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GOVERNMENT OF INDIA

Report

OF THE

TAXATION ENQUIRY COMMISSION

1953 - 54

VOL II

REPORT

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VOLUME II

MINISTRY OF FINANCE (DEPT. OF ECONOMIC AFFAIRS)
GOVERNMENT OF INDIA

PRINTED IN INDIA BY THE MANAGER, GOVT. OF INDIA PRESS, NEW DELHI
AND PUBLISHED BY THE MANAGER OF PUBLICATIONS, DELHI, 1955

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CHAPTER I

HISTORICAL AND INTRODUCTORY

Income-tax in its modern form was introduced in India for the first time in 1860 to overcome the financial difficulties which followed the events of 1857. The period between 1860 and 1886 saw a series of experiments in the field of direct taxation, alternating between income-tax proper, and a licence tax on trades and professions, akin to the indigenous *Mohturfa* and *Veesabuddy*. The final form of the tax was settled in 1886 in favour of the former, and the first systematic legislation on income-tax was enacted in the same year.

2. In the last 70 years or so, the structure of the tax has undergone a series of changes. While the principal factor responsible for changes has been the need for additional revenues, other factors such as changing economic conditions, judicial decisions, and the proposals made by a number of Enquiry Committees have also played their part in shaping the structure of income-tax. It may be added that, in the process of its assimilation to Indian conditions, the tax acquired distinctive characteristics as evidenced by the treatment of agricultural income and of the income of the Hindu undivided family, and by developments in the sphere of taxation of corporate income.

3. Today income-tax is a major source of revenue and one in which not only the Central Government but also the State Governments are vitally interested. Its importance is also likely to grow in future. We propose to give in this chapter a brief review of the historical development of its main features and its role as one of the principal sources of revenue. This, we think, will help to provide the necessary background for a proper appreciation of the main problems arising from the present working of the income-tax system.

4. The following are the main heads under which we propose to deal with the historical development of the various facets of income-tax legislation and administration:—

(1) the 'base', *i.e.*, the *net* taxable income to which the charge is applied;

(2) the charge or the rate of income-tax;

(3) taxation of special entities, and corporations including insurance concerns;

(4) special aspects of the tax:

  (i) special forms of income taxation;

  (ii) division of proceeds of the tax between the Central Government and the State Governments;

(5) administrative problems including evasion and avoidance of the tax; and

(6) statistical trends.

Basis of liability

5. The Income-tax Act, 1886, levied a tax on income accruing or arising to or received by a resident in India and income accruing to or received by a non-resident through an agent in India. The terms 'resident' and 'non-resident' were not defined in the law and were largely interpreted on the analogy of the decisions of the courts of law in the United Kingdom. The foreign income of a resident was brought to charge on the 'remittance' basis for the first time in 1922 in respect of income accruing and arising outside (British) India under the head 'business'. With effect from 1st April 1933, the basis was widened to apply to income from all sources. In 1939, as a result of the recommendations of the Income-tax Enquiry Committee, 1936, the entire income of a resident, whether accruing in (British) India or outside, became chargeable to tax. The remittance basis, therefore, faded into the background except for its applicability to persons 'resident but not ordinarily resident' and to a small portion of the foreign income of resident and ordinarily resident persons in some instances. The liability of non-residents to tax on income deemed to accrue or arise in India through business connection was amplified to cover income arising through certain other activities also. At the same time, resident, non-resident and not ordinarily resident persons were, for the first time, defined in the law on the analogy of the recommendations made by the United Kingdom Income-tax Codification Committee presented to the British Parliament in April 1936.

6. The following factors were responsible for the changes that were introduced, from time to time, in the law relating to the basis of liability to tax:—

(i) the desire to bring more income into the tax net with a view to increasing the yield;

(ii) considerations of equity as affecting different persons;

(iii) preferential treatment accorded to European business community and European civil servants; and

(iv) the existence within the country of different governmental units in the shape of the former Indian States.

7. The political changes in the last decade, the special problems facing capital-importing countries and the evolution of steeply progressive rate structures in almost all countries leading to demands for double income-tax avoidance or relief arrangements make it necessary that the main features of the present law relating to the basis of liability to income-tax should be reviewed. We have attempted this review, in broad terms, in Chapter II of the present Volume.

8. Certain types of income are either specifically saved from or are made chargeable to tax in the law itself. Agricultural income is an example of the former type and certain forms of distribution by companies, which the courts have declared to be of a capital nature, but which are made chargeable under the law, are examples of the latter type. In view of the difficulty of defining income precisely, the determination of what constitutes income is a rich field for controversy. We have discussed the subject at length in Chapter III of the present Volume.

Agricultural income

9. The present treatment of income from agriculture is a unique feature of the Indian income-tax system. Agricultural income was subject to income-tax in the legislation introduced in 1860. Since 1886, however, successive Income-tax Acts have excluded agricultural income from their scope. The principal reason for making this distinction appears to have been the existence of a local rate or land revenue whose incidence was of comparable magnitude with, or higher than, that of the very low rates of income-tax levied in the beginning. A definition of agricultural income was inserted in the Act of 1886 which, except for minor changes, has remained substantially in the same form. The Government of India Act, 1935, made the taxation of agricultural income a provincial subject and this position has been maintained in the Constitution of India. Taxes on agricultural income are now levied in several Part A and Part B States. Although the absolute exemption of agricultural income from income taxation has been rescinded by the constitutional provisions referred to above, its exclusion from the total income detracts from the operation of the principle of ability to pay as applicable to different classes of income earners in the country. We have discussed the problems arising from this dichotomy in the chargeable income in Chapter V of Volume III relating to State Taxes.

Concept of income

10. A commonly accepted feature of income is that it should be received with some degree of regularity. An exception to this rule was, however, introduced in India as early as in 1918. Section 3 (2) (viii) of the income-tax Act of that year brought under charge receipts of a casual or non-recurring nature which arose from business or from the exercise of a profession, vocation or occupation or were by way of addition to the remuneration of an employee. Another important variation of the concept of regularity in this country was the taxation of capital gains arising between 1st April 1946 and 31st March 1948 on the consideration that such receipts increase ability to pay. The treatment of what have been termed as irregular incomes and lump sum receipts has been discussed by us in Chapter III.

'Previous year'

11. As income-tax is a recurring annual impost, an assessee has to pay tax on the income relating to successive and definite periods, usually of twelve months each. The criteria laid down for determining these periods have changed from time to time. Under the Income-tax Act of 1886, salaries and interest on securities were to be assessed on the basis of the income of the year of assessment, while profits of companies and income from other sources were to be assessed on the income of the 'previous year'. Under the Act of 1918, the year of assessment became the basis in respect of all sources of income; a provisional assessment had first to be made on the income of the preceding year, and this was adjusted subsequently after the income of the year of assessment was finally ascertained. This system was given up in 1922, and the procedure was simplified by basing each year's assessment on the income of the 'previous year'. These provisions have continued to remain in force since then with some minor modifications, the most important change being that an assessee can choose different periods as his 'previous year' for different sources of income.

Net income

12. From the very beginning, income-tax in India has been a charge on net income. No specific provision existed before 1918 for computing net income. The deductions were regulated on the basis of executive instructions. The following criterion laid down by the Bombay Government (when income-tax was administered by Provincial Governments) for computing net income is of interest:—

> "(Net profits are) that portion of gross earnings in the year of assessment which remains at the disposal of the company after paying all charges necessarily incurred in effecting those earnings and in providing against destruction of capital from which those earnings are derived".*

13. A specific provision was inserted in the law in 1918 to regulate the admissibility of business deductions. After enumerating broad items of expenses, both as regards their nature and the extent to which they were admissible, the law prescribed a general test for the admissibility of other items. It was worded as "expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits".† This test continued until 1939 when it was replaced by the present clause (xv) of sub-section (2) of section 10 of the Income-tax Act practically in the same form as it exists today. A general test of this nature naturally furnishes a field for controversy and a number of suggestions regarding the admissibility of individual items have been made to us, which we discuss in Chapter IV of this Volume.

14. We may refer here briefly to the history of the law on depreciation in India as this item of admissible deduction is of special significance. There was no specific provision for deduction on account of depreciation in the Act of 1886. Depreciation was allowed under executive orders issued by the Government of India or by the Local Governments. The following are two specimen orders of this kind:—

(i) a deduction of five per cent. of the cost in respect of depreciation in the case of machinery. No separate charges for repairs and renewals of machinery were to be allowed;‡

(ii) a deduction of two and a half per cent. in respect of depreciation of buildings which housed heavy machinery instead of the actual cost of repairs and maintenance. The allowance was permissible in respect of the actual mill premises and not bungalows, chawls and other subsidiary premises. In the case of the latter class of buildings, the actual amount of expenditure on repairs, up to a maximum of ten per cent. of the annual rental valuation, was to be allowed.§

The orders issued by the Local Governments were by no means comprehensive or uniform. The Income-tax Act of 1918 for the first time took stock of this nebulous position and introduced in the

*G.R.F.D. No. 1796 of 24th June 1886.

†Section 9(*i*)(*ix*) of the Indian Income-tax Act, 1918.

‡G. I., F. & C. No. 399 of 27th January 1887.

§G. I., No. 246-F of 18th January 1912.

statute itself provision for allowances for depreciation. Accordingly, section 9(2) (vi) of that Act provided for the depreciation allowance on the straight-line method. The rate of depreciation for any year was not to exceed a percentage of the original cost of the asset in question, which was to be fixed, subject to the approval of the Governor-General in Council, by the Local Governments for different assets having regard to the estimated life thereof. The cost of current repairs was separately allowable under section 9(2) (v) of the Income-tax Act, 1918.

15. The rates of depreciation were laid down statutorily for the first time by rules made under the Income-tax Act, 1922. They were revised in 1939 when the written down value method was substituted for the straight-line method of charging depreciation.

16. During the last decade or so, the law in respect of depreciation has been amplified from time to time taking into consideration the special problems facing business and industry. Special depreciation allowance was provided from 1940-41 for plant and machinery which were used for double and triple shifts. An initial allowance of 20 per cent. in respect of new plant and machinery installed after 31st March 1945, and an additional allowance equal to the normal allowance available for a period of five years in respect of new plant and machinery installed after 31st March 1948; were also introduced in order to encourage investment in fixed assets in the post-war period. The aggregate of all the allowances mentioned above was, however, not to exceed 100 per cent. of the original cost of the asset.

17. Representatives of the business community, who appeared before us, have questioned the validity of determining depreciation allowances on the basis of 'original cost', a subject which is now a matter of world-wide controversy round which a large mass of special literature has grown up. In Chapter V, we have discussed briefly the various aspects of this issue, more especially in relation to the practical necessities of the case as revealed by our survey of the finances of the public limited companies.

18. Closely allied to the subject of depreciation is the concept of depletion as applicable to wasting assets particularly to assets in the mineral industries. As mining is an important factor in industrial development, we have given special attention in Chapter VI of this Volume to the problems that have been raised before us by the various mining interests and the Ministry of Natural Resources and Scientific Research.

Losses

19. Before 1922, losses were not allowed as a set-off against income. The Income-tax Act, 1922, provided for the set-off of a loss from one source against income from other sources in the *same year*. The Income-tax (Amendment) Act, 1939, went a step further in this direction and permitted carry-forward of unabsorbed business losses for a period of six years. The carried forward loss, however, could be set off only against the profits of the *same* business. By an amendment made in 1953, a further restriction has been imposed to the effect that losses arising from transactions of a speculative nature can, even during the year of assessment, only be set-off against profits of the same business. Losses are an important factor for determining net income and we

have discussed in Chapter IV the many issues brought to our notice in this connection.

Exemptions

20. Exemptions, credits and abatements are given to reduce tax liability under special circumstances or for special categories of assessees. They are of two kinds: (i) those that reduce the base of the tax to which the rate is applied and (ii) those that have the effect of moderating the rate itself. We deal with the more important exemptions of category (i) at this stage and those that figure at (ii) above will be discussed in paragraphs 33—36.

21. Sub-section (3) of section 4 of the Income-tax Act details the specific items of income that are to be excluded altogether from 'income'. The rest of the exemptions are interspersed all over the Act or are provided for in notifications issued under section 60. The power of granting exemptions by notification was taken away from the executive in 1939 so that each exemption has now to be specifically approved by the Parliament. Exemptions take many forms such as:—

(a) income which is excluded from total income altogether, *e.g.*, income of certain public religious and charitable institutions, agricultural income, yield of Post Office cash certificates, the privy purses of the rulers of the former Indian States;

(b) income excluded from total income for super-tax but included for income-tax, *e.g.*, the amount of income which a partner of an unregistered firm or a member of an association of persons is entitled to receive where the unregistered firm or the association of persons has paid super-tax;

(c) income included in total income but exempt both from income-tax and super-tax, *e.g.*, the business profits of any co-operative society or the dividends or other payments received by members of such a society out of such profits;

(d) income included in total income but exempt from income-tax though not from super-tax, *e.g.*, the amount of income which a partner of an unregistered firm or a member of an association of persons is entitled to receive where the unregistered firm or association of persons has paid income-tax but not super-tax;

(e) income included in total income and subject to income-tax but not to super-tax, *e.g.*, dividend income of investment trust companies.

22. We discuss below the evolution of the more important items of exemptions which are at present included in the Indian Income-tax:—

(i) business income of co-operative societies;

(ii) income of certain public religious and charitable trusts;

(iii) income of local authorities;

(iv) certain exemptions on political grounds.

23. The exemption in favour of co-operative societies has been in existence since 1904, when the Co-operative Credit Societies Act was passed. At present, the business profits of co-operative societies are exempt from tax but are to be taken into account for determining the rate of income-tax on their other income. For super-tax the exclusion is complete. The rates of super-tax on co-operative societies are also substantially lower than those on personal incomes. At present, co-operative societies are charged super-tax at a flat rate of 2½ annas in the rupee *plus* three pies surcharge, on that portion of their income which is in excess of Rs. 25,000. Dividends distributed by co-operative societies out of exempt profits are not taxable in the hands of their members, but are to be included for determining the rate of tax on their income. The grant of exemption appears to have been based partly on the principle of mutuality and partly on the policy of promoting thrift and self-help. Co-operative societies are likely to play a more active part than hitherto in promoting savings in rural areas. The Five Year Plan has also drawn attention to the various ways in which co-operative societies can be useful for promoting economic advancement in the rural sector, particularly in the sphere of agriculture and small-scale industries.

Co-operative societies

24. The exemption from taxation of income derived by religious and charitable trusts from property held under trust or under other legal obligation, and from voluntary contributions is among the oldest exemptions in the Indian tax system. The business income of such organisations is also exempt if certain conditions are fulfilled. As the law now stands, the benefit of exemption is subject to certain restrictions, the most important of which is that the income must be applied to religious or charitable objects relating to anything done in the taxable territories.

Religious and charitable trusts

25. Various suggestions, which have been put forward before us for the modification of the exemptions in favour of these two types of organisations, will be dealt with in Chapter VIII.

26. Another exemption which deserves mention is that in favour of local authorities. The entire income of local authorities was being treated as exempt even from 1886, and the Income-tax Acts of 1918 and 1922 placed the exemption on a statutory footing. Pursuant to a recommendation of the Income-tax Enquiry Committee, 1936, the scope of the exemption was restricted by the Income-tax (Amendment) Act of 1939; as the law now stands, income arising to a local authority from business is liable to tax, except where the business consists of the supply of a service or commodity within its own jurisdictional area. On its taxable income, a local authority pays income-tax at a flat rate of four annas in the rupee *plus* five per cent. surcharge, and super-tax at two and a half annas in the rupee *plus* three pies surcharge without any exemption limits.

Local authorities

27. The rulers of the former Indian States enjoyed exemption under the Income-tax Act until 1953 from income-tax and super-tax on interest on Government securities held by them or on their behalf as their private property. But this exemption has now been discontinued. Article

Political exemptions

291 (1) (b) of the Constitution of India has exempted the taxation of the privy purse granted to ex-rulers of Indian States only where the privy purse has been guaranteed or assured under an agreement entered into before the commencement of the Constitution. This exemption has since been incorporated in the Indian Income-tax Act. As further instances of exemptions given on political considerations may be mentioned the exemptions granted to diplomatic and consular representatives and (in certain circumstances) to members of their staff and to employees of international organisations.

Changes in personal rate structure

28. We shall now refer to the evolution of the rate structure applicable to personal incomes. Under the Income-tax Act of 1886, income-tax was being levied on income from four different 'classes' of income and the concept of basing liability to tax on the total income of a tax-payer was introduced only in 1918.

Graduation

29. Graduation in the rates of income-tax which existed before 1916 was only nominal as a standard rate of five pies on a rupee was applicable to all incomes above Rs. 2,000. Graduation in the real sense of the term was introduced in 1916, when eight different rates of tax were laid down for incomes in different brackets.

30. Before 1939, income-tax was being levied at 'step' rates and super-tax at 'slab' rates. A change-over for income-tax from the 'step' system to the 'slab' system was introduced in 1939, as a result of a recommendation of the Income-tax Enquiry Committee, 1936. In both systems, progressively increasing rates of tax are laid down for different income brackets. Under the 'step' system, all persons in a particular income bracket bear the same effective rate on every rupee of their income; under the 'slab' system, however, the taxes on each slab are calculated separately and then added up.

The 'slabs'

31. Since 1939, further graduation for income-tax has been effected by introducing a tax free slice of Rs. 1,500 followed by progressively increasing rates of income-tax and super-tax on successive slabs of income. The slabs for income-tax have remained the same ever since 1939 and the changes have been confined to variations in the rates applicable to the slabs. However, for super-tax purposes there have been changes both in the number of slabs and the range of each slab, and the rates of tax applicable to different slabs have also been varied.

Exemption limits

32. The Indian tax system has always attempted to keep the incidence of tax on the lower income groups at a relatively low level. Persons whose total income was below Rs. 2,000 were exempt from taxation from 1922 to 1947 (except in certain years when 'lower' incomes, *e.g.*, exceeding Rs. 1,000 or Rs. 1,500 were subjected to tax). Since 1947, the exemption limit has been gradually raised, and is now Rs. 4,200 for individuals and twice this amount for Hindu undivided families satisfying certain conditions.

Exemptions and abatements

33. Exemptions and abatements moderate, to some extent, the incidence of higher progressive rates for particular types of assessees and may also be used in order to encourage any desirable social and economic objectives with which the concession is linked. Life

insurance premia paid by an assessee on policies on his own life or on that of his wife, have been exempt in India since 1886; similar exemption has been available since 1918, to contributions to provident funds governed by the Provident Funds Act. The total amount enjoying exemption in respect of these items is subject to a maximum of one-sixth of the total income, a monetary limit of Rs. 6,000 (Rs. 12,000 for Hindu undivided families) being added in 1939. The exemption now takes the form of a rebate of income-tax (but not of super-tax) at the average rate of tax applicable to the total income of an assessee.

Differentiation

34. The introduction of the principle of differentiation between earned income and unearned income is another interesting development in the history of Indian income-tax. The differentiation was effected in two different ways. For income-tax purposes, the assessee was allowed to exclude from his income a fixed proportion subject to a maximum limit. This scheme was introduced in 1945 and has continued ever since with changes in the amount of exemption granted from time to time. For super-tax purposes, the method adopted was to levy tax on the earned income at lower rates than on unearned income. The latter differentiation was, however, short-lived, the rates of super-tax on earned as well as unearned incomes being uniform at present.

Abatement for voluntary donations

35. Another allowance, introduced in 1948, was an abatement in respect of voluntary donations to approved religious and charitable institutions. The abatement is at present at the average rate of income-tax and super-tax applicable to an assessee (but not exceeding a total of 8 annas in the rupee), and applies to donations of not less than Rs. 250 or not more than Rs. 1 lakh in a year, and not exceeding five per cent. of the assessee's income.

Family allowances

36. The present structure does not take into account fully the personal circumstances of assessees. The role of family allowances, which is a feature of the income-tax structure of many countries, is sought to be filled in India by a tax-free slab available to all assessees. The slab is supposed to represent the minimum subsistence needs of an average family.

Hindu undivided family

37. The exemption limits and rates of tax for Hindu undivided families, unregistered firms and other associations of persons were the same as for individuals from 1939-40 to 1948-49, the higher exemption limit for super-tax, which was previously available for a Hindu undivided family, having been given up, during this period. Subsequently, however, they were given a higher exemption limit for income-tax, in partial-implementation of a recommendation of the Income-tax Investigation Commission. Thus, for 1949-50 the exemption limit for a Hindu undivided family with two or more members was fixed at Rs. 5,000 as against Rs. 3,000 for individuals, and from 1950-51 the exemption limit for a Hindu undivided family has been twice that for individuals.

Non-residents

38. There have been some significant changes since 1928 in the rates of tax applicable to non-residents. Prior to that year, such rates depended only on the income of the non-resident which was liable to tax in India. The law was amended in 1928 so as to withhold the grant of refund on

company dividends and interest on securities from non-residents; this amendment was intended to bring the law into conformity with that prevailing in the U.K. An exception was, however, made in favour of non-residents who were British subjects or subjects of an Indian State; their personal rates of tax were to be calculated as if their income accruing in all countries arose in India and refund was to be allowed with reference to this rate. The principle underlying this differentiation was extended in 1939 to the taxation of all income of non-residents. Non-resident British subjects and subjects of Indian States were to be taxed at the rates applicable to their 'total world incomes', and other non-residents were to be charged to income-tax at the maximum rates and to super-tax at the rates appropriate to their total world income. After India became a Republic, the distinction between different classes of non-residents was abolished. An amendment inserted by the Finance Act of 1951 (which is still in force) provides that all non-residents are to be charged to income-tax at the maximum rate, and to super-tax on their total income at the rate applicable to the lowest slab for super-tax or at a rate appropriate to their total income, whichever is higher. The assessee is, however, given the option of being charged to tax on his total (Indian) income at the rate appropriate to his total world income. The option once exercised is binding on him for the future.

39. A number of representations have been made in regard to the rate structure, some in the direction of stiffening it, others in that of liberalising it. The considerations which arise relate not only to revenue, but also to social policy, and effect on savings and investment. We have already stated our general approach to this question in Volume I of our Report. Our detailed recommendations regarding the rate structure and the justification for them form the subject matter of Chapter IX of this Volume.

Taxation of special entities: Corporations

40. Companies have all along been treated as distinct taxable entities. In 1886, the net profits of a company were taxed at a flat rate. In 1916, an element of graduation was introduced by exempting from tax companies with an income of less than Rs. 1,000. Companies were made liable to super-tax, from 1917, on incomes exceeding Rs. 50,000. The amount paid or declared for payment by way of dividend was allowed to be deducted before super-tax was charged. The dividends were, however, assessed to super-tax in the hands of the shareholders. The taxation of undistributed profits to super-tax was considered by the Select Committee on the Super-tax Bill of 1917 "to operate harshly on those companies which had adopted the perfectly sound method of devoting a considerable portion of such undivided profits to creating a reserve fund......... We agree that there is a good deal to be said for this point of view, especially in India where commercial enterprises need careful nursing.....". The point was, however, not pressed as the Finance Member was willing to agree to an alternative provision allowing a deduction from taxable income of ten per cent. of the income chargeable under the Income-tax Act. This position was modified by the Super-tax Act, 1920, under which companies were to be charged to super-tax on both the distributed and undistributed profits at a flat rate of one anna in the rupee on that part of their income which was in excess of Rs. 50,000. Dividends were to be charged to super-tax in the hands of the shareholders.

41. The Income-tax Act of 1918 introduced a new provision for including dividends received by a shareholder in his total income for the purposes of determining the rate of tax on his other income; the dividends, however, continued to be exempt from tax in the shareholders' hands.

42. The Income-tax Act of 1922, which consolidated the law relating both to income-tax and super-tax, provided for credit to the shareholders for the income-tax (but not for the super-tax) paid by the company. The dividends were to be included in the shareholders' total income at a 'grossed' figure which included the proportionate income-tax paid thereon by the company and the shareholders were entitled to a refund on the gross dividend calculated at the difference between the company rate of tax and the personal rate of income-tax applicable to them.

43. In 1939, an important modification was introduced in the method of taxing companies in that the exemption of the first Rs. 50,000 of the income was given up and they were made liable to super-tax on every rupee of their income in the same way as for income-tax. In 1948, however, a principle of differentiation in favour of smaller companies by levying income-tax of only 2½ annas in the rupee on Indian companies with total income not exceeding Rs. 25,000 as against five annas in the rupee on other companies was introduced. Since 1949 this differentiation has taken the shape of an additional rebate of one anna in super-tax to companies whose total income does not exceed Rs. 25,000.

44. The Income-tax (Amendment) Act, 1939, also introduced a modification in the method of taxing dividends in the assessment of shareholders. The gross dividends were made taxable in the hands of the shareholder at the rate applicable to his personal income. At the same time, he was allowed a credit in his assessment equal to the proportionate income-tax paid by the company on such dividends.

45. There was a continuous rise in the rates of income-tax and super-tax on companies until 1944-45. In 1944-45, Government felt that some relief was necessary in order to enable companies to build up larger resources for purposes of post-war rehabilitation and expansion of industry. The Finance Acts of 1944 and 1945 provided for a rebate of super-tax of one anna in the rupee on the total income of a company as diminished by dividends declared on equity shares. In 1946, the differentiation between distributed and undistributed profits took the shape of an additional super-tax on companies which distributed dividends exceeding both five per cent. of the capital of the company and 30 per cent. of the total income. This additional super-tax was at graded rates progressing from two annas to seven annas in the rupee. In 1948, this method, which operated in the form of a penalty for excessive dividends, was replaced by a rebate of income-tax at the rate of one anna in the rupee on the amount by which the disposable income of a company (*i.e.*, its total income as reduced by seven annas in the rupee) exceeded the dividends declared. When profits which had been retained in one year and had attracted rebate were distributed in the subsequent year additional tax had to be paid on such distribution at a rate equal to the difference between five annas and the rebate already granted. This method still continues in operation. A number of questions, however, have been raised in regard to taxation of companies by witnesses who

appeared before us. These and other relevant issues are dealt with by us in Chapter X of this Volume.

Closely controlled corporations

46. A feature of the taxation of companies is the set of provisions prescribing compulsory distribution of a specified proportion of the profits of the companies in which the public are not substantially interested. The amending legislation was first enacted in 1930 in view of a series of instances that came to the notice of the Government in which the distribution of profits was being withheld in order to escape liability to super-tax and the profits were being subsequently withdrawn as 'loans' etc., free of interest. The provisions followed closely the U.K. law on the subject. It was prescribed that if a company, which was under the control of not more than five members, had failed to distribute a reasonable proportion of its profits having regard to its existing and contingent business needs, the Income-tax Officer was authorised, with the previous approval of the Assistant Commissioner of Income-tax, to treat the company as if it were a partnership. The additional demand raised under this provision was, however, recoverable from the company and not from the shareholders. As the criterion of 'reasonable needs' was found to be difficult of application in practice, the provision was amended in 1939 on the recommendations of the Income-tax Enquiry Committee, 1936, so as to require companies in which the public was not substantially interested to distribute 60 per cent. of their profits *less* tax as dividends; the proportion could be raised to 100 per cent. in certain circumstances. If a company failed to distribute the necessary portion of its profits, the Income-tax Officer could make an order deeming the balance to have been distributed as dividends, and recover tax thereon at the rates appropriate to the personal incomes of the shareholders, either from the shareholders themselves, or, if this was not possible, from the company. The rationale and the working of this provision are a subject of sufficient importance to merit an exhaustive discussion of the various issues raised before us which we have attempted in Chapter XI of this Volume.

Insurance business

47. Before 1918, the income-tax law did not contain any special provisions for the determination of the profits of life insurance business. The procedure of calculating these profits on the basis of the annual average of the surplus disclosed by the actuarial valuation was evolved departmentally to suit the special features of insurance as a business. This practice was given statutory recognition under the Acts of 1918 and 1922, both of which empowered the rule-making authority to make rules laying down the method of determining the profits of insurance business. The rules, which were made, provided for the calculation of profits on the basis of the annual average of the valuation surplus, and for the refund of tax deducted in excess from interest on investments. The profits of mutual life insurance companies were treated as being exempt from taxation, on the basis of judicial decisions. The profits of other forms of insurance business were to be calculated on the basis of the company's accounts, and allowance was to be made for a reserve for unexpired risks and for additional reserves made by the company.

48. The method of assessing the profits of life insurance companies was completely revised by the Income-tax (Amendment) Act, 1939.

The present method will be discussed in Chapter VIII. In the same chapter we shall also discuss the case for lower rates of taxation for insurance companies as compared to other companies.

Excess Profits Tax

49. An Excess Profits Duty was levied for the first time in 1919, and was in force only for one year. This form of income-taxation was, however, exploited more fully during the second World War. The Excess Profits Tax, which was introduced in 1940, applied to profits earned during the period from 1st September 1939 to 31st March 1946 by all businesses and professions, except (a) life insurance business, (b) professions where the earning of profits depended mainly on personal qualifications, (c) profits assessable only on the remittance basis and, (d) profits arising in Indian States after 31st March 1942. For each accounting year falling within the above years, a 'standard profit' had to be calculated. For the profits of the period between 1st September 1939 and 31st March 1941, excess profits tax was levied at the rate of 50 per cent. on the excess over the standard profits while a rate of 66 2/3 per cent. was applied on such excess during the period 1st April 1941 to 31st March 1946. If the profits of the accounting year were less than the standard profits, the consequential 'deficiency' of profits could be carried backwards or forwards. The excess profits tax was to be deducted in computing the assessee's income liable to income-tax and super-tax.

50. A deposit scheme was introduced in 1942 and was made compulsory from 1st January 1943 onwards. In addition to the excess profits tax payable by them, the assessees had to deposit an additional amount equal to certain prescribed percentages of the excess profits tax. These deposits were repayable after the termination of the War and one-tenth of the excess profits tax was also to be refunded to the assessees.

51. The excess profits tax charged and collections made during each of the years from 1940-41 to 1950-51 are shown in the following table:—

TABLE 1.—*Demand and collection of Excess Profits Tax from 1940-41 to 1950-51*

(Figures are in lakhs of Rupees)

Year ending (1)	Excess Profits Tax charged during the year (2)	Collections made during the year (3)
31-3-1941	56	54
31-3-1942	9,22	7,85
31-3-1943	26,21	20,78
31-3-1944	68,07	60,30
31-3-1945	1,14,00	1,02,15
31-3-1946	1,01,34	88,31
31-3-1947	94,46	75,76
31-3-1948	37,09	21,19
31-3-1949	35,30	28,49
31-3-1950	13,22	7,51
31-3-1951	13,27	8,12

The tax was abolished in 1946 and there has been no attempt since then to revive it.

Business Profits Tax

52. With the discontinuance of the Excess Profits Tax in 1946, however, a 'Business Profits Tax' calculated in a simpler manner than the excess profits tax was levied on profits earned by businesses from 1st April 1946 to 31st March 1949. This tax was imposed as an anti-inflationary measure. The types of business and profits subject to this tax were the same as for the excess profits tax, only the excess of the profits over a standard figure called the 'abatement' being chargeable to the tax. The abatement for companies was six per cent. of the working capital subject to a minimum of Rs. 1 lakh per annum upto 31st March 1947 and Rs. 2 lakhs per annum subsequently. For other assessees, the abatement was Rs. 1 lakh per annum* up to 31st March 1947 and Rs. 2 lakhs per annum subsequently. The tax was levied at the rate of 16⅔ per cent. of the amount of excess profits over the abatement up to 31st March 1947 and ten per cent. thereafter. The business profits tax, like the excess profits tax, was an admissible deduction for determining an assessee's income chargeable to income-tax and super-tax. This tax was abolished in 1949 and there has been no proposal to revive it since then.

Our views regarding the future use of special business taxes of the type mentioned above are contained in Chapter VIII of Volume I of the Report.

Division of proceeds of tax between the Central Government and the State Governments

53. Income-tax is one of the most elastic sources of revenue, and although the administration and collection of the tax is now Central, a part of the proceeds go into a divisible pool and are made available to State Governments. Accordingly, the tax plays an important role not only in the finances of the Central Government but also of the State Governments.

54. Before 1919, income-tax was a 'divided head' of revenue, but the proportion of the various divided heads of revenue which was retained by the Central Government varied from province to province. A complete separation between Central and provincial finances followed the Montague-Chelmsford Reforms; income-tax then became a part of the revenues of the Central Government. Even at that stage, however, a beginning was made, through Devolution Rules 14 and 15, in the direction of assigning a portion of income-tax to the provinces. Each province was to receive three pies in the rupee of the amount by which the assessed income of any year exceeded that of the year 1920-21; some *ad hoc* adjustments were made on account of the fact that certain large industrial units had their manufacturing organisations in a province different from the province in which they were assessed.

55. This scheme of allocation continued until after the Government of India Act, 1935 came into operation. The Taxation Enquiry

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*A higher abatement was admissible in some cases, as follows :—

To firms with three working partners	Rs. 1½ lakhs.
To firms with four or more working partners and to a Hindu undivided family	Rs. 2 lakhs.

Committee of 1924-25 had expressed the view that, if any division of taxes was to be made between the Centre and the provinces, the choice of income-tax as the main balancing factor was inevitable.

56. The Government of India Act, 1935, provided for assignment to provinces of a part of the net proceeds of central taxes on income after excluding therefrom the proceeds of corporation tax, income-tax and super-tax from Chief Commissioners' provinces and on federal emoluments, and after deducting the cost of collection; a surcharge could, however, be imposed wholly for federal purposes. The proportion of the total yield of income-tax to be assigned to the provinces was fixed at 50 per cent. on the recommendation of Sir Otto Niemeyer; the share of each province being calculated in an *ad hoc* manner on a variety of considerations. The percentages so fixed were given statutory recognition through an Order-in-Council, and distribution on this basis continued to be operative till 15th August 1947. As a consequence of Partition, the award of Sir Otto Niemeyer was reviewed by Shri C. D. Deshmukh and the revised percentages became effective from 1st April 1950.

57. The Constitution of India has, in Article 270, prescribed the procedure to be followed regarding the division of the revenue from taxes on income between the Central Government and the State Governments. Corporation tax is, however, excluded in terms of the Constitution from the definition of taxes on income and is therefore not divisible. The proportion of revenue to be assigned to the State Governments, and the allocation of this amount among them is to be decided on the recommendations of a Finance Commission to be appointed once in five years. The first Finance Commission so set up reported in December 1952. The Commission had to consider various conflicting suggestions regarding the criteria to be adopted for allocation such as the collection of income-tax in each State, or the collection adjusted with reference to the residence of the individuals paying tax or the origin of the income, the population of each State, the per capita income in each State, and the needs of each State for finances. The recommendations made by the Commission were based on the formula of distributing twenty per cent. of the States' share of the divisible pool according to collections in each State, and 80 per cent. according to population. These recommendations were given effect to by an Order of the President and 55 per cent. of the net divisible pool, is distributable among States in the proportions specified in the Order with effect from 1952-53.

58. We have given these details in order to underline the importance of income-tax from the point of view of both the Central Government and the State Governments. State Governments have thus specific interest in the working of the income-tax system. Their full co-operation is needed, especially in regard to the collection of arrears, which work is entrusted to the State administrative machinery.

Administrative machinery

59. We have so far discussed the growth of the various concepts which have been built into our income-tax system and have gone to mould the rate structure. We shall now briefly review the growth of the administrative machinery employed for assessing and collecting the tax. In the earlier days, the assessment and collection of

income-tax formed only one of the multifarious duties of the land revenue departments in the provinces. The need for specialised personnel for this work was realised only when its contribution to revenue became substantial; and a Central Department meant exclusively for income-tax administration was created in 1922. Since then, the administrative framework of the income-tax system has not undergone any substantial alteration. The present structure of the Income-tax Department consists of a Central Board of Revenue at the top, with Commissioners of Income-tax posted on a regional basis who are in turn assisted by Inspecting Assistant Commissioners of Income-tax. Assessment is made by an Income-tax Officer whose work is supervised by the Inspecting Assistant Commissioner and the Commissioner of Income-tax. The appeals from his orders are heard, in the first instance, by an Appellate Assistant Commissioner who, though he is under the administrative control of the Central Board of Revenue, is ensured under the Act independence in regard to his appellate functions.

Procedure of assessment

60. The procedure for the reporting of income by assessees has undergone a process of gradual evolution. The Income-tax Act of 1886 laid an obligation only on companies to file every year statements of their net income and it was entirely within the discretion of the Collector to devise means for finding out other persons likely to have taxable income and to adopt the appropriate method of determining their income. The Act of 1918 prescribed a more elaborate form of return to be filled in by companies, and required the Collector to send notices calling for a return of income to other assessees believed to have incomes of over Rs. 2,000 per annum. Since 1939, a statutory obligation has been laid on assessees having taxable income to file voluntary returns of their income although individual notices still continue to be sent.

61. The methods of determining a person's income and the tax payable by him have gradually become more and more elaborate. Under the Act of 1886, the procedure for assessment was summary and the Collector could intimate the amount of income and tax determined by him to the assessee either through a list published in his office or through an individual notice; normally, individual notices had to be sent to assessees whose income was over Rs. 2,000 per annum, but the Collector had considerable discretion in the matter.

Composition of tax

62. Companies and other persons could also enter into an agreement with the Collector for composition of the tax for a number of years at an agreed annual amount.

63. The Act of 1918 required the Collector, when he was not satisfied that an assessee's return was correct and complete, to give him an opportunity to produce his accounts and evidence. With increasing rates of tax and with successive changes in the law, an elaborate procedure for scrutiny of the evidence has been evolved so as to provide adequate safeguards both for revenue and for the assessee.

64. The power to reopen assessments, where income chargeable had escaped assessment or been under-assessed, was first conferred

on the revenue authorities in 1918. Such re-assessments were to be made within a period of one year following the normal year of assessment. Since 1939, this period has been extended to eight years in cases of deliberate concealment and to four years in other cases.

Appeals

65. Assessees, who were aggrieved by the assessment made on them, had the right, under the Act of 1886, to appeal to the Collector in certain cases and to the Divisional Commissioner in other cases. The Act of 1918 provided for all appeals to be filed direct before the Commissioner of Income-tax. Discretionary power was also given to the Chief Revenue Authority, on its own initiative or on application by the assessee, to refer to the High Court any points of law other than those arising from penalty or prosecution proceedings.

66. In the new administrative machinery set up in 1922, assessments were to be made by the Income-tax Officer, and appeals lay to the Assistant Commissioner (except where the assessee had defaulted in filing a return or in producing his accounts). A second appeal lay to the Commissioner, and the Commissioner could refer points of law to the High Court, at his own instance or on the application of the assessee. If the Commissioner declined to state a case to the High Court (which he could do only if he considered that no point of law was involved), the assessee could approach the High Court for a *mandamus* requiring the Commissioner to state a case. In 1926, a further right of appeal to the Privy Council was given, in order to resolve the situation which had been created by conflicting decisions given by different High Courts on the same point.

Changes made in 1939

67. The machinery for appeals was completely changed in 1939, as a result of the recommendations of the Income-tax Enquiry Committee, 1936. A separate cadre of Appellate Assistant Commissioners of Income-tax was created, whose function was exclusively to deal with appeals against orders passed by Income-tax Officers. The function of hearing second appeals was transferred from the Commissioner of Income-tax to a new authority established in 1941. The decisions of this authority, the Income-tax Appellate Tribunal, are final on questions of fact: on questions of law, it may make a reference to the High Court, on application either by the Commissioner of Income-tax or the assessee. The Commissioner of Income-tax continues to have the power of reviewing the decisions of the lower authorities. It will be seen, therefore, that with the growing complexity of income-tax assessments and the vast increase in the amounts involved, increasing facilities are being provided to the assessee to have his point of view adequately taken care of. Several suggestions, however, have been made before us for improvement in this regard; and we discuss them in detail in Chapter XIII of this Volume.

Collection and recovery

68. The principle of deduction of tax at the source (from salaries and interest on securities) has been adopted in the Indian system from the very beginning. The Income-tax Act of 1886 made the paying officer responsible for deduction from the salaries of Government servants and of employees of local authorities. Other employees were under an obligation to pay the tax in instalments as and when the salary was paid but the Collector could enter into an agreement with an

employer for the deduction of the tax and its payment into the treasury, in which case the employer was entitled to payment of a commission. Where there was no such agreement, the tax found due on assessment was to be paid within the time specified by the Collector, and arrears of tax could be recovered as if they were arrears of land revenue. The Income-tax Act of 1922 extended to all employers the obligation to deduct tax at the source on salaries. Although assessments were now made by a department of the Central Government, the machinery of the provincial revenue departments continued to be used for recovering arrears of tax from defaulters. Where defaults occurred, the Income-tax Officer could issue a certificate to the Collector, and the Collector could then proceed to recover the amount covered by the certificate as if it were an arrear of land revenue. The system of collection and recovery has remained substantially the same as described above.

Payment of tax in advance and provisional assessments

69. An important development has been the introduction of a scheme of payment of tax in advance, something in the nature of 'pay-as-you-earn'. An assessee is required under the scheme to pay the estimated tax on the income of each year in advance, in three or four instalments. The amount of advance tax to be paid is determined by the Income-tax Officer on the basis of the last completed assessment but the assessee can submit his own estimate subject to a penalty if his estimate falls short of the actual tax by a margin of over twenty per cent. When a return of income filed by an assessee shows that he will have to pay some more tax in addition to the advance tax already paid by him, the Income-tax Officer has been given the power, since 1948, of making a provisional assessment on the basis of the return, and of collecting the tax found due. Another improvement which was effected in the process of recovery was the conferment of power on the Income-tax Officer to issue a *garnishee* order to any person from whom money may be due to an assessee to pay over the amount towards arrears of tax due from the assessee. Despite all these measures, the fact still remains that there is a large volume of arrears awaiting recovery. We deal with this problem of arrears in detail in Chapter XIII of this Volume.

Evasion and avoidance

70. Evasion and avoidance of income-tax are as old as the tax itself. Numerous amendments have had to be made to the Income-tax law since 1886 for closing loopholes which gave room for leakage of revenue as and when they were discovered. The history of legislation regarding the taxation of a firm, the evolution of the concept of receipts which are 'deemed' as income, the invalidation for the purposes of income-tax law of acts that are otherwise legal, and the regulation of distribution of profits by companies in which the public are not substantially interested—these are only a few instances which illustrate the vigilance with which the law has had to protect revenue against those who use their skill to outwit its intentions.

71. The Income-tax Investigation Commission submitted in 1948 a report on the adequacy of income-tax law from the point of view of preventing evasion and avoidance. Some of its recommendations were incorporated in the law by the Income-tax (Amendment) Act, 1953, while others still remain to be implemented. In Chapter XII

of this Volume, we have reviewed some of the more important of its recommendations as well as some other points that emerged during the course of our discussions and have recorded our recommendations in respect of them.

Use of income-tax as an incentive

72. We may notice one more feature of the income-tax system, *viz.*, inclusion of incentives for capital formation and economic development. This is a recent feature. Thus, a rebate of one anna in the rupee is given on all undistributed profits of companies. A new section, 15C, has been introduced in 1949 under which new industrial undertakings which were not formed by the splitting up or reconstruction of an existing business, and which began to manufacture articles on or after 1st April 1948 are exempt from tax, for the first five years after the commencement of the manufacturing operations, on that part of their profits which is not in excess of six per cent. of the capital employed. The concession was originally available to undertakings which employed at least 50 persons, but from 1st April 1952, it has been made applicable to undertakings which have ten or more workers in a manufacturing process carried on with the aid of power, and twenty or more workers, without the aid of power. The exemption from corporation tax to dividends received by a company on shares held by it in another company is an incentive to investment included in the present law. Such an exemption in respect of Investment Trust Companies fulfilling certain conditions is as old as 1933; a new provision was introduced in 1953 whereby a similar concession has been extended to companies which hold shares in an Indian company which is wholly or mainly engaged in any one of the ten industries specified in the section subject to the necessary conditions being fulfilled.

Statistics on Income-tax

73. Having surveyed briefly developments in the law and practice of income-tax in India, we now proceed to give a brief review of the operation of the tax in terms of income assessed, the number and distribution of assessees, and the amount of revenue collected. The statistical material that we have utilised is not, however, satisfactory for a historical and comparative analysis. The separation of Burma, the partition of the country in 1947 and the financial integration of Part B States are some of the factors affecting the utility of the statistical material. In addition, we may draw attention to the fact that income-tax statistics are compiled on the basis of the number of assessments completed and the demand raised. As arrears of assessment and collection are included in the statistics, they vitiate comparative analysis.

Net collections

74. Net collection from income-tax rose from Rs. 1·37 crores in 1886-87 to Rs. 191·3 crores in 1944-45—a significant increase judged by any standard. The net collection remained between Rs. 2 crores and Rs. 3 crores until 1915. With the introduction of graduation and the concept of total income and of super-tax between 1916—18 the net collection rose to Rs. 22 crores in 1919-20. The figure continued to range during 1930 to 1939 between Rs. 15 and 18 crores. After the comprehensive amendments in the law in 1939 and the introduction of slab rates, the net collection rose to Rs. 26 crores in 1940-41. Thereafter, the net collection rose rapidly as a result of the operation of various

factors such as the expansion of money incomes during the War, the levy of the surcharge, which was ultimately amalgamated with the normal rates, at progressively increasing rates, and the levy of the Excess Profits Tax. The peak figure for net collection was Rs. 191 crores in 1944-45. The Excess Profits Tax was abolished with effect from 1st April 1946 but the disposal of arrears continued to yield substantial revenue in the next three or four years. Net collections stood at Rs. 163 crores in 1953-54. Annual figures for the period 1948-49 to 1953-54 are given below:—

TABLE 2.—*Net collections of income-tax and super-tax from* 1948-49 *to* 1953-54

Year	Amount (in crores of Rupees)
1948-49	183
1949-50	160
1950-51	173
1951-52	188
1952-53	185
1953-54	163

Broadly speaking, the present level of net yield is attributable to (i) the enlargement of the basis of liability brought about as a result of the 1939 legislation, (ii) the introduction of slab rates in that year, (iii) the steep rise in the rates during the Second World War and (iv) the increase in taxable income due partly to economic development but more particularly to the inflationary conditions of the economy during and since the War. The increase in the yield is thus also reflected in the number of assessees and the volume of taxable income, but the proportions of increase among different income groups, sources of income and industrial groups show considerable variations.

Number of assessees

75. The number of assessees in 1904-05 was 2,43,000, when the exemption limit was Rs. 1,000; after the exemption limit was raised to Rs. 2,000, the number registered was 2,73,311 in 1922-23; and it was 2,85,940 in 1938-39 on the eve of the Second World War, with the exemption limit continuing at Rs. 2,000. The increase in the tempo of War activities was reflected in 1940-41 when the number of assessees rose to 3,63,532. It was 4,47,494 in 1946-47 immediately before the Partition of the country. There has been a considerable increase in the number of assessees since partition, which may partly be attributable to the inclusion of new assessees from Part B States since 1950-51 and partly to the new assessees that have been discovered as a result of the external survey referred to in paragraphs 7—9 of Chapter XII of this Volume.

76. The following table shows the number of assessees on the Index Register of the Income-tax Department as on 1st April for

each year since 1948-49 by income groups and separately for salary earners:—

TABLE 3.—*The number of assessees since 1948-49 according to income groups*

Year	Assessees with annual business income of				Salaried assessees, cases involving loss etc.	Total
	More than Rs 25,000	Between Rs. 10,000 and Rs. 25,000	Between Rs. 5,000 and Rs. 10,000	Less than Rs. 5,000		
1	2	3	4	5	6	7
1948-49	36,598	59,352	92,130	1,42,769	1,90,996	5,21,845*
1949-50	39,242	61,090	87,832	1,42,500	2,15,852	5,46,516*
1950-51	43,830	75,526	1,17,063	1,61,555	3,06,257	7,04,231*
1951-52	45,761	81,229	1,31,312	1,55,717	3,82,297	7,96,316
1952-53	51,795	96,173	1,46,635	1,61,030	4,44,773	9,00,406
Percentage increase between 1948-49 and 1952-53	*40*	*39*	*59*	*13*	*133*	*42*

*Contains assessments re-opened under section 34 for which no separate record was kept before 1951-52.

77. The largest increase in numbers has been taken place among salaried assessees in spite of the rise in the exemption limit from Rs. 3,000 in 1948-49 to Rs. 3,600 in 1951-52.

Total income assessed

78. The total income assessed was Rs. 33 crores for assessees with income above Rs. 2,000 in 1886-87, Rs. 53 crores in 1903-04; Rs. 236 crores in 1922-23 after the concept of 'total income' and graduation had found a place in the system, and it had dropped to Rs. 174 crores in 1937-38, owing to the 'depression' of the 'thirties. It rose to Rs. 215 crores in 1940-41, to Rs. 406 crores in 1943-44 and Rs. 483 crores in 1946-47, *i.e.*, immediately before Partition. The table below shows the variations in the post-partition period:—

TABLE 4.—*Incomes subjected to income-tax from* 1948-49 *to* 1952-53

(In crores of Rupees)

Year	Total Income*
1948-49	571
1949-50	587
1950-51	575
1951-52	783
1952-53	710

*After deduction of earned income relief, where due.

A portion of the increase from 1950-51 is attributable to the inclusion of figures relating to Part B States.

79. The total assessed income is distributed among companies and assessees other than companies as follows:—

(In crores of Rupees)

Category	1940-41	1952-53
Companies	47·39	200·34
Other than companies	167·54	510·68

The total assessed income of companies increased by 325 per cent. since 1940-41 while the increase for assessees other than companies in the corresponding period was 200 per cent. The income earned by companies in 1952-53 was roughly of the order of 30 per cent. of the total income earned by all assessees put together, which shows the importance of the company form of organisation among the income earners in India.

80. The comparative figures of total assessed income for assessees other than companies with income from 'business and professions' and companies are shown in the table below:

(In crores of Rupees)

Category	1940-41	1952-53
Business and professions	57·60	215·78
Companies†	47·39	200·34

†Includes income from sources other than business also.

The income from business and professions is practically of the same order as that of the income of the companies.

81. Among the companies, those with an income above Rs. 2 lakhs accounted for Rs. 174 crores of the total assessed income out of Rs. 200 crores in the year 1952-53; *i.e.*, about 87 per cent. of the total income from companies as against the corresponding figure for 1940-41 which was 82 per cent. Among non-company assessees, the distribution of total assessed income shows that the larger proportion accrues to assessees with an income of Rs. 25,000 and under. They accounted for Rs. 338 crores out of a total assessed income of Rs. 510 crores in 1952-53, *i.e.*, nearly 66 per cent. of the total income relating to that category; the corresponding figure for 1940-41 was nearly 80 per cent. The share of persons with incomes below Rs. 25,000 in the total assessed income has gone down in 1952-53 as compared to 1940-41.

82. The position regarding the distribution of total income according to various sources of income is as follows:—

TABLE 5.—*Distribution of income assessed according to sources of income*

(In crores of Rupees)

Sources	Total assessed income in		
	1940-41	1948-49	1952-53
Salaries	65·20	130·36	167·14
Interest on securities	6·59	14·33	23·54
Property	13·51	21·45	32·09
Business including companies	104·99	344·67	416·12
Other sources*	24·46	74·13	90·71
TOTAL	214·75	584·94	729·60

* 'Other sources' include dividends.

83. The income assessed under the head 'salaries' has shown an increase of nearly 150 per cent. over the 1940-41 level; the income from interest on securities has increased by 260 per cent.; that from 'property' by 150 per cent.; that from business by 300 per cent. and from other sources, which include dividends, by 280 per cent.

84. The distribution of total assessed income according to different types of industries is of some interest. The industries have been classified into nine groups for purposes of income-tax statistics and some of them consist of heterogeneous elements but the comparative analysis is useful for understanding the relative importance of different industries:—

TABLE 6.—*Distribution of income assessed according to industries*

(In crores of Rupees)

Categories of industries	Total taxable income in	
	1941-42	1951-52
Mines, quarries, etc.	7·46	17·42
Textile manufacture	7·59	26·46
Manufacture of metal and metal goods	11·43	20·12
Food manufacture etc.	7·27	27·41
Manufacture of chemicals, leather goods etc.	4·05	17·64
Building and miscellaneous manufacturing trade	4·53	20·65
Distribution and communications	47·78	235·86
Finance	14·61	53·69
Professions, *i.e.*, doctors, lawyers, etc.	12·44	36·68
TOTAL	117·14	455·93

85. Expansion of income has taken place almost in every trade but it is most marked under the classifications 'distribution and communications'. The former includes, among others, wholesale and retail merchants in almost every line, managing agents, road and air transport business.

86. The broad picture that emerges from study of figures relating to the distribution of the total assessed income among the various sectors of the economy is:—

(i) that the company form of organisation is gaining importance as a major income-earning activity;

(ii) that proprietary business is and continues to be an important factor in the economy;

(iii) that in the business sector, trading concerns predominate, thus underlining the fact that we have still a long way to go in productive and industrial development; and

(iv) that the share in the total assessed income of persons with incomes above Rs. 50,000 a year has increased, and of persons with incomes below Rs. 25,000 has declined since 1940-41. The significance of money incomes in real terms, however, has altered greatly since that year.

87. In the succeeding chapters in this Volume, we proceed to discuss the income-tax system in detail, examine the various suggestions made for its improvement, and put forward our recommendations with a view to rationalising the system and enabling it to play a more adequate and efficient role in both the fiscal system and the economy of the country.

CHAPTER II

BASIS OF LIABILITY TO TAX

Present Indian law

We have already referred in paragraph 5 of Chapter I of this Volume to the history of the law regarding the basis of liability to income-tax. The present provisions affecting liability to income-tax were brought into force from 1st April 1939 as a result of the recommendations of the Income-tax Enquiry Committee, 1936. The basis of liability is defined in sections 4, 4A and 4B of the Indian Income-tax Act. Briefly stated, the position is as shown in the table below:—

	Status of assessee		
	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
1. Income accruing, arising or received, or deemed to accrue, arise or be received, in the taxable territories.	* Taxable	* Taxable	† Taxable
2. Income accruing or arising outside the taxable territories (subject to a deduction of unremitted income up to a maximum of Rs. 4,500).	‡ Taxable	§ Taxable, if it is derived from a business controlled in, or a profession or vocation set up in India.	Not taxable
3. Remittances received out of income which accrued outside India after 1-4-1933 and before the beginning of the previous year.	** Taxable, unless already taxed in the year of accrual.	Taxable, unless already taxed in the year of accrual.	Not taxable

*Section 4(1) (*a*) and (*b*) (1) of the Indian Income-tax Act.

†Section 4(1) (*a*) and (*c*), *ibid.*

‡Section 4(1) (*b*) (*ii*) and third proviso, *ibid.*

§Section 4(1) (*b*) (*ii*) and second proviso, *ibid.*

**Section 4(1) (*b*) (*iii*), *ibid.*

Taxation of residents

2. It will be observed that a 'resident and ordinarily resident' person is liable to pay tax on:—

(i) income accruing or arising to him or received by him or deemed to have accrued or arisen to him or to have been received by him within the taxable territories;

(ii) income accruing or arising to him or received by him outside the taxable territories, subject to a deduction of Rs. 4,500; and

(iii) remittances received by him out of profits which arose to him outside the taxable territories from any source subsequent to 31st March 1933.

Double income-tax relief is allowed under section 49D of the Indian Income-tax Act on that part of an assessee's income which accrued or arose outside India, unless special arrangements exist between India and the country in which the income arose regarding the manner in which relief should be calculated.

'Non-residents'

3. A 'non-resident' person pays tax only on income which accrues or arises to him or is received by him in India or which is deemed to accrue or arise or be received in India. The rate of tax is determined by special provisions contained in section 17(1) of the Indian Income-tax Act. Briefly stated, he has the choice—which, once made, is final—of the rate of tax applicable to him being determined on the basis of the total world income or on the basis of the maximum rate of income-tax *plus* super-tax at the rate applicable to the first slab above the slab exempt from super-tax, or super-tax applicable to his income accruing or arising or received in India, whichever is greater.

'Resident but not ordinarily resident' persons

4. A person who is 'resident but not ordinarily resident' is liable to pay tax on all income accruing or arising or received in India and income deemed to accrue or arise or be received in India, and on such of his foreign income as is attributable to a business controlled in or a profession or vocation set up in India. In addition, a person who is 'resident but not ordinarily resident' is chargeable to income-tax on all remittances received by him from outside India, in the same way as a fully resident person. The rate of tax is determined on the basis of his income brought to charge in the taxable territories.

5. Different tests of residence apply to individuals, Hindu undivided families, companies, firms and associations of persons; these will be described in the appropriate context in this chapter when issues relating to them are under discussion.

Suggestions for modification

6. The important questions affecting the basis of liability to income-tax, which arise from the various suggestions made to us or otherwise, are indicated below:—

(i) foreign profits of 'residents' should be exempted from tax;

(ii) the category 'resident but not ordinarily resident' should be abolished;

(iii) special provision should be made for foreign technicians who are being increasingly employed by Indian industry;

(iv) the criterion for determining the residence of a company by comparison of its Indian income and foreign income, should be abandoned;

(v) the concessions recently granted in respect of remittances of foreign income should be continued;

(vi) the provisions in the law relating to income deemed to accrue or arise in India as a result of 'business connection' should be liberalised; and

(vii) there should be a review of double income-tax relief or avoidance arrangements.

Taxation of foreign profits

7. One of the important suggestions made to us is that income arising outside India to a resident should not attract liability to Indian income-tax, though it may be taken into consideration for determining the rate of tax on Indian income. It is stated that this will facilitate the expansion of Indian trade and business abroad and will also assist them in competing in the world markets. It is also contended that risks attending the investment of Indian capital outside India are greater than those attending its investment in India, and the economic justification for taxing foreign earnings is therefore comparatively weaker than that for taxing income arising in India. The psychological effect of exempting foreign income would be to develop Indian trade and business abroad, with corresponding augmentation of invisible exports and exchange resources. Such funds when remitted to India will also add to the capital resources of the country. It is also suggested that the cost to the exchequer will not be very heavy, as unilateral relief in respect of double income-tax is already available under the Indian Income-tax Act.

8. Foreign income was brought to charge on the accrual basis on a recommendation of the Income-tax Enquiry Committee, 1936, and the principal reasons that influenced its views were:—

(a) opportunity is afforded for evasion and legal avoidance of tax, which, it stated, it had seen in several cases, if foreign profits were exempt from Indian tax; and

(b) encouragement is afforded to investment abroad by wealthy persons. There are thus likely to be adverse effects on the supply of capital for Indian industry.

The Committee added that there was no reason in equity why investment of money abroad, as contrasted with home investment, should be given immunity from taxation.

9. We think that these arguments still have force though their importance will decrease with the conclusion of double income-tax avoidance arrangements on the model of the Indo-Pakistan Agreement. Until then, remittances of foreign profits to India will bear a higher rate of tax, notwithstanding the unilateral relief arrangements, provided the Indian tax rates are higher than those of the country where the foreign income arises. We, therefore, think that some arrangement is necessary under which the remittances of foreign income are relieved of this additional burden and at the same time foreign income continues to be taxed on the accrual basis as hitherto.

10. We, therefore, recommend the adoption of the following scheme:—

(i) the foreign income of a resident should continue to be taxed as hitherto in the year of accrual;

(ii) unilateral relief should also continue to be extended to such income if it has suffered tax abroad;

(iii) in the year in which the assessee remits the earnings so taxed to India, he should be given a refund of the actual tax borne by him. This will be regulated as follows:—

(a) there will be no refund if the Indian and foreign tax rates are the same;

(b) the refund will equal the difference between Indian and foreign rates if the former is higher; and

(c) no refund will be involved if the Indian rate is lower than the foreign rate.

Transitional provisions would be necessary in respect of income which had accrued before the system of full unilateral relief came into force, or in respect of which double income-tax relief had been granted on some other basis.

Resident but not ordinarily resident persons

11. One of the consequences of accepting the recommendations of the Income-tax Enquiry Committee, 1936, regarding the taxation of foreign income of residents on the accrual basis, was that persons who did not habitually reside in India attracted the same liability to income-tax as those who had been habitual residents of India. This particularly affected the European official or the trader in the early years of his stay in India, and the Indian trader abroad who had an ancestral house in India and who visited the country only occasionally. The amendments carried out to the Income-tax Act in 1939, therefore, provided for the creation of a third category which was styled as 'resident but not ordinarily resident'. Two concessions were given to them:—

(i) their foreign income was not taken into consideration for the Indian tax unless it was derived from a business controlled in or a profession or vocation set up in India;

(ii) the rate of tax applicable to them was determined on the basis of their Indian income, unlike on the basis of global income for residents and non-residents.*

We have received strong representations for the abolition of this category. The point was considered by the Income-tax Investigation Commission, which also suggested its abolition. We find ourselves in agreement with it as we think that there should be no feeling among tax-payers that there is a favoured class among them. Secondly, it does serve as an inducement for reducing tax liability if business or other transactions could be arranged accordingly. We, however, fully appreciate that the sudden withdrawal of the category will mean hardship to some assessees in the category 'resident, but not ordinarily resident'. We, therefore, recommend that, simultaneously with its withdrawal, the tests for residence should be reviewed.

12. An individual is, under the present law, resident if he satisfies any of the four following conditions contained in section 4A of the Indian Income-tax Act:—

(i) he is in India for periods totalling at least 182 days in the year;

*Subject to the provisions of section 17(1) of the Indian Income-tax Act.

(ii) a dwelling place in India is maintained by or for him for periods totalling at least 182 days in the year, and he is physically present in India for *any time* in the year;

(iii) he has been in India for periods totalling at least 365 days in the last four years, and is in India at any time in the year otherwise than on an occasional or casual visit;

(iv) he is in India for any time in the year, and the Income-tax Officer is satisfied that he is likely to remain in India for at least three years from the date of his arrival.

If the condition in the second and third clauses, of being physically present in India for *any time,* is relaxed and a specific period fixed, several persons who are residents under the present law would become non-residents. The fourth clause was intended to help foreigners coming into India by treating them, in the year of arrival, as not ordinarily resident instead of non-resident; if the former category is abolished, they would become fully residents, and would thus be at a disadvantage. This clause could, therefore, be repealed.

13. We accordingly recommend that section 4A(a) of the Income-tax Act should be recast so as to read as follows:—

"For the purposes of this Act,

(a) any individual is resident in the taxable territories in any year if he:—

(i) is in the taxable territories in that year for a period or periods amounting in all to one hundred and eighty-two days or more; or

(ii) maintains or has maintained for him a dwelling place in the taxable territories for a period or periods amounting in all to one hundred and eighty-two days or more in that year, *and is in the taxable territories for a period or periods amounting to ninety days or more in that year;* or

(iii) having within the four years preceding that year been in the taxable territories for a period or for periods amounting in all to three hundred and sixty-five days or more, *is in the taxable territories in that year for a period or periods amounting to ninety days or more*:

Provided that if he has, within the seven years preceding that year, been in the taxable territories for a period or for periods amounting in all to seven hundred and thirty days or more, he will be deemed to be resident in the taxable territories in that year, if he is in the taxable territories at any time in that year otherwise than on an occasional or casual visit."

14. The proviso to clause (iii) has been added to prevent the possibility, which might otherwise arise, of a person managing to spend nearly three months in India every year (and longer periods in some years), without attracting liability to tax as a resident at any time.

15. The criteria for determining the residence of Hindu undivided families, firms and other associations of persons do not need any change.

16. One of the consequences of the suggested abolition of the category 'resident but not ordinarily resident' is that foreign technicians would attract liability as 'residents' if they spent more than 182 days in India in any year. It has been represented to us that this would cause hardship and would act as a deterrent to the employment of foreign technicians whose services are necessary in the present stage of India's development. Under Section 4(3) (xiv) of the Indian Income-tax Act, which was inserted in 1953, the remuneration received by an employee of a foreign enterprise, for services rendered during his stay in India, has been completely exempted from tax if the periods of his stay do not exceed 90 days in any year, where the employer is not engaged in any trade or business in India. We consider that some concessions should also be granted to foreign technicians employed by concerns which carry on business in India. Any loss of revenue which might be caused through such concessions would, in our opinion, be more than counter-balanced by the resultant encouragement to the industrial development of the country. We would recommend that the income of a foreign technician during the year in which he arrives in India should be completely exempted from income-tax and super-tax in this country. His income in the second year should also be completely exempted, if the total period of his stay in India is not more than 365 days. If, however, the period of stay exceeds 365 days, he should be charged to tax on the income of the second year either as a non-resident or as a resident, according to the application of the normal law.

Foreign technicians

17. Our attention has been drawn to the immunity from taxation enjoyed under the United Nations (Immunities and Privileges) Act, 1947, by certain employees of the United Nations and of its organisations who are Indian citizens. The Central Government have the power to extend this immunity to employees of other international organisations also. We understand that, in the United States, no such immunity is available to citizens of the United States. We see no reason why a citizen of India working in India should be exempt from tax on the remuneration received by him. We recommend that the law should be amended so as to subject to tax the remuneration received by Indian citizens employed by such organisations in India.

Exemption of employees of International Organisations

18. Under the present law, a company is 'resident' in any year either if the control and management of its affairs is situated wholly in the taxable territories in that year or if its income arising in the taxable territories in that year exceeds its income arising abroad. For the application of the latter criterion, all the income arising to the company in India (including agricultural income and other non-taxable income) is compared with the income arising abroad. The effect of a company being resident under this criterion is that its global income is brought to charge in India and remittances are also taxable under certain circumstances. Such companies are entitled to double income-tax relief, but certain anomalies arise. For example, no double income-tax relief is allowed on income that is brought to charge on the remittance basis. As most of the companies affected are incorporated and controlled outside India, some witnesses have argued that this

Criteria for determining residence: Income criterion for Companies

criterion constitutes an act of discrimination against foreign capital and creates a psychological atmosphere which is not conducive to the flow of foreign capital. On the other hand, some of the witnesses examined by us have pointed out that there are a large number of companies which derive practically all their income in India, but are controlled from abroad. As the economic activities of such companies are largely in India, they argue that it would be equitable to treat such companies as resident companies. The present law, it is stated, gives an unfair advantage to companies as compared to 'firms' and 'associations of persons'. While the latter type of organisations are treated as 'resident' if there is even partial control in India, companies are treated as 'resident' only if they are *wholly* controlled in India. As the 'control' of the affairs of a company is exercised by the directors, usually in one place, it will not be practical to apply the criterion of partial control to them. These witnesses argue, therefore, that it is necessary to have some other criterion to secure equitable treatment which is what the income criterion achieves.

19. We would like to point out, at the outset, that the argument regarding discrimination against foreign capital is far-fetched as the criterion, if it imposes additional liability on certain companies, also secures to them certain rights regarding the treatment of foreign losses. The last factor was considered so important that the Income-tax Investigation Commission recommended that special safeguards should be provided against the set-off of foreign losses which had become a feature of the working of this criterion. There are, however, other reasons for which we would suggest that the criterion of income should be deleted from the law. Before federal financial integration took place in 1950, companies were incorporated in Indian States which derived a substantial part of their income in the then (British) India. They would have escaped income-tax on their foreign income if the criterion of control alone was in force. This problem no longer exists, and we are now concerned only with companies incorporated outside India. Income arising in India or deemed to arise in India to such a company is fully taxable, whether the company is treated as resident or non-resident. Income arising outside India becomes taxable only if the company is resident. Out of the tax so levied, a portion is refunded on account of the unilateral relief for double income-tax or in virtue of double tax relief agreements, where they exist. The extra tax liability on the company is, therefore, not large.

20. We have noticed a trend in recent international agreements to relate taxability of income mainly to its origin. If India enters into agreements with other countries, on the model of the Indo-Pakistan Agreement, even the limited advantage to revenue which now flows from the criterion of income will disappear.

21. Considering all these factors, we believe that there is no longer any justification for retaining the income criterion for determining the residence of companies. We, therefore, recommend that it should be abandoned.

22. In view of this recommendation, it is not necessary to consider the further suggestion that has been made to us, *viz.*, to make special provisions regarding the carry-forward and set-off of losses sustained by such companies outside India.

23. In an earlier paragraph we have recommended that a rebate of tax should be granted when remittances are received by residents of India out of foreign income which has already suffered tax in the year of accrual. In addition, there are certain items of income which are now taxed only on remittance.

Remittance basis

These comprise:—

(i) amounts earned abroad in the previous year for 1939-40 or subsequent years when the tax-payer was non-resident, and remitted to India in a subsequent year when he is resident;

(ii) income earned abroad between 1st April 1933 and the previous year for 1939-40 assessment, and brought in subsequently during a year when the tax-payer is resident; and

(iii) remittances attributable to the deduction of Rs. 4,500 a year allowed to residents out of income accruing abroad.

24. It has been suggested to us that there is an element of hardship in taxing profits earned abroad in a year when the tax-payer was non-resident, just because he is resident when he brings them into India. The remittance basis of taxation is likely to disappear gradually from our income-tax system if, as we hope will be the case, double income-tax avoidance agreements are concluded with other countries in which Indians derive income. As long as this basis continues to be in force, however, some mitigation of the consequent hardship is desirable. We observe that two concessions have recently been introduced, which go a long way in this direction. The first concession, which was intended to help Indian nationals who return to India with their savings to settle down here in view of changed political circumstances, is to exempt remittances received by a person who was non-resident in two out of the three preceding years. The second concession, which is intended as an incentive to the flow of capital into the country and is applicable to all residents, exempts remittances received between 2nd September 1951 and 31st March 1956 on certain conditions.

