our opinion, no more validity than a claim that the rate of income-tax in respect of salary and other emoluments should never be increased.

Whatever justification there may have been originally for this exemption, we agree with the representations made that there is no justification for it now and we recommend that it should be revoked.

In the exceptional case where residence on leave in the United Kingdom is of sufficient duration to render the leave pay liable to the United Kingdom tax, taxation in British India also would involve no hardship as the double taxation provisions would come into operation.

To secure collection of tax in these cases, we suggest:

(*a*) that, in the case of officers of Government, only such sums should be made available for receipt abroad as represent the leave pay due less tax at the rates applicable thereto;

(*b*) that in the case of other employees, the employer should be made responsible for the tax due on leave pay.

SECTION 7.—INTEREST ON SECURITIES PAYABLE ABROAD CHARGED ON INDIAN REVENUES OR ON INDIAN INCOME.

(a) *Sterling securities of the Government of India.*—As the interest on such securities is payable in London, it has been held to accrue or arise without British India and therefore not to be taxable, except to the comparatively small extent to which the securities are held by residents in British India and the interest is brought into this country. Repeated representations have been made to us that since this interest is a burden upon Indian revenues, there is no justification for not subjecting it to Indian Income Tax. As against this contention it may be remarked that when these securities were issued, the non-taxability of the Interest under the existing Income Tax Law was a known fact and may almost have been taken to be an implied condition of issue. This policy of issuing securities in such circumstances that the interest is not taxable by deduction is continued by Section 315 (4) of the Government of India Act, 1935, during the transitional period, and the exemption of interest on existing loans is maintained by Section 178 (3) of that Act. If, in spite of these considerations, it is desired to bring such interest within the scope of British India Income Tax, this could only be done by amendment of that Act by the United Kingdom Legislature. In such an event, special machinery for the deduction of tax would need to be provided.

The view was also expressed that even if non-taxability in respect of the interest on existing loans must be retained, it should be avoided in respect of any future issues by making the interest payable in India, but this is a matter of Governmental financial policy.

(b) *Other securities.*—In the same way as in the case of Government securities, it has been held that interest made payable without British India on securities issued by commercial concerns in British India arises without British India and is not taxable unless brought into this country. Although superficially the same considerations would seem to apply to both classes of securities, a definite distinction can be drawn between the case of a security issued by a commercial concern and one that is issued by the taxing authority itself, and we are of opinion that the governing consideration is the fact that such interest emerges from the employment of foreign loan capital in India. We, therefore, recommend that in the case of interest on securities payable without British India by an assessee in British India, provision should be made for the taxation of such interest by an amendment of Section 8 of the Act, deeming such interest to arise or accrue in British India.

SECTION 8.—CASUAL PROFITS OR GAINS.

We have only one comment to offer with regard to the existing law and practice on this matter and that one not of principle but of administrative expediency. We have observed that in some areas, claims in respect of losses on speculative transactions are of frequent occurrence but that only rarely does an assessment include profits from such transactions. This position is practically inevitable in any country, if only because such transactions can in general only come to the notice of the assessing authorities if divulged by the speculator who will naturally

give himself the benefit of the doubt when profits emerge. Even with a speculator who has claimed and has been allowed losses, there is no guarantee that all profits are disclosed.

In the United Kingdom, this position has been met by the settled practice, based upon decided cases, which treats transactions of purchase and resale as liable to taxation only if these are sufficiently numerous or so organised as to constitute the carrying on of a trade.

In order to secure uniformity of practice in British India, we recommend that a similar course be followed where it is not followed already. This could be assured by the addition to Section 4 (3) (vii) of an explanation to the effect that the word "casual" in relation to transactions of purchase and resale covers all such transactions as do not, by reason of their number or organisation, amount to the carrying on of a business.

CHAPTER II.—THE CHARGE OF INCOME-TAX AND SUPER-TAX.

SECTION 1.—THE BASIS OF CHARGE.

(a) *"Step" or "Slab" system.*—We are of opinion that the existing scale is defective in that the actual tax payable on various ranges of income is excessive as compared with that on incomes above and below. Having regard to the conditions of British India, we do not think that Rs. 2,000 is too low a figure for the point at which liability should commence, but we do think that the rate of taxation is relatively high in the lower ranges of income above that point.

The principal defect is that the present scale provides (subject only to the inadequate provision of marginal relief) for taxation of the whole income at a specified rate when the income exceeds a certain limit, and not merely the taxation of the excess over the limit at that rate. Thus an assessee with income of Rs. 14,999 pays Rs. 1,015 tax as compared with Rs. 1,399 tax payable on an income of Rs. 15,500, an increase of Rs. 384 tax on an increase of Rs. 501 in income.

As a result of this feature of the present scale, we have found a tendency on the part of the assessee to claim bad debts, etc., not strictly allowable within the year, in order to keep his income below a particular limit, with a corresponding tendency on the part of some Income-tax Officers to endeavour to keep the computation above that limit. This tends to a conflict which has little regard to the merits of a case but is mainly concerned with the rate of tax chargeable on the whole income.

A tax-free allowance which has been asked for in the majority of representations made to us, would go far to remedy this defect in the lowest ranges but would be an insufficient correction of the defects in the higher ranges of the scale.

These features are illustrated by the figures and graphs given in Appendices 3 and 4.

In our search for a scale and a method of charge which would remedy the defects mentioned, we have considered the adoption throughout of the "slab" system, *i.e.*, the application of progressive rates to successive slices of income, a system which is already in operation for the charge of super-tax. This has the undoubted advantage, if the "slabs" and rates of tax are carefully chosen, of providing effective rates of tax that steadily increase, without sudden jumps, as total income increases.

Objections raised against the introduction of such a system in India have been based mainly on the increased complexity which, it is argued, would be involved in computing the amount of tax payable. If, however, a simple scale such as that given in Appendix 2 be adopted, we consider that the calculations would not be so complicated as to make it undesirable to adopt the "slab" system. One of the greatest objections is that in the case of salaries, it would always be necessary to find an effective rate to be applied to each rupee of income; but, as explained in Chapter X, Section 3, of this Report, this is not the case.

At first sight, there seems to be more substance in the objection that greater difficulty would be experienced in computing the tax deductible when allowance has to be made for life assurance premiums and provident

fund contributions, but if our suggestions for the modification of this allowance be accepted, this difficulty should disappear.

A scale on the slab system which charges at low rates merely the excess of income above the tax-free slab would result in a large number of cases in which (a) the reduction in the tax chargeable as compared with that chargeable under the present system would be excessive, and (b) the tax chargeable would be so small as hardly to be worth the labour involved. To meet these objections, the scale, although retaining the exemption limit at Rs. 2,000, could provide for tax to be levied on the excess over, say, Rs. 1,500, with marginal relief to secure that tax is not payable in excess of one-half of the amount by which the income exceeds Rs. 2,000.

We, therefore, recommend the adoption of a suitable "slab" system and give in Appendix 2 a *specimen* scale.

This scale includes a rate applicable to companies which it is intended should be regarded as the "standard" rate at which tax is to be deducted at source. The adoption of the slab system makes it necessary to state specifically the method of calculation of the relief due to the non-resident who suffers deduction of tax at this standard rate. At present, the world income is only imported into calculations affecting non-residents when a refund is claimed and a direct assessment does not fall to be made, with the result that the rate of relief given in this case is less than that allowed when there is Indian income liable to direct assessment. For example:—

A has Indian income of Rs. 2,500 liable to direct assessment and non-Indian income of Rs. 20,000. He is assessed on Rs. 2,500 at 6 pies in the rupee the tax payable being *Rs. 78.*

B has Indian dividends of Rs. 2,500 to which the company rate of 2 as. 2 pies is applied and has also non-Indian income of Rs. 20,000. After allowance of relief under Section 48 by reference to his total world income of Rs. 22,500, he ultimately bears tax on Rs. 2,500 at 1 a. 7 pies = *Rs. 247.*

To remove this anomaly, it is recommended that the liability of a British non-resident who has Indian income, whether taxed at the source or not, should be calculated on the same basis, *i.e.*, by reference to his world income whichever system of rates is adopted. On the assumption that the "slab" system is adopted, we recommend that the tax payable be the proportion of the tax (including super-tax) chargeable on an amount equal to the assessee's total world income (after making allowance for life assurance) that his Indian income bears to that world income.[1]

In Chapter I, we have recommended that agricultural income be taken into account in fixing the amount of tax payable on other income, and have suggested a method of making such inclusion in "total income" effective.

As regards interest on tax-free securities and other income referred to in Paragraph 18 of the Income Tax Manual, we have considered the adoption of a similar course, but are inclined to the opinion, that as in the United Kingdom, those items should be ignored in computing Income Tax but included as now for Super Tax purposes. If, however, it be found on

[1] Whether or not the scale is changed to one on the "slab" system, those non-residents who are precluded by Section 48, sub-section (5) from claiming reliefs should, in the case of direct assessment, be assessed at the "standard" rate.

investigation that the amount of revenue involved is very considerable, it may be necessary to treat this income in the manner suggested for agricultural income.

(b) *Allowances for wife, children, etc.*—It has been urged that the domestic circumstances of the married assessee should be taken into account in determining the amount of tax payable by him. This, as a measure of differentiation, would be comparatively ineffective since the married state is the general rule in India and the proportion of unmarried assessees is not great enough to justify the complications that would be involved in an attempt to differentiate in favour of the remainder. Further, unless the total yield of tax were to be seriously diminished, it would be necessary to counterbalance the concession of the various allowances claimed by increasing the rates of tax, with the result that the principle of differentiation would be little more honoured than at present. The special position of Hindu Undivided Families is dealt with in Chapter III of this Report.

(c) *Earned Income Relief.*—The Taxation Enquiry Committee of 1924-25 considered that the then existing conditions of India did not justify any attempt to differentiate between earned and unearned income. We are in agreement with that conclusion and as there has been no material change in conditions since the date of their Report, we do not recommend any such differentiation.

Section 2.—Life Assurance Premiums. Provident Fund Contributions, etc.

(a) *Basis of allowance in assessment.*—If the changes suggested in Section 1 are adopted, it will be necessary to modify the method of allowing this relief. In our opinion, the simplest method would be to give the allowance as a deduction in arriving at the income assessable. If, however, the whole allowable premium were thus deducted, the result would be, given our suggested basis of charge, that the allowance would be made at the highest rates of tax applicable to the assessee. This, particularly in the higher ranges of income, would give relief in terms of tax considerably greater than that under the present system. It may be noted that the existing relief is never given at a higher rate than 2 annas 2 pies plus the surcharge if any (at present 1/12th only). Further, if the allowance is intended to be an encouragement of thrift, it becomes a question whether large premiums which are paid by persons with large incomes were ever intended to be the subject of relief. On the assumption that some restriction is desirable, we suggest that the maximum amount of premium to be taken into account for relief purposes should be Rs. 6,000, retaining the existing restriction to 1/6th of the total income. In the case of a Hindu Undivided Family with more than one married adult male member, if our suggestion in Chapter III, Section 3, be adopted, the maximum should be Rs. 12,000 instead of Rs. 6,000. In order that the suggested relief should not generally exceed in terms of tax that given at present, we recommend that one-half of the allowable premium and contributions be deducted from the total income to arrive at the income assessable for income-tax only. This would secure that the effective rate of relief corresponds roughly to the average rate or tax chargeable.

(b) *Restrictions on Life Assurance Relief.*—The question has been raised of excluding from relief premiums paid in the following cases:—

(i) policies not providing indemnity against death.

(ii) single premium policies,

(iii) where the income is above a certain level, and

(iv) policies effected outside British India.

We consider that the first three cases are sufficiently dealt with by our recommendation of a maximum for allowable premiums.

As regards the fourth case, there seems to be sufficient reason for their exclusion in the fact that the interest and profits accruing to the Assurance Company are not subject to British India Income Tax. If this restriction be incorporated in the Act, we suggest that it should apply only to policies effected after the date from which such restriction becomes effective.

(c) *Provident Fund Contributions.*[1]—It seems to have been the settled policy of the Government of India to encourage this particular form of thrift by exempting both contributions to these funds and the interest earned by them. It has, however, been considered necessary to prevent abuse by imposing restrictions upon such exemption. In our discussions with representative commercial bodies, we found a strong feeling that the regulations designed to secure these restrictions were unduly complicated and detailed having regard to the tax at stake in any normal case. For example, if the contributions in a given year for any member exceed one-sixth of his salary, it is necessary, under the Act as it stands, to segregate such excess, and to calculate the interest separately thereon for the whole of the remaining period of his membership. With due regard to the prevention of abuse, we consider that there is room for considerable simplification with no appreciable loss of revenue. To this end we suggest, that, whether or not the "slab" system be adopted, interest credited, so far as it does not exceed 6 per cent, on the accumulated balance and does not exceed one-third of the salary for the same year, should be deducted from the employee's total income, inclusive as at present of employer's contributions and added interest, in computing the income to be taxed, and that disallowed sums should no longer be segregated in order to compute for further disallowance the interest thereon. The restriction to one-third of the salary is intended to provide a simple method of avoiding excessive allowance of interest in respect of past accumulations.

There is also the case of the employee ceasing to be a member of a fund within five years. We suggest that the provisions of Section 58-G, sub-section (3), be amended to provide that a calculation of tax payable on the total incomes of all the years concerned shall be made as if, in his case, the fund had not been recognised, and from the total amount of tax so computed, there shall be deducted the total amount of tax already collected for those years, the balance, if any, being payable by the employee.

[1] Lump sums received from unrecognised Provident Funds are considered in Chapter V, Section 2 (*b*).

Another objection to the present system of allowance which has been advanced is that it operates in some cases to increase the rate of tax upon the whole taxable income while leaving other cases entirely unaffected. Thus we have seen particulars of actual cases where the additional tax payable year by year, by reason of the inclusion of the whole annual accretion, considerably exceeds that which would be payable if the accumulated balance in the fund were wholly taxable when withdrawn. In such cases recognition of the fund involves a penalty instead of giving a relief. This hardship is inherent in the "step" system of rates and gives an additional reason for the adoption of the "slab" system as recommended earlier in this Chapter, since the latter would remedy the hardship complained of.

Our attention has been called to the anomalous position under which official and commercial provident Funds are dealt with in different sections of the Act, the requirements applied to the latter being apparently waived in the case of the former. There may be funds whose objects are quite beyond reproach but which nevertheless are not of the kind to which Income Tax exemption was intended to be given. Official funds, (*i.e.*, those to which the Provident Funds Act, 1925, applies) should be required to fulfil the same conditions as any others in order to obtain Income Tax exemption. Approval of such a fund under the Provident Funds Act, 1925, should not carry with it automatic exemption from Income Tax, nor should unsuitability for Income Tax exemption preclude its approval under the Provident Fund Act, 1925, and we recommend, therefore, that Chapter IX-A of the Income Tax Act, with the Indian Income Tax (Provident Fund Relief) Rules, should be made applicable to all Provident Funds in respect of which income tax relief is granted.

(d) *Superannuation Fund Contributions.*—Representations were received from some quarters claiming that these funds should receive similar treatment to that accorded to Provident Funds. The contributions by an employer to a properly constituted trust for the provision of employees' pensions are already allowed to him as an item of expense, but it was represented that the contributions of employees and the interest earned by the fund should also be exempted. Equity and logic alike support this claim and we recommend its adoption. This might be effected by notifications under Section 60 (1) of the Act. Pensions payable out of such funds should, however, be made wholly liable to assessment in the hands of the recipients as is the case in the United Kingdom. Contributions returned to an employee with or without added interest should, we suggest, be dealt with on the lines indicated in the previous Section for the case of a person ceasing within five years to be a member of a Provident Fund.

Section 3—Company Super-Tax.

Numerous representations have been made to us regarding the incidence of this tax, but they all proceed on the assumption that it is one of the nature of an income-tax. It is clear, however, from the Government of India Act, 1935, (Section 138 etc.,) that it is intended to be a corporation tax, *i.e.*, a tax levied upon corporations as such, and not an income-tax, although calculated by reference to income and although treated as income tax for the purpose of a double taxation relief claim by a company.

This precludes examination by us of the claim that company super-tax, equally with income-tax paid by a company, should be treated as paid on behalf of shareholders, and should be taken into account in the computation of any refund under Section 48.

The claim is also made that if this tax is to be a corporation tax, it should be allowed as a deduction in computing the profits of a company for income-tax purposes, as was the case with the United Kingdom Corporation Profits Tax. There is much to be said in favour of this contention, but it would have the effect, if conceded, of varying, adversely to the Provinces, the prescribed allocation of revenues between the Centre and the Provinces, since company super-tax (or corporation tax) is purely a Federal source of revenue, and its allowance as claimed would reduce the income-tax which in the future is to be allocated partially to the Provinces. In view of this consideration, we make no recommendation on this point.

A further claim made is that where dividends are received by a company from another company which has itself paid company super-tax on its profits, these dividends should not be assessed to company super-tax in the hands of the recipient company. It may be observed that investment trust companies, in the strict sense of the term, are already exempted from this tax on such dividends, and the question arises as to whether, and if so to what extent, this exemption should be extended. It may be said that fundamentally the tax is a levy in respect of the benefits of limited liability, and that this exemption, therefore, is granted not in order to avoid what is sometimes described as double taxation, but in order to encourage the class of company which makes possible the aggregation of small savings for investment over a wide field. Having regard to what is stated to be the basic theory of the tax as set out above, we find no grounds for any general extension of this exemption.

Our attention has been directed also to the illogicality of the existing exemption limit of Rs. 50,000. We agree fully with the remarks on this matter made by the Taxation Enquiry Committee of 1924-25 (page 203 of their Report), which are as follows:—

"If the tax is recognised as a corporation profits tax, it becomes clear that the exemption limit of Rs. 50,000 is illogical. Small companies derive relatively as much advantage as large ones from the privilege of incorporation, and the amount of profit made by a company bears no necessary relation to the wealth or poverty of its shareholders. It is recommended therefore that the present exemption limit, which seems to have been based on a false analogy, should be abolished."

We strongly favour the acceptance of this recommendation.

CHAPTER III.—ASSESSEES.

Section 1—Individuals.

(a) *Wife's Income.*—Our attention has been drawn to the extent to which taxation is avoided by nominal partnerships between husband and wife and minor children[1]. In some parts of the country, avoidance of taxation by this means has attained very serious dimensions. The obvious remedy for this state of affairs so far as husband and wife are concerned is the aggregation for assessment of their incomes, but such a course would involve aggregation in a quite different class of case, *i.e.*, where the wife's income arises from sources quite unconnected with the husband. We may consider from the point of view of "ability to pay" the following cases, the family circumstances being similar in the four cases:

(i) *A* has an income from business etc., of Rs. 4,000, his wife having no income.

(ii) *B* has an income from business of Rs. 4,000, his wife earning Rs. 1,800 from her employment or profession.

(iii) *C* has an income from business of Rs. 4,000, his wife having an income of Rs. 1,800 from investments.

(iv) *D* has an income from business etc., of Rs. 5,800, his wife having no income.

Under the present scheme of taxation, *A*, *B* and *C* will each pay jointly with his wife exactly the same amount of tax although it is quite clear that the ability to pay of *B* and *C* considerably exceeds that of *A*. It may, however, be pointed out that the ability to pay of *B* and *C* is not necessarily equal, since the preoccupation of the wife of *B* with her employment or profession will possibly involve heavier household expenses than in the case of *C*.

We are of opinion that the income of the wives of *B* and *C* should be taken into account in determining the liability of *B* and *C*, with however some recognition of the difference in circumstances of the two cases. The point has been made that there should be no aggregation of the incomes of husband and wife without some special allowance in respect of the wife. It will be seen, however, from the examples above that the "ability to pay" of *C* is equal to that of *D* and there seems therefore to be no case for a special allowance for *C* that is not available to *D*. The question of allowance for a wife is a general one not dependent upon whether or not the wife has income of her own, and this general question which is entirely unconnected with the question of aggregation of the incomes of husband and wife, is examined in Chapter II, Section 1, of this Report.

We recommend, therefore, that the incomes of a wife should be deemed to be, for Income-Tax purposes, the income of her husband, but that where the income of the wife is derived from her personal exertions and is unconnected with any business of her husband, her income from her personal exertions upto a certain limit, say Rs. 500, should not be so included.

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[1] Minor children are dealt with in sub-section (*b*) of this section.

It may be objected that aggregation for the purpose of assessment may have the result of throwing an undue proportion of the joint taxation burden upon one spouse or the other, and to meet this it is suggested that either spouse should have the right to claim separate assessment on the lines of Rule 17 of the General Rules applicable to all Schedules of the United Kingdom Income Tax Act, 1918, and Section 25 of the United Kingdom Finance Act, 1920, which provide that on application by either husband or wife, within a period to be specified, the husband and wife shall be separately assessed in respect of his or her income, and that the tax chargeable on each shall be that proportion of the tax assessable on the joint income that the income of the spouse bears to the aggregate of the two incomes.

(b) *Income of minor children.*—There is also a growing and serious tendency to avoid taxation by the admission of minor children to the benefits of partnership in the father's business. Moreover, the admission is, as a rule, merely nominal, but being supported by entries in the firm's books, the Income-Tax Officer is rarely in a position to prove that the alleged participation in the benefits of partnership is unreal. There is the genuine case which is intended to be relieved by the Income-Tax (Second Amendment) Act, 1933, and the question arises as to the nature and extent of the restriction which will exclude from relief only the case in which a father is attempting to obtain an allowance for what is, in effect, merely the cost of maintenance of his children. We suggest that the income of a minor should be deemed to be the income of the father (i) if it arises from the benefits of partnership in a business in which the father is a partner or (ii) if, being the income of a minor other than a married daughter, it is derived from assets transferred directly or indirectly to the minor by his or her father or mother, (iii) if it is derived from assets apportioned to him in the partition of a Hindu Undivided Family.

The income of a minor from a revocable disposition is covered by our suggestion in Chapter XII.

Section 2—Partnerships.

(a) *Registration.*—Numerous representations have been made to the effect that the present system of registration of firms for Income-Tax purposes works harshly in practice and produces many anomalies.

In considering the position of unregistered firms, which are treated at present as separately assessable entities, the following matters need to be taken into account:—

(i) The extent to which firms as to whose status there is little doubt having regard to the Income-Tax records, are refused the privileges attaching to registration owing to technicalities.

(ii) The extent to which the real facts of a partnership are not divulged by the assessee, either from ignorance, or because the real position is somewhat nebulous.

(iii) The practice of dividing up a business and forming each portion into a separate firm but taking no steps to secure registration, with the result that the liability to tax is considerably diminished.

In the case of partners in registered firms, the provisions of Section 48 clearly import the equitable consideration that the rate of taxation of partnership profits should depend upon the total income of the individual entitled to such profits, and we see no reason why this should not be aimed at in the case of other firms also. It is inequitable that it should be possible for two firms each earning, say, Rs. 5,000, each with three equal partners, to be so differently dealt with that no tax is payable by one of them while the other is charged Rs. 156. It is similarly unjust that a man who earns, say, Rs. 50,000 in each of five partnerships, which he refrains from registering, should pay approximately Rs. 40,000 only as against the Rs. 65,000 approximately payable by a man who earns the same amount from registered firms.

On the other hand we have been impressed by the very great difficulties experienced by Income Tax Officers in their endeavours to ascertain the exact facts as to proprietorship of businesses.

For example, there is the case of the Hindu Undivided Family which alleges partition and produces a partnership deed, obviously in order to obtain assessment at the individual rates of tax appropriate to the alleged partners.

Another example is the case of a business believed to be owned by an individual but alleged by him to belong to a partnership for which there is no deed, and the books of which have not been closed. Here the choice is between assessment as an individual and as an unregistered firm, the difference in tax depending upon whether or not there is other income for assessment.

Another is the case where each year a different partnership deed is produced, naming as partners one or more persons who were previously employees and perhaps still are. Comparison of the deed with the books is of no avail since such persons were not alleged to have been partners in the *previous* year, generally leaving the Income-Tax Officer no option but to treat these "employee-partners" as entitled for the whole of the year of assessment to the proportions of the profit stated in the deed, although he may be convinced that they will in fact not share in the profits at all. Our suggestion in the next sub-section that the basis of division to be applied to the assessable profits should be that according to which the profits of the "previous year" were actually divided, would enable the Income-Tax Officer to determine the sum, if any, which the employee partner actually received and to assess the proprietor upon his real share of the profits.

We feel that every endeavour should be made to relate the incidence of taxation to the total incomes of the persons to whom the incomes actually belong, but we are bound to recognise that many cases exist where there is no reliable evidence as to the manner in which the profits are divisible. We have considered the advisability of the abolition of the system of registration of firms, but, owing to the danger of admitting the existence of partnerships and of terms of partnerships on evidence which is not necessarily binding on the partners themselves, we have come to the conclusion that this is impracticable.

We recommend as under:—

(i) That in general the Assistant Commissioners should make more use of their powers under Rule 2(c) to permit registration at any time up to the determination of any appeal. The

abuses in cases to which Section 26 of the Act applies owing to the production of new partnership deeds specially drawn up to affect the apportionment of the profits assessed should disappear if our recommendation in Chapter VI, Section 2, is accepted.

(ii) That the form of Return for a partnership should provide for declaration of the constitution of the partnership and of the basis on which profits of the "previous year" have been divided, and that such declaration, if supported by proper accounts, should normally suffice for automatic re-registration as long as there is no change from the particulars recorded at the date of the last registration.

(iii) That when the Income Tax Officer is satisfied that non-registration involves less tax being paid than would be paid otherwise, he should be empowered to deal with a firm not claiming registration in the same manner as if it were registered. This is intended to meet the type of cases in which non-registration is used to reduce the tax payable.

(iv) That the position regarding the registration of a firm following the execution of a proper partnership deed should be made clear to the public. A suggested method is the enclosure, with the return form issued to each firm, of a short printed memorandum on the subject.

(b) *General considerations.*—As in the case of changes in partnerships dealt with in Chapter VI, Section 2, of this Report, and for the same reasons, we consider that the actual basis of division obtaining in the "previous year" should govern the division of the assessable profits of that year between the partners for Income-Tax purposes, and not the basis at the time of making the assessment as provided by Section 14(2)(b) of the Act.

Apart from this, there is, however, considerable controversy and lack of uniformity of practice in the method of computing the individual partners' shares of a firm's profit or loss, particularly where interest and salaries are payable in excess of the assessable profits. The following example illustrates the difficulty mentioned:—

A, *B* and *C* are partners in a registered firm, the trading profit of which is Rs. 3,500. The partnership deed provides for the payment of salaries of Rs. 5,000 to *A* and Rs. 4,000 to *B*, and for interest on capital, which for the year amounts to Rs. 1,000 to *A*, Rs. 1,500 to *B* and Rs. 2,000 to *C*, the balance of profit or loss being divisible in the proportions of 10 per cent. to *A*, 10 per cent. to *B*, and 80 per cent. to *C*. The entries in the books of the firm would show:—

	A.	*B.*	*C.*	*Total.*
Salary	5,000	4,000	..	9,000
Interest	1,000	1,500	2,000	4,500
Balance	—1,000	—1,000	—8,000	—10,000
Total .	5,000	4,500	—6,000	3,500

There are two ways in which this result may be interpreted for Income-Tax purposes.

The first is that the firm has made a profit of Rs. 3,500 which is the sum assessable, and that *A*, and *B*, being the only partners having a positive share in this profit, must be taken to have received the whole of the Rs. 3,500, their shares thereof being, in the ratio of 5,000: 4,500, *A* Rs. 1,842, *B* Rs. 1,658. If the firm is assessed on Rs. 3,500 or the partners *A* and *B* are assessed separately on Rs. 1,842 and Rs. 1,658, respectively, the result is that *C*'s loss of Rs. 6,000, has been effectively allowed against the profits of *A* and *B*. If *C* claims and is allowed a set-off of his loss of Rs. 6,000 against other income, the net result would be Rs. 3,500 assessed, Rs. 6,000 relieved, *i.e.*, a net relief of loss of Rs. 2,500, although the firm made a profit of Rs. 3,500.

The other interpretation of the same facts is that *A* by reason of his twelve months' activities in the business of the firm has earned an income of Rs. 5,000, that *B* similarly has earned an income of Rs. 4,500 whilst *C* has suffered a loss of Rs. 6,000. On this interpretation, it would follow that *A* and *B* should be assessed, whether individually or jointly, on Rs. 5,000 *plus* Rs. 4,500 leaving *C* to set off or carry forward (if carry forward of losses be in operation) his loss of Rs. 6,000.

We have no hesitation in recommending the adoption of the latter point of view, which is, in our opinion, the only equitable and realistic interpretation of the facts. The same basis and method of computation should apply where the firm as such has made a loss, but one partner has a positive income from the partnership while another suffers a loss in excess of the firm's trading loss.

In this connection, we may observe that there is some diversity of treatment of salaries and interest payable to partners. In some cases, salary or interest has been treated as an allowable deduction in computing the profits of a firm and as a source of income separately assessable on the partner. There is the further complication that in such a case interest is sometimes separately assessed on the basis of the amount actually paid and in others on the amount due and credited in the firm's books. We recommend that in the computation of the profits of a firm, whether registered or not, no deduction should be made in respect of any sum, whether described as salary, interest, commission or otherwise, which is payable to a partner, and that any partner's assessable income from partnership business should be his actual share of the profit or loss of the previous year calculated on the lines indicated above.

We recommend also that the Act be amended to provide that the profits of each partner in a registered firm should be assessed upon him personally but in the name of the firm in the case of a non-resident partner, Section 44 of the Act being expanded to provide for the recovery of tax in such cases. Incidentally we notice that Section 57 does not cover the case of a firm, all of the partners of which are non-resident, and we suggest an amendment of that Section accordingly. We may add that separate assessment of partners in registered firms is already in operation as a matter of administrative convenience in a number of cases in order to obviate the need for dealing with refund claims. Every firm should still be required to make a return of the partnership profits and should in addition be required to state exactly how such profits were in fact divisible between the partners. It would be necessary to provide for the passing of an order by the Income Tax Officer determining the profit or loss of the firm and its allocation between the partners which should be subject to appeal as an actual assessment order is at present.

Any partner should have the right of appeal against this order but each partner should be notified as to the hearing of the appeal and have the right to attend. Thereafter no partner should have any right of appeal against his individual assessment so far as it includes profit or loss from the partnership business.

Section 3—Hindu Undivided Families.

Representations as to the hardships involved in the present system whereby a Hindu Undivided Family is treated almost as if it were an individual irrespective of the number of its members, have been insistent and widespread. We are bound to admit that hardship exists. For example, while a registered partnership of four persons engaged in business and sharing equally in a profit of, say, Rs. 7,800 is not liable at all, a Hindu Undivided Family with, say, four adult male members similarly engaged in business would pay in respect of a profit of Rs. 7,800, tax amounting to about Rs. 400. On the other hand, it may be pointed out that a Hindu Undivided Family, being a continuing legal entity, is not liable to pay death duties, and disruption, with its consequent effect upon the Income Tax liability, is a matter entirely within its own control. Further the separate assessment of income falling within the provisions of the Hindu Gains of Learning Act puts some Hindu families in a more favourable position than other assessees. Thus a Hindu barrister forming with one or more minor sons a joint family with an income from property of Rs. 50,000 will pay tax upon his professional earnings of say, Rs. 25,000 at the rate of 19 pies only and on the rupees 50,000 at the rate of 25 pies with no super-tax, whereas if it were not the case of a Hindu Undivided Family, income-tax would be payable on Rs. 75,000 at 25 pies with super-tax on Rs. 45,000.

The suggestions made to us range from allowance for every member and dependent of the joint family to the treatment of the family's income as if it belonged equally to a number of individuals corresponding to the number of married adult males. The most extreme proposal would place all Hindu Undivided Families in a more favourable position than other families, thus going much further than remedying the existing hardship, while as regards the more moderate proposals, it should be remembered that not every married male member of a Hindu Undivided Family is actively engaged in assisting to earn the family income. Again we may point out that in Section 1 above, we have already recommended that incomes of husbands and wives and of minor children should in certain circumstances be aggregated for the purposes of taxation and this would tend to bring the taxation of families other than Joint Hindu Families more in line with that of the latter.

We are of opinion that there is some case for the recognition of the special position of Hindu Undivided Families. Since, however, the effect on the Revenue of any concession would be very considerable, we have had to take into account the practicability of the various suggestions made. If the Government is prepared to accept the reduction in the yield of tax involved, a practicable concession, which we consider should not be exceeded in view of what is said above, would be to ascertain the rate of tax applicable, in cases where there are more than one adult married male member, by dividing the family's income by two, but to include in the income of the Joint Family the individual income of all members (includ-

ing wives and minor children) from whatever source derived whether covered by the Hindu Gains of Learning Act or not, and to abolish the special scale of super-tax rates for Hindu Undivided Families.

SECTION 4—OTHER ASSOCIATIONS OF INDIVIDUALS (INCLUDING TRUSTEES AND BENEFICIARIES).

As stated in Section 2 of this Chapter, we consider that to relate the ultimate rate of tax on income to the total income of the individual recipient is a principle which should be carried into effect as far as possible. In the present state of the law, this is far from being the case with income of trustees, or income from investment in joint names. We discuss the extent and basis of liability of certain classes of Associations in Chapter VII, Section 3, of this Report and in this section, we deal with other classes which need some consideration.

(i) *Joint ownership.*—One High Court has held that joint ownership of property constitutes the joint owners an "association of individuals" assessable as such. It will be readily seen that the tax payable on the present basis may be either more or less than the tax that would be payable if the income were assessed in the hands of the individual owners. For example, two persons own property in equal shares, which yield an income of, say, Rs. 9,000, each of them having other income in excess of Rs. 40,000. In this case, the Rs. 9,000 would be assessed at 9 pies in the rupee although the rate of tax appropriate to the individual assessees is 2 annas 1 pie.

Another example may be given. *A* and *B*, each with a personal income of Rs. 400, share equally the joint ownership of property producing Rs. 3,000. Taken individually each has an income of Rs. 1,900 upon which no tax is payable, but assessing the Rs. 3,000 as the income of an association of individuals, the tax payable is Rs. 94.

A not uncommon type of case is that where husband and wife hold investments in their joint names. Consider the case of a man with a salary of Rs. 12,000, he and his wife receiving Rs. 1,600 from investments in their joint names. In this case the husband and wife, being treated as an "association of individuals" which is the shareholder, can claim under Section 48 refund of the whole of the tax appropriate to the dividend, although the husband's rate of tax is 1 anna in the rupee.

(ii) *Trustees.*—The present system provides, in general, for the assessment of trust income in the hands of the trustees (*a*) in the case of business income, and (*b*) in respect of any other income not specifically allocated to individual beneficiaries. In the former case, the rate of tax chargeable is that appropriate to the total income of the trust and not those rates appropriate to the total income of the beneficiaries, but in the second case we find that there is diversity of practice.

(i) and (ii).—We consider that in the case of both joint ownerships and trust incomes, the income, so far as it is specifically the income of an individual beneficiary, should be assessed as income of that individual and that if the income is taxed by deduction there should be the right to small income relief. So far as the income of trustees, etc., is *not* the income of an individual beneficiary or co-owner, (*e.g.*, income of a trust for accumulation against a contingency, or for capital expenditure) or so far as the individual shares are indeterminate, the income should be

assessable on the trustees or on the co-owners jointly at the "standard rate" of Income Tax, and also at the appropriate rate of Super Tax. Suitable amendment of Sections 14 and 55 of the Act would be necessary.

Minor matters.—(*a*) Our attention has been directed to the phrase "other associations of individuals" which appears in Section 3 of the Act, which provides for the assessment of stated classes of assessees. A large number of associations, such as Chambers of Commerce, are to a considerable extent associations of companies, firms and other bodies as well as of individuals. There may be some doubt as to whether such an association is literally within the terms of the section, and it is therefore recommended that the expression "association of individuals", wherever it occurs in the Act, be amended to "association of persons". "Person" is defined in the General Clauses Act, 1897, to include any company or association of body of individuals, whether incorporated or not.

(*b*) Where the income of a trust is only partly taxable in British India, we consider that the allocation of the income between beneficiaries, including annuitants, should be made on a proportionate basis.

(*c*) Sections 40 and 41 of the Act refer to income *received* by "any guardian, trustee or agent on behalf of a minor, lunatic or idiot or person residing out of British India". We suggest the transference to Section 42 of the reference to persons residing out of British India, and, in order to cover all cases that may arise, that the words "entitled to receive" be substituted for the words "in receipt of".

CHAPTER IV.—CLASSIFICATION OF INCOME.

Representations have been made to the effect that the present classification in Section 6 of the Act is illogical and leads to anomalies.

(*a*) Sections 10 and 11 suggest that the computation of the profits of a trade and of a profession respectively have to be made on different lines, in that the majority of the clauses in Section 10(2) are not reproduced in Section 11. Clearly a number of these clauses, *e.g.*, (i), (ii), (iii), (viii) and (viii-a) have in general as much relevance to professions as to trades. It is therefore recommended that class (iv) in Section 6 should be amended to:—

"Business, profession, or vocation."[1]

(*b*) A minor point is that some of the "heads of income" in Section 6 describe income, while others describe sources from which income may be derived. For the sake of consistency we suggest the following heads:—

(i) Salaries,

(ii) Interest on securities,

(iii) Income from property,

(iv) Profits or gains of business, profession or vocation,

(v) Income from other sources.

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[1] *Consequential amendments.*—Expansion of 10 (1); 11 (3) to become 10 (4); delete Section 11. (This deletion would cut out the too wide depreciation provision for professions).

CHAPTER V.—COMPUTATION OF INCOME.

SALARIES AND PROPERTY.

SECTION 1—SALARIES.

(*a*) *Basis received or receivable.*—It has been brought to our notice that the existing basis of assessment, *viz.*, the remuneration actually received in the previous year, leads to an anomalous position, as it is possible for an assessee in some circumstances so to arrange matters, by anticipation or deferment of the drawing of the remuneration due to him, as to affect in his favour the rate of tax applicable to his income for a particular year.

This anomaly is most striking in the case where an assessee defers the drawing of his pay in order that it shall be received in a subsequent year, when by reason of his being on leave, his rate of tax is much lower than usual. The effect of such action will be partially remedied if our recommendation in Chapter 1, Section 5, for the taxing of leave pay is adopted.

Further, if the "slab" system of rates of tax be adopted, the defect would partly disappear since no longer would an addition to the total income of a year affect the rate of tax chargeable upon the *whole* of that income.

There are other cases, *e.g.*, (*a*) deferring remuneration of the penultimate year of service and drawing it in the final year when remuneration is less than that for a full year, (*b*) drawing only part of commission in a year when it is abnormally high and (*c*) taking loans in lieu of salary.

To meet this type of avoidance, it is recommended that Section 7 of the Act be amended so that liability may be based upon the remuneration *due*[1] in a year, which, however, would make no difference to the tax payable in the normal case.

(*b*) *Lump sum payments other than lump sums received from recognised Provident Funds.*—The law on this subject is uncertain, but a measure of elucidation is expected from the decision of the Privy Council in the case of Commissioner of Income-Tax, Madras *vs.* B. J. Fletcher which is being referred to them.

We conceive that the only useful purpose that can be served by our examination of this matter is consideration of a practical line of demarcation between lump sums that should be made assessable and those that should not.

In our view, any lump sum that represents remuneration for past services including a lump sum received from an unrecognised Provident Fund may be regarded as a proper subject of taxation, while compensation for loss of employment should not be so regarded. But to treat any lump sum as income of the year of receipt may involve, under the present system, taxation at relatively high rates as compared with those applicable to the assessee in the years in which the services were rendered. This we think should be recognised and we suggest that if a lump sum payment for past services is to be assessed, such a lump sum should be assessed separately at the effective rate of tax applicable to the assessee's total income (exclusive of the lump sum) for the last complete year of service.

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[1] NOTE.—The word "due" is intended to refer to the date on which remuneration becomes payable, and has no reference to the period *for* which it was earned.

(c) *Expenses.* (i) *Allowances by Employers.*—It has been brought to our notice that cases exist in which an allowance is made to employees ostensibly to meet travelling or other expenses which are so out of proportion to the actual expenses incurred as to contain a considerable element of remuneration. Whilst it would be quite undesirable to attempt to tax relatively small surpluses from such allowances, we consider that there should be no doubt as to the assessability of the excess allowances. We therefore recommend that section 4, sub-section (3) (vi) of the Act, be amended by the addition of words such as: "so far as it is actually expended for such purposes".

(ii) *Expenses incurred by employees out of remuneration.*—Our attention has been drawn to the fact that the employee who by the conditions of his employment is required out of his remuneration to incur expenses wholly and necessarily in the performance of his duties, receives no deduction therefor in his Income-tax assessment, and we recommend that provision be made to meet this case.

SECTION 2.—PROPERTY.

(a) *Basis of liability.*—A number of representative bodies urged that liability should be based upon the actual net receipts in the previous year. It may be remarked that such a proposal was considered and rejected by the Council of State in 1934. A change to this basis would involve many difficulties in ascertaining the liability where proper records are not kept and would make it necessary to deal specially with cases of privilege rentals. Given the proper application of the instructions in paragraph 47 of the Manual, we see no sufficient reason for any alteration of the present basis.

(b) *Computation of Annual Value.*—A complaint is made by some bodies that in certain areas the municipal valuation is taken as the measure of annual value in cases where it exceeds the actual rent, even though there is no suggestion of a privileged rent or of a rent not fixed in relation to current values. Neither the Act nor the Instructions bind any Income Tax Officer to such a course and it is considered that it would be sufficient if paragraph 41 of the Manual were amended to make it clear that in the normal case, actual rent payable should be the basis of assessment, departing therefrom only where special circumstances show that that rent is not the full current value. Attention should, perhaps, be drawn in the Manual to the case where the payment of a premium makes the rent reserved under a lease less than the full annual value.

(c) *Residence owned by the occupier.*—(i) *Mutual Concerns.*—Some doubt has been expressed as to whether property owned and occupied by a mutual trading concern for the purpose of its business is exempt from taxation on the annual value of such property under section 9 (1) of the Act although the concern is not assessable under the head "Business". It seems clear that only property used in *business assessable to tax* should be excluded from assessment under section 9 and to secure this we suggest the addition after the words "of his business" in section 9 (1) of words qualifying "business" to that extent.

(ii) *Generally.*—It is difficult to find any logical reason for the provision that the annual value of a residence owned by the occupier shall be deemed not to exceed 10 per cent. of the total income of the owner. It

may be argued that it is difficult to fix a fair annual value in such cases and that 10 per cent. of the total income is generally a reasonable approximation; but in the case of an owner of his residence who has a very variable income, the proviso may have quite ludicrous results, *e.g.*, in a year when his other income is say, *nil*, the value of his residence becomes *nil* also. In our opinion, the proviso to section 9 (2) should be repealed, making it the duty of the Income Tax Officer to compute the annual value by reference to the rents of other properties in the locality and other relevant circumstances.

(*d*) *Municipal Taxes.*—Representations have been made generally that local rates in respect of property payable by the owner, especially those levied for specific services such as water-supply or conservancy in respect of property, should be deductible in arriving at the annual value.

As evidenced in the Report of the Taxation Enquiry Committee of 1924-25, great diversity exists between Province and Province in the method of providing for local expenditure, which varies from a levy bearing direct relation to a specific service to an impost that may be described as a local income-tax. We cannot recommend any general provision for the allowance of local burdens borne by a property owner, since they include an element of taxation levied upon the property owner as such. It is recommended, however, that instructions be given that in computing the annual value of property, allowance should be made for charges borne by the owner, levied specifically in respect of services, *e.g.*, water and conservancy, rendered to the occupier of the property.

(*e*) *Other deductions including Depreciation.*—The representations received on this subject have dealt almost exclusively with collection charges, depreciation and interest paid, but some Associations claimed that the existing $\frac{1}{6}$th repairs allowance is in some cases insufficient, and suggested allowance of the actual cost. Our own impression is that, taking one year with another, the allowance is adequate and in many cases excessive, and that the work and trouble that would be involved for both assessee and Income-Tax Officers makes the suggestion unacceptable.

On the subject of collection charges, it has been urged that there are cases in which the prescribed maximum of 6 per cent., does not cover the actual expenditure of the year, notably where legal proceedings have been taken for recovery of rent. For the majority of cases, the 6 per cent. maximum appears to be adequate and in a large proportion of the remaining cases, the excess of the repairs allowance over the actual expenditure provides a sufficient compensation. From the evidence which we have collected, we are convinced that the number of cases in which the *aggregate* allowances over a term of years may be insufficient is extremely small.

Depreciation.—Several bodies made a claim for depreciation allowance in respect of property not used by the owner for the purpose of business. The position at present is that in cases where the owner of buildings uses them for the purpose of his own business, there is no direct assessment of the property and therefore no allowance of $\frac{1}{6}$th for repairs, but he is allowed as an expense of business, the actual expense incurred; whereas assessments are made under section 9 on other buildings with an allowance of $\frac{1}{6}$th under sub-section 1 (i). The All-India Income Tax Committee's Report of 1921 admitted that the flat rate allowance of

one-sixth instead of the actual cost of repairs was generous and we are therefore unable to recommend any further concession to this class of assessee.

Interest paid.—The question of the allowance of losses on property, whether or not due to the payment of interest is dealt with below, while the allowability of interest as such is dealt with in Chapter VIII, Section 2.

Other Charges.—Although, we understand, the Second Income Tax Amendment Act of 1933 was intended to provide for the allowance to the same extent as interest, of annual payments charged on the property, the wording of section 9 (1) of the Act does not provide for any charges other than interest and ground rent, and we suggest that the clause in question should be amended accordingly.

We recommend also that the restriction which we suggest in Chapter VIII, Section 2, as regards interest paid, should be extended to the allowance of other charges.

(*f*) *Losses on Property.*—Many representations were received to the effect that a loss incurred on property should be allowed to be set off against other income. It was pointed out that in the majority of cases, this non-allowance amounts to a restriction of the allowance of interest charged on the property, or paid on money borrowed for the purchase thereof. Having regard to the treatment accorded to interest paid on money borrowed for the purchase of shares and securities [See paragraph 39 (xi) of the Income Tax Manual], there is some justification for the claim. We may remark that under the United Kingdom system, the limitation of allowances from property assessments to the amount of the annual value assessed is not nearly so stringent a limitation as that in force in India since in the United Kingdom, interest paid is not treated as an allowance from annual value but as a deduction from the total income. The cases, however, in which apart from the deduction of interest, a loss may arise are few in number and we see no valid reason for their exclusion. We recommend, therefore, deletion of the proviso to Section 9 (1) of the Act.

CHAPTER VI.—COMPUTATION OF INCOME—*continued.*

BUSINESS, PROFESSIONS AND VOCATIONS.

Section 1.—Discontinuance.

Representations have been made to the effect that the relief provided by sub-section (3) of Section 25 of the Act is in some cases less than the hardship involved in the assessment twice of the profits of the year 1921-22. It is, of course, true that in other cases, exactly the opposite obtains, and, in fact, the option given to the assessee by the sub-section brings about the broad result that for cases of discontinuance in the aggregate, tax is paid to the Revenue on less rather than on more than the profits earned. It is, we think, quite out of the question to endeavour to legislate so that the assessments for the whole life of any business shall, notwithstanding the change introduced in the Income-Tax Act, 1922, exactly equal the actual profits made. A broad solution is all that is practicable, and this, it is considered, is secured by the existing legislation.