25. The effect of the first concession is that a person who has previously been non-resident, and comes to India to take up residence here, will be exempt from tax on remittances received by him within the first two years of his becoming 'resident'. It has been represented to us that this period has proved insufficient in practice because of restrictions which are in force in various countries on remittances outside the country concerned. A suggestion has, therefore, been put forward that the period of two years should be extended to five years, or until the embargo on remittances is removed. It does not appear that remittances abroad are completely barred in any country: the position is that they are subject to restrictions of varying degrees. We do not, therefore, suggest any general extension of the concession. At the same time, power should be conferred on the Central Board of Revenue to grant exemption in cases of hardship, where the tax-payer in spite of his best efforts, was not able to remit his funds to India within the period allowed by the existing proviso.

26. As regards the second concession, which is useful in encouraging repatriation of profits to India, we recommend that it should be continued for an indefinite period beyond the 1st April 1956, when the concession would otherwise lapse.

Business connection

27. We now turn to a problem which has attracted a good deal of attention, *viz.*, the taxation of non-residents on income deemed to arise in India through 'business connection'. Section 42 of the Indian Income-tax Act provides that income arising through a 'business connection' in India, or through or from money lent at interest and brought into India in cash or in kind, or through or from any property in India, or through or from any asset or source in India, shall be deemed to accrue in the taxable territories.

28. There are inherent difficulties in defining 'business connection' owing to the numerous forms in which business transactions can be arranged. Judicial decisions have, by and large, established the principles by which the terms should be interpreted, so that the scope for uncertainty in its interpretation has been considerably narrowed down.

29. In order to avoid the difficulties in interpretation, it has been suggested that the scope of the term 'business connection' should be defined more clearly. Various methods have been suggested by which such clarification may be effected—by amendment of the Act, or by statutory rules, or by 'explanations' inserted in the Act, or by executive instructions.

30. The main anxiety of those who advocate these methods is that 'business connection' should be so defined as to make it coterminous with 'trade exercised within India'. We are satisfied that the scope of the transactions in respect of which a non-resident may properly be taxed would be unduly circumscribed by such an interpretation. The import of the term 'business connection' is much wider, and any attempt at statutory definition would lead to difficulties as it is impracticable to cover all possible transactions within a few well-defined groups.

31. Another method that could be adopted for securing the largest possible measure of uniformity would be through executive instructions. We recommend that the Central Board of Revenue should issue a comprehensive set of instructions, after taking into consideration the numerous judicial decisions on the subject and as many as possible of the types of transactions that are likely to arise in practice. These instructions should also be made available to the public. We further recommend that assessees should be encouraged to bring freely to the notice of the Central Board of Revenue any cases, which in their opinion, are not being handled in accordance with these instructions or where the instructions themselves operate harshly in a particular case. It is, of course, recognised that the instructions of the Central Board of Revenue cannot have the force of law and that it is the tax-payer's inherent right, if so advised, to seek an authoritative interpretation of the law in the courts. In view, however, of the uncertainties connected with the interpretation of the term 'business connection' and of the fact that economic rather than legal questions are mainly involved in its interpretation, we are of the opinion that the greatest degree of uniformity in the

working of this section can be secured through executive instructions rather than through legislative enactment.

Scope of the term 'business connection'

32. Suggestions have been made to us for excluding certain types of transactions from the scope of the term 'business connection'. One such suggestion is that profits from transactions on a principal-to-principal basis, where the ownership of the goods passes from the non-resident to the resident outside the taxable territories, should not be deemed to accrue in India. We learn that the Central Board of Revenue has already accepted this position and has issued executive instructions to the Income-tax Officers to that effect. In view, however, of the importance of the matter, we recommend that a suitable provision might be inserted in the law itself.

33. When goods are purchased in India regularly, through an established agency or otherwise, a portion of the profits is now deemed to accrue in India as being attributable to the purchasing operations. It has been represented that this imposes undue hardship. In a buyer's market, it is possible that such liability has adverse effects by reducing the price received by the Indian seller or, in extreme cases, by partly diverting trade away from India. In a seller's market, the incidence of the tax will no doubt be shifted to the foreign consumer. It will, however, not be possible through the income-tax machinery to watch the wide fluctuations in market conditions, or to adopt a sufficiently dynamic policy which will bring into the exchequer a reasonable proportion of profits which may be made due to a sudden spurt in prices. We have ascertained that the revenue from the tax on profits deemed to arise from purchasing operations is not appreciable in magnitude. We recommend that the law should be amended to the effect that, when goods are purchased in the country, whether through a regular agency or otherwise, and are not subjected to any manufacturing or other process before export, no profit should be attributed to such purchasing operations.

34. Another suggestion that has been made to us relates to the profits on goods manufactured outside India and purchased by a person resident in India. It is stated that:—

(a) if the sale has taken place in India, only a proportion of the profits should be held to accrue in India; and

(b) if the sale has been effected outside India, the profits should not be taxed on the 'receipt' basis.

35. As regards the first point, the principle has now been established* that the profits should be allocated among the various operations leading up to their realisation and that only such portion of the profits as is attributable to selling operations in India should be charged to tax. The question arises as to the principles on which such allocation should be made. In Australia, principles governing such allocation where the sale is effected by manufacturers or merchants find a place in the statute itself (Sections 38 and 39). Section

*Supreme Court's decisions in C. I. T. *vs.* Ahmedbhai Umarbhai & Co. [1950 (18) I. T. R. 472] and Anglo-French Textile Co. *vs.* C. I. T. [1954 (25) I. T. R. 27.]

40 of the Commonwealth Income-tax Act provides that, where profits cannot be ascertained under either section 38 or 39, the profits shall be deemed to be such an amount as the Commissioner determines. We recommend that similar provisions should be incorporated in the Indian income-tax law.

36. Regarding the second point, the entire profits are now taxable on the 'receipt' basis. The taxation of profits on this basis is one of the fundamental principles of the Indian income-tax system. In our opinion, no statutory relaxation of it is desirable, but in cases of hardship where the fact of receipt is only an end incident of the transaction, relaxation should be allowed by executive instructions. We understand that the Central Board of Revenue has already issued instructions to the effect that, where the non-resident exporter makes over the shipping documents to a bank in his own country, which discounts them and arranges for collection through bankers in India, the exporter will not be held to have received the profits in India. We do not consider that any further relaxation is necessary in this respect.

Liability of the agent

37. A non-resident may be assessed direct or through an authorised agent or through a person with whom he has business connection and whom the Income-tax Officer deems (after giving notice) as an agent of the non-resident. The present procedure of deeming persons as agents of non-residents has been criticised as leading to hardship. We consider that the crux of the problem is the extent of the liability attached to the person who is deemed as an agent of a non-resident. As such liability is limited to the extent of the tax on income arising from transactions carried on through the particular agent and any of the further funds of the non-resident which such an agent has with him, there can be no genuine grievance. We would add that the law entitles any person, who apprehends that he may be assessed as an agent, to apply to the Income-tax Officer for a certificate showing the amount which he should retain out of the non-resident's moneys which may come into his hands. Once such a certificate is given, his liability is limited to the amount specified therein, unless further funds of the non-resident come into his possession. Representations have been made to us that considerable delay often occurs in issuing such certificates. We have, however, ascertained that no applications for such certificates have been received by the Income-tax Department in Bombay in the last two years; and there are not likely to have been many applications elsewhere. We would suggest that a freer use of the provision for obtaining certificates can be made by the business community, and that the Central Board of Revenue should issue instructions to ensure that they are issued promptly, and a proper watch is kept to prevent delays.

Assessment through a 'principal' agent

38. A suggestion has been made to us that the law should be so amended as to enable the income arising to a non-resident from his dealings through several agents to be assessed on any one of them as the 'principal' agent of the non-resident.

39. The argument advanced in favour of this suggestion is that the Income-tax Department finds it difficult to trace all the persons

through whom a non-resident may have earned income and to proceed against all of them individually. The Income-tax Investigation Commission had recommended the introduction of such a provision in the Act. We are unable to see how the difficulty of tracing out all the agents could be got over by the fixing of the entire responsibility on one of them. Every person with whom a non-resident has dealings is not likely to be aware of the complete details of the non-resident's income-earning activities in India and abroad. Nor does he have the power to ask for detailed information on these matters, either from the non-resident principal or from any of the other agents. On the other hand, the Income-tax Department has ample powers to compel the 'principal' agent to disclose whatever information he may have in his possession regarding the identity of the other agents and details of the transactions done through them. So long as the liability of the 'principal' agent for the payment of tax is limited as it is at present, we fail to see how any tangible benefit could result by throwing on him the onus of proving certain facts—which responsibility, in the normal course of events, he cannot be expected to be in a position to discharge.

Double income-tax relief arrangements

40. Assessees have sometimes to pay tax on the same income in more than one country, because the tax liability may be attracted with reference to the 'residence' of the assessee, or the 'origin' of the income, or both, according to the respective tax statutes. In extreme cases, the total tax on a given income may exceed the income itself. The importance of providing some relief to tax-payers in respect of double taxation is, therefore, obvious.

41. The League of Nations Expert Committee of 1923, which considered this matter, pointed out four possible alternative methods of granting relief. These are:—

(1) a country may deduct from the tax due from its residents any tax paid by them to a foreign country on income arising in that country. This would be analogous to the method adopted in the U.S.A., where, however, the credit for tax paid in each country is limited to the lower of the rates of tax in U.S.A. and in the country concerned, and the total credit for foreign taxes is subject to a similar overall limit;

(2) the converse would be where the country of origin exempts non-residents from taxation imposed on income from sources within its borders. This would have the effect of encouraging the inflow of capital from abroad. On the other hand, under-developed countries rely for their fiscal resources, to a large extent, on the revenue from industrial enterprises set up with the aid of foreign capital, and they cannot, therefore, afford completely to exempt such profits;

(3) the tax payable might be divided by convention so that a specific portion should be retained by the country of origin and the remainder by the country of residence. The original arrangements between India and the United Kingdom, which were in force until 1947, were based on this principle. The relief was so adjusted that the net tax

borne by the taxpayer was at the higher of the rates applicable to him in the two countries. The taxpayer had to obtain relief first from the United Kingdom whose law allowed refund of half the U.K. rate. If this refund exceeded the whole of the Indian tax, no further refund was admissible. Where it was less than the Indian tax, the difference was refunded by India up to a maximum of half the Indian rate; and

(4) it might be possible to provide by convention for the specific allocation of sources of income between the two countries, each country taxing the income arising from the source allocated to it either wholly, or partially, as agreed upon. The advantage of this method, which is called the Double Taxation Avoidance Agreement Method, is that taxation of the same income by more than one country is avoided *ab initio*, and no need therefore arises for any relief from double taxation.

42. India has bilateral agreements with Pakistan, Aden and certain African countries in regard to double taxation. We understand that the feasibility of concluding such agreements with other countries is under consideration. Pending the conclusion of such agreements, a resident of India who has income accruing or arising in any other country, on which he has paid that country's as well as Indian income-tax, is entitled to unilateral relief at the rate of the lower of the two taxes, provided that the income is not deemed to accrue or arise in India under the special provisions of the Indian Act. The combined effect of these arrangements is that relief is now available on all foreign income, except such portion of this income as (i) is *deemed* to accrue in India and (ii) remittances out of such income earned in prior years where such income has not been taxed in those years on the accrual basis.

Need for bilateral agreements

43. Most of the organisations which have tendered evidence before us have suggested that India should enter into bilateral agreements with other countries as early as possible. We entirely agree with this suggestion, though we appreciate that, in actual practice, many complicated issues are likely to arise which might cause delay in the completion of the negotiations. We would, however, like to take this opportunity of making some general observations as regards the principles which we think should govern such agreements.

Principles of the Agreements

44. It has been suggested in certain quarters that the Model Bilateral Conventions drawn up by the Fiscal Commission of the League of Nations should be followed as a model for agreements to be entered into with other countries. In particular, the suggestion has been made that profits of industrial or commercial undertakings should be taxed in the State where the undertaking has a permanent establishment and that, if the undertaking has a permanent establishment in each of the contracting States, each State should tax the profits produced in its territory. Witnesses advocating this view have also suggested the adoption of the provisions of the Model Agreement which provide for the profits of shipping and aviation to be taxed in the State where the enterprise has its fiscal domicile.

45. On the other hand, the view has been expressed by some other witnesses that several articles of this Model Convention are unsuited for adoption by India. They have pointed out that the definition of permanent establishment in the Model Convention implied the existence of a fixed place of business, of a productive character. The adoption of the principle of taxing only profits attributable to a permanent establishment in this country would deprive India of revenues on profits derived from 'business connection', unless 'permanent establishment' is defined so as to include an agency.

46. Another important article in the Model Convention which, it has been urged before us, is unsuitable for adoption in any bilateral agreement that India may enter into is the one which stipulates that the profits of shipping should be taxed by the country in which the shipping company has its registered office. We agree that, until such time as the Indian shipping industry has made substantial progress, the adoption by us of this provision in the Model Convention would operate unfavourably for India which would get practically nothing in return for the large amount of tax on the profits of the carrying trade arising from the country which we now collect.

47. A large volume of opinion favours the conclusion of agreements on the model of the Indo-Pakistan Agreement, with suitable modifications. Both the Indo-Pakistan Agreement and the Model Convention proceed on the basis of allocation of sources of income and we agree that this is the most satisfactory basis for such agreements. But it must be remembered that the League of Nations Model Convention is suitable for adoption in its entirety only as between two fully developed countries. As between two countries at different stages of economic development, modifications depending on their comparative development will be necessary before it can be adopted.

48. Until agreements on the lines suggested are entered into, the present basis of unilateral relief appears to us to be quite suitable for retention.

49. Representations have been made to us that hardship is caused by the absence of provision for relief in respect of income deemed to arise in India through 'business connection'. This is a problem which will have to be kept in view when agreements with individual countries are negotiated, so that suitable provisions for relief might be incorporated.

50. Certain witnesses have suggested that international agreements should provide for the income to be computed on the same basis in both the countries concerned; and that, as tax rates in the United Kingdom have recently been reduced and may be reduced further, care should be taken to secure that the rates of Indian tax on non-Indian companies should not exceed the U.K. rates. It is not usual for international agreements to interfere with the internal tax systems of the countries concerned, and any inequalities arising out of the differences in the legal systems cannot be helped. Nor are we able to support the latter suggestion: the only claim which a tax-payer can put forward in equity is that the total demand on him should not exceed the tax at the highest of the rates in force in

the countries concerned. The fixation of the rates in each country must obviously be with reference to all relevant factors, including its own fiscal needs, and we do not consider it reasonable to expect that they should be linked in any manner with the rates prevalent in another country.

CHAPTER III

TAXABLE INCOME—I

Introduction

We have divided the whole subject of the determination of taxable income into two chapters for facility of discussion. In this chapter we deal with the classification of receipts into those that attract liability to tax and those that do not. We also refer to certain issues arising out of special types of receipts. In the succeeding chapter we discuss certain important questions of income-tax practice—stock valuation, business and non-business deductions and the treatment of losses.

2. Income, profits and gains, from whatever source they are derived, are made chargeable under the Indian Income-tax Act. The terms are not defined precisely in the law, but section 2(6C) of the Income-tax Act enumerates specific receipts which are made taxable in addition to what is liable under the commonly understood import of the term 'income'. The Act further describes the various sources of income and mentions the special charges that have to be adjusted against income from each source, of which 'business deductions' are the most important. One of the provisions* lists a number of items of receipts which are expressly excluded from the scope of chargeable income. Income from all sources is then aggregated (known as total income) and further adjustments are carried out in respect of certain exemptions which are available under specific conditions applicable to each. The charge is applied to this adjusted total income (known as taxable income) for determining the liability of an assessee to income-tax.

Definition of 'income'

3. Though a precise definition of income is not given in the Income-tax Act, it is quite clear from the Act that the charge is to be applied only to *net* income, that is, it should not fall on capital or on any element of necessary cost. It is also specifically provided in the Act that in arriving at the net income to be charged to tax certain types of losses must be excluded. Nevertheless, some witnesses have suggested to us that a precise definition of 'income' should be introduced in the Income-tax Act in order to ensure that this important aspect of taxation law is placed beyond the scope of controversy or litigation. While we agree that this objective is laudable, the task seems to us to be well-nigh impossible. The concept of income is not merely a creature of judicial pronouncements but is also influenced, from time to time, by the trend of economic thought and the evolution of accountancy principles. We do not think it is worthwhile attempting to compress the large volume of judicial decisions and other diverse literature on the subject of the concept of income into a succinct and workable definition. Moreover, as regards judicial decisions, it is necessary to remember that they turn on the facts of each case which are bound to differ. Even a small variation might conceivably make a material difference to the determination of the

*Sub-section (3) of section 4 of the Income-tax Act.

question whether a particular receipt is or is not of the nature of taxable income. It seems to us, therefore, that it will be impracticable to reduce the principles evolved by judicial decisions in the leading cases on this subject into an exhaustive and self-contained definition of income in our taxation Act. We are also of the opinion that perhaps more harm than good may result from including in the taxation Act a rigid definition of income. We think that guidance in this matter should continue to be drawn in the future, as heretofore, from the extensive case law on the subject.

4. Some of the important issues in connection with the concept of income on which the courts in this country and elsewhere have pronounced their opinions over a long period have been raised before us by certain witnesses who have suggested changes being made in the law in regard to these. We discuss these issues below.

Capital receipts vs. income

5. One of the principles enunciated by the courts is that capital receipts should be distinguished from income. The important tests, which are illustrative and not exhaustive, laid down for this purpose are:—

(i) receipts which arise from the substitution or conversion of fixed capital in a business should be treated as capital, while those pertaining to circulating capital such as from the sale of stock-in-trade should be treated as income;

(ii) receipts arising from the replacement of a source of income, by its sale, exchange or transfer, should be treated as capital;

(iii) lump sum receipts need not always be of a capital nature, for example, a lump sum paid to a director of a company as consideration for his continuing to serve on a reduced salary; on the other hand, recurring receipts in some cases may be regarded as not being income, for example, when the stipulated purchase price of a property is paid in instalments;

(iv) the right to receive future income may in certain circumstances be converted into a capital receipt, *e.g.*, the outright sale of patent rights.

A number of suggestions have been made in regard to the last test mentioned above (item iv). Certain receipts, *e.g.*, income from the sale of patent rights or copyrights, premium on leases, etc., which were held to be of a capital nature are now being treated in many income-tax systems as of a revenue nature. It has been urged before us that this is a development on the right lines, and that it is inequitable, with the tax rates at their present pitch, that the mere arrangement of transactions in a particular manner should lead to differences in the taxability of certain receipts as between different taxpayers. We agree with this approach. Government would be justified in taxing such receipts on the ground that the sale of a right to income has resulted in extinguishing future income which would otherwise have been taxable. If there is any capital element involved in the sale, due to the transfer of the title, it is likely to be very small and by suitably spreading the receipt over a long enough period, the inequity, if any, on that account, would be eliminated.

6. The following individual items have been suggested to us for consideration in this connection:—

Suggestion for taxation of certain receipts now treated as capital

(i) premium on leases;

(ii) sale proceeds of patent rights and copyrights;

(iii) compensation received for termination of managing agency agreements or similar business agreements; and

(iv) compensation for loss of employment.

7. We recommend that the receipts at (i)—(iii) above should be brought to charge to the extent and in the manner indicated below. The lump sum receipts from the sale of patent rights should, in our opinion, be spread over a maximum period of six years; those from premia on leases over a maximum period of twenty years; and those from compensation for loss of managing agency commission over a period that may be considered appropriate by the income-tax authorities, the decision depending on the nature of the agreement. We would also recommend that the receipts should be spread backwards, except for those arising from premia on leases which should be spread forwards.

8. We may refer in somewhat greater detail to the taxability of compensation for loss of employment. The position in regard to this item of receipt is that under Explanation (2) to section 7 of the Income-tax Act, 1922, any payment made solely as compensation for loss of employment, which is not by way of remuneration for past services, is not taxable. The rule as it stands would appear to turn on the interpretation of the word 'solely' and on the distinction that had been established between 'compensation for loss of office' and 'remuneration for past services'. There is obviously a possibility of the same facts being interpreted differently by the tax-payer and the taxing authorities in view of the ambiguity that arises from the use of the phraseology referred to. We, therefore, agree that it is necessary to clarify the law.

9. We are in favour of 'compensation for loss of office' being brought to charge in the same manner and for the same reasons as compensation for loss of managing agency commission, but even so some hard cases are likely to arise which will need special treatment in the application of this rule. Compensation for loss of office may be made in any of the following forms:—

(i) damages awarded by a court for the employer's repudiation of service agreement or for wrongful discharge or dismissal;

(ii) amount agreed upon between the employer and the employee for the latter's going out of employment as a result of differences of opinion or due to other circumstances;

(iii) provision made in the contract itself that compensation would be awarded in case the employee is asked to quit service.

10. We would recommend that compensation of the nature referred to at (i) above should not be taxed. The justification for this exception is that such compensation is not necessarily related to the remuneration of the employee, and is more in the nature of an *ad hoc*

replacement of the source of income of the employee that is destroyed by his dismissal or discharge. We would suggest that receipts relating to the other two forms of 'compensation for loss of employment' should be spread backward over an appropriate number of years, the period depending on the nature of the agreement or the contract to which they pertain.

Casual and non-recurring receipts

11. Another test which the courts have laid down for distinguishing taxable income is that it should be received with regularity or expected regularity. Economists also attach considerable importance to this characteristic of income, but the present income-tax law departs from it in one respect. Casual and non-recurring receipts, which arise from business or from the exercise of a profession, vocation or occupation or by way of addition to the remuneration of an employee have been specifically made taxable. It is thus possible for isolated receipts falling in the above categories to be subjected to tax provided certain conditions are satisfied. The courts have usually relied upon the following criteria for this purpose:—

(1) the character of the articles purchased and sold; whether they are of such a nature as would be held as investments, because they give pride of possession or for other reasons, or whether they have been bought only for disposal;

(2) the ordinary occupation of the tax-payer;

(3) the processes to which the articles are subjected and the methods of their disposal;

(4) the number of operations—whether the sale is effected in lump, or over a series of transactions;

(5) the period occupied; and

(6) the nature of the organisation employed for the disposal of the goods.

12. Opinion is divided on the question of the taxability of casual receipts. It has been argued by some witnesses that regularity or expected regularity should be the proper test for the taxation of a receipt. Any departure from this concept would bring to charge items of a capital nature such as accretions to the capital value of a security or shares the sale of which may constitute only an isolated transaction. It is further contended that if this is not possible, a time-test should be evolved under which a receipt of this type accruing to an assessee other than a dealer should be brought to charge only if the asset had been in possession of the person concerned for more than three months. On the other hand, a section of the witnesses is in favour of the abolition of even the present exemption in favour of casual receipts. These witnesses suggest that all types of casual receipts, whether arising out of business, etc., or otherwise, should be charged to tax. It is argued that such receipts add to disposable income and increase the ability to pay. It is inequitable that they should be exempt when the rates of tax are as high as at present.

13. We think that there is a great deal to be said for the latter view, but practical considerations would seem to rule out any modification of the present law. We are impressed by the difficulty of selecting the types of receipts to be taxed and, even more, of defining

them or the criteria applicable for their selection in terms which will be sufficiently precise to elude attempts at legal avoidance. It would also not be equitable to bring them to charge in the year of accrual; they will have to be either spread over a number of years or charged at a lower rate. The likelihood of receipts taxable at normal rates being passed off as casual receipts chargeable at lower rates cannot be overlooked. It would also not be easy to determine admissible expenses relating to receipts of this type.

14. We are, therefore, of the view that the present provision, which is working satisfactorily, should not be disturbed. We do not think that the suggestion regarding a distinction based on short-term and long-term gains is appropriate to income-tax law. It is more relevant to the taxation of capital gains which we have not recommended for the reasons stated in paragraphs 56 and 57 of Chapter VIII of Volume I of our Report.

15. We would, however, recommend that certain types of casual receipts, which are obviously an addition to one's ability to pay, should be charged to tax at a flat rate but this should be done through a separate tax levied under item 97 of the Union Legislative List in the Seventh Schedule to the Constitution of India. We have in mind receipts from the winning of cross-word puzzles, lotteries, etc.

Perquisites

16. It has been ruled by the courts that a receipt, in order to be taxable, should be in money or money's worth, either actual or constructive. In actual practice, this dictum has been applied in various forms depending upon the interpretation of the terms 'money's worth' or 'constructive receipt' in the light of the facts of each case. The test is not, therefore, capable of general application, and does not afford much guidance as regards the taxation of benefits in kind or perquisites, a question that has been raised before us.

17. The present position in regard to the taxation of perquisites is that perquisites in lieu of or in addition to any salary or wages are taxable under section 7(1) of the Income-tax Act. Under explanation (1) to this section, it is only the right of a person to occupy as a place of residence any premises provided by the employer free of rent that is specifically defined as a perquisite. The trend of thought on this subject has been influenced by a leading English decision* in which it was held that the advantage acquired should be such that it could "be turned to pecuniary account". In other words, the acquired advantage should be considered equivalent to a receipt of money's worth, only if the circumstances are such that it is capable of being disposed of by the person receiving it.

18. Clause (vi) of sub-section (3) of section 4 of the Income-tax Act also lays down that any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit will be considered non-taxable.

19. The effect of the two provisions of the law referred to above is that, except for the value of rent-free quarters, all other benefits in kind are exempt from taxation.

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*Tennant *vs.* Smith (3 Tax Cases 158).

20. Several witnesses appearing before us have questioned the wisdom of exempting from taxation perquisites or benefits received in kind. Their argument is that the enjoyment of a perquisite is in the nature of an indirect advantage in lieu of the receipt of cash. Perquisites add to the comfort and privileges of those who receive them. Not to tax them would, therefore, be a departure from the fundamental principle that the charge should be levied on the total income of a person, and that personal expenditure should be met out of disposable income. As the receipt of perquisites means increase in disposable income indirectly, it raises questions of equity as between tax-payers. The importance of this has become greater in view of the rate structure having become steeply progressive. We have, therefore, been asked to re-examine the whole question from the point of view of equity rather than of the amount of additional revenue that will be secured thereby. On the other hand, some of the witnesses have argued that perquisites assist in attracting personnel in out-of-the-way places; the additional revenue involved is inconsiderable; and taxation of perquisites will only result in harassing enquiries into the personal affairs of employees without any substantial benefit of revenue.

21. We are in broad agreement with the former view, and are in favour of the taxation of perquisites on considerations of equity rather than on the basis of the additional revenue that may be obtained. We are, however, convinced that the evaluation of perquisites received by all employees might result in harassing enquiries; hence practical considerations suggest that the number of assessees on whom this extra liability should be imposed should be limited. Accordingly, we recommend that the full value of any benefits granted to an employee by his employer and any sum paid by the employer in respect of any charge or other obligation which but for such payment would have been paid by the employee, should be treated as taxable income in the latter's assessment. For the present, however, the liability should be confined to employees whose total emoluments (including the value of the perquisites) exceed Rs. 24,000 in a year, and to directors of companies irrespective of their emoluments. The omission of a limit for emoluments in respect of directors is based on the consideration that, by virtue of their power of control over a company's affairs, they would ordinarily be able to arrange perquisites to their own advantage; their other emoluments would depend on the amount of time which they devote to the company's affairs and various other factors, and it would not be practicable to lay down a specific limit. We further recommend that the Central Board of Revenue should issue executive instructions to ensure that no attempt is made to evaluate or tax petty items.

22. We recognise that, if provisions on the lines suggested above are introduced, some assessees may resort to various ingenious devices for escaping the consequent liability. The less scrupulous among them may succeed in diverting the cost of perquisites to business deductions, and claim that the expenses have been laid out for genuine business purposes. As the State does not have the power to regulate the quantum of business expenditure, the remedy lies in a careful scrutiny by the income-tax authorities of the relevant facts. Another possible method of circumventing the provisions would be by invoking the provisions of section 4(3)(vi) and making it appear

that some of the perquisites which are a clear addition to income are intended to meet expenses wholly and necessarily incurred in the performance of the duties of office of the recipient. It will, in our opinion, be necessary to amend section 4(3) (vi) of the Income-tax Act suitably to prevent such attempts.

Other receipts

23. We discuss below some miscellaneous receipts which have been suggested to us for specific treatment. The first three receipts involve modifications in the definition of agricultural income [Section 2(1) of the Income-tax Act], which will continue to be operative until the distinction between agricultural and non-agricultural incomes disappears. We have suggested in Chapter V of Volume III that both the income should eventually be treated as one for the purposes of taxation but the change should, however, be brought about gradually.

Income from forests of non-spontaneous growth

24. 'Agricultural income' which is defined in section 2(1) of the Income-tax Act is specified as a non-taxable receipt in section 4 (3) (viii). The courts have ruled that income from forests of spontaneous growth is non-agricultural, whereas income from cultivated forests on which some human skill and labour have been employed is agricultural. The suggestion has been made to us that both kinds of forest income should be treated as non-agricultural in view of the difficulties that are stated to exist in the matter of differentiating between cultivated forests and those which are not. While we agree that the difficulty is there, we believe that, as income from privately owned forests is now a rapidly decreasing source of revenue since the abolition of zamindaris in most States, a change in the existing law is not called for at present. The rule, as it is, seems to us to be fair enough and has worked satisfactorily. We, therefore, do not propose any amendment to the definition of agricultural income on this account.

Income from dairy farming

25. One of the tests laid down by the courts is that income from dairy farming is non-agricultural if the cattle are stall-fed but agricultural if they are pasture-fed. In practice, this test creates a distinction between different types of dairy farms based merely on the accident of their location and appears to us to be inequitable. We recommend that income from such forms of dairy farming as are undertaken as a commercial venture should be regarded as non-agricultural, and subjected to income-tax.

Income from poultry-raising

26. So far as poultry-raising is concerned, the vocation is sometimes carried on on agricultural land. It is also often an ancillary occupation to agriculture. It is, however, not an agricultural activity in the proper sense, though it may be carried on by the owner of agricultural land. We, therefore, suggest that income from poultry-raising, which is undertaken as a commercial venture, should also be brought to charge under the Indian Income-tax Act.

Income from usufructuary mortgage

27. Income from usufructuary mortgage is held by the courts to be agricultural income as legally the assessee is in possession of the land from which that income arises. We think that the question of taxability of such income should be decided irrespective of the nature of

source from which the service charges or the repayment of debt is met. The position of the assessee is fundamentally that of any one lending money, and we recommend that his income from that source should be brought to charge under the Indian Income-tax Act.

Debts foregone

28. Debts foregone are allowed as deductible expense in the assessment of a creditor under certain conditions, but they are not chargeable as income in the assessment of the debtor. Normally, the latter contingency does not arise as the debts are foregone only when the financial condition of the debtor is bad and he is hardly likely to have any taxable income. It is, however, possible in certain circumstances to take advantage of the present state of the law, to the detriment of revenue. For example, a debt may be foregone in respect of a transaction which has already been allowed as an admissible deduction in the assessment of the debtor. We think that the position needs rectification in view of a decision of the Bombay High Court*. We recommend that debts of the type referred to above, which are foregone, should be treated as income in the assessment of the debtor but we would suggest that executive instructions should be issued to prevent detailed enquiries in cases involving small sums.

Unclaimed balances

29. Similar to foregone debts are unclaimed balances in respect of which also a suggestion has been made to us that the amount of expenses which was allowed as a deduction on the mercantile basis, but was not actually paid, should on the expiry of three years be treated as taxable income. This would cover such items as wages which became due and were debited in the accounts, but were not claimed by the employees concerned. This suggestion strikes us as reasonable, and we recommend that provision should be made accordingly.

Suggestions for exclusion of certain items of receipts

30. We now proceed to consider suggestions which have been made to us for excluding from tax certain receipts which are now treated as taxable.

Surrender of managing agency commission

31. One of the grievances brought to our notice relates to the tax treatment of that part of the managing agency commission, which is surrendered by the managing agents, in order to rehabilitate the financially weak position of a managed company. It is argued that a mere legal right to something should not mean the actual exercise of such a right. It is further stated that it is an obvious hardship that the surrendered commission should be brought to charge in the assessment of the managing agents, and that, at the same time, it should not be taken into consideration for the purposes of admissible deduction in the assessment of the managed company.

32. The rationale of this method of treatment of the surrendered commission is that it constitutes an amount that has become due if the accounts are maintained on the mercantile basis. As such, its further disposition, howsoever laudable the object, is in the nature of an application of income after it has been earned. These rules are based on a long line of judicial decisions and embody, in our opinion, a salutary principle. We are aware that a departure was

*Orient Corporation *vs.* C. I. T. (1950 I. T. R. 28.)

made from this position by enacting the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1950. We suggest that it should not form a precedent for the future.

33. The inadmissibility of the amount surrendered is also justified as the actual outgo has not been in excess of that allowed and the right to the balance has already been waived. It is, therefore, not in the nature of an outstanding liability. In our opinion, therefore, there is no case for a statutory provision of the nature suggested by business interests.

34. We are opposed to any statutory recognition to the surrender of managing agency commission for another reason also. There is a possibility of this method being used for avoiding super-tax liability in certain cases. We are hence in agreement with the procedure evolved by the Central Board of Revenue recently. It prescribes, *inter alia,* that where a public company has suffered a loss or will suffer a loss if the commission is paid, no attempt should be made to tax the surrendered amount of the commission in the assessment of the managing agents provided (a) the managing agency is held by a public company, or (b) the managing agency is held by a private company or an individual or a firm and the managing agents and their relations do not hold more than 25 per cent. of the shares of the managed company, and (c) the managed company does not claim the amount of commission as an expense in its assessment. Assessing officers have also been asked to bring other cases where special hardship is stated to exist, to the notice of the Central Board of Revenue, for final orders. These instructions appear to us to be sufficient to cover any cases of genuine hardship that may arise in this connection.

Exclusion of balancing charge

35. Another suggestion that has been made is that the excess of the sale proceeds of a depreciable asset over its written down value limited to the original cost of the asset, which is at present chargeable under section 10(2) (vii) of the Income-tax Act, should be exempt from taxation or should be suitably spread over a number of years for the purposes of taxation. We have recommended in Chapter V that this excess should not be brought to charge, but that it should operate to reduce the original cost of the new asset provided certain conditions are satisfied. We consider that this meets substantially the point made in the suggestion under consideration.

36. We recommend that similar treatment should be accorded to compensation received from an insurance company on account of the destruction or loss of a building, machinery or plant as the principle involved is the same in both cases.

Other receipts

37. The following other receipts have also been suggested for exclusion from the scope of income-tax. These suggestions have been dealt with in the appropriate context in other chapters of this volume:—

(i) foreign income of residents of India;*

(ii) annual value of owner-occupied property;†

(iii) profits of mutual life insurance business;†

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*Chapter II.

†Chapter VIII.

(iv) income of charitable institutions from business activities of all types;*

(v) dividends received by a shareholder out of the capital profits of a company.†

Irregular and lump sum receipts

38. The progressive rate structure and the present pitch of the rates of tax have focussed attention on the treatment of certain types of irregular and lump sum receipts. They may represent effort over a period of time, but are charged to income-tax in the year of accrual or receipt. A heavy tax liability is thus placed on an assessee merely because of the accident of their receipt in a particular manner. It is possible that a measure of inequity might result from some taxpayers getting away with a lighter charge than others who receive the same amount of income during a given period, but the manner of accrual of which might attract a higher rate of tax.

39. There is no doubt that such differences in tax liability cannot be avoided so long as the charge is based on annual computation of income which is a fundamental principle of income-tax. The possibility of a variation of incidence among assessees following the mercantile system of accounting is less than among those following the cash system of accounting. Any attempt at adjusting such variations may result in the manipulation of the timing of the receipt of income of this type in order deliberately to reduce tax liability. These considerations, therefore, suggest the need for caution in making a selection of receipts for special treatment. This special treatment should consist, in our opinion, of such receipts being spread backwards or forwards, depending on the nature of each receipt. It is not possible to lay down a statutory criterion for this purpose. Each case should be considered on its merits in order to decide whether it should be accorded preferential treatment and the manner in and the extent to which the concession should operate.

40. We indicate in the following paragraphs the exact treatment that should be accorded to each type of such receipts, the principle being that there should be some correspondence between the period over which income is earned and the period over which it should be spread over for assessment.

Income from speculation

41. Speculation is a typical instance of a business where the risks are very much higher than in normal types of business, but a person who indulges in speculative transactions enters into them with the full knowledge that wide fluctuations in the results are to be expected in his ventures. We do not think that we can recommend any special protection to income arising from this kind of business.

Income of works contracts

42. It has been represented to us that the results of a contract as a whole can be ascertained only after the entire work is completed. In the meantime, tax is charged every year on the basis of estimated profits, and, if the final result is a loss or a profit less than what has already been assessed, hardship may result. Under the current procedure, it is understood that it is possible for the income finally computed to be spread backwards and the necessary adjustments are

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*Chapter VIII.

†Chapter X.

allowed to be made provided the accounts maintained are accepted as reliable. We do not think that any further concession is necessary, or that it should be embodied in the statute, as we are satisfied that the condition regarding the reliability of accounts is essential and this can be enforced only by treating each case on its merits.

Income of film producers, etc.

43. It has been represented to us that the production of a picture usually takes more than a year, but the payment is received by the producer in a lump sum and is brought to charge in the year of its accrual or receipt. It is stated that this causes hardship and that the receipt should be distributed suitably over the period it has taken to produce a picture. The extent of the hardship involved will largely depend on the manner in which the business of production is organised. If the assessee has a regular business of production, his income is likely to even out over a period of years and no particular hardship would be caused. However, we appreciate that if a single picture is produced by an assessee and it takes him a number of years to do so, there will be hardship in bringing to charge the sale proceeds in the year of accrual or receipt. We understand that a considerable proportion of producers are single-picture producers. We, therefore, recommend that if the production of a picture takes more than eighteen months the sale proceeds may be spread backwards over a period of two years.

44. The distributors have represented that the amortisation of the payment made by them to the producers has no relation, under the procedure in force at present, to the actual life of the picture. The system in force is that 60 per cent. of the total cost is written off in the first year after the picture is released, 25 per cent. during the second year and 15 per cent. during the third year. The whole value of the picture is amortised during a period of 36 months. The Film Enquiry Committee, which considered this question from the technical angle, suggested that the cost of the picture should be spread over a period of 24 months as given below:—

1st four months	10 per cent. per month.
2nd ,, ,, ...	6 ,, ,, ,, ,,
3rd ,, ,, ...	3 ,, ,, ,, ,,
4th ,, ,, ...	2 ,, ,, ,, ,,
5th ,, ,, ...	2 ,, ,, ,, ,,
6th ,, ,, ...	2 ,, ,, ,, ,,

45. Alternatively, they suggested a system of provisional assessment being made of the profits earned, subject to these being adjusted after a period of two years on the basis of actual receipts. We prefer the former method, as the latter involves difficulties in its practical working and might possibly involve loss of revenue. We agree to the schedule suggested by the Film Enquiry Committee for the amortisation of the payment made by the distributors to the producers.

Income of actors and cinema artistes

46. Preferential treatment has been claimed for the income of actors and cinema artistes, on the ground that their working life is relatively short, and that during this period they have to lay by sufficient savings for a future period of unemployment or under-employment.

We are unable to accept the suggestion that the length of normal working life should be treated as an appropriate criterion for distinguishing their incomes from those of other professional people, and therefore see no reason to recommend any special treatment to them.

Interest on long term cash certificates issued by banks

47. Certain banks issue cash certificates redeemable at the end of a specified period. The interest on the certificates is payable at the end of the period and it is understood that it is charged to tax in the year of receipt. We recommend that this is a deserving case in which interest should be allowed to be spread backwards over the period for which cash certificate is issued or for a period not exceeding four years, whichever is less. There should, however, be a stipulation that only persons who do not hold cash certificates of a value more than Rs. 25,000 should be eligible for this concession.

Income from nidhis and chit funds

48. 'Nidhis' and 'chit funds', which are forms of institutions mostly confined to South India, provide lump sum payments in return for periodical payments spread over a number of years. The subscribers to these funds belong mostly to the lower income brackets, and may normally pay income-tax at very low rates, or none at all. The receipt of such incomes in a particular year may make the recipient taxable or may unduly increase his rate of tax. As these funds furnish a method of encouraging small savings, we recommend that interest received from the funds should be suitably spread backwards over a period of three to five years at the maximum.

Accumulated preference dividends

49. The suggestion has been made that, where cumulative preference dividends for two or more years are paid together in one year, income from the dividends should be spread backwards over the years to which they relate. Income from such dividends is by its very nature fluctuating, dependent on the profits of a company and the discretion of the directors in timing the declaration of dividends. The investor is well aware of this at the time he purchases shares. There is, therefore, no case for giving preferential treatment in respect of income from these dividends.

CHAPTER IV

TAXABLE INCOME—II

Introduction

An assessee is entitled, under practically all systems of income-tax law, to choose his own method of accounting, provided his income can be properly deduced from his accounts. It is usual, however, for assessees to follow the forms and procedures prescribed by accountancy practice to determine the gross and net profits of their undertakings. Adjustments are then made to the *net* profits in conformity with the income-tax law which lays down specific rules regarding the taxability of various kinds of receipts, and the admissibility of various kinds of expenses. The treatment of losses, as prescribed in the income-tax law, also operates as an adjustment to the net income so arrived at. We have already dealt with the question of the treatment of various kinds of receipts for taxation purposes in the preceding chapter. In this chapter we deal with the other questions which bear on the determination of taxable income, *viz.*, (i) the various methods of stock valuation as affecting the computation of gross profits, (ii) the treatment of expenses, and (iii) the treatment of losses.

Stock valuation

2. The valuation of stock-in-trade has a considerable bearing on the determination of gross profits as these profits, being the result of trading operations, can properly be determined only by taking into account the terminal values of stock-in-trade, purchases (or manufacturing costs), sales and certain charges specifically relatable to these operations. It is, therefore, important from the point of view of the tax law that the method of stock valuation adopted by the taxpayer does conform to the accepted principles of sound accountancy, and is capable of yielding a fair and true picture of the gross profits earned.

3. The problems which arise in this connection may conveniently be dealt with under the following three main headings:

(a) relative merits of various methods of stock valuation;

(b) stock valuation during a period of inflation; and

(c) other specific issues.

Methods of valuation of stock-in-trade

4. The Income-tax Act does not prescribe any specific method of stock valuation. The method generally favoured by accountants is to value terminal inventories at their cost price or market price, whichever is lower. This method ensures that unrealised profit is not taken into account in determining income but anticipated loss is allowed for. In the long run, this method works out evenly for the assessee and the revenue. Difficulties, however, arise if an assessee changes his method of valuation of stock-in-trade or the income-tax authorities require an assessee who is regularly employing some other method to abandon it in favour of 'cost or

market price, whichever is lower'. In order to meet the difficulties created by the assessee changing over from one method to another, the following suggestions have been made to us for incorporation in the Income-tax Act; it has been claimed that these suggestions would secure the necessary measure of regularity and uniformity in this matter without sacrificing elasticity:—

(i) that the choice regarding the method of stock valuation should be made at the time of the first assessment;

(ii) that all subsequent accounts should be accompanied by a certificate declaring that the method of valuation originally adopted has been followed;

(iii) that in special circumstances, a change in the method of valuation should be allowed only with the previous approval of the Inspecting Assistant Commissioner and subject to such conditions as he may impose.

5. We are of the opinion that the formula set forth above suffers from a certain amount of rigidity without any appreciable compensating advantages either to the tax-payer or to the revenue. The special certificate suggested at (ii) above seems to us hardly necessary as, firstly, this will not relieve the Income-tax Officer of the duty of examining the accounts with a view to ascertaining the facts independently, and secondly, a certificate of the kind could be incorporated in the return of income (Form I.T. 11) itself. We are also not satisfied that there is sufficient justification for taking away from the Income-tax Officer the discretion which he has at present in the matter of accepting a change in the method of valuation of stock-in-trade, and vesting it solely in the Inspecting Assistant Commissioner [*vide* (iii) above]. We are not generally in favour of making in the tax law any rigid provision about the method of accounting, of which stock valuation is only one aspect, that an assessee should follow.

'Pick-and-choose method' *vs.* 'global method' of stock valuation

6. Apart from the difficulty created by the assessee changing over from one method to another, questions also arise as to whether some of the variations of the method generally known as the 'cost or market price, whichever is lower' method are intrinsically sound enough to be accepted by the Income-tax Department for purposes of arriving at gross profits. There are two such methods, *viz.*, (i) the 'pick and choose' and (ii) the 'global'. In both forms, each item of stock is valued separately at market price and cost price. In the former, the lower of the two values is adopted for each item separately, and the total value arrived at. In the latter form, the lower of the total value on cost basis of all items and on market basis for all items is taken. Judicial decisions* have established that an assessee can choose either of the two methods so long as he follows regularly the method that he has chosen. The Central Board of Revenue has, however, urged before us the desirability of prohibiting the use of the 'pick-and-choose' method as it is detrimental to revenue. In its opinion, "this method works against the Department by enabling the tax-payer to get benefit in respect of the items, the market price of which has dropped down below cost, and to retain at the same time at cost

*C.I.T. *vs.* Chari and Ram [1949 (17) I.T.R. 1].

price the remaining items which have gone up in market value". We are unable to agree that this method, which has been accepted as a satisfactory one by legal decisions, involves any loss of revenue. Any changes in value are ultimately reflected in the subsequent year's opening stock, and an automatic adjustment is secured over a long enough period. As a matter of fact, the 'pick-and-choose' method strikes us as the more logical of the two methods. In this we are in agreement with the Income-tax Investigation Commission which has rightly stated that stock is only an aggregate of individual items and as each item is purchased and sold separately it has a distinct cost or market value and is capable of being valued separately. So long as the provision of section 13 to the effect that any method may be adopted by the assessee provided income can be properly deduced is satisfied—which we think is the case with the 'pick-and-choose' method—we cannot find anything wrong with it.

Effect of rise in prices on stock valuation practice

7. Another important aspect of stock valuation methods in their relation to taxation is that, as a continuous rise in prices results in a larger requirement of working capital for the business, the necessity might arise for the adoption of methods of stock valuation which would take into consideration the needs of a business for the replacement of stock-in-trade at high prices. It has been suggested that in such circumstances an appropriate method of stock valuation would be the 'last in, first out' method (referred to usually as LIFO). This method of valuation is in vogue in U.S.A. According to this method, the last article purchased is presumed to be consumed first, with the result that in a period of rising prices taxpayers are able to set off against their sales the high prices paid for the latest purchases and value the unsold stock at the end of the year at the lower price paid earlier. A definite tax advantage is gained if this method is brought into use during a period of rising prices. On the other hand, in a period of falling prices, the use of the LIFO method will have the opposite effect. The LIFO method, once it is adopted, is, therefore, not allowed to be changed in U.S.A. save in exceptional circumstances. In the long run, the old stocks purchased at lower prices are exhausted, and if prices stabilise, after a period of inflation, even at a higher level than before, the LIFO method does not afford any particular advantage over the orthodox 'cost or market value, whichever is lower' method. We think that the present legal provision regarding freedom of choice for the accounting method employed by an assessee is wide enough to permit the adoption of the LIFO method if circumstances so warrant.

Consideration of other suggestions

8. It has also been suggested to us that a provision should be made in the Income-tax Act by which, if at the time of submitting the return or at the time of assessment, prices are found to be substantially lower than those at which the stocks are valued at the end of the last accounting period, the losses arising should be taken into account by revaluing the closing stock at rates current at the time of assessment. It is stated that assessments on the basis of original valuation would be a hardship when the actual realisable value is known to be lower than the price at which the stock was valued at the close of the accounting year. In short, the suggestion is that

a fall in the prices during the interval between the close of the accounting year and the filing of the return of income or the date of assessment should be given effect to in the valuation of closing stock.

9. This suggestion runs counter to the principle that income should be computed over an annual period. In any case, the advantage secured in one year will be neutralised by the corresponding decrease in the value of the opening stock in the next year. A refinement of this character will merely introduce greater complexity in the system than at present and will increase work all round. The suggestion is, therefore, not acceptable to us.

Deductions

10. We now come to the subject of deductible expenditure as a factor in the computation of net taxable income. Before we proceed to discuss the individual items of deductions in detail, it would be as well to refer to one suggestion that has been made to us on the subject of deductions in general, *viz.*, that, following the practice in U.S.A., income should be treated collectively from whatever source it is derived, and the expenditure should also be viewed in a collective manner, so that a particular class of deductible items of expenditure is not rigidly linked up with a particular head of receipt as it is in India. The actual position in U.S.A. law, however, is that though deductions relating to all sources of income are enumerated in one place, *i.e.*, in section 23 of the Internal Revenue Code, the expenses allowed are not available equally for all sources of income. The content of each deduction is carefully defined with reference to the source of income for which it is functionally meant. In the Indian law, each head of income is listed separately along with the deductions allowable in respect of it. The procedure for determining the admissibility of deductions claimed in both the countries is the same, *viz.*, to examine them on their merits in relation to the source of income for which they are meant. There is hardly any difference in actual practice between the two procedures and we do not think that any material advantage will accrue by simply following U.S.A. practice as regards the enumeration of admissible deductions in one place. The law in India is well understood and the connotation of its language has been settled by judicial pronouncements. Any alteration in its form and language will only create fresh controversy and litigation.

Existing statutory provisions

11. It will be convenient to deal separately with deductions relating to business and those relating to non-business incomes. The law relating to deductions in respect of business incomes is contained in section 10 (2) of the Income-tax Act. Clauses (i)—(xiv) enumerate specific types of admissible expenditure. The scheme of each clause is that it is self-sufficient as regards the nature of deduction, the purpose for which it is allowed, and the extent of and the conditions under which the expenditure is admissible. Clause (xv) is of the nature of a residuary clause and is applicable to all types of expenses other than those covered by clauses (i)—(xiv). The courts have ruled that the expenses referred to in all the clauses [(i) to (xv)] should be allowed in the year in which they are actually incurred.

12. The tests prescribed in clause (xv) for the admissibility of residuary expenditure are:—

(a) that it should be wholly and exclusively laid out or expended for the purposes of business;

(b) that it should not be of a personal nature; and

(c) that it should not be of a capital nature.

Some of the other important tests relating to the application of clause (xv), which have been laid down by the courts and in regard to which representations have been made to us, are indicated below:—

(a) the expenditure should be incidental to business and not merely remotely connected with it;

(b) a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be treated as having been expended wholly and exclusively for the purposes of the trade;

(c) the application of income already earned is not an expenditure and is, therefore, not allowable.

Expenses wholly and exclusively 'laid out or expended for the purpose' of business

13. The test that the expenditure should be 'laid out or expended wholly and exclusively for the purpose of' business is a comprehensive one, and a considerable amount of criticism has been directed to its scope and detailed application. It has been represented to us that the words in clause (xv) "not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive", which were added by section 8 of the Indian Income-tax (Amendment) Act, 1953, with effect from 1st April 1952 have curtailed the scope of the clause. It was held by the Madras High Court* that the cost of replacement of a boiler, though not admissible under section 10(2) (v) as 'current repairs' to plant or machinery, was allowable under section 10(2) (xv) as 'expenditure laid out or expended wholly and exclusively for the purposes of business'. When specific provision is made for particular types of expenditure, *e.g.*, interest, rent, repairs, etc., under separate clauses and the conditions under which they should be allowed are prescribed, it would nullify the effect of these clauses, if expenditure inadmissible thereunder were to be allowed under a general clause. Clauses (i) to (xiv) are self-sufficient provisions and should be treated as such. Clause (xv) should be taken as applicable only to the 'residue' of expenditure outside the expenses covered by clauses (i) to (xiv).

14. One of the controversial issues arising from the interpretation of clause (xv) is the extent to which the taxing authorities possess the right to question the reasonableness of expenses claimed as admissible deductions. It has been argued by certain witnesses that the existing law, as interpreted by the courts, places too wide a discretion in the hands of the taxing authorities and that this should be curtailed as, otherwise, it would amount to giving the

*C.I.T. *vs.* Sri Ram Sugar Mills, Ltd. [1952 (21) I.T.R. 191].

taxing authorities the power to direct the business operations of an assessee. On the other hand, it has been pointed out that the claiming of large amounts as deductible expenditure might well constitute a loophole of considerable dimensions for the evasion of tax, particularly in view of the rates of taxation being as high as they are in the upper brackets. In order to close this loophole, it is urged, the Income-tax Officer should be able to satisfy himself that amounts claimed as expenditure for the purposes of the business are of a reasonable order of magnitude. An amendment of the law has been suggested to empower the Income-tax Officer to compel the assessee to establish this position to his satisfaction. The sponsors of this amendment do not desire the Income-tax Officer to be authorised to dictate to the assessee what amount could appropriately be spent by the latter on each particular item. All that they want is that, if the Income-tax Officer has reason to think that the amount stated to have been spent on a particular object is *prima facie* so high as to appear unreasonable, the assessee should be called upon to prove to the satisfaction of the Income-tax Officer that it was spent wholly and exclusively on that object.

15. According to present judicial rulings, the taxing authorities appear to be competent to question the reasonableness of the remuneration paid by an assessee to his employees provided *prima facie* grounds exist for the presumption that the scale of remuneration allowed is not warranted by commercial considerations, but is fixed with the intention of distributing profits under the guise of remuneration. In a leading English case*, it was ruled as follows:—

> "the Commissioners cannot interfere with the prerogative of the company to pay to its directors whatever they think fit, but they are entitled to find in a proper case that the sums so paid are not wholly and exclusively laid out for the purposes of the trade and it is their duty to direct their minds to that question and to that question only".

This shows that there are clear limitations to the extent to which income-tax authorities have the power to question the reasonableness of the amount of remuneration.

16. As regards business expenses other than remuneration, the legal decisions do not accept the unqualified right of the income-tax authorities to challenge the reasonableness of the expenditure incurred generally or on specific objects, except where facts appear to have been distorted by the assessee, in which event it is the inherent right of income-tax authorities to query the statements. The following quotation from a leading case† will be of interest in this connection:—

> "I wish to guard myself against being thought to hold that the taxpayer may deduct only expenditure properly incurred if that expression implies a right on the part of the taxation authorities to criticise the manner in

*Copeman *vs.* William Flood & Sons, Ltd. (1941 I.T.R. Suppl. 85).

†Toohey's Ltd. *vs.* Commissioner of Taxation (1922) 22 S.R. (N.S.W.) 432, per Ferguson J., at p. 440.

which he carries on his business. Obviously there can be no such right. A taxpayer is liable to be taxed on the income he has made, not on what he might have made. It is nothing to the point that if he has been more capable, more experienced, or more prudent, he might have cut down his expenses. The question is what he did in fact spend on his business. If he chooses to employ a hundred men where twenty would have been ample, that is his own affair".

17. The judicial rulings quoted above were, however, given many years ago when the rates of tax were not so steeply graduated as now, and there was comparatively less temptation to use business deductions to reduce the net chargeable income or to divert personal expenses to business. The latter tendency is observable in almost every country where the effective rates of tax are high. Since tax is chargeable on residual income after deductions, Government have, in the circumstances, a greater stake than before in the correctness of admissible expenses not only from the point of view of 'vouching' but also as regards their reasonableness. The burden of taxation should not be capable of reduction through adjustment of deductions, since, in such circumstances, apart from its effect on revenue, the honest man will carry a comparatively heavier burden. While, however, we are convinced that the law as it stands today needs to be amended so as to vest power specifically in the hands of the Income-tax Officer to scrutinise this kind of expenditure properly, we also think that this is peculiarly a field in which it should be ensured by the issue of appropriate executive instructions that the scrutiny must be conducted in such a manner as to cause no more than the minimum amount of irksomeness to assessees, and that no harassment is caused.

18. We have examined in this connection whether the addition of the word 'necessarily' to 'wholly and exclusively' in clause (xv) would secure a better control of admissible deductions. A scrutiny of the decisions given in other countries, where the words 'necessary' or 'necessarily' are employed, leads us to the conclusion that the refinement proposed may not make a material difference to the present state of affairs. On the other hand, it might give rise to new controversies of interpretation. We, therefore, think that it would be inadvisable to amend the clause on these lines, and that the balance of advantage lies in maintaining the *status quo*, except that the present implicit right of the Income-tax Officer to question the reasonableness of the remuneration paid to employees should be specifically provided for in the statute. We think that a provision on the lines of section 16 of the Land and Income-tax Amendment Act, 1951 of New Zealand summarised* below, with such drafting changes as may be found necessary for purposes of incorporating into Indian law, should suffice:—

"*Unreasonable remuneration.*—Where a taxpayer employs a relative in his business, or a company employs a relative of a director or a shareholder, or where a partnership employs a relative of a partner, or a relative of a director or shareholder of a company which is a

*Summary as given in Income Taxes in the Commonwealth (Supplement)—Paragraph 731A.

member of the partnership, the Commissioner may, if he is of opinion that the remuneration or share of profits payable to the relative is unreasonable, allocate the profits of the business before the deduction of the amount payable to the relative, between the parties concerned in such proportions as he considers reasonable.

Where an amount is so allocated to a company, the amount is deemed to have been received as a dividend from the company by the person to whom it was paid.

For this purpose relative includes a husband or wife, a blood relative within the *fourth* degree or a relative by marriage or adoption and a trustee of such a relative."

19. We think it should be made clear in the law that the onus should be placed on the taxing authorities and not on the assessee for proving that the remuneration paid is not reasonable.

Expenditure remotely connected with business

20. Suggestions have been made in varying forms to the effect that all expenses directly or indirectly 'connected' with a business should be allowed as deductible expenditure. 'Connection' is a very ambiguous test. It is, therefore, difficult to agree that a test of this nature should be embodied in the statute. This can only be done in lieu of the existing test 'expenditure wholly and exclusively laid out etc.'; it is obvious that the latter wording is more precise than 'connected with business'. The courts have held that if the expenditure is 'incidental to business', it is admissible, though it may be only indirectly connected with it. On the other hand, a remote connection has not generally been accepted as a qualification for an admissible deduction. For example, medical expenses of a businessman are only remotely connected with his trade, and are, therefore, not deductible; a bad debt arising out of a loan to a client by a firm of lawyers is also not deductible as it is only remotely connected with business. It is impracticable in our view to lay down in the law a test for defining proximity or remoteness of connection with business. Each case should continue to be dealt with on its merits in the light of judicial interpretations.

Expenditure incurred out of business expediency

21. A suggestion has been made that all expenses incurred voluntarily but out of 'business expediency' should be treated as having been incurred wholly and exclusively for the purposes of the business. It is obviously not possible to provide by law that 'business expediency' should be a test for the admissibility of expenses. There will be endless difficulty in the interpretation of such a provision; nor is it necessary since it is possible to allow 'expedient expenditure' even under the present law provided it can be proved that it is wholly and exclusively laid out or expended for the purpose of the business.

Admissibility of certain types of capital expenditure

22. There is a class of expenditure which is disallowed on the ground that it produces an advantage of an enduring nature, although it does not result in the acquisition of a capital asset. Normally, such expenditure is treated as capital, and is therefore

treated as inadmissible. It has been suggested that, as such expenditure is in the nature of quasi-capital or deferred revenue expenditure, it should be allowed over a number of years. The U. K. (Tucker) Committee on the Taxation of Trading Profits recommended that expenditure of this nature should be allowed to be written off to revenue, provided that the advantage gained was for a limited duration. We observe that the principle has already been conceded in the Indian Income-tax Act by making capital expenditure on scientific research admissible under section 10(2) (xiv). In fact, this provision goes even further than the recommendation made by the U.K. (Tucker) Committee on Trading Profits as expenditure on scientific research is meant to secure an advantage or benefit over an indefinite period. While we consider that the suggestion made by the Tucker Committee provides useful guidance, the question should not be decided solely with reference to the duration of the benefit resulting from the expenditure. We would suggest that other considerations of public policy should also be taken into account.

23. Of the various items of expenditure of this nature which have been brought to our notice we recommend that the following two should be treated as admissible deductions:—

(i) cost of acquisition of patent rights and copyrights, and premium on leases; this is a corollary to the suggestion which we have made in the preceding chapter for bringing to charge the sale proceeds of patents, copyrights and premium on leases in the assessment of the recipient. We recommend that the payment made for the acquisition of patent rights should be spread over the number of years for which the rights are acquired, up to a maximum period of sixteen years. The period for the premium on leases should be a maximum of twenty years and for copyright it should depend on the nature of agreement under which it is acquired;

(ii) legal costs and other expenditure in connection with the acquisition of a lease for a period exceeding one year. This is consequential on the recommendation that we have already made in the preceding chapter that the premium on acquisition of a lease should be charged in the assessment of the recipients.

Consideration of individual items of expenditure

24. We now proceed to discuss in detail the representations made to us by a number of witnesses regarding the admissibility or otherwise of certain items of expenses.

25. (*i*) *Repairs.*—Section 10(2) (v) of the Indian Income-tax Act permits a deduction in the computation of taxable income, in respect of the amount paid on account of current repairs to buildings, machinery, plant or furniture used for the purposes of business. It has been represented to us that the word 'current' in the phrase 'current repairs' used in the section should be deleted and that the allocation made between revenue and capital by the management and the Chartered Accountants in respect of expenditure on repairs should be accepted by the Income-tax Department. The use of the word 'current' adds precision to the ordinary connotation of the term 'repairs' as contra-distinguished from alterations, etc., which

are chargeable to capital and on which depreciation is allowed. We do not think, however, that it is appropriate that the decision of the management and of the accountants in this respect should be made binding on the Income-tax Department.

26. (*ii*) *Expenditure on periodical renovation of studio equipment and cinema fittings.*—The cinema exhibitors have represented to us that they have to incur periodically heavy expenditure in making substantial alterations in and additions to their buildings, fittings and equipment in order to comply with the regulations of the licensing authorities and that it should be allowed in full as revenue expenditure in the year in which it is incurred, in view of the compulsory element involved. We do not consider that the fact of compulsion alters in any way the capital nature of the expenditure. The present method of amortising this expenditure by means of depreciation allowance is, in our opinion, fair enough and calls for no change.

27. (*iii*) *Cost of income-tax appeals.*—The present position is that, as income-tax paid by an assessee is not treated as a deductible item of expense, any expenditure incurred in connection with the determination of the tax due, whether in the initial proceedings or in appeals, is also treated as inadmissible. It has been held by the courts that the cost of tax appeals is in the nature of an application of income after it has been earned, and is not an expense incurred in the course of business. Notwithstanding this theoretical position, the Central Board of Revenue has issued executive instructions, as reproduced below, allowing certain expenses incurred in connection with income-tax proceedings and appeals:

"(a) expenses of settling the income-tax liability of an assessee before an Income-tax Officer will be ordinarily allowed, but expenses connected with subsequent proceedings before the higher authorities in appeal, review or reference to the High Court will not be allowed;

(b) expenses of an appeal to the Appellate Assistant Commissioner or to the Income-tax Appellate Tribunal against the application of section 23A will be allowed if the company succeeds in establishing in appeal that the section should not have been applied in its case."*

We recommend that this concession should be further liberalised by having a specific provision inserted in the law to the effect that, in case the Appellate Assistant Commissioner or the Appellate Tribunal is satisfied that an appeal was *prima facie* a wholly justifiable one, or a partially justifiable one, the appellate authority could order the payment to the assessee of an amount equivalent to the refund that he would be entitled to if either the whole or a portion (as may be decided upon by the appellate authority) of the actual expenses incurred by him on the appeal proceedings is treated under section 10(2)(xv) as a deductible expenditure in his assessment.

28. (*iv*) *Fines and penalties.*—It has been suggested that penalties imposed for infringement of any law or regulation in the course of carrying on of trade, *e.g.*, penalties imposed for violating import

*Income-tax Manual, Part III (Tenth Edition), page 454.

and export regulations, etc., should be regarded as an addition to the cost of purchasing goods. This seems to us to be an untenable proposition, and we are unable to support it.

29. (*v*) *Travelling expenses.*—The main grievance that has been made before us in connection with the treatment of travelling expenses is that a portion is always disallowed as representing boarding and lodging expenses which would have normally been incurred by the taxpayer even if he had not gone out. It is of course true, strictly speaking, that a person must incur some expenditure on his board and lodging wherever he might happen to be, but it is, in our opinion, going too far to suggest that the outstation expenditure incurred by a person on his board and lodging should, therefore, be disallowed. We understand that the Central Board of Revenue has issued a circular instructing Income-tax Officers not to be unduly strict regarding expenditure on travelling. We recommend that the circular should be supplemented by definite instructions to the effect that the practice of challenging travelling allowance on the grounds referred to above should be given up.

30. Another suggestion that has been made in this connection is that expenses incurred by directors of a company or proprietors or partners of a business on business visits to foreign countries should be allowed as a deduction. We understand that here also the Central Board of Revenue has issued instructions to the effect that such expenditure should be allowed as long as it is incurred in the interests of business liable to tax in India and is not in the nature of a capital expense. We are of the opinion that no general rule can be laid down on the subject and each case has to be treated on its merits. The instructions already issued by the Central Board of Revenue seem to us to meet satisfactorily the issue raised before us.

31. (*vi*) *Certain payments to non-residents.*—Under the present law, interest and salary paid outside India and chargeable to Indian tax are not allowed as a deduction in the computation of business profits unless the tax has been paid or it has been deducted at the source. This restriction, however, does not apply to expenses other than interest and salary admissible under section 10 of the Income-tax Act.

32. It has been pointed out to us that some concerns doing business in India make payments on account of commission and salary to non-residents for the services that they perform outside India for the business concerned. Such payments are treated as admissible expenditure in the firm's assessment but the recipients are not taxable, as the income does not accrue or arise to them, and is not received by them, in India. The suggestion that has been made is that such payments should be disallowed in the assessment of the business concerned.

33. We cannot subscribe to the principle implicit in the above suggestion, *viz.*, that every admissible deduction in the assessment of a payer should be liable to taxation in the assessment of the recipient. When an assessee is charged on income arising in and out of India, it is only fair that such income should be calculated after deducting all relevant admissible expenditure.

34. (*vii*) *Construction on lease-hold sites.*—Where a tax-payer has constructed buildings on leased land and claimed depreciation, he is not in a position to claim a balancing allowance under section 10(2)(vii) when the lease expires, as the allowance is given only when the building is "sold or discarded or destroyed or demolished". It has been suggested that, in these circumstances, the assessee should be allowed to deduct the excess of the written down value over any amounts recovered. The object of section 10(2)(vii) of the Income-tax Act is to equate, to its net cost to the owner, aggregate depreciation allowances over the period during which an asset is used for the business. On this principle, the allowance suggested is reasonable, provided a balancing charge is made when the amount recovered exceeds the written down value. We recommend that section 10(2)(vii) of the Income-tax Act be amended accordingly.

35. (*viii*) *Balancing charge under section 10 (2) (vii) arising from the compulsory acquisition of an asset.*—Another suggestion that has been made is that, in taxing the excess realised over the written down value on the sale of plant and machinery, the term 'sale' should be held to include compulsory acquisition of the asset. This is intended to get over the difficulty created by the decision of the Calcutta High Court* to the effect that the term 'sale' does not include compulsory acquisition. We recommend that the necessary amendment should be made in the law to secure this object.

36. (*ix*) *Expenditure on the training of personnel.*—It has been suggested to us that expenditure on the training of personnel, in India, and more particularly abroad, should be allowed as a deductible item of expenditure, without imposing the condition that the training should be of existing employees only and not of prospective candidates. The point stressed by those who have urged this before us is that the distinction between an existing employee and a prospective one for the purposes of applying the criterion of the necessity for the expenditure is very thin, and, in any case, no such distinction should be made. We understand from the Central Board of Revenue that the distinction made is not really between an existing employee and a prospective one, but between different kinds of training. Both existing employees and prospective ones may be given training in some aspects of the assessee's existing business; in this case the expenditure incurred on the training of both classes of employees is allowed as a revenue expenditure, subject to the Income-tax Officer being satisfied that the training was necessary and that it was meant solely and exclusively for purposes of the assessee's business. (Where the trainees happen to be the assessee's relatives this test is applied rigorously in order to ensure that the facts as stated are quite correct). There may, however, be cases where both existing as well as prospective employees are trained, not for the existing business of the assessee, but for some new business he intends to set up, or for the expansion of an existing business. In such cases, even though the expenditure may have been genuinely incurred wholly and exclusively for business purposes, it is treated as capital expenditure and not revenue. We are satisfied that in the circumstances no change in law or practice is called for.

*Calcutta Electric Supply Corporation Ltd. *vs.* C.I.T. [1951 (19), I.T.R. 406].

37. (*x*) *Cost of training cinema artistes.*—It has been suggested to us that the expenditure incurred by cinema artistes in receiving the training necessary for their profession should be allowed. There is no difference between such expenses and those incurred by other tax-payers for equipping themselves for getting employment or practising a profession or for securing a better career and better remuneration. The expenditure is of a capital nature and we see no justification for making any special concession to cinema artistes.

38. (*xi*) *Depreciation.*—We received numerous suggestions in regard to depreciation and, as the consideration of this item raises several important points, apart from the limited issue of deductible expenditure, we have thought it necessary to devote a separate chapter to a discussion of the subject.

39. (*xii*) *Reserve for expenditure connected with 'lay off' and 'retrenchment'.*—The provision in the Industrial Disputes Act, 1947, for the payment of gratuities or compensation to the workmen on the occasion of 'lay off' or 'retrenchment' no doubt places a burden on the industry. But this burden is dependent on the occurrence of a particular contingency which may not materialise at all in many units. Even in circumstances where payments have to be made, it is not possible to foresee the time of payment or its magnitude. Any appropriation to reserve for this purpose will be in the nature of pure guesswork, and the tax element on it will amount to an interest-free loan by Government. An alternative suggestion that has been made is that the whole of the payment should be treated as a loss to be carried backwards. It is difficult to create a fiction that 'payment' by itself is a 'loss'.

40. (*xiii*) *Expenditure on research in social and statistical sciences.*—A suggestion has been made that the scope of section 10(2)(xiii) of the Income-tax Act should be enlarged to include any sum paid to a university, college or other institution, which is approved by the prescribed authority, to be used for research in statistical and social sciences, provided it relates to the class of business carried on by the assessee. We are in agreement with this proposal and would suggest that the prescribed authority for this purpose should be the Planning Commission.

41. (*xiv*) *Bad debts.*—There is a distinction in law between irrecoverable loans and bad debts. The former relate to advances made by an assessee in the course of money-lending trade and the latter are trade debts which are irrecoverable. Both are treated as admissible deductions under law. A long line of judicial decisions has laid down the circumstances in which a 'debt' should be considered to be bad in order to qualify for deduction. Any recoveries made against bad debts, which have already been allowed, are treated as income in the year in which they are effected. The importance of bad debts in income-tax largely arises from the fact that their 'worthlessness' is a matter of judgment and opinions in respect of them are likely to differ as between the Income-tax Department and the assessee. The Income-tax Department has also to keep a watch that bad debts are not prematurely claimed merely to avoid taxation at a high rate in the year in which the claim is made.

42. A number of complaints have been made to us that Income-tax Officers are too rigid in their approach, and that they invariably insist on the institution of legal proceedings before recognising the worthlessness of a debt for its admissibility as a deduction. The Central Board of Revenue, whom we consulted, stated before us that the institution of proceedings is only one of the criteria, but not necessarily an indispensable condition, of accepting a debt as bad for taxation purposes. We think that a large number of legal decisions have fairly crystallised the criteria that should be employed to determine the 'worthlessness' of a debt. Practically all of them recognise that some discretion has to be exercised by the Income-tax Department in scrutinising the admissibility of bad debts. We fail to see how any further legislation, which is the course recommended by many witnesses, can operate to take away this discretion from the departmental authorities. The problem is essentially one of administration, and the only recommendation that we can make is to suggest that the Central Board of Revenue should take steps to satisfy itself that the departmental practice is substantially in accordance with the spirit of the judicial decisions on this question. We would, therefore, recommend an analysis of a sample of bad debts that have not been accepted by the Income-tax Department and the publication of the findings of the Central Board of Revenue on this analysis for general information.

43. (*xv*) *Bad debt reserves raised by banks.*—The problem of the tax treatment of bad debts is a matter of considerable importance in the assessment of banks. It has been represented that banks should be allowed to build up a tax-free reserve for bad debts, and that either the reserve set aside by the bank in its accounts should be allowed as a deduction or the amount to be allowed should be computed on the basis of a moving average as in the United States of America, or according to a schedule to be laid down by law. It is suggested that a reserve of this nature will assist banks to even out the incidence of bad debts from year to year and also help them to tide over occasional banking crises. As regards assistance in the event of a crisis, a reserve built up on the basis of 2-3 per cent. of outstanding debts could hardly be of substantial help. The allowance of bad debts on the basis of a reserve rather than of actuals does not appear to us likely to make any material difference to the financial strength of a bank.

44. If the suggestion is based on the belief that the creation of a bad debt reserve might obviate the need for scrutiny by the Income-tax Department of each individual item of bad debt claimed, it seems necessary to point out that the mere fact that a reserve is created will not obviate the need for scrutinising individual items, as the allowance will have to be adjusted from time to time with reference to the bank's actual experience. The onus of proving that a debt is bad has been placed by the courts on the assessees, and precise criteria have been laid down as to when debts are to be regarded as bad for the purposes of income-tax law.

45. It has also been urged that the scrutiny by the Income-tax Department of bad debt claims takes a long time to finalise. We have had an analysis made of the assessments of banks in Bombay and found that, out of bad debt claims totalling Rs. 65·28 lakhs in

60 assessments (four years' assessments each for fifteen banks), Rs. 59·18 lakhs was allowed by Income-tax Officers, and only a further amount of Rs. 3,048 was allowed in appeal. From this it would appear that most of the deductions for bad debts are allowed in the year in which they are claimed.

Deductions in respect of non-business income

46. We now proceed to discuss admissible deductions in respect of non-business incomes, *viz.*,

(i) income from salaries (section 7);
(ii) interest on securities (section 8); and
(iii) income from 'other sources' (section 12).

As regards income from property, the issues involved cover a wider field than admissible deductions. We have, therefore, dealt with this particular class of income in greater detail in Chapter VIII in this Volume.

Income from salaries

47. As regards income from salaries we recommend that persons chargeable under section 7 of the Indian Income-tax Act should be allowed the amount actually expended by them on the purchase of books and periodicals upto the extent that they are required for study and reference in the pursuit of their vocations. We would limit this concession to a maximum of Rs. 500 per year.

Interest on securities

48. Income from interest on securities is computed under section 8 of the Income-tax Act and the following deductions are allowed:—

(i) commission charged by a banker realising such interest on behalf of the tax-payer; and
(ii) interest payable on money borrowed for the purpose of investment in securities.

The cost of collecting interest on securities by the assessee personally is an inadmissible item. This rule also applies to banks, insurance companies and proprietary concerns that make their own arrangements for the collection of interest on securities held by them. We understand that, though technically such expenditure is not admissible, it is in fact being allowed. As banks, insurance companies, etc., are likely to have a large portfolio of investments, we think the admissibility of this expenditure should be placed beyond doubt by a suitable amendment of section 8 of the Income-tax Act.

Income from 'other sources'

49. While computing income under this head, admissible expenses are restricted to those incurred solely for the purposes of making or earning such income, except personal expenses and expenses of a capital nature. Expenses incurred on the collection of dividend income are not covered by this formula as they are not regarded as incurred for the purposes of earning income but for its collection after it has been earned. The issue that arises is similar to the one that we have dealt with in respect to income from interest on securities and we suggest that amendment to the law should be made in this case on the same lines.

Treatment of losses

50. The law relating to the set-off and carry-forward of losses is contained in section 24 of the Income-tax Act. It provides that losses arising under any head of income can be adjusted against income from any other head in the same year. The law further provides for carrying forward losses from any business, profession or vocation if they cannot be wholly set off against income in the same year. The unabsorbed portion of such loss, or the whole of such loss where there was no income against which it could be set off, is carried forward to the subsequent years up to a maximum of six years and set off against income, profits and gains from the *same* business, profession or vocation of those years. Losses arising from speculative transactions of a specified character, though they are in the nature of losses from business, are not allowed to be set off or carried forward for adjustment against income from other business. They can only be adjusted against income arising out of other speculative transactions of the same nature.

Suggestions made

51. Suggestions made to us on this subject may be divided into two categories:—

(a) suggestions involving the replacement of the present system either wholly or partially by a new system: namely,

(i) averaging of income and losses over a period to be specified, in preference to the system of set-off and carry-forward of losses; and

(ii) introduction of the system of adjusting losses of a particular year against profits of earlier years (carry-back) or of a mixed system involving both carry-forward and carry-backward of losses;

(b) suggestions for liberalising the scope and operation of the present law: namely,

(i) removing the present restriction against the setting off of 'carried forward' loss against profits of the *same* business, profession or vocation in subsequent years;

(ii) allowing losses arising under all heads of income and not only under the head of income 'business, profession or vocation' to be carried forward for being set off against profits of subsequent years;

(iii) allowing losses to be carried forward without a time limit; and

(iv) deletion of the special provision relating to speculation losses.

Averaging

52. Of the methods available for absorbing losses in the income stream, the averaging of income and losses over a period of years is a logical solution but it has practical limitations. The essence of the proposal is that taxable income of each of the years comprised in the 'averaging period' is worked out every year by dividing the aggregate of profits and losses by the number of years. A further tax demand is made or a refund of tax already paid is given, as the case may be, as a result of such re-assessment.

53. The working of this system would depend upon the length of the period that is adopted for averaging. The administrative convenience of keeping records would suggest a short period while in order to be equitable a fairly long period is indicated. Wherever this system has functioned, the period has generally been between three and five years. The disadvantage of a short period is that, if losses are incurred in a majority of the years comprised in the averaging period, the assessee will be denied altogether the benefit of absorbing them. This will particularly affect new undertakings which usually sustain losses in the early years of existence and look forward to loss-offsets in subsequent years. This is an important factor to be reckoned with in this country in view of the planned programme of industrialisation.

54. The averaging system has other disadvantages also, mainly of an administrative character. The computation of the tax will become more complex and uncertainties will arise in estimating refund claims which will ultimately make it difficult to forecast budget estimates. Appellate decisions, which take some time, will introduce further complications. In fact, the longer the averaging period—and it must be long enough if it has to achieve the desired objective—the greater would be the difficulties in this respect.

55. We are, therefore, of the view that averaging, as a device for loss offsets, has serious practical limitations: it is not likely to be equitable as among tax-payers, apart from the administrative difficulties that it would give rise to. It may be mentioned that a three-year average was in force in U.K. up to 1926-27 and the evidence led before both the Royal Commission on Income-tax, 1920, and the (Tucker) Committee on the Taxation of Trading Profits, 1951, shows that business interests did not favour a system of averaging in preference to carry-forward or carry-backward of losses.

Carry-back *vs.* carry-forward

56. The second main suggestion that has been made to us is for introducing the principle of carrying losses backwards for set-off against profits of the past years instead of the future years. The precise suggestions are (i) that an assessee should be given the choice between the 'carry-back' and the 'carry-forward' methods and (ii) that losses should first be carried back for a specified number of years and the remaining loss, if any, should then be carried forward.

57. 'Carry-back' implies adjustment of losses against income earned in the past upto a prescribed number of years. The taxable incomes, and the tax liability, for the years affected are re-calculated, and the consequent refund of tax is allowed to the assessee. In the carry-forward system no refund is involved; tax relief takes the form of a reduction in the taxable income of the future years.

58. The main justification of the 'carry-back' system is that adjustment of losses under it is a matter of certainty. The profits of the past years are a known quantity and the assessee gets a cash refund in the year in which losses occur. Under the 'carry-forward' system, adjustment of losses is dependent on profits emerging in future. If, however, it is assumed that profits occur more normally than losses, the advantage of either system depends on the rates of tax in the past and the prospective rates of tax. From this point of view, there is hardly anything to choose between the two systems.

59. The 'carry-back' system has certain drawbacks. The new concerns, which usually sustain losses in the initial years, will have hardly any past profits for adjustment of their losses. Even if a mixed system, based partly on 'carry-back' and partly on 'carry-forward' systems is introduced the advantage gained by older and well-established concerns will be greater than by new concerns and it will place the former in a better competitive position in the market.

60. In addition to the major objection mentioned above, the 'carry-back' system implies comparatively greater administrative complications than the 'carry-forward' system. Either claimants of refunds will have to wait until appeals are disposed of finally or the Income-tax Department will have to revise the assessments every time changes are made on appeal. The reopening of assessments under section 34 of the Income-tax Act will further complicate matters. Apart from this, the work in the income-tax office will also increase as, every time a loss has to be set off backwards, the records of at least three or four immediately preceding years will have to be gone into and the liability to tax for some of those years re-calculated.

Losses in the last year of business

61. For the reasons set forth above, we are opposed to the introduction of the 'carry-back' system except in circumstances where it may be impossible to adjust losses against future years owing to the cessation of business, profession or vocation. As a provision of this nature is susceptible of misuse, we would suggest that it should be applied with certain safeguards as indicated below. It should not be extended to a company unless it is wound up compulsorily under the orders of a court. Nor should it apply to a Hindu undivided family on partition. As regards individuals, it should apply when the business, profession or vocation is permanently discontinued and where such discontinuance is brought about by circumstances outside the control of the assessee, *e.g.*, at the time of his death. We would not, however, recommend its extension to partnerships as the interests of the individual partners will be looked after under the previous suggestion.

We suggest that such losses should be carried backward for one year and should be set off against profits arising from any source in the preceding year.

Types of losses to be carried forward

62. A refinement in the 'carry-forward' system, that has been suggested to us, is that losses sustained by an assessee under *any* head of income, and not only from 'business, profession or vocation', should be allowed to be carried forward and set off against future profits. The argument is that, as income from all sources is taken into account collectively for tax purposes, so should all losses be computed and adjusted collectively. Although the argument seems plausible on the face of it, the benefit to the assessees from the removal of the present restriction will, in practice, be illusory. There is hardly any possibility of a loss arising from salary, from interest on securities and from property except when in the latter two instances 'borrowed capital' comes into the picture. As regards 'other sources' of income assessable under section 12 of the Income-tax Act, the

position is practically similar. We are not, therefore, in favour of amending the law as suggested.

Length of carry-forward period

63. The present provision, which restricts the adjustment of the carried forward loss against the profits of the six subsequent years, has been criticised. It is stated that the limit placed on the period is arbitrary and that, if income-tax is not to fall on capital, the entire loss arising should be absorbed by the income of the subsequent years. We understand that the six-year period was introduced on the recommendations of the Income-tax Enquiry Committee, 1936, which had indicated illustratively that the period might be fixed at six years. On the other hand, it has been argued before us that losses ordinarily get absorbed in six years and, if they do not, the concerns incurring them are hardly likely to continue in business any longer. This seems to us to be in itself a refutation of the argument ordinarily advanced that an extension of the six-year period will lead to a substantial loss of revenue. We are also not impressed by the administrative objections raised against the extension of the period, *viz.*, that it will lead to greater burden on the Income-tax Department by necessitating the maintenance of records for long periods. All that is necessary in the circumstances is that the last assessment order should specify the amount of loss to be carried forward to the next year.

We are, therefore, of the opinion that losses of this nature should be allowed to be carried forward indefinitely, *i.e.*, until they are fully absorbed.

'Same' business

64. Another suggestion that has been made is that the present restriction on the adjustment of the carried-forward loss of a business against the income of the same business should be abandoned. It is pointed out that apart from the difficulties of interpretation of the word 'same' it is not equitable that the loss offset should be restricted on arbitrary grounds. The rates of taxes have also steeply risen since 1939 and the situation has altered materially from the point of view of the assessee since then. We recommend that the restriction for loss offsets against the same business should be removed, subject to the safeguard that the business in which the loss is occasioned is carried on by the *same* assessee in subsequent years. We also suggest that the working of this recommendation should be reviewed after five years.

Set-off of carried-forward business loss against non-business income

65. Another suggestion that has been made is that the carried forward loss from a business, profession or vocation should be set off against not only the income from any other business, profession or vocation but also against any non-business income, *i.e.*, income falling under heads other than 'profits and gains of business, profession or vocation'. The argument for the acceptance of this suggestion is based on the consideration that while the tax is laid on total income, the losses from all sources should also be aggregated for set-off. The principle is recognised in so far as the income and profits of the same year are concerned. The extension of the principle to the adjustment of the carried-forward losses in future years is not free from difficulties

such as the possibility of creating artificial losses where business is only a side-line. On the other hand, we think that the business should be allowed a period of one year to recover and should not have to face the possibility of the payment of the tax on non-business income in the next year by drawing upon its capital. From the very nature of the issues involved, the acceptance of the suggestion in its original form is impracticable. We, therefore, recommend that carried-forward loss from a business, profession or vocation may be allowed to be set off against 'non-business' income of the year next following the year in which the loss arises, provided that the business, profession or vocation, in respect of which the loss arises, is carried on by the assessee in the subsequent year.

Losses from speculation

66. The differentiation made between losses from speculation and other losses (*vide* the amendment made to section 24 of the Income-tax Act by section 2 of the Finance Act, 1953) was strongly criticised by some of the witnesses. This amendment, it has been claimed, was effected to counter the tendency of claiming speculative losses without bringing into account speculative profits, and of 'buying up' of speculative losses.

67. There are three main criticisms of this enactment. Firstly, it has been represented that it violates the basic concept of 'total income' in the Income-tax Act by including speculative profits in the income chargeable to tax while excluding speculative losses from the computation of the total income chargeable, except to the extent of any speculative profits available. The second objection is that the enactment hits not only 'bought up' losses but *all* speculation losses; that it hits not only the tax-dodgers but all persons who carry on speculation and that, in this process, it not only affects adversely business enterprises in general but also has repercussions on the working of stock and other exchanges. Lastly, the enactment is criticised on the ground that with all its resulting inequalities, it is at present of little use to the revenue authorities as it has come in when the contingency, if any, that gave rise to it, has practically disappeared.

68. In discussing this point it is useful to bear in mind the fact that even under the present law in regard to which complaints have been made, the following types of transactions are not treated as 'speculative':—

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him;

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; and

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transactions in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member.

69. Genuine hedging transactions, which are undertaken in the normal course of business, have thus been excluded from the scope of this legislation. Departmental instructions have further been issued to the effect that, in respect of hedging in raw materials, the Income-tax Officers should not be too particular about the quantities and timing so long as the transactions constitute genuine hedging.

70. The criticism of the present provisions takes two contradictory lines. It is claimed that the amendment is not effective as it is even now possible to 'buy up' losses under the guise of hedging and that it is inequitable as all the genuine hedging transactions are not excluded. It is also argued that it is not possible for the law to circumscribe speculative business within a legal definition and that the best remedy for the situation confronting the Income-tax Department is to examine the accounts more diligently than at present. We are of the view that transactions of the nature of 'buying up' of losses or of keeping speculative profits out of books cannot be located merely through the examination of accounts as these are not maintained, according to the Income-tax Investigation Commission which examined this matter, in a satisfactory manner. We are, therefore, unable to agree that there is no justification for some provision to prevent the adverse effect on revenue of such transactions escaping taxation. It appears to us that the present provision in the law is the only way in which it can be done, *viz.*, to define speculative transactions and then to exclude genuine hedging from its scope. We, therefore, do not agree that the amendment involves any violation of the true concept of 'total income'. So long as the transactions in question lead to loss of revenue, and they cannot be discovered by the ordinary means at the disposal of income-tax authorities, it is legitimate, in our opinion, to invalidate them for income-tax purposes.

71. Some witnesses have suggested that speculative transactions should be ignored altogether for income-tax purposes; we do not think that this is a feasible proposition.

72. We have recommended elsewhere that the present time-limit of six years for the carry-forward of losses should be removed altogether. This will apply equally to speculative losses, except that they would be available only for being set off against income from speculative transactions.

Set-off of carried-forward losses incurred by a company

73. A company has a legal status, separate from its shareholders, which remains intact although the shareholders may go on changing from year to year. It is thus possible for a few persons to acquire the shares of companies, which have sustained losses in earlier years, and then commence to carry on profitable business through such companies; they will, in this way, be able to reduce their tax liability through securing set-off of losses of earlier years made when the shares in the company were held by different shareholders. It has been suggested, in order to safeguard revenue against loss arising from transactions of the kind mentioned above, that the set-off loss against subsequent profits of

companies should be allowed only if the shareholders in the year when income is earned are substantially the same as those in the year when loss occurs.

74. We think there is justification for enacting a provision of this nature. We, therefore, accept the suggestion, subject to the condition that its application should be restricted to companies 'in which the public are not substantially interested' (according to the definition of this term that we have suggested in the chapter on "Taxation of Corporate Profits—II").

CHAPTER V

DEPRECIATION ALLOWANCES

Salient features of depreciation allowances

The present law on depreciation allowance is contained in clauses (vi), (via) and (vii) of sub-section (2) of section 10 of the Income-tax Act. Depreciation is allowed under these provisions only up to an amount representing the original cost of an asset to the assessee; and it is permitted on what is known as the 'written down value' basis on all assets except ships (other than ships ordinarily plying on inland waters) in respect of which it is allowed on what is known as the 'straight-line' method. The cost of replacements is allowed as a deduction in lieu of depreciation in respect of certain assets. Depreciation unabsorbed against profits in any year is allowed to be carried forward indefinitely; precedence, however, is given in the matter of set-off to losses that are carried forward.

2. As regards the assets on which depreciation is allowed, these may be divided into three broad categories, *viz.*, (i) plant and machinery, (ii) buildings and (iii) furniture. Depreciation is admissible for only such of the above-mentioned assets as (a) are owned by the assessee and (b) are in use during the relevant accounting year for the purpose of the business under assessment.

3. The amount of depreciation admissible in each accounting year is a prescribed percentage of the written down value. These percentage rates have been fixed keeping in view generally the estimated life of each asset. Rates have been fixed on an 'item' basis (*i.e.*, for individual items of plant or machinery such as motor cars, typewriters) as well as on a 'group' basis (*i.e.*, overall rates prescribed for the entire plant and machinery used in specified types of industries such as flour mills, sugar factories) for certain industries. The amount of depreciation allowance for any year in respect of an asset is proportional to the number of months of its use in the year. Extra-shift allowance is admissible for certain items of plant and machinery, working in double or multiple shifts.

4. Where an asset is sold or discarded or demolished or destroyed in any year, the difference between its written down value and the sale or scrap value is allowed as a deduction in such a year; this is usually referred to as the 'balancing allowance'. If the sale proceeds, etc., exceed the written down value, the excess of the sale price over the written down value is treated as taxable profits. This excess is known as a 'balancing charge'; it is limited to the difference between the original cost and the written down value, any part of the sale price realised over and above the original cost being treated as a capital receipt.

5. Provision also exists for depreciation actually allowed or notionally allowed, under the taxation laws of Part B States before their financial integration, being taken into account for depreciation purposes under the Indian Income-tax Act.

6. The validity of the original cost basis of depreciation has been questioned on the ground that it embodies the assumption of stable price levels; for, the depreciation allowance admissible at present enables a fund to be built up, free of tax, which approximately equals the replacement cost only if the latter were equal to the original price. If replacements fall due in a period of extended inflation, the normal depreciation reserves will obviously be inadequate relatively to the requirements of replacement of assets (even by like assets), as prices will have substantially risen. Unless the shortfall can be met by raising external finance and/or by diverting other reserves, it would not be possible for a business to preserve intact its physical assets. It is argued that, if such a situation were allowed to arise, production would be affected adversely and, therefore, in the long run, revenues also.

Basis of depreciation: original and replacement costs

7. It is further stated that prices of capital assets have actually risen considerably in the post-war period, but no increase beyond original cost has been permitted in the depreciation allowance. The internal sources are also not sufficient to meet the reasonable needs of industry, this being ascribed directly to the taxation policy of Government during the War. The tax rates, including the incidence of excess profits tax, during the War, absorbed as much as 60 per cent. of the profits even in the case of companies and much higher in the case of proprietary business involving high incomes. At the same time, circumstances have not been favourable for securing funds from the capital market or from any other external source. Industry has, thus, been confronted with the grave problem of replacement of fixed assets; and it is suggested that special tax reliefs should be provided to enable it to overcome this difficulty.

Revalorisation: case for and against

8. In this connection, theoretical support is sought to be secured for a 'new look' at the problem of depreciation allowances by invoking the doctrine of revalorisation. Revalorisation is normally interpreted as a restatement of fixed assets in the balance sheet in terms of current values, though logically it ought perhaps to be taken to apply over the whole field of the balance sheet. Whether applied to fixed assets or over a wider field, revalorisation has meaning only on two basic assumptions, *viz.*, that the price level has risen very steeply and that it is likely to remain at that level for a considerable length of time. Where the latter condition is not fulfilled, revalorisation does not solve the problem created by a price rise unless it is identified with the concept of continuous revaluation. And that is in fact what the strict application of the theory of revalorisation sets out to do, *viz.*, to seek a periodical reappraisal of asset values by the use of price indices.

9. We find it difficult to accept the validity of the theory of revalorisation. To expect a stable level of prices over a continuing period is unrealistic and not in accord with economic history; and the risk of gain or loss resulting from price changes is an inevitable adjunct of a monetary economy. To pick out one form of income or wealth such as fixed assets used in business and attempt to secure for them some kind of a stability of value in real terms is neither equitable nor practicable. Thus, write-up of assets would tantamount to a subsidy of business income, while other incomes, though equally subject to the strain of rising prices, would

be denied the subsidy. Moreover, rising prices, while increasing the costs of replacement for business, also reduce the real burden of its contractual obligations, which may, in some cases, be more than a set-off against the former. There is also the fundamental objection that, in an age of technological advance, it is rarely possible even physically to repeat an equipment manufactured many years ago with the result that replacement, even in normal times, almost always includes elements of improvement of varying degrees of magnitude. Nor must it be forgotten that replacement is not necessarily occasioned by physical depreciation of an asset to the point of exhaustion; on the contrary, it is often the result of other factors such as technological change, intensity of competition, availability of capital, rates of corporate taxation and general industrial outlook. Revaluation of assets with its necessary implication of depreciation allowances in excess of original cost, benefits established and stationary business units, especially such of them as have delayed replacing their assets as also those which deliberately retain obsolete plant as a stand-by for emergency use, while new business units and old business units which have followed a progressive policy regarding replacement or gone in for expansion are left without any special favour from the exchequer. There is also the extreme difficulty of devising a workable method of applying continuing price changes for revaluation of business assets of various kinds and ages. There is the further fact that revaluing assets in terms of current prices would prove a source of embarrassment to business interests themselves during periods of falling prices, while during periods of rising prices, Government may well claim some measure of detailed control in the matter of replacement, as they will have to bear the brunt of the extra cost of replacement through a system of appropriate tax relief. In the circumstances, we cannot but reject the principle of revalorisation or continuous revaluation not merely as defective in theory, but certainly as unworkable in practice.

10. Objections of unworkability in practice though not of inequity in theory, are perhaps not so strong in the case of a modified form of revalorisation, where there is only a single act of revaluation of assets to provide a basis for tax allowance for an indefinite period, but objections in terms of equity are so strong that they can be set aside only on the ground of overwhelming public interest such as exists when prices have risen so steeply and there has been so large a degree of inflation that any statement of the value of assets in terms of their original money cost ceases to have any meaning. This was the case when fixed assets were revalued in Austria between 1922 and 1924, in Germany in 1924, in France, Germany and Belgium after World War II, and in Japan in 1950. But that is not the case now in India where the degree of price rise is comparatively modest in the context of inflation and where the rise in the prices of capital assets is even less, being of the order of about 150 per cent.

Problem of replacement in Indian industry

11. It may be conceded, however, that, while there is not such a rise in prices of assets as to justify revalorisation of business units in India, there is a substantial rise in replacement costs as compared with the original costs of the assets concerned. Suggestions have been made that, failing revalorisation, the

problem of replacement costs could be solved either by *ad hoc* increases in depreciation allowances or by treating replacement costs, when actually incurred, as a revenue expenditure either wholly or partially or by giving tax relief on that portion of the profits as is used for financing replacement. All these are but various ways of tax relief, direct or indirect. Tax relief either by way of larger depreciation allowances or otherwise is, however, only one of the ways of finding the additional funds required for replacement. Moderation in the declaration of dividends and larger retention and reinvestment of profits is another way. Yet another way would be the provision of loan finance at concessional rates by a State-sponsored financial institution.

12. We would add, however, that, irrespective of • cause, any indication of a decline in the potential of industry even to continue production at the existing level because of inability to replace worn-out assets would be a serious national problem. It would be poor policy to invest in new concerns, whether in the public or the private sector, if the productive capacity of established undertakings were in danger of deterioration due to difficulties of financing replacement. Whether such a situation of the nature of a crisis exists or not in India is a question of fact and cannot be answered without an analysis of the post-war situation in regard to capital formation in the corporate sector.

13. In this connection, we would refer to the results of the survey carried out by us into the finances of the corporate sector in industry (*vide* Chapter VIII, Volume I). The survey indicates broadly the dimensions of the problem in regard to the replacement needs of industry. Thus, it was found that the 492 public companies for which data were obtained by issuing a special questionnaire, required, as of 1951, an estimated amount of Rs. 16 crores a year on an average for a period of fifteen years for replacing the assets (excluding buildings but including plant, machinery and other assets) acquired before 1946; and this represented the requirements at their maximum. These companies had, during the period 1946—51, an average amount of Rs. 11·5 crores per year of retained profits, and Rs. 8·8 crores a year of additional paid-up capital, excluding capitalised reserves of Rs. 7 crores. On the whole, the companies were able to undertake a gross fixed assets formation during this period at a significantly larger rate than the estimated average rate of requirements for replacement as given above: and this they were able to do from funds which they obtained from their internal reserves or from the capital market. This fixed assets formation, of course, comprised expansion as well as replacement, and gives the position for all industries. If past performances, therefore, were to be regarded as an indication of the future, replacement has not been such an intractable problem for corporate industry as a whole as would appear from the demands and statements of representative business interests.

14. There is no doubt that, while part of the reason for the satisfactory state of affairs during 1946—51 was to be found in the trend of profits during the period, part also lay in the significant tax relief that the companies obtained either directly or indirectly during that period. Among the items of relief should be mentioned the abolition of the excess profits tax and the business profits tax

and the tax relief of one anna in the rupee on undistributed profits. Of particular significance is the contribution made by the system of special initial and additional depreciation allowances instituted during the period. It is true that these allowances did not constitute any permanent tax relief. In fact, they were of the nature of a tax-free loan by Government, but they were helpful in enabling industry to find funds from internal resources for replacement and expansion. Thus, an initial depreciation allowance on plant and machinery at twenty per cent. which is not deducted for calculating the written down value has been given since 1st April 1946; the corresponding rate is fifteen per cent. on buildings the erection of which is begun and completed between 1st April 1946 and 31st March 1956 and ten per cent. for other buildings. Additional depreciation, equal to the normal rate, was allowed from 1st April 1949. These measures were designed to stimulate replacement of old assets and to encourage investment. The statistical data gathered by us shows that the liquidity position of 293 companies included in our sample survey was assisted by faster write-offs between 1947 and 1952 to the extent of about Rs. 14·5 crores. For the corporate sector of industry as a whole, on the basis of the ratio of paid-up capital, this yields an approximate figure of Rs. 36 crores; this figure is broadly exclusive of the new companies started after 1946, in respect of which initial and additional allowances would also be fairly substantial. Initial and additional depreciation allowances are based on the current replacement costs of assets. In the past few years, the grant of these allowances has considerably increased the proportion of total depreciation allowed on the basis of the capital goods prices of the more recent periods. In effect, in the case of expanding concerns, these allowances have provided substantial financial accommodation to meet the situation arising from higher costs of replacement. Thus, in respect of 293 manufacturing companies which were in existence in 1946, of the total depreciation allowed by the Income-tax Department amounting to Rs. 77 crores between 1947 and 1952, as much as Rs. 55 crores was in respect of assets acquired in or after 1946. Initial allowances amounting to Rs. 18 crores and additional depreciation of a somewhat lower order contributed very largely to this result. It would be, however, correct to say that the problem of replacement has not been solved either for all industries or for all units in each industry. Thus, *e.g.*, industries like cotton textiles, jute and iron and steel require some special attention. There is also the problem of the smaller concerns which perhaps have not been able to accumulate enough of internal funds, and, at the same time, find it very difficult to obtain finance from the open market. Under the circumstances, it may be necessary to make some other arrangements to assist particular industries and units, though a few of them are probably to blame for their present plight and may need to be protected compulsorily from a recurrence of the practices that may have led them to their present position. We understand that arrangements are being made to utilise the resources of the newly formed Industrial Development Corporation to assist cotton and jute textile industries in their replacement programmes. For financing the replacement programme of the Iron and Steel industry, a loan of Rs. 10 crores is to be given to the Tata Iron and Steel Company. Also in fixing the prices of steel and cement, additional provision for depreciation has been taken into account. Accommodation by way of loans at moderate rates of interest through State-sponsored financial corporations, both at the Centre and in the States, seems to be peculiarly suitable to meet the special needs of the bulk of these concerns. In addition, we are of the opinion that the system of initial and additional depreciation allowances instituted in 1946 and 1949 respectively should be continued for another period of five years, after which there should be a review of the position in regard to the problem of replacement in industry.

15. We would suggest, however, a change in the manner of calculating depreciation allowances. Initial depreciation allowance should, in our view, be taken into account for determining the written down value of an asset. The proviso to clause (via) of sub-section (2) of section 10 of the Income-tax Act requires that depreciation allowances already availed of should be recalculated after five years on the basis of the market value of the asset if it is lower than the original cost, and the difference between the written down values calculated with reference to the original cost and to the then existing market price should be allowed as a further deduction on account of depreciation charges. We recommend that this provision should be deleted for all kinds of assets and that the rate of the initial depreciation allowance in respect of plant and machinery should, in consequence of these changes, be increased from 20 per cent. to 25 per cent. of the original cost of the asset.

16. For certain industries, however, for which we want to provide special inducement for capital formation, we have recommended the grant of a development rebate which should take the place of the initial depreciation allowance and which would partake of the character of a straight tax relief in place of the tax-free loan that the initial depreciation now represents. We deal with this matter in detail in Chapter VII.

17. We now proceed to an examination of some questions relating to the method, scope and rates of the depreciation allowances.

Method of depreciation

Depreciation, in its present form, is a matter of timing of the allocation to expenses of the original cost of assets. Various methods are adopted for charging depreciation. Of these, the two most commonly used are the straight-line and the diminishing balance or written down value methods. Some witnesses have suggested the adoption of what has been called the 'free method'. Under this method, tax-payers have full discretion to vary, within the overall limit of 100 per cent. of original cost, the depreciation charged from year to year; it may be increased, for example, in good years and reduced in years of poor working and low profits. The main advantage claimed for this method is the stimulus it could afford to investment. There is, however, a clear distinction between faster write-off or accelerated depreciation on a systematic basis and the unregulated variations that are permitted under the free method. One of the basic functions of depreciation accounting is the orderly charging of plant costs to operating profits so as to lead to a proper ascertainment of annual profits and tax liability. This calls for the selection of a proper method and of rates which would lead to an equitable periodic assignment of the total depreciable amount in respect of each asset over its useful life. The major defect of the free method is that it gives rise to considerable uncertainty of tax receipts. The uncertainty is liable to be magnified owing to possibilities of changes in rates of taxation, which might themselves lead to fluctuations in the depreciation charged to take advantage of tax changes. Also, as depreciation allowances provide ready resources immediately, there are chances that the amount of depreciation may be varied in response to the need for resources; under the method, business funds are liable to be misdirected. Everything considered, we do not recommend the adoption of this method.

18. Under the straight-line method, the annual provision is given by the original cost of an asset divided by the number of years of its estimated or assumed life, *i.e.*, the amount is distributed in equal instalments over the useful life of the asset. Under the written down value method, a fixed percentage is charged for depreciation each year. It is not a percentage of original cost, but of what remains of the original cost after deducting the sum of depreciation allowances in the preceding years. The straight-line method was replaced by the written down value method in 1939 on the recommendation of the Income-tax Enquiry Committee, 1936. The Committee considered that the latter method was simpler to operate as, unlike, the straight-line method, it did not require identification of each asset. The identification of the asset, however, becomes important in the written down value method also if an asset is sold, discarded, destroyed or demolished and if a balancing charge, or allowance, under clause (vii) of sub-section (2) of Section 10 arises, though these cases are not of frequent occurrence. The real merit of the written down value method is that it tends to equate depreciation *plus* maintenance expenses over the whole life of the asset. When the asset is new, maintenance charges will be lower and depreciation higher than in later years of the working of the asset. The method assists in reducing risk since the larger part of the cost is charged off in the earlier years.

19. There are certain assets, however, for which the straight-line method of charging depreciation is more appropriate than the written down value method. Some exceptions to the written down value method therefore already find a place in the income-tax law, as for example in the case of ships other than those plying on inland waters.

20. Certain interests, particularly electricity undertakings, have brought to our notice the difficulties caused to them by the adoption of the written down value method for tax purposes in that the Electricity (Supply) Act, 1948, provides for the charging of depreciation for purposes of working out the cost of the service on the straight-line method or the compound interest method. This divergence creates a lack of correspondence between the book profits and assessed profits. We recommend that in instances of this nature the method statutorily provided for in the special laws applicable to particular industries should be adopted for income-tax purposes also.

Apart from the suggestion made above, we recommend that no change is necessary in the method of charging depreciation allowance for income-tax purposes.

Unabsorbed depreciation and unabsorbed losses

21. According to the second proviso to clause (vi) of sub-section (2) of section 10 of the Income-tax Act, unabsorbed depreciation can be carried forward indefinitely, whereas losses can, at present, be carried forward only for six years under sub-section (2) of section 24 of the Income-tax Act. When losses and unabsorbed depreciation occur together in the same year, the law—proviso (b) to sub-section (2) of section 24—provides that losses will have priority for set-off against the subsequent year's income, the income being calculated, of course, after charging depreciation. It has been represented to us that losses carried forward from a previous year should be allowed to be set off against the income of a year before depreciation for the year has been charged. The carry-forward of losses being subject to a time limit and of unabsorbed depreciation being allowed indefinitely, the suggestion, in effect, involves the conversion of losses into unabsorbed depreciation with a view to availing of the facility of indefinite carry-forward which attaches to the latter. We have recommended elsewhere that losses may be allowed to be carried forward indefinitely. If the recommendation is accepted, the proposal under consideration will cease to be of any significance. We are, however, opposed in principle to the suggestion made as it would involve a fundamental change in the method of computing taxable income.

Classification of assets

22. The suggestions made in regard to classification of assets are twofold:—

(a) proposals for changes in the present classification of assets, and

(b) proposals for addition of new items to the list of assets entitled to depreciation.

We have received a large volume of evidence in support of the view that the present classification of assets is satisfactory. Some witnesses have, however, stated that the present schedule which was drawn up a long time ago does not take account of the more recent advances made in the engineering and industrial fields. They have accordingly suggested a periodical revision of the schedule by a technical body of engineers, accountants and tax experts. The Central Board of Revenue has stated that suitable changes in the classification are made from time to time in response to the representations received. Although the system is reported to be working fairly satisfactorily, a periodical examination of the classification of assets has advantages. We suggest that the Central Board of Revenue should undertake a comprehensive revision of the schedule classifying the assets for depreciation with a view to taking into account the latest technical developments.

Additions to list of assets entitled to depreciation

23. Depreciation is, at present, admissible in respect only of plant, machinery, buildings and furniture. It has been suggested that depreciation allowances should be granted in respect of certain other capital assets also, namely:—

(a) *tangible assets*:

(i) roads and bridges; and

(ii) buildings used for housing employees of a business;

(b) *intangible assets*:

(i) premia paid on leases;

(ii) patents; and

(iii) goodwill.

Depreciation on roads and bridges

24. Depreciation on assets such as roads and bridges has been asked for on the ground that these assets, like others, are liable to wear and tear. Depreciation allowance is not admitted on these assets now as the annual deterioration, apart from being very small, is effectively taken care of by the deduction from taxable income allowed for periodical repairs. Roads and bridges have practically unlimited life if normal repairs are effected regularly, and a depreciation allowance does not appear to be called for. The present provision in respect of these assets, which is in accord with practice elsewhere, seems to be based on unexceptionable principles and, therefore, does not, in our opinion, require any change.

Depreciation on buildings used for housing business employees

25. The Income-tax Act allows depreciation on buildings if they are used for the purposes of a business, profession or vocation carried on by a tax-payer. Depreciation is thus granted in respect of factory buildings, godowns, office buildings, etc. It has been suggested by some witnesses that depreciation should also be admissible in respect of buildings used for the purpose of housing business employees. The departmental instructions on this point issued by the Central Board of Revenue are as follows*:—

> "buildings belonging to the owner of a business and used by him in order to house his employees are buildings used for the purpose of business where the occupation by the employees of property owned by the employer who carries on a business is subservient to, and necessary for, the performance of their duties. In any other event such buildings would be chargeable under section 9 irrespective of the fact whether any rent is paid by the employees or not".

Where the occupation of the property by business employees is not subservient to, and necessary for, the performance of their duties, the employer and the employees are in the same position as any landlord and tenants, and income from such buildings is rightly assessable under section 9 of the Income-tax Act. The demand for depreciation allowances on such property is thus linked up with the general demand that depreciation should be an admissible deduction under section 9 of the Income-tax Act. This question has been examined by us in Chapter VIII of this Volume and for the reasons stated there, we do not think that there is any case for allowing depreciation on such buildings.

Depreciation on intangible assets

26. It has been suggested that the law should provide for depreciation or amortization of intangible assets used for the purposes of the business, *e.g.*, premia on leases, cost of patent and goodwill. As regards the first two, we have already recommended in paragraph 23 of Chapter IV that the expenditure involved should be allowed to be

*Income-tax Manual, Part III (Tenth Edition) p. 447.

charged to revenue by spreading it over a suitable number of years. As regards goodwill, its benefits are indefinable and it is an asset that can be manipulated at will in the balance-sheets; also, it should normally not depreciate and may appreciate as a concern progresses. If it depreciates this must be due to bad management and similar factors and there is hardly any case for depreciation on such an asset.

Depreciation on leased property

27. The present law in regard to depreciation on leased property has been criticised on the ground that it allows depreciation only to the owner of an asset and not to a lessee. There is, however, no case for a general provision to the effect that depreciation should be admissible to lessees of assets also, because in that case depreciation on the same asset may be claimed twice, once by the owner and a second time by the lessee. The lessee is allowed full deduction of the annual lease-hire and the lessor is allowed the depreciation. In view of this, we do not see any justification for the suggestion made.

Rates of depreciation

28. While a few witnesses have stated that the present rates of depreciation are excessive in some specific cases, quite a large number of persons have expressed the view that the rates are generally low and need an upward revision. We have not had the time or the means of carrying out an investigation of this matter which is essentially of a technical nature. We suggest, therefore, that the Central Board of Revenue should make an overall examination of the rate schedule, together with the classification of assets referred to earlier.

Group vs. item basis

29. Rule 8 of the Income-tax Rules prescribes the rates of depreciation on plant and machinery on an item basis as well as group basis as explained at the beginning of the chapter. Assessees, however, have the option of claiming the special rates of depreciation in respect of certain specified categories of assets for which special rates have been prescribed on the item basis.

30. Another of the modifications suggested is to the effect that depreciation should be allowed on the basis of rates fixed with reference to the estimated life of each type of plant or machinery. On the other hand, certain witnesses have advocated that the group basis should be generally extended by grouping together the various minor assets in each industry so that the entire machinery should be entitled to depreciation at the rate applicable to the particular industry. The question whether the group basis or the item basis should be generally followed involves a detailed technical examination. On the whole, however, the present system appears to us to be satisfactory. The group basis leads to a saving both in time and work for the Income-tax Department, secures a greater simplicity from the point of view of the assessees and, in the long run, does not affect the total quantum of depreciation allowable to any business concern. At the same time, the option has been given to the assessee to claim the special rates applicable to individual assets whenever such rates are higher than the overall rate fixed for the industry concerned; this ensures that the interests of assessees do not suffer even from the short term point of view.

31. It has been suggested by some witnesses that the present method of restricting the amount of depreciation allowable in a year according to the number of months in the year for which the asset is used should be replaced by the method which prevailed before 1948, according to which depreciation for the whole year was admissible in respect of any asset acquired during any part of the accounting year. It is stated that the new method involves greater calculation work both for the Income-tax Department and the assessees without serving any real purpose since the total amount admissible over a number of years is fixed. While it is true that, in certain cases, where unusually high profits have been earned, an asset brought into use at the fag-end of the year may make a material difference to the tax-payer's liability if there are no prospects of the same level of income being maintained in subsequent years, the advantage to revenues in such isolated cases does not appear to us to justify the additional labour involved in every case in the application of the present method. We, therefore, recommend that this practice may be abandoned by repealing the amendment of Rule 8 of the Income-tax Rules effected in 1948 by Notification No. 31-I.T., dated 15th May 1948.

Depreciation based on months of use

32. At present, clause (vii) of sub-section (2) of section 10 of the Income-tax Act, under which a balancing allowance representing the excess of written down value over the sale or scrap value is given, applies only to buildings, plant and machinery. It has been represented that the provisions of this section should be made applicable to furniture also. We are informed that this is being done already under executive instructions. We, however, recommend that this should be provided for statutorily by a suitable amendment of the law.

Modification of section 10 (2) (vii)

33. Some witnesses have suggested that the excess of sale proceeds over the written down value of an asset which is now brought to charge to the extent provided for under clause (vii) of sub-section (2) of section 10 should be excluded for purposes of taxation, provided the sale proceeds are utilised for financing the replacement of that asset. We think that the suggestion is reasonable and should be accepted subject to:

(i) the amount saved from taxation being set off against the original cost of the new asset before depreciation is charged on it, and

(ii) the new asset being purchased within two years of the sale of the old asset.

34. Under the Indian Income-tax Act, the written down value of any asset for depreciation purposes is computed by deducting from its original cost the amount of depreciation actually allowed in the past. When the law was extended to Part B States on their financial integration with India, the same provision was applied to them. In some of the Part B States which had their own income-tax laws in force before their financial integration with India, the law provided that, in computing the written down value, all depreciation notionally allowable (in respect of the past years)

Depreciation on assets used in Part B States

would be deducted. In the case of these States, this provision was retained by suitable enactment of an explanation in the Taxation Laws (Part B States) (Removal of Difficulties) Order, 1950. We understand that this was done with a view to continuing the position as obtaining in those States before their financial integration. A distinction thus came to exist between such States and States which had no income-tax law in force in their territories before their financial integration with India; in the latter States, depreciation was allowed on the basis of the full original value irrespective of the period for which assets had been in use. Some witnesses have represented against this discrimination and suggested that business concerns in the States concerned by the orders of 1950 should also be allowed to charge depreciation on the full original cost as in the other States. A more logical way of ensuring uniformity would have been to provide that the assets of all old concerns coming under assessment for the first time should be written down to take account of the wear and tear which had already occurred so as to prevent their getting in future assessments depreciation on past wear and tear. The distinction is sought to be justified on the ground that at the time of the financial integration, the Government of India took up the thread only at the point at which the individual States had left it. In the process, business concerns in the States which had no income-tax before integration undoubtedly gained some advantage. But this affords no justification for a general departure from the basis of written down value in States which had an income-tax system at the time of financial integration.

CHAPTER VI

TAXATION OF MINING INDUSTRIES

The spokesmen of the mining industry have made the following suggestions to us for amending the present Income-tax Act so as to provide for the special needs of that industry:—

(i) depletion of the wasting mineral assets should be treated as a deductible cost in determining the net taxable income;

(ii) certain items of expenditure which are not now allowed as 'deductible' for taxation purposes but which are peculiar to and essential for mining operations should be allowed; and

(iii) special tax concessions should be given as an incentive to further effort in the development of this key industry.

2. It has been pointed out to us that, with the exception of bedded minerals such as occur on or near the surface, and which can, therefore, be extracted without any appreciable capital outlay, the exploitation and development of mineral resources involve, generally, operations of a more costly, hazardous and uncertain nature than in other enterprises. Large-scale investment of capital is needed, and the risk involved is appreciably greater, than in ordinary trading or manufacturing industries. Capital has to be locked up for a relatively longer period owing to the delay that is necessarily involved in the discovery of minerals. A large amount of abortive expenditure has also to be incurred before a commercially workable mine is proved. The prices of minerals, it is stated, are governed by world market conditions to a much greater degree than those of other industrial goods; the profits, therefore, are more uncertain. It has been represented to us that these factors have proved a serious disincentive to the development of mineral resources in this country, particularly deep mining and oil mining. On the other hand, the importance and urgency of the development of the country's mineral wealth is well recognised. It has, therefore, been contended that not only should the income-tax law provide for a fair and just treatment of various types of expenditure which have to be incurred by mining concerns so that they, like other industrial concerns, can recover, free of tax, the capital sunk by them in the business, but that special tax incentives should also be provided to stimulate the development of the industry.

3. We are of the view that the mineral industry in India in general is yet in an undeveloped state and requires encouragement. Hence we accept generally the justification given above for treating the mineral industry in India on a special basis for income-tax purposes. We recognise that the Indian mineral industry competes on uneven terms with foreign mineral industry as the latter receives special tax concessions in most of the advanced countries of the world. We briefly review in the following paragraphs the directions in which special provisions are necessary and indicate the extent to which we recommend their adoption.

4. Mining operations, we understand, involve expenditure of the following types:—

Types of expenditure incurred by mining concerns

(i) expenditure on the acquisition of mineral property, or the right to work mines;

(ii) preliminary expenditure on exploration, *i.e.*, expenditure incurred for the purposes of ascertaining the existence, location, extent and quality of any deposit of ore or mineral (this also includes such portion of the expenditure as proves to be abortive);

(iii) expenditure on the development of a mine or other natural deposit after the existence of ores or minerals in commercially marketable quantities has been duly established after exploration; and

(iv) capital expenditure on buildings, machinery or plant other than that included in (ii) and (iii) above.

The admissibility from the income-tax point of view of each type of such expenditure is examined below.

5. Expenditure on the acquisition of minerals, or of rights to work minerals, generally consists of:—

Acquisition expenditure

(i) dead rent and surface rent for the surface area used which is usually payable annually;

(ii) royalty payable periodically; and

(iii) a capital sum in lieu of, or in addition to, royalty, in the form of a premium on lease or of *salami*.

6. (i) *Dead rent and surface rent.*—Dead rent and surface rent are allowed as deductions under the present law.

7. (ii) *Royalty.*—Royalty may be payable on the basis of production or on the basis of profits, or on the basis of a combination of the two. For income-tax purposes, where royalty is considered as a charge on the profits of a business, it is treated as an admissible deduction. Where it is considered as a payment in the nature of sharing of profits after they are earned, it is not allowed as chargeable expenditure. The true nature of the payment, and not the mode of its determination, is the deciding factor, and must necessarily depend on the facts of each case. Where royalty is payable on the basis of production, it is clearly admissible. Where, however, it is payable on the basis of profits, the Income-tax Officer will have to consider its true nature by construing properly the agreement under which it is payable.

8. Royalty which is held, on the facts of a case, to be an application of profits is, therefore, not admissible under the present law as expenditure wholly and exclusively laid out for the purposes of business. Such cases are, however, not likely to arise in future as with effect from 25th October 1949 royalty is to be calculated at rates specified in the First Schedule to the Mineral Concession Rules, 1949, which are based on production and not on profits. The treatment of royalty based on profits is, therefore, a material

question only in respect of lease agreements entered into before 25th October 1949. One way of escaping income-tax liability in such cases is to re-negotiate lease terms regarding royalty and to express them in terms of production. But we realise that there are factors which make it difficult to reach a new agreement. Where the royalty is less than that calculated according to the Mineral Concession Rules, the lessee will not agree; and, where it is more, the lessor will object. There is, however, justification in the demand that such royalty should be treated as an admissible expense of business. We recommend that the Central Board of Revenue should issue executive instructions allowing this as a special measure. The amount which is admitted should not exceed the royalty computed in accordance with the rules laid down in the First Schedule to the Mineral Concession Rules, 1949.

9. (iii) *Premium on mining leases.*—The Mineral Concession Rules, 1949, prohibit any person, granting or transferring a prospecting license or a mining lease or any right, title or interest in any such licence or lease, from charging any premium in addition to or in lieu of the prospecting fee, surface rent, dead rent or royalty specified in such licence or lease. The question of capital expenditure on the acquisition of minerals, or of the right to work minerals can arise, therefore, only in connection with leases taken out before the Mineral Concession Rules, 1949, came into force, or for mineral rights acquired outside India. We have already made recommendations in Chapter IV that such expenditure should be allowed as a charge against profits spread over a specified number of years.

Exploration expenditure

10. It has been claimed that all expenditure incurred by a taxpayer on exploration, whether it relates to an existing undertaking or to a proposed undertaking, whether it is incurred before or after the commencement of production and whether it relates to the same geological 'area' or not, should be treated as admissible expenditure. We are of the opinion that such expenditure is an essential preliminary to establishing the occurrence of deposits in a particular area before actual mining operations can commence, and for maintaining production after it has started. No mining business can commence without exploration, nor can it be maintained without further exploration. We, therefore, recommend that exploration expenditure should be treated for tax purposes as admissible expenditure in the following manner subject to our observations in paragraph 25:—

(i) expenditure which results in tangible assets should be admissible for depreciation; and

(ii) expenditure which results in intangible advantages should be amortised.

Abortive expenditure on exploration

11. Exploration expenditure which proves abortive (*i.e.*, expenditure by which no asset of any kind is improved, created or acquired, and from which no advantage or benefit of any kind results) needs special consideration. Such expenditure is, at present, treated as inadmissible expenditure on the ground that it is expenditure incurred in an attempt to create a new capital asset. It is urged that this practice needs modification in view of the fact that not

only is exploration essential to the commencement of a mining business but, in the very nature of things, a part of the exploratory operations is bound to be unsuccessful and abortive; several holes may have to be dug up and abandoned before a commercially workable mine is proved. We have given careful consideration to this matter, and we recommend that abortive expenditure in mining exploration should be treated as having been laid out wholly and exclusively for the purposes of the business and should, therefore, be regarded as an admissible expenditure, subject to our observations in paragraph 25 below.

Development expenditure

12. The third main category of expenditure is that on the development and maintenance of mines. Representations have been made to us that such expenditure is not usually allowed under the present income-tax law. We are of the view that expenditure of this nature is an essential requisite for the successful working of any mineral industry and that it stands on the same footing as exploration expenditure for the purposes of its treatment for income-tax. We would, therefore, suggest that all development expenditure should be charged to revenue in the following manner:—

(i) that incurred on tangible assets should be admissible for depreciation; and

(ii) that incurred on intangible benefits should be amortised.

Expenditure on acquisition, exploration and development

13. There are two methods by which expenditure of the types mentioned above, other than that incurred on depreciable assets, should be charged off in the accounts:—

(i) amortisation over a period of years; and

(ii) charging it to revenue in the year in which it is incurred which is ordinarily known as 'expensing'.

14. There is unanimity among the witnesses that expenditure on acquisition of leases etc., should be amortised, but there are differences of opinion regarding the exact treatment of the other types of expenditure.

Some of the witnesses have suggested that a distinction should be drawn between:

(a) expenditure incurred in the pre-production period, and

(b) expenditure incurred after production starts.

The former should be amortised while the latter should be charged to accounts as revenue expenditure in the year in which it is incurred. For example, it has been suggested that the cost of original shafts should be amortised but once the reserves are established, the cost of subsequent shafts or extensions to shafts or other development expenditure should be charged to revenue. The justification for the latter is that it pertains to the search for raw materials of the business and is, therefore, admissible properly as a revenue charge.

15. The suggestion for such expenses being allowed to be charged to revenue is made on the analogy of the provisions contained in the Internal Revenue Code of the United States of America, which

permit exploration and development expenditure to be 'expensed' under certain conditions. Adoption of similar provisions in the Indian Income-tax Act does not, however, appear to us to be proper mainly for two reasons. First, such a provision will not be equally beneficial to all assessees in the present stage of development of the Indian mineral industry. It will benefit only those concerns that are already well established and are making substantial profits every year which can absorb the expenditure in question. It will be of little use to new concerns which undertake exploration and mining of minerals *ab initio*, the encouragement of which is the need of the day. Secondly, the introduction of any such provision is likely to create difficulties, for the tax-payers as well as for the administration, at the time of assessment in the matter of distinguishing between such expenditure which is to be allowed as an outright deduction in the year in which it is incurred and the other expenditure which is to be amortised. These difficulties will be avoided if all such expenditure is grouped with the other admissible expenditure and allowed to be amortised over a period of years.

16. Such expenditure is either (i) of the nature of (tangible) capital expenditure, *e.g.*, on subsequent shafts or (ii) of the nature of deferred revenue expenditure, *e.g.*, intangible expenditure in the form of salaries, wages, etc. It is also clear that the benefits of such expenditure are not limited to the year in which it is incurred but are available over a number of years, and even over the entire period of the working of the mine. For this reason, and in view of the principles determining the method of deduction of business expenditure mentioned earlier, we are of the opinion that it will be more appropriate if such expenditure is spread over the number of years over which its benefits are likely to be available. It is, therefore, recommended that all (productive) exploration and development expenditure, whether incurred in the pre-production stage or later, should be allowed on the basis of amortisation.

Abortive exploration expenditure

17. Abortive expenditure on exploration, however, stands on a different footing. Such expenditure, while wholly and exclusively laid out for the purposes of the business, does not result in the improvement, creation or acquisition of any asset; no benefit or advantage of any kind accrues from it. The allowance of such expenditure on the basis of amortisation is not appropriate. We, therefore, recommend that such expenditure as does not result in the discovery of any mineral may be allowed as a charge to revenue in the years in which it is incurred.

Method of amortisation: (i) on the life of the mine or the lease

18. Another important question that arises in this connection relates to the basis on which various kinds of expenditure, *viz.*, acquisition, productive exploration and development expenditure should be amortised. Since such expenditure enures to the benefit of the business over the entire period of the working of the mine, it can be amortised either over the estimated life of the mine or over the period of the mining lease if the mine is being worked under a lease. The adoption of either of these methods, is, however, likely to lead to practical difficulties. The estimation of the probable life of a mine (*i.e.*, the period over which the deposits in the mine are

likely to last) will involve technical issues. As for a mine worked under a lease for a specific period, the calculations of the expenditure to be allowed from year to year are likely to become unrealistic in most cases where the leases are renewed.

(ii) 'Output' formula

19. A more appropriate method would be that the expenditure in question should be amortised on the basis of the 'output' formula, *i.e.*, an allowance should be given in each year which bears to the total admissible expenditure the same proportion as the quantity (in terms of units) of the mineral produced during the year bears to the sum of the production during that year and the total estimated units of the mineral likely to be obtained from the mine as at the end of that year. An example will illustrate the working of this formula.

Total admissible expenditure on acquisition, exploration, development, etc: Rs. 10,00,000

Year	Production during the year (In tons)	Estimated reserve at the end of the year (In tons)
I	10,000	40,000
II	15,000	60,000
III	10,000	30,000
IV	10,000	10,000
V	5,000	Nil
	50,000	

Allowances will be given as under :—

Rs.

Year I : $\frac{10,000}{10,000+40,000} \times 10,00,000 = 2,00,000$

Year II : $\frac{15,000}{15,000+60,000} \times 8,00,000 = 1,60,000$

Year III : $\frac{10,000}{10,000+30,000} \times 6,40,000 = 1,60,000$

Year IV : $\frac{10,000}{10,000+10,000} \times 4,80,000 = 2,40,000$

Year V : $\frac{5,000}{5,000+\text{nil}} \times 2,40,000 = 2,40,000$

10,00,000

20. One of the main objections to the 'output' formula is that it is linked only to production, which may vary according to circumstances, and has no relation to the wear and tear of assets, such as shafts, whose cost is also included in the expenditure that is being amortised. To avoid hardship in such cases, we recommend that the permissible allowance for any one year will be either as computed under the 'output' formula or (say) one-twentieth of the total admissible expenditure, whichever is greater. The fixation of the number of years over which the expenditure is to be spread under the latter formula is, however, a matter which calls for examination from the technical angle.

21. It may be added that provisions similar to the present clause (vii) of sub-section (2) of section 10 of the Income-tax Act will have to be introduced into the law for regulating the quantum of the allowance in the last year of the working of the mine or of the lease.

'Free method' of amortisation

22. Another suggestion is that in view of the violent fluctuation of profits resulting from the very nature of mining enterprises, the mining concerns should be allowed the freedom to write off a larger proportion of the total admissible expenditure during periods of high profits. For reasons given in the preceding chapter, we are, however. not in favour of the adoption of such a suggestion.

'Revalorisation' of 'acquisition cost'

23. Some prominent business interests have also represented to us that, as a number of existing mineral rights were purchased many years ago at exceedingly low prices, they should be "regularised to equate them with present day values" so as "to enable the industry to accumulate funds to purchase new mineral rights". This demand is similar to the one relating to 'revalorisation' in respect of plant and machinery, which we have examined in the preceding chapter and, for the reasons mentioned therein, we are unable to accept this suggestion also.

Depreciation on plant and buildings on the basis of the life of the mine

24. Another suggestion that has been made to us on this subject relates to the rates at which depreciation should be allowed under clause (vi) of sub-section (2) of section 10 of the Income-tax Act read with Rule 8 of the Income-tax Rules in respect of buildings, plant and machinery used for the business of a mining concern. At present, such depreciation is admissible on the basis of rates laid down in Rule 8 of the Income-tax Rules. These rates are fixed generally with reference to the estimated useful life of each asset. It has, however, been represented to us that in mining companies, a special treatment of assets such as plant and machinery is called for because their life is largely dependent on the life of the mine or the mining lease, and not on the normal life of the plant or the machinery itself. There appears to be considerable force in this suggestion. We recommend, therefore, that an option may be given to the tax-payers to claim either (i) that depreciation be allowed on the basis of the rates laid down in Rule 8, which may be suitably amplified and amended to meet fully the requirements of the mining industry, or (ii) that the original cost of such plant or machinery and buildings, less their estimated residual value at the time when the mine is likely to cease working, may be amortised in the same way as the expenditure on acquisition, productive exploration and development as mentioned in paragraphs 19-20 above.

25. Before proceeding further, it will be useful to summarise the recommendations that we have made so far. These are:—

(i) royalty, even where it is held to be an appropriation of profits, should be allowed to the extent of the amount which would be admissible if it were calculated as prescribed in the Mineral Concession Rules, 1949;

(ii) abortive expenditure on exploration should be allowed as a revenue expenditure in the years in which such expenditure was incurred;

(iii) all other expenditure, consisting of

(a) capital acquisition expenditure,

(b) (productive) exploration expenditure,

(c) development expenditure, and

(d) at the option of the assessee, the cost of the buildings, plant or machinery used for exploration or mining purposes,

should be allowed to be amortised on the basis indicated above, the allowance for the last year of the working of the mine being subject to 'balancing' provisions similar to clause (vii) of sub-section (2) of section 10 of the Income-tax Act.

These recommendations are, however, subject to the following reservations which are mainly designed to prevent any possible abuse of the concessions recommended by us:—

(i) there is no large scale development of mineral industry in the country at present and it will not be possible for Income-tax Officers to examine the reasonableness of the expenditure on exploration which may be claimed by a tax-payer. The Government of India may, in consultation with the Bureau of Mines, consider the desirability of imposing maximum limits for each industry separately, beyond which such expenditure will not be allowed;

(ii) abortive expenditure on exploration should only be allowed to be set off against profits from other mineral undertakings worked by the assessee and not against profits from any other kind of business that may be carried on by the assessee. The reason for this restriction is that expenditure of this type is not susceptible of verification by Income-tax Officers and there is a risk of the concession being misused if it is allowed to an unlimited extent;

(iii) the concessions which we have recommended should be available only to undertakings which are engaged in the exploitation of minerals (a) which are of the non-bedded variety, (b) which lie at a deep level, and (c) the prices of which are subject to significant fluctuations in the export market;

(iv) the concessions mentioned in the earlier paragraphs have been recommended with the sole object of stimulating mining industry in the country. It is, therefore, desirable that the continuance of these concessions should be subject to a periodical review to determine whether the object with which these concessions have been recommended is actually being fulfilled.

26. In addition to the amortisation of special types of expenses incurred by the mining industry, the mining interests have asked for additional tax incentives in order to encourage the development of the industry. The reasons advanced by them in favour of such concessions are:—

Other concessions sought

(i) the rapid development of the mineral industry is very important from the points of view of national economic progress and defence, and every encouragement should be provided for this purpose;

(ii) mining operations are extremely costly and hazardous, and hence special tax incentives are necessary to attract capital to such industries; adequate return must be ensured to induce the investment of such risk capital;

(iii) the existence of tax concessions to mineral industry in the tax statutes of a number of other countries emphasises the necessity of providing similar incentives in India with a view to (a) creating favourable fiscal conditions to attract foreign capital which in the absence of such incentives will have a tendency towards investment in countries which already allow such concessions and (b) enabling the Indian industry to establish itself on a competitive basis in the world markets.

27. We accept the justification of tax incentives for mineral industries but we are of the opinion that, in view of the amortisation of practically the whole of the capital expenditure invested in a mineral industry, the additional incentive, if any, which may be allowed, and the consequent loss of revenue, must be fully justified on the score of being absolutely necessary in the sense that it is expected that the exploration and production of minerals is not likely to develop without such incentive. It follows, therefore, that special tax incentives should be restricted to the mining of certain minerals only, the main considerations to be kept in view for this purpose being as under:—

(i) concessions should be given only to undeveloped minerals or to those which are in the initial stages of development and the development of which is considered essential for economic or strategic reasons. No useful purpose will be served by sacrificing Government revenue to help the development of minerals which are already being produced in sufficient quantities in the country; in fact, the grant of any tax incentives to such minerals may have undesirable effects on the country's economy. The Five Year Plan has indicated the minerals the development of which is considered necessary in the national interest; it is only from amongst such minerals that selection should be made for special tax incentives;

(ii) even among the minerals covered by (i), there is a stronger case for the grant of tax concessions to non-bedded minerals which lie deep under the surface of the earth as their exploration involves much greater outlay and risk of capital;

(iii) the Planning Commission has indicated that conversion of minerals into finished or semi-finished products for purposes of export is one of the essential features of the policy to be followed in regard to the development of the mineral resources of the country. To encourage such conversion of minerals produced in India into finished or semi-finished products, rather than their being exported to foreign countries in a crude state, the concessions may be restricted to those concerns only which undertake to convert the minerals into finished or semi-finished products before their export to foreign countries;

(iv) the Planning Commission has also indicated the importance of assessment of reserves of low-grade ores. A special tax incentive may be allowed for this purpose; this will serve as a stimulus to the extraction of the lower grades of ore resulting in the fuller utilisation of national mineral resources and lengthening the life of the mines. The concession may take the form of a rebate of income-tax based on the tonnage of sub-economic grades of ore mined in any year.

It may be stated in conclusion that it is not possible to lay down a general rule for the grant of incentives, if any, in respect of all minerals. Differentiation will have to be made on the basis of the special circumstances and features of each mineral.

Depletion allowance

28. In deciding the form that the tax incentives should take, we may first deal with the demand that the industry has made for a 'depletion allowance'. In its original form, depletion allowance aimed at charging to revenue the actual cost of the acquisition of mineral property or mineral rights. It thus served exactly the same purpose in respect of wasting assets as depreciation allowance does in relation to fixed assets.

Several variants of 'depletion allowance' have developed lately in which the 'actual cost' basis has been abandoned. In the 'discovery value' method, the basis is the 'reserve ore' value of the mineral property; while in the 'percentage' method, a proportion of the gross profits is charged to the revenue thus reducing tax liability. The depletion allowance in the latter two forms now acts more as an incentive than as amortisation of a necessary element of cost in order to arrive at the true profits of a business. We have already conceded the grant of depletion allowance in its original form by recommending that the actual cost of acquiring mineral property etc., should be amortised. In addition, we have also suggested the amortisation of capital expenditure on exploration, development etc. The point, therefore, is whether any further concessions should be given to mining industry and if so in what form.

'Discovery value'

We are not in favour of 'depletion allowance', whether based on discovery value or on percentage of gross profits, for the following reasons. Under the 'discovery value' method, as it prevails in the U.S.A. at present, instead of the 'acquisition cost', the fair market value of the mine at the date of its discovery, or within 30 days thereof, is allowed to be amortised over the life of the mine, the annual allowance being limited to 50 per cent. of the net income from the mining property for that year. The grant of such an allowance will reduce tax liability considerably, but its operation will be difficult as the art of estimating the ore content and its value has not yet developed in this country; and hence such a concession will be largely based on guesswork.

Percentage allowance

Under the U.S.A. Internal Revenue Code, tax-payers have a choice each year between (a) deducting an allowance based upon cost depletion which permits recovery, over the useful life of the mining property, of its actual cost, and (b) computing the deduction on the basis of 'percentage depletion' which is a stated percentage of gross annual income, varying from five per cent. for certain common minerals like sand and gravel to 27½ per cent. for oil and gas; the deduction is, however, not allowed to exceed 50 per cent. of the net income of the property.

The 'percentage method', although it is supposed to compensate for the gradual exhaustion, or depletion, of the minerals, works in an entirely different way. The quantum of the percentage allowance is in no way related to the amount of capital invested. In fact, it is admissible over the entire working period of a mining property, even after the capital invested has been recovered. After providing for allowances mentioned in the preceding paragraphs, the claim for a percentage allowance is simply a claim for a tax incentive in the form of a direct reduction in the tax liability of a mining concern. Any such allowance will confer a special privilege on tax-payers engaged in exploiting the particular minerals in respect of which it is admissible. Another inequity involved in the percentage allowance is that one concern may get a far more liberal concession than another. The maximum benefit of such an allowance is secured by long-lived prosperous concerns which are already making substantial profits and which, therefore, are least in need of any tax incentive. On the other hand, most marginal mining concerns, which have to struggle hard for their consolidation, will derive little, if any, benefit from such an allowance.

We are, therefore, of the opinion that a percentage depletion allowance is extremely ill-suited to the present needs of Indian mineral policy which has as its central feature the exploration and discovery of further mineral resources.