Section 2.—Changes in Proprietorship.

Section 26 provides an exception to the general rule that is exemplified in the immediately preceding sections of the Act, that tax liability in respect of the profits of any year should attach to the person or persons actually entitled to them. This gives rise to a number of anomalies. For example:

(*a*) Where a Hindu Undivided Family carrying on a business is disrupted and its members enter into a partnership, it is not quite clear whether the assessment in the year following disruption should be made in accordance with section 25A or section 26. In the former event, the liability would be calculated according to the circumstances of a Hindu Undivided Family whereas in the latter, it may depend upon the circumstances of the individual partners. How very different the liability may be according to which of these sections is applied, may be seen from the example given in Section 3 of Chapter III of this Report.

(*b*) Where a firm carrying on business converts itself into a limited company, the profits of the year of change are assessed upon the company at the maximum rate although the profits prior to the change were divisible among the partners whose appropriate rates of tax may have been much lower.

(*c*) Where an assessee takes over a business that was set up after the Act of 1922 came into operation and at some later date discontinues it, he has not only been assessed in respect of all profits made by himself but in addition has paid tax upon the profits of his predecessor's final period of trading; whereas if tax had been paid by his predecessor under the Act of 1918, sub-section 3 of section 25 operates to reduce the total period in respect of which he is assessed to one corresponding to the actual period of his trading.

(*d*) Where there are important changes in the constitution of a firm considerable hardship or loss of revenue may be involved.

For illustration take the case of a registered partnership making in the year ended 31st March 1935 a profit of Rs. 1,00,000, the partners having no other income. In that year, the partners were A taking 40 per cent., and B and C taking 30 per cent., each. At the time of assessment in 1935-36, A has retired, B and C remaining equal partners. The assessment for 1935-36 would be in the sum of Rs. 1,00,000 and the tax payable, based upon the current division between B and C, would be Rs. 17,378, to be borne equally by them, whereas the tax payable on the basis of the division of the profits which actually obtained would be only Rs. 13,068, of which the retiring partner's share would be Rs. 6,138.

In the case of the introduction of new partners, the converse effect would obtain.

It is therefore recommended that section 26 be amended so as to provide for the assessment of profits of the "previous year" on the persons who actually received those profits, with power, if necessary, to recover the tax from the existing owners of the business.

This recommendation makes it necessary to amend also section 25 (3) to ensure that relief under the section enures to the person who would otherwise be assessed for one year more than the period of his trading. We recommend therefore that in the case of the first succession (other than a change in the constitution of a partnership) after the coming into operation of the amending Act, to a business which has at any time been assessed under the Act of 1918, the predecessor shall be entitled to claim the relief that could have been claimed had there been complete cessation at the date of succession. Whether or not relief has been claimed on the occasion of the first succession, no relief should be granted on the occasion of either a subsequent succession to, or a complete cessation of, the same business, since any assessee after the first succession will have been charged tax on his actual profits for all years.

Section 3.—New Businesses.

A difficulty arises in the case of a newly set-up business, the accounts of which are made up to a date other than 31st March. Clause 11 (*a*) of section 2 of the Act provides that the "previous year" shall be the 12 months ending on the 31st March preceding the year for which the assessment is to be made, or, at the option of the assessee, the year to some other date within the said 12 months, if accounts were made up *for a period of a year* on that date, and does not provide specifically for the case of a new business.

In some Circles, it appears to be the practice in the case of a new business to take such proportion of the profits shown by the first account as corresponds to the period from the date of the setting up of the business to the following 31st March for the purpose of the first assessment of the business, again taking a full 12 months' proportion of the profits shown by that account for the second assessment. This may involve the assessment twice of the same profits. For example, a business is commenced on 1st January 1935, and the profits for its year's trading to 31st December 1935 amount to Rs. 10,000. There would be an assessment for the 3 months to 31st March 1935 of Rs. 2,500 and an assessment for the 12 months to 31st December 1935 of Rs. 10,000—a double assessment of Rs. 2,500 for which no relief is provided.

To clarify the position it is suggested that the following addition be made to clause 11 of section 2:—

"(c) in the case of a newly set up business, either (i) the period from the date of setting up to the 31st March next following, or, at the option of the assessee (ii) where accounts are being made up regularly to a fixed date, the period from the date of setting up to such fixed date falling within the financial year preceding the year of assessment; provided that where the fixed date does not fall between the date of setting up and the next following 31st March, there shall be deemed to have been no previous year."[1]

SECTION 4.—DEDUCTIONS.

(a) *Rent Paid.*—Representations were made on behalf of a professional association to the effect that where premises are used partly for professional purposes and partly as a residence, it is a common practice to base the proportionate allowance of rent solely upon floor space without reference to other factors affecting the relative values of the various rooms. We recommend that after the word "proportional" in section 10 (2) (i) of the Act, there should be inserted the words "value of the".

(b) *Commissions for services rendered.*—We have seen cases where, without any suggestion of attempted fraud or evasion, an Income-Tax Officer has embarked upon the almost impossible task of determining what would be reasonable remuneration of an employee as compared with the amount actually paid to him, his justification being the terms of the proviso to section 10 (2) (viii*a*) of the Act. It seems clear from the history of this proviso that it was intended only to meet the case of avoidance of fraud, and we consider that only that class of case requires such action. We recommend, therefore, that the present proviso to the sub-section in question be deleted and a new proviso be substituted to the following effect:—

"Provided that the Income Tax Officer is satisfied that the amount of bonus or commission is not paid with a view to the avoidance of the payment of tax by the employer."

(c) *Bad Debts.*—General dissatisfaction was expressed in every Province visited regarding the treatment of bad debts. It was alleged—

(1) that at times a debt disallowed in one year as prematurely written off was disallowed in a subsequent year as having become bad in an earlier year;

(2) that in some cases, bad debts were disallowed because no legal action for recovery had been taken, whilst in others, where legal proceedings had been taken, the expenses of such action were disallowed because the Income-Tax Officer considered it unjustified;

(3) that in some cases, where a legal decree had been obtained, allowance was refused on the ground that the time limit for execution of the decree had not expired although recovery was obviously impossible; and

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1 Examples might be given in the Manual.

(4) that in insolvency proceedings, often no allowance was made until the insolvent estate had been finally wound up, even though the prospect of any considerable dividend was negligible.

We are bound to state that, although bad debts were fairly treated in many cases examined by us, we have found in other cases justification for the statements made, and that the treatment of bad debts claims is one of the principal causes for the existing dissatisfaction with the Income-Tax Department. In some cases, it appeared to us that the efforts of the Income-Tax Officer were directed towards the discovery of technical objections to allowance rather than to the determination as a fact whether or not the debt claimed was actually irrecoverable. The contention advanced by a number of associations that the writing off of a debt in the books of an assessee should by itself be sufficient warrant for the allowance thereof is obviously unsound. It is the duty of the Income-Tax Officer to satisfy himself, not only that the debt is actually bad, but also that it became bad in the year in respect of which it is claimed, as otherwise, debts proper to a year of liability at a low rate of tax, or of no liability, may be claimed for a year in which the rate of tax is high, and it should be put on record that the Income-Tax Officer has frequently to resist improper claims. This point will, however, lose some of its importance when business losses are allowed to be carried forward.

As suggested by various bodies, we recommend the addition to section 10 (2) of the Income-Tax Act, 1922 of a specific clause on the following lines:—"(viii*b*) where the assessee's accounts are kept on the mercantile basis, in respect of bad and doubtful debts, such sum as is estimated by the Income-Tax Officer to be irrecoverable, but not exceeding such sum as is actually written off in the books of the assessee.

"Provided that if the sum ultimately recovered in respect of such a debt proves to be greater or less than the sum estimated under this clause to be recoverable, such excess or deficiency in the sum recovered shall be deemed to be profit or expense, as the case may be, of the year of recovery."

Further, the instructions in the Manual for the guidance of Income-Tax Officers should be amended so as to make it clear that the assessee's estimate in the case of doubtful debts and the year for which allowance is claimed, should only be challenged for adequate reasons.

In the case of a succession, we consider that the value of book debts adopted for Income-Tax purposes in the final account of the predecessor should be taken as the cost to the successor of those debts if taken over by him, and that his losses or profits on recoveries should be calculated on that basis.

(*d*) *Payments to Hospitals, etc., for benefit of employees.*—Paragraph 64 (iv) of the Income Tax Manual lays it down as a principle that whilst expenditure for the maintenance by an employer of a hospital, school, etc., provided by him solely for the benefit of his employees is allowable, no allowance is to be made for contributions by an employer for the benefit of his employees to outside bodies providing similar services. There seems to us to be no justification for this distinction and we recommend that payments made by employers definitely for the benefit of their employees or the dependents of those employees should be allowed, with, of course, the exclusion of subscriptions to such bodies for capital purposes.

(*e*) *Sundry customary payments.*—We have had numerous representations on the subject of payments by traders such as Chandla, Diwali gifts, etc. It would be quite impossible to make a comprehensive list of these and to specify which should be allowed, and we think it sufficient to say that where such payments are made in the ordinary course of business as quasi-discounts to customers, or as remuneration to employees, or are in the nature of advertisements, and not as obligations arising from the personal, social or religious status of the assessee, they should be allowed.

(*f*) *Payments to Trade Associations.*—The circumstances in which these should be allowed are dealt with in Chapter VII.

(*g*) *Managing Agents' Commission.*—Some associations mentioned cases in which the Managing Agents of a Company, in order to secure subscriptions to the capital of the Company, undertake to pay to the subscribers a stipulated proportion of the commission received by them under their contract with the Company. It was stated that purporting to apply the decision in the Pondicherry Railway Company Case (5 I. T. C. 363), Income-Tax Officers refused allowance of the commission so paid away in computing the liability of the Managing Agents. We understand that a case on this point is being taken to the Privy Council but we consider that whatever the result of that case, the tax liability in respect of such commissions should be imposed upon the recipients and allowance made therefrom in computing the liability of the Managing Agents by, we suggest, notification under section 60 (1) of the Act.

SECTION 5.—DEPRECIATION AND OBSOLESCENCE.

(*a*) *Basis of Computation—Cost or written-down value.*—Sections 10 (2) (vi) and 11 (2) (ii) provide that in the computation of profits of businesses, professions and vocations, allowance shall be made in respect of the depreciation of buildings, machinery, plant and other assets of a percentage, prescribed by rule, of the original cost thereof to the assessee.

The first question for consideration is whether the allowance should be calculated as now upon the basis of cost, or whether it would be better to change over to calculations based on the written-down value, *i.e.*, the original cost less year by year the depreciation previously allowed. The following example illustrates the difference between the two methods:—

	Cost method.		Written-down value method.
Year 1, Original cost	10,000	20% on	10,000
Allowance 15% on cost	1,500	written-down value.	2,000
Year 2, written-down value	8,500	,,	8,000
15% on cost	1,500		1,600
Year 3	7,000	,,	6,400
15% on cost	1,500		1,280
Year 4	5,500	,,	5,120
15% on cost	1,500		824
Year 5, written-down value	4,000		4,296

The system at present in operation makes it a matter of great difficulty to keep track of the various items of plant purchased at different dates and of the years in which they should drop out of the depreciation computations by reason of the full 100 per cent., allowance having already been made. We have found that in practice the depreciation records on the files are often complicated, so that the position is not at all clear and involves much discussion and research. The written-down value basis automatically secures that the aggregate allowance can never exceed 100 per cent. Moreover, the necessary calculations are simpler and more easily followed with a corresponding saving of time even after allowing for the more detailed statements necessary in connection with an obsolescence claim.

On theoretical grounds, there is at least as much to be said for the written-down value basis as for the present basis, but no method has been found which gives universally satisfactory results. This is evident from the recurrent discussions in professional journals and technical publications, but the United Kingdom Royal Commission on Income Tax, 1920, after full consideration, reported definitely in favour of the written-down value basis. Obviously higher percentage rates would be necessary under the written-down value basis to give corresponding results and this should be borne in mind when the rates are being revised as recommended in paragraph (e) of this Section of our Report, but this does not necessarily mean an increase in all the existing rates because some of them appear to us to be much too high already.

A further point for consideration is the fact that however carefully the prescribed rates of depreciation are arrived at, such rates at the best can only be fair averages for the various classes of plant, etc., and must be either more or less than the rates of depreciation actually suffered in many cases. Where the prescribed rate is inadequate, a remedy is provided by the obsolescence allowance [see paragraph (g) of this section]. To meet the case where the rate is excessive, we suggest as a safeguard that the allowance should not exceed that which the assessee has actually written off in his books.

We recommend therefore the amendment of section 10 (2) (vi) of the Act on the following lines:—

"in respect of depreciation of such buildings, machinery, plant or furniture, being the property of the assessee, a sum equivalent to such percentage on the written-down value thereof as may in any case or class of cases be prescribed, but not exceeding the amount actually written off in the books of the assessee, provided that where the aggregate allowances from the commencement of this Act up to and including any year, do not exceed the aggregate of the sums written off in the books of the assessee for the same years, this limitation shall not be applied,"

"Written-down value" means:

(a) in the case of assets acquired in the "previous year", the actual cost to the assessee,

(b) in the case of assets acquired before the "previous year" but after the coming into operation of the amended section, the actual cost to the assessee less all depreciation allowed to him under this section,

(c) in the case of assets acquired before the coming into operation of the amended section, the actual cost to the assessee less (i) for all years for which he has been assessed in respect of the business, all depreciation which has been calculated as allowable in respect of those years whether effectively allowed or not, and (ii) for all years for which he has not been so assessed, depreciation calculated under the provisions of section 10, at the rates in force for those years, but, for any year prior to the coming into operation of the Income Tax Act, 1922, at the rates in force on 1st April 1922.

The words at the head of the second column of the statement in Rule 8 would need amendment to 'Percentage on written down value'.

(*b*) *Whether an expense or an allowance from ascertained profits.*—A second and perhaps more fundamental consideration is, the allowance due for any year having been ascertained, how such an allowance should be treated in the computation of profit or loss. At present, depreciation is treated differently from any other expense, provision being made for the allowance thereof only so far as there are profits or gains sufficient to cover such allowance, any unallowed balance being carried forward to be treated as an allowance for subsequent years. There seems to be no justification for such differential treatment, which, moreover, is opposed to the principles adopted generally by commercial concerns in their own accounts. On the assumption which is inherent in the system, that the loss of value of plant and machinery, etc., used in the carrying on of business is an allowable expense in computing the results of that business, such loss can only fairly be regarded as an expense of the year in which it occurs. It is recommended, therefore, that depreciation should be allowed each year as an expense in determining the profit or loss of such year, the provisions for carrying forward of depreciation as such being abolished. Where the allowance of depreciation brings out a loss, such loss should be carried forward no more and no less than losses arising from any other cause. A concession which might be considered for cases in which there is a carry forward of depreciation under the existing Act, is the allowance of such carried forward depreciation for the six years prior to the year of amendment of the Act against the profits of the business otherwise assessable for the succeeding six years.[1]

(*c*) *Machinery working double shifts.*—The representations made to us included a widespread claim that where machinery is working double shifts, there should automatically be an increase over the prescribed rate. The matter is not so simple as was assumed in the representations made. For one thing, it is by no means certain that depreciation varies directly with the hours of user of the plant or machinery. In fact, there is reason to believe that depreciation may sometimes be greater when the machinery is only occasionally used than when it is in regular use. A further consideration is that apart from classes (which may be specially considered) where double user is a constant and regular incident of the business, the claim in question would logically involve an enquiry in the case of every trader using plant and machinery, as to the number of working hours contemplated by the prescribed rates and as to the actual hours worked in the year under consideration. This would throw a burden upon the assessee and the Department quite incommensurate with any result to be obtained. The prescribed rates are obviously intended to be fair averages for the

[1] Carry forward of business losses is dealt with in Chapter VIII of this Report.

various classes of plant and machinery dealt with and it was admitted by various deputations that a number of the rates are on the high side. It is suggested, therefore, that there is no case for dealing with double shifts in every instance in which it occurs, but that special consideration need be given only to cases where it is a regular incident of a trade or a section of a trade.

(*d*) *Assets only partly used for business.*—A further point represented to us is the unfair treatment of buildings, plant and machinery (motor cars are specially in question) used only partially for the purposes of trade or profession. Under Rule 8 as it stands at present, the rate of 15 per cent. is prescribed for motor cars used solely for the purpose of the business. Motor cars partially so used are often treated as falling within the general class of machinery, plant, or furniture, the rate for which is 5 per cent., irrespective of the extent to which the car is used for business purposes. It is recommended that the rules should provide that the allowance for buildings, plant or machinery used partially for business purposes should be such proportion of the allowance, calculated at the prescribed rate, as corresponds to the proportion in which its use is for business purposes.

(*e*) *Fixation of rates.*—It has been represented to us that in the case of some trades the prescribed rates which we understand were fixed many years ago, bear little relation to present day conditions. We suggest, therefore, that there should be a periodical revision, say every 10 years, of the prescribed rates, with special attention to newly introduced types of plant and machinery.

In our view, a striking example of the need for revision is that of buildings.[1] The existing classification is so vague in its terms that it is a matter of difficulty for either assessee or an Income-Tax Officer to determine in which class a given structure should fall. For example, the present wording suggests that every wooden building used for business purposes is of necessity a temporary erection to which an allowance of 10 per cent. is applicable, whereas it is obvious that many wooden buildings in India have a life much greater than 10 years. Further, the rates for classes 1 and 2 seem to be much too high since they imply that no building of the most up-to-date construction will have a life exceeding 40 years,[2] and that less substantial ones will last no longer than 20 years. A really first class building may be expected to last at least one hundred years, and it is most unlikely that any buildings, apart from the temporary structures which are adequately dealt with in class (3), are erected for business purposes in contemplation of a life of less than 40 years. In our opinion, the rates for buildings other than those in class (3) should vary from 1 per cent. to 2½ per cent. It is also suggested that the special deterioration in the case of buildings used in the industries mentioned in the remarks column of Rule 8 is not as much as 100 per cent., above the normal.

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[1] It is a question whether the existing allowances in respect of all buildings should not be restricted. In 1920 the Royal Commission on Income Tax in the United Kingdom rejected claims for the extension to ordinary premises of the allowance given in respect of mills, factories and similar premises on the grounds of the appreciation in value which often occurs and of the consequent difficulty in dealing fairly in this matter between one property and another. A suggestion made to us is that the depreciation allowance might be restricted to buildings which are fitted up with heavy machinery.

[2] In this connection it may be observed that the Calcutta Custom House which it is proposed to pull down because the accommodation is not up-to-date, and not because it is worn out, was erected in 1819.

A further class in which the rates appear to be too high is that of ships.

When revising rates of depreciation it should be borne in mind that section 10 (2), as interpreted by paragraph 56 of the Income-Tax Manual, authorises the allowance of the cost of such replacement of parts of a unit of plant and machinery as do not destroy its identity. The extent to which parts of a unit can be so replaced varies very considerably as between different types of plant and machinery and the normal life of any unit of plant or machinery as a whole varies accordingly. It is common knowledge that many types of machinery are built up of parts of standard patterns, most of which are replaceable without destruction of the identity of the machine. In such a case it is obvious that the possible life of the machine is long.

(*f*) *Wasting assets generally.*—Claims were made to the effect that premiums for leases of business premises and "Salami", *i.e.* lump sum payments to landowners for leasehold rights in respect of minerals, should be treated as if they were revenue expenditure paid in advance, and should be allowed as a deduction over the period of the lease. In the United Kingdom, such an allowance has been consistently refused from the inception of the Income-Tax system in that country. This attitude towards the wastage of assets of this character was examined by the Royal Commission on Income-Tax of 1920 and approved, and we see no sufficient reason for adoption of a different attitude in British India.

It may be pointed out that section 11 (2) (ii) of the Act provides for allowance of depreciation of "other capital assets". It is suggested that when revising sections 10 and 11 as recommended in Chapter IV of this Report, these words should be deleted as they appear to be dangerously wide. The expressed intention of these words as set out in paragraph 67 of the Manual, *i.e.*, allowance of depreciation on books purchased by an assessee for the purpose of his profession, might be secured by the addition of an "explanation" to the section as amended.

(*g*) *Obsolescence.*—It has been represented to us that the existing allowance in India is much narrower in scope than the corresponding allowance in the United Kingdom. In practice, in the latter country, the allowance is given in respect of replaced plant and machinery which is disposed of as being no longer suitable for the purpose of the business in which it was used, no question being taken as to whether or not it was technically obsolete.

The strongest of the cases put to us was that of plant and machinery worn out in the service of the business and disposed of at a date when the aggregate depreciation allowance fell short of the full cost. It is quite impossible so to prescribe depreciation rates that the assumed life shall correspond to the actual life in all cases, and there is therefore much to be said for the allowance of obsolescence as a corrective to insufficient depreciation allowance. We have considered the application of the same restriction as is in operation in the United Kingdom, *viz.*, that the obsolescence allowance should be limited to the cost of replacing the obsolete plant or machinery. This limitation, however, has in practice in the United Kingdom led to a number of complications and inequities which it has been found necessary to meet by extra-statutory concessions. We consider a simpler basis of allowance more suitable to the conditions of India.

It is therefore recommended that obsolescence allowance should be granted in all cases where plant and machinery is disposed of (whether by sale or by scrapping) provided that the asset has been completely written off in the books of the assessee. Since the suggested allowance is intended to cover insufficient depreciation allowance, there should be a provision for bringing in as profit any excess in price obtained for the plant disposed of over the difference between the depreciation already allowed and the original cost of the plant or machinery.

(*h*) *Allowance of Renewals as an alternative to Depreciation.*—Apart from the practical method adopted in respect of petty items of furniture set out in paragraph 59 (vi) of the Manual which might be extended to books, etc., we are of opinion that if adequate allowance be given for depreciation and obsolescence, there should be, in general, no option to claim allowance of the cost of renewals.[1]

The only cases known to us in which such option is at present allowed are those of railways and tramways (excluding electric tramways) and Tea companies, in which the option is given by notification under section 60 of the Act. In certain of those cases, difficulties have arisen by reason of claims made to revert to the depreciation basis. An unrestricted right so to change from one basis to the other would in some cases involve the granting of excessive allowance over the whole period of trading, and any attempt to compute the fair value upon which depreciation should be allowed from the date of reversion would be practically impossible. We therefore recommend that a further notification be issued or a further proviso be added to section 10 (2) (vi) to the following effect:—

"Provided, further, that any assessee who has exercised an option under a notification under section 60 of the Act to claim the allowance of the actual expenditure on replacements and renewals in lieu of depreciation shall not thereafter be entitled to claim allowance for depreciation under this sub-section for any year."

(*i*) *Plant, machinery and furniture let on hire.*—It has been represented to us that there is no provision for the allowance to the owner of depreciation of plant, machinery, etc., let on hire as is the case in the United Kingdom. We can find no valid reason for not allowing depreciation in such cases and we recommend that provision be made accordingly.

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[1] Renewals of parts as distinct from renewals of units of plant and machinery are dealt with in paragraph (*e*) above.

CHAPTER VII.—COMPUTATION OF INCOME—*Continued.*
SPECIAL TYPES OF BUSINESS.

SECTION 1.—LIFE ASSURANCE COMPANIES.