The evaluation of tax incentives to be allowed to the mineral industry cannot be made to depend automatically on the methods used elsewhere. For example, the percentage depletion in the U.S.A. is 27½ per cent. of the gross income for oil and gas or 50 per cent. of the net income, whichever is lower. No special concession in respect of tax rates is allowed. In Canada, the percentage depletion for oil and gas is 33 1/3 per cent. of net profits but tax exemption is allowed for three years. Coupled with the other peculiarities of each income-tax system, the exact effects of the two are not on a comparable basis. Each country has to devise its own criterion for incentives depending on its tax and administrative machinery as well as in the light of the other tax provisions applicable to such undertakings.

29. While we have found ourselves unable for the reasons mentioned above to recommend the grant of a depletion allowance, we suggest that such mineral industries, as fulfil the tests laid down by us in paragraph 27 above, should be eligible for either the development rebate or the section 15C concessions, as the case may be, on the lines recommended by us in Chapter VII.

CHAPTER VII

INCENTIVES TO DEVELOPMENT OF PRODUCTIVE ENTERPRISE

One of our terms of reference requires us to examine the effects of the structure and level of taxation of income on capital formation and the maintenance and development of productive enterprise. We have already referred to this subject in the chapter on "Outlines of Tax Policy" in Volume I. We propose to indicate in this chapter our general approach to and specific recommendations in respect of the subject.

Approach to problem of incentives : forms of tax incentives

2. With the increase in rates of personal income-tax recommended by us, we are of the view that it would be necessary to afford specific incentives in the tax system to productive investment. Our review of the problem of replacement of fixed assets in industries (Chapter VII, Vol. I) brings out the fact that the problem is one of maintaining and strengthening the incentives for expansion, including replacement, in the industrial sector generally rather than of replacement specifically. The problem of replacement in fact varies from industry to industry and from unit to unit and lends itself to solution more appropriately by way of loan finance through the various Government and semi-Government financial organisations than through tax relief. The tax system may more suitably be utilised for affording a general incentive, leaving the differential needs of units and industries to be met from other sources. The increasing intensification of competition in the world market makes it all the more necessary that the capacity of Indian industry to finance development should be reinforced in a general way.

3. The expansion and development of productive enterprise may be specifically assisted in two ways. Tax relief may be given in such a manner as to reduce taxable profits and hence tax liability. Thus, for example, a proportion of new investment in fixed assets may be allowed to be charged to current costs of production and taxable profits may thereby be brought down. Alternatively taxable profits may be exempted from tax or charged to a reduced rate of tax for a specified period. For an adequate system of tax incentives to investment, it may be necessary to combine both these forms of relief.

4. In making specific proposals for the introduction of such relief in our tax system, we have been influenced by the need to get the maximum benefit for the economy from the limited funds that can be released for this purpose. We are of the opinion that this objective cannot be secured unless the relief suggested by us is confined to a limited sector of industry. It is also essential that it should be linked with specific acts of investment in fixed assets. Relief is necessary both for expansion of existing concerns and setting up of new concerns in the selected industries. It may be necessary to provide a somewhat greater stimulus in the case of new concerns

than in that of existing concerns in a few selected industries of special national importance. At the same time, we suggest the continuance of the tax relief which is already being given to industry, even where this relief is applicable to all industrial concerns and is not confined only to selected industries as we are recommending in the case of the new reliefs proposed by us. We now outline the general scheme of the incentives to productive enterprise and capital formation that we recommend for adoption.

5. Our scheme deals with three categories of enterprise. The first category includes all companies, whether commercial or industrial, irrespective of the industry they relate to. They are at present given a rebate of one anna in the rupee on their undistributed profits. This concession has been of some use in stimulating a greater retention of corporate profits. We therefore recommend that it be continued. The other two categories comprise selected industries of national importance.

A development rebate for industries of national importance

6. The second category consists of selected industries and the concession we recommend is a development rebate on all specific acts of investment in these industries in fixed assets in the form of plant and machinery. The development rebate should be available not only to companies but also to individuals, partnerships and other proprietary concerns engaged in these industries. Our suggestion is that, in the year of installation of fixed assets by an assessee, a proportion of the cost of new assets —we suggest 25 per cent.—should be charged to revenue in lieu of the present initial depreciation allowance. The additional depreciation allowance should, however, be continued as at present. The development rebate should be available for all purchases of fixed assets, whether intended for replacement or for expansion and to new as well as existing concerns in the industries selected.

7. To the extent that expansion is stimulated by the measure, there will, in due course, be a larger flow of taxable profits and greater receipts in consequence of the allowance. The allowance should afford a direct stimulus to expansion and quicker replacement and aid the efficiency and competitive power of the industries assisted. Being directly linked to the act of fixed investment, it provides a surer way of encouraging such investment by all concerns, new and old, than alternative methods.

8. We suggest the following criteria as the basis on which industries should be selected for the grant of the proposed development rebate: (1) importance of the industries concerned from the point of view of national development, and (2) extent to which they are unlikely to be developed—either by way of expansion of existing concerns or establishment of new concerns—if left to the voluntary effort of private enterprise and without any special stimulus by way of tax relief. In practice this should mean confining the concession we have recommended to the group of industries that are broadly described as producers' goods and capital goods industries. For obvious reasons, the selection of the specific industries which should receive the concession cannot be left to the income-tax authorities. It would be necessary for an appropriate body constituted by Government such as the Planning Commission to draw up

a list of the industries which conform to the above criteria and which should receive the concession.

9. It is necessary to provide for adequate measures for preventing any abuse of the tax relief that will be afforded by the proposed development rebate. We are of the opinion that these will have to be worked out by an appropriate expert committee of officials, but we may outline here some of the measures which we think are necessary for this purpose. Thus, the development rebate should not be given either in respect of renovated plant and machinery or on such assets bought secondhand. Nor should it be applicable to assets other than plant and machinery or to motor cars and such other transport as may be considered by Government to be capable of being used for private as well as for business purposes. Where the development rebate is granted on new plant and machinery, it must be provided (i) that the sale of such plant and machinery will not be allowed if it is made to a person or a corporation or any other taxable entity the major portion of whose business income is not subject to Indian Income-tax; (ii) that the rebate will not be allowed if the asset is utilised for a purpose other than that for which it was acquired unless it would have qualified for the development rebate even for the latter purpose at the time it was purchased.

A tax holiday for industries of special national importance

10. The third category includes only a small number of industries selected from time to time by Government as of special national importance, our intention being to give a somewhat greater measure of stimulus to this group as compared to the other and larger group of industries which are included in the second category. We suggest that industries in this category should be given the concession of exemption from tax of their profits during a specified period. It is true that even at present Section 15C of the Income-tax Act grants a limited measure of tax exemption to the profits of new concerns, but it has, in practice, proved infructuous on account of the reasons detailed in a subsequent paragraph. Before we outline our recommendation for the tax exemption of profits of new industrial concerns in selected industries in replacement of the existing concession, it would be useful to set out the salient features of the existing concession under section 15C and review its working.

11. The salient features of this concession are as follows:—

(i) profits upto the extent of six per cent. per annum on capital employed in the new undertaking are exempted;

(ii) the exemption is available for five years commencing from the accounting year in which the manufacture or production of articles begins;

(iii) no tax is payable by a shareholder in respect of so much of any dividend received from such an undertaking as is attributable to that part of profits of the undertaking which is exempt under section 15C;

(iv) the concession applies to all new industrial undertakings except those which are formed by splitting up or reconstruction of business already in existence or by transfer to a new business of building, machinery or plant used in a business which was being carried on before 1st

April 1948; the concession is admissible if the undertaking starts manufacture or production in any part of India within a period of eight years from 1st April 1948;

(v) the section, as it was originally introduced, restricted the exemption to such undertakings as employed more than fifty persons and involved the use of electrical energy or any other form of energy which was mechanically transmitted and was not directly generated by human agency. The Income-tax (Amendment) Act, 1953, however, liberalised these conditions so as to extend the scope of the concession to small industries. The exemption is now available if the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power;

(vi) the Central Government has reserved to itself the power of excluding any particular industrial undertaking from the scope of this exemption.

Working of section 15C

12. That the actual effect of this concession has been small is borne out by the statistics given below:—

TABLE 1.—*Exemptions granted under section* 15C *of the Income-tax Act during the years* 1950-51, 1951-52 *and* 1952-53

	1950-51	1951-52	1952-53
(i) Number of assessees . .	27	91	118
(ii) Amount of income exempted under section 15C (Rs.) .	7,55,295	3,41,666	8,57,270
(iii) Tax involved in respect of (ii)			
(a) Income-tax (Rs.) . .	1,44,411	81,178	1,58,199
(b) Super-tax (Rs.) . .	1,471	64	1,49,260

The main reason for the ineffectiveness of section 15C is the grant of initial and additional depreciation allowances which, together with normal depreciation allowances, make up nearly 80 to 85 per cent. of the cost of fixed assets in the form of plant and machinery within the first five years of the life of the concern. As these depreciation allowances have to be deducted first before computing profits for purposes of income-tax, it has been difficult for any appreciable number of new concerns to claim the benefits conferred under section 15C. Moreover, as the concession applies to all industrial concerns, it loses some of its effectiveness as a stimulus to capital formation. At the same time, there is no doubt that the principle embodied in section 15C can constitute a powerful incentive for the formation of new industrial concerns, provided it does lead to some actual exemption from tax of profits, while its effectiveness will be enhanced if it were applied to a selected and therefore limited number of industries. It is for these reasons that we make our new proposals for a reformulation of the section 15C provision of the Income-tax Act.

13. We recommend a complete tax holiday, (*i.e.*, exemption from tax) for all the new concerns in the selected industries included in the third category which we term industries of 'special national importance'. These industries must obviously fall within the group of producers' goods and capital goods industries. In addition, they must be restricted to a certain small number from amongst the industries which are included in the larger list.

Proposed revision of section 15C

14. The period of tax holiday should be six years, commencing from the accounting year in which manufacture or production begins.

15. During the period of six years for which the concession lasts, the calculation of profits which are exempted should be based on normal depreciation allowance. From the seventh year onward, when the profits of a concern become subject to tax, double the normal annual depreciation should be allowed for a (further) period of five years.

16. An industry should get the benefit either of the development rebate or of the proposed tax exemption for a period of six years, whichever is higher, but not of both. If, therefore, the profits during the period of six years for which the concession lasts, computed after taking normal depreciation into account fall short of the admissible development rebate, the excess of the development rebate over such profits should be adjusted against the profits of the seventh and subsequent years, until the development rebate is worked off in full.

17. The dividends received from companies falling within this category to the extent they are attributable to the exempt income of the companies concerned should be exempt from income-tax in the hands of the shareholders.

18. The concerns should submit regular returns of income during the period of the tax holiday to enable, among other things, a record to be kept of the tax relief thus afforded.

19. The present concession has been criticised on the ground that it excludes from its scope expansion of or extensions to old established concerns and amounts to preferring untried ventures to those whose ability to manufacture is proven; therefore it deters older concerns from expansion or induces them to start new ventures under different names with a view to satisfying the criterion of the present section 15C. This criticism ceases to have any real validity in view of our recommendation regarding the development rebate. In any case, it would not be practicable to isolate the profits attributable to expansion from the total profits of these concerns.

20. In our opinion, the modification of section 15C on the lines suggested by us will make it an effective instrument for stimulating the establishment of new industrial concerns in the selected industries included in the third category.

21. The actual choice of the small number of selected producers' goods and capital goods industries which should enjoy the benefit of the revised section 15C will again have to be made on the recommendation of an appropriate body constituted by Government, such as the Planning Commission, and it should be open to this authority to

suggest changes in the list of these selected producers' goods and capital goods industries in the light of the working of the concessions and according to changing national requirements in the context of planned development.

22. The concessions we have recommended by way of development rebate and tax holiday for stimulating industrial development in selected fields constitute a new and important departure in tax policy which needs to be carefully watched in its working. We therefore recommend that a review should be made of their working at the end of five years from their inception and the results placed before Parliament.

Other recommendations for stimulating productive enterprise

23. In addition to this important recommendation for the promotion of industrial development, we have made elsewhere in this Report a number of other recommendations for the stimulation of savings and investment and the growth of productive enterprise generally. It would be useful in concluding this chapter to summarise these recommendations. One of our recommendations is that the rebate in respect of insurance and provident fund contributions should be increased. We may also mention in this context our scheme for surcharge *cum* compulsory deposit in the case of higher incomes. The readjustment of the structure of the corporation tax which we recommend results in a reduction in the rate of corporation tax in respect of small and medium-sized public companies. We have also suggested the continuance of the rebate on undistributed profits. In respect of mining industries we have recommended several specific reliefs. There are other recommendations of value for the purpose of creating a proper atmosphere for risk-taking enterprise, of which mention may be made of some of the changes which we have suggested regarding the carry-forward and set-off of losses.

24. We expect that the measures recommended by us will go a long way not only in the direction of offsetting any adverse effects our proposals for enhanced taxation may have on capital formation and the maintenance and expansion of productive enterprise but also in the more positive direction of stimulating capital formation and industrial expansion particularly in fields selected in the context of the planned economic development of the country.

CHAPTER VIII

SPECIAL TAXABLE ENTITIES AND RECEIPTS

Religious and charitable trusts and institutions

We have received a large number of representations urging the necessity for revising the legal provisions relating to the exemption from taxation of income derived by public religious and charitable trusts and institutions from property held under trust or other legal obligation, and from voluntary donations. The law on the subject is contained in section 4(3) of the Income-tax Act, and was amended as recently as in 1953. The section, as it stands now, is reproduced below:

"*4 (3)*: Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:

(i) Subject to the provisions of clause (c) of sub-section (1) of section 16 any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes, in so far as such income is applied or accumulated for application to such religious or charitable purposes as relate to anything done within the taxable territories, and in the case of property so held in part only for such purposes, the income applied or finally set apart for application thereto.

Provided that such income shall be included in the total income—

(a) if it is applied to religious or charitable purposes without the taxable territories, but the Central Board of Revenue may, in the case of property held under trust or other legal obligation created before the commencement of the Indian Income-tax (Amendment) Act, 1953, the income wherefrom is so applied, by general or special order, direct that it shall not be included in the total income;

(b) in the case of income derived from business carried on on behalf of a religious or charitable institution, unless the income is applied wholly for the purposes of the institution and either—

(i) the business is carried on in the course of the actual carrying out of a primary purpose of the institution, or

(ii) the work in connection with the business is mainly carried on by beneficiaries of the institution;

(c) if it is applied to purposes other than religious or charitable purposes or ceases to be accumulated or set apart for application thereto in which case it shall be deemed to be the income of the year in which it is so applied or ceases to be so accumulated or set apart.

(ii) Any income of a religious or charitable institution derived from voluntary contributions and applicable solely to religious or charitable purposes.

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In this sub-section "charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility, but nothing contained in clause (i) or clause (ii) shall operate to exempt from the provisions of this Act that part of the income from property held under trust or other legal obligation for private religious purposes which does not enure for the benefit of the public".

Business income of trusts

2. This concession has been a feature of the income-tax law since 1886 and is based on the principle of exempting public charity, within reasonable limits, from taxation. Religious and public charitable trusts and institutions have all along been exempt from tax on income from property held under trust or other legal obligation, and from voluntary contributions. Where property is held under trust partly for religious or charitable purposes, exemption applies to the portion of the income applied, or finally set apart for application, to those purposes. The Income-tax Enquiry Committee, 1936, recommended that, when business is carried on by trustees, exemption should be granted only to those trusts where the business activities are themselves the primary purpose of the charity, or the work is mainly carried on by its beneficiaries. A clause exempting such business was inserted by the Income-tax (Amendment) Act, 1939. But the Lahore High Court held* that the term 'property held under trust' was wide enough to exempt business carried on by trustees. Hence this clause, as drafted, had failed to achieve the object of restriction. In order to enable the law to secure what was originally intended, under the Income-tax (Amendment) Act of 1953 the section was drafted so as to make it clear that the business income of such bodies would be taxable unless the business satisfied either of the conditions mentioned above.

3. A business carried on by a charitable trust, which is granted tax exemption, enjoys a competitive advantage over similar private business. In our view the amendment carried out in 1953 to clarify the exact intention of the law embodies a sound principle and does not stand in need of any revision.

Application of income in the taxable territories

4. Another amendment made in 1953 was to the effect that the income of a charitable trust would be exempt only if it was applied or accumulated for application to such religious or charitable purposes as relate to anything done within the taxable territories. The Central Board of Revenue has been given the power to relax this condition in favour of trusts created before 1st April 1952. This amendment was inserted on the recommendation of the Income-tax Investigation Commission, which had pointed out that a corresponding restriction was recognised in certain other countries under judicial decisions, and suggested that the Indian law should make this position clear.

5. It has been represented to us that the Central Board of Revenue should be empowered to relax the condition in favour of trusts established even after 1st April 1952, if the funds of the trusts were devoted to the promotion of objects of international appeal in which

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*Gadodia Swadeshi Stores *vs.* C. I. T. (1944 I. T. R. 385).

India is interested, *e.g.*, approved schemes of medical and humanitarian research which cannot be carried out without international co-operation but which are conceived in the general interests of the country. We think that this is a sound principle and that it should be embodied in the law.

6. Apprehensions have been expressed in the evidence before us that the restriction referred to above may have the effect of denying exemption to institutions granting scholarships to Indian students undergoing training abroad. We observe that this matter was also raised in Parliament when the Income-tax (Amendment) Bill, 1953, was under discussion, and the Finance Minister gave the assurance that "so long as this is proved to have been done for the benefit of the country, exemption will be available in respect of the amounts spent on such scholarships". In view of this assurance, which we have no doubt will be honoured in a liberal spirit, we believe that there is no need for any special legal provision being made in this behalf.

Greater control of charitable institutions

7. The exemption from income-tax of the income of charitable trusts provides opportunities for tax avoidance, the scope for which becomes wider with the levy of the estate duty. It has been represented to us that the present law places certain restrictions on charitable trusts, but it does not provide for any suitable machinery for the Income-tax Department to see that the restrictions are not violated. In view of the public interest involved in the proper functioning of charitable trusts, and of the fact that some of them are utilised for the purpose of evasion or avoidance of tax, we are of the view that a more permanent machinery than occasional scrutiny by the Income-tax Department is necessary for the control and supervision of charitable trusts. We have been impressed, in this connection, by the provisions of the legislation regarding the control of public charities now in operation in Bombay State. The Bombay Public Trusts Act, 1950, provides for the registration of trusts, the audit of their accounts by Chartered Accountants, and control and inspection by the Charity Commissioner appointed under the Act. The Commissioner has power to levy surcharge on any person liable for any loss caused to a trust. We would recommend the enactment of similar legislation in other States. We would also recommend that the Charity Commissioner appointed under such legislation should be statutorily required to issue an annual report containing, among other things, the names of the institutions with the amount of income exempted from tax in each case. In addition to this, we recommend that charitable and religious trusts should be required to send returns of income to the Income-tax authorities once in three years. The accounts of such trusts should be examined by the Income-tax Department, and the income that has been exempted subjected to scrutiny. This will ensure the implementation of the present restrictions placed on charitable trusts in the Income-tax Act.

Assessment of trustees and guardians

8. A change has been suggested in the method of taxing estates and trusts with a view to relieving the burden of the maximum rate of tax being levied on them. The maximum rate of tax is leviable under the present law on the income of trusts where any part of

the income is not specifically receivable on behalf of any person or where the individual shares of the persons on whose behalf they are receivable are indeterminate or unknown. It has, however, been provided that the maximum rate will not be applied if the total income of each of the beneficiaries is below the taxable minimum and none of them is an artificial juridical person, *i.e.*, a corporation etc. The income of such a trust is charged on the basis of an association of persons at the rate applicable to its total income.

Where beneficiaries and their shares are known, the income of the trust is allocated among the various beneficiaries *pro rata* and the tax on each portion is calculated at the rate applicable to the total income of the beneficiary. The assessment may be made on the beneficiaries themselves or on the trustees.

9. The fundamental basis of the procedure governing the assessment of trusts in the Indian Income-tax Act is that the charge should be on the person who benefits at the rates applicable to his total income, *i.e.*, according to his ability to pay. The recovery may be made either from the trust or from the beneficiary, whichever is feasible. The maximum rate becomes chargeable only when an element of indefiniteness enters into the calculation.

10. The U.S.A. scheme has been cited by some witnesses as a model to be followed in India. The essence of that scheme is that the income distributed or currently distributable to beneficiaries is taxed in their hands while the residual income of the trust is taxed in the hands of the trustee.

It is possible under such a system, by retaining a large part of the income with the trust, to effect a considerable reduction in the tax liability of the beneficiaries, if the rates applicable to their total income are considerably higher than the rates applicable to the residual income left in the trust. A person could also be simultaneously a beneficiary of two trusts, in which case he would split his income into three portions—in his hands and in the two trusts—and get the benefit of lower rates. While discussing the United States legislation, a leading writer has observed:

> "The sum total is almost incomprehensible except after long and careful study in the light of the history of the subject and the Congressional objectives. It is small wonder that everyone is now anxious to go back to something simpler."*

11. Artificial arrangements of the above kind are not possible under the present Indian system. In view of the introduction of the Estate Duty Act and the possibilities of the creation of trusts on a larger scale than hitherto, the adoption of the American method of assessment would facilitate avoidance of tax on a large scale. The Indian system is fair alike to the assessee and to Government, in that in a majority of cases it works equitably in assessing income in the hands of the beneficiaries along with their other income. It is only in a very few cases, where there are certain indeterminate factors, that the maximum rate is charged; and even there relaxations have been provided specifically for the benefit of poorer beneficiaries, such as widows and children who have no other chargeable

*Henderson—Introduction to Income Taxation (Second Edition), p. 421.

income. We are, therefore, of the opinion that the Indian law relating to the taxation of trustees and guardians needs no modification in this respect.

Life insurance business

12. The law requires that in assessing life insurance companies, the assessable income is to be computed at the higher of the two following figures:—

(a) gross external incomings of the nature of rent, interest, etc. (but exclusive of premiums and other similar receipts from policyholders) *less* management expenses. (Payments to policyholders by way of claims, bonus etc. are, of course, not treated as management expenses). Management expenses are to be limited to certain prescribed percentages of the premium receipts of the year; these percentages were increased by the Income-tax (Amendment) Acts of 1944 and 1953; or

(b) annual average of the valuation surplus disclosed by the last valuation made under the Insurance Act, after deducting a part of the surplus paid to or reserved for or expended on behalf of the policyholders. This part was originally 50 per cent. but was increased to 80 per cent. by the Income-tax (Amendment) Act, 1953.

Since 1943, the rates of tax for life insurance business, as fixed by the Finance Acts, have been lower than for other business. The reduction in rate has, since 1951, taken the form of an abatement of corporation tax at the rate of two annas in the rupee on the profits of mutual life insurance business, and of one and a half annas in the rupee on the profits of other life insurance business.

13. It has been represented on behalf of life insurers that a ceiling should be fixed for rates of tax on life insurance business, substantially lower than on other business. The reasons urged in favour of this proposal are as follows. Life assurance policies form a long-term contract between a company and the person assured, and premiums (which are fixed at the outset) are calculated on the assumption, *inter alia,* of a particular rate of interest (*i.e.,* gross interest *less* income-tax) being earned. Any increase in the tax burden might, therefore, react adversely on the company's ability to fulfil its contracts, and may result in reduction of the bonus which it can distribute, or even in actual loss. Of the policy liabilities (with certain adjustments) 50 per cent. have under the Insurance Act to be invested in Government securities or other approved securities, and this puts a limit on the interest-earning capacity. Insurance offers an attractive form of social security, and the large investments by insurance companies aid capital formation. In the United Kingdom, the rate of tax on that portion of the income from life insurance business which is treated as belonging to the policyholders has been maintained at a level of 7*sh.* 6 *d.* in the £ since 1940. A difference of 2 *sh.* in the £ in favour of mutual life insurance companies and of the 'mutual' profits of proprietary companies exists in Australia also.

14. We have referred above to the special lower rates of tax applicable to life insurance companies. The position in this country in the matter of tax differential compares favourably with that in other countries. The pitch of taxation does not appear to have exercised any distinct restraining effect in relation to the growth of

life insurance business. We have recommended a reduction in the rate of corporation tax applicable to the first slab of profits (of Rs. 25,000) in respect of all companies, which reduction will also apply to insurance companies. We do not consider that a further reduction in the rates of tax, or a further increase in the present differential in favour of insurance companies, is justified.

Deduction of policyholders' share of valuation surplus

15. Another suggestion made is that, where the assessment is made on the basis of a valuation surplus, the full amount of surplus reserved for policyholders should be allowed as a deduction. The main argument that has been put forward in favour of this proposal is that the premimus are calculated with reference to certain assumed rates of mortality and interest, and that the bonus is only a return of the excessive amount. The Income-tax Investigation Commission, which considered this matter, pointed out that, while a part of the surplus comes out of the specific load on premiums on participating policies, a part is also derived from favourable rates of mortality and interest experienced by a company. The Income-tax Investigation Commission held that the former represented return of premium which should be allowed as deduction, and the latter represented return *on* premium. Insurance companies have suggested that the Investigation Commission erred in thinking that only the load represents the policyholders' contribution. According to them, the logical position would be to treat the policyholder as having a right to the surplus in all circumstances; if a lower bonus, or no bonus, is declared the company should be held to have made a loss, and allowed to carry it forward.

16. This argument confuses the position of the company with that of the policyholder. Even if the policyholder were treated as having a right to the bonus represented by the load, the question of treating any excess or loss can only arise in *his* assessment; in practice, the question does not arise, because no part of the bonus is treated as taxable profit. The claim for deduction of the full amount allotted to policyholders is partly based on the fact that full deduction is admissible under the law in the United Kingdom. The analogy is, however, misleading. The procedure followed in the U.K. for the assessment of life insurance companies amounts to giving the revenue authorities the right to base the assessment either on valuation surplus less allocation to policyholders, or investment income less expenses, whichever is higher. In practice, however, most companies in the United Kingdom are assessed on the latter basis, as it almost invariably shows higher profits. In India this basis usually shows low profits, or a loss, on account of the high expense ratio. At the same time, the valuations reveal a surplus which enables the companies to declare bonuses. This shows that a considerable part of the surplus comes from favourable mortality and interest factors.

17. The Income-tax Investigation Commission suggested that a formula should be evolved for allocating the surplus between return *on* premiums and return *of* premiums. As it was not found possible to evolve a formula which would cover all cases, an *ad hoc* increase from 50 per cent. to 66 2/3 per cent. of the surplus allocated to policyholders was proposed in the Income-tax (Amendment) Bill of 1951, and the actual percentage fixed in the Amendment Act of

1953, was 80. The view has been expressed that the allowance of 80 per cent. is, on the whole, quite fair. We are in agreement with this view and do not recommend any further increase in this proportion.

Limitation of expenses

18. When assessment is made on the external incomings basis, it has been urged either that there should be no limitation on admissible expenses or that the expenses admissible under the Insurance Act should be allowed for income-tax also. It is a basic principle of allowing deductions for income-tax that only expenditure which is wholly and exclusively laid out for the purposes of the business should be allowed. This implies determination of the quantum of reasonable expenses. The Insurance Act itself recognises the need for some limitation; this shows that insurance companies sometimes incur unreasonably high expenditure, and it is necessary to have a corresponding limitation for income-tax purposes. The maximum percentages admissible under the Income-tax Act have now been brought more or less in line with those prescribed in the rules made under the Insurance Act, and further modification does not seem to be called for.

Mutual life insurance business

19. Mutual life insurance associations have claimed complete exemption of their profits from income-tax on the ground that the transactions are governed by the principle of 'mutuality'. It has also been urged before us that the directors are all elected by the policy-holder members, and the constitution is democratic; and that policy-holders in such societies are largely composed of persons whose income is below the taxable limit. Further support for exemption has been sought to be derived by drawing an analogy with co-operative insurance societies, whose profits are now exempt from tax.

20. Before 1939, the profits of mutual insurance business were being treated as exempt from tax in India in view of judicial decisions to that effect. The Income-tax (Amendment) Act of that year specifically provided for the taxation of profits of the business of mutual life insurance to be calculated in the same manner as those of other life insurance business.

21. Our attention has been drawn to the fact that proprietary companies are prohibited from distributing more than 7½ per cent. of their valuation surplus to shareholders; an inference is sought to be drawn from this that, to this extent, every life insurance company can claim to be a 'mutual' company. The difference in practical working between a mutual insurance company and a proprietary concern is, therefore, small. The fact that the board of directors consists solely of representatives of policyholders is hardly relevant for the purposes of taxation. The average sum assured per policy in respect of mutual companies is not significantly lower than for proprietary companies. It is not, therefore, established that policy-holders in mutual insurance companies come from lower economic strata.

22. Mutual life insurance companies already enjoy an advantage as compared with joint stock companies in respect of the rate of tax, to which reference has been made above. A further advantage

arises as follows. When assessment is made on the valuation surplus basis, 80 per cent. of the portion reserved for policyholders is allowed as a deduction. In a mutual company, the entire surplus belongs to the policyholders, as there are no shareholders. The taxable income is accordingly lower in the case of a mutual company.

23. It appears from the foregoing discussion that the essential distinction between mutual and other insurance companies is that the former have no shareholders and their entire valuation surplus, therefore, goes to policyholders. The advantages which we have just indicated fully compensate for this factor, and we do not recommend any further tax concession for mutual life insurance companies.

24. As regards the analogy with co-operative insurance societies, the complete exemption enjoyed by co-operative societies is fortuitous. Normally, only the business profits of a co-operative society are exempt from tax. The special rules for computing the income of an insurer appear in Section 10 of the Income-tax Act, which relates to business income. The courts have accordingly held that all the income of an insurer (including investment income) comes into the definition of 'business profits'. The result is that co-operative insurance societies enjoy complete exemption from income-tax, which is available neither to other insurers nor to co-operative societies doing other business. The tax exemption gives them a competitive advantage as compared with other life insurance companies, though there is no essential difference in the method of working. We would, therefore, recommend that the present exemption in favour of co-operative insurance companies should be withdrawn.

General insurance business: reserves for unexpected losses

25. Companies carrying on non-life insurance business generally issue policies on an annual basis. As policies are issued throughout the year the result is that, when accounts are made up at the end of a year, there are a large number of policies on which there is unexpired risk for varying fractions of a year. A reserve for such risk is generally made on the basis of a percentage of premiums received during the year, and an additional reserve is also often made to meet unexpectedly large claims. Under executive instructions, the reserves actually made by a company are allowed, subject to a maximum limit of 100 per cent. of the current year's premium receipts in respect of marine insurance business, and 50 per cent. of the premium receipts in respect of other business.

26. It has been urged that companies should be allowed to build up a tax-free reserve in order to put them in a position to meet sudden catastrophes resulting in huge losses. It is pointed out that Indian companies, being relatively new to this business, are at a disadvantage as against older non-Indian companies which were able to build up heavy reserves during a period of low rates of income-tax, and which now enjoy a large portion of the Indian business. A sizeable reserve, it is urged, will thus help to strengthen the competitive position of Indian companies, in the Indian market itself as against non-Indian companies; and it will also enable them to expand their field of operations outside India. The specific suggestion that has

been put forward is that companies should be allowed to add five per cent. of their annual premiums to the reserves every year, until they reach 100 per cent. of annual premiums in respect of fire and miscellaneous business, 150 per cent. in respect of marine cargo business and 200 per cent. in respect of marine and aviation hull business.

27. We agree that general insurance in India is still in an early stage of development and needs encouragement for building up reserves. We accordingly recommend that the companies should be allowed to add five per cent. of their annual premia to the reserves every year free of tax until the reserves reach 75 per cent. of annual premia in respect of fire and miscellaneous business and 150 per cent. in respect of marine and aviation hull business. We do not recommend any change in respect of marine cargo business.

Re-insurance

28. A company issuing a policy for a large amount usually distributes the risk by re-insuring portions with other companies. In the case of general business, re-insurance is mostly placed with non-Indian companies. It has been brought to our notice that assessments have recently been made on certain foreign re-insurers on the basis that the course of transactions with the Indian company forms a 'business connection' within the meaning of section 42 of the Income-tax Act. On a strict interpretation of the law, it is perhaps arguable that the Indian company acts more or less as an authorised agent of the foreign re-insurer; and that the former is in a position to accept policies for fairly large sums when it knows that it can automatically pass on a portion of the risk to the re-insurer. There is also the possibility of evasion by a group of foreign insurance companies acting together. Only one of them may register itself under the Indian Insurance Act, and may pass on large parts of its business to the other members of the group by way of re-insurance.

29. Despite these contentions we are impressed by the consideration that such taxation will make foreign re-insurance companies reluctant to accept re-insurance from India. In the alternative, they will add the element of tax to the premiums charged to Indian companies.

In the interests of general insurance business being built up in India, we would suggest that the best policy would be not to apply the interpretation that a 'business connection' arises in such transactions. No amendment of the law is necessary to bring about this result, which could be secured by the issue of suitable executive instructions.

Trade associations, chambers of commerce, etc.

30. We may now consider some suggestions which have been made to us for modification of the procedure governing the taxation of trade and professional associations, chambers of commerce, etc. Such organisations may hold property or other investments, and it is common ground that the yield from these sources should be taxable. In addition, they may render specific services to individual members and charge fees therefor; they also receive periodical subscriptions from the members, which ordinarily form a major part of their gross income.

The surplus of fees received for specific services over expenses incurred in rendering those services is taxable under section 10(6) of the Indian Income-tax Act, which was inserted in 1939 as a result of the following recommendations of the Income-tax Enquiry Committee, 1936:

> "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."

31. So far as general subscriptions are concerned, a suggestion has been put forward that they ought to be exempt from tax on the principle of mutuality, but this argument is not impressive. Few associations can be said to satisfy the stringent conditions which courts have laid down for the application of this principle. We would prefer to put the case for exemption on the ground that a large part of the subscriptions would be spent on objects of common interest to the members, and the expenditure would have been an admissible deduction if spent by each member separately. A part of the subscriptions may also be spent on non-business objects, or accumulated for capital expenditure; we do not think that exemption can be claimed in principle for this part of the receipts. Strictly speaking, therefore, a process of allocation would be needed in order to determine the taxable profits of the association; and a similar allocation would have to be made to decide the proportion of the subscription which could be allowed as an admissible deduction from the business income of the members. The time and labour involved in such allocation would, however, be out of proportion to the revenue involved.

32. The Income-tax Enquiry Committee, 1936, therefore recommended that administrative arrangements might be entered into with such associations by which (a) the associations would be taxed on the entire surplus of receipts over outgoings, without allocation, (b) the members would get the entire annual subscription allowed in their assessment, and (c) any sums distributed by the association to its members would be allowed as a deduction from its income and taxed in the hands of the recipients.

In practical working, administrative arrangements on the lines suggested by the Income-tax Enquiry Committee, 1936, have not been entered into with any association. At the same time, the departmental practice has been to exclude the full amount of subscriptions from the association's total income, and to allow the full amount as a deduction from the assessable profit of the members. A part of the association's expenditure is set off against the exempt income. There may be differences of opinion in regard to the allocation of expenditure as between taxable and non-taxable income, but this is not a point which can be legislated for.

33. A suggestion has been made to us that such associations should be given the option each year of being assessed on the net surplus of receipts from all sources over all outgoings. An option which could be changed every year is capable of placing the association in a position of undue advantage. Moreover, in order to decide which option is more advantageous, calculations will first have to

be made by both methods, and thus the trouble of making an allocation of expenses would not be avoided. We believe that a long-term arrangement as suggested by the Income-tax Enquiry Committee, 1936, would be administratively more convenient, and would avoid disputes as to allocation. We recommend, therefore, that associations which are prepared to agree to such a standing arrangement should be allowed to do so.

34. Our attention has also been drawn to the fact that certain associations conduct professional examinations, and the suggestion has been made that they should not be assessed on examination fees and tuition fees. It is not possible to accept this suggestion, as the surplus from these sources is merged in the association's general funds and is available for being spent for other purposes.

Investment trust companies

35. The income of investment trust companies, derived from dividends paid by any other company which pays corporation tax in respect of the profits out of which such dividends are paid, is exempt from corporation tax, but not from income-tax (*vide* Notification No. 47, dated the 9th December 1953), if all the following conditions are satisfied:—

(i) it is a company having for its principal business the acquisition and holding of investments in the stocks, shares, bonds, debentures or debenture stocks of other companies or in securities issued by public authorities;

(ii) it is not a company formed for the purposes of, or engaged in, acquiring or exercising control over any other company or groups of companies or enabling any other persons to acquire or exercise such control; and

(iii) it is a company in which the public are substantially interested within the meaning of section 23A of the Indian Income-tax Act.

36. It has been represented to us that this exemption should be incorporated in the statute as a permanent feature and made applicable automatically without satisfying any additional conditions and without seeking prior approval of Government. It is further suggested that the exemption should apply to all investment companies. The justification for the above suggestions is stated to be that these companies perform a useful function in promoting investment.

37. The notification was meant to promote the formation of genuine investment trusts. The conditions prescribed are an attempt at a definition of such a concern and the limits that should be placed on the scope of its investment policies. The usual purpose of an investment trust company is to diversify small outlay by operating a collective fund contributed by shareholders each of whom, through the medium of a large portfolio, has a stake in a number of individual companies. It is necessary, if this purpose is to be fulfilled, that the fund should be designed for safety by eliminating, as far as practicable, the speculative element and that the benefit of tax reduction accrues to a large body of genuine investors. We have not carried out an examination of the operation of the conditions prescribed at present to see whether they are a sufficient safeguard to

achieve this purpose, but we are not in favour of enlarging the scope of the present concession to cover all types of investment companies without any restriction on the nature of their business and their investment policies. We are also not impressed by the suggestion that the present concession should be embodied in the statute.

38. As regards investment companies which are not covered by the notification referred to, it has been suggested to us that their income, being of a fluctuating nature, should be averaged. Fluctuation of income is not peculiar to investment companies. To a considerable extent it can be avoided or cushioned by judicious adjustment of their investments. We do not think that the taxation system should be utilised to even out the effects of such fluctuation in the profits of investment companies.

39. A suggestion has also been made that investment companies which are closely-held corporations, should be compulsorily made to distribute their entire profits (less tax) in the shape of dividends, and not merely 60 per cent. of the profits. We shall consider this suggestion in Chapter XI, while discussing the application of section 23A of the Income-tax Act.

Electricity undertakings

40. The representatives of electricity undertakings have brought to our notice certain difficulties arising from the methods of computing depreciation as laid down in the Electricity (Supply) Act, 1948, which, it is submitted, conflict with the provisions of the Income-tax Act.

41. The Electricity (Supply) Act, 1948, contains detailed provisions regulating the maintenance of accounts by electricity undertakings, and the basis on which they can charge consumers for the current consumed. One of the provisions is that depreciation is to be charged either on a straight-line basis or on a compound interest basis, so that, by the end of the estimated life of the asset, an amount of 90 per cent. of its original cost is accumulated. Another is that the charge to the consumer has to be periodically adjusted so as to leave to the undertaking only a clear profit of five per cent. of the capital base *plus* income from investments.

42. This gives rise to various difficulties. In the first place, the Electricity (Supply) Act does not provide for initial and additional depreciation. Consequently, in the first few years after the installation of new machinery, the book profits would exceed the assessable income, while the position would be the reverse in later years. At the same time, the charge to consumers has to be adjusted with reference to the book profits.

The result is that, in the earlier years, the tax saved is compulsorily passed on to the consumers, while in later years, the tax liability is higher than that on the book profits, but no reserves would have been accumulated to meet the liability.

We consider that the best way out of the difficulty would be to allow the concerns to put into reserve any extra surplus that they get as a tax relief on account of the initial and extra depreciation allowances. We recommend that the Electricity (Supply) Act be amended so as to permit the creation of such a reserve.

43. The fact that assessable income may be less than the book profits in the year of installation of new machinery and in the next few years, also leads to some difficulties. The company's dividend policy has to be based on book profits. It is possible, however, that on account of the accelerated depreciation allowances the assessable income (less tax thereon) is less than the dividends distributed. The excess dividends will then become liable to additional income-tax under the annual Finance Acts. The assessment might even result in a loss, and if this happens the shareholders will not be entitled to any tax credit in respect of the dividends.

These difficulties will cease to exist if the method of taxing companies is revised on the lines suggested in Chapter X.

The Hindu undivided family

44. The Hindu undivided family is a unique institution which has been recognised by the Indian Income-tax Act as a distinct unit meriting special treatment for purposes of assessment. The concept of the Hindu undivided family in the Indian Income-tax Act is in substantial agreement with the position under the Hindu law as applied by courts in this country, according to which properties and income of such a family are treated as one unit so long as the family continues undivided. It is because of this peculiar feature that the Hindu undivided family has been treated as a distinct taxable entity in every Income-tax Act since the Act of 1886. The legal propriety involved in the treatment of the Hindu undivided family in such manner was examined in detail by the Income-tax Investigation Commission which concluded that "the assessment of the Hindu undivided family as a unit not only is not inconsistent with but substantially agrees with the legal position under the Hindu law". We are in agreement with this view. The only point that we propose to consider is whether the treatment of the Hindu undivided family as a separate unit for income taxation leads to any inequity which needs to be remedied.

45. The special provisions regarding the Hindu undivided family in the Income-tax Act are contained in sections 14(1) and 25A which are reproduced below for ready reference:—

Exemption of a general nature

"14(1). The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family where such sum has been paid out of the income of the family or in the case of an impartible estate where such sum has been paid out of the income of the holder of the estate belonging to the family.

Assessment after partition of a Hindu undivided family

25A. (1) Where, at the time of making an assessment under section 23, it is claimed by or on behalf of any member of a Hindu family hitherto assessed as undivided that a partition has taken place among the members of such family, the Income-tax Officer shall make such inquiry thereinto as he may think fit, and, if he is satisfied that the joint family property has been partitioned among the various members or groups of members in definite portions he shall record an order to that effect:

Provided that no such order shall be recorded until notices of the inquiry have been served on all the members of the family.

(2) where such an order has been passed, or where any person has succeeded to a business, profession or vocation formerly carried on by a Hindu undivided family whose joint family property has been partitioned on or after the last day on which it carried on such business, profession or vocation, the Income-tax Officer shall make an assessment of the total income received by or on behalf of the joint family as such, as if no partition has taken place, and each member or group of members shall, in addition to any income-tax for which he or it may be separately liable and notwithstanding anything contained in sub-section (1) of section 14, be liable for a share of the tax on the income so assessed according to the portion of the joint family property allotted to him or it; and the Income-tax Officer shall make assessments accordingly on the various members and groups of members in accordance with the provisions of section 23:

Provided that all the members and groups of members whose joint family property has been partitioned shall be liable jointly and severally for the tax assessed on the total income received by or on behalf of the joint family as such.

(3) where such an order has not been passed in respect of a Hindu family hitherto assessed as undivided, such family shall be deemed, for the purposes of this Act, to continue to be a Hindu undivided family."

The annual Finance Acts also provide exemption limits for income-tax for Hindu undivided families higher than that for individuals and associations of persons; in the latest Finance Act, the limit is Rs. 8,400 as against Rs. 4,200 for other units such as individuals and associations of persons. (There is no difference in the limit for super-tax). The share of the income of the family received by its members is not taken into account in their personal assessments.

The family is also entitled under the law to a partial partition and to establish a business with the capital so provided. Such a business can be run as a partnership. Although, therefore, the exemption limit for the Hindu undivided family with two or more members entitled to claim partition is now Rs. 8,400, the real benefit enjoyed by the family as a whole is much more because of the concessions referred to above.

46. Certain witnesses have submitted that the treatment of the Hindu undivided family as a separate unit for taxation purposes confers on it advantages such as those mentioned above which are totally unmerited and that the correct thing would be to assess it as an association of persons, with suitable provision for adequate safeguards for avoiding hardship to families in the lower income brackets. We have considered this matter carefully and have come to the conclusion that it is not desirable to make this change. If the Hindu undivided family is treated as an association of persons the

share of income received by every member from the family will have to be included for rate purposes in the separate assessments of the members of the family, and considerable hardship would be caused thereby, particularly to families in lower income groups. Once the concept of an association of persons is accepted it would be difficult to provide in the law for relief to any special class of assessees.

47. Another suggestion that has been made to us is that the Hindu undivided family should be treated as if it were a registered firm. In concrete terms this will involve allocation of the income of a family among the various persons constituting it, and the aggregation of such share of income with any separate income which any particular member may have for assessment.

A variant of this method which has also been suggested is to calculate the tax which would be due from each member of the family on his share of the income at the personal rates applicable to his total income, and demand from the family the aggregate of such separate taxes. This suggestion would lead to serious legal and administrative difficulties in determining the shares of income of the individual members. So long as the Hindu family is undivided, the members have no legal right to any separate share in the income, and any notional division would create a legal fiction. In order to ascertain the actual share of each member, regard would have to be had to the births and deaths which have occurred in a family during a year. A suggestion which has been made by some witnesses in order to get over this particular difficulty is to treat the income as notionally belonging only to the adult male members of the family. Delay in completing the assessment, after ascertaining the personal rates applicable to the several members, and difficulties in collection of tax will arise in practice and make the proposal unworkable. This suggestion has also therefore to be ruled out of consideration.

48. In coming to the conclusion that it would be inexpedient to make any far-reaching changes in the tax treatment of the Hindu undivided family at the present moment, we have also been influenced by the fact that the Hindu Code Bill is pending before the Parliament, and that, when it is passed into law, it is likely to effect radical changes in the legal and social framework of the Hindu joint family system, the full extent of which cannot now be foreseen. Whatever changes may be made in the meantime can, therefore, only be in the nature of an interim measure, for which we see no justification.

49. The exclusion of the share of family income from the total income of a member of a Hindu undivided family results in certain anomalies. When the individual members have large separate incomes, and their personal rates of tax are higher than those applicable to the family, the present system results in the total tax being less than the tax which would be leviable if the incomes were aggregated. However, in view of the considerations set out in the preceding paragraph, we do not recommend any modifications. On the other hand, families in the lower and middle income groups, where more than one member may contribute to the earning of the family income and the members have no separate incomes or only small incomes, would gain an advantage if the shares of income were to be aggregated with their separate income (if any) and taxed separately.

Suggestions have been made to us that such families should be granted some tax concessions through a higher abatement for life insurance premia or higher earned income relief, in proportion to the number of adult male members in the family. We recommend, in the next chapter, an increase in the maximum limit for abatement on insurance premium to one-fifth of the total income subject to a maximum of Rs. 16,000 for Hindu undivided families and Rs. 8,000 for others. We think, however, that a higher limit of abatement for Hindu undivided families in proportion to the number of members is hardly justifiable in view of the fact that individual members of the family are also entitled to abatement in respect of premia paid out of their separate incomes (if any). As regards earned income relief, the determination of the particular members who took an active part in the earning of the family's income would involve harassing enquiries and would also lend itself to manipulations of various kinds. We do not, therefore, recommend further relief in either of these directions.

50. The Income-tax Investigation Commission had recommended that the non-taxable maximum, both for income-tax and super-tax, of families with two or more members entitled to claim partition, should be fixed at twice the general exemption limit, and that the exemption for families with four or more members entitled to claim partition should be fixed at three times this amount. Partial effect has been given to this recommendation, in respect of income-tax, but not of super-tax, by fixing the exemption limit for Hindu undivided families with two or more members entitled to claim partition at Rs. 8,400 as against the general limit of Rs. 4,200. We recommend that, for families with four or more such members, the exemption limit for income-tax may be fixed at three times the general exemption limit (this will come to Rs. 12,600 at the present rate). We do not recommend any relief in respect of super-tax.

Evidence regarding partition

51. The provisions of section 25A of the Income-tax Act, which stipulate a division of the assets of the family into definite portions before the disruption of a Hindu undivided family could be accepted for income-tax purposes, have been criticised as unduly harsh. It is urged that a mere unequivocal declaration of an adult male member of the family of his intention to separate should be accepted as sufficient evidence for purposes of the Income-tax Act. Under the Hindu law, partition is a severance of joint status and, as such, is a matter of individual volition. All that is necessary to constitute partition is a definite and unequivocal indication by a member of a Hindu family of his intention to separate himself from the family. It is immaterial whether the other members agree to the partition or not. The intention to separate may be expressed either by an explicit declaration or by conduct. Such a partition may be partial either in respect of property or in respect of the persons making it.

52. The intention to divide may only result in fixing the proportion of interest of each member in the property. This is, however, not of much use for income-tax purposes. The partition of the family involves the division of wealth and not of income. It is possible for some members to get only wealth and no income-producing source while it may be *vice-versa* in other cases. Unless it is known definitely in what proportion 'income' is divided, it is obviously not

possible to tax it separately in the hands of the members of the family. We are, therefore, unable to recommend a change along the lines suggested.

Registration of firms

53. Partnerships are regarded as aggregation of individuals for tax purposes if they satisfy certain conditions laid down in the law; otherwise as distinct taxable entities. The income of firms of the former type is apportioned between the partners and assessed at the rates applicable to the total income of each. In the majority of cases, where the rates applicable to the personal incomes of the partner are lower than the rate that would be applicable to the total income of the firm as such, this amounts to a tax concession. Possibilities of abuse are, however, inherent in this concession in that it is not difficult to introduce bogus partners with a view to fractioning income and reducing the total tax liability. It is, therefore, proper that adequate safeguards should be embodied in the law to ensure that the concession is availed of only by genuine partnerships. We are, however, of the view that procedural formalities, enabling the concession to be enjoyed, should be the minimum possible compatible with the safety of revenues.

Procedure for registration

54. The Indian Income-tax Act makes a distinction between registered and unregistered firms with a view to achieving the object mentioned in the preceding paragraph. An unregistered firm pays tax, like an individual, on its total income at the rate applicable to that income. The income of a registered firm is apportioned among its partners, and the tax liability is placed on the partners at the rate applicable to their total incomes. A firm can obtain registration if it complies with the procedure laid down in section 26A of the Income-tax Act and Rules 2 to 6B prescribed thereunder. The main features of these regulations may be described as under:—

(i) the firm must have been constituted under an instrument of partnership;

(ii) the instrument of partnership must specify the individual shares of the partners;

(iii) the firm, seeking registration, has to make an application to the Income-tax Officer in a prescribed form;

(iv) the application for registration should be personally signed by all the partners (not being minors);

(v) the application must be accompanied by the original instrument of partnership or a certified copy thereof;

(vi) the application for initial registration must be made within six months of the constitution of the firm or before the end of the accounting year of the firm (in which it is constituted), whichever is earlier;

(vii) in the application, the firm has to certify that the profits (or loss) of the accounting period have been or will be divided or credited to the various partners in accordance with the details to be furnished;

(viii) on receipt of a proper application, the Income-tax Officer gives the certificate of registration if he is satisfied that there is or was a firm in existence constituted as shown in the instrument of partnership.

Renewal of registration

55. The registration certificate given under the rules mentioned above is valid only for one year's assessment. Registered firms have to apply in relation to every subsequent year's assessment for renewal of registration. Such an application has also to be signed by all the partners (not being minors) and has to be made before 30th June in every year. The firm has to certify that its constitution and the individual shares of the partners have remained unaltered. Renewal of registration is, thereafter, granted by the Income-tax Officer if he is satisfied that the application is in order and that there is or was a firm in existence constituted as shown in the instrument of partnership.

Objections to the present scheme

56. The main objections which have been voiced before us against the present law and procedure may be summarised as under:—

(i) under the general law relating to partnership, no written instrument of partnership is necessary. The requirement of filing an instrument of partnership, prescribed by the Income-tax Act, it is stated, amounts to legislating away from the law of partnership, and should be abrogated;

(ii) the time limits prescribed for filing application for initial registration and renewal of registration lead to practical difficulties. Registration should not be refused simply because a firm could not file the application in time, if the income-tax authorities are satisfied that the firm is genuine; and

(iii) Income-tax Officers should not refuse registration simply because the application as furnished by the firm is defective in some respects without affording an opportunity to the firm for rectifying the mistakes.

We now consider these objections *seriatim.*

Requirement of furnishing partnership deed etc.

57. The requirement of filing a written partnership deed and furnishing other particulars embodied in the prescribed application forms has been laid down in the Income-tax Act with a view to ensuring that the concession available to a registered firm is enjoyed only by a genuine firm. It legislates away from the general law as all legislation, which is intended to counter tax avoidance, must. In the absence of such evidence being furnished by a firm, it will be extremely difficult for Income-tax Officers to determine the genuineness and the constitution of the firm and the manner in which the profits have in fact been divided between the partners. All the relevant information and evidence is obviously in the possession of the partners and the means for external verification available to the Income-tax Officer are necessarily meagre. The absence of account books in some cases adds to these difficulties.

We are of the opinion that, in principle, the requirement mentioned above should continue. It is completely justified on the ground that the law must provide adequate safeguards to prevent abuse of the concession which registered firms enjoy under the Income-tax Act. We are also convinced that the obligation which this requirement places on this class of assessees is not incommensurate with the concession which they enjoy on registration.

Time-limits for filing applications for initial registration and renewal of registration

58. It has been suggested to us that the position obtaining before 1952 in respect of the time-limit for filing applications for initial registration and for renewal of registration should be restored. Before 1952, it was open to the partners of a firm to apply for registration at any time before the assessment of the firm for the particular accounting year was completed. This procedure was open to abuse by presenting to the Income-tax Officers ante-dated partnership deeds, which was made possible because of the considerable time-lag between the termination of the accounting year and the completion of the assessment in respect of the profits of that year in a large number of cases. The Income-tax Investigation Commission examined this position and recommended that "registration of the deed by the income-tax authorities, if it is to be useful, must, therefore, be registration within a short interval—say three or at the highest six months—after the commencement of the partnership". Rule 2 of the Income-tax Rules was accordingly amended in 1952. We are in agreement with the views expressed by the Income-tax Investigation Commission that, in principle, some such time-limit must be prescribed.

59. We are, however, of the opinion that a narrow view should not be taken and registration refused merely on the ground that the application has not been filed in time if the income-tax authorities are otherwise satisfied about the genuineness of the firm. We note that, consistently with this view, provision has been made statutorily for the time-limit to be relaxed in suitable cases. Where a firm is registered under the Indian Partnership Act or where the deed of partnership is registered under the Indian Registration Act, it is provided that application for registration may be made at any time before the end of the accounting year of the firm. The law also gives the discretion to the Income-tax Officer to entertain applications made after the expiry of the specified time-limit, if he is satisfied that the firm was prevented by sufficient cause from making the application within the prescribed time. We also learn that Income-tax Officers have been instructed to take a lenient view when belated applications are filed. The following instructions which have been issued by the Central Board of Revenue in this behalf would appear to be sufficient:—

(i) where the genuineness of a firm is not in doubt, or the case of a new assessee is under consideration, the Income-tax Officer should not refuse to entertain a somewhat belated application in relaxation of the time-limit;

(ii) for renewing the registration of an existing firm with no change in its constitution, it would be unnecessary to be very meticulous about the date by which the renewal application should be made. Provision already exists in the rules empowering the Income-tax Officers to relax the time-limit on sufficient cause being shown. The Board, therefore, direct that a belated application for renewal of registration should not normally be rejected except for sufficient reason such as wilful default in compliance with the notices.

Refusal of registration on defective applications

60. The last main criticism of the present procedure that has been made before us is that registration is refused in some cases merely on the ground that the prescribed form of application had not been properly or completely filled in without providing an opportunity to the assessee for rectifying such omissions. We understand that, if a return of income filed by an assessee is incomplete or fails to comply with a particular provision, it is the departmental practice to send such defective returns back to the assessee and give him an opportunity to rectify the mistakes or make up the deficiency before taking any adverse action. We see no reason why the same procedure should not be followed in respect of applications for registration, and we recommend that the Central Board of Revenue should issue instructions to Income-tax Officers to ensure that a genuine firm is not refused registration merely because of some formal defects in the application without affording the partners an opportunity for rectifying such defects.

Simplification of present procedure

61. While in principle we approve of the system of registration of firms, we are of the opinion that the procedure involved should be simplified in some respects with a view to alleviating the technical difficulties which assessees may now be experiencing. As regards the registration of firms, it should be enough, in our opinion, if the rules require the filing within specified period, of only the instrument of partnership signed by all the partners and specifying the date of the commencement of the partnership, names of all the partners and their individual shares in the profits (or loss) of the partnership and such other particulars as may be prescribed. The application for registration and the various certificates contained therein, as prescribed in Rule 3 of the Income-tax Rules, may be incorporated in the form of the income-tax return itself to be filled in by the partners at the time of furnishing the return.

Renewal of registration

62. Once registration of a firm has been initially granted by the Income-tax Officer, no material purpose appears to be served by the separate procedure for renewal of registration. There is no reason why partners of a firm should be required to file before the 30th June every year a separate application for renewal of registration. The relevant application and the certificates contained therein, as prescribed in Rule 6 of the Income-tax Rules, could be incorporated in the form of the income-tax return itself. This should suffice for automatic re-registration, subject to the reservations (i) that there has been no changes in the constitution of the firm since the date of its last registration and (ii) that the Income-tax Officer is satisfied about the existence of the firm constituted as shown in the instrument of partnership.

63. It is, however, necessary to provide that the annual return of income of a firm should be signed by all the partners or where the return is made after dissolution of the firm, by all partners who were partners in the firm immediately before dissolution and by the legal representatives of any such person who is deceased.

64. We now turn to co-operative societies. Our recommendations in respect of the concessions in income taxation granted to this form of economic organisation involve—

Co-operative societies

(1) the continuance of the existing concessions;

(2) the enlargement of these concessions for certain types of societies; and

(3) in either case, the provision of safeguards to ensure that the concessions are not abused, *e.g.*, by these being claimed by societies which are 'co-operative' in legal form, but not either in their organisation or in their operation.

Broadly, our recommendations are based on the following grounds:—

(i) the co-operative form of organisation is avowedly the one best suited for a large sector of economic activity, including agricultural credit, in which it is of advantage for small men to combine their resources and efforts in the promotion of the production, distribution or consumption of the goods or services in which they have a common interest;

(ii) there still exists in this country a vast scope in many spheres for the extension of this form of economic organisation; and

(iii) tax concessions are one of the means, though undoubtedly a minor means, of helping to bring about such development.

It follows that the concessions, as well as the safeguards against their abuse, should be reviewed from time to time in the light of the objectives postulated. We suggest that there should be such a review at the end of ten years from the time these concessions commence to be implemented. In particular, the review should aim at assessing (a) the results achieved by way of co-operative development; (b) the extent of revenue foregone; and (c) whether the safeguards have operated substantially to prevent the abuse of the concessions. On the basis of this review, and of periodical reviews thereafter, if necessary, could be formulated further lines of policy in regard to both concessions and safeguards.

65. Co-operative institutions are registered under the Co-operative Societies Act, 1912, which is a Central Act, or under the corresponding enactments of different States. The general structure of the all-India legislation and the State laws is the same, although there are some differences in point of detail as also in the degree of control exercised by Government. In recognition of the fact that co-operative societies are intended "to encourage thrift, self-help and co-operation among agriculturists, artisans and persons of small means", the Government of India granted certain tax exemptions to co-operative societies from the very inception of the movement. The basis of exemption was embodied in the Co-operative Credit Societies Act, 1904 (later replaced by the Co-operative Societies Act, 1912). The same principles, clarified from time to time, have continued to govern practice. The exemption from income-tax was in respect of 'profits' of a society and of all the dividends or other payments received by the members of the society 'on account of profits'. The

term 'profits' was interpreted by Government as referring to 'business profits' and to exclude other income such as interest on securities. To place the matter beyond doubt, the notification granting the exemption was amended in 1934 by the addition of an explanation that the exemption did not extend to (a) income from interest on securities, (b) income from property, (c) income from dividends, and (d) income from other sources. The exemption to members was restricted to dividends and other payments made out of the profits exempt in the hands of the society. The following notification, as last amended in 1945, regulates the assessment of co-operative societies for purposes of income-tax:—

"The following classes of income shall be exempt from the tax payable under the said Act, but shall be taken into account in determining the total income of an assessee for the purposes of the said Act:—

(1) * * * * * * *

(2) The profits of any Co-operative Society other than the Sanikatta Salt-Owners' Society in the Bombay Presidency for the time being registered under the Co-operative Societies Act, 1912 (II of 1912), the Bombay Co-operative Societies Act, 1925 (Bombay Act VII of 1925), the Madras Co-operative Societies Act, 1932 (Madras Act VI of 1932), or the dividends or other payments received by the members of any such society out of such profits.

Explanation.—For this purpose the profits of a Co-operative Society shall not be deemed to include any income, profits or gains from—

(1) investments in (a) securities of the nature referred to in section 8 of the Indian Income-tax Act, or (b) property of the nature referred to in section 9 of that Act,

(2) dividends, or

(3) the 'other sources' referred to in section 12 of the Indian Income-tax Act".

66. In the course of half a century, the movement has made appreciable, but not substantial, progress in many parts of the country. Its most needed and most dominant form continues to be the agricultural credit society; indeed, the movement itself started with the establishment of primary agricultural credit societies; it has since extended to other forms of societies, both rural and urban, and among the diverse types covered are numerous forms of non-credit co-operative organisation. While the co-operative movement continues to diversify and expand, it would be easily recognised that, in view of the size of the country's agricultural population, the significant place which the handicraftsman and the artisan occupy in the rural economy and the large volume of other business operations conducted by persons of small means in cities, towns and villages, the scope for further expansion and development of the co-operative form of organisation is very considerable. The Five Year Plan recognises this fact as well as the basic importance of co-operation for the socio-economic progress of the country and accords a very important place to this form of organisation in many programmes

of national importance. Recent surveys conducted by the Reserve Bank of India, by universities and by research institutions, all point to the need to intensify effort for providing various services and aids to agriculture and cottage industries through organized co-operative agencies. We have ourselves no doubt of the extreme importance of planned co-operative development for the future welfare of the country. It is evident that in India such a development, on the requisite scale, will not be possible without the active assistance of the State. One form of State aid is relief from taxation. In these circumstances, we see every justification for continuing the exemptions from income-tax hitherto enjoyed by co-operative societies.

Enlargement of concessions

67. The reasons we have just mentioned also justify the enlargement of the existing concessions in certain cases. To this end, we make the following recommendations:—

(i) all co-operative societies, including State co-operative banks, central or district co-operative banks, etc. (but excluding housing societies, transport societies, co-operative insurance societies and urban consumers' societies) of which the total annual income is below Rs. 20,000 should be exempted from the operation of the 'explanation' which figures in the Government of India Notification reproduced above. In other words, income from investments in (a) securities of the nature referred to in section 8 of the Indian Income-tax Act and (b) property of the nature referred to in section 9 of that Act will also be exempt in their case;

(ii) under the existing provision, the business profits of a co-operative society are exempt from the payment of income-tax, but they are included in the total income for determining the rate of tax on the balance of the society's income. For purposes of super-tax, the business profits are completely excluded. The explanation in the notification referred to makes it clear that the income which is exempt does not include income from property or interest on investments or dividends. We recommend that when a co-operative society makes an investment with another co-operative society and gets income by way of interest or dividend, such income from transactions between co-operative societies should not be deemed taxable even if its total annual income exceeds Rs. 20,000. Moreover, in calculating the tax-free element in the dividends of members of co-operative societies, no distinction should, we recommend, be made on the ground of the source from which the divisible profits arise;

(iii) in the scheme of agricultural organisation that is favoured by competent authorities, the extension of a system of warehouses in rural areas is deemed to be of considerable importance. Where warehouses are constructed by co-operative societies or by regulated market committees enjoying statutory recognition, the income from such property is liable to income-tax under the existing practice referred to above. In view of the usefulness of this development in our rural economy, we recommend that co-operative societies (including banks, marketing societies, etc.) and statutorily constituted market committees which provide warehousing or godown facilities, should enjoy exemption from tax on such part of their income as is derived from godowns and warehouses, even if their yearly income exceeds Rs. 20,000;

(iv) so far as housing societies are concerned, we recommend in regard to 'tenant ownership societies' that income from property should be taxed in the hands of tenant members and not the society. We understand that the present practice in respect of 'co-partnership housing societies' is to charge the *bona fide* annual value of all the buildings owned by the society in the hands of the society as a unit. The residential houses built by the society and occupied by the members are actually meant for the benefit of the latter, though legally the society continues to be the owner of the houses. There is obvious hardship involved in the present procedure of taxing the income from the rent of such buildings in the hands of the society. We would, therefore, suggest that the proportionate annual value of the property occupied by each member should be taxed in his hands and the recommendation made by us elsewhere regarding the concession, *viz.*, exemption of the annual value upto half or Rs. 1,800, whichever is lower, to be given in respect of owner-occupied houses should be extended to the tenants of co-partnership societies also.

Safeguards against abuse

68. We recognise the need for ensuring that these concessions are available only to genuine co-operative societies, *i.e.*, those that fulfil certain basic principles of co-operation. These may be broadly listed as one man having one vote, restrictions on share-holdings by an individual, limitation of the return on share capital, and the indivisibility of reserves. The dealings with non-members is also an index that determines the extent to which a co-operative society is genuine, though no hard and fast rules can be laid down for this purpose, since some types of co-operative societies cannot exist without dealing with non-members. We would recommend that the State Governments should ensure through adequate supervision that no improper use is made of tax concessions by different forms of co-operative societies and would suggest that they should take into consideration, for this purpose, the tests mentioned above, notwithstanding the fact that the relevant law under which they are registered does not prescribe these tests as *sine qua non* for their registration. We recommend that, on a society of which the total income exceeds Rs. 20,000 furnishing a certificate from the State Government to the effect that its constitution and working conform to these tests, the Income-tax Officer should ordinarily grant the concession without further examination. Should, however, the Income-tax Officer find that a particular society which has produced a certificate of the kind mentioned above from the State Government has had an unduly large proportion of its dealings with non-members, he should bring the matter to the notice of the Central Government, through his Commissioner of Income-tax, and we suggest that a final decision regarding the admissibility of the concession should not be taken till after consultation between the Central Government and the State Government has taken place.

Salaries

69. We now proceed to consider certain issues that have been brought to our notice regarding the computation of two special types of income, *viz.*, salaries and income from property.

We have already considered (in Chapter III) a suggestion to subject to charge certain additions to salary in the shape of perquisites in kind. A closely connected question is the exemption of certain allowances received by employees. Section 4 (3) (vi) of the Income-tax Act exempts from tax any special allowance, benefit or perquisite specifically granted to an employee to meet expenses wholly and necessarily incurred in the performance of the duties of his office. This covers such items as travelling allowance, an allowance for entertaining customers on behalf of the employer and other similar items. Our attention has been drawn to the fact that, as the tax authorities have no right to question the reasonableness of the allowance, it is possible for the employer and employee, in concert, to arrange for the avoidance of considerable amounts of tax by the latter by the grant of unduly large allowances.

70. We consider that there is a lacuna in the law which it is desirable to fill, and recommend that section 4(3) (vi) of the Income-tax Act should be amended so as to make it clear that the allowances covered by it will be exempt only to the extent that expenses are actually incurred in the performance of the assessee's duties of office. We would further suggest that, in order to avoid unduly detailed enquiries, taxing authorities should be instructed not to call for details of expenses except in cases where the allowances are *prima facie* unreasonably high.

71. With reference to one type of allowance, *viz.*, entertainment allowance, we are of opinion that the problem of determining the amount of expenditure incurred in the course of the employee's duties is likely to lead to endless wrangles, as there is considerable scope for elasticity in business practice in this matter. We recommend, therefore, that entertainment allowances paid in cash should in all cases be treated as a taxable receipt in the employee's hands. To the extent that it is considered reasonable it will of course be allowed as a deductible expenditure in the hands of the employer.

72. While on this subject, we would also like to refer to the practice prevalent in various large business concerns of expressing salaries paid to their employees as a particular amount free of tax. In the higher ranges of salaries, the net amount after tax is very much smaller than the gross salary. For instance, a 'tax-free' monthly salary of Rs. 3,000 (*i.e.*, a net annual payment of Rs. 36,000), is equivalent to a gross annual payment of Rs. 53,039 less income-tax and super-tax thereon amounting to Rs. 17,039; and a tax-free monthly salary of Rs. 5,000 (*i.e.*, a net annual payment of Rs. 60,000) is equivalent to a gross annual payment of Rs. 1,47,360, less tax of Rs. 87,360 thereon. We are, of course, aware that this practice does not lead to any loss of revenue; in the illustrations cited, the employer would pay into the treasury amounts of Rs. 17,039 and Rs. 87,360 respectively, which would be treated as a deduction at the source on behalf of the employee. At the same time, the mention of the smaller amount is apt to give a misleading idea regarding the size of the salary to the lay public and to the shareholders of the employer-company (where it is a company). We would, therefore, suggest that the practice of paying salaries expressed as 'tax-free' should be discouraged.

73. Income from property is computed for purposes of taxation on the basis of its '*bona fide* annual value', which is the notional amount for which the property can reasonably be expected to be let from year to year.

Income from property

74. It has been represented to us that the notional basis of computation of income from property should be abolished and the taxable income should be based on actual rental receipts *less* actual outgoings. In most cases the adoption of the proposed basis would not involve any change in liability, in view of the departmental practice of treating the rent actually received by a landlord as equivalent to the annual value unless there are reasons to believe that it does not represent the actual state of affairs. Though no substantial change is likely to result in tax liability from the adoption of the proposal, the onus is likely in that case to shift to the Income-tax Officer to prove that the actual receipts do not represent the proceeds of a genuine rental.

Notional basis *vs.* actual receipts

75. We also observe in this connection that most enactments governing local taxation also adopt a more or less similar definition of 'annual value'. It would, therefore, be an advantage if a closer co-ordination could be established for the determination of 'annual value' by these two sets of tax authorities. In dealing with Local Taxation we have suggested the creation of a State-wide agency for the assessment of property taxes on behalf of all the local bodies in a State. We recommend that, in States where such an agency has been established, income-tax authorities should normally adopt the same annual value as that determined for municipal assessments.

No legislative provision will be necessary to achieve co-ordination on these lines, but the matter could be covered by executive instructions to be issued by the Central Board of Revenue.

76. The most important of the deductions against income from property now admissible is an allowance for repairs, which is calculated at a flat rate of one-sixth of the annual value. Suggestions have been made that actual expenses should be allowed or that, alternatively, the allowance for repairs should be raised to a higher proportion than one-sixth.

Repairs

Verification of actual expenditure on repairs to property would be difficult in practice, as it is likely that most owners do not maintain authentic accounts for the purpose. It seems to us, therefore, that the present method of linking the allowance to the annual value of the property is convenient in practice. We are satisfied that the present allowance is adequate for reasonable repairs. Those who suggest its modification proceed on the assumption that the allowance fixed, at a time when prices were low, was just adequate. It is probable, however, that it was pitched somewhat generously at that time.

77. At present actual collection charges are allowed, subject to a maximum of six per cent. of the annual value. It has been suggested that the allowance for collection charges should be increased to

twelve per cent. or fifteen per cent. of the annual value, or that the entire collection charges actually incurred should be allowed. We are in favour of placing an upper limit on the charges so incurred. From such evidence as we have been able to obtain, we consider the present ceiling to be reasonable and therefore do not suggest any modification in respect of it.

Municipal taxes

78. A suggestion has been made to us that the whole of the municipal taxes, as well as urban immovable property tax, should be allowed as a deduction in the computation of net income from property. Such a deduction is not now allowed but, in computing the annual value of the property with reference to rent received from the tenant, the tenant's liability in respect of property taxes paid by the landlord is excluded. The tenant's liability is defined as one-half of the total amount of taxes levied by a local authority (whether payable wholly by the owner or partly by the owner and partly by the tenant) or one-eighth of the annual value of property, whichever is less.

79. Municipal taxes on property do not form an expenditure laid out for the purpose of earning income from the property. The municipal or State property tax levied on the owner is a charge on the net income from the property, in much the same way as income-tax itself. If property tax is to be made deductible for income-tax purposes, it would amount to the Central Government meeting a part of the property taxes payable by the owner. We are, therefore, unable to recommend any modification of the law in this respect. We however suggest that the limit of one-eighth fixed should be deleted as it is possible that it might lead to a denial of the 50 per cent. of total amount of tax in some local bodies. Regarding the percentage itself, we would suggest that the Central Board of Revenue, in consultation with the Ministry concerned, should examine whether it should not be raised.

80. In regard to the urban immovable property tax levied by the State for State purposes, we have recommended that it should gradually be given up and replaced by a municipal levy or if the State continues to levy a property tax the proceeds should be made over to local bodies. To the extent the State levy is replaced by a municipal levy, it would automatically be covered by our above recommendation. Where the State levies the tax but passes on the proceeds to the local bodies, it should be treated in the same way as a municipal levy, *i.e.*, it should be added to the other municipal property and service taxes for the purposes of calculating the admissible deduction in respect of municipal taxes.

Depreciation

81. Suggestions have been made to us by various persons for allowing depreciation on property. Residential buildings have a fairly long life, and their rate of wear and tear is usually quite low. The grant of an allowance for depreciation would mean a good deal of trouble and labour to both the assessees and the Income-tax Department in proving the value of old buildings and the cost of new buildings, and in maintaining a record of the depreciation allowed. We do not therefore recommend the grant of any depreciation allowance.

Interest on mortgages

82. Under the present law, interest paid on mortgage of property is allowed as a deduction, irrespective of the use to which the borrowed amount is put. It has been suggested to us that this leads to the allowance of expenditure which is not necessary for the purpose of earning the income from the property, and that the allowance should be restricted to cases where the borrowed money is utilised for acquisition or maintenance of the property or for any other purpose connected with it. Interest on a mortgage is in the nature of a first charge on the income from the encumbered property, and the allowance has been in force for a very long time. On a balance of all the considerations, we do not see adequate justification for withdrawing this long-standing concession.

Taxation of income from owner-occupied property

83. Under the present law the annual value of owner-occupied property is also treated as income, subject to a maximum of ten per cent. of the total income of the assessee. It is argued that such tax amounts to a levy on a hypothetical income which the assessee would or might have earned if he had utilised his capital in some other manner; alternatively, that the occupation by a person of his own house does not yield him any income, but only enables him to save rent which he might otherwise have had to pay. Without going further into this controversy, we believe that the provision of a house for one's family is an act which is distinctly deserving of encouragement, and some tax concession should be given in order to assist lower and middle income groups.

We therefore recommend that the annual value of owner-occupied property, as determined in accordance with section 9 of the Income-tax Act, should be reduced by one-half or Rs. 1,800, whichever is less. If such reduced annual value exceeds ten per cent. of the assessee's total income, the assessee should be given the benefit of a further reduction of the annual value to ten per cent. of the total income, as at present.

Exemption of income from newly constructed property

84. Section 4(3) (xii) of the Indian Income-tax Act grants exemption from tax for a period of two years in favour of income from properties constructed between 1st April 1946 and 31st March 1956. We have recommended another form of recurring concession for owner-occupied houses; in respect of houses intended for letting out, the present concession amounts to specific encouragement of investment in a form of activity for which the demand is ordinarily strong and which does not require any special stimulus. This is borne out by the high rents earned in respect of new buildings. We, therefore, recommend that this concession should be withdrawn.

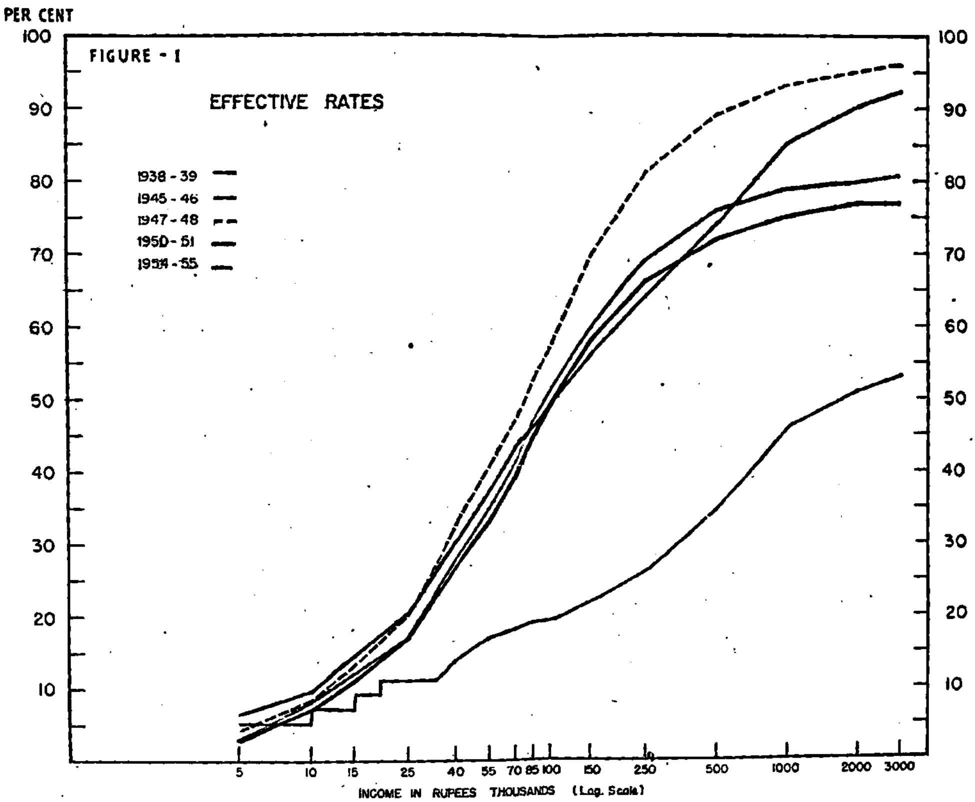
CHAPTER IX

THE RATE STRUCTURE OF INCOME-TAX OTHER THAN CORPORATION TAX

Developments in the rate structure of Indian income-tax

The developments in the structure and system of income-tax before World War II have been given in an earlier chapter. The structure of rates has undergone considerable changes since 1938-39. Statement I at pages 146—148 gives details of the rates of income-tax and super-tax since 1938-39. Figure 1 shows the pattern of the rate structure on the basis of effective rates in 1938-39, and in 1945-46, 1947-48, 1950-51 and 1951-52, being the years in which significant changes took place; no change has occurred since 1951-52 except that the exemption limit was raised from Rs. 3,600 to Rs. 4,200 in 1953-54. Rates of income-tax in 1938-39 were based on the step system, although super-tax rates were on a slab basis. Consequently, the curve showing effective rates in 1938-39 in Figure 1 shows the rise by steps in the early stages, in contrast to the smooth rise in all the other curves for later years. In 1939, on the recommendation of the Income-tax Enquiry Committee, 1936, the basis of charge for personal income-tax was changed to the slab system. On the eve of World War II, there was available to Government a convenient and elastic fiscal tool which could be operated to meet growing revenue requirements. The basic rates of income-tax and super-tax, however, remained unaltered during the period 1939-40 to 1945-46, and the increases during wartime were effected by means of surcharges. In 1940-41 and 1941-42, the surcharges on income-tax and super-tax were one-twelfth and one-third respectively, on all basic rates. During the period 1942-43 to 1945-46, the surcharge rates were themselves graduated and further increased. In 1945-46 the maximum rate of income-tax was 57 pies in the rupee and the highest slab rate of super-tax was 10½ annas in the rupee. The exemption limit was Rs. 2,000 throughout the period, except in 1942-43 and 1943-44 when it was lowered to Rs. 1,500. In 1946-47, the surcharges were merged with the basic rates, the number of super-tax slabs was increased from eight to twelve and there was a steep rise in the rates of super-tax beyond Rs. 1,50,000, four new slabs carrying the maximum rate of income-tax and super-tax to 15½ annas above Rs. 5 lakhs being introduced. Earned income differentiation was introduced in 1945.

2. In 1947-48, the exemption limit was raised to Rs. 2,500, effective rates upto Rs. 15,000 were lowered, and rates beyond Rs. 25,000 were raised. By shortening the slabs, the maximum rate of 15½ annas in the rupee became applicable to incomes above Rs. 1,50,000. In general, the rate-structure of 1947-48 showed a much steeper progression than that of 1945-46. The structure of rates in 1950-51 shows a downward readjustment of effective rates throughout as compared to 1947-48, but the reduction is larger as one goes higher up the scale of incomes, particularly beyond Rs. 85,000. By that



PER CENT
FIGURE - I
EFFECTIVE RATES
1938 - 39
1945 - 46
1947 - 48
1950 - 51
1954 - 55
100
90
80
70
60
50
40
30
20
10
5
10
15
25
40
55
70
85
100
150
250
500
1000
2000
3000
INCOME IN RUPEES THOUSANDS (Log. Scale)

year, too, the number of super-tax slabs had been reduced to eight and the highest rate of income-tax and super-tax was down to 12½ annas on income above Rs. 1,50,000; the maximum rate of normal income-tax was reduced in 1950-51 to four annas. The present rate structure which came into effect from 1951-52 reflects the uniform upward adjustment of rates effected by the surcharge of five per cent. imposed in that year on income-tax and super-tax on personal incomes above Rs. 7,200.

Some general comparison with other countries

3. A comparison of the rate structure of income-tax in India with that of several important foreign countries is instructive. Among the rate structures of economically advanced foreign countries, at one extreme stands the Japanese structure in which the marginal rate attains a level of 50 per cent. at Rs. 15,000 and stabilises at the maximum of 55 per cent. at Rs. 40,000; on the other hand, in the United Kingdom, the marginal rate stabilises only after reaching 95 per cent. Marginal rates in the other tax structures stabilise somewhere in between these two extreme limits. The initial marginal rates in India are lower than in a number of other tax structures; partly for the same reason, the degree of progression is greater. The marginal rate in India is very low when compared to that in many other countries at Rs. 10,000, and remains lower than in several countries at Rs. 15,000 and Rs. 25,000. It rises rather steeply from this level and is among the highest at Rs. 40,000; this, it may be recalled, is the end-point of the first slab of super-tax in India. From Rs. 70,000 and throughout thereafter, the Indian rate remains next only to that of the United Kingdom.

4. A comparison of effective rates indicates conclusions broadly similar to those in respect of marginal rates regarding the relative levels of the Indian rate and progression therein. While the effective rates in India are the lowest of many countries upto Rs. 25,000, the effective Indian rate rises above that of one country after another until, at the level of the top Indian slab, it becomes second only to that of the United Kingdom.

5. The existence in different countries of a system of family allowances would somewhat reduce the graduation in respect of assessees with families larger than the average size (*viz.*, married person with two children), in relation to which the above general comparison is made. It is also somewhat fallacious to compare the absolute heights of marginal or effective rates in different countries, determined as these are by the conjuncture peculiar to each country in regard particularly to such factors as concentration or dispersion of incomes, per capita income levels, government revenue requirements, etc., apart from problems of inter-currency comparisons. The relative position of different income groups in the community is a relevant consideration in comparing the incidence of a tax system. In countries where inequality of incomes is great—and India, with many other under-developed countries, falls in this class—the upper income-groups, almost by definition, stand much farther above the average income level of the mass of the population, and their net incomes after tax may still leave them in a more privileged position judged by per capita income standards, than income-groups in the same absolute range in other countries where per capita incomes

are higher. One basis of comparison of the level of taxation in different countries which is sometimes used, therefore, is to take the rates for 'corresponding' and not the same income levels, corresponding income level being taken to be one that forms the same multiple of per capita income in each country. In India, a person is not subject to income-tax until his income exceeds fifteen times the national per capita income level while in most other countries this multiple is smaller. Similarly, the level at which the Indian income-tax reaches its highest rate is over five hundred times the per capita income level, while this multiple is much smaller in many other countries. Consequently, the effective rates for *'corresponding'* income levels (*i.e.*, levels which form *equal* multiples of the respective per capita incomes in different countries) are much lower in India than in other countries. These comparisons, again, have to be made with caution, but they serve to emphasise that the value of absolute comparisons of tax levels in different countries is very limited.

The general case for higher income-taxation

6. The class of income-tax payers is very small relatively to the population, being between 1 and 1½ per cent. comparison of the average income of an income-tax payer with the per capita income, gives a very rough measure of the degree of inequality which requires some attention in formulating the scheme of direct income-taxation. Over and above the question of regulating the incidence of income-taxation *within* the income-tax paying class, *viz.*, from one tax slab to another, an increase in the general level of direct taxation should contribute to a reduction in the large measure of inequality that exists as between income-tax payers in general and the mass of the population. The possible objection that this involves levelling down rather than levelling up, for one thing, overlooks that the process of levelling up is associated with expenditure of the proceeds of taxation, and with its beneficent and developmental character. Secondly, if savings and investment are protected from the incidence of higher taxation, the incentives for economic advance can remain unimpaired. It has been brought out in the chapter on "Tax Policy" in Volume I how for purposes of achievement of the national economic objectives, an upward adjustment of tax rates and greater use of the income-tax mechanism is necessary.

Considerations in formulating a rate structure of income-tax

7. We may now proceed to a closer examination of the present structure of rates and consider readjustments in tax rates and in allowances in some detail.

Figure 2 gives a graphic representation of the structure of slabs (marginal rates) and the curve of effective rates. Table 1 at page 135 gives the number of income-tax assessees (individuals) and their percentage distribution in different slabs or sub-slabs of income as well as the amount of tax demand from assessees in various slabs in 1952-53; the marginal and effective rates of tax at different levels of income are also shown alongside for convenience.

Larger number and smaller size of slabs

8. The concentration of assessees by number in the lowest slabs of income-tax, as well as of super-tax payers by number in the first one or two slabs of super-tax is clearly brought out. The relatively considerable spread of several of the slabs, particularly from the point of

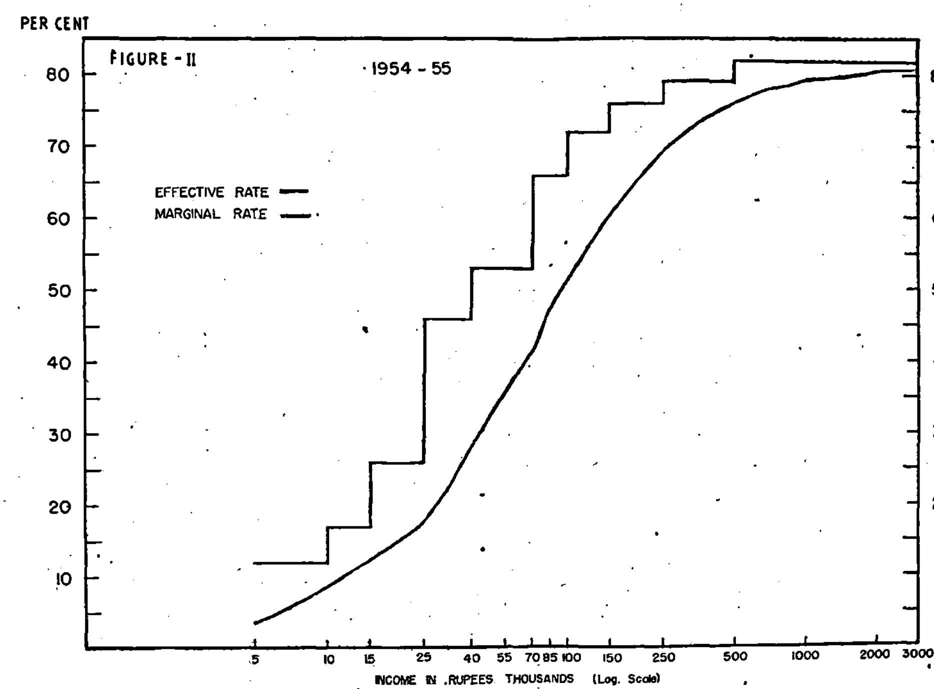

PER CENT
FIGURE - II
1954 - 55
EFFECTIVE RATE
MARGINAL RATE
80
70
60
50
40
30
20
10
5
10
15
25
40
55
70
85
100
150
250
500
1000
2000
3000
INCOME IN RUPEES THOUSANDS (Log. Scale)

TABLE 1.—*Analysis of income-tax assessees and tax demand by income groups* 1952-53

Income-tax

Income	Number of assessees	Per cent.	Tax demand (In lakhs of Rs.)	Per cent.	Marginal rate	Effective rate
1	2	3	4	5	6	7
Rs.					per cent.	per cent.
3,601— 5,000 .	1,23,803	32·9	1,42	2·9	..	3·3
5,001— 7,200 .	99,239	26·4	2,45	4·9	10·9	5·6
7,201—10,000 .	57,387	15·3	2,90	5·9	11·4	7·5
10,001—12,500 .	27,592	7·3	2,38	4·8	19·7	9·9
12,501—15,000 .	16,098	4·3	2,10	4·2	19·7	11·5
15,001—20,000 .	17,568	4·7	3,71	7·5	26·3	15·2
20,001—25,000 .	10,033	2·7	3,43	6·9	26·3	17·4
Over 25,000 .	23,953 (*)	6·4	31,21	62·9	..	..
TOTAL . .	3,75,673	100·0	49,60	100·0		

Super-tax

Income	Number of assessees	Per cent.	Tax demand (In lakhs of Rs.)	Per cent.	Marginal rate	Effective rate
25,001—40,000 .	16,094	56·7	1,72	6·3	45·9	28·1
40,001—55,000 .	5,534	19·5	2,33	8·5	52·5	34·8
55,001—70,000 .	2,383	8·4	2,04	7·5	65·6	41·4
70,001—85,000 .	1,415	5·0	2,07	7·6	72·2	46·8
85,001—100,000 .	787	2·8	1,65	6·0	75·5	51·1
100,001—150,000 .	1,183	4·2	4,10	15·0	78·8	60·3
150,001—200,000 .	420	1·5	2,45	9·0	82·0	65·8
Over 200,000 .	550	1·9	10,90	40·0	82·0	..
TOTAL . .	28,366*	100·0	27,26	100·0		

*(a) the discrepancy is mainly due to the fact that the income groups shown under income-tax relate to total income less earned income relief.

(b) marginal and effective rates relate to the combined rates of income-tax and super-tax.

view of the number of assessees covered, would also be apparent from the above table. This suggests the need, for the purpose of ensuring smoothness of progression and equitable distribution of the tax burden, for paying particular attention to the scheme of tax on ranges of income which contain the largest number of assessees.

9. The tax structures of many countries with a span of income-tax rates as wide as that which obtains in India have a larger, and often much larger, number of slabs. We think that it is desirable to achieve a more equitable differentiation in the tax liability of large number of assessees in certain brackets by introducing a larger number of slabs into our income-tax and super-tax rate structure. This will also secure a more even progression. The number of assessees in income ranges below the normal income-tax limit, and the number of super-tax payers in the first one or two slabs, also point to the need for some further splitting up of the present slabs, specially for these ranges of income.

Extent of progression and exemption limit

10. In revising the rate structure, we think certain important considerations relating to the level of rates and the degree of progression at various levels should be borne in mind. First, it would be inappropriate to increase the burden of direct taxation on the lowest income ranges appreciably, particularly in view of our recommendations to increase indirect taxes. Secondly, while a certain increase in the schedule of rates including the highest seems necessary, having regard to the objectives of tax policy, the proportionate room for increase in respect of the topmost brackets is correspondingly smaller than for upper-middle brackets; the present rate on the highest bracket, inclusive of surcharge is 82 per cent. Broadly, a maximum marginal rate of 13½ annas in the rupee or 85 per cent. on incomes above Rs. 1·5 lakhs seems to us to be as far as one can go in present circumstances. Thirdly, taking into account the per capita income levels of the community, and the desirability as far as practicable of direct taxation of small incomes, there is a case for reducing the minimum taxable income limit. The exemption limit was Rs. 2,000 in 1946-47 and was raised by stages to Rs. 4,200 in 1953-54; we recommend that the exemption limit should be Rs. 3,000. It may be argued that the lowering of the exemption limit would impose considerable administrative strain and involve disproportionately large costs of collection. We are satisfied that administrative considerations are not so weighty as to militate against any lowering of the exemption limit. In so far as the assessees in this range are salaried classes, their assessment would be relatively easy. Even in respect of others, we do not think this step would require diversion of staff from assessment work on larger cases. Besides, we consider that it will become more and more important for effective administration at all levels that a considerably larger number of persons should be on the list of assessees.

Family allowances

11. We have received a large volume of evidence in favour of introducing some system of family allowances in framing a properly devised structure of rates. In this regard, our income-tax system is almost alone among the income-tax systems of the major countries of the world in not having any degree of differentiation of tax liability according to the differences in family obligations and circumstances of the tax-payer.

12 The Taxation Enquiry Committee of 1924-25, and the Income-tax Enquiry Committee, 1936, specifically rejected the plea for family allowances on the grounds that in a country like India where practically everyone marries and the size of families is generally

large, an elaborate system of personal and family allowances was not necessary, and that the rough-and-ready method for exempting incomes below a certain limit, coupled with the device of a tax-free slice, was sufficient for the purpose in a general way.

13. For a completely satisfactory system of graduation related to family obligations, dependents should be taken into account. But a system which does include benefits to dependents may be inquisitorial and difficult to administer in Indian conditions; and, on the other hand, a system which does not include dependents may, nevertheless, make an advance towards greater equity. We consider that recognition of a certain differentiation in the position of different income-tax payers according to the size of the immediate family in its very restricted sense of the earner, wife and children will be a move in the direction of greater equity of the direct tax system.

14. Given the need for variation of tax liability on the above general basis, what kind of system will be most suitable in Indian conditions? There are, broadly, three systems in vogue: (1) an allowance in terms of deduction from income, which affords graduated relief in various ranges of income; (2) a rebate in terms of fixed amounts of tax for each member of family; and (3) a combination of the two systems, *i.e.*, a deduction from income, subject to a maximum amount of tax saved; this has the effect of affording graduated relief upto a certain income, beyond which the proportionate relief diminishes. At present, in India, the first Rs. 1,500 slice of income is exempt from tax. This corresponds to the second of the above methods, since the exempt slice of Rs. 1,500 forms a part of the lowest slab in every income, otherwise taxable at the fixed rate of nine pies, and is equivalent to a fixed tax rebate.

15. We do not agree with the view that the present tax-exempt slice serves as a substitute for a system of family allowances. We recommend the introduction of a regular system of family allowances. We realise, however, that this may not be practicable of immediate adoption owing to administrative and other difficulties, but we recommend that the necessary steps should be taken from now onwards with a view to introducing an appropriate scheme of family allowances, not later than three years. Meanwhile, to begin with, we recommend that the present tax-exempt slice of Rs. 1,500 may be increased to Rs. 2,000 for married assessees and reduced to Rs. 1,000 for unmarried persons so that there would be a clear difference of Rs. 1,000 in favour of every married person.

16. As regards the suitability of the various methods mentioned above, the fixed tax rebate would taper off rapidly as income rises. On the other hand, a deduction from income which is to afford relief that is at all appreciable in the lowest income brackets would, by reducing the graduation of tax on higher income, result in too great a loss of revenue. A shift to the basis of straight deduction from income seems, therefore, hardly practicable even with a ceiling to the amount of tax saved. There is another method, which appears to be more satisfactory under our conditions where the problem is of starting from a system of fixed rebate (the Rs. 1,500 tax-free slice, as explained is equivalent to that) and increasing it to some extent for incomes in medium slabs. This is to give a tax rebate on a portion of income at the average rate of tax appropriate to total

income, subject to a maximum tax rebate; the aim would be to have some elasticity in the amount of tax rebate with reference to income without entailing too great a loss of revenue. The above method may be considered in working out a system of family allowances.

17. One of the problems to which special attention will have to be given will be the position of the Hindu undivided family. The treatment of the members of the Hindu undivided family on the same lines as of the family of the individual assessee might result in an unduly liberal treatment as compared with the individual, unless a way could be found to include the separate incomes of members of the Hindu undivided family; we recommend in the next paragraph that in respect of individual assessees, aggregation of the income of the members of the family should accompany the introduction of family allowances. Since the treatment of the Hindu undivided family is liable to be altered in consequence of pending legislative changes, we have not made a search for a precise formula for the treatment of the family for the purpose of allowances. We are of the view that the larger reform of the income-tax system relating to the introduction of family allowances for the main body of income-tax payers should not be held up owing to difficulties in finding a strictly logical way of treating the Hindu undivided family.

18. The justification of a system of family allowances is that, though a person's ability to pay depends on the quantum of his income, it is also limited by his obligations in respect of supporting a family. On the same reasoning, the unit of assessment should ordinarily be the family, not the individual. If both husband and wife have separate sources of income, it is obvious that their combined ability to pay would be higher than that of two separate persons with the same aggregate income. This is the common ground for a system of aggregation of the income of husband and wife, which is in force in the United Kingdom. Under the Indian law, the normal procedure is for separate assessments to be made in respect of the husband and wife when they have separate incomes of their own. A provision to aggregate the incomes of husband and wife in all circumstances (except where the wife has earned income, not exceeding Rs. 500), was included in the Income-tax (Amendment) Bill of 1938, but was dropped on account of opposition in the Legislature.

19. In certain special circumstances, however, the law even now provides for treating the income of the wife or child of an individual as part of his taxable income. These provisions were designed to counteract legal avoidance. When an individual's wife or a minor child is a partner of a firm in which he is also a partner, the share of income of the firm attributable to the wife or child is treated as his income. Income arising to the wife from assets transferred directly or indirectly by her husband, otherwise than for adequate consideration or in connection with an agreement to live apart, and income arising to a minor child (other than a married daughter) from assets transferred without adequate consideration, are also included in the total income of the husband or father.

20. The provisions just mentioned have not been very effective in practice. The Income-tax Investigation Commission found that they were being circumvented in several ways. Thus assets could be transferred by a grand-parent to a grand-child, or two brothers

might each transfer assets of more or less equal value to the other's child. A provision designed to counteract such methods was included in the Income-tax (Amendment) Bill of 1951, which was eventually not proceeded with. We are also informed that claims are often put forward that certain assets are *stridhan* (property of a female member of the family), and that it is not always easy in practice to distinguish such assets from those transferred by the husband. Transfers of the assets of a member of the Hindu undivided family to his wife would also not be prevented by the existing provisions. The result is that, in a large number of cases, separate assessments are made and the husband and wife are able to claim separate reliefs.

21. We think it is both equitable and necessary for effective administration to aggregate the incomes of husband and wife, and, indeed, of the whole family, at least coincidently with the introduction of a system of family allowances.

Differentiation of earned and unearned income

22. Differentiation between the treatment of earned and unearned income for income-tax purposes was first introduced in India in 1945. The portion to be deducted for earned income relief was to be one-tenth of earned income included in total income, exclusive of any income chargeable under the head 'salaries', subject to a maximum of Rs. 2,000. In the Act of 1946, the portion to be deducted was fixed at one-tenth of earned income chargeable under salaries subject to a maximum of Rs. 2,000 and one-fifth of other earned income: the total income thus deducted was not to exceed Rs. 4,000. Since 1947, one-fifth of earned income of all kinds, not exceeding Rs. 4,000, has been allowed to be deducted. Earned income allowance is given as a deduction from total income; the relief in terms of tax is therefore at the marginal rate of tax applicable to the highest slab. Relief is not given at present for super-tax, though during 1946-47 to 1949-50 this relief was extended to super-tax also, with two schedules of rates—one for earned income and the other for unearned income.

23. In justification of earned income relief, it is urged that it is necessary to provide for some kind of 'depreciation allowance' for the human machinery; that cognizance has to be taken of the relatively precarious nature of earned income; that it is necessary to stimulate the incentives to work in order to encourage productive effort, and that the taxable capacity of those who receive 'unearned' income is greater since they have also a fund of capital in addition to the income which arises from it. The last argument appears to us to be more important than the other arguments. Besides, we consider that it is right to tax income arising without any direct effort on the part of the recipient more heavily than income arising from work (associated with special skill or knowledge, or enterprise). The importance of the considerations in favour of differentiation, however, diminishes as one goes higher up in the income scale. It appears desirable, therefore, to impose a limit in terms of income beyond which the allowance should not be available.

24. We recommend, accordingly, that earned income allowance should be given only in respect of incomes which are below a

specified limit, say Rs. 24,000, and that all incomes above that limit should be deemed to be wholly unearned. To obviate the inequity of (earned) income just above this limit being subject to a tax liability which leaves an income after tax, which would be lower than the income after tax for earned income of this level, marginal adjustments will be necessary and should be provided for.

Some illustrative rate structures

25. The four illustrative rate structures given below incorporate substantially all the recommendations that we have made in the foregoing paragraphs.

TABLE 2.—*Illustrative rate structures of Income-tax and Super-tax*

Rates of Income-tax

A.—In the case of every individual, Hindu undivided family, unregistered firm and other association of persons:—

	Illustration I	Illustration II	Illustration III		Illustration IV	
			Per rupee			
	Per cent.	Per cent.	As.	Ps.	As.	Ps.
On the first Rs. 5,000 * of total income	5	6	0	9	1	0
On the next Rs. 2,500 of total income	10	12	1	9	2	0
On the next Rs. 2,500 of total income	15	16	2	6	2	9
On the next Rs. 5,000 of total income	22.5	22	3	6	3	6
On the balance of total income	25	26	4	0	4	0

Provided that no income-tax shall be payable on a total income, which, before deduction of the allowance, if any, for earned income, does not exceed Rs. 6,000 in the case of every Hindu undivided family, and Rs. 3,000 in every other case.

B.—In the case of every company:—

On the whole of total income	25	26	4	0	4	0

Rates of Super-tax

On the first Rs. 20,000 of total income	Nil	Nil	Nil		Nil	
On the next Rs. 5,000 of total income	12.5	12	2	0	2	0
On the next Rs. 5,000 of total income	20	18	3	0	3	0
On the next Rs. 10,000 of total income	25	24	4	0	4	0
On the next Rs. 10,000 of total income	35	34	5	6	5	0
On the next Rs. 10,000 of total income	45	44	7	0	6	6
On the next Rs. 20,000 of total income	50	50	8	0	7	6
On the next Rs. 20,000 of total income	55	56	8	6	8	6
On the next Rs. 50,000 of total income	57.5	58	9	0	9	0
On the balance of total income	60	60	9	6	9	6

*On the first Rs. 1,000 of total income for unmarried persons and Rs. 2,000 of total income for married persons, no tax will be payable.

It will be seen that the principal elements common to all these illustrative structures are an increase in the number of slabs, a reduction in the size of some slabs, a lowering of the limit of super-tax and increase beyond a level in the rates of tax with a general smoothening of the progression, a lowering of the exemption limit accompanied by a reduction in the size of the exempt slice in respect of single assessees and increase in respect of married persons. We consider that changes in the general level of income taxation from time to time should be effected preferably by an adjustment of rates rather than of slabs.

Rates of tax on non-residents

26. A non-resident assessee has the option of being taxed at rates of income-tax and super-tax applicable to his world income *or* at the maximum rate of income-tax *plus* super-tax on total income applicable to the first slab of income liable to super-tax or the effective rate of super-tax applicable to the total income whichever be greater. We are aware that some reduction in the tax liability of non-residents incidentally results from the lowering of the rate of super-tax on the first slab in our illustrative schedules; we do not consider it necessary that any adjustment should be made in regard to this small benefit which will accrue to non-residents.

Partial exemption of savings and investment

27. With the generally higher level of taxation that we have recommended, specific protection for and incentive to savings becomes necessary. In regard to individual savings, the problem is to find forms of savings to which relief may be attached with the least possibility of abuse. A partial exemption of savings is a feature of almost all income-tax systems. Insurance and provident funds are two forms of long-term savings which have been found to be specially suitable for the purpose of extending relief to savings from high rates of personal taxation.

28. In India, the relief is given in the form of an abatement of income-tax. Abatement is admissible in respect of amounts paid to effect an insurance on the life of an assessee or his/her spouse and, when the assessee is a Hindu undivided family, to effect an insurance on the life of any male member of the family or his wife. So far as contributions to provident funds governed by the Provident Funds Act, 1925 (which include funds maintained for Government servants, railway servants and employees of certain public institutions such as local authorities and universities), are concerned, abatement is admissible on the periodical contributions by the employee himself. Contributions by the employer, if any, are not subjected to tax and are not taken into account for determining the rate of tax on the other income. Interest credited to the individual account of each subscriber is also similarly exempt from tax.

29. Contributions to provident funds maintained by private employers qualify for abatement only if the funds are recognised by the Commissioner of Income-tax under section 58B of the Income-tax Act. Certain conditions are laid down for recognition of a trust, the most important of which is that the fund should be vested in two or more trustees or in the Official Trustee under a trust which shall not be revocable save with the consent of all the beneficiaries.

in order to ensure that the interests of the employees are fully safeguarded. When a fund has been recognised, the contributions made in each year by the employer to the individual account for an employee and interest credited to that account are treated as part of the employee's total income for the year. Abatement of tax is admissible on contributions by the employer and the employee as well as on the interest. When the employee finally ceases to be a member of the fund and withdraws his accumulated balance, the receipt of this accumulated amount is not treated as taxable income.

30. If a provident fund maintained by a private employer has not received recognition from the Commissioner of Income-tax, no abatement of tax is admissible in respect of contributions made to the fund from year to year. When the accumulated balance becomes repayable to the employee on his final withdrawal from the fund the portion of it which is made up of the employer's contributions and interest thereon are treated as part of his total income in the year of withdrawal subject to relief being granted, by spreading the amount over three earlier years, by an order of the Central Government under section 60(2) of the Income-tax Act in each case.

31. The maximum amount of life insurance premia *plus* contributions to provident fund in respect of which abatement is admissible is limited to one-sixth of the total income, or Rs. 12,000 for a Hindu undivided family and Rs. 6,000 for any other assessee, whichever is lower. There is an additional restriction to the effect that the amount of premium on which abatement is admissible should not exceed one-tenth of the sum assured on each insurance policy. Abatement is also admissible on the interest on recognised provident funds, provided it does not exceed one-third of the year's salary and to the extent that it does not exceed a rate of six per cent. per annum. The abatement is given at the average (effective) rate of income-tax applicable to the employee; no abatement of super-tax is admissible.

32. Suggestions have been made to us for liberalising the scope of the abatement in relation to recognised provident funds and for increasing the maximum limits for abatements both in respect of life insurance premia and of contributions to provident funds. We have considered the various proposals put forward in relation to contributions to provident funds. We are impressed by the argument that the grant of abatement on both the employer's and employee's contributions exhausts most of the amount on which abatement can be allowed and leaves very little margin for insurance premia which can qualify for the concession. We accordingly recommend that contributions made by employers maintaining a recognised provident fund should not be treated as part of the total income of their employees; consequently, it will not be necessary to give abatements on these contributions but only on the contributions of the employees themselves. The interest credited to the individual account of each employee should also be completely excluded from consideration for the purposes of assessment.

33. Proposals have also been put forward for increasing the maximum amount on which abatement is admissible, either in relation to total income, or in absolute money terms, or both; a suggestion has also been made that separate maxima should be

fixed for insurance premia and provident fund contributions respectively. As we are convinced that this form of concession is one of the most appropriate means of promoting personal savings, we recommend that the maximum amount for abatement may be increased from one-sixth to one-fifth of the total income, subject to a maximum of Rs. 16,000 for Hindu undivided families and Rs. 8,000 for other assessees. The present limit of ten per cent. of the sum assured for the insurance premium on each policy should also continue. In view of our recommendation for excluding employers' contributions to provident fund from consideration, we do not think it necessary to prescribe separate maxima for insurance premia and provident fund contributions.

34. It must be recognised that restriction of relief to these two forms of savings, *viz.*, insurance and provident funds, gives a certain degree of stimulus to investment in government securities and other comparatively less risky forms of investment and correspondingly restricts the scope for risk-bearing equity investments. Theoretically, there is a case for including other forms of savings within the scope of relief; if all forms of savings could be included, we shall have found a way by which income-tax is converted into what in effect would become a pure spending tax. The problem would be to find forms of savings or to work out administrative procedures which prevent liability to abuse of any wider extension of the relief. Meanwhile, the relief has to remain confined to the two forms of savings which are at present eligible for it.

Surcharge-*cum*-compulsory deposit

35. The structure of rates of income-tax suggested above involves an appreciable increase, above a level, in the present burden of direct taxation (Finance Act, 1954). We are convinced that a higher measure of increase in direct income-taxation would not be a practical expedient and, therefore, is one which could not be recommended at this stage. There is, however, a widespread feeling that large disposable incomes in the higher income ranges allow conspicuous and wasteful consumption among the richer classes, which bears no relation to average living standards or to the resources available for consumption in the present situation. We are of the opinion that, besides what can be achieved at present through an increase in direct taxation, means should be found to bring about a reduction in the volume of disposable income in the hands of private individuals in the higher income brackets. To a certain extent this will be achieved by our recommendations in regard to increases in the rates of personal income taxation, and the restriction of concessions and reliefs so as to relate them directly to investment and savings Over and above this, we recommend the adoption of the following scheme of a surcharge-*cum*-compulsory deposit in respect of incomes of over Rs. 25,000. We may add that the scheme will have to be examined in greater detail in the Ministry of Finance with a view to ensuring the fulfilment of the objectives we have in view, *viz.*, reduction in the disposable incomes available for consumption purposes but without prejudice to the amounts available for savings and investment.

36. The two main features of this scheme are:

(i) the levy of a *special surcharge of tax* on all incomes over Rs. 25,000, at the rates indicated in the schedule given below, subject to the condition that the assessee will be entitled to have from Government a long-term loan, say for 45 years, at a nominal rate of interest, of an equivalent amount for being invested in any manner specifically approved by Government; and

(ii) in addition to the above, the collection from each assessee with an income of over Rs. 25,000 of a *compulsory deposit*, at rates indicated in the schedule given below, subject to the condition that it will be refunded to him only on the expiry of 20 years (with interest at a nominal rate), and even then, only in the form of Government bonds, which will be encashable only after the expiry of 25 years thereafter.

TABLE 3.—*Schedule of rates of the proposed scheme of special surcharge-*cum*-compulsory deposit*

Grade of income in rupees	Surcharge as percentage of income	Compulsory deposit as percentage of income	Total surcharge and compulsory deposit as percentage of income
25,001— 30,000	0·25	0·25	0·5
30,001— 40,000	0·50	0·50	1·0
40,001— 50,000	0·80	0·80	1·6
50,001— 60,000	1·20	1·20	2·4
60,001— 70,000	1·60	1·60	3·2
70,001— 80,000	2·30	2·30	4·6
80,001—1,00,000	2·80	2·80	5·6
1,00,001—1,20,000	3·40	3·40	6·8
1,20,001—1,50,000	3·90	3·90	7·8
1,50,001—2,00,000	4·40	4·40	8 8
2,00,001—2,50,000	5·00	5.00	10·0
2,50,001—5,00,000	5·50	5·50	11·0
Over 5,00,000	5·60	5·60	11·2

As regards the long-term loan mentioned at (i) above, we recommend that Government should consider the feasibility of including the following forms of investments in their 'approved' list:—

(a) investment in any purpose for which the Industrial Finance Corporation of the Centre, or of a State (by arrangement made between the Central Industrial Finance Corporation and the State Industrial Finance Corporation) would ordinarily (*i.e.*, even under the existing rules) grant a loan; and also in other purposes which would comprise the purchase by the assessee of plant and machinery either for a *new* enterprise or for the expansion of an existing business, of industrial and commercial buildings necessary for such business, and of patents and copyrights, etc., necessary for such business;

(b) investment in selected securities, or in approved debentures as well as shares of approved co-operative societies, corporations and companies.

In the case of each of the above investments a condition should be prescribed that the assets acquired by the utilisation of the loan [including the securities and debentures mentioned at (b)] should be pledged to either the Industrial Finance Corporation or to the Government, as the case may be, so that they are not capable of being converted into cash by the assessee before the loan is repaid. The Industrial Finance Corporation could act as the agent of the Government for the purpose for which, if necessary, the Industrial Finance Corporation Act and rules may be liberalised.

37. As regards the compulsory deposit mentioned at (ii) of para. 36 above, we would suggest that, in the event of the death of the depositor before the expiry of 20 years from the date of the recovery of the deposited amount, the entire amount standing at the credit of the depositor should be paid to the depositor's estate, upon which any estate duty that is due will be payable by the heirs. We would further suggest that the heirs of the depositor should be given the option to retain the deposit with Government, on exercising which the collection of any estate duty due on this portion of the depositor's estate should be postponed till the expiry of the full twenty-year period from the date on which the deposit was originally made.

Statement I.—*Rates of Income-tax and Super-tax in India*

Income-tax

(Rate per Rupee)

Grade of Income	1938-39*	Grade of Income	1939-40—1945-46	1946-47—1948-49	1949-50	1950-51—1954-55
(Step system)	(pies)					
2,000—4,999	6	On the first Rs. 1,500 of total income	Nil	Nil	Nil	Nil
5,000—9,999	9	On the next Rs. 3,500 „	9 pies	1 anna	9 pies	9 pies
10,000—14,999	12	On the next Rs. 5,000 „	15 pies	2 annas	1 an. 9 pies	1 an. 9 pies
15,000—19,999	16	On the next Rs. 5,000 „	24 pies	3½ annas	3½ annas	3 annas
20,000—29,999	19	On the balance of total income	30 pies	5 annas	5 annas	4 annas
30,000—39,999	23					
40,000—99,999	25					
1,00,000 and above	26					

Surcharge

(Rate per Rupee)

Grade of Income	1940-41	1941-42	1942-43	1943-44	1944-45	1945-46	1951-52—1954-55
On the first Rs. 1,500 of total income	Nil	Nil	Nil	Nil	Nil	Nil	Nil
On the next Rs. 3,500 of total income	1/12	1/3	6 pies	2/3	6 pies	6 pies	1/20
On the next Rs. 5,000 of total income	„	„	9 pies	„	10 pies	10 pies	„
On the next Rs. 5,000 of total income	„	„	14 pies	„	18 pies	18 pies	„
On the balance of total income	„	„	15 pies	„	24 pies	27 pies	„

*There was a surcharge of 1/12 in 1938-39.

Rates under "Lower Incomes" for the years 1942-43 *and* 1943-44 :

Where total income does not exceed Rs. 2,000, on the first Rs. 750 of total income: Nil; on the next Rs. 1,250 of total income : 6 pies in the rupee.

Minimum exempt limit :

1939-40 to 1941-42	No tax payable on total income which did not exceed	Rs. 2,000
1942-43 and 1943-44	Do.	Rs. 1,500
1944-45 to 1946-47	Do.	Rs. 2,000
1947-48	Do.	Rs. 2,500
1948-49 and 1949-50	Do.	Rs. 3,000
1950-51 and 1952-53	Do.	Rs. 3,600
1953-54 and 1954-55	Do.	Rs. 4,200

Earned income allowance was introduced in 1945-46 and has obtained since then.

Super-tax

(Rate per Rupee)

1938-39†	(pies)	1939-40 to 1945-46	(as.)	1946-47	Earned	Unearned	1947-48	Earned	Unearned
1. First Rs. 30,000	Nil	1. First Rs. 25,000	Nil	1. First Rs. 25,000	Nil	Nil	1. First Rs. 25,000	Nil	Nil
2. Every rupee of next 20,000	9	2. Next Rs. 10,000	1	2. Next Rs. 10,000	2 as.	3 as.	2. Next Rs. 5,000	2 as.	3 as.
3. Do. 50,000	15	3. " 20,000	2	3. " 10,000	3	4	3. " 5,000	2½	3½
4. Do. 50,000	21	4. " 70,000	3	4. " 15,000	4	5	4. " 10,000	3	4
5. Do. 50,000	27	5. " 75,000	4	5. " 20,000	5	6	5. " 10,000	4	5
6. Do. 50,000	33	6. " 1,50,000	5	6. " 30,000	6	7	6. " 10,000	5	6
7. Do. 50,000	39	7. " 1,50,000	6	7. " 40,000	7	8	7. " 10,000	6	7
8. Do. 50,000	45	8. On the balance	7	8. " 50,000	8	9	8. " 15,000	7	8
9. Do. 50,000	51			9. " 50,000	9	9½	9. " 15,000	8	9
10. Do. 50,000	57			10. " 1,00,000	9½	10	10. " 15,000	9	10
11. Do. 50,000	63			11. " 1,50,000	10	10½	11. " 30,000	10	10½
12. Do. 50,000	69			12. On the balance	10½	10½	12. On the balance	10½	10½
13. Every rupee of the remainder.	75								

†The rates were different for a Hindu undivided family, with exemption of Rs. 75,000.

STATEMENT I.—*Rates of Income-tax and Super-tax in India*—contd.

Super-tax—contd.

(Rate per Rupee)

	1948-49 Earned	1948-49 Unearned	1949-50 Earned	1949-50 Unearned	1950-51 to 1954-55	
1. First Rs. 25,000	Nil	Nil	Nil	Nil	1. First Rs. 25,000	Nil
2. Next Rs. 15,000	2 as.	3 as.	2 as.	3 as.	2. Next Rs. 15,000	3 as.
3. ,, Rs. 15,000	3	4½	3	4½	3. ,, Rs. 15,000	4
4. ,, Rs. 15,000	5	6	5	6	4. ,, Rs. 15,000	6
5. ,, Rs. 15,000	6	7	6	7	5. ,, Rs. 15,000	7
6. ,, Rs. 15,000	6½	8	6½	8	6. ,, Rs. 15,000	7½
7. ,, Rs. 50,000	7	9	7	9	7. ,, Rs. 50,000	8
8. ,, Rs. 1,00,000	9½	9½	8	9½	8. On the balance	8½
9. ,, Rs. 1,00,000	10	10	8½	10		
10. On the balance	10½	10½	9	10		

Surcharge	1940-41	1941-42	1942-43	1943-44	1944-45 to 1945-46	1951-52 to 1954-55
	(annas in rupee)					
First Rs. 25,000	Nil	Nil	Nil	Nil	Nil	Nil
Next Rs. 10,000	1/12	1/3	½	1	1	1/20
,, Rs. 20,000	1/12	1/3	1	1½	2	1/20
,, Rs. 70,000	1/12	1/3	1½	2	2½	1/20
,, Rs. 75,000	1/12	1/3	2	2½	3	1/20
,, Rs. 1,50,000	1/12	1/3	2½	3	3	1/20
,, Rs. 1,50,000	1/12	1/3	3	3	3	1/20
On the balance	1/12	1/3	3½	3½	3½	1/20

CHAPTER X

TAXATION OF CORPORATE INCOME—I

Introduction

Companies are subject to income-tax as well as super-tax; the super-tax on companies is known as corporation tax. The rates of income-tax as well as corporation tax are prescribed annually in the Indian Finance Acts. It has been a long-standing practice for the rate of income-tax for companies being equated to the maximum rate of income-tax that is prescribed for entities other than companies. Super-tax on companies is also levied at a flat rate. The present rate of income-tax on companies is four annas in the rupee, and that of super-tax is 4·75 annas in the rupee. A surcharge of five per cent. is levied on income-tax but not on super-tax. An important feature of the rate structure of companies is the rebates that are given to certain companies for specified purposes under conditions which are prescribed in the Finance Act from time to time. The present rebates are indicated below in the form of a table:

TABLE 1.—*Rebates of income-tax and super-tax admissible to companies*

Tax	Rate of rebate	Conditions under which given
Income-tax . .	One anna in the rupee on undistributed profits [*i.e.*, the amount by which the total income, as reduced by seven annas in the rupee and by exempt income (if any) exceeds the dividends declared]*	(a) If the company has made the prescribed arrangements for declaration and payment of its dividends within India, and has deducted super-tax at the source from dividends paid to non-residents, and (b) if an order under section 23A of the Income-tax Act has not been made in respect of the company.
Super-tax . .	(i) three annas in the rupee on the total income.	If the company— (a) satisfies condition (a) as shown against 'income-tax';† and (b) is a public company with total income not exceeding Rs. 25,000.
	(ii) Two annas in the rupee on the total income.	If the company satisfies condition (a), but not condition (b), against item (i) [*i.e.*, this rebate applies to public companies with total income exceeding Rs. 25,000 and to all private companies, if they satisfy condition (a)].

*If the dividends exceed the total income as reduced in the manner indicated, an additional tax will be levied on the excess at a rate equal to the difference between five annas and the amount of tax (if any) actually borne by such excess in prior years.

†For the purpose of this rebate, a public company means a company which is not a private company within the meaning of the Indian Companies Act, and in which shares carrying more than fifty per cent. of the voting rights were not held by less than six persons at any time in the year of account.

TABLE 1.—*Rebates of income-tax and super-tax admissible to companies*—contd.

Tax	Rate of rebate	Conditions under which given
	(iii) One anna six pies in the rupee on dividends from a subsidiary Indian company, and six pies in the rupee on the balance of total income.	If the company does not qualify for rebate under item (i) or (ii), but is a public company whose shares were offered for sale in a recognised stock exchange or a company all of whose shares were held by one or more of such public companies.

2. The distributed part of the income of a company (known as dividend) is added to the personal income of a shareholder and is charged at a rate appropriate to his total income, and the shareholder is given credit for the income-tax recovered from the company. The undistributed portion, *i.e.*, what is retained by the company, thus bears tax at the combined rate of income-tax and super-tax applicable to companies. No credit is given to the shareholders for the super-tax recovered from the company.

Nomenclature of corporation tax

3. Before proceeding further, we might refer to the nomenclature of super-tax in relation to companies. The term super-tax is not used in the Constitution. The two relevant entries in List I of the Seventh Schedule are "Taxes on income other than agricultural income" (Entry 82) and "Corporation tax" (Entry 85). Corporation tax is defined in Article 366(6) as follows:—

"'Corporation tax' means any tax on income, so far as that tax is payable by companies and is a tax in the case of which the following conditions are fulfilled:—

(a) that it is not chargeable in respect of agricultural income;

(b) that no deduction in respect of the tax paid by companies is, by any enactments which may apply to the tax, authorised to be made from dividends payable by the companies to individuals;

(c) that no provision exists for taking the tax so paid into account in computing for the purposes of Indian income-tax the total income of individuals receiving such dividends, or in computing the Indian income-tax payable by, or refundable to, such individuals."

4. The attributes of the corporation tax are the same as that of super-tax on companies which is defined in section 55 of the Income-tax Act as an "additional duty of income-tax". We suggest that the term 'super-tax' should be changed to 'corporation tax' and it should be appropriately defined in the Income-tax Act in the light of Article 366(6) of the Constitution referred to in order to avoid any possible misunderstanding as to the nature of 'super-tax' on companies.

5. The principal suggestion for modification of the present procedure of taxing companies is that the corporation tax should be abolished. The grounds for this suggestion are that the denial of credit of corporation tax in the assessment of the shareholder constitutes double taxation of the same income, *viz.*, once in the hands of the company and again in the hands of its shareholders. It is also stated that such a levy differentiates adversely against one type of business organisation, *viz.*, the company, as against other forms of economic activity such as partnerships and individual enterprises. These arguments are based on the assumption that a company is not a separate entity in any real sense; that it is only an agent of its shareholders; that it has, therefore, no income of its own, and that what is called its income is really the income of its shareholders. It is, therefore, argued that no taxes should be levied on the company; its income should be included proportionately in the assessment of the shareholders and charged at rates appropriate to their personal income. if this is not considered feasible from an administrative point of view, the further suggestion is that the shareholders should be given credit for the tax paid by the company which should be regarded as in the nature of deduction at the source.

Suggestions for modification of procedure regarding taxation of companies

6. Both in India and in the United Kingdom the courts have held that the tax paid by a company is paid by it as a separate entity, and not as an agent of its shareholders. If, nevertheless, the income-tax laws of these countries contain a provision giving credit to the shareholder for the income-tax paid by the company it is done purely on practical considerations rather than on a legally deductible principle. This is brought out clearly in the following extract from the judgment of the British House of Lords in Blott's case*: "Plainly, a company paying income-tax on its profits does not pay as agent for its shareholders. It pays as a tax-payer, and if no dividend is declared the shareholders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate amount of the tax previously paid by the company; and in that case the payment by the company operates in relief of the shareholder. But no agency, properly so called, is involved." This principle has been accepted by courts in India also. In a recent case†, the Bombay High Court observed: "Not only are a company and a shareholder separate and independent entities under the general law, but even under the Indian Income-tax Act a company is a separate entity for the purpose of assessment from a shareholder. A company pays income-tax on its income or its profits. It does not pay income-tax on behalf of the shareholders...... The law provides that a shareholder is entitled to refund if tax has been paid by the company on the income which is represented by the dividends received by him. But it is merely as a legal fiction that it is recognised that the tax has been paid by the company on behalf of the shareholder and therefore the shareholder is entitled to a refund. In fact and in law income-tax is paid by the company as a company on its own income and the shareholder also in fact and in law has to pay tax on his own income...................."

*Inland Revenue *vs.* Blott, 8 Tax Cas. 101.

†Mrs. Guzdar *vs.* C.I.T. Bombay [1952 (22) I.T.R. 158].

7. In general law, the company can sue and be sued in its own name and, though its membership may vary from time to time, it has a separate juristic personality "in like manner", to quote Blackstone "as the river Thames is still the same river, though the parts which compose it are changing every instant." A company holds properties in its own name, and the shareholders enjoy the advantage of limited liability in respect of its debts. They have no legal claim to any portion of the corporation's profits except when these are actually distributed to them in the form of dividends or in the event of liquidation. The distinction between the shareholder on the one hand and the company in which he holds shares on the other is clearly established also by reason of the fact that a company and a shareholder may enter into almost any form of contract with each other, and there is nothing to prevent a shareholder from holding shares in different companies engaged in competing business.

It is clear, therefore, that the company is distinct and separate from its shareholders and has, in law, the undeniable character of a special entity.

8. Apart from the legal aspect set forth above, it is worth noting that a company is also a separate economic entity. The shareholder exercises only a remote control over the earning of its income. Ordinarily, in a public company, the control virtually vests in a minority of shareholders as represented by the directors. The power of disposal of productive capital, in practice, is exercised by those who have contributed only a part of it. In other words, shareholders form an organisation in the direction of which most of them have no effective voice. The identity between ownership and control is, of course, closer in private companies, but in public companies, the shareholder is only an inactive participant, except to the extent that the law provides by way of safeguards. He, therefore, resembles less an enterpreneur and more a lender of money.

9. The distinctive character of a company as an economic entity is also brought out by the special advantages which it enjoys as compared to a partnership or a proprietary concern. The liability of a shareholder in a company is limited, while, in a partnership, every partner is fully liable for the debts incurred by the concern. Besides, the business acts of one or more partners may render the other partners financially liable, and they may have to meet the liability out of their own resources. Another advantage that a corporation has over proprietary concerns is in regard to the raising of capital, which is a result of the confidence generated among investors by the corporate form of organisation, and also because of the various forms (debentures and different types of share) in which investments can be held, whereas the capital funds of a partnership are limited to what the partners can put in from their own savings, or raise by borrowing on their own credit. A corporation has also perpetual succession, and changes in the membership do not affect the continuity of its operations. By contrast, a partnership has no legal existence apart from its partners; the death, withdrawal, bankruptcy or legal disability of one partner ordinarily automatically terminates a partnership, and may even lead to the liquidation of its business. Finally, a company has the right to decide how much of its profits it need distribute to shareholders, and when. It is only on distribution in the form of

dividend that the shareholders have to pay tax. The partners of a firm, on the other hand, pay tax concurrently on their entire share in the profits of the business, whether distributed or not. There are thus substantial economic advantages arising solely from the corporate form of business activity, which distinguish it from other forms of business organisation and could, therefore, be held to justify the payment by it of a special tax such as the corporation tax.

10. While we hold that a company is a separate legal and economic entity and that, therefore, the corporation tax is only of the nature of an additional income-tax on companies, the fact remains, nevertheless, that the law accords a different treatment to corporate income in the hands of the shareholder in respect of the income-tax and the corporation tax; and it is this apparent anomaly that lies at the root of the demand for the treatment of corporation tax in the same manner as income-tax for purposes of refund. Strictly speaking, there is not only no case for the refund of the corporation tax, but there is justification for scrapping the existing system of refunds of income-tax as well. We do not, however, think we should be justified in carrying the argument to its strictly logical conclusion and recommending the discontinuance of the refunds of income-tax. Our reasons for doing so are mainly based on considerations of practical policy in regard to the promotion of equity investment in corporate undertakings. The dividend income accruing to shareholders would undergo a considerable reduction as compared to their present levels—if the credit for income-tax at present allowed is withdrawn. This can be seen from the fact that during the three financial years comprised in the period 1950—53, the total amount credited to shareholders on account of income-tax paid by companies amounted, on an average, to Rs. 11,60 lakhs a year. Details are available for the latest year 1953-54, from which it is seen that of the refunds totalling Rs. 14,60 lakhs during that year, Rs. 6,19 lakhs accrued to companies, holding investment in other companies, while Rs. 8,41 lakhs accrued directly to individual shareholders. Among the latter are 48,277 shareholders with incomes below Rs. 25,000 a year but above the exemption limit, in addition to a large number of shareholders (separate figures are not available) with incomes below the exemption limit. Details are given below:—

TABLE 2.—*Distribution of dividends to shareholders by grades of income*

Grade of total income	Number of assessees who had income from dividends	Refund granted on dividends (In lakhs of Rupees)
(A) *Companies*		
Below Rs. 25,000	554	8
Over Rs. 25,000	1,061	5,94
Unclassified	316	17
TOTAL	1,931	6,19

TABLE 2.—*Distribution of dividends to shareholders by grades of income*—contd.

Grade of total income	Number of assessees who had income from dividends	Refund granted on dividends (In lakhs of Rupees)
(B) *Other than companies.*		
Below Rs. 5,000	10,506	26
Rs. 5,001—Rs. 10,000	19,011	62
Rs. 10,001—Rs. 25,000	18,760	1,31
Rs. 25,001—Rs. 40,000	5,801	85
Rs. 40,001—Rs. 1,00,000	5,189	1,76
Rs. 1,00,001—Rs. 2,00,000	1,119	1,01
Rs. 2,00,001 and over	538	1,55
Unclassified	52,326	1,05
TOTAL	1,13,250	8,41

NOTE.—The figures shown against 'Unclassified' represent dividend incomes of (i) persons who get a net refund (ii) assessees who are totally exempt from levy of tax and (iii) assessees who have incurred a loss and hence are not liable to tax.

11. Moreover, both the shareholder and the market have become accustomed to these refunds, and take this factor into account in deciding on their choice of the form of investment. If these refunds are now stopped it would not only adversely affect the interests of a large number of persons, including many in the low-income groups, but may also act as a disincentive to the holding or purchasing of equity investment in general.

12. In the circumstances, we feel justified in recommending the continuance of the practice of giving credit to shareholders in respect of the income-tax paid by their companies.

13. We now come to the problems connected with the method of calculating refunds.

Abatement of income-tax to shareholders

The dividends which a company distributes after paying income-tax and corporation tax on its taxable profits constitute *net* receipts in the assessment of the shareholder. But as under the law the shareholder is deemed to have paid the income-tax his *gross* receipt is the actual amount of the dividend *plus* the income-tax that he is deemed to have paid on it. The dividend is therefore 'grossed' so as to add to it the income-tax which he is 'deemed' to have paid through the company. Thus, if a shareholder gets a dividend of Rs. 270 and the company rate of income-tax is four annas, it is 'grossed' to $\frac{270}{1-\frac{4}{16}}$ or Rs. 360, which is treated as the gross income of the shareholder, and a credit of Rs. 90 (360—270) is given to him in his assessment pursuant to the provision in the law under which the income-tax paid by the company is 'deemed' to have been paid by the shareholder himself. Thus, a shareholder whose total income is below the taxable limit and who is 'deemed' to have himself paid the entire tax paid by the company, gets refund of the whole of this tax as the tax due on the dividend at the rate appropriate to the total income of the individual is *nil*.

14. If the company has income from both taxable and non-taxable sources, the dividend is deemed to have come proportionately out of the two sources and the grossing formula is suitably altered. Thus, if 40 per cent. of a company's income from all sources is liable to income-tax, which is paid at the rate of four annas in the rupee, and 60 per cent. consists either of income not subject to income-tax or of tax-free income like interest on tax-free securities, a dividend of Rs. 270 will be 'grossed' as shown below:—

$$\frac{270}{1-\left\{\frac{40}{100}\times\frac{4}{16}\right\}} \text{ or Rs. 300.}$$

Out of the gross amount of Rs. 300, which is included in the assessment of the shareholder, 60 per cent. (*i.e.*, Rs. 180) is treated as having come out of untaxed income, and 40 per cent. (*i.e.*, Rs. 120) is treated as having come out of taxed income and to have borne an income-tax of Rs. $(120 \times \frac{4}{16})$ or Rs. 30. The shareholder is given credit for this amount, which it will be noticed is the difference between the gross (Rs. 300) and net (Rs. 270) dividends.

15. One of the main difficulties in connection with the calculation of refunds arises from the fact that as some companies may have income exempt from tax, such as interest on tax-free securities and agricultural income, the grossing of the dividend has to be done [*vide* section 16(2) of the Income-tax Act] with reference to such portion of the dividend as the amount of the profits and gains of the company liable to income-tax bears to the company's total income. This involves complicated and elaborate calculations which call for a high degree of clerical accuracy and also efficient supervision and test checks.

16. A second difficulty is that until the company's assessment is completed, the percentage of its taxed income to its total income is not known, and as without this information it is not possible to gross the dividend received by the shareholder his assessment also gets held up. Apart from the inconvenience caused to the shareholders by the delay involved in their obtaining refunds, there is also the revenue aspect of the delay inasmuch as the collection of super-tax due from the bigger shareholders is held up.

17. Some anomalies also arise from the fact that a company may have paid no tax, or a small amount of tax, in a particular year because of heavy adjustments on account of accelerated depreciation. These adjustments reduce taxable income, but, since they are not simultaneously carried out in the accounts, they do not affect the book profits. The funds thus made available to a company are distributed as dividends. Under the present law the shareholders are not entitled to any credit if the tax paid by the company is *nil*, but are entitled to a full credit for income-tax on

dividends distributed if some tax is paid, whatever its amount, and irrespective of the fact that the total credit given may exceed the total tax recovered.

Suggestion regarding alternative procedure for taxing companies and their shareholders

18. In order to get over the administrative and other difficulties mentioned above, we would suggest the adoption of the method described below. The essential feature of this method is that, when a company declares dividends, it will deduct income-tax at the maximum rate from the gross dividends, distribute the net amount to the shareholders and pay the tax to the credit of Government. Adjustments are then made in the course of the company's income-tax assessment, so that the total amount which it has to pay out by way of taxes and dividends is the same as under the present law.

19. No change will be involved in the method of calculating the corporation tax payable by the company. The income-tax payable will be calculated on its total income as reduced by the gross dividends (on which it has already deducted and paid income-tax).

20. It may happen that part of the income of certain companies, as, *e.g.*, those working tea and other plantations, is derived from sources which are outside the scope of the Income-tax Act, *e.g.*, agricultural income. It is also possible, in a few instances, that the company has some income from sources exempt from income-tax alone such as interest on tax-free securities. Such a company will also, under the proposed scheme, deduct full tax at the maximum rate while distributing dividends, and pay the tax deducted to the credit of Government. When the company's assessment is made, income-tax will be demanded on its income from taxable sources as reduced by the portion of the gross dividends attributable to its taxable income. For this purpose, the gross dividends will be allocated proportionately to taxable and non-taxable sources of income.

21. In certain circumstances the gross dividends may exceed the total income of the year. This may happen because the company draws upon accumulated undistributed profits of prior years which have already suffered tax, or the excess dividends may come out of capital receipts or may be due to the book profits being higher than the assessable profits on account of accelerated depreciation not being adjusted in the company's accounts. Where taxed profits of earlier years are available an adjustment will be made in the company's assessment by deducting the income-tax on such profits from the total demand on the company; this will ensure that the same profits are not taxed twice. For deciding the amounts of prior years' profits available, the excess of gross dividends over total income will, in the first place, be attributed to the undistributed profits of the immediately preceding year which have been carried forward unappropriated; and the balance (if any) to the year preceding that year; and so on.

22. If the excess dividends come out of the other sources indicated, this procedure safeguards the revenue against the grant of credit to the shareholders for tax which was never paid by the company.

23. A few examples showing the practical working of this proposal are given below:—

Example A.—A company with 100 per cent. taxable income has a total income of Rs. 1,00,000 and pays dividends of Rs. 30.000 (gross).

			Rs.
It will pay corporation tax at three annas (say) on Rs. 1,00,000 or . . .			18,750
Total income	Rs.	1,00,000	
Less—gross dividends . . .	Rs.	30,000	
	Rs.	70,000	
Income-tax at (say) four annas on Rs. 70,000			17,500
On the dividends, the company will withhold tax at the rate of four annas on Rs. 30,000, *i.e.*			7,500
Thus the company pays in all			43,750
and the shareholders get credit for			7,500

Example B.—A company has income of Rs. 1,00,000 made up of agricultural income of Rs. 25,000, interest on tax-free securities of Rs. 15,000 and business income of Rs. 60,000. It distributes dividends of Rs. 30,000.

The dividends will be allocated as follows:—

Head of income	Income of the company	Part paid as dividend	Balance	Taxable portion
	Rs.	Rs.	Rs.	Rs.
Agricultural income	25,000	7,500	17,500	..
Interest on tax-free securities	15,000	4,500	10,500	..
Business income	60,000	18,000	42,000	42,000
—	1,00,000	30,000	70,000	42,000

	Rs.
The company will therefore pay—	
Corporation tax at three annas on Rs. 75,000 (Rs. 1,00,000 minus agricultural income of Rs. 25,000)	14,063
Income-tax at four annas on Rs. 42,000	10,500
and withhold tax at four annas on the *entire* dividends of Rs. 30,000 .	7,500
Out of this, shareholders get credit for	7,500

In both examples A and B, the total amounts payable by the company, and receivable by the shareholders, are the same as under the present system as will be seen from the following figures:—

Example A

	Rs.
Present system:—	
Company will pay corporation tax at three annas on Rs. 1,00,000 or . .	18,750
and income-tax at four annas on Rs. 1,00,000 or	25,000
making a total of	43,750

The company will pay to the shareholder only Rs. 22,500 and Government will add a sum of Rs. 7,500 (*out of Rs. 43,750 already paid by the company*) making a total of Rs. 30,000. The total amounts paid by the company and received by the shareholder are the same as shown below:—

Example B

	Rs.
Under the present system, the company will pay—	
corporation tax at three annas on Rs. 75,000 or	14,063
and income-tax at four annas on Rs. 60,000 or	15,000
making a total of	29,063

The total amounts received and paid under Example B above by the various parties to the transactions will be as follows:—

		Under present scheme	Under proposed scheme
		Rs.	Rs.
Company pays	Tax to Government (including withholding tax)	29,063	32,063
	Net dividend to shareholder	25,500*	22,500
	TOTAL PAYMENT . .	54,563	54,563
Government collects	Tax from company	29,063*	32,063
	less Credit to shareholder	4,500	7,500
	NET RECEIPT	24,563	24,563
Shareholder receives	Net dividend from company	25,500*	22,500
	Credit from Government	4,500*	7,500
	TOTAL	30,000	30,000

*As 60 per cent. of the company's income is taxed, the net dividend of Rs. 25,500 will be grossed to $\frac{25,500}{1 - \frac{60}{100} \times \frac{4}{16}}$ or Rs. 30,000. The shareholder gets credit for the difference of Rs. 4,500.