A number of representations concerning the basis of assessment of Life Assurance Companies have been received by us and may be summarised as follows:—

(*a*) That bonuses to participating policy-holders should be excluded from the computation of assessable profit;

(*b*) that assessable profit should be the interest earned less management expenses with or without taking profits computed on an actuarial basis as a minimum;

(*c*) that the charge should be at less than the full Company rate of tax;

(*d*) that only that proportion of the surplus that the Company's Actuary certifies to be attributable to interest earned should be taxable;

(*e*) that interest on tax-free securities should be deducted from the profit before assessment;

(*f*) that credit should be given for tax deducted at source during the "previous year" and not on the basis of the average tax deducted in the valuation period;

(*g*) that where a foreign Life Assurance Company, which does not keep a separate Fund in respect of its Indian life business, makes a separate valuation in respect of such business, a *pro-forma* account based on such valuation should be regarded as "more reliable date" for the purposes of Rule 35, that the interest credited in such statement should be calculated at the world average rate, and that a reasonable debit should be allowed for Head Office expenses; and

(*h*) that the profits of the annuity business of a foreign company should be calculated separately from the profits of the life assurance business, and that the proportion should be based on the amount of annuities assured under policies effected in British India instead of on the premiums received in British India.

To the extent that the profits of carrying on Life Assurance business are allocated to, or available for allocation to, the shareholders there can, of course, be no doubt that they should be subjected to Income-Tax. Such profits are made up of (i) interest earned on investments (ii) profits (less losses) on the sale of investments, (iii) the profit arising by reason of the fact that actual mortality proves to be lower than that in the mortality tables taken, (iv) the profit on surrendered policies, (v) minor profits such as fines, fees, etc.

The business of Life Assurance can, however, be regarded, in the case of a Proprietory Company, not merely as a profit-making concern for the shareholders but as a combination of this and of joint investment for the benefit of the policy-holders whereas in the case of a mutual concern the only profit-making element is the latter. In computing the premiums to be paid to assure a given sum, the fact that the premiums when invested by the Company will earn interest is taken into account so that it may be said

that the sum assured paid out includes accumulated interest earned by the Company on behalf of the policyholder. Thus the interest earned by the Company year by year is allocated partly to the policyholders and partly to the shareholders. Since, to the extent to which it is the intention of the Government to subsidise this form of saving, an allowance is given direct to the policyholder in his own income-tax assessment, there is no reason why the full interest including that allocated to policyholders should not be taxed in the hands of the Company.

It is argued that bonuses paid to participating policyholders represent merely the return of part of excessive premiums, and that in computing the total profit of a Life Assurance Company, it is therefore incorrect to include the gross premiums on the one side and not to allow on the other side, the amounts returned to the policyholders in the form of bonuses. It might as easily be argued, however, that these bonuses represent in the first place interest earned on the premiums and not the alleged excess premium. As may be gathered from the foregoing, neither of these contentions exactly represents the position.

One basis suggested, namely to assess the total interest earned by the Company and deduct expenses of management, leaves out of account other kinds of profit made by the Company on behalf of the shareholders out of transactions with the policyholders. The present basis seeks to assess in the hands of the Company the total profit from all sources whether allocated to shareholders or to policyholders, but, theoretically, such surplus may include an element of excess premiums, which we agree should not be included in the Company's assessment. Although there is this theoretical possibility, we have not in our experience met a case in which the surplus disclosed by actuarial valuation actually exceeded the income from interest, dividends, etc.

We suggest therefore that the computation of profits should continue (i) on the present lines but (ii) that where the profit so computed exceeds the gross income of the company from interest on investments plus (or minus) profits (or losses) actually realised on the sale of investments, without any deduction for management expenses, the liability should be restricted to the latter figure, provided that this is not less than (iii) the sum distributed to or reserved for the shareholders in the case of a Proprietary Company. The reason for such a restriction to income earned from outside sources (*i.e.*, interest plus profits on realisations of investments) is that when the profits computed on an actuarial basis exceed this latter figure, it is clear that part of the profits allocated to the policyholders represent excessive premiums.

Our comments on the various representations set out above are as follows:—

(*a*) This is clearly unacceptable since it means the exclusion from the profits of something which is definitely income from outside sources allocated to the policyholders.

(*b*) This is based on the assumption that the expenses are first met out of interest so that surplus arises primarily from excess premium and is not taxable. This contention, for the reasons given above, we are unable to accept.

(*c*) A similar claim was made to and rejected by the United Kingdom Royal Commission of 1920. The reasons for the rejection of such a claim are (i) the practical impossibility of

arriving at an appropriate rate by reference to the circumstances of all its policyholders for each Life Assurance Company. (Moreover no one can trace before maturity of their policies the individual policyholders' interests in the income that arises from the Company's investments), (ii) the fact that the policyholders who may be exempt or liable at a low rate may be balanced by policyholders liable to super-tax whose rates are in excess of the Company rate.

(*d*) Since the profits of an Assurance Company include elements other than interest, which, as stated above, we consider, should enter into the computation of liability, this proposition is unacceptable.

(*e*) This tax-free interest is one of a number of items of gross income all of which may be deemed to enter proportionately into the surplus and there is no case for the deduction of more than that proportion of tax-free interest included in the surplus.

(*f*) We cannot accept this suggestion since in the case of a growing business, the profits computation would still be based upon the smaller business of the previous valuation period, while credit would be given for the interest earned upon the larger funds in the "previous year". While, however, it is reasonable, in our opinion, to compare the profits and the interest for the same basic period, as the profit so ascertained is chargeable at the rate of tax for the year of assessment it is, in our opinion, only fair to compute the tax to be set-off at the same rate; or to put it in another way, the difference between the profits and interest should be computed and the charge or refund of tax thereon, as the case may be, should be at the rate for the year of assessment.

(*g*) We are advised that this course is impracticable because the Indian policyholders participate to the same extent as other policyholders in the world profits and it is a well known fact that these are generally on a higher scale than those arising from the Indian business.

(*h*) Neither the method suggested nor that at present in operation necessarily gives a correct result, and if there must be an estimated basis, one seems to be as good as the other.

In addition to the points raised in the representations, there is another matter of vital importance, *viz.*, the effect on the computation of liability of Rule 30 which deals with appreciation and depreciation of investments. It is a common practice for Insurance Companies during a period of falling investment prices to write off large sums in respect of the depreciation of their investments, and, when prices recover, not to write up the investments, but to leave appreciation as an inner reserve. Under the Rule, only appreciation actually credited in the accounts is brought into the Income-Tax computations, with a resultant very heavy loss to the Revenue. We have considered whether the Rule should be amended to provide for the re-crediting for Income-Tax purposes of all such recovered depreciation, whether credited in the Companies' accounts or not, but have come to the conclusion that a better course would be to allow no further depreciation and not to take into account appreciation

except in so far as it represents the recrediting of depreciation already allowed, and to continue to bring into computation, profits or losses actually realised on sales. The question arises as to how existing investments which have been written down should, after a change to the basis suggested above, be treated for the purpose of calculating any such profit or loss. We suggest that after the change, the cost price of any stock for the purpose of calculating realised profit or loss should be taken to be the written-down value as previously accepted for Income-Tax purposes. This might involve the rendering by each company of a statement of the whole of its investments showing the book value for each investment as at the date of the last Valuation Balance Sheet prior to the change. Where there are two or more parcels of the same stock, the value of each unit should, we consider, be taken at the average book value for the whole of the holdings of such stock.

Section 2.—Investment Companies.

A few representations have been made to us to the effect that allowance should be made to Investment Companies in respect of management expenses. The computation of the income of companies which make a *business* of buying and selling investments in addition to receiving dividends and interest is made under section 10 of the Act, and the question at issue is that of investment trust companies which are regarded as not carrying on a business. Where interest is paid on money borrowed for the purchase of shares and securities, the interest paid is already being allowed under executive instructions. Other expenses in connection with the investment of capital and with the collection of interest on securities and dividends, other than banker's commission allowed under section 8 of the Act. are not allowed in the case of other assessees and there seems no reason why an investment trust company should be placed in a privileged position.[1]

Section 3.—Trade Associations, Chambers of Commerce, Mutual Benefit Societies, etc.

In this sub-section, we consider the position for income-tax purposes of various associations in the activities of which there is some element of mutuality. They range from the sports club whose activities are solely the provision of sports facilities for its members to concerns which render services which, in a broad sense, can be regarded as nothing less than the carrying on of a trade.

(*a*) *Members' clubs.*—It is, we think, common ground that where persons do no more than co-operate to provide for themselves social, sporting and similar amenities, there can be no question of such activities being liable to tax as the carrying on of a business. We recommend that no attempt be made to assess the surplus arising from the operations of a members' club, whether incorporated or not, which merely provides social or other amenities.

(*b*) *Trade and professional associations with mutual activities only.*—Similarly where traders or professional men have merely united for the purpose of co-operative expenditure for the benefit of their business, of such a nature that the cost thereof would have been allowable as a

1 See Chapter II. Section 3. of this Report, as regards exemption from Company Super-Tax of investment trust companies.

business expense if it had been incurred individually, such activities cannot be regarded as amounting to the carrying on of a business. Contributions to such an association merely take the place of what would otherwise be individual allowable expenditure and should be allowed to the members. Where, however, an association of this character collects subscriptions more than sufficient to meet such expenditure, the allowance of the full subscriptions would be excessive. The excess subscriptions in such a case may be used to build up reserves or for non-allowable expenses, *e.g.*, capital expenditure. It is considered that section 10 (2) (ix) of the Act already provides for the disallowance of a fair proportion of such excessive subscriptions inasmuch as the excess cannot be regarded as incurred for the purpose of earning the assessable profits.[1] The ascertainment and disallowance of portions of such subscriptions in the assessments on the members would obviously involve work incommensurate with the amount of tax at stake and it may be considered whether administrative arrangements should be entered into as is done in the United Kingdom. The arrangements in that country are shortly these:—

(i) The association agrees to pay tax at the standard rate on the excess in any year of its receipts over its outgoings with suitable adjustments as in the case of a trader.

(ii) If the result for any year thus computed is a loss, such relief may be claimed as may be claimed by any other tax-payer in such circumstances.

(iii) The whole subscription is allowable to the member in computing his profits.

(iv) Any sums distributed by the association to its members are allowed in computing its liability and treated as assessable in the hands of the recipients.

We recommend that attempts should be made to bring Chambers of Commerce, Trade Associations and similar bodies into an administrative arrangement similar to that set out above.

(*c*) *Trade and professional associations with business activities.*—There is next the association whose activities are primarily those of the type of association just mentioned but which, in addition, performs specific services for members or non-members for remuneration definitely related to those services, the payments therefor being generally allowed as expenses in computing the profits of those traders. We consider that even where such services are performed for members only, these activities should be regarded as the carrying on of business. If necessary, an explanation to this effect should be added to section 10 of the Act. There is, perhaps, a still stronger case here for an administrative arrangement on the lines suggested above to obviate the necessity of calculating in such a case (*a*) the profit from such activities as amount to business and (*b*) the proportion of a member's subscription not allowable to him.

(*d*) *Pooling Associations.*—Another type of association is that which, in order to maintain prices in a particular industry or section of it, fixes price at which the various grades of goods are to be sold by its members, involving generally payment into a pool by some members for distribution to the others. The current practice in India is to allow such payments

[1] See also Lochgelly Iron and Coal Co.; Ltd., V. Crawford, 6 U. K. T. C. 267.

as a business expense and to treat such receipts as taxable profit. This accords with the decision in the United Kingdom case of Guest, Keen and Nettlefolds Ltd., V. Fowler (5 T. C. 51) and is in harmony with the underlying assumption, with which we agree, that such an association is not carrying on a business.

(*e*) *Mutual Benefit Societies.*—We next consider the class of society registered under the Companies Acts a typical example of which operates in the following manner. With or without initial share capital, members pay recurring subscriptions for a given number of weeks or months, receiving at the end of the period an agreed sum corresponding to the aggregate of the subscriptions plus interest. These monies are utilised in making loans to members and sometimes to non-members also. The Madras High Court (VI I. T. C. 326 and VII I. T. C. 317) has held that the activities of such a body amount to business, and also that interest is not an allowable deduction when paid in respect of share capital subscribed in a lump sum as contrasted with share capital paid by recurring subscriptions. From any realistic point of view, it seems to us that the manner in which share capital is subscribed is far less important than whether the recipient of interest on that capital is individually liable to taxation. We understand that a large proportion of the members of all such societies, in whatever manner the capital is subscribed, are far removed from the point of liability, and we consider that the scheme of taxation should, as far as possible, avoid taxing income received by them. We recommend that, where the Income-Tax Officer is satisfied that the majority of the members of a society are not liable to tax, all interest payable to members should be allowed as a deduction in arriving at the surplus for assessment, particulars of the interest paid being rendered by the society. (See Chapter X, Section 1, of this Report).

Where these conditions are not satisfied, and the interest paid to members is included in the assessment upon the society, members not liable to tax, or not liable at the standard rate, should be entitled to refund.

(*f*) *Thrift Funds.*—The only assessable income in these cases is interest arising from the investment of the mutual fund. As suggested in the case of Mutual Benefit Societies, we consider that such interest should be exempted where the majority of the members are not liable to tax. In the exceptional case where some of the members are liable, an administrative arrangement for the assessment of the proportionate part only of the interest should, we think, be adopted. In a case where the interest received by the association is taxed by deduction, the appropriate refund should be allowed to the association.

(*g*) *Co-operative Societies.*—These are partially exempted by notifications under Section 60 of the Act and we have no comments to offer.

(*h*) *General.*—The foregoing takes it for granted that income from outside sources such as property [see Chapter V, Section 2(*b*)], securities and shares are items of income assessable as such.

CHAPTER VIII.—COMPUTATION OF INCOME—CONTINUED, GENERAL MATTERS.

Section 1—'Previous year'.

(*a*) The practice, where the assessee has more than one source of income and closes his accounts therefor at different dates is, as set out in paragraph 6 (viii) of the Income-Tax Manual, to calculate the income from each separate source[1] according to the separate accounting year adopted for it. This practice has been recently disapproved by the Bombay High Court in the case of Abu Baker Abdul Rahman and we suggest that it be reaffirmed by amendment of clause 11 of section 2 of the Act, by the addition after the words "'Previous year' means" of words such as "for each separate source of income".

(*b*) It has been represented to us that when an assessee exercises the option under section 2 (11) (*a*) for the first time after his first year of assessment, this involves doubts assessment of part of his profits in the normal case. To remedy this, we suggest that the proviso to that sub-section be amended as follows:—"Provided that where an assessee has been previously assessed in respect of the same source of income, he shall not exercise this option so as to vary the meaning of the expression 'previous year' as then applicable to him except with the consent of the Income Tax Officer, and upon such conditions as he may think fit." This amendment would enable the Income Tax Officer to prevent double assessment in all cases of change of accounting date on the lines suggested in paragraph 6(iv) of the Manual.

Section 2—Interest payable.

An anomaly arises from the fact that interest paid on money borrowed for private purposes may be allowable if the loan is secured on real property but not otherwise, and we recommend that interest should be allowable in arriving at the income from property only when it is paid in respect of a mortgage or other charge to which the property was subject when it was acquired by the assessee, or in respect of money borrowed specifically for the acquisition of the property or for its repair, renewal or reconstruction.

In the computation of business profits, we consider that *bona fide* interest in respect of capital borrowed for the purpose of the business, payable to persons other than to the proprietors of the business, should be allowed whether dependent or not on the earning of profits. Such interest should only be disallowed in the circumstances described in the next paragraph. To effect this, the notification in paragraph 18(2) of the Manual would need modification.

In Chapter I, we have recommended the extension of the scope of the tax to all income arising to persons abroad from assets in British India, and in Chapter X that income-tax at the standard rate be deducted at source. This, however, does not meet the case where the interest is payable under a contract made outside British India. This feature of the system leaves an opening for successful avoidance which should be closed, and we suggest that where interest is paid in such circumstances that tax cannot be deducted, such interest should not be allowable as a deduction in computing profits.

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[1] Separate businesses are intended to be treated as separate sources.

In the case of disallowance, the amount disallowed should be treated as the income of the assessee for all purposes including super-tax.

We have considered a more fundamental proposition, *viz.*, that all annual interest payable by an assessee should be an allowable deduction from his total income irrespective of the purpose for which the money was borrowed, but, having regard to the special conditions of British India, this is not in our opinion desirable.

Section 3.—Carry forward of business losses.

This allowance was promised some years ago as soon as the finances of the country would permit, and hardly any representative body failed to stress the claim for an early fulfilment of this promise.

The time when the promise should be carried into effect is, of course, a matter for the decision of the Government, and we therefore confine ourselves to the manner in which this allowance should be introduced, the extent of the allowance and similar technical matters.

Description of losses under consideration.—It is clear from the history of this question that the undertaking provisionally given related only to losses arising from business, but we consider that professions and vocations have an equal claim. We have suggested the amalgamation under one head, in section 6 of the Act, of business, professions and vocations, and any relief should, in our opinion, cover this extended class.

Method of allowance.—It should be clearly laid down that as is at present the case with depreciation, the loss in a business of any year should first be set off as far as possible against any other assessable income of that year, leaving only any balance of loss that has not been so allowed to be carried forward for allowance against the subsequent profits of the same business. The earliest loss of those which are within the prescribed time limit should be set off first, and other losses should follow in chronological order.

To whom allowable.—Companies and Hindu Undivided Families and Unregistered Firms should be treated in the same way as individuals, but Registered Firms need special consideration. In the same way that an individual's loss in any business carried on in partnership may be set off against his income from other sources, we recommend that business losses allowed to be carried forward should be computed for the individual partner, and only allowed against *his* profits in subsequent years from the same business, a registered firm itself having no claim to the set-off of losses carried forward.

Introduction and extent of allowance.—While these are matters of policy, there are one or two comments that we wish to make. One is that our suggestion that the carry-forward of depreciation should be abolished (Chapter VI, Section 5) is so bound up with the proposal to carry-forward losses that in our opinion their introduction should be simultaneous.

Another is that circumstances probably necessitate gradual introduction of the relief, but nevertheless we see no reason why, when the relief is enacted, provision should not be made for the gradual extension of the carry-forward to the full period of, say, six years. We suggest that the gradual introduction of the relief may best be effected by providing that losses of the first "previous year" to which the Act as amended applies

be carried forward for one year, those of the second year for two years, those of the third year for three years and so on until losses are carried forward for six years.

General.—The somewhat important incidental question arises as to the point at which the computation of losses by the Income-Tax Officers should be appealable. On the one hand, it may be urged that unnecessary work would be involved in settling, whether by negotiation or by appeal, the quantum of a loss that may never be effectually allowed. On the other hand, it may be said that the time for settling such questions is when the facts are readily ascertainable, and not years later when books, etc., may no longer be available. In our opinion, the second consideration carries the greater weight, and we recommend that computations of loss should be notified to the assessee in an order which should be subject to appeal just as an assessment order is. The quantum of the loss so determined would be binding for the purpose of set-off in future years apart from cases in which action under Section 34 of the Act would be competent.

Our proposals, both as regards depreciation and losses carried forward, may be illustrated by an example. A company carries on business and makes profits and losses as follows, year 2 being the year of enactment of the proposed changes and year 1 being the 'previous year' for assessment in year 2:—

	Profit or loss in the year.	Depreciation of the year.	Profit or loss for income tax purposes.
Year 1.	Loss before allowing depreciation . . 15,000	10,000 (Depreciation brought forward 40,000).	Loss . . 25,000[1]
„ 2.	Profit 30,000	10,000	Profit . . 20,000
„ 3.	Loss 15,000	10,000	Loss . . 25,000
„ 4.	Loss 5,000	10,000	Loss . . 15,000
„ 5.	Profit 40,000	10,000	Profit . . 30,000
„ 6.	Loss 20,000	10,000	Loss . . 30,000
„ 7.	Profit 30,000	10,000	Profit . . 20,000

In year 2.—The result of year 1 being a loss there is no assessment and the loss Rs. 25,000 is carried forward for one year (*i.e.*, to year 3).

In year 3.—The result of year 2 is a profit of Rs. 20,000 from which is allowed Rs. 20,000 of the loss of year 1 leaving a net assessment of *nil*, the balance not being carried forward further.

In year 4.—The result of year 3 is a loss of Rs. 25,000 which is carried forward up to a maximum of three years (*i.e.*, to years 5, 6 and 7).

In year 5.—The result of year 4 is a loss of Rs. 15,000 which is carried forward up to a maximum of four years (*i.e.*, to years 6, 7, 8 and 9).

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[1] It will be seen that this involves the exclusion from allowance of all depreciation carried forward from the years prior to the 'previous year' the profits of which are assessable in the year of change—but see Note to Chapter VI, Section 5 (*b*).

In year 6.—The result of year 5 is a profit of Rs. 30,000 from which is allowed Rs. 25,000 loss of year 3 and Rs. 5,000 loss of year 4 leaving a net assessment of nil, with a balance of Rs. 10,000 loss of the year 4 to carry forward to years 7, 8 and 9.

In year 7.—The result of year 6 is a loss of Rs. 30,000 which is carried forward up to a maximum of 6 years (*i.e.*, up to year 13).

In year 8.—The result of year 7 is a profit of Rs. 20,000 from which is allowed Rs. 10,000 balance of loss of year 4 and Rs. 10,000 loss of year 6 leaving a net assessment of *nil* and a balance of loss of Rs. 20,000 of year 6 to be carried forward for a further period of five years.

CHAPTER IX.—PAYMENT OF TAX

SECTION 1.—DATE OF PAYMENT.

Numerous representations were received by us to the effect that there should be statutory provisions (*a*) fixing the period between the issue or receipt of assessment order and the date on which payment of the tax is due, and (*b*) for payment of tax by instalments.

We have seen cases in which the time allowed for payment has been as short as one or two days and, in our opinion, such short notice cannot be regarded as reasonable. On the other hand, to allow say 30 or even 60 days, as asked for by some associations, would be unfair to the Revenue in cases where the assessment is not made until towards the end of the financial year. We see no reason for altering the existing statutory provisions but recommend the issue of instructions by the Central Board of Revenue to the effect that the time allowed for payment, except in cases where the Revenue appears to be in danger, should not be less than 14 days.

Since payment of tax by instalments would necessarily much reduce the Revenue receipts in the year of inauguration of such a system, we do not recommend acceptance of this suggestion.

SECTION 2.—PENALTIES FOR DELAY IN PAYMENT.

Under the existing law, [sections 46(1) and 46(1-A) of the Act], where payment of tax is not made at the due date, power is given to the Income-Tax Officer to add to the tax a penalty not exceeding the amount of the tax in arrear. Special provision is made, if default continues, for the addition of successive penalties, provided that the penalties do not exceed in the aggregate the amount of the tax in default. The system of imposing and collecting these penalties seems to be subject to very little control and to be liable to abuse. We have seen cases in which after the imposition of a penalty and its entry in the Demand and Collection Register, the entry in the Register has been deleted by the Income-Tax Officer without any authority from a superior officer.

We recommend that once the Income-Tax Officer has imposed a penalty, it should not be cancelled or reduced except on the authority of the Assistant Commissioner. If Assistant Commissioners are appointed Inspecting Officers, as suggested in Chapter XVI, Section 2 of this Report, such authority should be obtained from the Inspecting Officer, and it should be a part of his duty to see, by inspection of the Demand and Collection Register, that the imposition of penalties is on a fair basis and that any instructions as to their record and collection are duly carried out.

SECTION 3.—WHEN ASSESSMENT UNDER APPEAL.

A number of representations were made to the effect that payment should be deferred in a case where an appeal is made against the assessment. This appears to be merely a matter of co-ordinating departmental practice since the necessary powers already exist under section 45 of the Act, and there is a clear instruction in paragraph 115 of the Manual, which is not honoured as fully as it might be. It is, of course, open to an aggrieved assessee to bring his case to the notice of superior officers, but we think that supervision by Inspecting Officers as suggested in Chapter XVI should secure an improvement in this matter

CHAPTER X.—DEDUCTION OF TAX AT SOURCE.

SECTION 1.—INTEREST PAID.

It follows, of course, that penalties under Section 46 should not be imposed in respect of tax allowed to remain unpaid in cases under appeal.