24. The adoption of the above method will simplify calculations as no grossing will require to be done. It will not disturb the present liability of the company and the shareholder which will continue to be exactly the same as under the old method. The revenues of the Government will also not be affected. It will, however, involve some changes in the manner of preparing dividend warrants, as, in future, it will have to be made obligatory for the companies to show the amounts of gross and net dividends separately in the dividend warrant.

25. Another advantage of the above method is that it can be easily adapted for avoiding delay in refunds to the small shareholders by introducing the system of exemption certificates on the lines of the proviso to section 18(3) of the Income-tax Act for interest on securities. This section provides for the issue of a certificate by the Income-tax Officer, on application by the assessee, authorising the person responsible for paying the interest to refrain from deducting tax (in cases where the assessee's income is below the taxable limit) or to deduct tax at a specified rate lower than the maximum. Our suggestion is that in respect of dividends also provision should be made for the issue of similar certificates. The company should be required, as soon as dividends are distributed, to send to the income-tax authorities a list in a prescribed form of shareholders to whom dividends have been paid without deduction of tax or after deduction at a rate lower than the maximum.

Taxation of distributed income of a company

26. Having dealt with the procedure of taxing corporations, we now proceed to consider certain important aspects of the taxation of dividends in the assessment of individual shareholders. The first question to be considered is, what constitutes a dividend.

Definition of 'dividend'

27. Before 1939, there was no definition in the Income-tax Act of the word 'dividend'. It was interpreted according to the commonly understood import of the word as modified by judicial pronouncements. It was settled by these judical decisions that bonus shares, bonus debentures, and distributions made on liquidation were in the nature of capital receipts in the hands of the shareholders. The Income-tax Enquiry Committee, 1936, which examined the question of including a definition of 'dividend' in the Income-tax Act, was of the view that the above forms of distribution were very often being utilised for purposes of tax avoidance both by private limited companies and by a certain section of public limited companies. It, accordingly, recommended the adoption of the definition of 'dividend' contained in the Dividends Duties Act, 1902, of Western Australia, which read as follows and which was held by the Privy Council to permit the taxation of bonus issues:—

> "A dividend shall include every dividend, profit, advantage or gain intended to be paid, or credited to or distributed among any members or directors of any company except the salary or other ordinary remuneration of directors".

The recommendation was accepted by Government of India and a definition on these lines was included in the Income-tax (Amendment) Bill, 1938. It, however, underwent important changes in the Select Committee and the Legislature, and finally emerged practically in the same form in which it is now included in section 2(6A) of the Indian Income-tax Act. The basic features of the modified definition was to extend the common law meaning of 'dividend' by enumerating some of the specific forms, which were declared by the courts, to be in the nature of capital receipts, as taxable distribution. The principle underlying the changes was that only distribution which involved the release of the assets of the company should be made taxable. The formula was expressly adopted to exclude the taxation of bonus shares until, as the Select Committee stated, "they were actually paid".

28. It has been suggested that the exclusion of bonus shares from the definition of 'dividend' is not justified and that bonus shares should be made subject to personal super-tax in the hands of individual shareholders. Vigorous opposition to this suggestion has also been voiced before us on the ground that a bonus share is not of the nature of taxable income at all. Some other suggestions have also been made for either enlarging or curtailing the scope of the present definition. As we shall be frequently referring to different clauses of the definition during our discussion of these suggestions, we have thought it fit to reproduce below the definition as it stands in the law at present:

"Section 2(6A) "dividend" includes—

(a) any distribution by a company of accumulated profits whether capitalised or not, if such distribution entails the release by the company to its shareholdrers of all or any part of the assets of the company;

(b) any distribution by a company of debentures or debenture-stock, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation of the company;

Provided that only the accumulated profits so distributed which arose during the six previous years of the company preceding the date of liquidation shall be so included; and

(d) any distribution by a company on the reduction of its capital to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April 1933, whether such accumulated profits have been capitalised or not;

Provided that 'dividend' does not include a distribution in respect of any share issued for full cash consideration which is not entitled in the event of liquidation to participate in the surplus assets, when such distribution is made in accordance with sub-clause (c) or (d);

Provided further that the expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April 1946 or after the 31st day of March 1948".

29. There are two distinct and diametrically opposed points of view on the subject of taxation of bonus shares. Those who argue in favour of the inclusion of bonus shares in the definition of dividend claim that:

Taxation of Bonus shares

(1) Bonus shares are but a way of distributing profits with a view to avoiding personal super-tax thereon.

(2) Bonus shares bring about a capitalisation of undistributed profits in the companies where the profits originate and thus lead to a linear development of corporate enterprise and greater concentration of economic power, incidentally also depriving the capital market of 'secondary' funds which would otherwise have flowed into more widely dispersed investments.

(3) Bonus shares enable companies to appropriate to their own use undistributed profits that otherwise may have led either to an increase in the share of labour or a reduction in prices for the consumer.

(4) The benefits of tax exemption attaching to bonus shares accrue to shareholders who pay super-tax, while the loss to the exchequer is substantial (Bonus shares issued during the years 1947—52 totalled a little less than Rs. 77 crores).

(5) Bonus shares result in a distinct gain to the shareholders of the companies which issue them in that

(a) a bonus share is a marketable commodity of ascertainable value conferring valuable rights on the holder thereof;

(b) a bonus issue gives the shareholders an element of individual proprietorship in the assets of the company and makes their interests in the reserves of the company transferable and heritable;

(c) as the bonus issue results in the permanent retention of the accumulated profits of the company, its earning capacity is likely to increase. This will result in larger dividends and better share values in future;

(d) as the bonus issue results in increasing the paid-up capital of the company, it enables the company so to exhibit its rate of dividend as to present an apparent picture of low dividend rates.

30. In opposition to these arguments and in favour of the present practice of excluding bonus shares from the definition of 'dividend' are the following arguments:

(1) It is not correct to attribute motives of tax avoidance to the issue of bonus shares; on the contrary, bonus shares are used as a device by the management of companies to promote capital formation, which is so important in the context of a developing economy.

(2) It is true that bonus shares increase the capital strength of existing companies; but existing companies cover most of the important sectors of business enterprise; and as it is open to companies to undertake activity in industrial fields other than their original activity (and many of them do so in practice), there is no damage done to the even and diversified development of the economy.

(3) In the absence of bonus issues, there is no guarantee that the undistributed profits would lead to an increase in the share of labour or a reduction in prices for the consumer; on the contrary, the likely result would be a larger distribution of profits and the consequent dissipation of capital.

(4) The benefits of bonus shares are not restricted to the small class of shareholders who are subject to super-tax; on the contrary, by increasing the capital strength of the companies concerned, their earning power is increased with consequent benefits both to the small shareholder and to the exchequer.

(5) The undistributed profits of a company are a part of its capital and get reflected in the price of the shares constituting its original capital. All that is done by the issue of bonus shares is to increase the number of scrips that constitute its paid-up capital including that part of its undistributed profit that is now capitalised. Legally, therefore, no change has taken place, what was originally represented by X is now being represented by X *plus* the bonus issue. There is, therefore, no special and immediate gain to the shareholder by the issue of bonus shares.

31. We have come to the conclusion that bonus shares are not income in any sense of the word as understood in income-tax. Judicial decisions both in U.S.A. and U.K. clearly support this view. In a leading case* on the subject, the Supreme Court of the United States of America held, that bonus shares are not taxable as income. The main reasons given by the Court, with which we are in agreement, were:—

"Here we have the essential matter; *not* a gain accruing to capital, *not* a *growth* or increment of value in the investment; but a gain, a profit, something of exchangeable value *proceeding* from the property *severed* from the capital however invested or employed, and *coming in* being derived, that is *received,* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers that description. Yet, without selling (the bonus shares) the shareholder, unless possessed of other resources has not the wherewithal to pay an income-tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend (bonus shares) is to tax a capital increase, and not income, than this demonstration that in

*Eisner *vs.* Macomber (1920) 252 U.S. 189.

the nature of things it requires conversion in order to pay the tax." (Italics by us.)

32. Similarly, in U.K., it was held by the House of Lords that, as the profits were distributed by the company as capital, they were not income in the hands of the assessee. The following remarks* of Lord Cave are relevant in this connection:

"The transaction took nothing out of the company's coffers, and put nothing into the shareholders' pockets; and the only result was that the company................came thenceforth under an obligation to retain it permanently as capital. It is true that the shareholder could sell his bonus shares, but in that case he would be realising a capital asset producing income, and the proceeds would not be income in his hands. It appears to me that, if the substance and not the form of the transaction is looked to, the declaration of a bonus was, as Mr. Justice Rowlatt said, 'bare machinery' for capitalising profits, and there was no distribution of profits to the shareholders."

33. One of the arguments that is frequently employed is that the exemption of bonus issues from taxation results in loss of revenue to Government. The loss of revenue is said to arise in this way. The face value of a bonus share, if the shares were taxable, would be treated as a dividend. It will be included in the assessment of the shareholder who will be given credit for income-tax paid by the company. The face value of bonus shares will thus entail a net liability on account of super-tax where the income of the shareholder is in the super-tax brackets. We think that the 'loss of super-tax' argument is based on a misunderstanding of the method followed for taxing companies. The loss of revenue from personal super-tax consequent on non-taxation of bonus issues is a part of the larger problem of the treatment of undistributed profits. In so far as bonus issues do not result in the distribution of retained earnings in the form of money or money's worth, they are available to the company for use for the purposes for which they were allowed to be retained after payment of a flat rate of tax unrelated to the personal rate of tax of the shareholder. If retained profits are drained away in the form of money or money's worth, the company cannot make use of them for its own development, and the purpose of foregoing personal super-tax in order to allow them to be built up is defeated. The tax system seeks to provide against the latter contingency. In so far as such distribution can be used for tax avoidance, a situation of this character is more likely to arise in respect of the private limited companies or closely held public limited companies than in public limited companies with widely dispersed shareholding. The former are already subject to special compulsion in regard to distribution of profits and we recommend further action in this regard in the next chapter. We have also made recommendations in regard to the non-admissibility of bonus shares in the calculation of the maximum permissible reserves for the section 23A companies. In the circumstances, we are satisfied that there is not sufficient validity in the argument that non-taxation of bonus issues as income in the hands of shareholders leads to loss of public

*Inland Revenue *vs.* Blott, 8 Tax Case. 101.

revenues. We may also add that we recommend later in this chapter that loopholes for effecting an actual distribution of retained earnings without, however, doing so formally thereby attracting the personal super-tax, *e.g.*, by loans and advances, deposit or bearer certificates, and liquidation at the end of six years followed by distribution of profits, should be closed by an appropriate amplification of the definition of dividends.

34. We think that the privilege of issuing bonus shares free of tax in the hands of the shareholder does confer some advantage both on the shareholder and on the company, and there may be a case for a small duty payable by the company on the issue of bonus shares. There was until recently a stamp duty on bonus issues in U.K. but it has now been given up. We are not in favour of levying any such duty here, especially because of the need for encouraging the retention of earnings within the company. We would, however, suggest that Government should exercise control over the issue of bonus shares in such a way as to ensure that there is no over-capitalisation of the company and that any other misuse of the facility is prevented.

35. Our discussion of the issue of bonus shares so far has had reference only to public companies. There are, however, private companies and also public companies where the shareholding is such as to suggest that the public as such are not substantially interested in these companies. These are comprehensively known as section 23A companies and we shall deal in some detail in the next chapter with various problems relating to the taxation of their incomes. In this chapter, however, it is relevant to point out that, by issuing bonus shares. there is a possibility of such companies manipulating the ratio between their reserves and paid-up capital including the loan capital of their shareholders in such a way as to escape the compulsory distribution of 100 per cent. of their profits in the circumstances prescribed in the proviso to sub-section (1) of section 23A of the Indian Income-tax Act. In our view, this is a question that is not so much one of regulating the issue of bonus shares as the larger one of both the logic and the implementation of the provisions of section 23A. That, as stated above, is a question which is dealt with by us separately in the next chapter.

Other suggestions for the modification of definition of 'dividend'

36. The other suggestions received by us for the modification of the definition of the term 'dividend' may now be discussed.

We have already drawn attention to the suggestion that the following items should be included in the definition:—

(i) loans and advances to directors and shareholders of companies in which the public are not substantially interested; and

(ii) distributions in the form of deposit certificates or bearer certificates.

Both suggestions are intended to close loopholes for drawing upon retained profits of the company without attracting super-tax liability in the assessment of the shareholders.

37. The former is confined to companies in which the public are not substantially interested within the meaning of section 23A of the Income-tax Act. The affairs of such companies are generally under the control of the principal shareholders who are in a position to utilise the funds of the company under the guise of loans without attracting super-tax liability. The Australian and Canadian laws contain special provisions for the treatment of such loans as income of the shareholder in suitable cases. It is clear that the grant of such loans is capable of being used as a device to evade the objective of profit retention by the company. We recommend, therefore, that the law should be amended so as to empower the income-tax authorities to treat loans and advances to directors and shareholders of such companies as dividends, where they are satisfied that they are made out of the accumulated profits of the company. It will also be necessary to secure that, when such loans and advances are set off against dividends subsequently declared, they are not taxed as dividends a second time. We suggest that the law on the subject be modelled on the lines of a similar provision inculded in clause 2(c) (iii) of the Income-tax (Amendment) Bill, 1951.

Loans and advances made by a company to directors, etc.

38. As regards the second suggestion, it is clear that deposit certificates when issued to shareholders represent acknowledgment for debts owed by the company issuing the certificates. The amounts are repayable after a stipulated period to the holders of the certificates, involving the payment of the retained profits to the shareholders. We, therefore, recommend that the amounts distributed in this form should be made taxable.

Deposit certificates

39. Some witnesses have argued that clause (b) of section 2(6A) of the Income-tax Act, relating to the taxation of bonus debentures as dividend, should be deleted, as there is hardly any distinction between them and bonus shares which are exempt from taxation. We are not convinced that there is any similarity between bonus shares and bonus debentures. In the latter case, there is a definite commitment at the time of issue to part with a portion of the assets of the company at a specified future date. The release of assets is thus implicit in the issue of the bonus debentures. We, therefore, see no justification for excluding them from the definition of 'dividend'.

Bonus debentures

40. Under clause (c) of section 2(6A) of the Income-tax Act amounts distributed out of the accumulated profits of a company on its liquidation are taxable, provided such profits arise within six years of the date of liquidation. It has been argued by some witnesses that the reference to a time-limit in this clause should be omitted so that all such distribution should become taxable. On the other hand, there is a demand for exempting such distribution from tax altogether, and, therefore, the complete abrogation of this clause. A suggestion that stands midway is for reducing the present period of six years to two years. The effect of this will be that the tax liability will attach to distribution out of the accumulated profits of the two years prior to liquidation instead of those of six years as at present.

Distribution on liquidation

41. The purpose of retained earnings is to assist a going concern to expand and develop. A company in liquidation is not capable of fulfilling this object and we are of the opinion that such distributions should be taxed irrespective of the period to which they relate. We have already discussed the rationale of this recommendation in paragraph 33 above in connection with the treatment of bonus shares.

Distributions made out of exempt income

42. The taxation of dividends paid out of agricultural income of a company, which is exempt from income-tax, is a question that has been raised by some witnesses. Before 1948, the departmental practice was to apportion such dividends in the ratio of the company's agricultural income and non-agricultural income, and to treat the former part as exempt from income-tax. Since 1948, however, this part is also being treated as income of the shareholder. This view has been upheld by the Bombay High Court in the case of Mrs. Bacha F. Guzdar *vs.* C.I.T. (22 I.T.R. 158), and an appeal has been lodged before the Supreme Court against this decision.

43. As the taxation of agricultural income is within the competence of State Legislature, no abatement was given when distributions out of such income were originally brought to charge in the assessment of the shareholders under the Indian Income-tax Act. This was a source of hardship which has since been rectified by amending section 49B of the Income-tax Act. The amendment provides for an abatement of tax to the shareholder equivalent to that calculated on the basis of the effective rate applicable to his personal income or an appropriate portion of agricultural income-tax paid by the company, as defined in the law, itself, whichever is lower.

44. As regards the principle underlying the taxation of such dividends, we consider that the fact that the dividend is paid out of exempt income has no bearing on the liability it should attract to income-tax in the assessment of the shareholder who is taxed independently on the basis of his ability to pay. Moreover the company and the shareholders, as we have already pointed out, are distinct and separate entities for the purposes of taxation.

45. Taking all these factors into consideration, we recommend that the second proviso to section 2(6A) of the Income-tax Act should be recast to make it clear that dividends should be fully taxable in the assessment of the shareholder irrespective of the nature of the profit fund of the company.

Inter-corporate dividends

46. Dividends received by companies are, except in certain special cases, taxed in the same manner as dividends received by persons other than companies, *i.e.*, the 'grossed' dividend is included in the total income of the recipient company and simultaneously credit is given for income-tax deemed to have been paid by it. The grossed 'dividend' thus attracts liability only for corporation tax in the assessment of the recipient company. It has been represented to us that inter-company investments are made either for the promotion of subsidiaries or by institutional investors who have surplus funds. As the purpose of both is to assist in capital formation of a type that is essential in the present state of the capital market,

encouragement should be given to them by exempting inter-corporate dividends from corporation tax also. It has been represented that subsidiaries serve a useful purpose in the organisation of productive enterprises and that in some cases, for reasons of business expediency, investments have to be made in a chain in a number of companies. Before the return on the investment reaches the parent company, it pays corporation tax at each successive stage. This is claimed to be a heavy burden on an essential investment activity without which capital formation will be considerably impeded.

47. While we recognise the utility of subsidiaries as well as of investments by institutional investors in providing equity capital under present conditions, we are not convinced of the soundness of many of the above arguments. We see no reason why investments by companies and by individuals should be treated differentially in the matter of taxation unless some public purpose is served. A study made by us of the finances of private limited companies, a reference to which has been made elsewhere in the Report, shows that most of the companies are controlled by four or less than four persons and that investments in other companies form a high percentage of their total investments. We cannot consequently overlook the possibility that the benefit of tax exemption will accrue in many cases in the last analysis to the persons controlling the parent company. We are not, therefore, in favour of any general relaxation of the principle that all dividend income should be treated alike for taxation purposes unless any public interest of an overriding character is involved.

48. Inter-corporate dividends are exempt under the present law from corporation tax in the following instances:—

(i) An investment trust company which satisfies the conditions laid down in the Government of India Notification No. 47, dated the 9th December 1933;

(ii) Under section 56A of the Indian Income-tax Act, which was inserted by the Finance Act of 1953, dividends received by a company from an Indian company, are exempt from corporation tax—

(a) if the latter is a company formed and registered after 31st March 1952 and is wholly or mainly engaged in any of ten specified industries; or

(b) if the dividend is on fresh capital raised by an Indian company after 28th February 1953 by public subscription for the purpose of increasing the production of, or starting a separate unit of, one or more of the specified industries.

49. Representations have been made to us that the exemption in (ii) above should be extended to dividends of all Indian companies engaged in the industries specified in section 56A of the Indian Income-tax Act whether they were registered before or after 31st March 1952 or whether the capital was issued before or after 28th February 1953 as the existing distinction is not justifiable and creates difficulties in practical working. The present concession was given to attract new capital in certain desirable channels and we

are not convinced that the existence of two types of capital in the same company leads to difficulties regarding the marketing of its shares. If a company holds shares of the latter description, it is entitled to exemption from corporation tax as long as it holds them, but if it sells the shares the buyer should not be entitled to exemption unless otherwise qualified for the concession. This will affect the marketability of the shares, but this result is in keeping with the object of the concession. We do not, therefore, see any occasion to recommend extension of the exemption to dividends on old shares.

Rate structure of income-taxes on corporations

50. We have so far dealt with the logic and the structure of the taxation of corporate income in India. We now turn to the important question of the rates of tax on corporate income and the need, if any, for changes therein in the light of our discussion of the development of the Indian economy and, in particular, the requirements of the corporation sector.

51. The optimum rate for the total burden of tax on a company depends on various factors, apart, of course, from the amount of revenue required. As the distributed profits of a company bear super-tax in the hands of the richer shareholders, the rates of tax on company profits cannot be pitched as high as the highest marginal rates of tax on individuals. At the same time, if the tax on company profits is substantially lower than the highest personal rate, there will be a tendency on the part of the richer shareholders of closely held corporations to retain a large part of the company's profits with the company itself, in order to avoid the payment of super-tax which they would have to pay on distributed profits. If, on the other hand, the difference is small, there might be a tendency to distribute an unduly large proportion of the company's profits. A balance has, therefore, to be struck between these two factors.

52. Once the total rate of tax on a company's profits has been determined, its allocation as between income-tax and corporation tax has to be made largely on a consideration of its effect on shareholders. So long as the total tax on the company is fixed, a lower rate of income-tax will be advantageous to the revenue by reducing the amount of abatement to be given to the shareholders, and *vice versa*. Here again, therefore, a balance has to be struck between budgetary needs on the one hand and the grant of reasonable relief to the shareholder (particularly the smaller shareholder) on the other. The rate of income-tax on companies has, in the Indian tax system, always been the same as the highest rate on personal incomes.

53. A tax concession in favour of undistributed profits has been in force in the Indian tax system since 1944. Since 1948 the differentiation has been in the shape of an abatement of income-tax on undistributed profits. The provision now in force is that, when the disposable profits (*i.e.*, the total income as reduced by seven annas in the rupee and by any amount exempt from tax of a company in any year) exceeds the dividends declared in respect of that year's profits, the company is entitled to a rebate of one anna in the rupee on such excess. This concession is subject to certain conditions as described in paragraph 1 *supra*. As the tax concession is meant to

encourage the ploughing back of profits into a business, it is necessary to secure that it is available only so long as these profits are in fact retained in the business. This is secured by a further provision in the Finance Act, to the effect that, if the dividends exceed the disposable profits of the year, such excess is deemed to have come out of the retained profits of the preceding years, and abatement already granted in those years is withdrawn. The company has to pay additional tax on such excess at five annas in the rupee less the tax already paid thereon.

54. On a review of the taxation of developmental enterprises, we came to the conclusion in Chapter VII that the present rebate of one anna in the rupee on undistributed profits should continue for the time being.

55. The corporation tax is now levied at a flat rate of 4·75 annas in the rupee of total income, subject to certain rebates, as described in paragraph 1 above. It will be observed that two distinct principles of differentiation are embodied in the above rebates. The first is a tax concession in favour of the smaller Indian companies. We consider that this differentiation is justified in order to encourage the extension of corporate enterprise to small scale industries in this country. In order to make it fully effective and at the same time to avoid any tendency for companies to break up into smaller units for availing themselves of the existing concession, we would extend the concession of lower corporation tax to all qualifying companies on a slab basis. We accordingly recommend that companies, which have made the prescribed arrangements for the declaration and payment of dividends in India, and for deduction of super-tax at the source, and which are public companies within the meaning of section 23A of the Income-tax Act as may be recast in consequence of our recommendations in the next chapter, may be subjected to corporation tax as follows*:—

On the first Rs. 25,000 of total income	One anna in the rupee.
On the balance	Two annas and nine pies in the rupee.

Indian companies, which are not public companies, will continue to pay two annas nine pies (*i.e.*, four annas nine-pies less a rebate of two annas) on their entire total income as at present.

56. The second principle of differentiation is between what may be termed as Indian companies (*i.e.*, companies which fulfil the above conditions) and non-Indian companies. Although at first sight this appears to be a tax-discrimination against foreign enterprise, no such discrimination is in fact involved. Before 1948, dividends distributed by a foreign company out of profits earned by it in India were deemed to be income arising in India; such dividends were to be 'grossed' in the hands of the shareholders, who were entitled to credit for income-tax paid by the company and were liable to pay income-tax and super-tax at their personal rates on such dividends. In practice, however, it was found that it was difficult to serve notices on foreign shareholders who had large

*These rates are mentioned only to illustrate the order of magnitude of the difference between the slabs ; it will be for Government to fix the actual rates from year to year.

interests in such companies and to recover tax from them, while most of the smaller shareholders applied for and got refunds; thus, a large part of the super-tax which ought to have been recovered from the larger shareholders could not be collected. Since 1948, therefore, the process of grossing has been given up on such dividends, and they are no longer deemed to be income arising in India. In order to recoup the consequential loss of super-tax, a small additional tax has been levied on these companies. This is not a novel principle, as the tax systems of several other countries also provide for the recovery from closely-held corporations of an additional tax in lieu of the super-tax payable by their shareholders on their dividends. The additional tax on a company is a rough-and-ready substitute for the super-tax payable by its shareholders. We are satisfied that this involves no discrimination against foreign enterprise as such. The lower rate of tax on the first slab of income, which we have recommended above for public 'Indian' companies, should be made available to public 'non-Indian' companies also by a suitable adjustment of the rates. In view of the above, we do not recommend any other fundamental changes in the rate structure as affecting non-Indian companies.

CHAPTER XI

TAXATION OF CORPORATE INCOME—II

Introduction

In a system in which the taxation of the distributed profits of a company is linked to the personal assessment of the shareholder as in the Indian Income-tax Act, it is comparatively easy, unless special measures are adopted to counter this, for those in charge of the management of companies, in which the shareholding and consequently the control and management vest in the hands of a few persons, to use their discretion in the matter of postponing or reducing the distribution of the company's profits in such a manner as to reduce their own tax liability to an appreciable extent. The amount of profits withheld from distribution could then be used as a fund from which it is possible to finance their consumption, or other, expenditure, though the ostensible purpose for the retention of profits would be the laudable one of capital formation within the company concerned. Thus, in addition to the loss of super-tax revenue to the State, this particular method of avoidance of tax leads also to inequities as between shareholders of different companies, and also to the utilisation of accumulated profits for the purposes of consumption. The revised definition of 'dividend', which we have suggested in the previous chapter, would go some way to meet this contingency. In addition, some method of regulating the distribution of profits by such companies is also called for. In practically all the tax systems of the more advanced States in the world, the provision for such regulation exists. In India this has been sought to be achieved by section 23A of the Income-tax Act.

2. This section applies to all companies in which the public are not substantially interested, and it also lays down the manner in which the tax liabilities of such companies and their shareholders are to be determined. Briefly speaking, the companies are required to pay tax on the basis that at least 60 per cent. of their assessable profits *less* income-tax and super-tax payable by them (to be called 'distributable profits') have actually been distributed. In case at least 60 per cent. of the profits is not distributed, their *entire* 'distributable profits' are deemed to have been distributed, and the whole amount is made chargeable to tax in the hands of the shareholders. There is also a provision that if these companies have accumulated undistributed profits equal to 100 per cent. of their paid-up capital plus loan capital which is the property of shareholders, or the actual cost of their fixed assets, whichever is greater, their entire 'distributable profits' are required to be distributed.

Power to assess individual members of certain companies

3. As the provisions of this section have been strongly criticised and it is necessary for us, in dealing with this matter, to refer to the detailed provisions of the section, it will be convenient if we reproduce the section for facility of ready reference:—

"23A. (1) Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent. of the assessable income of the company of that previous year, as reduced by the amount of income-tax and super-tax payable by the company in respect thereof he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profits made, the payment of a dividend or a larger dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for income-tax purposes and reduced by the amount of income-tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income:

Provided that when the reserves representing accumulations of past profits which have not been the subject of an order under this sub-section exceed the paid up capital of the company, together with any loan capital which is the property of the shareholders, or the actual cost of the fixed assets of the company whichever of these is greater, this section shall apply as if instead of the words 'sixty per cent.' the words 'one hundred per cent.' were substituted:

Provided further that no order under this sub-section shall be made where the company has distributed not less than fifty-five per cent. of the assessable income of the company as reduced by the amount of income-tax and super-tax payable by the company in respect thereof, unless the company, on receipt of a notice from the Income-tax Officer that he proposes to make such an order, fails to make within three months of the receipt of such notice a further distribution of its profits and gains so that the total distribution made is not less than sixty per cent. of the assessable income of the company of the previous year concerned as reduced by the amount of income-tax and super-tax payable by the company in respect thereof:

Provided further that this sub-section shall not apply to any company in which the public are substantially interested or to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.

Explanation.—For the purpose of this sub-section, a company shall be deemed to be a company in which the public are substantially interested if shares of the company (not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by the public (not including a company to which the provisions of this sub-section apply), and if any such shares have in the course of such previous year been the subject of dealings in any stock exchange in the taxable territories or are in fact freely transferable by the holders to other members of the public.

(2) The Inspecting Assistant Commissioner shall not give his approval to any order proposed to be passed by the Income-tax Officer under this section until he has given the company concerned an opportunity of being heard.

(3) (i) Repealed.

(ii) Where the proportionate share of any member of a company in the undistributed profits and gains of the company has been included in his total income under the provisions of sub-section (1) the tax payable in respect thereof shall be recoverable from the company, if it cannot be recovered from such member.

(iii) Where tax is recoverable from a company under this sub-section, a notice of demand shall be served upon it in the prescribed form showing the sum so payable, and such company shall be deemed to be the assessee in respect of such sum, for the purposes of Chapter VI.

(4) Where tax has been paid in respect of any undistributed profits and gains of a company under this section, and such profits and gains are subsequently distributed in any year the proportionate share therein of any member of the company shall be excluded in computing his total income of that year.

(5) When a company is a shareholder deemed under sub-section (1) to have received a dividend, the amount of the dividend thus deemed to have been paid to it shall be deemed to be part of its total income for the purpose also of the application of that sub-section to distributions of profits by that company."

4. The companies which fall under the purview of sub-section (1) above will be referred to by us, for convenience, as 'Section 23A companies' in our further discussion.

Suggested modifications in section 23A

5. Certain representatives of the business community have suggested to us very strongly the repeal of the entire section. Failing this, the alternative that they have suggested is a substantial modification of the section. We summarise below the main points of their criticism of the existing section, and the suggestions that have been made for its modification.

6. The first criticism is that, as section 23A companies form an important segment of the corporate sector, and have played, and are playing, a very useful part in the development of industry and trade and in capital formation, the obligation that is now cast on these companies to distribute sixty per cent. of their distributable

profits prevents them from accumulating as undistributed profits more than 100 per cent. of their paid-up capital plus loan capital which is the property of shareholders (or the value of their fixed assets, whichever is greater). It is argued that thereby the Income-tax Act not only discriminates between different types of companies but also makes for a positive deterrent to capital formation, a result which is opposed to the interests of a developing economy such as ours. It is suggested, therefore, that:

(1) section 23A should be repealed and all companies placed on the same footing in regard to the treatment of their undistributed profits and of their dividend distribution policies;

(2) in case this suggestion is not accepted, at least the following modifications should be made in the present treatment of the section 23A companies:

(a) instead of compelling the distribution of a fixed proportion of their 'distributable profits', the law should insist on the distribution only of such portion of the profits as is arrived at after taking into account the reasonable needs of the business, as in the U.K. and U.S.A. Such reasonable needs should also take into account a reasonable provision for offset of future losses. In case, however, the Income-tax Officer is not satisfied that a reasonable distribution has been made, he might then deem 30 per cent. of the profits, computed according to accountancy practice, to have been distributed;

(b) the present virtual ban on the accumulation of undistributed profits beyond 100 per cent. of their paid-up capital and loan capital or cost of fixed assets (whichever is greater) should be removed;

(c) action in respect of any one year should not be taken if the next year's working loss goes beyond 60 per cent. of the previous year's assessable profits less tax, in which case, proceedings under section 23A should be commenced only after the following year's assessment is completed and the result known. In the alternative, it is suggested that account should be taken of losses subsequently suffered so far as these have been ascertained before the date of passing of any order under section 23A;

(d) the company's 'assessable' profits should not be made the basis for action under section 23A. These profits may, and do, differ from 'accountancy profits'. Such variations may be due either to difference of opinion on admissibility of certain items of expenditure or to additions made by the Income-tax Officer on the ground that the reported profits have been understated. Examples of the former are taxes and other public charges that the company has to pay from its distributable profits, but which are not admissible for income-tax purposes, such as property tax. The reserves which banking companies are required, under section 17 of the Banking Companies Act, 1949, to set aside before being permitted to declare a dividend form another example. Reference has also been made to the inclusion of 'blocked' remittances in assessable profits for the purposes of section 23A. The suggestion is that the order under section 23A should take into account the actual cash available with the company and that it should not be based on a notional estimate of its income;

(e) the limit of 55 per cent. for distribution below which the penal clause of 100 per cent. distribution now applies automatically, should not so apply, when the deficiency is due to differences between book profits and assessable profits resulting from the non-admissibility of certain items of expenditure;

(f) the exemption now accorded to subsidiaries of companies from the operation of section 23A should not be confined to 100 per cent. subsidiaries of companies in which the public are substantially interested, but should be extended to those whose share capital or voting power to the extent of more than 50 per cent. is held by such parent companies;

(g) in case distribution by a company falls short of the 60 per cent. required by section 23A, only the difference between the said 60 per cent. and the amount actually distributed should be deemed to be distributed and not the entire distributable profits of the company;

(h) where a company has distributed more than 60 per cent. in any year, the excess over 60 per cent. in that year should be allowed to be carried forward to the subsequent year before section 23A is made applicable to the company for that year;

(i) some time-limit should be prescribed in the Income-tax Act within which the Income-tax Officer should initiate and complete proceedings under section 23A. At present he can do so without any limit of time which creates difficulties for shareholders to meet additional liability for tax or for the companies to find cash for the additional distribution involved a long time after the completion of their normal assessments.

7. We deal first with the criticism made of the concept of section 23A itself, and then proceed to discuss *seriatim* the suggestions made above for its amendment.

Suggestion for repeal of section 23A

8. The repeal of section 23A is urged on the ground that the companies that attract its application play a useful role in capital formation. This is not denied, but it is equally true that proprietary business and industry—individual and partnership—also play an important part in capital formation. The capital

requirements of the latter sector are provided for by the individuals owning the concerns after meeting their super-tax liability, while in the former case, retained profits are allowed to be built up at rates of tax which bear no relationship to personal rates of tax applicable to the shareholder. We have already pointed out the possibility of the misuse of such a concession by companies that are closely controlled. Since the justification of differential treatment to section 23A companies thus rests on the nature of their ownership, we thought it useful to have an investigation made into the ownership of the controlling shareholdings and investments of such companies. Data were not easily available for the public companies falling under section 23A, but we were able to make a comprehensive inquiry in regard to private limited companies through consolidated information supplied by the Income-tax Department. The main results of this study are given below.

9. Of the 4,589 private companies assessed to tax, data regarding the minimum number of shareholders, who account for 50 per cent. or more of their shares, were available only for 3,005 companies and reveal the following position:—

TABLE 1.—*Analysis of private limited companies according to number of shareholders exercising control*

Minimum number of shareholders who account for 50 per cent. or more shares	Number of companies with paid-up capital						
	Not more than Rs. 1 lakh	More than Rs. 1 lakh but not more than Rs. 5 lakhs	More than Rs. 5 lakhs but not more than Rs. 10 lakhs	More than Rs. 10 lakhs but not more than Rs. 50 lakhs	More than Rs. 50 lakhs but not more than Rs. 100 lakhs	More than Rs. 100 lakhs	Total
1	611	230	53	32	12	6	944
2	616	255	34	31	..	1	937
3	293	134	19	13	1	..	460
4	135	91	10	11	1	..	248
5	75	48	9	5	..	..	137
6	49	25	1	2	..	..	77
7	14	25	2	4	..	..	45
8	21	15	..	2	..	..	38
9	17	9	3	1	..	..	30
10	10	12	..	..	..	..	22
More than 10	32	31	3	..	..	1	67
TOTAL	1,873	875	134	101	14	8	3,005

10. It will be seen that, out of the 3,005 companies for which data are available, as many as 2,589 (or 86 per cent.) are controlled by four or fewer persons. Out of these, there are 944 companies (31·4 per cent. of the total) in each of which the majority of shares are owned by one shareholder, and 937 companies (31·2 per cent.) in each of which the majority of shares are held by two shareholders. If the analysis is confined to the 257 companies with a paid-up capital of more than Rs. 5 lakhs, as many as 224 (or over 87 per cent.) are under the control of not more than four persons; out of these, 103 are under the control of one person and 66 are under the control of two persons.

11. From among these 3,005 companies, a sample of 372 companies was selected and analysed for finding out the percentage of shares held by the largest single shareholder in these companies.* This showed that the majority of shares in each of 114 companies (or 31 per cent. of the total) were owned by one person. Details are given below:—

TABLE 2.—*Analysis of private limited companies according to percentage of shares held by the largest shareholder*

Paid-up capital	Number of companies in which the percentage of shares held by the largest shareholder is :					Total
	1—10	11—25	26—50	51—75	76 or more	
More than Rs. 1 lakh but not more than Rs. 5 lakhs . . .	18	47	45	17	16	143
More than Rs. 5 lakhs but not more than Rs. 10 lakhs . .	8	33	33	19	19	112
More than Rs. 10 lakhs but not more than Rs. 50 lakhs . .	5	41	24	12	17	99
More than Rs. 50 lakhs but not more than Rs. 100 lakhs . .	1	1	..	4	6	12
More than Rs. 100 lakhs . .	..	..	2	2	2	6
TOTAL . . .	32	122	104	54	60	372

12. A further analysis was conducted with regard to the 25 companies which had a paid-up capital of more than Rs. 50 lakhs each and it was found that the controlling shares are held by one single person in as many as 21 companies, by two persons in two companies, and by three and four persons, respectively, in one company

*A sample of 500 companies was selected by including all companies with a paid-up capital exceeding Rs. 5 lakhs and one-third of manufacturing companies with paid-up capital from Rs. 1—5 lakhs, the latter being selected by a random sampling method. Among these 500 companies, full particulars regarding shareholdings were available only in respect of 372 companies.

each. The total paid-up capital of these companies was Rs. 31,31 lakhs. Details are given below:—

TABLE 3.—*Statement of controlling shareholdings in 25 private limited companies*

Sl. No.	Industry group	Paid-up capital (in lakhs of Rs.)	No. of shareholders who account for at least 50 per cent. shares	Percentage of shares held by the largest individual shareholder
1	2	3	4	5
1	Managing agents	60	1	99·9
2	Managing agents	50	4	24·2
3	Hire of machinery, furniture, etc. . .	80	1	96·3
4	Leather goods	75	1	77·3
5	Copper, brass, lead, zinc, tin, etc. . .	80	1	99·9
6	Managing agents	70	3	..
7	Printing, book-binding, engraving, etc. .	60	1	..
8	Copper, brass, lead, zinc, tin, etc. . .	75	1	66·7
9	Stock and share brokers and jobbers .	1,00	1	..
10	Miscellaneous manufactures . .	90	1	53·3
11	Electrical goods	58	1	99·9
12	Managing agents	76	1	50·1
13	Miscellaneous business and professions .	1,00	1	99·9
14	Managing agents	56	1	59·0
15	Manufacture of building accessories .	60	1	..
16	Finance companies	2,51	1	99·9
17	Tobacco and biri manufacture . .	4,16	1	99·9
18	Miscellaneous business and professions .	1,25	1	56·8
19	Iron and steel works	1,41	1	..
20	Finance companies	2,09	1	99·9
21	Finance companies	1,18	2	33·9
22	Wholesale merchants, warehousemen, etc.	1,80	2	41·0
23	Managing agents	2,25	1	99·9
24	Rice milling	1,75	1	66·7
25	Miscellaneous brokers and agents . .	2,01	1	56·1
	TOTAL . .	31,31		

13. These figures show very clearly that private companies are, by and large, of the nature of closely-held corporations. In this connection, it should be remembered that these figures show ownership of shares according to the actual registered shareholdings in the companies. It is a matter of common knowledge that, in a number of such companies, large blocks of shares are held by groups of close relatives.

14. In the circumstances, private limited companies can obviously not be treated in the same manner as public companies. On the contrary, even as amongst public companies, there is a case for treating those whose shareholdings and management are vested in the hands of a small group of persons in a different manner from those which are truly public companies in the proper sense of the word. We cannot, therefore, accept the plea for the repeal of section 23A of the Income-tax Act and the placing of companies that attract its application on a par with companies in which the public are substantially interested.

Definition of substantial 'public interest'

15. It is, however, necessary to arrive at a clear and workable definition of what constitutes substantial 'public interest'. Under the present law, a company is deemed to be a company in which the public are substantially interested if the shares of the company (not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than 25 per cent. voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by the public (not including a company to which the provisions of section 23A apply), and if any such shares have, in the course of such previous year, been the subject of dealings in any stock exchange in the taxable territories or are, in fact, freely transferable by the holders to the other members of the public.

Suggestion for altering definition of companies in which the public are substantially interested

16. We find that this definition suffers from two important defects which need rectification. The first is the test of voting power which is utilised for the purpose of bringing into the net of section 23A such companies as may be 'closely controlled' *i.e.*, those in which the public cannot be said to be substantially interested. The test can, however, be defeated by holding shares in *benami* names, so that although the voting power will be technically held by a member of the public yet in fact it will be exercised according to the directions of the controlling shareholders, as what is required under the present law is to manage the necessary voting power on a particular day, namely the last day of the accounting year concerned. We suggest that the test of voting power should be relatable to any day in the year instead of a particular day as at present; 25 per cent. voting power to be held by the members of the public should be raised to 50 per cent.; and the majority of the shares (*i.e.*, over 50 per cent.) should not be held by less than six persons.

17. The second vulnerable point in the present definition of a company in which the public are substantially interested is the interpretation of the word 'public'. The Income-tax Act does not

define this word. Although the word 'public' seems to have been used in this section in contradistinction to the directors of a company (who may be said to control it), the shares held by their nominees and their relatives as their *benamidars* may yet be treated as held by members of the 'public' unless it can be proved by the Income-tax Officer that such persons are really under the control of the directors. It will be necessary in each particular case for the Income-tax Officer to come to a finding of fact that a director exercises *de facto* control over a shareholder. We can well appreciate the difficulties which taxing authorities will have to face in collecting evidence of *de facto* control exercised by a director over a shareholder. An interpretation of this character will practically neutralise the purpose of the section. It is, therefore, necessary to provide that the word 'person' should be deemed to include all near relatives and nominees.

18. Thus, there can be public companies in which the public are not substantially interested in any real sense and which therefore function in effect as private companies, which nevertheless do not come under the provisions of section 23A on account of the lacunæ we have pointed out in the current legislation. We would, therefore, suggest that section 23A should contain a more suitable definition of what can be treated as substantial public interest. The main ingredients of such a definition, in our opinion, should be:

(i) shares carrying more than 50 per cent. of the voting power, *i.e.*, a clear majority, should be in the hands of the public;

(ii) this voting power should be held not only on a particular day in the year but at any time throughout the year;

(iii) the majority of the shares (*i.e.*, over 50 per cent.) should not be held by less than six persons;

(iv) the word 'person' itself should be defined in the Act in order to prevent the possibilities of dispersing shares among close relatives with a view to retaining *de facto* control on the company.

A somewhat similar definition has already been included in the Estate Duty Act for determining 'controlled companies' a part of the assets of which will, in certain circumstances, be included in the principal value of the estate passing on the death of one of their controlling shareholders. The problems of avoidance of tax in both cases are similar in nature and require, in our opinion, to be as effectively dealt with under the Income-tax Act as it has been done in the Estate Duty Act. We, therefore, recommend that the explanation to sub-section (1) of section 23A should be suitably modified to include the specific suggestions made above.

Examination of the formula of 'reasonable needs of business'

19. As regards the suggestion made in 2(a) of paragraph 6 above of our summary of the representations received on the subject of section 23A companies, we are unable to agree to the proposal that 60 per cent. distribution should be replaced by a distribution based on the formula of 'reasonable needs of business'. It is difficult to establish what constitutes reasonable distribution. We cannot, for obvious reasons, accept the opinion that it is for the directors of a company to decide, in their discretion, what

constitutes the reasonable needs of a business for this purpose. It is true that in the U.K. and the U.S.A. this criterion has been adopted, but we gather that this has entailed a great deal of controversy and litigation in regard to what constitutes the reasonable needs of a business. In India also, section 23A, when first introduced in 1930, included the test of the Income-tax Officer being satisfied that a company's "profits and gains are allowed to accumulate beyond its reasonable needs, having regard to the maintenance and development of its business"; this was subsequently abandoned as a result of the recommendations of the Income-tax Enquiry Committee, 1936, which in referring to the application of this test, pointed out that "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". In fact, the sort of difficulties that are bound to arise in the interpretation of the term 'reasonable needs' are well illustrated by the demand that the reasonable needs of business should provide for a reasonable provision to offset losses, and that in the event of the Income-tax Officer coming to the conclusion that the distribution was unreasonable, he should deem only 30 per cent. to be distributed. We can see no justification either in theory, or in foreign practice, for allowing the building up of a reserve for losses in the future at the expense of super-tax revenues. Nor can we see much force in the contention that the needs of business will always be of such magnitude as to leave no more than 30 per cent. as distributable profits, especially in the light of the fact that even public limited companies usually distribute, as we have observed in Chapter I of Volume I, about 58 per cent. of their profits after tax. We are, therefore, unable to accept the replacement of the 60 per cent. distribution formula by one based on the vague and controversial concept of the reasonable needs of business. At the same time, we must point out that, even as the law stands at present, the 60 per cent. distribution is not enforced in a mechanical and rigid manner. Thus, action under section 23A may not be taken by the Income-tax Officer provided he is of the opinion that, having regard to losses incurred by the company in earlier years or to the smallness of the profits made in the relevant accounting year, the payment of a dividend or a larger dividend than that declared by the company would be unreasonable. Moreover, if the distribution made by the company within the prescribed time exceeds 55 per cent. but is less than 60 per cent. of the distributable income, the Income-tax Officer is obliged, before actually passing an order under section 23A, to give an opportunity to the company to bring its distribution of dividends upto 60 per cent. of the distributable income. A period of three months is allowed to the company for this purpose. Thus, there is a significant element of flexibility in the present law which ought to meet the legitimate complaints of business.

Deletion of the 100 per cent. clause

20. The suggestion made in 2(b) of paragraph 6 above is a little misleading. Even under the present legislation, a company is not actually compelled to distribute 100 per cent. of its profits, once it has built up its reserves to the designated level; it is only deemed to have distributed them, which means that, after payment of the personal super-tax appropriate to its shareholders, there is nothing to prevent the company from using the balance for building up its reserves. In other words, this provision does not militate

against the building up of reserves. It only compels the company to slow down its rate of building up reserves after they reach the particular level indicated in the law. We think that this is a reasonable restriction in view of the nature of the ownership of these companies.

Consideration of losses of subsequent year in the application of section 23A

21. The proposal contained in 2(c) of paragraph 6 above contemplates that the loss arising in a subsequent year (say 1952-53) should be adjusted against the profits of a previous year (1951-52), and the operation of section 23A modified accordingly. We see no merit in this proposal as the loss will be carried forward in the normal course, and will reduce the taxable profits in the next year (1953-54). Thus the advantage gained in one year (say 1951-52) would be lost in the other year (say 1953-54) as this loss can be adjusted only once. We are therefore unable to accept this suggestion.

Book-profits *vs.* assessable profits

22. The point made in 2(d) of paragraph 6 above, *viz.*, the difficulties arising from the difference between the book profits of a company and its assessable profits are undoubtedly real in the circumstances in which its cash resources are reduced for meeting obligations of a compulsory character which are not treated as admissible expenses under the Income-tax Act. We are in favour of adjusting such charges against assessable income arrived at for income-tax purposes, but we do not agree that the same treatment should be accorded to other additions made by an Income-tax Officer to reported profits. We recommend therefore that the amount of 'distributable income' should be determined by deducting from the assessable income not only the income-tax and corporation tax payable, but also the amount of any tax levied by the Government of a State or by a local authority, whether or not such tax is wholly or partly an admissible deduction under section 9 or section 10 of the Income-tax Act

Reserves of banking companies

23. We are also of the opinion that the grievance of banking companies in regard to the admissibility of their statutory reserve requirements in determining their distributable profits is legitimate and should be attended to. We recommend, therefore, that the 'distributable income' of banking companies should be determined by deducting from the assessable income, *inter alia*, the amount transferred to a reserve fund under section 17 of the Banking Companies Act, 1949.

Blocked remittances

24. As regards the inclusion of 'blocked' remittances in the assessable income for determining the statutory distribution under section 23A, we agree that it does lead to a genuine hardship to the company. It would not, however, be correct to exclude them altogether from the assessable income of the company, as they have been earned in that particular year. We suggest, therefore, that in order to meet this difficulty, the Central Board of Revenue should issue instructions to the effect that although such profits are taken into consideration for the purposes of section 23A, the tax liability in respect of them may be kept in abeyance till the restrictions on the remittance of such profits are relaxed or removed.

25. In consequence of these changes, we recommend that the words 'smallness of the profits' used in clause (1) of section 23A should be amplified to provide that it is assessable profits as reduced by charges of the types referred to above that should be taken into account in determining the applicability of section 23A to a company in a particular year.

Application of *locus poenitentiae* clause

26. The next suggestion for change [2(e) of paragraph 6 above], *viz.*, about the desirability of taking into account the difference between book profits and assessable profits in the application of the **locus pœnitentiæ* clause was examined by the Income-tax Investigation Commission and we find ourselves in agreement with its opinion, which is reproduced below:—

> "By referring to the 'assessable income', the section has excluded all revenue expenses and permissible deductions. It is nevertheless possible that by reason of difference of opinion or in method of calculation between the assessing officer, and the company's officers the amount distributed may prove to be less than 55 per cent. insisted on by the second proviso to section 23A as a condition precedent for giving a *locus pœnitentiæ* to the company for escaping a penal order under this section. As such situations may arise even from honest difference of opinion, the second proviso to section 23A may be enlarged so as to include cases where the distribution actually made has fallen short of 60 per cent. of the assessable income by reason of the assessing officer determining the assessable income to be greater than it was according to the calculations made by the company."

We recommend that appropriate legislative action should be taken to give effect to this opinion.

Application of section 23A to subsidiaries

27. Subsidiaries, of which the entire share capital is owned by a company, do not attract section 23A if the parent company is one in which the public are substantially interested. It is suggested in 2(f) of paragraph 6 above that a similar concession should be extended to subsidiaries, of which the parent companies hold 50 per cent. or more of the share capital. The former type of subsidiary is really part and parcel of the parent company and it can be automatically assumed that it partakes of its character. It will be appreciated that this presumption cannot be made as a matter of course for the latter type of companies. Each case will have to be investigated on its merits after taking all relevant facts into account. We are, therefore, unable to agree to the suggestion made.

28. The suggestion made in 2(g) of paragraph 6 above for the confining of an order under section 23A to the difference between 60 per cent. and the proportion actually distributed is not acceptable to us, as it will provide an inducement to companies to await action by the Income-tax Officer before distributing 60 per cent. We regard it as sound in principle that there should be some penalty for non-compliance with the law.

**Locus pœnitentiae* means 'opportunity to withdraw or resile from an obligation' (Webster.)

29. The suggestion made in 2(h) of paragraph 6 above, *viz.*, the carrying forward to subsequent years of distribution in excess of 60 per cent. and taking the same into account before any orders are passed under section 23A is a reasonable one and we recommend its acceptance. We suggest, however, that the period of such carry-forward should be fixed at three years.

Carry forward of excess distribution to subsequent years

30. Finally, the suggestion made in 2(i) of paragraph 6 above, *viz.*, that some time-limit must be prescribed within which the Income-tax Officer should initiate and complete proceedings under section 23A has, in our opinion, a great deal of force behind it. Some element of delay is, however, inherent in the present scheme of section 23A and it would be, therefore, difficult to prescribe a statutory time-limit for action under section 23A. We recommend, however, that the Central Board of Revenue should issue strict instructions to the Income-tax Officers that action under section 23A in the case of both companies and shareholders should be initiated and completed with the least possible delay and should also ensure that these instructions are complied with in practice by prescribing an appropriate periodical return on the subject.

Time-limit for initiation and completion of section 23A proceedings

31. The suggestions dealt with above had as their objective a liberalisation of the operation of section 23A from the point of view of the assessee. We examine below some of the suggestions which are designed to prevent loopholes in the working of the present law with resulting disadvantage to the exchequer.

32. It has been pointed out that one of the conditions under which 100 per cent. distribution is insisted upon is when the accumulated reserves exceed the paid-up capital plus the loan capital which is the property of the shareholders or the actual value of the fixed assets whichever is greater. The words 'paid-up capital' include not only the capital which is subscribed in cash but also the capital which is acquired by capitalisation of reserves, *i.e.*, in the form of bonus shares (out of the 40 per cent. of the distributable profits which the law allows to be retained every year) a company can indefinitely avoid the application of provision relating to the distribution of its entire 'distributable profits'. Our investigation into the ownership and finances of private companies, to which reference was made earlier in this chapter, has shown that private companies, in practice, take full advantage of this loophole, and thus reduce the effectiveness of the operation of section 23A. An extreme example is that of a company which had built up a reserve of Rs. 44 lakhs against a paid-up capital plus loan capital of Rs. 48 lakhs; it was, therefore, getting ripe for the application of this particular clause of section 23A; the company, however, issued bonus shares to the tune of Rs. 42 lakhs with the result that its paid-up capital plus loan capital increased to Rs. 90 lakhs, its reserves fell to Rs. 2 lakhs, and the application of the 100 per cent. distribution clause was put off for an indefinite period. Another example was of a company with a paid-up capital plus loan capital of Rs. 22 lakhs which, when it found its reserves reaching Rs. 20·6 lakhs thus soon qualifying for the 100 per cent. distribution clause, issued bonus

'Paid-up capital' to exclude capitalised reserves

shares to the tune of Rs. 18 lakhs and brought down its reserves to Rs. 2·6 lakhs, simultaneously increasing its paid-up capital plus loan capital to Rs. 40 lakhs. Examples could be multiplied, but there is no need to do so. It would be obviously unrealistic to expect that advantage would not be taken of such an easy and legal method of avoiding the application of section 23A. We recommend, therefore, that the expression 'paid-up capital' in the first proviso to section 23A should be re-defined so as to exclude capitalised reserves. We also recommend that the words 'reserves representing accumulation of past profits' should be deemed to include any portion of the profits which has in the past been capitalised by the issue of bonus shares. The justification for the difference in treatment we recommend for bonus shares of companies in which the public are substantially interested and section 23A companies is the difference in the nature of their proprietorship and the consequent possibilities that arise for avoidance of the personal super-tax. At the same time, we must reiterate the view that our recommendations do not prevent a build-up of reserves beyond 100 per cent. by section 23A companies; all that they do is to ensure that such reserves are built up after payment by their shareholders of personal super-tax due on them.

Application of 100 per cent. clause to investment companies

33. Section 23A of the Indian Income-tax Act does not make any distinction between investment companies and trading or manufacturing companies; the requirement of 60 per cent. distribution applies equally to all. The formation of 'private' investment companies, or what may be termed as 'personal holding companies', enables rich persons to escape tax liability, by transferring their assets (including house property, stocks and shares) to such a company in exchange for the shares of the company, inasmuch as personal super-tax on 40 per cent. of the distributable income of the company is saved. Such companies admittedly do not require funds for internal financing or capital formation as the industrial or trading companies do. It has, therefore, been suggested that the entire (100 per cent.) amount of the distributable profits of such companies ought to be required to be distributed.

34. The foreign practice on this point also shows that the Indian law is unduly lenient towards such investment companies. In the U.K., investment companies ('companies the income whereof consists mainly of investment income') are treated on special lines in respect of their investment income (*i.e.*, income which, if the company were an individual, would not be earned income); such income is automatically deemed to be the income of the members of the company according to their interests, while the estate or trading income of such a company is treated in the same manner as the income of non-investment companies.*

35. Very stringent regulations have been laid down in the income-tax law of the U. S. A. in respect of the distribution of earnings of 'personal holding companies'. A special surtax is payable by them upon their undistributed profits, subject to certain adjustments, in addition to the regular corporate normal tax and surtax. This surtax is at the rate of 75 per cent. of the undistributed profits

*Section 262 of the U. K. Income-tax Act, 1952.

upto $ 2,000 and 85 per cent. of the amount of undistributed profits in excess of $ 2,000. A corporation is a personal holding company if (i) at least 80 per cent. (or 70 per cent, in certain cases where a corporation was a personal holding company in a prior year) of its gross income for the taxable year is 'personal holding company income' and (ii) at any time during the last half of the taxable year more than 50 per cent. in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. It has been specifically provided in section 503 of the Internal Revenue Code that an individual is considered as owning the stock owned not only by or for himself but also the stock owned, directly or indirectly, by or for his family (brothers, sisters, spouse, ancestors and lineal descendants) or by or for his partner. 'Personal holding company income' is practically synonymous with income from investments or income from dealings in investments. It includes dividends and annuities, interests, royalties, gains from stock, security and commodity transactions, rents and certain income from estates and trusts, subject to certain qualifications.

36. It will thus be seen that the suggestion requiring investment companies in which the public are not substantially interested to distribute 100 per cent. of their distributable profits is reasonable, and we accordingly recommend its incorporation in section 23A.

Practical difficulties in the application of section 23A

37. While we are satisfied, broadly speaking, with the correctness of dealing with section 23A companies in a manner different from that accorded to companies in which the public are substantially interested, we find that the method of operation of this differential treatment leads to a number of difficulties. At present, when an order is passed under section 23A, the undistributed portion of the 'distributable profits' is deemed to have been distributed as dividends amongst the shareholders as on the date of the general meeting of the company in which its accounts for the year concerned are considered. The proportionate share of each shareholder then becomes liable for inclusion in his total income and, therefore, liable to personal super-tax. The liability is in this way laid on the shareholders for the super-tax payable in respect of such 'deemed' dividends. It has, however, been also provided that tax in respect of such dividends payable by the shareholders can be recovered from the company if, for any reason, it is not recoverable from the shareholders.

38. It has been pointed out to us that the present system involves administrative difficulties in the assessment and collection of tax resulting from action under section 23A. A good deal of correspondence has to be carried on between the Income-tax Officer dealing with the case of the company and the Income-tax Officers dealing with the assessments of the shareholders. This correspondence is necessary first for determining whether action under section 23A is called for in respect of any company and then for raising assessments on the shareholders. Changes in the assessable income of either the company or the shareholders as a result of appeals or action under section 34 of the Income-tax Act might affect the entire calculations, and this introduces another complication in the matter. We are informed that experience has shown that this exchange of

information between the various Income-tax Officers often takes considerable time and involves voluminous correspondence.

Alternative methods of assessment and collection of tax on the 'deemed distribution'

39. We are satisfied that the present procedure embodied in section 23A leads to several difficulties in practice which have the effect of rendering this section infructuous to some extent, and that some alternative scheme should be devised which, while tackling the problem on a rational basis from the point of view of the assessee, will at the same time, remove most of these practical difficulties. Two alternative suggestions have been made in this behalf:—

(a) the Income-tax Officer should be empowered, on applying section 23A, to calculate the amount of super-tax payable by the shareholders (as if the 'deemed' dividend were included in their total income) and recover it from the company without observing the present elaborate proceedings under section 34 of the Income-tax Act; in the alternative,

(b) an additional tax at a flat rate may be charged on a company to which section 23A is applied in respect of the deemed dividends of shareholders liable to super-tax, *i.e.*, a tax should be levied on such companies in respect of the undistributed portion of the 'distributable' profits, in addition to the income-tax and corporation tax already payable by them.

40. The first scheme mentioned above, while it will do away with the formality of raising assessments on the shareholders in respect of the 'deemed' dividends, will not reduce to any appreciable extent many of the other difficulties involved in the present working of section 23A. In fact, all those difficulties—heavy correspondence, complications caused by giving effect to decisions in appeal, etc.—will remain, while it is doubtful if it will facilitate collection of the demands raised as a result of the application of section 23A. On the other hand, it will introduce the further complication that every time the assessment of any shareholder is revised, upward or downward, under section 34 or in appeal, the assessment on the company in respect of this tax will have to be revised and all calculations made over again.

41. In substance, the first alternative discussed above amounts to the levy of an additional tax on companies computed meticulously having regard to the personal income of the shareholders. From this point of view, the second alternative mentioned above appears to be more workable. It will do away with most of the practical difficulties which are now being experienced in the working of section 23A. The references between the various Income-tax Officers will be avoided as also the raising of the additional assessments on the shareholders in respect of their 'deemed' dividends. It will simplify administration, and facilitate collection of tax. In itself, the scheme is simple to operate; the additional tax payable by the company can be easily determined once it is decided by the Income-tax Officer that the constitution of any particular company is such as to attract the provisions of section 23A. Ultimately, this will result is expediting the working of section 23A and of making it a

really effective instrument for preventing the avoidance of personal super-tax through excessive retention of profits with companies in which the public are not substantially interested.

42. The scheme offers certain advantages from the point of view of the assessees also. It will obviate the necessity of re-opening the assessments of individual shareholders for assessing tax on the 'deemed' dividends. From the point of view of the companies, it will enable them to adopt any distribution policy which they consider best in their own interests. By paying an additional tax on such undistributed profits, they can retain as much of the profits, after distributing 60 per cent., as they consider necessary with the company itself, and have the freedom to follow their own dividend policy. The proposed scheme will also remove the uncertainty which companies now feel about their liability in respect of the tax recoverable from the shareholders as a result of action under section 23A.

43. The scheme is open to one objection. It may be argued that the efficacy of such a scheme depends on the rate at which the additional tax is to be made payable by the company, and since such a rate cannot be pitched as high as the highest rate at which super-tax is payable by individual shareholders, some shareholders may still find it advantageous to keep the profits with the company rather than distribute them. The argument is theoretically correct, but the proposed scheme will have the advantage of deterring the company from excessive retention of profits, and of compensating revenue for the loss of super-tax resulting from non-distribution of profits. At the same time, the difficulties in working the present section, which lead to its being seldom used in practice, will be avoided.

44. We, therefore, recommend that, if, by virtue of the conditions laid down in section 23A of the Income-tax Act that section becomes applicable to any company, an additional corporation tax should be levied on the company calculated on the basis of a flat rate on the undistributed portion of the 'distributable' profits.

CHAPTER XII

EVASION AND AVOIDANCE

Introduction

In the previous chapters we have suggested ways and means of rationalising the present system of income-tax. The successful implementation of this objective depends on the efficiency of the machinery of enforcement. The aim should be to prevent leakage of revenue, whether through evasion or avoidance of tax, for it results in disturbing the burdens which are imposed with due regard to equity. We review in this chapter the adequacy of the existing arrangements for the prevention of leakage of revenue. The discussion in the next chapter is devoted to a consideration of the grievances of the assessees, which have been brought to our notice during the course of our enquiry, and the directions in which the administrative machinery could be improved.

Estimate of leakage of revenue

2. It is not possible to estimate accurately the extent of the leakage of revenue in the past. It is observed from statistics in connection with the 'Disclosure Drive' that income as originally included in the returns sent to the Income-tax Department by assessees who made disclosures was grossly understated, the difference between the income as originally returned and that disclosed later to the Department being, on the average, as much as 600 per cent. Such other statistics as have been made available to us by the Central Board of Revenue also give evidence of the fact that evasion is prevalent on a considerable scale. When it is remembered that these statistics are of *attempted* evasion, which has been detected by the Income-tax Department, and allowance is made for the fact that the Income-tax Department is ill-equipped in the matter of trained staff to cope adequately with the problem of evasion, the quantum of the evasion which actually takes place and goes undetected could rightly be estimated at a very high figure indeed. The existence of evasion on such a large scale cuts at the very root of any sound structure of income taxation, and results in an inequitable burden being placed on the honest tax-payer. The importance of adequate measures—administrative and legal—to combat evasion and avoidance cannot therefore be over-emphasised.

Evasion and avoidance

3. Leakage in revenue may occur either through a deliberate distortion of facts relating to an assessment *after* the liability has been incurred, or by so arranging one's affairs *before* the liability is incurred as to prevent its occurrence or to reduce the incidence of the tax within the framework of the existing legislation. The former set of transactions is usually referred to as 'evasion' and the latter as 'avoidance'. 'Avoidance' ordinarily arises from drafting defects in the tax legislation. Both avoidance and evasion result in loss of revenue to Government, but the former has a colour of legality about it. In

the net result the burden on the honest citizen increases *pro tanto*. It is, therefore, necessary that the public conscience should be awakened to the fact that the more widespread the leakage of revenue, the larger the burden on the honest tax-payer.

Illustrations of evasion and avoidance

4. Among the numerous devices employed for tax evasion may be mentioned the: (i) omission to report taxable income, (ii) fraudulent changes in account books, (iii) maintenance of multiple sets of account books, (iv) opening of bank accounts under assumed names, (v) securing of contracts in the name of dummies or figureheads, and (vi) keeping transactions out of account books. Illustrations of tax avoidance are the use of the device of creating corporate institutions to escape liability to personal super-tax, the use of charitable trusts for the same purpose, the constitution of trusts and family partnerships and the transfer of income-earning assets to one's wife and children for fractioning income for tax purposes.

Avoidance

5. While tax evasion is universally condemned, there is a disposition in certain quarters to regard tax avoidance as a permissible course of action. We are unable to endorse this view. The mere fact that the income-tax law is not violated does not mean that the procedure which results in tax avoidance is justifiable. We might take as an illustration the act of introducing, without adequate consideration, one's wife or minor children as partners in a business of which the assessee himself is a partner. It is an attempt to fraction income and reduce tax liability under a provision of law meant to apply to genuine partnerships. Conduct of this nature, though legal, cannot but be regarded as anti-social. In the very nature of things, avoidance may be said to be endemic to a complicated piece of legislation such as the Income-tax Act. It is, therefore, necessary that the Income-tax Department should keep a vigilant eye on inroads into revenue by persons who seek to 'avoid' taxation so that prompt remedial action, in the form of necessary legislation, is taken by Government. In various chapters of this Volume, we have made several suggestions for amendment to the income-tax law with a view to preventing leakage of revenue.

Evasion

6. Evasion can be tackled effectively only by improving and strengthening the enforcement machinery. We therefore, propose to review the present arrangements in this behalf which may be broadly classified as follows:—

(i) administrative measures adopted for tracing 'new' assessees, (*i.e.*, those who have taxable incomes but fail to send in returns), and for verifying the accuracy of the returns submitted by existing assessees, by

  (a) external survey;

  (b) exchange of information collected from the records of existing assessees available in the Income-tax Department;

  (c) collection and collation of information obtained from outside sources (including informers);

(ii) special arrangements for dealing with cases of substantial evasion;

(iii) legal provisions for enforcing 'back duty', *i.e.*, section 34 of the Income-tax Act, etc.;

(iv) public censure as a remedy for evasion;

(v) proper representation in income-tax proceedings;

(vi) strict enforcement of collections; and

(vii) voluntary disclosure of concealments.

External survey

7. Under the income-tax law, assessees are allowed freedom to maintain their accounts in any manner they like, provided income can be correctly deduced from them. The period within which they have to submit their return of income to the Income-tax Officer generally falls a few months after the close of the annual accounting period. The Income-tax Act lays on every person having income exceeding the taxable limit, the obligation of submitting his return voluntarily and prescribes a penalty for default in this respect. In practice, however, Income-tax Officers invariably issue individual notices, which serve as a reminder, to each person who is already an assessee, in pursuance of an undertaking given in 1939 in the old Legislative Assembly. In spite of this, many assessees delay their returns beyond the time fixed for submission while several others altogether fail to send returns.

8. The latter class constitutes an important section of tax-evaders, and it has been found necessary for a large staff of external surveyors to be employed in the Income-tax Department in order to enable such evaders being tracked. The following table, which shows the results of the survey work done by this staff over a period of five years, will be of interest:—

TABLE 1.—*Results of External Survey by the Income-tax Department*

	1948-49	1949-50	1950-51	1951-52	1952-53	Total
1. No. of shops and homes visited during the year	25,476	65,815	1,42,477	1,27,127	2,28,767	5,89,662
2. No. of possible new cases reported	8,716	17,828	30,544	30,511	33,153	1,20,752
3. No. of new assessees discovered in (2)	5,289	10,052	20,628	21,963	21,559	79,491
4. Assessment completed during the year out of (3)	3,899	7,960	13,343	23,922	22,155	71,279
5. Demand raised during the year (in thousand rupees)	12,64	35,06	25,09	28,75	40,66	1,42,19
6. Collections during the year (in thousand rupees)	9,00	25,85	16,41	16,47	22,42	90,17

We are of the opinion that the existing staff should not merely continue to carry out their task but should do so with greater vigour, as it enables the Income-tax Department not only to bring new assessees on to its register but also to discover important information regarding existing assessees. We also think that the Committee, the appointment of which we are suggesting in the next chapter, should examine the methods of work and the adequacy of the staff employed on external survey, particularly of the clerical staff engaged on the proper tabulation and communication to the Income-tax Officers of the information gathered by the surveyors.