(*a*) *Interest paid to residents (other than interest on securities)*.—The suggestion has been made that the payer of interest, in all cases or in cases where the interest exceeds a specified amount, should deduct tax therefrom and account for it to the Revenue. Although this idea is attractive, principally as a means of preventing evasion, there are weighty objections to its adoption. There is first the fact that this would involve a considerable increase in the number of refund claims, with heavy additional work thrown on the Department, and a measure of hardship to a large number of assessees. There is also the difficulty of so defining interest for this purpose as to avoid taxing by deduction interest, *e.g.*, money lender's interest, which forms part of the gross receipts of business. Further, a large number of the payers of interest would be persons not within the purview of the Income-Tax Department, and there would be considerable risk of the tax deducted not reaching the Revenue.

On the whole, we think that the best method to secure the tax due on interest paid to residents in British India is the application of the statutory provision in section 20-A of the Act for the rendering by payers of interest of returns of the names and addresses of the resident recipients with the amount of interest paid in the year, reducing the prescribed minimum to, say, Rs. 100.

(*b*) *Interest paid to non-residents (other than interest on Government securities)*.—Considerations differing from those applicable to residents arise in the case of non-residents. In the former, it is a question of taxation by deduction as against direct assessment, whilst with the latter, it is a case of taxation by deduction as compared with no assessment at all in the majority of cases. The attempted use of section 43 of the Act to obtain tax through the payer of interest in such cases is of doubtful validity and, moreover, may result in a demand for tax being made upon him when he has no power of recovery.

There is the further point that in dealing with the accounts of traders, the Income-Tax Officer is quite often unable to disprove the claim made that considerable sums of interest are paid to non-residents, although he is practically certain that the claim is a mere device to avoid the full taxation of business profits. Taxation at source of such interest although not a complete remedy in the case of a trader who is liable to super-tax would, however, go a long way to stop this loss of revenue.

We, therefore, recommend that it be enacted that interest paid to a non-resident by a resident should be subject to deduction of tax at the "standard rate[1]" with the obligation upon the payer to make a return to the Income-Tax Officer of such interest and to account for the tax on the lines laid down in section 18 (6) of the Act. When the contract for payment of interest by a resident to a non-resident is made outside British India, so that the resident has no right of deduction of tax, it is suggested (See Chapter VIII, Section 2) that such interest should not be allowable as a deduction in computing profits.

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[1] See Chapter II.

Section 2.—Dividends.

It does not appear to be the general practice to make a specific deduction of tax from dividends, either preference or ordinary, and there seems to be no sufficient reason for statutory enactment providing for such a deduction, particularly as such provision might have the effect of reducing the dividend actually received by preference shareholders. At present, a dividend is grossed up in the computation of total income at the "company rate" for the year in which the dividend is paid. This takes no account of double taxation relief obtained by the paying company, with the result that repayment may be made to a shareholder of tax at a rate in excess of the actual rate finally borne by the Company. We, therefore, suggest that the dividends should be grossed up at the company rate for the financial year in which the dividend is declared, less the rate at which double taxation relief (in respect of Income-Tax[1] only) has been obtained by the Company. Since in the majority of cases, a Company's double taxation relief claim in British India can only be made after relief has been allowed in the United Kingdom, the rate of British India relief for any year cannot be determined for some considerable time after the end of that year. We propose therefore, as a practical expedient, the adoption of the Company's rate of relief allowed for the year *preceding* the year in which the dividend was declared, such rate being required to be shown on the dividend certificate and being the rate by reference to which double taxation relief should be deemed to have been allowed to the shareholder.

There remains to be considered the case of the company a portion only of whose income is assessable to Income-Tax. We have received many complaints as to the delay in obtaining refunds owing to the difficulty of agreeing the proportion of the non-assessable profits and, consequently, the proportion of the dividend not available for relief. The non-assessable income is generally either agricultural income or interest on tax-free securities, in the latter case, often of relatively trivial amount and, we understand, a diminishing quantity in the aggregate. We think that with only a very small loss of revenue, the existence of proportionately small amounts of tax-free income could be ignored, with a reduction of delay in refund cases and saving of time in their handling. We recommend that where such tax-free income does no exceed, say 10 per cent., of the total income of the company, the whole dividend should be treated as having borne tax. Where the proportion is more than 10 per cent., the dividend certificates should show separately the percentage of profits which has borne tax and only that portion should be "grossed up". To avoid delay in these cases, we suggest that instead of applying the proportion for the year in which the dividend is declared, the proportion for the previous year should be taken.

The recent decision in the Hungerford Investment Trust Case makes it necessary to provide that subject to the limitation suggested in the previous paragraph, relief or refund shall not be allowable in respect of that proportion of any dividend corresponding to the proportion of the profits (out of which the dividend was paid) which was not assessable in the hands of the paying company; and also that that proportion of a

[1] See Chapter XI, Section 5.

dividend paid out of profits not assessed to tax but which would have been assessed had they been the profits of a Company resident in British India[1] shall be assessable in the hands of the shareholder.

The amendment of section 14 (2) (a) of the Act should follow, and credit should be given on production of the prescribed certificate for the difference between the gross dividend as ascertained for assessment purposes and the net dividend received.

Although the foregoing deals primarily with dividends received by a resident from a resident Company, the same principles should be applied to dividends received by a resident from a non-resident Company that has paid British India tax on a portion of its profits, so that, whilst the whole dividend is assessable, credit should be given for tax only on that proportion of the dividend corresponding to the proportion of the paying Company's income that has borne British India tax.

SECTION 3.—SALARIES.

The provision, when the rates of income-tax are altered, that for salaries, as for interest on securities, the rates of the previous year (by reference to which tax was deducted) shall remain effective, avoids large numbers of adjustments by refund or assessment, as the case may be; and, in view of the great amount of work that would be involved in such adjustments, we consider that this provision should stand.

We have considered two alternative methods of deducting tax from salaries, if the "slab" system of rates of tax be adopted, *viz.*,—

(a) to deduct from each month's salary, one-twelfth of the estimated tax applicable to a year's salary,

(b) to treat the successive payments of salary as corresponding to the successive "slabs" of income to which different rates of tax are applied. Thus with a salary of Rs. 1,500 a month, by reference to the specimen scale in Appendix 2, the first month's salary corresponds to the tax-free slab and no tax is deductible; the second month's salary is treated as part of the second slab and tax is deductible at 3/4 annas per rupee; the third month's salary is treated as part of the second slab and tax deducted at 3/4 annas per rupee; the fourth as to Rs. 500 as part of the second slab taxable at 3/4 annas per rupee and as to Rs. 1,000 as part of the third slab taxable at 1¼ annas per rupee, and the fifth is treated as part of the third slab taxable at 1¼ annas per rupee and so on.

The objection to method (a) is that a change in the rate of remuneration, or cessation of employment, would in many cases necessitate adjustment of the earlier deductions. The objection to method (b) is that the deductions month by month are on a rising scale. Example shows however, that in no case does the deduction become an unreasonable proportion of any month's salary, and it may be observed that the tax burden is still spread over the year, while the ordinary assessee has to find his tax in one sum. We recommend that super-tax also should be deducted by the employer, with the effect in many cases of spreading a burden which is now payable in one sum. The positive advantage of method (b) is that whatever the remuneration may be, the tax deducted is automatically

[1] This proceeds on the assumption that our recommendation that the foreign income of resident Companies should be assessed on the full income arising, is adopted.

neither more nor less than the real liability, any other income being assessed as a higher slab of income. Incidentally, a considerable number or refund claims would be obviated. Our recommendation is, therefore, that tax should be deductible as set out under (b).

Section 4.—Other Payments.

There are certain payments made to non-residents, which, in the absence of any provision for deduction of tax, escape taxation although admittedly they are income arising in British India. Examples are copyright royalties, patent royalties, and rents including ground rents. We recommend that provision be made for deduction of tax as in section 1 (b) of this Chapter.

CHAPTER XI.—DOUBLE TAXATION RELIEF.

SECTION 1.—UNITED KINGDOM.

(*a*) *Payment of tax.*—Doubts have been expressed as to the force of the word 'paid' in the first line of section 49 (1) of the Act, that is to say whether a person receiving dividends from a company which has paid Indian Income-Tax should be regarded as having himself paid Indian Income-Tax. It seems clear that the intention of the Legislature is to give relief to all persons who have suffered double taxation whether directly or indirectly, and it is, therefore, suggested that after the word 'paid' wherever it occurs in section 49 (1), there should be inserted the words 'by deduction or otherwise' and that there be added to sub-section (2) a clause, such as:—

"(e) A shareholder in receipt of a dividend from a company which has paid Indian income-tax or United Kingdom income-tax, as the case may be, shall be deemed himself to have paid Indian income-tax (but not Indian Company super-tax) or United Kingdom Income Tax respectively in respect of such dividend."

(*b*) "*Corresponding year*".—As a result of the decision in the case of Assam Railways and Trading Co., Ltd. V. Commissioners of Inland Revenue, it has been found necessary in the United Kingdom to treat the Dominion Tax year corresponding to a year of assessment in the United Kingdom for the purpose of Double Taxation Relief, as the year for which an assessment is made by reference to the same basic period of accounts as that of the United Kingdom assessment on which relief is claimed. It becomes necessary to bring the basis of computation of Indian relief into line with the new practice in the United Kingdom. The system should also be amended so as to remedy the hardship which at present exists where the bases of computation in the United Kingdom and in India differ. The following example illustrates the points involved:—

AB Ltd., commences business in year 1 in such circumstances that the whole profits are assessable both in the United Kingdom and British India, and ceases business during year 6. The profits and the assessments in the two countries are as follows:—

Year.	Profits.	United Kingdom[1] Assessment.	British Indian Assessment.
	£	£	£
1	1,000	1,000	*Nil.*
2	800	800	1,000
3	500	500	800
4	1,000	500	500
5	2,000	2,000	1,000
6	1,200	1,200	2,000
7	..	*Nil.*	1,200

[1] NOTE.—Owing to special provisions in the United Kingdom Income-Tax Acts regarding the commencement and cessation of business it will be seen that in this case in the United Kingdom all years except year, 4, are assessed on the basis of the actual profits of the year instead of those of the previous year.

The United Kingdom under the new practice above mentioned will give relief as follows:—

Year 1	by reference to Indian assessment of year . . .	2
,, 2	Ditto . . .	3
,, 3	Ditto . . .	4
,, 4	Ditto . . .	4
,, 5	Ditto . . .	6
,, 6	Ditto . . .	7

Under the existing interpretation, no double taxation relief can be given in India for year 1 or year 7 because in neither of those years is tax paid in both countries, and we recommend (i) that the words 'for that year' in line 5 (as printed in the Manual) of section 49 (1) of the Act be amended to 'for the corresponding year'; (ii) that the definition of "corresponding year" prescribed by the Central Board of Revenue under section 59 (2) (d) should be:—

"The United Kingdom year of assessment corresponding to a British Indian tax year is the year for which an assessment is made by reference to the same basic period of accounts as that of the Indian assessment on which relief is claimed."

It will be noticed in our example that there is no United Kingdom assessment corresponding in amount or basis year with the Indian assessment for year 5. Further, other cases must arise in which there are United Kingdom assessments for two years, based upon the income of one year. To meet these difficulties, we propose the addition to the definition of "corresponding year", of words such as:

"Where there is no such year, or where there are more such years than one, the corresponding year shall be the United Kingdom year of assessment preceding the Indian year of assessment."

(*c*) "*Part of Income*".—The meaning of these words in the United Kingdom Income-Tax Acts has been recently the subject of interpretation in the Courts, with the result that the older practice of regarding them as meaning a separate source of income has been superseded. It has been held that where a part of income, such as 60 per cent., of the profits of tea gardens, or such as the part of the profits, if any, that is paid away as debenture interest, is included in the United Kingdom assessment but not in the Indian assessment, the United Kingdom double taxation relief is not allowable thereon. Consequently the current practice in the United Kingdom now is to deduct from the United Kingdom assessment—

(*a*) income from any source included in the United Kingdom assessment which is not included in the Dominion assessment;

(*b*) any interest or other annual payment which has been allowed as a deduction in arriving at the Dominion assessment and has not been allowed as a deduction in arriving at the United Kingdom assessment; and

(*c*) any expenditure or other deduction allowed from, or in arriving at, the Dominion assessment which is not, or does not correspond to, a deduction allowable in computing liability to United Kingdom tax.

Relief is then allowed on this reduced figure or the amount of the Dominion assessment, whichever is the lower.

To bring the two systems into harmony we consider that the amount upon which relief should be granted in India should be ascertained by deducting from the amount of the Indian assessment on any source of income which is taxed both in India and in the United Kingdom, any expenditure or other deduction allowed from or in arriving at, the United Kingdom assessment, which is not, or does not correspond to, a deduction allowable in computing liability to Indian tax, and to allow relief either on the Indian assessment as so reduced, or on the amount on which relief has been given in the United Kingdom, whichever is the less.

It should be stressed in the instructions to Income Tax Officers that, as in the United Kingdom, (i) allowances in the one country which correspond to different allowances in the other, *e.g.*, renewals or depreciation of the same assets, should not be eliminated from the amount upon which double taxation relief is calculated, and (ii) no adjustment should be made in respect of relatively unimportant items.

Our attention has been directed to the position in the case where one country assesses a source of income on an earnings basis and the other on the remittance basis. This may involve hardship as shown by the following example:—

	Assessment in India on earnings basis.	United Kingdom assessment on remittance basis.
	Rs.	Rs.
Year 1	10,000	5,000
Year 2	10,000	15,000

Here the assessments in the United Kingdom are exactly equal in total (Rs. 20,000) to those in India, but double taxation relief would only be granted in both countries on Rs. 5,000 for year 1 and on Rs. 10,000 for year 2. A possible remedy would be the addition to section 49 of the Act of a proviso to the following effect:—

"Where $\frac{\text{United Kingdom}}{\text{Indian}}$ Income-Tax is payable for any year in respect of remittances out of profits which have been earned in $\frac{\text{India}}{\text{the United Kingdom}}$ and on which $\frac{\text{Indian}}{\text{United Kingdom}}$ Income-Tax has actually been paid at any time in the past but the $\frac{\text{Indian}}{\text{United Kingdom}}$ assessment for the corresponding year is either nil or less than the amount of the assessment in $\frac{\text{the United Kingdom}}{\text{India}}$, the assessment in $\frac{\text{India}}{\text{United Kingdom}}$ shall be deemed to have been increased by the amount of the deficiency and tax shall be deemed to have been paid at the appropriate rate thereon for the purpose of the relief to be given under this Section".

This proposal would secure the desired object but it depends upon agreement with the United Kingdom since it is clear that the relief should be reciprocal.

(*d*) *Maximum rate of relief.*—Owing to differences of opinion in the two countries as to the extent to which an individual has suffered tax in either country, it is possible for relief to be claimed in India at a rate in excess of one half of the Indian rate of tax. We recommend, therefore, the restoration of the provision that the rate of relief in India should not exceed one half of the Indian rate of tax.

(e) *Double taxation relief (Section 49) in relation to small incomes relief (Section 48).*—It may be seen by reference to paragraph (a) of this Section and to Section 2 of Chapter X that we propose that the recipient of a dividend from an Indian company shall be treated (i) as having received relief at the rate (See Section 5 of this Chapter) allowed to the company. Double taxation relief is intended to be restricted to one half of the Indian rate of tax appropriate to the assessee, and it is therefore necessary to amend the definition in section 49 on the following lines:

"The expression 'Indian rate of tax' means the amount of Indian income-tax (after allowance of any relief due to the claimant under sections 48 and 48-A, but before deduction of any relief due to him under this section) divided by the amount of income in respect of which such tax has been paid, added to the amount of Indian super-tax (before deduction of any relief due to the claimant under this section) divided by the total income[1]."

Since the rate of double taxation relief obtained by a company may exceed the rate appropriate to a shareholder after he has obtained small income relief, provision should be made (on the lines of Section 27, subsection 3 of the United Kingdom Finance Act, 1920) as follows:

"Where by reason of allowance of relief under this section to a company, the rate at which a dividend is 'grossed up' under section 16 (2) of the Act is less than the company rate of tax, and the rate of tax at which such relief was allowed to the company is greater than that appropriate to the case of the recipient of the dividend, such adjustment shall be made as may be necessary to secure that the rate of relief under section 49 ultimately allowed to him shall be equal to that appropriate to his case".

For the sake of clarity we append a few examples:

1. A resident in British India has an income from dividends of Rs. 800 (as grossed up[2] at 2½ as. less 1¼ as. double taxation relief) and other assessable income of Rs. 1,700. The refund due is calculated as follows:—

Tax liability.

		Rs.	a.	p.
Rs. 1,500	@ nil[3] . . . . . =	*Nil.*		
Rs. 1,000	@ ¾ as. . . . . =	46	14	0
Rs. 2,500 (effective rate — 3/10ths anna) . . . =		46	14	0
Less double taxation relief Rs. 800 @ half effective rate (3/20th anna) . . . . . =		7	8	0
Tax chargeable . . . . . =		39	6	0
Tax suffered . . . . . =		62	8	0
(Rs. 800 @ 2½ as. less 1 ¼as. double taxation relief)				
Refund due—		23	2	0

2. A non-resident being a British subject has Indian dividends amounting to Rs. 1,000 (as grossed[2] up at 2½ annas less 1 anna double taxation relief). He has other income not liable to Indian tax of Rs. 5,000.

[1] In the case of a British non-resident 'total income' should be taken to mean that proportionate part of his world income which is liable to Indian taxation.

[2] See Chapter X, Section 2.

[3] Rates on the specimen "slab" scale in Appendix 2 have been taken.

The refund due to him is calculated as follows:

	Rs.	a.	p.
Total world income . . . . . =	6,000	0	0
On which tax would be [1] say Rs. 1,500 @ nil . . . . . =	*Nil.*		
Rs. 3,500 @ $\frac{3}{4}$ anna . . . . . =	164	1	0
Rs. 1,000 @ $1\frac{1}{4}$ anna . . . . . =	78	2	0
Rs. 6,000	242	3	0

(Effective rate $= \frac{243}{6,000} = 7\frac{3}{4}$ pies).

Liability on Indian income irrespective of double taxation relief $= \frac{1,000}{6,000} \times$ 242-3-0 . . =	40	6	0
Double taxation relief @ $7\frac{3}{4}$ pies ÷ 2 on Rs. 1,000 . =	20	3	0
Ultimate liability. . . . . =	20	3	0
Tax suffered on dividends = 1,000 × $1\frac{1}{2}$ as. . . . =	93	12	0
Refund due — .	73	9	0

Section 2.—Ceylon.

Since the basis of assessment in Ceylon is broadly that in operation in the United Kingdom, the considerations and suggestions set out in Section 1 of this Chapter apply equally to Ceylon. We suggest, therefore, that the agreement with Ceylon should be amended accordingly, provided that Ceylon now agrees. We are aware that Ceylon declined two years ago to agree to a modification of the agreement but in view of our recommendations, the objections then raised may now disappear.

As regards "part of income" for example, modification seems to be particularly necessary in view of the fact that the present system operates in some cases to grant excessive relief. The case may be mentioned of income arising in Ceylon and assessed there, on the full Rs. 1,00,000 arising, at the rate of 10 per cent., while the British Indian assessment on remittances is, say, Rs. 10,000 at the rate of 19·79 per cent. On the principles generally adopted, the relief to be granted in British India in this case would be a sum not exceeding one half of the lower of the two rates (*i.e.*, 10 per cent ÷ 2) on Rs. 10,000 which equals Rs. 500, whereas under the present agreement the relief granted would be one half of the lower amount of tax, *i.e.*, Rs. 1,979 ÷ 2 equals Rs. 990.

Similar results arise in the case of a tea plantation assessed in British India on 40 per cent., only of its profits and in Ceylon upon the whole profits. We understand that the comparison of amounts of tax instead of a comparison of rates of tax was adopted in order to avoid the anomalies that arose in the case of British India/United Kingdom reliefs owing to the practice hitherto of ignoring differences in methods of computing profits, and differing bases of assessment, but in view of our proposals in Section 1 such anomalies should disappear.

[1] Rates in the specimen "slab" scale in Appendix 2 have been taken.

Section 3.—Burma (after separation).

The general principles upon which reciprocal relief is to be granted by British India and Burma after separation are the subject of negotiations,[1] and we have no general comments to offer thereon, but in its detailed administration, 'payment of tax', 'corresponding year', etc., should, we think, be interpreted as set out in Section 1 of this Chapter.

The agreement, however, must presumably cover cases where income is taxed in British India, Burma and the United Kingdom, and in such cases, the general restrictions proposed to be inserted in section 49 of the Act that the rate of relief shall not exceed one half of the Indian rate is not appropriate. We suggest, therefore, as regards the shareholder in receipt of a dividend from a company which has received relief from each of the three countries, that it should be provided that the rate of double taxation relief allowable in British India in respect of such dividend income be restricted to that proportion of his effective rate of tax that the rate of relief allowed to the company bears to the company rate of tax.

Section 4.—Indian States.

We have received a number of complaints as to the arbitrary methods of assessment adopted in some of the Indian States, and of delay in dealing with double taxation relief claims in those States. It is obviously not for us to offer any comment upon the way in which any State administers the provisions of its own Income-tax Act, but it does appear to be within the scope of our enquiry to consider whether such action has any adverse effects on British Indian revenues by reason of the double taxation provisions.

It has been brought to our notice that owing to the wide interpretation placed upon the charging sections of their Income-tax Act by certain States, a much greater proportion of the profits of certain British Indian assessees is assessed to State Income-tax than would be the case if those Acts were interpreted as similar provisions of the Indian Income-tax Act of 1922 are interpreted. This may involve the granting of relief in British India in respect of State taxation on profits which in the British Indian view are not assessable in the States. This would seem to be a matter susceptible of remedy by arrangement with the States,[2] so that British India relief is restricted to that part of the profits assessed both in a State and in British India as appears to the Income-tax Officer to arise from *operations* in the State.

Section 5.—Company Super-tax in relation to Double Taxation Relief.

On the assumption that relief to companies will still be given by reference to company super-tax as well as income-tax, and that company super-tax will still be regarded as not affecting the relief due to the shareholders in receipt of dividends, it becomes necessary to determine, in

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[1] We are informed that these negotiations have been completed and that an Order-in-Council was issued dated 26th September 1936.

[2] To permit discussion of the respective computations we suggest that sub-section 2 (*d*) of Section 54 of the Act be amended so as to allow the communication of particulars relevant to double taxation relief claims to authorised officers of any part of the British Empire granting reciprocal relief.

view of our recommendations in Chapter X, Section 2, what proportion of the company's relief is to be attributed to income-tax as distinct from company super-tax. We propose that as a practical measure, the total rate of relief allowed to a company shall be divided between income-tax and company super-tax in the proportions that the rates of those taxes paid by the company bear one to the other before any such relief is granted. The effect of this suggestion is shown in the following examples:—

(i) A Company pays tax—

in the United Kingdom at 4 annas in the rupee.

in British India—

Income-Tax at $2\frac{2}{5}$ annas in the rupee.

and Super-Tax at $\frac{4}{5}$ anna in the rupee.

It obtains Double Taxation Relief—

in the United Kingdom at 2 annas in the rupee,

in British India at $1\frac{1}{5}$ annas in the rupee $(2\frac{2}{5}+\frac{4}{5}-2)$.

The British India relief is divided thus:—

Income-tax $\frac{2\frac{2}{5}}{3\frac{1}{5}} \times 1\frac{1}{5} = \frac{9}{10}$ anna in the rupee.

Super-tax $\frac{\frac{4}{5}}{3\frac{1}{5}} \times 1\frac{1}{5} = \frac{3}{10}$ anna in the rupee.

A shareholder whose effective rate is $1\frac{3}{5}$ annas in the rupee receives a dividend which is to be grossed up at the rate of $2\frac{2}{5}$ less $\frac{9}{10}$ annas $= 1\frac{1}{2}$ annas in the rupee. He has received through the Company excessive relief under Section 49 at the rate of $[\frac{9}{10} - (\frac{1}{2} \times 1\frac{3}{5})]$ annas $= \frac{1}{10}$ anna in the rupee which should be set against any relief due to him under section 48.

(ii) A Company pays—

	India pies in rupee.	Burma pies in rupee.
Company Super-Tax	10	12
Income-Tax	32	23
	42	35

Total rate of refund to company in India and Burma together (being the lesser of the two totals) is 35 pies in the rupee.

British India proportion:—

$$\frac{42}{77} \times 35 = 19\frac{1}{11} \text{ pies.}$$

Burma proportion $15\frac{10}{11}$ pies.

Total 35 pies.

Income-tax proportion of British India relief is:—

$$\frac{32}{42} \times 19\frac{1}{11} \text{ pies} = 14\frac{6}{11} \text{ pies.}$$

A shareholder whose effective rate is 24 pies receives a dividend from the company which is to be grossed up by reference to the Income-tax rate of 32 pies less Double Taxation Relief $14\frac{6}{11}$ pies. He has received through the Company excess relief under section 49 at the rate of $14\frac{6}{11} - (\frac{1}{2} \text{ of } 24) = 2\frac{6}{11}$ pies in the rupee which should be set against any relief due to him under section 48.

(iii) A Company pays tax:—

	United Kingdom pies in rupee.	India pies in rupee.	Burma. pies in rupee.
Company Super-Tax . . .	*Nil*	10	12
Income-Tax	48	32	23
Totals .	48	42	35

It obtains double taxation relief in the United Kingdom at 24 pies in the rupee and jointly from India and Burma at $42 + 35 - 24 = 53$ pies in rupee. This is divisible between India and Burma in the proportion of 42:35, *i.e.*,

India $\frac{6}{11}$ths of 53 pies = $\frac{318}{11}$ pies in rupee.

Burma $\frac{5}{11}$ths of 53 pies = $\frac{265}{11}$,, ,, ,,

Of the Indian $\frac{318}{11}$ pies relief the Income-tax proportion is $\frac{32}{42}$, *i.e.*, $\frac{32}{42} \times \frac{318}{11} = 22\frac{2}{77}$ pies in rupee.

A shareholder whose effective rate is 24 pies receives a dividend from the Company which is to be grossed up by reference to the Income-tax rate of $32 - 22\frac{2}{77} = 9\frac{75}{77}$ pies. He has received through the Company excess relief under section 49 of $22\frac{2}{77} - 16\frac{40}{77}$[1] $= 5\frac{39}{77}$ pies in the rupee which should be set against any relief due to him under section 48.

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[1] (See Section 3 of this Chapter. The rate of double taxation relief to which he is personally entitled is $\frac{\text{Personal effective rate of tax}}{\text{Company rate of income tax}} \times$ Company rate of relief $= \frac{24}{32} \times 22\frac{2}{77} = 16\frac{40}{77}$).

CHAPTER XII.—LEGAL AVOIDANCE.

Section 1.—General.

In this Chapter, we do not deal with fraudulent evasion but with cases in which the tax payable is minimised or avoided by methods which are within the law. The principal classes of such cases are—

(a) deferment of drawing of remuneration resulting in a reduction in the rate of tax payable,

(b) the drawing of remuneration in the guise of allowance for expenses,

(c) the introduction into a registered firm of a partner for a short period only, so that an undue proportion of the firm's assessable profits is treated as his; or the giving of a share in partnership profits to a wife or minor child,

(d) the formation by an assessee of a number of unregistered firms,

(e) the taking of overdrafts in British India against unremitted income abroad,

(f) a manufacturing concern controlled in British India, having its factory in an Indian State, making all sales therefrom so that only remittances to British India are assessable,

(g) the taking of usufructuary mortgages in respect of money-lending transactions,

(h) interest on debentures which is due to a resident from another resident being made payable abroad,

(j) charging Indian profits with interest payable to a non-resident allied concern.

(k) Settlements and Dispositions,

(l) non-distribution as income of a Company's profits, and

(m) transfer of assets abroad.

Classes (a) to (j) have already been dealt with in the undermentioned chapters of this Report:—

(a)	in Chapter	V,	Section	1 (a).
(b)	,,	V,	,,	1 (c).
(c)	,,	III,	Sections	1 and 2.
(d)	,,	III,	Section	2.
(e)	,,	I,	,,	1.
(f)	,,	I,	,,	1.
(g)	,,	I,	,,	4 (d).
(h) and (j)	,,	I,	,,	7.
		VIII,	,,	2.
		X,	,,	1.

Section 2.—Settlements and Dispositions.[1]

We find that owing to the terms of the relevant sections of Chapter III of the Act and of the refund sections, the assessee who has charged his income under any head other than property cannot claim a deduction for the amount of the annual charge, unless, broadly, such charge is incurred for the purpose of earning the income. In Chapters V and VIII of our Report, we recommend restrictions which will bring income from property into line in this respect with other classes of income.

[1] Transfer of income or assets to a minor child by his father is considered in Chapter III, Section 1.

There is, however, the further possibility of an assessee transferring by deed the income from specified assets to a beneficiary in such circumstances that he could claim the income to be no longer his but to be that of the beneficiary. Similarly there is the possibility of an assessee transferring by deed actual assets (property, stocks, shares, etc.,) so that, for the time being at least, the income therefrom must be regarded under the present law as the income of the transferee.

The remedy suggested is the addition to the Act of a section to the effect that (i) all income arising to a person by virtue of a settlement or disposition of income, whether revocable or not, and whether effected before or after the coming into operation of the amending legislation, from assets remaining the property of the settlor or disponor shall be deemed to be the income for all income-tax purposes of the settlor or disponor; (ii) all income arising to a person by virtue of a revocable transfer of assets shall be deemed to be the income of the transferor for all income-tax purposes. No action is considered necessary in the case of irrevocable transfers of assets except in the circumstances dealt with in section 1(b) of Chapter III of this Report.

Although these suggestions would no doubt, if adopted, be modified and expanded in the process of drafting, we consider that broad simple clauses are best suited to the conditions of British India, and that the refinements embodied in the United Kingdom legislation[1] on the subject should be avoided here.

SECTION 3.—NON-DISTRIBUTION AS INCOME OF A COMPANY'S PROFITS.

(*a*) *Distribution in the form of bonus shares, etc.*—We think that this type of case should be countered by the enactment of a wide and simple clause, without conditions and exceptions that would still leave loopholes for avoidance. We have considered the clause in the Dividend Duties Act, 1902, of Western Australia which defines a dividend as follows:—"*a* 'dividend' shall include every dividend, profit, advantage or gain, intended to be paid, credited to, or distributed.....". This wording was held by the Privy Council to cover an issue of bonus shares and we suggest that the same definition be applied to dividends in the Indian Income-tax Act. It is, however, a matter for consideration as to whether its application should be limited to companies whose control is in the hands of not more than five persons as defined in Section 23A of the Act. We find that legal avoidance is not confined to such companies and we do not therefore recommend any such limitation.[2]

(*b*) *Non-distribution.*—We are informed that in practice section 23A(2) of the Act, which is designed to deal with non-distribution of profits by companies under the control of not more than five of its members, is virtually a dead letter, only one order having been passed under that sub-section from its insertion in 1930 up to the end of the year 1935-36. The major difficulty in the way of the application of the sub-section may lie in the fact that before an Income-tax Officer can pass an order thereunder, he must be satisfied that a company's "profits and gains are

[1] Section 20, Finance Act, 1922, and Section 21, Finance Act, 1936.

[2] See the recent case of Mohanlal Chotalal Shah, *V. C. I. T., Bombay.*

allowed to accumulate beyond its reasonable needs, existing and contingent, having regard to the maintenance and development of its business", and that "such accumulation or failure to distribute is for the purpose of preventing the imposition of tax upon any of the members in respect of their shares in the profits and gains so accumulated". This task, involving as it does not only an assessing of motives, but also an estimation of the future possibilities of an individual business, may well deter an Income-tax Officer. The section could, we think, be made more effective if the criteria for the application of the section are made more specific.

In considering this question it may be borne in mind that in the case of a business carried on by an individual or a registered firm, the whole of the profits irrespective of the requirements of the business, or of the extent to which profits are drawn from the business, are liable to super-tax at the graduated rates for individuals in the hands of the individual proprietors. On the other hand, a company pays company super-tax[1] at a flat rate in addition to the super-tax paid by its shareholders on the dividends received by them. Having regard to these considerations, we are of opinion, notwithstanding the practice in the United Kingdom, that questions of motive and of possible future requirements of the business for expansion, etc., should not be taken into account but that the fairest test is the ratio of the amount distributed to the total income of the company. This ratio must obviously be less than 100 per cent., and we suggest that the section should apply only to cases where the profits distributed (grossed up to include Income-tax) are less than 60 per cent., of the assessable income of the company, provided that where the reserves representing past profits which have not been the subject of an order under section 23A(2) exceeds the paid up capital, the section shall apply if the profits distributed are less than the whole of the assessable income of the company.

There are other respects in which the section is susceptible of improvement:—

(i) Since a company can be controlled by persons who are not members but who hold shares through nominees, the word 'members' in the third line of sub-section (2) should, we suggest, be altered to 'persons'.

(ii) Under the section as it stands at present, the only possible order provides that no tax *including Company Super-tax* shall be payable by the Company, with the possible result that the tax payable by the members may be less than that which would have been payable by the Company if the section had not been invoked.[2] In any case, the section does not necessarily encourage distribution of profits because distribution involves for that part of the profits individual super-tax as well as company super-tax whereas the application of the section at present cancels the liability to company super-tax. We recommend that orders under the sub-section should merely deem a member's proportionate share of the income of the company to be dividends and therefore part of his total income, leaving the company assessable in the ordinary way both to Income-tax and Company Super-tax.

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[1] If our recommendation in Section 2 be accepted, super-tax would be payable by a company on the whole of its profits and not only on the excess over Rs. 50,000.

[2] It may be pointed out that the application of the Section thus involving the non-assessment of Company Super-Tax adversely affects a purely Federal source of Revenue.

(iii) In the United Kingdom, since the law requires determination of questions of motive and of future needs of a business, provision is made for all cases to be dealt with by the Special Commissioners, and for appeals against their orders to be heard by a Board of Referees. As, however, we have recommended the adoption of a simple quantitative test only, we consider that the assessment and appeal provisions relating to other assessments should apply to orders under Section 23A and that the present provision for appeals to Boards of Referees under Section 23A should be repealed.

(iv) The section is silent as to the time within which distribution of profits would operate to prevent application of the section. We suggest that this condition should be made specific, the section applying where a sufficient distribution has not been made within, say, six months of the date on which the accounts for the year in question have been presented to the shareholders in general meeting.

(v) Income of a Company which has under section 23A(2) been deemed to be part of the income of a shareholder which is itself a company should be deemed to be part of the income of the latter company for the purpose of comparison with the dividends paid by that company.

(*c*) *Distribution by companies in liquidation.*—It is possible for individuals to arrange that their incomes shall be received by them in the form of a distribution by a liquidator of a company which holds shares in another company which receives the primary income and escapes the provisions of Section 23A by declaring adequate dividends. This case, we think, can be met by legislation on the lines of sub-section (6), Section 20 of the United Kingdom Finance Act, 1936.

There is the further case of a company with large accumulations of undistributed profits which goes into liquidation with the result that all distributions thereafter must be treated as capital. This course of action is sometimes used as a device for the avoidance of tax and we recommend that in the case of a company, other than a company to which the proviso to section 23A(2) of the Act applies, all distributions in a liquidation to the shareholders out of accumulated profits should be deemed to be "dividends" within the meaning of that word in section 14(2)(a).

Section 4.—Transfer of assets abroad.

The outstanding instance in British India of this type of case is one recently the subject of a Privy Council decision. Briefly, the result of a series of operations in that case is the creation of a liability on the part of a British India Company to pay a large sum of interest to a Company resident in China. So far as Income Tax is concerned, the position should be met by our suggestions in Chapters VIII and X that tax on such interest be paid at source, but, given accumulation of its income by the foreign company and no declaration of dividends, super-tax is avoided, section 23A having no application to a non-resident company. The only means of dealing with such a case would be, in our opinion, legislation on the lines of Section 18 of the United Kingdom Finance Act, 1936, which moreover is designed to cover a wide variety of other schemes for avoidance of tax.

PART II.

Administration.

CHAPTER XIII.—INTRODUCTION—THE EXISTING SYSTEM.

Under the Act of 1922 the responsibility for setting the law in motion and for securing the assessment of persons liable to tax is laid upon the Income Tax Officer. It is his duty to ascertain what persons are assessable, to serve them with notices to make returns, to compute their income from the evidence available, to make the assessments and to see that the tax is paid. From his assessment orders, appeals lie to the Assistant Commissioner who is his superior officer and exercises some measure of control over his activities. Commissioners of Income Tax are appointed by the Governor General in Council and within areas assigned to them, they are responsible for the appointment of Income-Tax Officers and Assistant Commissioners, for the allocation to such officers of areas of jurisdiction, and for the general administration of the Act. The Central Board of Revenue is in practice the authority which is responsible generally for the administration of the Act throughout British India.

CHAPTER XIV.—ASSESSMENTS.

Section 1.—Inspectors and Survey Work.

Representations were made to us criticising the manner in which outdoor survey work is conducted. We found that there was insufficient instruction and control of these officers in some areas, with the result that their reports often contained no concrete evidence but gave estimates of income which, judged by subsequent assessment proceedings, were little better than wild guesses.

Further we find that quite elaborate systems exist for the purpose of the collection of information bearing upon possible liabilities to tax, but that the extent to which such information is utilised varies considerably between one Circle and another. Moreover there is in some areas a failure to organise this work with a reasonable sense of proportion. For example, in one area we saw a register into which had been extracted thousands of entries of particulars of decrees in Small Causes Courts. Not only were many of these for such small sums as to have little if any bearing upon liability to tax, but the work of correlating the particulars that were relevant to the position of a person liable to tax was so badly in arrear that they were rapidly becoming out of date and the work was in consequence largely wasted. In another area, a clerk was engaged full time in extracting particulars from Telephone Accounts which could have no real evidential value.

On the other hand, it seems clear that the work of Inspectors is often ineffective because they have no statutory powers. The powers of the Income-Tax Officer are certainly stultified at times by the production of false books of accounts, or by the allegation that no books are kept or that those kept have been destroyed; and we have been informed by responsible members of the public that in some areas, the practice of maintaining two sets of books is very common. At present the Department is in a very weak position in such cases and a remedy is necessary, although it is equally necessary to ensure that any powers granted to Inspectors are not abused.

The criticism as to the general quality of the work of Inspectors should, we think, be met by adequate instruction and closer control and supervision by the Income Tax Officers, but we recommend that the Act be amended to give Income Tax Officers and Inspectors powers—

(*a*) to make enquiries, in the case of an Inspector on the instructions of the Income-Tax Officer, as to persons liable to assessment and

(*b*) on the written instructions of the Commissioner, to enter the premises of an assessee, between reasonable hours, to search for and seize his books of account for examination by the Income-Tax Officer.

Section 2.—Liability to make Returns of Income.

An anomalous feature of the existing law is that, save as regards Companies, there is no obligation on an assessee to make a return unless served with a notice to do so by the Income Tax Officer. Unless the Income Tax Officer broadcasts notices to all and sundry with little regard to probabilities, it is practically certain that a number of liable persons will escape taxation; and since the onus of notifying the fact of liability is not placed on them, there is no penalty for their failure to make returns.

At present, elaborate efforts are made by the Department to gather information on the basis of which notices to make returns are served on persons apparently liable to tax, but even when liability is established, there are no powers of assessment beyond the current and one preceding year.

We feel strongly that so long as there is a possibility of any considerable number of persons evading payment of tax with impunity, a grave injustice is suffered by those upon whom the burden of taxation does fall. The present system puts a premium on successful evasion.

It is considered that as in the United Kingdom, every person who has an income liable to tax, should be required by law to make a return, subject to a penalty for failure (see Section 7 of this Chapter), whether or not an individual notice to make such a return has been served on him by the Income-Tax Officer. Public notice of the requirements of the Act should be given by announcement in the press, and by other suitable means where necessary. This provision for penalties for failure to notify liability, taken in conjunction with our recommendation for an extension of the period for assessments under Section 34, should go far to remedy the present unsatisfactory state of affairs. In the case of a person proved not to be liable to tax, a penalty should be exigible only if he has failed to comply with a specific notice requiring him to put in a return.

Section 3.—Place of assessment.

Difficulties arise by reason of the fact that Section 64 of the Act is silent as to the point of time at which questions of jurisdiction may be raised by an assessee and as to the person who has the right or duty of referring the matter to the Commissioner for a decision.

For example, a case has occurred of an assessee who was assessed in two different provinces, who took no steps to obtain a decision on the point of jurisdiction until action under section 34 was timebarred, and then claimed successfully that jurisdiction existed in the Circle where he was under-assessed.

It is true that if our recommendations regarding the extension of the time limit within which assessment proceedings may be instituted are accepted, this point should lose some of its importance, but in any case the position needs to be clarified.

In view of our recommendation that the rendering of a return should be the statutory duty of every person liable to assessment without individual notice from the Income-Tax Officer, we recommend that the Act be amended so that: (*a*) the prescribed return form requires the particulars set out in section 38(3) of the Act, (*b*) where the Income-Tax Officer is not satisfied with the correctness of the claim, he should refer the matter to the Commissioner for his determination before making an assessment, and (*c*) where an assessee has not claimed assessment in a particular circle prior to the making of any assessment on him, he shall be debarred from making subsequently any such claim in respect of the year in question.

The question has been raised as to where jurisdiction resides in the case of liability assessable under section 34 when the place of business or residence has changed since the year to which such liability relates. As a practical proposition there is no doubt that additional assessment proceedings in such a case could best be taken by the Income-Tax Officer

for the area of business or residence at the time when such proceedings are commenced, and this is not out of harmony with the provisions of section 64 of the Act.

Section 4.—Convenience of the tax-paying public.

The fairly general complaint that the Income-Tax Officers do not show enough consideration for the convenience of the assessee is certainly not without foundation. For instance, notices are issued for the attendance of a number of assessees on the same day and at the same time, and we have seen a group of them waiting with indifferent accommodation when the office opened to the public, and many of them still waiting when the office closed for the day. We have also seen cases in which, apparently without reasonable cause, assessees were given only 24 hours' notice to attend at the Income-Tax Office to produce evidence, and others in which books were called for and retained for some days pending their examination. Thus our own observations confirm to some extent the complaints made in a number of representations. On the other hand, we found in many cases that assessees themselves were unpunctual and negligent. Nevertheless, we think that appointments should be made as far as possible at reasonable intervals and with due regard to the convenience of the assessee. Such a course would put the officer concerned in a stronger position to deal with the negligent assessee, while leaving no ground for this type of complaint. When selecting buildings for Income Tax Offices, care should be taken to provide as far as possible convenient waiting rooms for assessees. Short period notices should not be given except for adequate reasons and an assessee's books of account should not be detained for long periods except in special circumstances such as in cases of suspected fraud.

Section 5.—Determination of income.

(*a*) *Examination of audited accounts.*—The complaint was made that in several circles, in cases in which audited accounts* are submitted by assessees, the Income-Tax Officer indiscriminately requires production of the books of account, and that these are subjected to a prolonged examination which often reveals little evidence bearing upon the income-tax liabilities. We ourselves found cases where the examination of books was directed to comparatively unimportant matters of detail to the exclusion of the intelligent consideration of the broad facts of the case and the neglect of indications given by the Balance Sheet and Profit and Loss Accounts of important matters needing enquiry.

In some Circles, the practice of examining the audited Balance Sheets and Profit and Loss Accounts, and basing written enquiries upon such examination is in operation and the books themselves are only called for in exceptional cases. The work in these Circles is generally well done, and we think that the practice should be extended. This suggestion, however, brings the criticism that there is with some officers a lack of sufficient accountancy knowledge to enable them to deal with accounts broadly and intelligently and the question is how to remedy this state of affairs.

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* A flaw in Rule 18 is the omission of a reference to Balance Sheets and we suggest the amendment of the Rule so that Balance Sheets as well as Profit and Loss Accounts are called for.

In Chapter XVII of this Report, we recommend that in considering candidates for the Inspector-Examiner grade accountancy qualifications should be given consideration equally with academic distinctions, that more attention should be given to the training of these officers during their probationary period and that in the Departmental examination more weight should be given to accountancy in its relation to the computation of Income-Tax liabilities. These probationary officers would, too, benefit considerably if they were given a short course of practical training in those centres where audited accounts are numerous and there is consequently some degree of specialisation in the work of examining them.

(*b*) *Examination of Books in cases where accounts are not audited.*—In the preceding sub-section, we have considered cases in which audited accounts are produced, but in other cases, the production of evidence means, in general, merely the production of books. These are, however, frequently not balanced and in very many cases have no summarised account corresponding to a Profit and Loss Account which brings out the actual profit or loss for the year. An assessee cannot perform his statutory duty of making a correct return of his income unless he summarises the various accounts in his books and extracts therefrom the figure of profit. In practice, however, it is left to the Income-Tax Officer in many cases to extract the relevant figures from the books, and the assessee is not even asked for a statement showing how, from his books, he arrives at the figure of his return. This involves the tacit assumption that he does not take the steps necessary to enable him to make a correct return, and the burden of ascertaining the profits shown by the books is thrown upon the Income-Tax Officer who thus performs what is strictly the statutory duty of the assessee. We consider that much fuller use should be made of the requirement set out in Notes 5*a* and 5*b* of the prescribed form of return, of statements showing how from his books an assessee has arrived at the profit returned. This would not give any right to an Income-Tax Officer to require an assessee to keep his books in any particular way or make up a Profit and Loss Account, but would merely provide a link between his books and his return. If such a course were more widely adopted, *in cases in which the books are found to be completely reliable and the profit or loss is brought out clearly*, there should no longer be any necessity to examine the books every year, but it would still be necessary for the Income-Tax Officer to satisfy himself periodically (*a*) that the whole relevant results shown by the books are incorporated in the statements and (*b*) that the books themselves cover the whole of assessee's transactions. Our recommendation for the extension of the time limit for making assessments under section 34 would lessen the danger involved in only periodical examination of books in such cases. In years in which books are not examined, it seems to us that any necessary discussion of the statements and the calling for further information could with advantage be carried on by correspondence in many cases, at least in the earlier stages. Such a practice would afford the maximum convenience to both the Income-Tax Officer and the assessee, with the added advantage that the information would be given in writing over the signature of the assessee or other responsible person after due consideration. A further advantage would be that the correspondence could form a permanent record for both parties, which should receive consideration when later accounts are being dealt with.

We received a number of complaints as to the extent to which books are called for indiscriminately for three previous years, but consider it

sufficient if Departmental instructions emphasise that such action should only be taken when there is good reason for it.

The Income-Tax Officer is assisted by subordinate (non-gazetted) officers who examine books and report to him. In the Income-Tax Officer's consideration of such reports and of the books, we found a very great diversity of practice. Many an Income-Tax Officer rightly treats the Examiner's report of the facts merely as a basis for his own broad consideration of the books and other relevant facts, so that the computation of liability is definitely his own. On the other hand, we found a few cases where the Income-Tax Officer did no more than accept the Examiner's computation, the assessment order being merely a transcript of the Examiner's report.

A further criticism is that the Income-Tax Officer, when examining books, sometimes fails to pay sufficient attention to the broad facts of a case and to other available evidence, such as the assessee's style of living and increase in his total resources, which might show that the books themselves were wholly unreliable. In some other cases, where there was positive evidence of omissions from the books, such omitted sums were merely added to the profit shown by the books, whereas, since the profit shown was on general considerations quite unreasonable, the evidence in question should have been taken as totally discrediting the books.