9. Another suggestion we have to make in connection with the survey work is that it should be legalised by a specific provision being made for it in the Income-tax Act. The staff engaged on this work will then have the assurance that their visits to business and residential premises in the course of their duties would be treated as legal. We also recommend that a responsible official of the survey team should be given statutory power to place marks of identification on the books of accounts, documents, etc., which are examined by him, and to prepare an inventory of such books of accounts and documents and get it signed by the person in charge of or present on the premises, and also, if necessary, to take duly certified extracts from these books and documents. Survey work would not be fully effective, in our opinion, without such powers.

Internal survey or exchange of information on record

10. A considerable amount of information of value to the Income-tax Officer could also be obtained from the returns of income and from supporting accounts and statements furnished by assessees. If the information that could be gathered about other parties from the accounts submitted by each assessee is tabulated and communicated to Income-tax Officers, who are concerned with the assessment of those parties, it would help considerably in the detection of evasion. We understand that this is done to some extent at present, but that there is scope for appreciable improvement. We suggest that this matter should also be examined by the Committee referred to above with a view to making the system more effective than it is at present.

Information from outside sources

11. Special arrangements are also in existence for the collection of information from various outside sources. A special organisation, known as the Special Investigation Branch, is located in the charge of each Commissioner of Income-tax for this purpose. Information is also gathered, relevant to assessments under examination, by Income-tax Officers with the help of inspectors attached to them. Information of an inter-State character is obtained, collated and disseminated by the Director of Inspection attached to the Central Board of Revenue. An important origanisation working under him is the Collation Branch at Madras, the functions of which are discussed in greater detail later in this chapter. The sources for such information usually are the records of public offices with which assessees, actual or potential, have dealings, such as records of local bodies (including municipal markets), civil courts, registration offices, transport authorities, booking offices in the railway stations, the offices of Registrars of Joint Stock Companies, etc. We understand that there is a considerable scope for improvement in the working of these arrangements. We therefore recommend that the question of providing additional staff for this work being done systematically and effectively should be reviewed. In particular, we would suggest that greater attention should be paid, than it has been possible so far, to the question of organising economic intelligence

at the level of the Commissioners of Income-tax and the Central Board of Revenue for checking returns comprising particular types of transactions and trading activities.

12. We can visualise various types of information that can usefully be gathered in this respect, *e.g.*, that relating to bullion, commodity, and stock exchanges; to special types of industries especially regarding comparative features of different industries in different charges of Commissioners of Income-tax etc. We suggest that the extent to and the manner in which it is possible to organise this work in the Income-tax Department should be investigated by the Committee, the appointment of which we are recommending in the next chapter.

Liaison with other tax departments

13. A considerable amount of useful information could be gathered through effective liaison arrangements with other Central revenue departments, such as Customs and Central Excise, and with State revenue departments such as those dealing with sales tax and agricultural income-tax. The secrecy provisions of the Income-tax Act have been relaxed, through clauses (j) and (k) of section 54(3) of the Income-tax Act, so as to enable income-tax officials to disclose confidential information from their records to officers of other departments, and the sales tax laws of most of the States authorise the disclosure of information to Income-tax Officers. We recommend that, where such a provision does not exist, it should be made. The disclosure of information by Customs and Central Excise officers to Income-tax Officers is however, prohibited by section 167(79) of the Sea Customs Act, 1878, and rule 232 of the Central Excise Rules. We recommend that these provisions should be suitably modified. Mere amendment of the law will, of course, be ineffective unless methods of achieving continuous liaison are established in practice. What is needed is not the mere exchange of routine information but that officers of each department should be able to appreciate the methods of investigation followed by the other department, and that necessary assistance should be rendered by each department with a view to making these investigations fully effective. This can only be accomplished by frequent personal contacts between the officials concerned after the necessary changes referred to above have been effected in the various laws.

Anonymous information

14. Information regarding the activities of individual assessees may occasionally be furnished by informers who may either choose to remain anonymous or may establish personal contacts with the income-tax authorities. Such informers may often be persons who have been in close contact with the assessee as his employee, or in some other capacity, and may possess a knowledge of the methods of evasion actually adopted by the assessee. At the same time, they almost invariably have a grudge to work off against the assessee, and considerable caution and discretion are called for in dealing with information supplied by them, which is apt to be exaggerated in the very nature of things.

Rewards to informers

15. This leads us to a consideration of the question of the usefulness of a system of giving rewards to informers for information given by them to the Income-tax Department in respect of tax evasion. The Income-tax

Investigation Commission which also considered the question, pointed out that provisions for such rewards exist in the income-tax systems of certain other countries, and also in the Indian Customs administration. On the other hand, it found that the consensus of public opinion was against the proposal, mainly on the ground that it might induce would-be informers to resort to the practice of blackmailing tax-payers and extorting monetary consideration for refraining from giving information to the Income-tax Department.

16. The position in regard to informers on the customs side is, in our opinion, somewhat different from that on the income-tax side. Tips from informers, regarding attempted smuggling operations are usually received by the customs authorities beforehand, and as soon as the operation is discovered and dealt with, the informer's task is finished. On the income-tax side, however, investigations start some time after the events to which they relate, and may be protracted in some cases upto eight years. The informer can, therefore, come up after the event, with evidence some of which he may have concocted, and he has ample opportunities of adding to, and modifying, his version from time to time. This puts him in a position to approach the assessee also from time to time with a view to blackmailing him.

17. We have been given to understand that a system of giving rewards has been in force in the Income-tax Department for the last few years, and that their grant is regulated by executive instructions, which lay down strict safeguards against abuse. The system has not, we understand, been in operation long enough to enable a proper appraisal of its merits and demerits to be made. We should, however, like to stress the dangers inherent in the system of rewards. Would-be informers are likely to be unscrupulous persons, and the possibility of their resorting to blackmail cannot be overlooked. It is also not unlikely that they may try to extract information from the income-tax authorities themselves on the plea that they require a 'scent' to follow up and that they may pass on this information to the assessee for a consideration. This would necessarily involve a breach of the secrecy provisions of the Income-tax Act, which, we are convinced, it would be quite improper to encourage in any circumstances. The assessee, who is affected by such a procedure, would not normally be aware of the fact that information from his assessment record had been made available to a third party, *viz.*, the informer. It would therefore be impossible for the secrecy provisions of the Income-tax Act to be invoked against the official guilty of their breach. This makes it all the more necessary, in our opinion, that the Income-tax Department should exercise the utmost caution in its dealings with the informers. Moreover, the reward that Government can give is not likely to be large and it is possible for the informer, where the evasion involved is considerable, to extract a much higher amount from the assessee as the price of his silence. This is another serious aspect of this matter, which we trust will be borne in mind when the question of the continuance or modification of the existing system of rewards to the informers is taken up for consideration in the light of the above remarks and the further experience of its working.

Collation Branch

18. We have already referred to the Collation Branch working under the Director of Inspection. Its function is to collate all the information that is sent to

it regularly, throughout the year, of payments made to various parties by the disbursing officers of the Central and State Governments, and by quasi-government bodies. The payment figures thus collated are extracted and communicated to the Income-tax Officers all over the country through 'payment intimation slips'. This branch also collates the annual returns made by companies showing payments of dividends of over Rs. 5,000 and distributes this information to Income-tax Officers through 'dividend intimation slips'. The intention is that such information should be used for tracing new assessees, and also for cross-checking the account books of existing assesses. The following statement shows the volume of work handled by the Collation Branch from 1943-44 to 1952-53:—

TABLE 2.—*Analysis of the work of the Collation Branch of the Directorate of Inspection (Income-tax)*

Year	No. of payment intimation slips sent out	No. of dividend intimation slips sent out	No. of statements received from disbursing officers
1943-44 . .	49,941	..	..
1944-45 . .	21,092	..	..
1945-46 . .	35,928	..	..
1946-47 . .	17,531	4,348	..
1947-48 . .	21,462	8,107	..
1948-49 . .	24,832	8,580	15,549
1949-50 . .	30,480	10,577	10,403
1950-51 . .	26,357	7,094	14,682
1951-52 . .	40,560	8,162	12,950
1952-53 . .	10,538	10,179	13,018
TOTAL .	2,78,721	57,047	66,602

19. We are satisfied that the work done in this branch is useful and we suggest a further extension of its activities in the following directions:—

(i) banks and insurance companies should be required, by a suitable amendment of section 38 of the Income-tax Act, to forward to this branch (which should be designated the prescribed authority) information relating to deposits, loans, remittances, overdrafts and policies exceeding a specified amount. Such amount could be fixed high enough to throw as small a burden on the authorities concerned as possible in the circumstances of each case; and

(ii) the limit of Rs. 5,000 fixed in rule 42 of the Income-tax Rules, regarding the information to be supplied about dividends distributed by companies, should be removed. In future such information should be sent in respect of all dividends distributed by them in each year.

We are of the view that information, under both the above items, is necessary to enable Income-tax Officers to exercise a check over the investment figures given by existing assessees and also to locate investments relating to new assessees.

Special arrangement for investigation into cases of substantial evasion

20. The methods described in the preceding paragraphs will, by themselves not suffice to tackle the more substantial type of evasion. There are at present three separate agencies at work in the Income-tax Department on the investigation of cases of suspected evasion of a substantial character. First, there is the Income-tax Investigation Commission which deals with certain specified cases which were referred to it under sections 5(1) and 5(4) of the Taxation on Income (Investigation Commission) Act, 1947. These represent cases involving suspected evasion on a substantial scale which, in spite of the persistent efforts by the normal machinery of the Income-tax Department, could not be tackled with success over a long period. The labours of the Income-tax Investigation Commission have resulted in the unearthing of concealed income to the extent of Rs. 45·97 crores up to December 1953.

21. Secondly, there are the two 'Central' Commissioners of Income-tax whose offices are located at Bombay and Calcutta but who have jurisdiction over any assessment from any part of India that is specifically allotted to either of them, and which, in the opinion of the Central Board of Revenue, needs more detailed and careful examination than would be possible in an ordinary income-tax office. The charges of 'Central' Commissioners were created as a result of the recommendations of the Income-tax Enquiry Committee, 1936. It is not possible to evaluate the work done in these charges in terms of the amount of concealed income that has been discovered. Considering that detailed investigations lasting for months are made in respect of such assessments, there are greater chances of success in discovering evasion in these charges than in the ordinary income-tax offices where assessing officers have to race against time to complete them.

22. 'Special Circles' have also been created recently in some charges of the Commissioners of Income-tax in order to investigate complicated cases of evasion that may arise and which may not be considered important enough to be transferred to the Central Commissioners.

The co-ordination of investigation work done in the two charges of 'Central' Commissioners and in the 'Special Circles' mentioned above is secured through a Director of Inspection who functions directly under the Central Board of Revenue. This officer is also charged with the responsibility of disseminating all relevant information regarding ingenious devices that are used by assessees for evasion and avoidance, and the best methods available to the Income-tax Department for countering them.

Income-tax Investigation Commission

23. Of the three agencies mentioned above, the Income-tax Investigation Commission, which deals with the most serious and difficult cases of suspected evasion, is a purely temporary organisation and is to continue, as the law stands at present, only until the end of December 1955, though it is open to Government to extend its life

again, as has been done in the past, with the approval of Parliament. We understand that Government have not only no intention of extending the life of this Commission beyond December 1955, but that they are contemplating closing it down almost immediately and transferring the work to the normal departmental agency, owing to two recent judgments of the Supreme Court holding certain operative sections of the Act, under which the Commission is constituted, as *ultra vires* of Article 14 of the Constitution. We have, therefore, considered (a) whether the legal defect pointed out by the Supreme Court could not be remedied by amending the Act suitably, and (b) whether, if this could be done, the Commission should not be converted into a permanent body.

24. The two judgments of the Supreme Court in question clearly indicate that whereas no legal objection exists to the special powers, functions and procedure of the Income-tax Investigation Commission, what offends the Constitution (Article 14) is that the class of cases which were referred to the Commission had not been specified with sufficient precision to demarcate them clearly from the class of cases which fall to be dealt with under the ordinary provisions of the Income-tax Act. It is also clear from the two judgments that failure to make this specific demarcation between the two classes of cases mentioned above was not open to legal objection at the time the Act was originally passed by the Legislature in 1947; this became objectionable in law only after the Constitution was promulgated in 1950. We, therefore, think that the problem is one of legal drafting more than that of any substantial change in the concept of the scheme itself, and that the amendments that will have to be made to restore the Act to legal form will not be numerous or of a complicated nature. We are satisfied that the Income-tax Investigation Commission has done useful work during its existence. The Central Board of Revenue has also stated before us that "the setting up of the Commission and its continuance has been fully justified" and that if the difficulties confronting a Commission of this nature had been appreciated in the beginning, the disposal of work would have been quicker than it has actually been possible to achieve. We, therefore, see no reason why this same body should not be enabled to complete the cases that remain to be investigated. We recommend that such legal provisions as are necessary should be made to enable it to do so.

25. Apart from the admitted inadequacy of the normal machinery of income-tax to deal effectively with this type of evasion cases (a subject which we examine at greater length in a subsequent paragraph) there is another consideration, which seems to us to be of importance. It is well known that the referred cases, which need further investigation, pertain to prominent business groups. The normal machinery of the Department, shorn of all the powers given to the Commission, would, therefore, be placed in an invidious position inasmuch as it would not be able to bring to bear on these cases the same amount of scrutiny, that was possible in the earlier cases decided by the Commission. Besides, it should not be overlooked that, in spite of the special powers available to the Commission, there are allegations that delaying tactics were adopted by certain interests. The position in this respect is bound to be worse if the investigation of such cases is undertaken by Income-tax Officers functioning under the normal income-tax law and procedure.

26. It is relevant to note in this connection that, in spite of the existence of the charges of 'Central' Commissioners, Government had to appoint the Income-tax Investigation Commission under a special statute. The reason for this was that the 'Central' Commissioners exercised no more powers under the law for conducting investigations and for compelling the production of the necessary evidence than the ordinary assessing officers of the Income-tax Department. Special powers had, therefore, to be given to the Income-tax Investigation Commission for this purpose, a provision which, we are told, facilitated its work to a great extent and made it a more effective organisation than the ordinary income-tax machinery. The Commission is also the final authority for the determination of questions of fact. The special powers enabled it to make more thorough investigations and thereby achieve greater speed and success, than was possible under the ordinary law, in the disposal of such assessments.

27. Taking all relevant factors into account, we are left with the impression that the balance of advantage lies in having a body such as the Income-tax Investigation Commission for investigation into cases involving substantial evasion. Such a body should be vested with special powers and should be presided over by a Judge of the High Court to inspire public confidence in its ability and integrity. It is not, in our opinion, in the interests of Government as well as of the general body of tax-payers that investigation into such cases should either be done spasmodically or that it should be delayed for a long time. We, therefore, strongly recommend that some separate and special organisation of this kind should be constituted and retained as a permanent feature of income-tax administration in this country. We would go further and also recommend that all the cases which would otherwise be considered important enough to be assigned to the two 'Central' Commissioners at Bombay and Calcutta should be referred to this newly constituted Commission for disposal. These two charges could then be abolished. We see no special advantage in the continuance of these two Commissioners' charges if it is not possible for the incumbents thereof to be given the special powers which the Income-tax Investigation Commission has. We are not prepared to suggest that the special powers which are now vested in the Income-tax Investigation Commission should be given to the 'Central' Commissioners or any other departmental officers. The Income-tax Investigation Commission is a special category by itself, as the Chairman has to be a serving or a retired High Court Judge. Extensive powers given to a Commission of this composition cannot obviously be given to any purely departmental organisation. We are convinced that in order to keep evasion fully and effectively under control an organisation possessing these special powers is necessary. It may be useful to repeat, in this connection, what we said in an earlier paragraph, that none of the special powers vested in the present Commission has been criticised as opposed to the principles of natural justice by the Supreme Court in the course of either of the two judgments that they delivered recently on the subject of the legality of the Taxation on Income (Investigation Commission) Act. The only alternative, therefore, to vesting these special powers in a purely departmental organisation is to vest them in a specially constituted body such as the present Income-tax Investigation Commission.

28. An important factor, which has also influenced us in coming to the above conclusion, is that we believe that an extra-departmental Commission of the kind that we are suggesting is the most appropriate organisation for discussing, and deciding on, 'settlement' terms with assessees whose cases are referred to them for special investigation. The assessee would, in normal circumstances, feel more at ease with and more ready to make his confessions to a body of this kind than to a departmental official or a board of departmental officials. There is also, in our opinion, less risk of unfounded charges of corruption and favouritism being levelled against a body of this kind than would be almost certain to be levelled against individual officers if complete discretion were vested in them for the 'settlement' of these big evasion cases.

Special circles

29. We are satisfied that the institution of 'Special Circles' has been a move in the right direction, and we think that this system should be extended gradually so as to enable the more difficult cases in the charge of Commissioners of Income-tax to be dealt with effectively by officers specially selected for this purpose. Detailed investigations of this nature take comparatively a longer time to complete. We would, therefore, suggest that the investigating staff including supervising officers should not, considering the nature of their work, be drawn from personnel that is nearing retirement or has been placed on the retired list.

Legal powers for adequate enforcement

30. Assuming that cases involving substantial evasion will be dealt with in the special manner that we have outlined above, there still remains the question of tackling the lesser cases of evasion which are bound to be large in number unless stringent measures are adopted. The essential requisite for this purpose is that the officials of the Income-tax Department should have the necessary legal authority to enforce effectively the provisions of the Income-tax Act. The additional powers which the Income-tax Department should, in our opinion, have for this purpose may be discussed under the following main heads:—

(i) powers for re-opening assessments, or starting new proceedings, in addition to those contained in section 34 of the Income-tax Act;

(ii) powers for search of premises and seizure of documents;

(iii) punitive powers—*i.e.*, the power to levy penalty for defaults of the law; and

(iv) power to call for information necessary for the enforcement of the Act.

We also discuss below some of the suggestions that have been made to us by various witnesses in regard to conferment of these powers on the officials of the Income-tax Department.

Section 34 of the Income-tax Act

31. The power to re-open past cases in which income has escaped assessment is a feature of the income-tax laws of all the leading countries. In India also, section 34 of the Income-tax Act which gives this power to the Income-tax Officer has been in existence for a long

time and has undergone various amendments. The major amendments were made in 1939 and 1948, the latter having been made on the recommendations of the income-tax Investigation Commission. The important features of this section, as it stands at present, are: —

(1) action under this section can be initiated if the Income-tax Officer has reason to believe that income has escaped assessment or has been under-assessed or has been assessed at too low a rate or excessive loss or depreciation has been allowed;

(2) before initiating action under this section, the Income-tax Officer has to obtain the approval of the Commissioner of Income-tax;

(3) a distinction is made between two types of cases: (i) where income escapes assessment or is under-assessed because an assessee has made a false return of income or has not disclosed fully and truly all material facts necessary for his assessment or has not made a return of his income at all, and (ii) where the evasion is not deliberate. In the former case, action for re-opening the assessment can be taken not later than eight years, and in the latter not later than four years after the end of the assessment year in which it was originally assessed or was so assessable;

(4) in cases of the first type mentioned in (3) above, the re-assessment can cover the income of eight previous years; in the second type of cases it can cover only four previous years' income;

(5) where the assessment proceedings are commenced shortly before the expiry of the time-limits of four and eight years mentioned above, the period for completion of the assessment has been extended by one year.

32. We deal below with certain suggestions made to us for the tightening up of the provisions of the section as well as with certain criticisms that have been levelled against the section by witnesses who have given evidence before us: —

(1) The first criticism is that because the words "Income-tax Officer has reason to believe" have wider scope than the corresponding wording which existed in the section before 1948 *viz.*, "if in consequence of definite information which has come into his possession the Income-tax Officer discovers", assessments are being reopened on mere suspicion, and that considerable harassment is being caused to the assessees as a consequence. This question was fully considered by the Income-tax Investigation Commission and we agree with the arguments advanced by it in favour of the wording of the section as it exists today. The evidence furnished to us also does not disclose that the discretion vested in the Income-tax Officer has been applied indiscriminately as is alleged by some witnesses. We therefore do not see any reason for reverting to the pre-1948 wording of the section which had practically rendered its working infructuous.

(ii) The present time-limits within which assessments can be reopened have been indicated as unduly long. Business interests have generally advocated a much shorter time-limit. We are unable to appreciate the reasons for fixing a time-limit at all in respect of cases in which fraud is involved. We observe that in the income-tax law of no other country, *e.g.*, U.K., U.S.A., Canada, or Australia is there a provision which lays down a time-limit for reopening cases where fraud is suspected. We think, therefore, that, far from the time-limit now provided being shortened, there should be none at all in cases where fraud is suspected. Where no fraud is suspected we think the present limit of four years is adequate and requires no change.

(iii) It has been suggested to us that the requirement of the previous approval of the Commissioner of Income-tax before an assessment can be reopened should be dispensed with. This is purely a formal requirement, as it is unlikely that a Commissioner of Income-tax will be able to find time to go into the facts of all the numerous cases that come up before him for prior approval. We recommend, therefore, that this provision should be repealed and the responsibility for reopening assessments placed squarely on the Income-tax Officer. We do not think that the present provision serves any useful purpose in actual practice as a safeguard to the assessee against harassment by the Income-tax Department.

Powers of entry and search

33. Another suggestion that has been made to us for strengthening the position of the Income-tax Officer in tackling the tax-evader is that he should be given the right, by specific provision in the law, to enter business premises and other buildings, and seize books and documents which he might consider relevant for purposes of assessment. The Income-tax (Amendment) Bill of 1938 included a clause to give effect to this proposal, but it was not enacted owing to opposition to it in the Legislature. The Income-tax Investigation Commission went into this question thoroughly. It considered that powers of search and seizure were essential for Income-tax Officers as otherwise there were no means of discovering the preparation of multiple sets of accounts kept by defaulting assessees. The Income-tax Investigation Commission recommended that the powers of search and seizure, which should be conferred on all Income-tax Officers, should be subject to obtaining the previous approval of the Inspecting Assistant Commissioner, or where this was not possible, to a report being made to the Inspecting Assistant Commissioner immediately after the Income-tax Officer had taken action. A considerable volume of opposition has been voiced before us to the conferment of any such powers even with the safeguards mentioned. The opposition is generally based on grounds of possible harassment to the assessees. We gather from the report of the Income-tax Investigation Commission that important evidence is deliberately kept away by some assessees from the income-tax authorities, and that subsidiary books which

contain valuable clues to concealments are not, many a time, produced along with the main account books. We are, therefore, of the opinion that the income-tax authorities should be placed in a position to be able to discover such evidence that is withheld from them.

We do not also see why Income-tax Officers, all of whom belong to a Central Class I or II Service, should alone be held as not fit to be trusted with even limited powers of entry, search and seizure, when such powers have been conferred on officials (of comparatively lower status) connected with the sales tax, excise, customs and rationing departments. We accordingly recommend that Income-tax Officers should be authorised, subject to the previous sanction of the Commissioner of Income-tax, to enter business premises and to inspect accounts and documents kept there, place identification marks on them and make copies and, if the officer has reason to think that they may not be forthcoming when required, to impound them; and to make a search of the places where there are reasonable grounds for believing that relevant books and records have been kept.

34. A closely connected suggestion is to invest Income-tax Officers with the power to inspect the contents of safe deposit vaults and lockers, as there is an increasing tendency on the part of tax-dodgers to invest their secreted profits in bullion and jewellery, or to hold shares on blank transfer certificates. We recommend that this power should also be conferred under similar safeguards, *i.e.*, subject to the previous sanction of the Commissioner of Income-tax.

Punitive Powers

35. We also think that the stiffening of the present penalty provisions of the Income-tax Act is called for in certain directions as a deterrent effect on tax-dodgers.

Penalties are at present calculated with reference to the amount of tax demand raised against the assessee. Under section 28 of the Income-tax Act, the maximum amount of penalty that can be levied is an amount equal to one and a half times the demand raised. Usually, the penalty is levied broadly with reference to the type of offence committed. It is also possible to prosecute assessees under sections 51 and 52 of the Income-tax Act for certain offences, but prosecutions are seldom resorted to in actual practice.

36. In the United Kingdom, the maximum penalty can be as much as three times the tax sought to be avoided as against the one and a half times in India. Also, in the United Kingdom the abetment, assistance, inducement of instigation in making or delivering false or fraudulent accounts or avoidance of super-tax through fraud is also a punishable offence. In India abetment is not punishable.

37. We consider that the maximum limit of penalty should be increased to three times the amount of tax evaded and that abetment or instigation to evasion should be made an offence punishable to the same extent as the main offence.

Power to call for information

38. As regards power to call for information, we refer to two important items, *viz.*

(a) the power to call for a statement of assets and liabilities of an assessee as on a particular date (this is also known as a 'net worth' statement); and

(b) the requirement placed upon the liquidator of a company to send information to the Income-tax Department within 30 days of the adoption of a resolution by the company for liquidation or winding up.

The former statement is useful for checking the growth in the 'worth' of the assessee against his assessment record between two terminal points of time. It is possible to call for this statement even now [under section 22(4) of the Income-tax Act] after the prior approval of the Commissioner of Income-tax has been obtained. We consider that the submission of a statement of this nature, every three years along with the return of income, should be made obligatory under the law. It will not only assist in checking income-tax returns but it will also facilitate the administration of the estate duty. The power to call for it at any point of time during the three-year period should continue as at present in order to enable the Income-tax Department to carry out the scrutiny of cases of evasion that may arise in the interval.

39. The purpose of the information referred to at (b) above is obvious and we revert to this subject in paragraphs 59—61 *infra*. In view of the consideration set out there, we consider that the submission of such a statement, which incidentally is also prescribed in the Internal Revenue Code of the U.S.A.*, will be useful for combating evasion through this source.

Disclosure of information in assessment records

40. Suggestions have been made from time to time that the secrecy provisions of the Income-tax Act should be relaxed so as to bring the pressure of social calumny to bear on tax-dodgers. Section 54 of the Income-tax Act provides for the secrecy of all particulars contained in any statement, return, accounts or documents produced, or evidence given, in the course of income-tax proceedings. Disclosure is, however, permitted in certain specific cases mentioned in section 54(3) The principle underlying this section is to make the information confidential so that the assessee may come forward with a full and true disclosure of all the relevant facts within his knowledge, with the assurance that any statement made by him would not be subsequently used against him. The exceptions contained in sub-section (3) provide for cases where disclosure is considered to be necessary in the public interest. An income-tax assessment necessarily involves the detailed scrutiny of an assessee's transactions, and we are of opinion that it is necessary to preserve the confidential nature of these transactions. We are, therefore, opposed to any further relaxation of the provisions of this section.

Publicity to names of offenders

41. Another suggestion that has been put before us is that the names of assessees against whom penalty action has been taken should be published in order that publicity might act as a deterrent to other would-be evaders. Publicity could, of course, be given only after the concealments have been fully established, and appeals (if any are filed) have been finally decided.

*Section 148 of the Internal Revenue Code.

When the assessments and appeals are decided, a long time will have elapsed after the original offence, and very little useful purpose will, in our opinion, be served by the publication of the names at that stage. It will clearly be inappropriate to publish names before the completion of appeals. In view of this, we see no great advantage in adopting this suggestion. Besides, the power to prosecute is available to the Income-tax Department, and if it is utilised in really bad cases, the necessary publicity will be automatically secured.

Representation in income-tax proceedings

42. Evasion of tax has in recent years increasingly become a matter for the expert to handle and it has been suggested to us that one way of cutting at the root of evasion would be to exercise strict control over the profession which caters for the representation of assessees in income-tax assessment cases. We have, therefore, thought it necessary to give this matter detailed consideration. There is, under the present law, no obligation on an assessee to get his accounts audited by a chartered accountant, or even to make use of the professional services of a qualified accountant for representing him before the income-tax authorities. Even where accounts are audited, the only statutory provisions governing the scope of audit are those contained in the Indian Companies Act relating to the audit of public limited companies. In reporting to the members of a public limited company on the accounts examined by him and on the balance sheet and profit and loss account, the accountant is required to state whether he has obtained all information and explanations required by him, whether in his opinion the balance sheet and profit and loss account are drawn up in conformity with the law, whether the balance sheet exhibits a true and correct view of the company's affairs according to the best of his information and the explanations given to him and as shown by the books of the company, and whether, in his opinion, the books of account of the company have been kept as required by law. If the Bill to consolidate and amend the company law, now before Parliament, is passed into law, he will hereafter have to report whether the company's accounts give a true and fair view of the company's affairs and its profit and loss at the end of the period of report. His report must specifically state whether all the information and explanations, which to the best of his knowledge and belief are necessary, had been obtained, whether from his examination he could state that proper books have been kept, whether he received adequate information about the branch offices which were not visited by him, and whether the balance sheet and profit and loss account dealt with in his report are in agreement with the books of account and returns.

43. The Madras High Court* has held that, unlike in the case of a company, an auditor's duty in the case of accounts of other types of business organisations is only to act on the instructions of his clients and to perform audit with due skill and diligence. While he is under an obligation to prepare and present a correct statement of accounts, he is not bound to verify whether the facts as incorporated in the accounts produced by the assessee are correct or not. In such a case the matter is entirely one between the parties,

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*C.I.T. *vs.* G. H. Dandekar (1952 I.T.R. 235).

and no third person (including the Revenue) can have any claim for damages because of any negligence on the part of the auditor.

The usefulness of audits by chartered accountants is thus limited, on the one hand, by the fact that their responsibilities are towards their clients and not to the Income-tax Department, and, on the other hand, by the fact that they must necessarily proceed on whatever information and evidence their clients choose to place before them.

44. The setting up of a system of nationalisation of chartered accountants has been put forward as a solution to the problem. The scheme is to have a Directorate General of Commercial Audit, under whom all auditors will work as whole time Government servants and also to have a code of accounts which they will use for purposes of audit.

45. An objection to the immediate adoption of any such scheme of nationalisation is that at present the number of qualified accountants available is quite inadequate for the purpose, and that the cost of audit will be greatly increased. The nationalisation of the accountancy profession will not also solve one of the most important problems which arise in connection with income-tax assessment, *viz.*, the evasion that is practised by the maintenance of double sets of accounts and by cash transactions being kept outside the business or being introduced into it surreptitiously. If accountants are to be able to cope with this problem, they will have to be given powers far in excess of what their normal activities would need. There will also be serious difficulties in laying down an account code defining the scope of the audit to be performed by the nationalised accountants, for instance, whether accountants are to be empowered to go into such matters as the reasonableness of various items of expenditure.

46. Another scheme which has been put forward before us is to insist on a certificate of audit by a chartered accountant being filed along with returns of income in all business cases with income exceeding a specified limit (say, Rs. 25,000). We are doubtful of the utility of any set arrangement of this kind. There might be businesses with large incomes where the accounts are quite simple, while on the other hand there might be businesses with quite complicated organisations where the profits are small. The real drawback in a scheme of compulsory audit is, however, that it cannot go far enough to meet the needs of the Income-tax Department in all cases. An accountant is restricted to the books of account and the evidence which the assessee chooses to place before him, and has no means of checking whether they are correct and complete. In cases of evasion, Income-tax Officers have necessarily to check the accounts against external information which may come into their possession, and for this purpose a further examination of the books by the Income-tax Officers will be unavoidable in some cases.

47. At the same time, it would clearly be useful to make better use of the services of chartered accountants. A suggestion has been made that it would be helpful to prescribe a detailed questionnaire, which accountants should fill up and submit along with their clients' returns. Such a procedure, it has been claimed, would relieve Income-tax Officers of a good deal of routine work and leave

them time to concentrate on evasion cases; it would also enable the accountants to demand with authority all material facts from their clients.

Any standard form of questionnaire is, however, likely to degenerate into mere routine procedure and will not enable the Income-tax Officer to appreciae the relevant facts of a case before him in all its bearings. What is feasible is that, after scrutinising the returns of income and the audit statements and, if necessary, after a general examination of the accounts, the Income-tax Officer should address a detailed set of questions to the accountant. At this stage, the responsibility for furnishing full and correct information should be legally placed on the accountant, and a convention should also grow up that the Income-tax Department will, as far as possible, rely upon the accountant's statements.

Income-tax practitioners

48. As the law now stands, an assessee can appear either in person or through a relative or person regularly employed by him, or a lawyer or accountant or income-tax practitioner. Persons entitled to appear as income-tax practitioners cover a wide range. Any person who has passed an accountancy examination recognised in this behalf by the Central Board of Revenue, or a graduate in commerce, law, economics or banking, including higher auditing, is entitled to appear in that capacity. As there were no statutory restrictions before 1939 on the qualifications required, any person who had represented an assessee before an income-tax authority prior to 1st April 1938*, has also been permitted to continue practising as an income-tax practitioner.

49. Suggestions have been put forward before us that only lawyers and chartered accountants should be allowed to appear as income-tax practitioners, or that various other restrictions should be imposed on admission into their ranks. The number of chartered accountants at present available in India is limited. In order to give all assessees a chance of being represented at reasonable cost, it is necessary to permit them to engage persons other than chartered accountants.

50. This raises other questions such as the most suitable way of regulating admission to the ranks of income-tax practitioners, and their professional conduct. Several witnesses have supported a suggestion—which had been put forward by the Income-tax Investigation Commission—that the Central Board of Revenue should hold an examination in income-tax law and accountancy similar to that held for Income-tax Officers, and that passing this examination should be a necessary qualification for fresh entrants to the profession. We are not impressed with the efficacy of a written examination as a method of selecting persons for following a profession of this kind. We are, therefore, not in favour of this suggestion.

Voluntary disclosures

51. We have hitherto considered anti-evasion measures which involve the stiffening of the law, generally to make it a more effective weapon against the tax-evader. A suggestion has been made to us that

*This date applies to the area included in 'British' India in 1938. Persons who appeared in any merged territory before 1st April 1949 or in any Part B State before 1st April 1950 have also been made eligible for the concession.

it would be useful to encourage persons who have evaded income to come forward and confess their lapses, on condition that they would make good the loss of revenue, by holding out the inducement of waiving the penalty which would ordinarily be levied on discovery of the evasion.

52. In the United Kingdom, the 'confession' method was introduced in 1923. The main features of this scheme were:—

(1) the tax-payer must take the initiative;

(2) where the initiative has not really been with the tax-payer it will be treated as such if certain conditions are fulfilled, although the penalty will be heavier than when the initiative is wholly his;

(3) the revenue investigations must be facilitated and full evidence, including both business and private records, must be produced;

(4) the present position of the defaulter will be taken into account in fixing the amount of tax to be paid in settlement, and fixing the date or dates of payment.

In the light of some legal difficulties which were noticed, section 34 of the U.K. Finance Act, 1942, (now section 504 of the U.K. Income-tax Act, 1952) was enacted in order to ensure the admissibility of evidence given in a pecuniary settlement case in courts of law. The method of confession, or what is called 'voluntary disclosure', is now a settled method of squaring the past accounts with the revenue authorities, and is increasingly utilised by accountants in particularly bad cases. It will be observed that the only assurance given is freedom from prosecution and mitigation of penalties in proportion to the co-operation offered to revenue authorities during investigations following disclosure.

53. In India, the Income-tax Investigation Commission has also made free use of the settlement procedure. Out of Rs. 46 crores of concealed income reported by the Commission upto the end of 1953, as much as Rs. 40·4 crores related to cases disposed of on a settlement basis.

54. A scheme of voluntary disclosure was also tried in 1951 and 1952. Assessees were encouraged to come forward with a full and true disclosure of past concealments. Those who did so, and gave full facilities to the Income-tax Department to investigate the correctness of their disclosures, were given an assurance that no prosecutions would be instituted, and that penalties would be mitigated, keeping in view the degree of co-operation afforded by the assessee as well as other relevant factors.

55. Disclosures were received in as many as 21,103 cases during the period allowed under the scheme and assessments had been finalised in 20,411 of these by the 31st May 1954. The income assessed was Rs. 73,85 lakhs and the tax demanded was Rs. 12,26 lakhs, giving an average of Rs. 36,181 in terms of income and Rs. 6,004 in terms of demand per case. The income which could have been assessed in these cases on the basis of the assessees' returns and other information available to the department was only Rs. 10,18 lakhs

and the concealed income brought to light through the disclosure scheme was as much as Rs. 63,67 lakhs, *i.e.*, rather over six times the income originally reported.

56. A feature of the scheme was that an undertaking was required to be taken from each assessee that if the disclosure was not true and complete the assessment could be reopened later. The disclosures given also covered the period beyond that for which assessments could be legally reopened. There were, however, certain elements of propaganda in the methods adopted for giving publicity to the scheme which might have had unfortunate psychological effects on some classes of assessees. It is possible that some of them may have got away with the impression that the Income-tax Department was no longer inclined to take a severe view of income-tax offences; and that they could escape lightly by confessing to only a fraction of their concealments. Such an impression would ordinarily do grave damage to morale, and we do not, therefore, recommend a repetition of the scheme in the form in which it was worked.

57. This does not, of course, mean that assessees should not be encouraged to come forward freely with confessions of the concealments and evasions which they have been guilty of. Even under the existing law, there is nothing to prevent an assessee from making a disclosure of past concealments of income. The executive has the discretion to determine the actual amount of penalty to be levied within the maximum laid down in the law. They have also the power to compound cases which are actionable under the Indian Penal Code on payment by the assessee of what is considered to be the loss caused to the exchequer by his actions. The degree of 'concession' to be given to an assessee in respect of these matters must naturally depend on the degree of co-operation that he voluntarily extends to the Income-tax Officer in the matter of investigating and settling his assessments. We think that the present practice needs no change.

Collection of tax

58. There are certain features of the machinery of collection which also have a bearing on tax evasion. We shall consider in the next chapter dealing with administrative machinery the adequacy of the existing provisions for the collection of income-tax, but we shall refer here to certain special features of collection of tax to the extent that they are related to the problem of evasion.

Recovery of tax from companies in liquidation

59. We have been informed that several cases have occurred where an attempt was made to evade tax by carrying on business through the formation of limited companies (generally private limited companies), and putting them into liquidation before assessment is made. Under sections 230 and 231 of the Indian Companies Act, only taxes which have become due and payable twelve months before the date of the winding-up order where the liquidation is through the court, or before the date of commencement of 'winding-up proceedings' in other cases, are entitled to rank for preference along with certain other specified debts.

60. So far as income-tax is concerned assessment proceedings in respect of a year of account cannot be commenced until the succeed-

ing financial year; the proceedings themselves may be protracted partly due to the assessee's dilatory tactics and partly on other grounds. After completion of assessment, a notice of demand has to be served on the assessee specifying the date by which the tax is payable. It is only after this period has expired that the tax can rank for priority. A claim of general priority in respect of debts due to the State was over-ruled by the Federal Court*. The Court held that the conditions of section 230 of the Indian Companies Act had to be fulfilled in order to secure priority. It is thus obvious that the tax on the income of one or two years preceding the commencement of winding-up proceedings cannot, in the present state of the law, rank as a preferential debt.

61. The Income-tax Investigation Commission, which considered this question, recommended that section 230 of the Indian Companies Act should be amended to the extent of allowing preferential payment of one year's assessment if assessed for a period prior to the winding-up, notwithstanding that the assessment was not made until after the winding-up. It also suggested consideration of the question whether priority could not reasonably be extended to more than one year. It further recommended that express provision should be made for the levy of tax on profits (if any) earned after the commencement of the winding-up and that a legal obligation should be thrown on the liquidator to give notice to the income-tax authorities within a specified period after his appointment and, on hearing from the income-tax authorities, to set aside sufficient assets for payment of the tax.

62. On the other hand, the Company Law Committee was of the opinion that the remedy for the existing state of affairs was not the conferment of preferential rights, but the energetic completion of assessment proceedings and vigorous measures for the collection of taxes. It is not possible sometimes, in the nature of income-tax procedure, for assessment to be raised before a company goes into liquidation. It is, therefore, necessary that there should be a specific provision that pending assessments should be completed and tax demand raised against the company in liquidation. Such tax demand should, in our opinion, rank as a preferential debt against its assets.

Power to recover taxes from the shareholders

63. Another suggestion that has been placed before us is that the Income-tax Department should have a right to recover taxes from shareholders when the tax cannot be recovered from the company or at any rate, from a company which has gone into liquidation, for a period of one year after the distribution of assets. This suggestion runs counter to the whole conception of a company as a separate legal and economic entity from its shareholders, and cannot obviously be entertained in relation to companies in which the public are substantially interested. We have, however, been informed that there are several instances of closely-held companies where assets have been sequestered by the shareholders and the company is put into liquidation before income-tax assessment is completed.

*Governor General in Council *vs.* Shiromani Sugar Mills, Ltd. (in liquidation) 1946 I.T.R. 248).

64. In 1949 an amendment was suggested to section 44 of the Income-tax Act proposing to fix personal liability on the shareholders of private limited companies in respect of taxes assessed on the income of the companies which could not be recovered from them. The introduction of such a procedure was opposed on the following grounds: (i) it militates against the principle of limited liability; (ii) it is difficult to justify a procedure for the collection of taxes from private limited companies distinct from the one for recovery of taxes from public limited companies; and (iii) such powers may be used to recover taxes even in cases where, due to no fault of the management, the company's resources are insufficient to meet its liabilities.

Fixing personal liability on shareholders

65. There is considerable force in the above arguments and yet the possibility of avoiding the payment of tax by making use of the closely controlled company is real. We, therefore, think that, subject to adequate safeguards, it is proper to accord a different treatment to private limited companies. Accordingly we recommend that the tax due from a company should be recovered from the shareholders only when the company goes into liquidation and if it is a company in which the public are *not* substantially interested. Even as regards liquidation we would suggest that the recovery should be effected only if the Commissioner of Income-tax is personally satisfied that liquidation has been undertaken with a view to avoidance of tax. In both the cases, appeals should be allowed to the Appellate Tribunal.

66. Another suggestion that has been made to us is that it should be provided for in the law that the Registrar of Companies should not strike off a company from the register of companies unless a tax clearance certificate has been obtained from the Income-tax Officer. The aim is to protect the interests of revenue against hasty distribution of the assets of a company on liquidation. This is a reasonable safeguard for revenue and we recommend its adoption.

CHAPTER XIII

THE ADMINISTRATIVE MACHINERY

There is perhaps no field of State-citizen relationship in which it is so necessary that justice should not only be done but should clearly appear to be done as in that of taxation. Taxes imposed with meticulous regard to equity can become oppressive unless (a) the machinery for their collection is so designed as to function with simplicity and speed and (b) the personnel entrusted with the duty of administering the tax laws bring to bear on the discharge of their daily tasks the maximum amount of tact and patience consistent with efficiency. We propose to examine in this chapter the extent to which these requirements are fulfilled in the administration of the Income-tax Act. The question may be divided for consideration under the following main heads:—

(1) assessment procedure;

(2) collection and recovery procedure;

(3) appellate procedure; and

(4) adequacy and training of personnel of the Income-tax Department.

Assessment Procedure

2. The grievances regarding 'assessment procedure' mainly relate to:

(i) arbitrary rejection of accounts and consequent estimated assessments;

(ii) delay in making refunds;

(iii) delay in completing assessments;

(iv) treatment of cash credits as income;

(v) interference by superior officers in work of the assessing Income-tax Officers;

(vi) insufficient time for compliance with notices; and

(vii) insufficient attention to public-relations aspect in dealing with assessees.

We propose to discuss the points raised in respect of these questions *seriatim*.

Estimated assessments

3. One of the major complaints against the Income-tax Department is that there is a tendency to reject accounts, on flimsy grounds, especially of small assessees, with the result that in a large number of assessments the tax liability is settled on the judgment of the Income-tax Officer. The proviso to section 13 of the Income-tax Act, which authorises recourse to an estimated assessment was, it is

urged, meant to be applied only in rare cases but, it is alleged that it has now become the common refuge of the Income-tax Department.

4. It is observed from the figures supplied by the Central Board of Revenue that estimated assessments constitute as much as 90 per cent. of the total assessments of retail dealers in the rural areas of Madras and 70 per cent. in the urban areas of the same State; the figure for Uttar Pradesh is 60 per cent. and for Assam 50 per cent. It is reasonable to conclude that the position in other States may not be materially different. We have been assured by the Central Board of Revenue that, generally speaking, accounts are rejected by Income-tax Officers not capriciously or without good reasons (recorded in the assessment order) but only because they are either demonstrably unreliable, or are maintained in such a manner that it is not possible to deduce the correct income, profits and gains from them. According to the Central Board of Revenue, the number of cases in which accounts have been rejected without full justification is not likely to be large.

5. The normal procedure is for the Income-tax Officer to carry out a detailed scrutiny of the assessee's accounts, and if these show an unusually low rate of gross profits as compared to those returned by other dealers in the same trade, to place on him the onus of proving that his accounts are correct. The majority of retail traders do not find it possible to maintain their accounts in accordance with the accepted principles of accountancy, and we are told that frequently accounts are rejected as unreliable because of one or the other of the following defects:

(a) absence of a quantitative tally of the opening stock and purchases with sales and closing stock;

(b) absence of genuine and reliable vouchers for purchases and sales;

(c) absence of manufacturing or production accounts; and

(d) failure to close accounts by valuing the opening and the closing stocks.

6. The Central Board of Revenue has further assured us that Income-tax Officers, while scrutinising accounts, point out the defects to the assessees verbally, and also mention them in the assessment orders. It is argued, therefore, that it should not be difficult for assessees to rectify the defects pointed out to them.

Accounts of retailers

7. There are complaints, on the other hand, that the attitude of the Income-tax Department is not helpful and that Income-tax Officers do not appreciate the difficulties of the assessees in maintaining accounts according to the accepted accountancy principles. Thus in the case of a retail trader the Income-tax Officer expects the assessee not only to maintain an inventory of the goods in stock at the end of the year, but also to prove the correctness of the quantities of each kind of goods included in that inventory. This is a task, it is argued, "which every sane man knows to be impossible, and yet in 99·8 per cent. of the cases of retail traders the Income-tax Officer rejects the accounts on

the ground that the stock lists have not been proved"*. It is, therefore, argued that unless this attitude of the Income-tax Department is changed the assessee's position is bound to be unsatisfactory.

8. While it is common ground that the accounts maintained by small assessees are defective, different opinions are held regarding the possibility of effecting improvements in them. The Central Board of Revenue is of the view that it is possible for the assessees to rectify the defects. On the other hand, some of the witnesses appearing before us have urged that it is simply not possible for small assessees to maintain a stock tally if it is a necessary requisite of the standard of accounts expected of them. We are left with the impression that, if a majority of the accounts of retail traders is being rejected in spite of the efforts of the Income-tax Department to improve them, either the assessees are incorrigible or there is some inherent difficulty in the maintenance of accounts in the manner acceptable to the Income-tax Department.

Inability of small assessees to maintain accounts in acceptable form

9. It is not possible to be dogmatic on a subject like this in regard to which much can be said on both the sides. We have not had the time to go into the question in detail, nor are we in a position to do so as a Commission charged with broad terms of reference. We do not feel inclined to subscribe to the extreme conclusion that a majority of the retail dealers are out to cheat the revenues and, therefore, deliberately maintain defective accounts year after year. Estimated assessment naturally involves some element of arbitrariness. No one would like to face that prospect deliberately unless he was sure that the estimate would be to his advantage. In that event, the conclusion that would emerge would be that there was consistent under-assessment by the Income-tax Department. If that were so, this would not be made the gravamen of a charge against the Income-tax Department. The causes lie deeper than these apparent considerations and we, therefore, suggest that the Central Board of Revenue should institute an enquiry into the reasons for accounts not being maintained in the required manner acceptable to the Income-tax authorities. The possibility of changing the present assessment procedure should be considered in the light of the results of this enquiry.

Delay in making refunds

10. Delay in the grant of refunds due from Government is another major grievance against the Income-tax Department. As most of the refunds arise from the procedure of deduction of tax at the source, an impression of this type tends to discredit the system itself. The Income-tax Investigation Commission, it would appear, was also convinced of the correctness of this charge against the Income-tax Department and had, therefore, recommended the payment of interest to assessees whose refund claims were outstanding for more than a specified period. Similar suggestions have also been made to us by various organisations. We have, therefore, considered it necessary to look into this matter in some detail.

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*Memorandum of Evidence of the Taxpayers' Association of India, Ltd., Bombay.

11. The following statistical table gives figures regarding the disposal of refund claims for the five years ending 31st March 1953:—

TABLE 1.—*Disposal of refund claims during the years* 1948-49 to 1952-53

	1948-49	1949-50	1950-51	1951-52	1952-53
1. No. of refund applications pending as on 1st April .	7,707	5,589	7,872	12,255	8,223
2. No. of refund applications received during the year .	40,227	41,788	52,928	59,577	65,750
3. Total of (1) and (2) . .	47,934	47,377	60,800	71,832	73,973
4. No. of refund applications disposed of during the year	42,345	41,573	48,546	63,609	66,553
(Percentage of 4 to 3) . .	*88*	*88*	*80*	*87*	*90*
5. No. of refund applications pending on 31st March .	5,589	5,804	12,255	8,223	7,420
(Percentage of 5 to 3) .	*12*	*12*	*20*	*13*	*10*
6. Classification of the applications pending on 1st April 1953:					
(a) No. pending for more than one year					975
(b) No. pending for more than three months					2,051
(c) No. pending for less than three months					4,394

It will be noticed that nearly 86 per cent. of the claims, on the average, were disposed of within the year in which they were received. Of the pending claims on 1st April 1953, approximately 60 per cent. were less than three months old while only thirteen per cent. were over a year old. The position, it would appear, has improved, since the Income-tax Investigation Commission reported although we appreciate that there is room for further improvement. We are told that it has now been made obligatory for refund claims pending for over three months to be shown in the monthly progress report of the Income-tax Officer, and the Inspecting Assistant Commissioners have been instructed to scrutinise such cases personally. This procedure should give an impetus to the drive for quicker disposal of refund claims. We suggest that the form of the monthly progress report of the Income-tax Officer should be amended to indicate also pending cases which are over one year old. The Commissioner of Income-tax should also carry out surprise inspection of some selected cases in order to satisfy himself that everything possible was being done to expedite the disposal of refund claims. We would also suggest a sample audit of pending claims in some of the offices in each Commissioner's charge by the Director of Inspection to find out the causes of delay so that suitable instructions could be issued.

Exemption certificates

12. The best way of tackling the question of refund claims is to arrange the system in such a way as to avoid deduction of tax at the source at more than the rate applicable to the personal income of the assessee. This is possible under the present law in respect of deduction of tax from interest on securities. The Income-tax Officer can issue an exemption certificate, which remains operative for a stated period, authorising the person paying interest to deduct tax therefrom at the rate shown in the certificate instead of at the maximum rate as is required to be done otherwise. Measures should be taken to see that

this facility is availed of by as many assessees as is possible and that the procedure is extended, wherever feasible, to other sources of income also.

13. As regards the former, it is understood that this facility is being availed of mainly by public institutions such as religious and charitable trusts, local bodies, etc. It is possible that other tax-payers, particularly small assessees, are not familiar with this provision. We suggest that wide publicity should be given to this by the Income-tax Department. The Public Debt Office and the treasuries which disburse interest to holders of securities may also give publicity to the fact preferably by attaching a coloured slip with the certificate.

14. As regards the latter, we have already suggested in the chapter on "Taxation of Corporate Income—I" that the system of exemption certificate should be extended to income from dividends also. A large number of refund claims could thus be avoided as statistics show that nearly 45 per cent. of the recipients of dividends are persons with income below the taxable limit.

We think that if the above measures are adopted and are pursued vigorously much of the irritation now caused on this account will disappear.

Refunds due to appellate decisions

15. The position is somewhat different in the case of refunds due as a result of appellate decisions. We have not been supplied with figures to indicate the magnitude of the problem, but the number of complaints of this type received by us is also large. We would, therefore, suggest that the Central Board of Revenue should make a detailed enquiry, on the basis of a random sample, into the outstanding claims as on a particular date and take necessary steps to prevent recurrence of delay, if any. It would be advisable to publish the results of this enquiry and the action taken on them.

Delay in completing assessments

16. Delay in the completion of assessments is another of the major grievances against the Income-tax Department. Apart from the undoubted inconvenience and uncertainty it causes to the assessees, it is also harmful to the interests of revenue. It has a bad effect on public relations inasmuch as the prevailing impression appears to be that the delays occur because of the inability of the Income-tax Department to arrange its work properly.

17. The complaint made seems to us to be fully justified as is evident from the figures, given in the table below, regarding the growth of arrears of assessment during the last five years.

TABLE 2.—*Statement showing the number of cases pending during the period* 1949 *to* 1953

Number of cases pending as on	Out of brought forward cases	Out of current cases	Total
1-4-1949	1,24,850	2,33,969	3,58,819
1-4-1950	1,34,462	2,51,039	3,85,501
1-4-1951	1,57,197	3,70,873	5,28,070
1-4-1952	1,62,539	2,51,985	4,14,524
1-4-1953	1,78,939	3,22,466	5,01,405

Except for 1951-52, when a special drive was launched to clear off arrears by relaxing the usual standards of scrutiny, the tendency has been for a steady rise in the pending assessments. The analysis of figures of arrears of assessment by the types of pending cases given in Table 3 below will be found interesting.

TABLE 3.—*Analysis of arrears of assessments*

No. of cases pending as on	1-4-1949	1-4-1950	1-4-1951	1-4-1952	1-4-1953
(1) With business income above Rs. 25,000	36,564	37,533	45,233	45,438	51,810
(2) With business income between Rs. 10,000—25,000 .	42,412	44,755	60,372	57,115	63,867
(3) With business income between Rs. 5,000—10,000 .	70,799	69,741	1,00,005	76,906	86,878
(4) Business cases with income below Rs. 5,000 and non-business cases . . .	1,12,525	1,11,808	1,43,132	1,03,176	1,32,523
(5) Others—Largely salary cases	96,519	1,21,664	1,79,328	1,31,889	1,76,327
TOTAL	3,58,819	3,85,501	5,28,070	4,14,524	5,01,405

18. It will be observed that 35 per cent. of the pending work relates practically to the returns of salaried persons. Income-tax is deducted at the source in such cases and the arrears of assessment have, therefore, very little significance from the point of view of revenue. Of the pending assessments, 26 per cent. relate to persons with incomes below Rs. 5,000. The tax in each assessment cannot exceed Rs. 164. The arrears of assessment in this category are not very material from the point of view of the magnitude of the revenue involved, but as they pertain to small assessees, they have a considerable public relations aspect. It is hard for persons of such means to be confronted with consolidated demands for a number of years at one time after the lapse of a long period. The same remarks apply to other categories which are also more important from the point of view of revenue. The pending assessments of persons with business income above Rs. 25,000 amount to one year's workload of the Income-tax Department in this category. The bulk of revenue has been already obtained from these cases through the payment of advance tax under section 18A of the Income-tax Act, but detailed scrutiny of assessments in this category is of the utmost importance from the revenue standpoint. The fact that this scrutiny is delayed not only inconveniences the assessees but also makes the investigation of facts difficult due to efflux of time.

19. The situation regarding pending assessments is serious enough to need radical treatment. We would suggest relaxation of the usual standards of examination of accounts for categories which do not involve any substantial revenue. These form nearly 80 per cent. of the total pending assessments and comprise categories (3), (4) and (5) of Table 3 above. As regards assessments in categories (1) and (2) of Table 3 above, we would not suggest any relaxation of

the standards of examination for assessment which the Income-tax Officer has reason to believe, from the previous history of the cases concerned, should be investigated fully. In other instances we would suggest that the Income-tax Officer should be given discretion, subject to prior consultation with the Inspecting Assistant Commissioners, to relax the usual standards of examination and complete assessments. Once the decks are cleared of the pending assessments, the magnitude of which is bound to exert an adverse influence on the future arrangement of work, it should be possible to devise ways and means of preventing a large accumulation of arrears in future. Sample audit of pending returns was done in the United States recently and it should not be difficult to draw up a similar scheme in India also in order to minimise drastically the arrears of work in the Income-tax Department.

20. We do not underrate the difficulties of the Income-tax Department in this respect arising as they do mainly from the inadequacy of trained personnel. A review of the work done by the Income-tax Department in the last five years has shown that an Income-tax Officer, on an average, disposes of nearly 1,200 cases every year, which works upto about five assessments for each working day. This is a heavy work-load and unless the number of assessing officers is increased, the Income-tax Department has to exercise a certain amount of discretion, with minimum risk to the revenue, to arrange their assessment work. The importance of sample audit of returns for categories of assessments involving small revenue is all the more important in the context of the shortage of staff.

21. We would now like to refer to some of the reasons that have been mentioned by various witnesses which also impede the expeditious disposal of assessment work. One of the complaints made is that frequent transfers of assessing officers result in a fresh investigation by the relieving officer of the partly finished cases. We observe that section 5(7C) of the Income-tax Act makes provision for validating the proceedings initiated by one officer and continued by another. At the same time, we appreciate that a certain amount of overlapping of investigation and examination of accounts is likely to occur when one officer takes over a partly finished assessment from another. We have ascertained that it is not a normal practice in the Income-tax Department to transfer an officer before three years of stay in one station. The effect of this type of overlapping of work is likely to be inconsiderable over the state of arrears as a whole although it may cause inconvenience in individual cases. We would therefore recommend that the Central Board of Revenue should issue strict instructions to ensure:

(i) that the case file contains exhaustive notes regarding the stages of work that have been completed and the type of investigations that were carried out as well as the results thereof; and

(ii) that the Commissioner of Income-tax should not normally transfer an officer unless he has satisfied himself that the number of incomplete cases is not likely to be large at the time of his transfer.

22. It has been urged by some witnesses that unnecessary delay is caused by Income-tax Officers continuing external investigations

even when it is obvious that it is profitless to proceed further with them. It is difficult to be dogmatic in a matter like this as it is inevitable that there should be differences of opinion between the Income-tax Officer and the assessee as regards the precise extent to which the former should push forward his investigations. We nevertheless think that it is possible even in this sphere to regulate investigation work intelligently and to avoid giving the impression to the assessee that the investigation is conducted merely for the reason that every assessee is suspected, as a matter of course, to be a potential tax evader. We would, therefore, recommend that inspecting officers should pick out cases in which avoidable delay has taken place owing to patently infructuous investigations conducted by the Income-tax Officers and take necessary steps to correct this tendency wherever it exists. If discrimination is properly exercised in this matter, it should be possible in our opinion to eliminate a good deal of infructuous enquiries that now delay the disposal of assessments and thereby adversely affect the collection of revenues as well as public relations with the assessees.

23. Some witnesses have stated that the scheme of 'pay-as-you-earn' contained in section 18A of the Income-tax Act has been responsible for delay in the completion of final assessments. It is contended that Income-tax Officers are not keen to take up the assessments as a large part of the tax is collected in advance. The analysis of assessments in arrears, as furnished by the Central Board of Revenue, does not, however, bear out this contention. The assessments pending on 1st April 1953 amounting to 5,01,405 consist of—

(a) 2,75,504 (55 per cent.) relating to assessment year 1952-53;

(b) 1,21,500 (24 per cent.) relating to assessment year 1951-52; and

(c) 1,04,401 (21 per cent.) relating to earlier years.

It will thus be seen that only 21 per cent. of the arrear assessments are more than two years old. Moreover, the cases where advance tax is of any importance (*i.e.*, cases with incomes above Rs. 10,000) constitute only about 20 per cent. of the total assessments in arrears. After making due allowance for the pending assessments taken over from Part B States and for the admitted shortage in personnel which the Income-tax Department has been facing for the last several years, these figures would seem to belie the contention that assessments have been delayed because of advance payment of tax.

Treatment of cash credits as income

24. The grievance in regard to the treatment of cash credits is that the amount introduced as cash into the business is invariably, and arbitrarily treated as concealed income which has escaped tax even though it may actually be of a capital nature, such as a loan from some party or the sale proceeds of family bullion and family jewellery. It has been urged that *stridhan* (wife's property) and gifts of jewellery being customary in Indian social practice some of the finance raised by businessmen is from these sources. On the other hand, it is also true that these two avenues have been used in the past by many tax-payers to introduce secreted money into the business. Each cash credit has, therefore, to be followed carefully to

its ultimate source and scrutinised with reference to all the relevant facts. Such scrutiny is bound to be inquisitorial but it is only right that the tax-payer's statements should be put to the strictest possible proof. We see little escape from this method of enquiry. Matters should improve, however, if the suggestion made elsewhere regarding the submission of 'wealth statement' every three years is adopted. This statement should also indicate *stridhan* and the value of jewellery in the possession of the assessee's wife and of other members of his family. These two important sources of introducing cash into business will then become subject to greater scrutiny and would furnish the limit of the tax-payer's drawal on them in future.

Interference by superior officers in the work of the assessing Income-tax Officers

25. Section 5(7B) of the Income-tax Act which was inserted by the Income-tax (Amendment) Act, 1953, empowers the Director of Inspection, the Commissioner of Income-tax and the Inspecting Assistant Commissioner of Income-tax to issue instructions for the guidance of any Income-tax Officer subordinate to them in the matter of any assessment. This provision has been criticised by a large number of witnesses on the ground that it is a violation of the important principle that the assessee should be given a hearing before a decision, unfavourable to him, is taken.

26. We do not see anything inherently wrong in instructions being given by superior authorities to Income-tax Officers as income-tax cases involve investigation into and determination of facts as well as application of the law. The investigation and determination of facts is to some extent an administrative function. Moreover, interference by a superior authority may not always be to the disadvantage of the assessee. We, however, appreciate that there is justification for the apprehension that the procedure at present in force is likely, in several cases, to result in decisions unfavourable to the assessee being taken without his being given an opportunity to rebut the premises on which they are based. It is possible that before a decision is given the facts may be carefully recorded by the Income-tax Officer after discussion with the assessee, but, nevertheless, there is always likely to be a feeling in the latter's mind that he might have been able to obtain a different decision if he had had the opportunity of being heard by the authority that issued the instructions. We have already stated that it is necessary in income-tax matters especially that not only should justice be done but it should also appear to be done. The procedure at present followed amounts to a breach of this principle and is calculated to create a feeling of dissatisfaction in the honest assessee. We think that there are two drawbacks in the existing system. One is the duality of control, by the Director of Inspection and by the Commissioner of Income-tax, on the Income-tax Officer. The other is that the Director of Inspection is not ordinarily in a position to give a hearing to the assessee and is likely to decide issues on the written material before him. We would, therefore, suggest that Income-tax Officers should be placed fully under the control of the Commissioner of Income-tax and any opinion given by the Director of Inspection should be communicated to the latter. It should be passed on to the Income-tax Officer after the Commissioner of Income-tax has given the assessee an opportunity to present his point of view. It is possible that in many cases an opportunity is

provided to the assessee by the Income-tax Officer but as the instructions come from the superior authorities, the Income-tax Officer is likely to be influenced by them in taking a decision on the issues involved. In order to permit the Commissioner of Income-tax to give an opportunity to the assessee in such matters, certain changes will be necessary in the law. In the first place, the words 'Income-tax Officer' wherever occurring in the Act should be replaced by the word 'Commissioner' and the latter should be defined to include all authorities subordinate to him to whom powers and functions of the Commissioner would be delegated appropriately. This would enable the Commissioner to give an opportunity to the assessee of being heard in matters in which he directly interferes with assessment in the interest of revenue while proceedings are being conducted by the Income-tax Officer. Secondly, in all cases in which the Commissioner interferes in this manner the appeal should go direct to the Appellate Tribunal and not to the Appellate Assistant Commissioner. The assessment would in that case be considered to have been done under the personal supervision of the Commissioner of Income-tax and, therefore, the appellate jurisdiction of authorities junior to him, operating under the Central Board of Revenue, would be barred.

Insufficient time for compliance with notices

27. Another of the frequent complaints made against the Income-tax Department is that enough time is not given by the Income-tax Officer to the assessee to enable the latter to comply with statutory notices. It has been suggested to us that a minimum period of eight days should be allowed for compliance with all notices issued by the assessing officers. This complaint has been repeated by so many responsible organisations that we think that the matter requires careful examination by the Central Board of Revenue. If assessment work is planned properly, we think that there should be no difficulty in allowing a period of eight days for compliance with notices which seems to us to be a reasonable demand on the part of the assessees. It would be useful, in this connection, to conduct a sample survey occasionally in order to ascertain the reasons, if any, for which a shorter period than eight days has been given. The fact that such an examination is being made will by itself have a beneficial effect, and we believe that exceptions to this rule will then be made by Income-tax Officers only where failure to do so would result in loss of revenue.

Insufficient attention to public relations aspect in dealing with assessees

28. There are two types of complaints under this head, *viz.*, (a) those that relate to specific acts done by departmental officers, and (b) those that relate to general impressions gathered by persons who come into contact with the work of the Income-tax Department. We would not have considered it necessary to refer to these points in detail but for the fact that we are convinced, from the evidence placed before us, that though, in themselves, these points might appear to be of a trifling nature, their effect on the relations of the Income-tax Department with the assessees is of a damaging character. We are inclined to believe that the resentment harboured by even honest and public-spirited citizens against the Income-tax Department owes its origin to certain misconceptions regarding its working which unfortunately appear to be widely

accepted. There is, for instance, a general belief that while the Income-tax Department shows assiduity in the collection of taxes it is indifferent to the making of refunds where they are due. It is perhaps not so well known, as it should be, that under the scheme of the Income-tax Act a refund can arise only as a result of an assessment, and that this necessarily involves certain formal action being taken, the procedure in regard to which is prescribed both in the statute and in the rules framed thereunder. In spite of the procedural formalities, it should, however, be possible in our opinion to expedite the disposal of refund claims and the connected assessments in view of repercussions on public relations. The procedure itself can also be simplified and we have made some suggestions to this effect in an earlier paragraph.

29. Another misconception appears to be that the Income-tax Officer considers every assessee guilty of evasion until the contrary is proved. The income-tax law lays on the assessee the onus of proving the correctness of his return of income; and rightly so, because he is the person who knows all the relevant facts fully. Some witnesses have suggested to us, however, that the task of discharging this onus is made difficult, and almost impossible, by an assumption of dishonesty at every stage of the proceedings. We consider that this picture is exaggerated; but at the same time, we think it a matter of some importance to give the honest assessee the feeling that he is not suspect. For this purpose, it is necessary that the Income-tax Officer should exercise his discretion intelligently in choosing the statements of the assessee that he should put to strict proof in the limited time at his disposal. Superior officers should encourage this attitude of mind and make due allowance for any *bona fide* mistakes that may be made by the Income-tax Officer when judging his fitness for further advancement.

30. A further matter on which there is a good deal of misunderstanding is the 'targets' that are supposed to be set for Income-tax Officers by the higher authorities for collection of revenue. Many assessees believe, we are told, that the promotion of Income-tax Officers depends upon the amount of revenue they gather, and that for this purpose they are given targets for each year below which the revenue should not fall without damage to their prospects in their career. The Central Board of Revenue to which we put this point has stated that there are no 'targets' of this kind at all. The misunderstanding might have arisen from the fact that each Income-tax Officer is required, for budgetary purposes, to submit every year an estimate of income-tax revenue likely to be collected in his jurisdiction during the following year, and this estimate is misinterpreted as a 'target' set for the Income-tax Officer. In fact, estimates are prepared by the Income-tax Officer himself usually on the basis of the average of the last three years' collections in his charge, with such adjustments as may be warranted by changes in conditions of the particular types of business dealt with by him. The estimates of the Income-tax Officers are consolidated by the Commissioner of Income-tax and modified according to his judgment. The Central Board of Revenue then consolidates the figures on an all-India basis, applying such correctives—downwards or upwards—as may be justified on its assessment of the conditions. This is the normal routine procedure regarding the preparation of the revenue budget. If variations occur between the estimates and

actuals, explanations are asked for as each Income-tax Officer is expected to examine thoroughly the possibilities in his charge before submitting his estimates. This is a legitimate instrument of budgetary and administrative control and is, in our opinion, wrongly represented as a device to harass the tax-payer.

31. The 'public relations' aspect is not confined to assessment and refund procedure alone. It is relevant also in connection with such matters as the general deportment and behaviour of departmental personnel towards assessees, the amenities provided for the latter in income-tax offices (in the form of waiting rooms, etc.) and the consideration shown for their convenience in the matter of granting adjournments, allowing payment of tax dues in instalments, etc. In the case of the less well-to-do assessees much good work in this direction could be done by giving them advice about the filling up of their income returns, and particularly, about any allowances or abatements that they could legitimately claim, and any refunds to which they would be entitled. Attention to these and similar matters would, we are convinced, amply repay the trouble and additional expense, if any. We, therefore, recommend that the Central Board of Revenue should initiate a regular 'drive' to implement these measures, and to impress upon the officers and staff of the department the value of 'public relations'.

32. Another grievance that has been brought to our notice by many witnesses is that assessees have to wait for a long time before their assessments are actually taken up by the Income-tax Officers. This leads to needless waste of time and causes considerable annoyance to the assessees. It has been suggested that notices issued by the Income-tax Officers should specify the time at which any assessee or his representative is required to attend. We are in complete agreement with this suggestion and recommend that the Central Board of Revenue should issue strict instructions to the following effect:—

(i) all notices requiring the presence of assessees or their representatives in the income-tax offices on a particular date should also invariably mention the time at which they should be present;

(ii) if, for any reason, a particular assessee or his representative cannot be accommodated at the time mentioned in the notice, he should be informed accordingly sufficiently in advance and given an alternative date and time in respect of which he should be given preference over others; and

(iii) Income-tax Officers should display outside their offices a daily 'cause-list' showing the names of assessees and the time at which their assessments are scheduled to be taken up.