Other criticisms made dealt with a tendency on the part of some officers when examining books to disallow all items in respect of which there could be any doubt whatever, leaving the question of allowability to be settled by the Assistant Commissioner if the case were taken to appeal. This tendency appears to us to be due most probably to an inability on the part of the Income-Tax Officer to arrive at a definite decision.

The defects indicated are in our opinion due to two main causes, the inadequacy of the training of officers in some areas in their earlier years and the lack of sufficient control and supervision. The question of adequate training is dealt with in the previous sub-section of this Chapter, while that of control and supervision is examined in Chapter XVI.

A further point as to which representations were made to us in a few areas was the practice of rejecting accounts entirely where there was no proper stock valuation or where a quantitative day to day stock account was not maintained. It is true that in many cases accounts are worthless unless they include authentic stock accounts, but we saw some cases in which the question of stock was only a minor factor and the entire rejection of the accounts, without any attempt to base an estimate of income thereon, on the ground of absence of stock accounts was unreasonable.

(c) *Estimation of profits in the absence of reliable evidence.*—We have received very strong representations as to the manner in which some Income-Tax Officers estimate profits in cases where either no accounts are kept or the accounts are in such a form that the profits cannot properly be deducted therefrom. It has to be remembered, however, that the problem set to the Income-Tax Officer in such cases is a very difficult one and is inherent in any system of charging tax upon income.

We have recommended that a statutory obligation should be placed upon every person in receipt of an income of taxable amount to make a return of that income, and it follows that where the income is from business, such an obligation cannot be properly discharged unless complete records are kept from which the profits can be accurately ascertained. If no

such records are kept the Income-Tax Officer has no alternative but to estimate the income, and if the estimate seems to the assessee to be wide of the mark the blame rests primarily on the assessee himself.

Nevertheless the sense of grievance in respect of this matter we found to be acute, and some bodies have felt that there could be no remedy short of the association of representatives of the public in the work of assessment. In our opinion, there are such weighty objections to this proposal that it is not a practical solution. It is, perhaps, sufficient to mention two obvious objections; first the discussion of an assessee's affairs with persons who may be his business competitors and, secondly, making an assessment depend upon the opinion of persons who may be strongly biassed either for or against the assessee, or who may know nothing about the business in question.

We must admit that in certain Circles, there is some evidence of insufficient consideration being given to *all* the relevant facts, with the result that some estimated assessment appeared on a broad view to be excessive. The practice of progressive enhancement of assessments is intended to meet cases of assessees who deliberately refrain from making returns of income in the hope that the Income-Tax Officer's estimates will be below their real profits, and indeed is his only counter to such a course of evasion. It is, however, quite clear, we think, that the practice should be confined to cases considered to be of that type and that it should not be automatically applied to every case of failure to render a return.

There is also a tendency in some Circles to make *excessive* assessments under Section 23(4) where there is only a technical default.

Our suggestion that all assessments should be subject to appeal, coupled with the extension of the time within which additional assessments can be made should be extended, should operate to remedy a great deal of this trouble.

The assessee of small income in some Circles receives at times what cannot be described as sympathetic treatment, notwithstanding the instructions in paragraph 86 (ii) of the Income Tax Manual. We think that in the case of small traders who keep no proper books, tactful and sympathetic discussion with the assessee is likely to lead to results which, while fair to the Revenue, would involve no hardship and should leave no justification for any feeling of grievance. We may add that in many Circles, cases are so handled with satisfactory results. The extension of this desirable practice should be one of the aims of the Inspecting Officers whose appointment we propose in Chapter XVI.

(*d*) *Application of flat rates of profits.*—Much has been said on the subject of the application of standard rates of profit when estimates are made on a turnover basis. The complaints may be reduced in the main to allegations that the rates are not impartially ascertained, that the highest rate of profit found in any businses in a given class of trade is treated as representative of that class, and that the rate applicable to one class of trade is sometimes applied to businesses not strictly within that class or to businesses having special features which make that rate inappropriate.

It is true that some estimation of the rate of profits is necessary in many cases, but it should be remembered that even when fairly ascertained, the "standard" rate of gross profit for a given class of trade is merely the average of a number of actual rates with possibly a wide range of variation. It follows that these rates, however carefully computed,

should be applied with discretion and with regard to the special circumstances of the individual case. A further point that should be mentioned is that it is generally more correct to apply a gross rate of profit and to deduct working expenses from the result than to apply a net rate of profit directly to the turnover. A suggestion made that trade associations should be allowed to co-operate in computing these standard rates which should be applied in all cases where accounts are not accepted, is in our opinion quite unacceptable, since this procedure would result in either general under-assessment or in over-assessment in some cases balanced by under-assessment in others.

(*e*) *Consultation of Income-Tax Officer with Assistant Commissioner.*—Numerous complaints have been made that Income-Tax Officers consult their Assistant Commissioners in the course of assessment proceedings to the prejudice of any subsequent appeals. This objection should be fully met, if our suggestion in Chapter XVI of this Report regarding the appointment of Inspecting Officers with no appellate jurisdiction, be accepted.

(*f*) *Requirement of particulars relating to other Assessees.*—At present, considerable time is often spent on the examination of an assessee's books for the purpose of extracting particulars of payments to other assessees, *e.g.*, rent, interest or commission. This practice has given rise to complaints that books are sometimes retained by Income-Tax Officers for unduly protracted periods. To meet this objection, we recommend the expansion of section 38 of the Act to give the Income-Tax Officer the statutory right to call for returns of particulars of such payments, so that retention of books for this purpose would be no longer necessary.

(*g*) *Examination of Witnesses.*—Representations have been made as to the practice of some Income-Tax Officers of examining witnesses called under section 37 of the Act, without giving the assessee the opportunity of being present. Such a course is in our opinion undesirable, and we suggest that administrative instructions should be given to ensure that assessees are given the right to be present at the examination of such witnesses.

Section 6.—Representation of Assessee.

Some bodies have urged that the right of appearing for an assessee should be restricted to members of the legal profession or of a recognised body of accountants, but in the main the representations made to us were directed to the exclusion of self-styled experts who have no professional qualifications and are subject to no control. Others were directed to the exclusion of the undesirable element among these "experts".

There are serious objections to the more drastic restrictions suggested. Among the existing unqualified practitioners are men who by reason of their experience are expert in Income-Tax matters and do in fact ably represent their clients in important cases. There are others who, without any special qualifications, are able satisfactorily to present the less important cases of assessees who may not be able to afford the cost of employing a fully qualified man and who are not competent to present their cases adequately themselves. In neither case is there any justification for depriving these practitioners of their means of livelihood. In some areas, restriction to the legal profession and qualified accountants would have the effect of depriving the assessee of all right of representation unless he were in a position to incur the cost of employing an approved representative from a distance.

These considerations have been met by the suggestion made by some associations that the right of acting as representatives should not be confined to lawyers and qualified accountants, but should extend to relatives or full time employees as now, and persons on a register of approved representatives to be compiled by the Commissioner of Income-Tax or by the Central Board of Revenue. The major objection to this proposal is the amount of work which would be involved in compiling such a register and keeping it up to date. It would be impossible to formulate or apply a standard of competence which would at the same time exclude the undesirable and not cause hardship to persons against whom there is no real objection. Further, it would be unfair to exclude any existing practitioners without giving them a right of appeal, and it would be necessary to provide also for the striking-off of the names of persons against whom improper conduct was alleged, with again the right of appeal. It is obvious that although an elaborate and expensive organisation would be necessary, it could not function so as to guarantee the competence or honesty of the persons included on the register, whilst it is inevitable that inclusion would be held out by some practitioners as implying such a guarantee and that this pretension would be accepted by some members of the public.

We suggest that a simpler and more satisfactory method of dealing with this problem is to modify the present position as regards existing practitioners to the extent of giving power to the Commissioners to compile a register of persons *not* entitled to act. It is intended that this list should include only persons guilty of proved misconduct, that the Commissioner should take action upon his own motion or on a reference from a subordinate officer, after hearing the person against whom misconduct is alleged. Inclusion in this "black list" is so serious a matter that a right of appeal must be provided, and this, it is suggested, should be to the special appellate body recommended in Chapter XV of this Report. In our opinion, the "misconduct" above referred to should be taken to be such matters as the submission, or connivance at submission, of false returns or false evidence, or being a party to bribery, or the attempted bribery of an Income Tax official, but mere incompetence or mere advertising should not of itself be deemed to be misconduct. As regards persons not already practising, we recommend that apart from members of the legal profession or of a recognised association of accountants, no person who is neither a graduate nor has passed a recognised accountancy examination should be allowed to practise as an Income-Tax representative appearing for clients in proceedings under the Act.

Representations have included a suggestion that retired Income-Tax officials should not be allowed to practise as representatives of assessees, but we consider that this is only a particular aspect of the larger question of the rights or obligations of retired civil servants as a class and should not be separately dealt with.

A minor matter that has been mentioned to us is the doubt whether an assessee summoned under section 37 to attend at the Income-Tax office can claim under section 61 to attend by deputy. We are of opinion that the existing general right to attend by deputy should be retained except where the order is specifically for personal attendance. This could be secured by the addition to section 61 of words such as "except in cases where the notice requires specifically the personal attendance of the assessee."

Section 7.—Penalties for failure to make returns and for incorrect returns and statements.

We have been considerably impressed by the insufficiency of the power at present vested in the officers of the Department to deal with the dishonest assessee and this has been emphasised in the representations made by some associations. In a year in which an assessee has made false returns, although there is no time limit to the institution of a prosecution under section 52 of the Act, the Income-Tax Officer cannot impose penalties under section 28 for more than one previous year, however long the period of under-assessment. This puts a premium on dishonesty by reason of the probability that if the fraud is discovered, the tax saved in the years preceding discovery will exceed the very limited penalty, if any, that can be imposed. Representations made to us both by responsible commercial bodies and by officers of the Department, coupled with our own investigation, lead us to the opinion that the degree of under-assessment existing is of serious dimensions. Elsewhere in this Chapter, we have considered the effectiveness of the Income-Tax Officer's examination of returns and relevant evidence, and have made suggestions intended to secure more accurate assessment. Such improvement in technique can, however, only be a gradual process, and there should be, in our opinion, such a strengthening of the statutory provisions regarding penalties exigible as will act as a definite deterrent to evasion.

We recommend, therefore, that penalties should be provided for deliberate failure to make returns, in addition to those for the making of incorrect returns, and that the maximum penalty exigible should be increased to twice the tax which would have been avoided, with a penalty limited to a maximum of Rs. 50 in any case where a person who has received a specific notice under section 22 or section 34 proves that he had no income liable to tax. Since we recommend that assessments made under section 23 (4) be subject to appeal, we consider that similar penalties should be provided also for the case of deliberate failure by an assessee to produce books or other proper evidence called for by the Income-Tax Officer by requisition under the provisions of the Act. Our recommendations for extension of the time during which additional assessments can be made will, if accepted, automatically extend the period for which penalties may be imposed.

To prevent indiscriminate or vexatious use of these powers, we recommend that the power of imposing these penalties which is vested in the Income-Tax Officer should only be exercised by him, in the case of a penalty exceeding say Rs. 1,000, after obtaining prior sanction from his Inspecting Officer (See Chapter XVI). There would of course be the same right of appeal on the part of the assessee as at present.

An obvious defect in the present Act is that it is not clear that penalties under section 28 apply to Super-Tax as well as Income-Tax, and we recommend the amendment of section 58 of the Act accordingly.

Section 8.—Additional Assessments.

For the reasons given in the preceding section, we recommend the extension of the time during which assessments may be made under section 34 to six years from the end of the year of assessment, but that the extended time limit shall not apply to income of any year prior to the

date of the amending legislation. Given this extension of time we consider that the mere initiation of assessment proceedings within the revised time limit is insufficient but that the assessment order itself should be made within the time limit.

Even within the existing time limit, difficulty is experienced in correcting under-assessments owing to the somewhat restricted meaning placed upon the opening words of section 34 of the Act. Some High Courts have held that an Income-Tax Officer can only make an assessment under this section in respect of a source of income already assessed if he obtains evidence that specific items have been omitted from the first assessment. However strong the general evidence showing that the first estimate was inadequate, the Income-Tax Officer, at least in some Provinces, seems thus to have no power to reconsider his estimate and to make a further assessment. We suggest that the section be amended by the insertion of the words "or has been under-assessed" after the words "or has escaped assessment". The necessity of having fresh evidence before taking action under this section should be emphasised by administrative instructions.

Minor points arising out of consideration of this section of the Act are—

(i) that the section needs amendment to allow for the rectification of excessive allowances or refunds including Double Taxation Relief; and

(ii) that, where in the same assessment there is under assessment of one source of income, and overassessment of another, additional assessment should not be made under section 34 except to the extent, if any, by which the underassessment exceeds the overassessment.

Section 9.—Rectification of errors.

In view of our recommendation for the extension of the period during which additional assessments can be made, we are of opinion that section 35 of the Act should be amended so that mistakes apparent from the assessee's record may also be rectified within six years of the end of the year of assessment in question.

Section 10.—Refunds.

(*a*) *Delay and general departmental attitude.*—We received a number of representations concerning the delay that occurs in dealing with refund claims and find that in a large proportion of cases, the delay is due to the necessity for awaiting advice from Circles dealing with Companies as to the percentage of profits which has borne tax each year, so that the appropriate limitation may be applied to dividends which are the subject of claim. It is true that Companies have been invited to state on their dividend vouchers their computation of the taxed percentage, but, there is a growing tendency to refrain from making such voluntary statements, and it has been represented to us that this is due to the meticulous criticism to which, notwithstanding the orders of the Central Board of Revenue, such statements have in some cases been subjected. On the other hand, the statements made by some Companies have been so seriously inaccurate that refunds made in accordance therewith have had to be revised when the percentage was worked out by the Department. A remedy for this particular cause of delay is suggested in section 2 of Chapter X of this Report.

Apart from the matter just mentioned, however, the general attitude of officers of the Department to refund claims leaves much to be desired. Many Income-Tax Officers regard refunds as the last matter to need attention and in many areas no attempt whatever is made to avoid large accumulation and long delays. This is in marked contrast to the practice in the United Kingdom where refund claims receive preferential treatment and appears to be due to slackness on the part of some officers and to insufficient direction from superior officers. In extreme cases, the Income-Tax Officer has been found even to refrain from initiating assessment proceedings where the likely result appears to be the emergence of a refund.

The desire of the Government for sympathetic administration of the Act is evidenced by paragraph 86 (ii) of the Income-Tax Manual but there is insufficient supervision to ensure that the spirit of this instruction is fully carried into effect. The requisite improvement in the attitude to this class of work can only be secured when it is made clear to Income-Tax Officers that they are responsible for seeing that refund claims are disposed of promptly, irrespective of the amounts involved. If Inspecting Officers are appointed as suggested in Chapter XVI, it should be a part of their duty to call for periodical reports of progress, and to see that the general progress made throughout the year is satisfactory and that no case is delayed without adequate reason.

(*b*) *Time-limit.*—Strong claims have been put forward to the effect that the existing time-limit as laid down in section 50 of the Act is too short, and in view of our proposal in section 8 of this Chapter regarding additional assessments, we recommend a similar gradual extension of the time limit for refund claims to six years from the end of the year of assessment to which the claim relates.

CHAPTER XV.

Appeals.

SECTION 1.—EXTENT TO WHICH ORDERS ARE SUBJECT TO APPEAL.

Stress was laid by a number of representative bodies upon the difference between the position in the United Kingdom, where all assessments are subject to appeal, and that in India, where there is no appeal against the many estimated assessments made under Section 23 (4). Assessments are made under this sub-section if an assessee fails without reasonable cause to comply with a notice issued by the Income Tax Officer, calling for evidence or for a return of income. It is no doubt true that this result is very often due to deliberate neglect by the assessee of his statutory duty, but the argument used by some Income Tax Officers that any over-assessment includes a penalty for such neglect is obviously bad, since the section requires the Income Tax Officer to estimate the profits *to the best of his judgment*. There is no authority deliberately to over-assess in these cases, and accidental over-assessment in some cases cannot be an equitable measure of the penalty properly exigible. An argument used in favour of the retention of non-appealability of these assessments is that, given the right of appeal, assessees would withhold information from the Income Tax Officer, appeal if his estimate of profits were excessive, but take no action if his estimate were below the true profits. This was, we understand, the principal reason for the change in the law in 1918 making these assessments non-appealable. The inference of under-assessment, however, may frequently be drawn if no appeals are lodged against a succession of estimated assessments, and whatever may be the force of the argument for non-appealability under the present law, we consider that it would lose its validity if provision is made for the imposition of penalties for failure to comply with notices, and for the extension of the time-limit within which additional assessments may be made, as suggested in Chapter XIV of this Report. We therefore recommend that all assessments be made subject to appeal. Where the Assistant Commissioner admits evidence which has been withheld from the Income Tax Officer without reasonable cause, it will be open to him, even though he reduces the assessment, to impose penalties commensurate with the offence.

There are several other types of orders which, it was urged, should be subject to appeal, but it may have been overlooked by those putting forward this claim that the right of appeal under section 30 (1) includes the right of appeal against orders (*e.g.*, orders under section 2 (11) (a) or 26) which are preliminary to the assessment order itself. We agree, however, that an order under section 43 (treating a person as an agent for a non-resident) should be the subject of a *distinct* appeal, and that assessment proceedings should not be continued until such appeal is disposed of.

It has been pointed out that there is no provision for a reference to the High Court on a point of law arising out of an Assistant Commissioner's order under section 50-A on a refund claim. Instead of remedying this apparent oversight by an amendment of section 66, a preferable course would, in our opinion, be to amend section 30 of the Act so as to allow a right of appeal against an Income Tax Officer's order under section 48, 48-A, or 49 of the Act.

Section 2.—Appellate Officers or Tribunals.

Under the present system, the principal function of the Assistant Commissioner is the hearing of appeals, and representations have been made to us that this work is not impartially performed. These representations, in general, failed to take sufficiently into account the difficulties which confront the Assistant Commissioner. Frequently the evidence put forward in support of an appeal is incomplete and unreliable, and the Assistant Commissioner is compelled in the interests of justice to reject it wholly or in part, or to confirm an assessment based on a pure estimate. Our examination of a number of appeal cases leads us to the conclusion that most appeals are dealt with in a spirit of fairness and that the complete supersession of the Assistant Commissioners in this work by outside bodies would not, in general, result in the more equitable settlement of appeals.

We have said that in our opinion, the Assistant Commissioners, in general, deal equitably with the appeals which come before them, but there remain five major criticisms of the present system *viz.*,—

(1) that there is not, as there is in the United Kingdom, an independent body to hear appeals, and that, therefore, the Departmental view on questions of fact must prevail,

(2) that the appellate officer is also the officer in control of the Income Tax Officer who makes the assessments appealed against, and therefore the assessment in some cases already represents the opinion of the Assistant Commissioner, so that the right of appeal to that officer is illusory,

(3) that in other cases, the Income Tax Officer considers himself unable to consult his superior officer (the Assistant Commissioner) on points of difficulty before making an assessment,

(4) that, in general, the Assistant Commissioner has not at the hearing of an appeal, the benefit of the Income Tax Officer's exposition of his order, and

(5) that the Income Tax Officer has no right of appeal.

To remove these defects, or some of them, numerous proposals have been made, but most of them are completely ruled out by practical considerations. To transfer jurisdiction from Assistant Commissioners to District Judges as has been suggested in some quarters, would be to transfer the work from persons who have specialised in it for years to others who are completely unfamiliar with the problems involved. It would, in our opinion, be equally impracticable to encumber the High Courts with appeals on questions of fact as well as of law.

In the United Kingdom, by far the greater number of appeals against Income Tax assessments are in fact settled by agreement between the assessee and the officers of the Income Tax Department. In many Districts there, the proportion of appeals not so settled and thus left over for hearing by the statutory appellate bodies, is less than 5 per cent., and in some, it is less than 1 per cent. Similarly in India, we consider that the majority of appeals should also be determined Departmentally as now, and that the complete supersession of Assistant Commissioners by independent local Tribunals is unnecessary and undesirable.

Proposals were made a few years ago for the setting up of Tribunals to whom appeals should be competent against the decisions of the Assistant Commissioners. The suggested composition and powers of these Tribunals varied considerably, but generally the personnel was intended to be of the status of High Court Judges. The proposed Tribunals were to hear appeals on questions of fact and of law, and the only appeal from their decisions was to lie to the Privy Council, the High Courts being relieved of their present functions in Income Tax cases. One advantage of transferring appeals on points of law to such a body, it was pointed out, would be to get consistent interpretations on the same questions of law throughout India. We consider that the desire to be able to appeal to an independent non-official body on important questions of fact is widespread and not unreasonable, and we recommend, therefore, that one all-India Tribunal be set up consisting of six persons chosen by the Governor-General in Council to hear appeals, on questions either of fact or of law, against decisions of Assistant Commissioners under section 31, and against orders of the Commissioner under section 32. Subject to the condition that at least two members should be persons who have acted as High Court Judges for, say, at least three years, to secure the adequate consideration of cases on points of law, we consider that the choice of the Governor-General in Council in this matter should be unfettered by Statute, but it would, in our opinion, be desirable to include two persons who have had wide experience in the Income Tax Department, and two with accountancy or business experience.

The question of the control of such a Tribunal has been considered but we think that the only control should be such Constitutional control as is applicable to the High Courts.

It is contemplated that there would be one Tribunal only for all-India and that appropriate centres would be visited by members of the Tribunal on circuit. The arrangements should be sufficiently elastic to allow the hearing of most cases in which only questions of fact are involved by individual members of the Tribunal, whilst cases of greater importance could be dealt with by a bench of two or more members, and cases involving a point of law by a bench of not less than two members, at least one of whom should be one of the *ex*-High Court Judges.

Appeals from decisions of Assistant Commissioners would be competent to the Tribunal by either the assessee or the Income Tax Officer.[1] To restrict to reasonable dimensions the number of appeals to the Tribunal, we consider that a fee of, say, Rs. 100 should be payable by the appellant with the notice of appeal, but that such fee should be refundable wholly or in part, at the discretion of the Tribunal, to a successful appellant.

The Tribunal's decisions on questions of fact should be final, but its decisions on questions of law should be subject to appeal only to the Privy Council.

It might be argued that the suggested Tribunal affords no remedy in small cases where the fee of Rs. 100 would alone prohibit an appeal against the decision of an Assistant Commissioner. We agree, however, with those who, while pressing for a tribunal as an *alternative* to the Assistant Commissioner, conceded that their objections to the present system would be largely met by taking away all administrative duties from

[1] Administratively, the Income Tax Officer should only take a case to the Appeal Tribunal with the sanction of the Commissioner.

Assistant Commissioners having appellate jurisdiction. Such a course would also meet the Departmental objection that on points of difficulty the Income-Tax Officer is unable to consult his superior officer. We recommend, therefore, that the Assistant Commissioners exercising appellate functions should have no administrative duties and that the Income Tax Officers should be controlled by Assistant Commissioners acting as "Inspecting Officers"(1) having no appellate functions.

Given this separation of the functions of Assistant Commissioners, we consider that the Income-Tax Officer should have the right to consult his Inspecting Officer openly and, if necessary, to obtain instructions from him before making an assessment. The Department should also have the right of being represented at the appeal before the Assistant Commissioner or before the Appeal Tribunal, although the right need not be exercised in all cases. It would be undesirable, however, for Departmental references, including instructions from the Commissioner, to be placed before the Assistant Commissioner hearing appeals, since the latter should be absolutely free to give his unfettered decision.

Section 3.—Admission of Fresh Evidence by Assistant Commissioner on Appeal.

Under section 31, the Assistant Commissioner has power, at his discretion, either to admit or to refuse to admit evidence not placed before the Income-Tax Officer. Given the power, which we suggest, of imposing penalties for the non-compliance with the Income-Tax Officers' orders under sections 22 and 23, there should be fewer cases in which the Assistant Commissioner would find it proper to refuse to admit fresh evidence. For cases assessed under section 23(4), since the right of appeal would be rendered nugatory by such a refusal, the evidence put forward should be admitted in all cases except those in which the Assistant Commissioner is satisfied that the assessee has been guilty of obstructive tactics.

Section 4.—Commissioner's Power of Revision.

Since the Income-Tax Officer is given the right of appeal to the Appeal Tribunal against the decision of an Assistant Commissioner, we are of opinion that it should become less and less necessary for the Commissioner to use his power of enhancing an assessment under section 33. We recommend that in cases in which he discovers an under-assessment, he should as far as possible instruct the Income-Tax Officer to proceed under section 34. The power of *reducing* an assessment under section 33 should also, we think, be retained for the present, although, with the appealability of assessments made under section 23 (4) and the right of appeal to the Appeal Tribunal, the use of the power should in practice diminish, and be confined to the exceptional case of hardship in which other remedies are not open.

Section 5.—Minor Points.

(*a*) *Time limit for lodging appeals.*—A number of associations urged that there should be an extension of the time limit for lodging appeals, but in our opinion the present limit of 30 days is not unreasonable, having

(1) See Chapter XVI.

regard to the Assistant Commissioner's power of extension where justified, and we do not, therefore, recommend any general extension. The time limit for appeal to the Appeal Tribunal should, we suggest, be 60 days whether the appeal is on a question of fact or of law.

(*b*) *Criticism of Income-Tax Officer's orders by Assistant Commissioner.* —We have observed in some circles a tendency on the part of Income-Tax Officers to extend their assessment orders to an inordinate length, and we found that such detailed orders which appeared to us to be out of proportion to the magnitude of the sums involved, were the direct result of criticisms by Assistant Commissioners, following appeals at the hearing of which some point was raised which was not dealt with in detail in the assessment order. It is, of course, impossible for an Income-Tax Officer to know in every case all the points which are likely to be taken to appeal and this practice of attempting to meet every contingency, even in very small cases, seems to us to involve much waste of time. We consider that definite instructions should be issued by the Central Board of Revenue to check this tendency wherever it exists.

(*c*) *Collection of tax following a Privy Council decision.*—It has been pointed out to us that under the present system, there is the possibility of loss of tax in a case where, following a High Court decision in an assessee's favour, tax is refunded to him and although the decision may be reversed by the Privy Council, the assessee's affairs are so arranged that re-collection of the tax from him is impossible. This is a real danger where assets are transferred abroad. To meet this danger, we recommend that power should be given to the High Court, or if appeals on points of law are transferred to the suggested Appeal Tribunal, to the latter, at its discretion, to authorise the Commissioner, in cases in which he has expressed his intention of appealing to the Privy Council and in which the Revenue might otherwise be endangered, to withhold refund until the appeal has been decided by the Privy Council.

Specific power to collect tax refunded to an assessee should be given to the Commissioner under Section 66-A (4) in cases where he succeeds before the Privy Council.

CHAPTER XVI.—CONTROL AND SUPERVISION.

Section 1.—Income-Tax Officer's Responsibility for Subordinate Staff.

The attitude of many Income-Tax Officers whom we met to the subordinate staff appears to be that the latter are appointed to perform various clerical and other duties preliminary to, or consequent upon, the orders of the Income-Tax Officer who, in this view, is to be regarded as a *quasi*-judicial officer appointed to examine evidence and assess income and entitled to leave the organisation and supervision of his office entirely to his head clerk. It is true that the responsibility of the Income-Tax Officer for the whole of the work of his office is clearly indicated in existing official instructions but we consider that this part of his duties should be more fully recognised by the Income-Tax Officer and that organisation and supervision should be specifically reported upon by his superior officer.

Section 2.—Inspections by Assistant Commissioners.

We have examined a number of inspection reports and have found that the work of some Assistant Commissioners shows that they have not a proper conception of what should be the underlying purpose of their inspections. Some of them show a meticulous attention to small details with insufficient attention to such important matters as (i) the making of proper enquiry in cases of apparent under-assessment, (ii) the ability of the Income-Tax Officer to deal adequately with the more important accounts in his Circle, (iii) the proper use of section 23(4), (iv) the reasonableness of orders on applications from assessees for further time in which to submit accounts, (v) delay in dealing with refund claims, (vi) office organisation, and (vii) convenience of the tax-paying public.

In Chapter XV, we have recommended that Assistant Commissioners hearing appeals should be relieved of their administrative functions. In order to secure the proper performance of these functions and to remedy the defects referred to above, we recommend that full-time "Inspecting Officers" of the Assistant Commissioner grade be appointed with no appellate jurisdiction. They would be responsible to the Commissioner for seeing that the work in the Circles under their control is efficiently performed, and it would be their duty, in addition to making thorough inspection of the Circles under their control, to give the Income-Tax Officers advice and instruction. It should be understood, also, that an Income-Tax Officer should refer to his Inspecting Officer any major point of doubt or difficulty before he makes the assessment in question. In view of the recommendation that the Assistant Commissioner hearing appeals should have no administrative control over the Income-Tax Officers, and that the assessee should have a second right of appeal to an independent Tribunal outside the Department, there can, we think, be no objection to this proposal which would, moreover, very often result in more accurate assessments and therefore fewer appeals.

A defect of the present system is that sometimes an Income-Tax Officer is called upon to deal with cases presenting unusual features (*e.g.*, an Insurance Company) of which he has had no previous experience and upon which he may consider himself precluded from seeking advice from the Assistant Commissioner. The result in such cases may be inadequate

consideration of the problems involved and perhaps serious over- or under-assessment. The Inspecting Officer with his wider experience would be able to guide the Income-Tax Officer as to the principles upon which the computation of profits should be made, making it unnecessary for the Commissioner to appoint an Assistant Commissioner under section 5(4) to deal specially with such cases.

The proposed Inspecting Officers should not confine their examination to the technical accuracy of the assessments but should deal also with such matters as the general organisation of the office, the control of the office staff, the settlement of refund claims in reasonable time, and the extent to which the convenience of the public is considered in such matters as arrangements for interviews, calling for books of account, etc.

Section 3.—Commissioner's Supervision.

It is anticipated that, if certain of our suggestions are accepted, the need for the intervention of the Commissioner in individual cases should considerably diminish, and leave him more time to devote to the general oversight of the work in his Province, which, in our opinion, should be recognised as his principal duty. We consider that there is room for much more attention on the part of the Commissioner to broad questions of organisation and to the standard of efficiency throughout his Province.

Section 4.—Central Control and Co-ordination.

The Act does not appear to give the Central Board of Revenue that power of control which, in our opinion, is necessary to secure proper and uniform administration of the Income-Tax Act throughout British India, and we suggest amendment of the Act to provide such power.

We are disturbed, not only by the poor standard of performance obtaining in some Circles, but also by the fact that the existing organisation is not adequate to secure the proper evaluation of the quality of work of the different officers, or where the work is found to be unsatisfactory, with the provision of a proper remedy. In some areas, the character of the supervision is such that in effect the Income-Tax Officer is left to formulate his own standards. With insufficient formulation and imposition of a Departmental standard, it is inevitable that the actual performance of some officers should be, as we have found, definitely unsatisfactory in various respects.

At present, the influence of the Central Board of Revenue is exercised mainly through the instructions in the Income-Tax Manual. The normal supervision of Income-Tax Officers by their superior officers is designed to secure that these instructions are fully carried into effect, but we have seen cases where the instructions have not been followed. We have made proposals elsewhere designed to secure more effective supervision and inspection of the Income-Tax Officers by Assistant Commissioners acting as Inspecting Officers, but we consider that the Central authority should be put into a position to take a more active part in the organisation and supervision of the Department. To us one of the most striking features of the administration of Income-Tax in British India is the absence of any provision at Head Office of a staff with practical Income-Tax experience to advise the Central Board of Revenue upon technical matters. We recommend the appointment of a Chief Commissioner of Income-Tax who would serve as a technical adviser to the Central Board

of Revenue and who would, subject to the general control of that Board, supervise and coordinate the administration of Income-Tax throughout British India. To assist him in his duties, we suggest that his staff should include one Senior Assistant Commissioner and one Income-Tax Officer.

The duties of the proposed Chief Commissioner and his staff should include—

(i) the consideration of copies of all inspection reports with the Commissioner's comments thereon and of all personal reports upon individual officers, to see that adequate measures are taken to secure the correction of any deficiencies disclosed and to see what amendments of the general instructions issued from the Central office are desirable;

(ii) to watch the methods of recruitment and the quality of recruits and to apply an independent check upon recommendations for promotions;

(iii) the drawing up of comprehensive instructions as to the method of examination of accounts with special reference to points affecting the Income-Tax liability in special types of cases such as Banks, Life Assurance Companies, Engineering Concerns, etc.;

(iv) responsibility for the systematic training and the departmental examination of cadet officers to secure that before promotion, they have a thorough knowledge of Income-Tax law, and an adequate knowledge of the general principles of Accountancy in relation to Income-Tax liabilities;

(v) the giving of advice and instruction upon points of general importance or of special difficulty submitted to him by Commissioners;

(vi) the supervision of the application of certain sections of the Act and of Rules made thereunder to secure consistent treatment in all areas. Examples of the type of case we have in mind are:—

(*a*) Chambers of Commerce, Trade Associations, Thrift Funds, etc. (See Chapter VII, Section 3, of this Report);

(*b*) Companies possibly liable under section 23A of the Act;

(*c*) important cases of concealed income, etc., where action under section 28 or section 52 is contemplated;

(vii) the continuous revision of the Income-Tax Manual;[1]

(viii) the periodical review of the methods employed and registers and forms prescribed, in connection with various branches of work. Examples of the need for this review are the Salaries Register, the employers' monthly returns of salary and the elaborate monthly Provident Fund statements, all of which should we think be simplified.

(ix) the requisition of periodical reports of progress in respect of assessment work and refund claims to ensure that Commissioners are taking proper steps to eliminate unreasonable delay; and

[1] This at present contains a number of errors and defects.

(x) the periodical revision of statistical requirements with a view to making the published returns as informative and intelligible as possible;

Another matter has been brought to our attention. All points of law upon which advice is needed are submitted to the Central Board of Revenue who are handicapped by the absence of a legal adviser specialising in Income-Tax law. Arrangements for the appointment of a full-time legal adviser to the Central Board of Revenue might therefore be considered in due course.

CHAPTER XVII.—RECRUITMENT AND PROMOTION.

SECTION 1.—INSPECTOR-EXAMINER GRADE.

To assist the Income-Tax Officer, subordinate non-gazetted officers styled generally Inspectors or Examiners of Accounts are employed. Their work consists of the examination of assessees' books of account and outdoor inspection for the purpose of discovering new liabilities and of making enquiries regarding the sources of income of existing assessees. Although in the more important cities, two grades of officers are appointed with distinct functions, accounts examination and inspection work, in the less important places, the officer, whatever his designation, is engaged upon both classes of work.

These grades jointly form at present the cadre from which, in general, promotions to the Income-Tax Officer grade are made, and the question of their recruitment and training is therefore of vital importance to the future of the Department.

Whether the separate grades wherever they exist are amalgamated or not, we definitely consider it advisable that there should, at the discretion of the Commissioner, be interchange of duties so that those officers who are potentially suitable for promotion to the Assistant Income-Tax Officer grade and all future entrants receive the widest possible training.

As regards new entrants to the grade, we recommend,

(i) that they should be appointed on probation for, say, two years, and the appointment of those officers who in that period fail to pass a suitable Departmental examination, or prove unsuited to the work and unlikely ever to become fit for ultimate promotion to the Income-Tax Officer grade, should be terminated;

(ii) promotion to the grade of Assistant Income-Tax Officer should be made dependent upon the passing by the higher standard, within three years of the confirmation of the appointment, of the examination prescribed for Income-Tax Officers;

(iii) that the Income-Tax Officer of the Circle to which a probationer officer is attached should be responsible for his training; and

(iv) that, as suggested in Chapter XIV, Section 5, the probationary period should include a short course of training at a centre in which important accounts are numerous.

The present system of recruitment is selection by the Commissioner whenever a vacancy occurs, but each Commissioner has his own method, which does not necessarily bring the existence of a vacancy to the notice generally of all suitable candidates. We have considered the advisability of having an All-India entrance examination, but in view of the differences in Provincial requirements, particularly having regard to language difficulties, and the small number of vacancies arising from year to year, such a course appears to us to be unsuitable. The average officer recruited under the present system is of a very good type, and there seems to be no reason at present to make any drastic change, but we suggest that full publicity should be given to vacancies as they occur so that all suitable persons have an opportunity to make application therefor. In view of the importance in Income-Tax work of accountancy knowledge we suggest that in considering candidates greater weight should be given to accountancy qualifications than is done at present.

We have been impressed by the importance and quality of the work done by Examiners in a few Circles in some large cities. This work appears to us to be as difficult as and, having regard to the amount of tax involved, more important than the work of an Income-Tax Officer in many a mofussil Circle. In our opinion, the officers engaged thereon should be of the Assistant Income-Tax Officer grade and we recommend that some of the posts of Examiners of Accounts in such Circles should be converted into posts of Assistant Income-Tax Officers.

Section 2.—Income-Tax Officers.

Taking British India as a whole, there are at present a number of posts of gazetted Assistant Income-Tax Officer on a scale of pay considerably lower than that of the Income-Tax Officer grade, and these officers are either in charge of unimportant Circles or assist Income-Tax Officers in charge of more important Circles. The scales of pay of the main grade of Income-Tax Officer are not uniform and have no necessary relation to the importance of the work performed by individual officers although a uniform scale has been fixed recently for all future entrants for the whole of British India.

Subject to the existing rights of officers at present in the service, we consider that there should be three separate grades, Assistant Income-Tax Officers, Income-Tax Officers and Senior Income-Tax Officers, each with a uniform scale of pay. This sub-division would enable the Department to recognise more fully than at present the varying difficulty and importance of the work. Promotion from the Inspector-Examiner grade should be to the grade of Assistant Income-Tax Officer and thence to the Income-Tax Officer grade. The division of the Income-Tax Officer grade into two would prevent an officer of mediocre ability from going almost automatically to the maximum of the undivided grade, and would afford earlier opportunity for selecting the best men for promotion. Further, it would allow of the recognition of the greater importance of the work of some Circles by putting them in charge of Senior Income-Tax Officers.

It may be urged that the language problem would be accentuated by the narrower field of choice for a particular Circle, but it is thought that there would be still sufficient choice of officers for Circles allotted to the lower grades while the Senior Income-Tax Officers would be posted generally to the larger cities where the language problem is less acute.

Section 3.—Assistant Commissioners.

In Chapters XV and XVI, we have recommended the separation of the present functions of Assistant Commissioners, and although this may involve a slight increase in the number of this grade, we are of opinion that the resultant increase in efficiency would be well worth the cost.

The variation in the importance and difficulty of the work performed, which has been noted already in the case of Income-Tax Officers, is present also in both branches of the work of Assistant Commissioners. We consider that this should be recognised by the division of the grade into two classes on different scales of pay. It is intended that in each grade, some officers would be engaged in appellate and others in inspection work. It is not, however, intended that an Assistant Commissioner should be

engaged permanently on either class of work, but that, without too frequent changes, he should have experience of both types of work to the benefit both of the work and of his individual efficiency.

These suggestions should have the effect of bringing into the upper grade of the Assistant Commissioner class officers who are capable of performing the most difficult work proper to that class, and who should be the body from which available vacancies in the Commissioner grade should be filled. The effectiveness of this grading to secure that the upper grade is composed of the best officers assumes that while seniority would be given due weight, efficiency and potential capacity would be primary factors in determining a man's fitness for promotion to any grade and particularly to the Senior Assistant Commissioner grade. In our opinion, too much weight has been given hitherto to seniority with definitely adverse effect upon the work of the Department. We cannot too strongly emphasise our conviction that unless when selections for promotion are made, much greater weight is given to capacity to perform the superior duties, the general standard of efficiency of the Department will remain unsatisfactory.

C. W. AYERS,—24-12-36.

S. P. CHAMBERS,—24-12-36.

J. B. VACHHA,—24-12-36.

APPENDIX I.

List of associations from whom representations were received.

*Agra Traders Association.
Amritsar Commercial Association.
*Amritsar Piecegoods Association.
Andra Chamber of Commerce, Madras.
*Association of Life Assurance Offices in India (Bengal).
*Benares Industrial and Trade Association.
*Bengal Chamber of Commerce.
*Bengal National Chamber of Commerce.
*Berar Chamber of Commerce.
*Bihar and Orissa Chamber of Commerce.
*Bihar and Orissa Muslim Chamber of Commerce.
*Bombay Chamber of Commerce.
*Bombay Shroff Association.
*Bullion Dealers of Peshawar City.
*Burma Indian Chamber of Commerce.
*Buyers' and Shippers' Chamber, Karachi.
East India Cotton Association Limited, Bombay.
Federation of Indian Chambers of Commerce and Industry.
Grain Merchants Association, Bombay.
Hindustani Mercantile Association, Delhi.
*Incorporated Accountants, Bengal and District Society.
Incorporated Accountants, Bombay District.
*Indian Chamber of Commerce, Calcutta.
Indian Chamber of Commerce, Coimbatore.
*Indian Chamber of Commerce, Lahore.
Indian Chamber of Commerce, Tuticorin.
*Indian Insurance Institute (Bengal).
Indian Life Assurance Offices Association, Bombay
*Indian Medical Association.
*Indian Merchants Chamber, Bombay.
Indian Society of Accountants and Auditors, Bombay.
Iron Merchants Association, Peshawar.
Iron Merchants of Peshawar City.
Jubbulpore Merchants Association.
*Karachi Chamber of Commerce.
*Karachi Indian Merchants Association.
Karnatak Chamber of Commerce (Bombay Presidency).
*Kiryana Association, Amritsar.
Lahore Traders.
*Madras Chamber of Commerce.
*Madras Trade Association.
*Madura Ramnad Chamber of Commerce (Madras).
*Maharashtra Chamber of Commerce (Bombay Presidency).
Marwari Association, Calcutta.
Marwari Chamber of Commerce, Bombay.

NOTE.—Associations marked (*) had also informal discussions with us.

Memon Chamber of Commerce (Bombay Presidency).
*Merchants Association, Peshawar Cantt.
*Merchants Chamber of United Provinces.
Moulmein Jewellers Association (Burma).
Muslim Chamber of Commerce, Calcutta.
*Myitkyina Taxpayers' Association (Burma).
Mysore Chamber of Commerce.
*Nattukottai Chettyers Association, Burma.
Nattukottai Nagarathans Association (Madras Presidency).
*Northern India Chamber of Commerce (Punjab).
Orissa Chamber of Commerce.
*Punjab Chamber of Commerce.
*Punjab Merchants Association, Lahore.
*Rangoon Jewellers Association (Burma).
*Registered Accountants and Auditors, Punjab.
Registered Cawnpore Kapra Committee (United Provinces).
*Society of Auditors, Madras.
Society of Registered Accountants, Calcutta.
*Southern India Chamber of Commerce (Madras Presidency).
Umbrella Merchants Association, Nagpur.
*United Provinces Chamber of Commerce.
Upper India Chamber of Commerce (United Provinces).

The following associations had informal discussions only :—

Amritsar Bar Association.
Burma Chamber of Commerce.
Meerut Trades Association.
Nagpur Chamber of Commerce.
Nagpur Cloth Merchants Association.
Nagpur Hardware etc. Association.
Native Share and Stock Brokers Association, Bombay.

NOTE.—Associations marked (*) had also informal discussions with us.

APPENDIX 2.

Specimen Scale of Rates on "Slab" System.

INCOME-TAX.

A.—Individuals, Unregistered Firms and Hindu Undivided Families not falling under heading B below :—

	Rs.	Rate.
First	1,500	*Nil.*
Next	3,500	9 pies in the rupee.
,, ...	5,000	1 anna 3 pies in the rupee.
,, ...	5,000	2 annas in the rupee.
Balance of income . . .		2 annas 6 pies in the rupee.

No tax payable on incomes not exceeding Rs. 2,000 ; and marginal relief of excess of tax over half the excess of income above Rs. 2,000.

B.—For Hindu Undivided Families with more than one adult married male member, as in A above but with double each "slab" of income.

C.—"Company" rate . . . 2 annas 6 pies in the rupee.

SUPER-TAX.

A.—*Assessees other than Companies and Hindu Undivided Families not falling under heading B below* :

	Rs.	Rate
First	25,000	*Nil.*
Next	10,000	1 anna in the rupee.
,, ...	20,000	2 annas in the rupee.
,, ...	70,000	3 annas in the rupee.
,, ...	75,000	4 annas in the rupee.
,, ...	1,50,000	5 annas in the rupee.
,, ...	1,50,000	6 annas in the rupee.
Balance of income . . .		7 annas in the rupee.

B.—Hindu Undivided Families with more than one adult married male member, as in A above but with double each "slab" of income.

C.—Companies.—No exemption.

Rate of tax . . . . . 1 anna in the rupee of the whole income.

APPENDIX 3.

Statement showing the tax payable as a percentage of income in selected cases (a) under the present scales of Income-tax and Super-tax including surcharge at 1/12th (b) under the specimen "slab" scale.

Income.	(a) Present Scale.		(b) Specimen Scale.	
	Tax.	Percentage.	Tax.	Percentage.
2,000	1	..	..	..
2,150	73	3·4	30	1·4
2,500	85	3·4	47	1·9
2,700	91	3·4	56	2·0
3,000	102	3·4	70	2·3
3,250	110	3·4	82	2·5
3,500	118	3·4	94	2·7
3,750	127	3·4	106	2·8
4,000	135	3·4	118	3·0
4,500	152	3·4	141	3·1
5,000	170	3·4	164	3·3
5,333	271	5·1	190	3·6
5,700	289	5·1	219	3·8
6,000	305	5·1	242	4·0
6,667	339	5·1	294	4·4
8,000	406	5·1	398	5·0
9,000	457	5·1	477	5·3
10,000	509	5·1	555	5·6
10,600	718	6·8	630	6·0
12,000	813	6·8	805	6·7
13,500	914	6·8	992	7·3
15,000	1,017	6·8	1,180	7·9
16,700	1,508	9·0	1,445	8·7
20,000	1,806	9·0	1,961	9·8
21,000	2,251	10·7	2,117	10·1
25,000	2,680	10·7	2,742	11·0
26,500	2,841	10·7	3,070	11·6

Income.	(a) Present Scale.		(b) Specimen Scale.	
	Tax.	Percentage.	Tax.	Percentage.
30,000	3,217	10·7	3,836	12·8
33,000	4,434	13·5	4,492	13·6
35,000	4,796	13·7	4,930	14·1
40,000	5,700	14·2	6,336	15·8
44,000	6,919	15·7	7,461	17·0
45,000	7,109	15·8	7,742	17·2
50,000	8,069	16·1	9,148	18·3
55,000	9,197	16·7	10,555	19·2
60,000	10,325	17·2	12,274	20·5
65,000	11,454	17·6	13,993	21·5
67,000	11,905	17·8	14,680	21·9
70,000	12,582	18·0	15,712	22·4
74,000	13,485	18·2	17,087	23·1
75,000	13,710	18·3	17,430	23·2
80,000	14,840	18·6	19,149	23·9

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(a) UNDER THE PRESENT SCALE INCLUDING SURCHARGE OF 1/12 TH
AND (b) UNDER THE SPECIMEN 'SLAB' SCALE.