33. We understand that this procedure is being followed in some offices. The mere issue of instructions is, however, not sufficient. It is necessary that ways and means should be devised to ensure that they are actually carried out. We suggest that senior officers should be particularly charged with the duty of surprise inspections of such arrangements.

34. We are told that in the income-tax offices located in Bombay City and Calcutta there is already a whole-time officer functioning as Public Relations Officer. We understand that the selection of these officers is made from among retired Commissioners or Assistant Commissioners of Income-tax. While we do not wish to suggest that these officers have not been selected with proper care or that they have not been discharging their duties to the best of their abilities, we think that, if the scheme is to be fully effective, a younger and more energetic type of serving officer, with a receptive mind and with enthusiasm and a flair for this kind of work, is needed. It would be useful to give selected officers a short course of training in public relations. For drawing up a suitable scheme of training we would suggest that an officer with the necessary background and experience should be sent on deputation to countries such as the U.K. and the U.S.A. where the problem of public relations in income-tax work has received special attention.

35. In addition to the Public Relations Officer, we recommend that there should be a small advisory committee of non-official advisers attached to each Commissioner of Income-tax. We understand such committees already function in the charges of Collectors of Customs. These committees should discuss matters of general policy relating to administration, but should be precluded from discussing individual cases of assessment.

Collection and recovery procedure

36. In income-tax administration, the methods adopted for the collection and recovery of tax are quite as important as those prescribed for the assessment of taxable income. Particular importance attaches to this aspect of income-tax administration at present in view of the arrears which have accumulated steadily over the past ten or fifteen years as will be seen from the figures given below:—

TABLE 4.—*Statement showing the amount of tax in arrears*

(Rupees in lakhs)

Year ending	I.T.	S.T.	S.C.	Penalty	B.P.T.	E.P.T.	Total
31-3-44	7,56	5,40	4,39	..	..	6,60	23,95
31-3-45	11,07	8,38	3,99	14	..	14,07	37,65
31-3-46	15,39	11,12	9,79	24	..	21,33	57,87
31-3-47	20,16	13,22	9,79	41	..	30,89	74,47
31-3-48	29,67	21,52	11,73	59	1,40	40,15	1,05,06
31-3-49	35,65	29,06	16,05	1,14	1,19	39,32	1,22,42
31-3-50	49,48	38,08	18,37	1,50	2,05	41,49	1,50,97
31-3-51	50,41	43,98	14,99	2,42	2,93	40,00	1,54,73
31-3-52	67,15	54,86	12,42	2,74	3,70	38,89	1,79,76
31-3-53	71,24	63,60	13,11	2,96	5,03	31,41	1,87,35

NOTE.—The above figures exclude the amount of tax in arrears relating to assessments made under the 'Voluntary disclosure scheme' and cases disposed of by the Income-tax Investigation Commission.

37. The following analysis has been furnished to us by the Central Board of Revenue of the arrears as on 1st April 1953 (excluding arrears of excess profits tax and business profits tax, but including arrears relating to assessments made under the 'Voluntary disclosure scheme' and cases disposed of by the Income-tax Investigation Commission):—

		(Figures in crores of Rupees)
(1) Amount of arrears as on 1-4-1953	..	175·16
(2) *Less* : Amount pending settlement of Double Income-tax Relief or other relief claims	..	24·87
(3) Balance	..	150·29
Analysis of (3)		
(a) Amount pending disposal of appeals (Demand may be partly reduced as a result of appeal)	17·61	
(b) Amount due from persons who have left India and who have no assets in India	10·09	
(c) Amount due from companies under liquidation . . .	4·40	
(d) Amount covered by certificates to Collectors	50·45	
(e) Amount in respect of which penalties under section 46 of the Income-tax Act have been levied	3·80	
(f) Amounts irrecoverable for other reasons	5·70	
(g) Total	92·05	92·05
(h) Balance recoverable		58·24

Analysis of (h)

Time for payment granted by Income-tax authorities had expired by 31-3-1953 in respect of Rs. 24·20 crores but it had not expired in respect of Rs. 34·04 crores.

From the information placed at our disposal, we find that the amounts at (b), (c) and (f) are practically irrecoverable and it is only a question of time before they are considered for eventual write-off. The amounts at (a), (d), (e) and (h), which work out to Rs. 130 crores, represent the arrears needing attention. The effective arrears are likely to be still smaller in magnitude. The sum of Rs. 34 crores included in (h) above stands for demands which did not fall due for payment before the close of the financial year and arose largely out of the assessments completed during the last one or two months of the financial year. The demand will be met by assessees in the early part of the next year. The arrears of Rs. 24 crores included in (h) however constitute somewhat difficult cases but practically the whole of the amount is likely to be collected in the next year. The balance of Rs. 58 crores out of Rs. 130 crores is, therefore, the normal carryover each year which arises from the fact that the bulk of assessment work is concentrated towards the end of the financial year. Assessments which have gone up for appeal on substantial points of facts and law account for arrears of

Rs. 17 crores and odd under (a). Only a part of the demand will be recoverable ultimately, but it is understood that it is usual for some guarantee to be taken in such cases to cover the amount of the pending demand.

38. The crux of the problem of arrears of collection is the Rs. 50·45 crores of demand pending recovery as arrears of land revenue with the Collectors. The Income-tax Officer issues to the Collector a certificate for recovery either when the limitation of time is about to expire or when he has exhausted all the means open to him to effect recovery. Usually, such arrears are partly covered by attachment of immovable property in the possession of defaulters. The rest of the arrears are uncovered for want of realisable assets with the assessees. In many instances, the Collector allows them instalments for payment and the pending demand is thus reduced by stages.

39. The analysis given above shows that the situation is not so bad as it appears from the first impression created by the aggregate arrears amounting to Rs. 175 crores. Even then the question of arrears of collection is important enough to justify its detailed discussion with a view to improving the present machinery. We understand that the Central Board of Revenue has made arrangements with State Governments for the appointment of special revenue officers exclusively for income-tax collection work. We would suggest an extension of this scheme, wherever it is not in existence, and a review of the working of these arrangements after a couple of years. The State Governments share substantially in the income-tax receipts and we have no doubt that they will extend their full co-operation in expediting collections. For this reason we are not inclined to support the suggestion, which some witnesses have favoured, of a separate recovery department under the control of the Central Board of Revenue independent of State Governments.

40. The main points for consideration regarding 'collection and recovery procedure' are:—

(i) deduction of tax at the source;

(ii) working of the 'pay-as-you-earn' scheme (section 18A) and the procedure regarding provisional assessments (section 23B); and

(iii) recovery from registered firms.

Deduction of tax at the source

41. Suggestions have been made regarding the extension of this system to cover income from rent, interest and other annual payments at the source as is the practice in the United Kingdom. To avoid the scheme resulting in unnecessary and uneconomic labour in respect of petty payments, a further suggestion has been made to exempt small payments from these provisions if the payers and recipients are persons of small means.

42. This question was also considered by the Income-tax Investigation Commission. While it was of the opinion that deduction at the source would reduce opportunities for evasion of payment of tax, it pointed out that there were obvious practical limitations to the application of this method. Effective arrangements will have to be made

to secure that persons deducting tax at the source pay the amount over into the treasury. There is also likely to be a large number of cases where the tax deducted at the source is more than the total tax payable by the recipients who will then have to apply for refund and be put to considerable inconvenience. On a consideration of all relevant factors, we do not think that the positive advantages of this system outweigh these disadvantages. Arrangements already exist for collecting information regarding payments of interest, rent, etc., exceeding Rs. 400 a year, and adequate arrangements for the collation and prompt utilisation of this information should go a long way towards fixing liability on those recipients who have taxable incomes. We do not favour any extension of the system of deduction at the source beyond the existing provisions in this respect.

'Pay-as-you-earn'

43. 'Pay-as-you-earn', which was introduced during the War, ensures that tax is paid in the year in which the income is earned on the basis of self-assessment or the tax liability of the last completed assessment whichever may be preferred by the assessee.

44. The following figures show collections of advance tax during the five years 1948—53:—

TABLE 5.—*Collection of advance tax*

(Rupees in lakhs)

Year	Collections by adjustment	Collections in cash	Total (2+3)	Total collections of income-tax and super-tax	Percentage of col. (4) to col. (5)
1	2	3	4	5	6
1948-49 . .	45	59,76	60,21	1,81,76	*33·1*
1949-50 . .	63	53,68	54,31	1,61,12	*33·7*
1950-51 . .	92	62,72	63,64	1,73,22	*36·7*
1951-52 . .	108	76,33	77,41	1,87,60	*41·3*
1952-53 . .	130	72,49	73,79	1,85,23	*39·8*

The advance tax contributes nearly 40 per cent. of the total income-tax collections which shows its importance. The scheme has come in for criticism from the business community for various reasons. We discuss below the suggestions made by some of the witnesses which range from its abolition to modifications in its working.

45. It has been represented to us that the payment of advance income-tax leads to a depletion of the working capital of a business and is, therefore, injurious to business interests. There is no doubt that payment of advance tax affects the cash resources of a business concern at the time of payment. On the other hand, an advance

tax recovered in instalments throws less strain on the liquid resources of a concern than would be the case if the aggregate liability were recovered in one instalment after a lapse of a year or two. We are not, therefore, impressed by this criticism of the scheme for payment of advance tax.

46. Another objection that has been raised is that it is difficult for an assessee to make an estimate of his income with any degree of accuracy until consolidated results of his annual transactions can be fairly accurately assessed. The right to furnish an estimate of income is an alternative to making payment of advance tax on the basis of the last completed assessment. When an assessee opts for the former basis, he is given, under the law, the advantage of making a series of estimates, if he so desires, from June or September onward depending on the accounting year adopted by him. A large proportion of business assessees adopt accounting years which end before January. Since the last estimate has to be submitted before the 15th March, the plea that the results of the preceding year cannot be fairly accurately computed does not appear to have any force especially as the law provides for a 20 per cent. margin of error before penalties are attracted. The law also gives discretion to the Income-tax Officers to reduce or waive the penal interest in suitable cases. We consider that the fixation of margin of error at 20 per cent. takes fully into consideration all reasonable difficulties in making an estimate of an assessee's income.

Interest on amounts deposited

47. The original enactment provided for payment of interest at two per cent. per annum on accumulated balances of advance income-tax until the date of assessment. In 1953, the law was modified to provide for the payment of interest at the same rate on the difference between the assessed liability and the advance tax paid. It has been suggested that the previous position in the matter of payment of interest should be restored.

48. The provision for payment of interest on all amounts of advance income-tax was probably intended to make the new scheme more readily acceptable to the public. Now that the system of advance tax has become a part of the regular method of collecting income-tax, we do not see any need to continue paying interest on such collections. Advance tax is more or less in the same position as tax deducted at the source, from such items of income as salary and interest on securities, on which no interest is now paid. We understand in this connection that in the U.S.A. interest is paid only on the portion of the advance tax which is in excess of the assessed liability and the rate of interest is six per cent. The only change in the system we would suggest is that the rate of interest payable in this country may be raised to four per cent. which is the rate now charged on under-payments by assessees.

Dividend income should be either omitted or should be covered by section 18A(4)

49. A further suggestion that has been made to us is that income from dividends should be excluded from the purview of advance tax altogether, or at least that the payment of advance tax should be held over till it is actually received.

50. Income from dividends included in an assessee's total income is not capable of being anticipated with any reasonable certainty

until after the dividends are declared. It is, therefore, arguable that an assessee should not be made to pay advance tax on that portion of his total income which relates to dividends on the basis of his last completed assessment. We therefore recommend that income from dividends should be placed on the same footing as income in the nature of commission for which a special procedure exists in sub-section (4) of section 18A of the Income-tax Act. This sub-section requires that where income in the nature of commission is receivable but is not received it may be taken into account for the purposes of paying advance tax when it is actually received or adjusted.

Revision of Income-tax Officer's order

51. The Income-tax Officer has to demand advance tax on the basis of the latest completed assessment. It may happen that this relates to the income of a period of two or three years earlier. If in the course of the year the Income-tax Officer completes a subsequent year's assessment, he may revise the demand pertaining to advance tax, but is not bound to do so. Some witnesses have stated that such a revision is generally made only when an additional demand is involved and not when refunds are likely to result.

We recommend that, whenever a subsequent year's assessment is completed, under section 18A it may be made obligatory on the Income-tax Officer to revise the demand.

Distinction between old assessees and new assessees

52. It is possible under the present law for assessments relating to an assessee to continue outstanding in the income-tax office for four years. Until at least one assessment has been completed, the Income-tax Officer is not obliged under the law to issue a notice calling on the assessee to pay advance tax under section 18A. The effect of this provision is that an assessee may continue to be a 'new' assessee for the purposes of section 18A for as long a period as four years, and be under a statutory obligation to make his own estimate of income and pay advance tax voluntarily for each of these four years. It has been represented to us that this requires rectification in the interests of persons who become subject to income-tax for the first time. We make recommendations later for the automatic submission of returns relating to advance tax in all cases including new and old assessees as the system of advance tax collection has been in force for a long time and is now fairly well known. This will obviate the distinction between old and new assessees and would therefore automatically lead to rectification of the situation which gives rise to a sense of discrimination against a section of assessees.

53. In addition to the various criticisms of the scheme which we have dealt with above—none of which strikes us as strong enough to warrant our recommending its withdrawal—it has been urged in the evidence before us that, as the inflationary conditions which necessitated the introduction of the scheme have almost entirely disappeared, the scheme also should be scrapped. We do not think that the easing of the inflationary situation by itself warrants the discontinuance of the scheme which has its uses also from the point of view of the collection of revenue. It also imposes an obligation on the assessee to earmark the tax due to be paid to Government from his current earnings which we think is a very

desirable attitude to encourage. We therefore recommend the continuance of the scheme with the following modifications which we have already suggested in the previous paragraphs:—

(i) the rate of interest payable under sub-section (5) of section 18A should be raised from two per cent. to four per cent.;

(ii) income from dividends should be treated in the same manner as the other items of income for which special provision exists in sub-section (4) of section 18A; and

(iii) whenever an Income-tax Officer completes the assessment of a year subsequent to the assessment on the basis of which a demand under section 18A has been made, it should be made obligatory on the part of the Income-tax Officer to revise the demand accordingly.

54. We also recommend the following further changes in the existing scheme:—

(i) the law lays down, as pointed out earlier, an obligation on the Income-tax Officer to issue a notice of demand practically reminding the assessees of the amount and the time by which the advance tax liability should be met. As this scheme has been in existence for some time now, it should be made obligatory for all assessees (both old and new) to make advance tax payments on the basis of their last completed assessment or on an estimated basis, voluntarily, and without notice from the Income-tax Officer. As the scheme applies to assessees whose income exceeds Rs. 6,700, the small assessees will not be affected by this modification;

(ii) the suggestion at (i) will involve the imposition of penalties for non-submission of returns *suo motu*. We, therefore, suggest that provision should be made in the law for giving Income-tax Officers discretion in genuine cases of hardship to vary the dates of payment, within one month of the due date.

We recommend elsewhere that appeal should be provided against the imposition of penal interest under section 18A.

Provisional assessments

55. Under the present law it is possible for an Income-tax Officer to make a provisional assessment on the basis of the return of income filed by an assessee and to demand the payment of tax due after making an adjustment in respect of payments already received under section 18 or 18A of the Act. The Income-tax Officer then completes the examination of the return later and finalises the demand at that time. It has been contended by some witnesses that section 23B under which this provisional assessment is made is redundant in view of the procedure of payment of advance tax under section 18A. This view is based on a misunderstanding of the purposes of the two sections, *viz.*, 18A and 23B referred to. The return relating to the accounting year in respect of which advance tax is payable is not normally filed until after the expiry of the financial year in which the obligation to pay

the advance tax arises. A provisional assessment, therefore, cannot be a substitute for payments under section 18A. The purpose of such an assessment is to expedite the collection of the tax due from an assessee on the basis of his own estimate of income, subject to its scrutiny later on. The purpose of section 18A on the other hand is to enable the assessee to discharge his liability to tax concurrently with the earning of the income. We are therefore unable to accept the suggestion that section 23B should be deleted.

Recovery of taxes from registered firms

56. Our attention has been drawn to certain difficulties which arise in effecting recovery of income-tax from registered firms. Under the law, no tax is payable by a registered firm as such or by a firm which is deemed to be registered under section 23(5)(b) of the Income-tax Act. The share of the income of the firm relating to each partner is included in the total income of the latter and is assessed in his hands. It then becomes a demand against the partner and is recoverable from him alone. It is not possible, under the law, to make recovery in respect of a default by a partner from his interest in the registered firm. The benefit of registration is in the nature of a tax concession and it seems to us that advantage should not be allowed to be taken of this seeming lacuna in the law in order to deny to the State its rightful tax dues. We are therefore in agreement with the suggestion made by some witnesses that a provision should be introduced in the law by which it should be possible for the Income-tax Department to proceed against the interests of the defaulting partners in the properties of the firm.

Recovery of taxes from property transferred to wife, children and benamidars

57. In certain circumstances, where assets have been transferred by a person to his wife and children, it is possible under section 16 of the Income-tax Act to aggregate the income arising out of those assets with the income of that person and to charge it to tax in his name. The law was intended to safeguard the avoidance of tax by persons who made fictitious transfers of assets. While it is possible to make an assessment on the person concerned, we have been informed that difficulties have arisen in actual practice regarding collection from an assessee of the demand so raised as it is not possible to proceed, in law, against the assets held by the wife and the children. We are convinced of the soundness of the provisions included in section 16 of the Income-tax Act. If the legal position in the matter of recovery is not free from doubt, we suggest that section 16 should be amended suitably to provide for the assessment made on the person concerned to be split up in proportion to the income attributable to the assets held by the wife and the children and a demand raised separately on each one of them. This demand may be made recoverable either from the person concerned or failing that by proceeding against the assets held by the wife and the children. The Income-tax Investigation Commission, which considered this question, also expressed a similar view. We would therefore urge that steps should be taken to amend the law in accordance with the suggestion made.

58. We understand that difficulties in regard to recovery of tax also arise sometimes when income from property held by a *benamidar* is included in the assessment of the real owner. It

would, in those circumstances, be justifiable to proceed against the property for recovery of any arrears of income-tax due from the real owner. We would, therefore, recommend that this should be made possible legally by a suitable amendment of the income-tax law, irrespective of the position under the general law.

Appellate Procedure

59. The following grievances have been brought to our notice in respect of the appellate procedure:—

Grievances in regard to appeal procedure

(i) delay in the disposal of appeals;

(ii) the control of the Central Board of Revenue over Appellate Assistant Commissioner;

(iii) absence of right to appeal against certain orders passed by the Income-tax Officer.

60. Many witnesses have complained that serious inconvenience and even financial loss is caused by delays that occur in the disposal of appeals by Appellate Assistant Commissioners. It is stated that arrears in appeals have now reached such a chronic stage that inordinate delays in disposal are endemic. We are satisfied after going through the relevant statistics (*vide* extracts given in the following table) that this complaint is justified:—

TABLE 6.—*Position of appeals as on 1-4-1953*

(i) Total number of appeals filed during 1952-53	81,972
(ii) Arrears brought forward from 1951-52	60,613
(iii) Total appeals for disposal in 1952-53	142,585
(iv) Number disposed of during 1952-53	72,119
(v) Arrears outstanding on 1-4-1953	70,466
(vi) *Analysis of (v)*—	
(a) Number of appeals filed during 1952-53	48,877
(b) Number of appeals filed during 1951-52	14,336
(c) Number of appeals filed during 1950-51	4,815
(d) Number of appeals filed during earlier years	2,438

61. The arrears on 31st March 1953, represent nearly one year's work of the Appellate Assistant Commissioners. It is, we think, necessary to take some effective measures for clearing off these arrears in spite of the shortage of officers of the status of Appellate Assistant Commissioners. It is difficult enough to get trained Income-tax Officers; more so, to get trained Appellate Assistant Commissioners. We are not also in favour of direct recruitment to Appellate Assistant Commissioners' posts: for one thing, the emoluments offered will not attract the right type of men, and for another, the prospects of promotion of existing experienced Income-tax Officers will be

jeopardised causing discontent in the Department. Yet effective steps must be taken to overtake the arrears and to prevent the work getting into arrears again. The figures given below show that the annual intake of appeals is roughly equal to the annual rate of disposal.

TABLE 7.—*Appeals before Appellate Assistant Commissioners*

	1948-49	1949-50	1950-51	1951-52	1952-53	Total
1. No. of appeals instituted during the year . . .	59,489	58,984	64,277	72,237	81,972	3,36,959
2. No. of appeals disposed of during the year . .	41,341	47,189	65,654	68,057	72,119	2,94,360

Once the outstanding arrears are cleared off, it should be possible to handle the situation satisfactorily in future. We would go to the extent of suggesting extraordinary powers being given to Commissioners of Income-tax (suitably assisted by an Assistant Commissioner wherever necessary) to compound the appeals where the amount of tax in dispute is small and no question of principle is involved.

Independence of Appellate Assistant Commissioners.

62. Many witnesses have urged the need for making the Appellate Assistant Commissioner of Income-tax completely independent of the Central Board of Revenue in the same manner as the Appellate Tribunal, which is under the administrative control of the Ministry of Law. It might be worthwhile recalling in this connection that prior to 1939 there were no Appellate Assistant Commissioners dealing exclusively with appellate work; appeal work as well as the work now done by Inspecting Assistant Commissioners (*viz.*, supervision of assessments and administrative work) used to be done by the same Assistant Commissioner. Representations were made before the Income-tax Enquiry Committee, 1936, that as the appellate officer also controlled the Income-tax Officer, who made the assessments appealed against, the assessment in some cases already represented the opinion of the Assistant Commissioner, and that the aggrieved assessee's right of appeal to the same Assistant Commissioner was, therefore, illusory. The Committee also took note of the fact that under that system the 'general purpose' Assistant Commissioner who combined appellate with executive functions could hardly be expected to be approached freely for advice by the Income-tax Officers on points of difficulty in connection with assessment matters. The Committee, therefore, recommend that a certain number of Assistant Commissioners should be detailed to do appellate work and that these Appellate Assistant Commissioners should have no administrative or advisory duties to perform. For these latter types of work, it was recommended that another set of Assistant Commissioners to be styled Inspecting Assistant Commissioners should be detailed, and these officers were to do no appellate work at all. It was also recommended that Appellate Assistant Commissioners should function under the direct control of the Central Board of Revenue instead of the Commissioners of Income-tax, and that even the Central Board of Revenue should not issue to them

any orders, instructions or directions so as to interfere with their discretion in the exercise of their appellate functions. This recommendation was accepted, and from 1st April 1939, separate Assistant Commissioners designated Appellate Assistant Commissioners and Inspecting Assistant Commissioners were appointed to perform appellate and executive functions respectively.

Control over Appellate Assistant Commissioners

63. Representations have been made to us that administrative control over Appellate Assistant Commissioners should not vest in the Central Board of Revenue, in order to ensure that these officers feel absolutely free to exercise independent judgment in their appellate work untrammelled by the fear that, if their decisions are prejudicial to revenue, their position and prospects in the service would be adversely affected. It has been urged that this fear does exist at present and does influence Appellate Assistant Commissioners in the conduct of their work and that this defect is by no means cured by the fact that statutory provision exists specifically barring the interference of the Central Board of Revenue with the discretion of Appellate Assistant Commissioners.

Views of Income-tax Investigation Commission

64. The Income-tax Investigation Commission, which examined this question in 1948, expressed the view that it was satisfied that Appellate Assistant Commissioners generally performed their duties fairly and impartially, and that their independence was not vitiated, to any extent, bv any considerations not relevant to the decision of the appeal. It, however, recommended that the scheme which was adopted in 1939 should be carried to its logical conclusion by Appellate Assistant Commissioners being removed from the control of the Central Board of Revenue and transferred to the control of the Law Ministry. In 1952, the Income-tax Investigation Commission (with a different personnel) cn a re-consideration of the matter, expressed the opinion that the transfer of control over the Appellate Assistant Commissioners from the Central Board of Revenue to the Law Ministry was not called for either on principle or by the result of past experience. Its views were put forward as under:—

(i) Appellate Assistant Commissioners require for the proper discharge of their duties not only intimate knowledge of income-tax law but also of accountancy practice and local business conditions as, in the course of their appellate work, they have to examine accounts, scrutinise such fresh evidence as may be brought in, and review the whole assessment. Such close knowledge of the practical aspects of law and accountancy can be acquired onlv by working as Inspecting Assistant Commissioners. From the point of view of efficient income-tax administration, therefore, an interchange of Inspecting Assistant Commissioners and Appellate Assistant Commissioners is very desirable, and it is only if both sets of officers are subject to the same administrative control that such interchange can be smoothly effected.

(ii) In practice, Appellate Assistant Commissioners have been impartial in the discharge of their duties. One proof of this is the fact that in at least 90 per cent. of the cases decided by them, their decisions have either been accepted by the assessees or upheld by the Appellate Tribunal during the years 1949-50 to 1951-52. "Even the decisions of civil courts do not exhibit such a high percentage of confirmation by appellate courts or acceptance by litigants".

(iii) The danger of an Appellate Assistant Commissioner being unduly swayed in his appellate work by his anxiety to fall in line with the views of the Commissioner of Income-tax concerned or the Central Board of Revenue is greatly, if not completely, minimised by the provision in the law of an appeal, both on facts and law, to the Appellate Tribunal which is completely independent of the Central Board of Revenue.

65. There are certain other important factors also which point to the desirability of continuing the existing system. We deal with these below.

Administrative difficulties if control over Appellate Assistant Commissioners is changed

66. If the proposal to place the Appellate Assistant Commissioners under the control of the Law Ministry is accepted, it will become necessary for the Income-tax Department to have a departmental representative of their own (of the grade of a senior Income-tax Officer) to appear before each Appellate Assistant Commissioner, as is now the practice with regard to each bench of the Appellate Tribunal. This would mean allotting 67 (the number of Appellate Assistant Commissioners at present) senior Income-tax Officers for this purpose. Apart from the extra expenditure involved, this will also present an almost impossible man-power situation for the Income-tax Department. There is also the important consideration already briefly mentioned that it is only if Appellate Assistant Commissioners are retained under the administrative control of the Central Board of Revenue that it will be possible to make the necessary interchange between Inspecting Assistant Commissioners and Appellate Assistant Commissioners smoothly and conveniently. Such interchange is very necessary in the interests of efficiency from the point of view of the Income-tax Department as well as of the assessee inasmuch as each of the two categories of officers benefits greatly by having practical experience, at frequent intervals, of the type of work done by the other. Thus, for example, the quasi-judicial nature of the work performed by an Appellate Assistant Commissioner helps to develop the judicial sense of an Inspecting Assistant Commissioner, who is posted to do appellate work at frequent intervals and this enables him to bring a proper judicial outlook to bear on his executive functions; this should play an important role in creating good public relations.

Appeals filed

67. Table 8 at page 235 shows the position regarding the number of appeals filed before the Income-tax Appellate Tribunal against the orders of the Appellate Assistant Commissioners. It will be noticed that about 88 per cent. of the decisions given by the Appellate Assistant Commissioners are not appealed against.

TABLE 8.—*Appeals against the orders of Appellate Assistant Commissioners*

	1948-49	1949-50	1950-51	1951-52	1952-53	Total
1. No. of appeals decided by Appellate Assistant Commissioners during the year . . .	41,341	47,189	65,654	68,057	72,119	2,94,360
2. No. of appeals filed before Appellate Tribunal by assessees .	5,473	6,237	8,232	7,612	7,661	35,215
3. Percentage of (2) to (1) . .	*13·2*	*13·2*	*12·5*	*11·2*	*10·6*	*11·9*
4. No. of appeals filed before Appellate Tribunal by Department	484	505	747	649	637	3,022
5. Percentage of (4) to (1) . .	*1·2*	*1·1*	*1·1*	*0·95*	*0·9*	*1·0*
6. No. of Appellate Assistant Commissioners' orders against which no appeal filed by assessees before the Appellate Tribunal	35,868	40,952	57,422	60,445	64,458	2,59,145
7. Percentage of (6) to (1) . .	*86·8*	*86·8*	*87·8*	*88·8*	*89·4*	*88·1*

Disposals by Appellate Tribunal

68. The following table gives an analysis of the disposal of appeals from Appellate Assistant Commissioners' orders by the Appellate Tribunal:

TABLE 9.—*Appeals before the Income-tax Appellate Tribunal*

	1948-49	1949-50	1950-51	1951-52	1952-53	Total
1. No. of appeals disposed of by Appellate Assistant Commissioners	41,341	47,189	65,654	68,057	72,119	2,94,360
2. No. of appeals filed before Appellate Tribunals by assessees	5,473	6,237	8,232	7,612	7,661	35,215
3. No. of appellate orders of Appellate Assistant Commissioners accepted by the assessees (1-2) .	35,868	40,852	57,422	60,445	64,458	2,59,145
4. No. of appeals rejected by Appellate Tribunal	1,857	2,275	2,621	2,816	3,271	12,840
5. Total number of admittedly correct orders of Appellate Assistant Commissioners (3+4) .	37,725	43,227	60,043	63,261	67,729	2,71,985
6. Percentage of (5) to (1) . .	*91·25*	*91·60*	*91·46*	*92·95*	*93·91*	*92·39*

It will be seen that as many as 91 per cent. of the orders of the Appellate Assistant Commissioners are either accepted as correct or are confirmed by the Appellate Tribunal. In the remaining nine per cent. cases where relief is given by the Appellate Tribunal, complete relief is given only in 20 per cent. of them; only partial relief is given in the rest.

69. These figures leave us in no doubt that the orders passed by Appellate Assistant Commissioners are, taken by and large, fair and adequate, and that the fact that they function under the administrative control of the Finance Ministry has not detracted from the quality of their work.

70. We are, therefore, of the opinion that, all things considered, the balance of advantage lies in leaving the existing structure unchanged. The demand for transferring the Appellate Assistant Commissioners away from the control of the Central Board of Revenue arises, in our opinion, from lack of a proper appreciation of the crucial fact that the assessment proceedings before the Income-tax Officer are *not* of the nature of judicial proceedings, and that the Appellate Assistant Commissioner, so-called, is in essence not, and was never meant to be, anything more than a reviewing and revising departmental authority within the Income-tax Department. The Appellate Assistant Commissioners go through the accounts themselves, receive additional evidence, examine the facts, review the whole assessment, and enhance it if income has been under-assessed. It is unfortunate that this basic fact was lost sight of when the term *Appellate* Assistant Commissioner was first used in 1939. The misunderstanding could probably have been avoided if some such term as 'Deputy Commissioner' of Income-tax had been used.

71. In this view of the matter, we see no inconsistency either in logic or in equity in retaining the Appellate Assistant Commissioner under the control of the Central Board of Revenue, and treating the Appellate Tribunal which is completely independent of the Central Board of Revenue as the forum for the first appeal. The second appeal would be to the High Court, but on questions of *law* only, and not on those of fact in respect of which the Appellate Tribunal would be the final court of appeal.

72. The procedure followed in regard to this matter in most of the advanced countries of the world is also similar to ours as the following table shows:—

TABLE 10.—*Appellate authorities in other countries*

Country (1)	First appellate authority (2)	To whom subordinate (3)	Remarks (4)
Australia . .	Deputy Commissioner of Taxation.	Commissioner of Taxation.	
Canada . . .	Deputy Minister of National Revenue for Taxation or other officer to whom power is delegated by the Minister.	Minister of National Revenue.	
United Kingdom .	(a) General Commissioners.	(a) appointed from lists of persons approved by Parliament. Laymen with wide knowledge of local conditions and with no	1. Majority of appeals are settled by agreement between assessees and the Inspector of Taxes without a formal hearing.

TABLE 10.—*Appellate authorities in other countries*—contd.

(1)	(2)	(3)	(4)
United Kingdom—*contd.*		specialised knowledge of income-tax. Assisted in legal matters by clerks appointed by Crown.	2. Onus is on assessee to show that the assessment is excessive. 3. Assessees have option to appeal to Special Commissioners regarding assessment under particular heads (*e.g.*, Schedule D).
	(b) Special Commissioners.	(b) appointed by the Treasury. Partly recruited from senior personnel of the Inland Revenue Department.	4. Surtax appeals solely heard by Special Commissioners.
U.S.A. . . .	Appellate Division of the Bureau of Internal Revenue.	Bureau of Internal Revenue.	1. Tax-payer first determines his tax liability. 2. Internal revenue agent then conducts local investigation and notifies tax-payer of additional tax payable. 3. Tax-payer then entitled to conference with the agent for settlement of the dispute. 4. If still dissatisfied case referred to authority in column (2).

Non-official participation

73. Suggestions have been made that non-officials should be associated with the appellate machinery to create greater confidence among the assessees. Non-officials, it is suggested, could either hear appeals themselves, functioning as honorary judges, or they could be associated with Appellate Assistant Commissioners as assessors. The former system would be extremely difficult to work as the persons concerned would not have the expert knowledge necessary for dealing with tax assessments which are often of a complicated character involving difficult questions of law as well as of accountancy. The system of having non-official assessors would also be hardly more feasible as a sufficient number of adequately qualified persons is not likely to be available for this purpose, especially at outstations. On the whole, we are convinced that this scheme has very little chance of being successful in existing conditions in this country.

Non-appealable orders

74. The machinery of appeal is available for practically all orders passed under the law except in the following cases:—

(i) order under section 18A (6) levying penal interest on account of insufficient payment of advance tax;

(ii) order cancelling registration of a firm under Rule 6B of the Income-tax Rules;

(iii) order including 'deemed dividend' in the assessment of a shareholder as a result of action under section 23A;

(iv) order under section 35 rectifying mistakes in assessment orders; and

(v) order under section 43 appointing a person as the agent of a non-resident.

The subjects covered by these provisions are of substantial character and we see no reason for denying the assessee the right of appeal from orders passed under them. We accordingly recommend that the law should be suitably modified to allow appeals in all the above cases.

Personnel, Organisation and Methods

Adequacy and training of personnel

75. We now proceed to deal with certain important problems connected with personnel which we think merit attention. So far as numbers are concerned we have been assured by the Central Board of Revenue that a long overdue expansion scheme is now well under way of implementation, and that on account of the demand for additional staff exceeding the supply through the usual source of recruitment (*viz.*, competitive examinations conducted by the Union Public Service Commission) a special recruitment by interview alone has been resorted to. We must emphasise the need to bring up the actual strength, as soon as possible, to the number required, and would recommend the repetition of the special recruitment procedure in case the normal intake through the Union Public Service Commission's competitive examination does not prove to be adequate.

76. We also find that the Income-tax Department is staffed with a large proportion of inexperienced officers. The following figures pertaining to Income-tax Officers furnished by the Central Board of Revenue illustrate this clearly:—

TABLE 11.—*Statement showing the number of qualified and non-qualified Income-tax Officers*

A. According to the grades of officers.	Income-tax Officers			Total
	Class I Grade I	Class I Grade II	Class II Grade III	
1. No. of officers who have not qualified by passing the departmental examination fully	..	67	180	247
2. No. of qualified officers	105	121	441	667
TOTAL	105	188	621	914

TABLE 11.—*Statement showing the number of qualified and non-qualified Income-tax Officers*—contd.

B. According to the length of service.	
No. of qualified officers with less than 5 years of service	211 (*31·6 per cent.*).
No. of qualified officers with 5—10 years of service .	377 (*56·6 per cent.*).
No. of qualified officers with 10—20 years of service .	56 (*8·4 per cent.*).
No. of qualified officers over 20 years of service .	23 (*3·4 per cent.*).
	667 (*100·0 per cent.*).

The large proportion of unqualified officers, which is as high as 27 per cent., is somewhat disquieting. We would suggest that steps should be taken to replace them by qualified officers as early as possible.

77. Another point that has struck us in regard to the quality of the personnel is that their training though adequate in so far as the technical aspects of law and accountancy are concerned needs to stress the public relations aspect much more than at present.

78. It has been represented to us by a number of persons that the question of language is important in influencing the relations of the department and assessees. Under the present curriculum for the probationers' examination every officer has to pass a test in two languages, one of which has to be Hindi and the other the principal regional language of the area in which he is posted. If the latter is Hindi, the officer must learn another language. The standard demanded is that which makes it possible for him to read and understand accounts prepared in that language. A good working knowledge of the language of the assessee is a valuable asset from the public relations point of view, and we would, therefore, suggest that officers should be made to learn also the principal language of the region to which they are allotted at a somewhat higher standard than at present.

79. We would also suggest a programme for training the lower staff before being actually appointed to regular work. This course should consist of elements of income-tax law, organisation and methods of work in the Income-tax Department.

80. We also think that there should be an adequate provision for a 'training reserve' in the Income-tax Department at all levels and that regular instructors should be appointed in each charge of the Commissioners of Income-tax to train the lower ranks for the appointments for which they are meant.

81. The above suggestions are not exhaustive but indicate our reactions to the present training programmes of the Income-tax Department. We would recommend the appointment of a small committee to chalk out in detail the necessary training programmes and the manner in which instruction should be given.

Suggestion for enquiry into organisation and methods of work

82. We have already drawn attention to the growing accumulation of arrears of assessment, appeals and collections over the last few years. The Central Board of Revenue has also suggested that some important items of work are not being done at

present for want of staff. Many witnesses who have appeared before us have particularly emphasised that delays in the disposal of work are attributable largely to lack of proper trained staff and to the absence of adequate attention to methods of work and organisation in the Income-tax Department. There are complaints also about the lack of adequate and suitable office accommodation, arrangements for the seating of assessees and equipment and stationery in the income-tax offices. The importance of securing a proper environment for the work cannot be overemphasised in a department that comes so closely in touch with the public as the Income-tax Department.

83. We understand that the only enquiry into the organisation and personnel of the Department was carried out in 1946. After that a number of changes have taken place which require a fresh appraisement of the factors that affect the efficient functioning of the Income-tax Department, *e.g.*, the Partition, and more especially the additional requirements of trained manpower due to the financial integration of Part B States. Trained personnel cannot be secured easily and some time must elapse before the shortage of manpower can be remedied, but in the meantime it should be possible by re-arrangement of methods of work and by instituting proper training programmes to utilise the existing personnel to the best advantage. We are of the view that this should be possible of achievement and we, therefore, suggest that a small committee should go into the 'organisation and methods' of the Income-tax Department, if necessary with the help of experts who have specialised in 'efficiency audit' of large-scale organisations.

Income-tax statistical organisation

84. The present statistical organisation in the Central Board of Revenue was set up in 1940 as a result of the proposals for the centralisation and mechanisation of the Income-tax statistical work made by Mr. S. P. Chambers in 1938-39. Since then the statistics are presented in two annual publications, *viz.*, (i) All-India Revenue Statistics and (ii) All-India Income-tax Report and Returns. Since 1951-52, even the publication of these reports has been suspended and only the All-India Income-tax Statements 3 to 6 are being published.

85. These statistics are primarily designed to meet the requirements of the Central Government for budget purposes and other administrative needs of the Income-tax Department. A Working Party was set up by the Central Statistical Organisation for suggesting improvements in the collection and presentation of income-tax statistics; this party reported in March 1952. We understand that their suggestions are receiving the attention of the Government.

86. The deficiency of the statistical material on income-tax was also commented upon by the Finance Commission. It was particularly interested in the 'origin' of business income, and suggested for this purpose a form of report for collecting the data in future, in respect of the larger assessees (those whose incomes exceed Rs. 25,000), which would throw some light on this particular aspect.

87. During our examination of the policy and problems of income taxation in India, we also felt serious difficulties because of the deficiencies in the coverage and the form in which the statistics were presented. The published income-tax statistics relate to *demands* of

income-tax and super-tax raised during a year by grades of income, and not to actual collections of tax from the different income groups. They refer to assessments and not to assessees and both arrears and current assessments are pooled together. Their usefulness for studies relating to distribution of income is thus seriously restricted. It would be useful to give the number of assessees, total gross income, tax demand and net income (*i.e.,* income after deduction of tax), according to grades of total gross income (*i.e.,* of income before deduction of earned income allowances), for different classes of assessees. In respect of companies, income-tax returns do not throw light on the distribution of shareholders by grades of income nor are details of dividend incomes in different income groups and the sources thereof, available. No idea can be obtained of the income (gross or net) and tax demands or payments of public limited and private limited companies separately, nor of business and professional incomes separately, and of resident or non-resident assessees by types of business. Useful data on some of these matters are, we believe, available in the offices of the Director of Inspection and Commissioners of Income-tax, and in the Collation Branch, but they are not sifted, processed and published. It was not possible for us to get information regarding dividend payments by grades of income of years prior to 1952-53 as it was stated that the 'punched cards' for those years had been destroyed for want of storage space. The information obtained by us regarding private limited companies shows that a wealth of material is available in the Income-tax Department which can be collected and classified at comparatively reasonable cost. We think that the Central Board of Revenue should have more adequate material at its disposal to enable it to advise Government on important questions relating purely to income-tax law and administration. For example, the figures relating to initial and additional depreciation allowances, dividend payments by grades of income, analysis of sources of income of persons in certain specified categories of income, etc., are some of the data which can, in our opinion, be collected without much difficulty and the usefulness of which for purposes of making important policy decisions is unquestionable. We, therefore, recommend that the statistical side of the Central Board of Revenue should be overhauled and improved and that an expert committee should be appointed to make detailed recommendations in this regard.

CHAPTER XIV

ESTATE DUTY

Position under Constitution of India

The levy of an estate duty in India was recommended by the Taxation Enquiry Committee of 1924-25, but constitutional and other difficulties stood in the way of the introduction of this form of taxation. The constitutional position is now clarified by the inclusion of items 87 and 88 in the Union List in the Seventh Schedule to the Constitution of India, under which estate duty in respect of property other than agricultural land and duties in respect of succession to property other than agricultural land come within the exclusive legislative jurisdiction of Parliament. At the same time, the net proceeds of the duty (except for that accruing in Part C States) do not form part of the Consolidated Fund of India, but are, under Article 269 of the Constitution, to be distributed among the States within which duty is leviable. Estate duty and succession duty on agricultural land are within the legal competence of State Legislatures (items 47 and 48 of the State List in the Seventh Schedule). Under Article 252 of the Constitution, however, Parliament can legislate on these subjects if the Legislatures of two or more States pass resolutions to that effect; after such legislation is enacted, it can be extended to other States by a resolution adopted by the Legislatures of those States.

2. Another difficulty had been caused by the peculiar features of the Hindu joint family system. In view of this, the succession duty form of the levy, which bases liability on the amounts inherited by various persons and their degree of relationship to the deceased person, was considered unsuitable for adoption in India. It was, therefore, decided to go in for estate duty, which bases liability on the total value of the estate left by the deceased. Special legal provisions have also had to be made to cover the levy of the duty on coparcenary interests under the Hindu law.

Estate Duty Act, 1953: main provisions

3. The Estate Duty Act was passed in 1953, and imposes a duty on property passing or deemed to pass on the death of a person, on or after the 15th October 1953. Property deemed to pass on death includes property which the deceased at the time of his death was competent to dispose of, and property in which the deceased or any other person had an interest ceasing on the former's death. Certain exceptions have been provided to this general rule. If the deceased was domiciled in India at the time of his death, the duty is leviable on all immovable property situated in India, and on all movable property (situated in India or outside) which passes on his death. If the deceased was domiciled outside India, the duty is leviable on all immovable property situated in India, all movable property situated in India and movable property situated outside India if it is settled property and the settler was domiciled in India at the time the settlement took effect. The *situs* of movable property of various kinds is determined by rules framed under the Act.

4. All property passing on the death of a person, subject to certain minor exceptions, is to be aggregated to form one estate. Agricultural land situated in eleven Part A and Part B States, whose Legislatures have agreed to central legislation, will form part of the estate subject to duty. Agricultural land situated in other Part A and Part B States is not subject to duty, but its value is to be taken into account for determining the rate of duty leviable on other property.

5. An important provision is that, on the death of a member of a Hindu coparcenary aged over eighteen years or less than eighteen years and with none of his lineal ancestors as a member of the coparcenary, who belongs to the Mitakshara, Marumakkatayam or Aliyasantana school, the share of the family property to which he would have been entitled if partition had taken place just before his death will be treated as property passing on his death. Different limits of exemption are prescribed for portions of the estate consisting of coparcenary property and of the rest of the deceased's estate.

6. The value of an estate is the market value of the properties comprising it, as at the time of death. From the value so determined, certain exclusions and abatements are permissible. Deductions are also permissible, subject to certain limitations, on account of reasonable funeral expenses and for debts and encumbrances.

7. The Act contains various provisions to counteract attempts at legal avoidance. One set of provisions is that gifts made 'in contemplation of death' (*donatio mortis causa*) as defined in the Indian Succession Act, are to be treated as passing on death. Gifts *inter vivos* for public charitable purposes made within a period of six months before the death, and gifts for other purposes made within two years before death takes place, are also to be treated as passing on death. Such gifts, however, will be exempt from duty up to a maximum of Rs. 2,500 in the case of gifts for charitable purposes and of Rs. 1,500 in the case of other gifts.

8. Another important set of provisions is to the effect that, where the deceased had transferred any property to a controlled company and had derived any benefits from it, a part of the assets of the company will be deemed to be property passing on his death, in the same proportion as the benefits derived by him on the last three accounting years of the company bear to the income of the company in those years. A controlled company is defined as one in which the public are not substantially interested and which has at any relevant time been under the control of not more than five persons, or which is not the subsidiary of a public company.

9. The first Rs. 50,000 of property consisting of a coparcenary interest in joint Hindu families of the Mitakshara etc., schools, and the first Rs. 1,00,000 of other chargeable property is exempt from charge. The balance is chargeable at progressive rates under the 'slab system' which rise from five per cent. on the slab from Rs. 50,000 to one lakh for joint family property, and seven and a half per cent. on the first Rs. 50,000 above Rs. one lakh in all cases, to 40 per cent. on the excess over Rs. 50 lakhs.

10. The administration of the estate duty has been vested in the Central Board of Revenue and in the officers of the Income-tax

Department. Assessments are to be made by the departmental officers, and all appeals lie to the Central Board of Revenue. At this stage, questions involving valuation of assets of various kinds are to be referred to Valuers chosen from a panel appointed by the Central Board of Revenue. References on questions of law can be made to the High Courts and the Supreme Court.

11. In view of the short experience of the working of estate duty, witnesses have generally refrained from suggesting any significant changes either in its structure or in the rates. They have, however, raised some points of principle in response to our questionnaire which we discuss below.

12. It has been suggested to us that the exemption limit is too high, particularly as compared to other countries where estate duty is levied, and also in relation to the *per capita* national income in this country. We are given to understand that the exemption limit has been fixed deliberately at the relatively high figure of Rs. one lakh for the present, in order to ensure that the volume of assessment and collection work that will require to be handled in connection with this new tax in the first few years of its introduction will not be much more than the relatively small staff, which has only very recently been recruited, and is still in the process of training, can effectively cope with. This strikes us as a good enough reason for hastening slowly in this matter, though we would suggest that the feasibility of reducing the exemption limit should be kept in mind by Government and all possible efforts made to increase the strength of the staff and to improve its quality, as early as practicable.

13. We also appreciate the relevance of the argument put forward by the Central Board of Revenue that in case the exemption limit is reduced very drastically—say, to Rs. 25,000 or some such figure—the cost of collection will become disproportionately high. Another point deserves notice. An amendment was introduced during the second reading of the Bill in the Parliament for the exclusion of residential houses in computing the principal value of the estate, but this was opposed by Government on the ground that the exemption limit was high enough to include the value of a residential house. If the exemption limit is now lowered appreciably, the question of excluding certain items like this will also have to be considered. We believe that, on the whole, it would be advisable to put off such changes till after more experience has been gained of the working of the new tax.

14. On all these grounds, we are of opinion that the exemption limit may be left for the present at Rs. one lakh. It may be of interest to note, in this connection, that the exemption limit in the United Kingdom has been increased steadily, over a period of years, from £2,000 to £3,000 in 1954-55.

15. Certain interests have suggested that investments in new industrial undertakings should be excluded from the principal value of the estate of a deceased, the concession being confined to investments in certain industrial units selected by Government. The justification for this suggestion is that the exemption of such shares from estate duty would act as an incentive for investment in new industries and would also incidentally prevent their being unloaded on the

market to the detriment of the industry concerned, for the purposes of payment of estate duty. We are alive to the question of incentives to productive efforts and we have already dealt with this question in its relevant context in relation to the structure of income-tax. We think it is not necessary at this stage to use estate duty as an instrument for the purposes of affording incentives to risk capital.

16. Section 84(1) of the Estate Duty Act has been criticised by certain foreign interests. It imposes a liability on the company in respect of the estate of a person who was not domiciled in India, but who possessed at the time of his death shares in a company which was not incorporated in India but which was resident in India for two out of the last three completed income-tax assessments. In view of the difficulty of recovering estate duty in such cases from the persons concerned, it has been provided in section 84 that the tax should be recovered from the company itself at a fixed rate which is *nil* if the value of the shares does not exceed Rs. 5,000 and seven and a half per cent. if it exceeds that figure. It is stated that the provision is inequitable inasmuch as it imposes a vicarious liability on the company and it will adversely affect the inflow of foreign capital into India.

17. The provision has been justified on the ground that it is not inequitable to place a charge on the company if its profits are largely derived from this country. In its ultimate effect, the charge will be borne by the whole body of the shareholders who are the beneficiaries of the profits made by the company. We agree with this view. The charge placed on the value of such shares is small and would not be a great burden on the current or accumulated profits of a company.

18. For the same reason, we consider that the effect of the estate duty on the inflow of foreign capital is exaggerated. More drastic provisions of this nature exist in other underdeveloped countries, *e.g.*, Ceylon.

19. We would, however, draw attention to the proposal that we have made in Chapter II regarding the deletion from the law of the test for determining the 'residence' of companies based on their income arising in India. In view of the change recommended, the criterion used for the charge under section 84(1) of the Estate Duty Act will have to be reviewed.

Gift tax

20. The introduction of a tax on gifts has also been suggested by some witnesses as a means of preventing the evasion of death duties and incidentally also of income-tax. The present provisions regarding the taxation of gifts may be recounted briefly. All gifts *inter vivos* made within two years of the death of a person are chargeable to estate duty. Gifts for public charitable purposes are taxable if they are made within six months of the death of a person. In both cases, an exemption has been provided upto a maximum limit under section 33 of the Estate Duty Act. Gifts made otherwise than under the above conditions are not chargeable to estate duty. The suggestion now made is that a small charge should be placed on such gifts as and when they are made. The analogy for this purpose is provided by the gift tax in vogue in many countries, including the U.S.A.

21. A gift tax is theoretically an attractive proposition, but it requires considerable experience of the operation of estate duty before it can be introduced. One of the pre-requisites for operating successfully a tax of this nature would be to introduce the submission by income-tax assessees of a statement of assets and liabilities. As more experience is gained of this type of work, the feasibility of introducing a gift tax can be considered. Moreover, the rates of death duty are at present low. The value of a gift tax as a second line of defence for estate duty is greater if the rates of the latter are steeply progressive. We are, therefore, not in favour of introducing the gift tax at this stage.

Appellate Tribunal

22. Another demand that has been placed before us is that an independent Appellate Tribunal should be set up to hear appeals against the decisions of the Estate Duty Controller. According to this view, appeals should not lie to the Central Board of Revenue but to an independent body. Those who have put forward this claim point out that under the Income-tax Act the judicial and executive functions of the Commissioners have been bifurcated and an independent Tribunal has been provided for. A similar arrangement can be made for estate duty administration also, it is argued. Government's point of view has been that, during the initial years of the working of the Act, the executive should have adequate powers and that, later on, if the need for a Tribunal is felt, its establishment could be considered. Some witnesses are of the view that if provision is made for an appeal to the Tribunal instead of to the Central Board of Revenue, it would encourage disputes arising out of points of fact to be taken up to the Tribunal, from the very commencement of the Act, and that this will lead to lack of uniformity in interpretation. As the Estate Duty Act is a highly technical and complicated piece of legislation, we see considerable advantages in retaining the appellate powers with the Central Board of Revenue for the time being.

Payment of duty

23. The question as to how the duty should be collected has also been raised, and it has been suggested that immovable property and shares and securities should be accepted in payment of dues. This, it is argued, would remove possible cases of hardship when the estate left by the deceased has inadequate liquid resources. Government can also collect the dues easily. It is further stated that, in the U.K., immovable property is accepted for payment and that a similar course should be adopted in India also.

24. The official point of view is that Government need money for development and that if company shares of fluctuating value or fixed assets not capable of easy disposal were given to them, it would only add to their worries. Although under the U.K. Act payment of duty in the form of immovable property is permitted, the provision is resorted to only in exceptional cases.

25. Section 70 of the Estate Duty Act empowers the Controller to allow payment to be postponed for such period, to such extent and on payment of interest at a rate not exceeding four per cent. or any higher interest yielded by the property as he may think fit. It is also provided that estate duty in respect of immovable property may, at the option of the person accountable, be paid in eight equal yearly

instalments or sixteen equal half-yearly instalments with interest at the rate of four per cent. per annum or higher. The Finance Minister has given an assurance that, in actual working, cases of hardship would be very sympathetically dealt with, and we have no doubt that this assurance will be carried out in practice.

Conclusion

26. It remains for us now to consider whether any change should be effected in the scheme of the estate duty and the rates at which it is levied. We have already pointed out that the Indian estate duty makes no distinction between acquired and inherited property, nor does it draw any distinction on the basis of the consanguinity of the inheritor. There is also no provision for the levy of succession duties. Moreover, the minimum value of property exempted from the duty is much higher than in other countries, while the rates of duty charged on the estates liable to tax are uniformly lower than in most of the other countries. Thus, the exemption limit is Rs. one lakh in India as against £3,000 in the U.K., Rs. 20,000 in Ceylon, and the equivalent of Rs. 30,000 in Australia. As regards rates, at Rs. one lakh level, the Indian rate would be nil, while it is 3 per cent. in the U.K., 2·6 per cent. in Australia, 1·3 per cent, in Canada, 7·3 per cent. in Sweden, and 29·3 per cent. in Japan. At Rs. ten lakhs level, the Indian rate works out at 15·25 per cent. as against 40 per cent. in the U.K., 16·9 per cent. in U.S.A., 20·6 per cent. in Australia, 14·2 per cent. in Canada, 32·7 per cent. in Sweden, and 56·8 per cent. in Japan. Indian rates are lower than foreign rates for almost every bracket. And the rate on the highest slab is 40 per cent. in India as against a 'step' rate of 80 per cent. in the U.K. Moreover, many of the recommendations we have made for the continued promotion of capital formation such as non-taxation of bonus shares, development rebate, tax holiday under section 15C of the Income-tax Act, etc., may lead, as a consequence, to the growth of savings and investments among individual tax-payers or the accumulation of undistributed profits and the issue of bonus shares in the private corporate sector and should, therefore, call for suitable action through the tax system to check the widening of inequalities in wealth. There seems to be, from this point of view, a case for recommending changes both in the system and in the rates of the estate duty with a view to making it a more effective instrument for lessening both the range and the magnitude of inequality of wealth in the country.

27. Three main objections are advanced against this view, *viz.*,

(1) it will act as a disincentive to saving and therefore to investment and capital formation;

(2) as the difficulties of collection increase with increasing rates, the danger of business units being broken up with consequent adverse effects on efficiency will also increase, a contingency particularly undesirable in a country in such urgent need of economic development as India;

(3) as estate duty has just been introduced, the administration has hardly had the time to acquire experience of, or work out, suitable ways of dealing with the various problems it gives rise to in respect of both assessment and collection.

28. We are not impressed by the first argument. Although, taken by itself, the estate duty might have a certain effect on savings, this effect should be smaller than that of a tax on personal incomes yielding the same revenue. In fact, foreign experience has shown that death duties have had hardly any adverse effect on the volume of personal savings, for the reason, among others, that where savings are not involuntary in the sense of being a residual element they are the result of motives which are not adversely affected by taxation of the estate after death. We do not, therefore, accept as valid the contention that any increase in the rates of estate duties in India will have adverse effects on the volume of savings and investment.

29. Estate duty has an important role in the Indian fiscal system not only from the standpoint of revenue but also as an instrument for reducing inequalities in wealth; and we are certain that it will have to undergo changes in the direction of making it more progressive than it is at the moment. The point is whether the present time is opportune for this purpose. We are impressed by the fact that the duty has come into force only recently and the administration is not yet acquainted with the types of problems that are likely to arise in its administration. We would, therefore, recommend that, as more experience is gained, the rates should be reviewed for the purposes of increasing them. The only change that we would recommend for very early consideration is that the period before death during which gifts *inter vivos* become liable to estate duty should be increased from two years as prescribed at present to five years. This would bring the Indian legislation into line with that of some other countries, and also close more effectively than at present one of the admitted loopholes in the operation of estate duty, especially since our law does not provide for a separate gift tax.

CENTRAL COMMODITY TAXES

CHAPTER I

A HISTORICAL REVIEW

Introductory

Commodity taxation in the sphere of the Central Government consists of import duties, export duties and excise duties. In this chapter we review the evolution of these taxes and the trends in the revenue from them since the end of World War I.

Share of commodity taxes in Central Tax Revenue

2. There have been large variations during the period covered by this review in the share contributed by commodity taxes to the total tax revenues of the Central Government. A substantial expansion in the share of the indirect taxes took place between 1920-21 and 1925-26 due primarily to the development of the import tariff. There was little change between 1925-26 and 1938-39 in the share of indirect taxes, though the relative importance of import duties, excise duties and the salt tax varied. An increase in the share of excise duties and of the salt tax (customs and excise) made up for a decline in the contribution of customs duties. There was a slight decline between 1925-26 and 1931-32 due to a fall in the share of customs duties as a result of the depression. The contribution of these duties to Central revenues once more almost reached the level of 1925-26 by 1938-39. By 1948-49 a substantial decline occurred in spite of the imposition of new excise duties, because of the war-time development of direct taxation, certain reductions in rates of import duty and changes in the pattern of trade, and the abolition of the duties on salt. A considerable increase has taken place since then due to an increase in the rates of import duty and in the volume of imports and also because of the significant expansion of revenue from export duties and Central excise. The relevant statistics are as follows:—

TABLE 1.—*Share of customs and excises in Central Government tax revenues*

Year	Total gross tax revenue of the Government of India	Gross customs revenue	Gross Central excise revenue	Gross salt revenue	Total gross customs, Central excise and salt revenue	Col. 6 as percentage of Col. 2
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	In crores of Rupees					
1920-21 . .	60·85	29·05	2·85	6·76	38·66	63·5
1925-26 . .	72·86	45·61	3·21	6·37	55·19	75·8
1931-32 . .	75·62	41·53	6·19	8·78	56·50	74·7
1938-39 . .	81·87	44·51	8·72	8·41	61·64	75·3
1948-49 . .	385·18	130·42	51·66	..	182·08	47·3
1953-54 . .	420·33	161·33	94·00	..	255·33	60·8

3. We now proceed to review the changes in yield which have taken place during this period in each of the groups constituting Central commodity taxes, *viz.*, import duties, export duties and excise duties, describing briefly the factors responsible for these changes.

Evolution of import tariff

4. At the end of World War I, the general rate of import duty was 7½ per cent. with machinery and iron and steel paying duty at 2½ per cent., sugar at 10 per cent. and motor spirit at 6 annas a gallon. Financial needs led to the raising of the general rate to 11 per cent. in 1921 and again to 15 per cent. in 1922. In addition, matches and luxury items were subjected to higher rates of duty. Also, in 1922, a new duty of 5 per cent. was levied on cotton yarn. Iron and steel and railway materials (till then assessable at 2½ per cent.) were subjected to a duty of 10 per cent.

The above rates remained practically unchanged up to 1931, except, of course, those which were altered for protective purposes. During the period 1922 to 1931, however, duties on sugar, unmanufactured tobacco, cotton piecegoods and kerosene were raised and the duty on silver was reintroduced.

5. In 1931, the economic depression caused a heavy deficit in the Central finances and additional taxation was introduced under the Indian Finance Act, 1931, and the Indian Finance (Supplementary and Extending) Act, 1931. The general rate of the import tariff was put up to 25 per cent. and varying rates of surcharges resulted in the upward revision of duties on numerous individual items like liquors, silver, sugar, spices, cotton piece-goods, tobacco (including cigars and cigarettes), fuel and lubricating oils, motor cars, motor cycles, art silk yarn and thread, art silk piecegoods and art silk mixtures. As a consequence of these changes machinery, coal-tar dyes, etc., which were hitherto admitted free, were subjected to a duty of 10 per cent. and a duty of half an anna per lb. was imposed on raw cotton. The changes introduced by the two Finance Acts of 1931 were incorporated in the tariff from 1st January 1935 by the Indian Tariff Act, 1934.

6. In the years immediately preceding World War II and shortly thereafter, in order to meet budgetary requirements, the rates of duty on several individual items were raised, notably on raw cotton (1939) and art silk yarn and thread (1941). The former had a duty of half an anna per lb. imposed on it in 1931. In 1939 this was doubled; and by the Cotton Fund Ordinance, 1942, this was doubled again, but one anna went into the Fund created under the provisions of the Ordinance. (In 1946, however, the Fund was abolished leaving the revenue duty itself at 2 annas per lb.).

7. An overall surcharge of one-fifth on all duties was imposed by the Finance Act, 1942; this was continued from year to year until 1951. At the same time, certain permanent adjustments in rates of duty were made in respect of which no surcharge was applied; notably, the duty (both customs and excise) on motor spirit was raised from 12 annas to 15 annas per gallon. The surcharge was not applied to industrial plant and machinery which, therefore, remained dutiable at 10 per cent. *ad valorem*. In 1944, the rate of surcharge on certain items (potable spirits and cigars, cigarettes and tobacco)

was increased from one-fifth to one-half. In the following year, the duties on all tobacco items were refixed so as to correspond with the enhanced rates of Central excise duty on indigenous tobacco which were introduced at the same time. In 1946, certain duties were readjusted and the duty on kerosene was substantially reduced from 4 annas 6 pies to 3 annas per gallon. The *ad valorem* duties on betelnuts and cinematograph films were replaced by specific duties. The duty on silver was enhanced, while gold was for the first time subjected to a duty, the rate being Rs. 25 per tola (this was later reduced by one-half by notification).

8. Certain important changes in the tariff took place in 1948. Firstly, the commitments entered into by India under GATT were given effect to in that year. Secondly, the duty on industrial plant and machinery was reduced from 10 per cent. to 5 per cent. The duties on a number of raw materials for industries were either removed or reduced. By an Ordinance promulgated in November 1948, the rates on a number of luxury articles were increased substantially, *e.g.*, on articles of gold and silver, fine and superfine varieties of textiles, fire-works, toilet requisites, motor cars, crockery, cutlery, tobacco, alcoholic liquors, etc.

9. In 1950, the rates of duty on parts and accessories of motor vehicles other than motor cycles were rationalised as a measure of anticipatory protection.

10. The next series of important changes came about under the Finance Act, 1951, after the outbreak of the Korean War. The general surcharge of one-fifth on import duties was enhanced to one-fourth. The rate of surcharge on liquors which was fixed at 100 per cent. under the 1948 Ordinance was enhanced still further to 155 per cent. The finer varieties of textiles were subjected to a surcharge of 55 per cent. Articles which were hitherto immune from the surcharge were subjected to a surcharge of 5 per cent. The specific rates of duty on mineral oils other than kerosene and motor spirit were replaced by alternative rates of duties, as it was feared that the specific rates were no longer keeping pace with the rise in import prices.

11. A substantial increase in rates of duty on certain consumer goods was a notable feature of the Finance Act, 1953. In certain cases, increase in duty was accompanied by a liberalisation of quotas. Also, substantial reliefs were granted in the duties on milk foods for infants and invalids, patent foods for infants and invalids, penicillin in bulk, antibiotics, sulpha drugs, scientific and surgical instruments and art works.

12. Under the Finance Act, 1954, the duty on betelnuts has been further enhanced, the preference in favour of U.K. in respect of motor cars has been abolished and anti-malarial drugs have, for the first time, been subjected to a duty, the rate being 20 per cent. *ad valorem*. In addition, duties on a number of items have been enhanced and import quotas liberalised. Simultaneously, action has been taken under section 23 of the Sea Customs Act, exempting from duty raw cotton, iron and steel plates and sheets, and railway track materials. The policy of liberalising quotas with enhanced duties has been carried still further through the introduction of another series of changes in September, 1954.

13. The following table sets out the revenue from import duties as a percentage of the total tax revenue of the Government of India and also as a percentage of the value of imports:—

Contribution of import duties to Central tax revenue

TABLE 2.—*Revenue from import duties at percentage of total tax revenue and value of imports*

Year	Gross revenue from import duties	Gross revenue from import duties as a percentage of total tax revenue of the Government of India	Gross revenue from import duties as a percentage of value of imports
	In crores of Rupees		
1920-21	23·08	38·3	7·3
1925-26	39·32	54·3	17·5
1931-32	36·08	48·1	30·8
1938-39	39·80	48·9	25·6
1948-49	97·98	25·4	17·6
1953-54	120·29	28·6	21·8

The revenue from import duties as a percentage of the value of imports will be referred to as the incidence of import duties. This percentage is relevant as a measure of the tax burden on imported goods. It may vary not merely as a result of changes in tariff rates but also because of variations in the composition of imports.

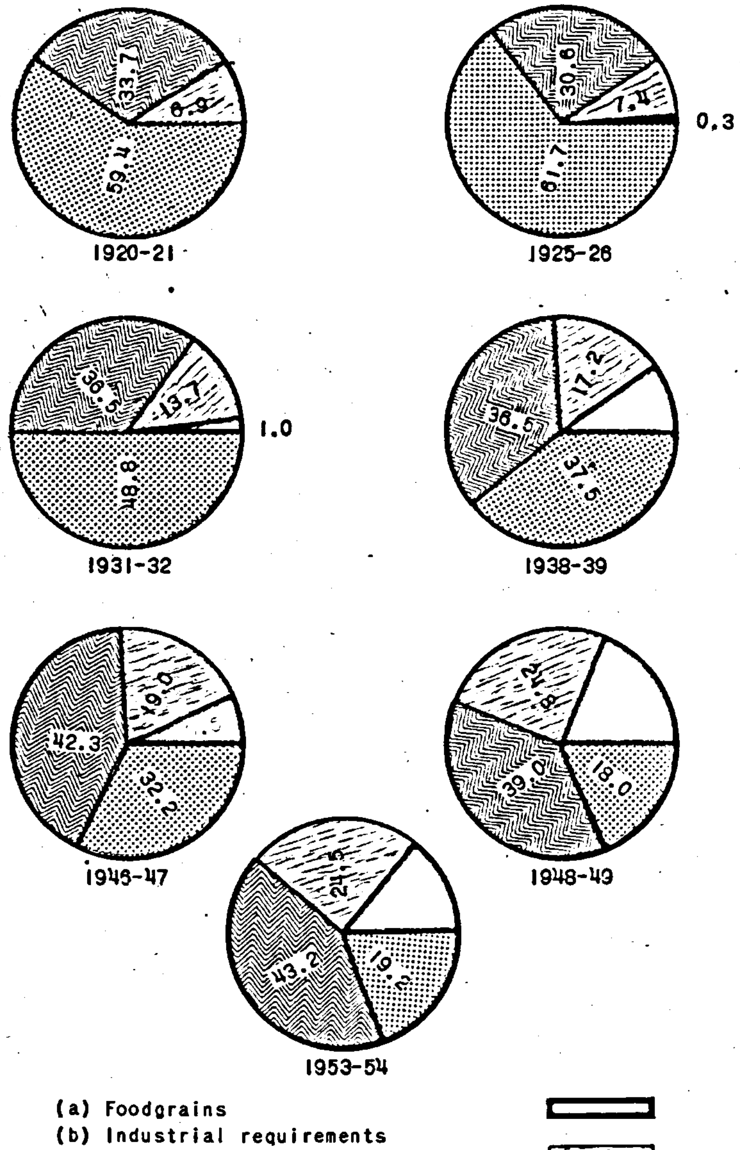
14. As stated earlier, the period from 1920-21 to 1925-26 was marked by the development of the import tariff. Revenue duties were raised and protection was granted on a large scale. As a result, the incidence of import duties increased from 7 per cent. to 17 per cent. and the contribution of import duties to Central tax revenues went up from 38 per cent. to 54 per cent.

15. The process was carried further up to 1931-32 and as a result of this factor and of the increased burden of specific duties due to the fall in prices, the incidence of import duties increased to 31 per cent. in 1931-32. Owing, however, to a fall in the value of imports as a result of the depression, the contribution of import duties to Central tax revenue declined slightly to 48 per cent.

16. There were no important tariff changes till 1938-39, but changes in the composition of imports were of importance during this period, reducing the incidence of import duties to 26 per cent. in 1938-39 from 31 per cent. in 1931-32. A contributory factor was the fall in the burden of the specific duties due to the rise in prices. The effect of protection was beginning to be felt and low duty items like machinery and raw cotton were increasing in importance. However, as the value of imports was on the increase, the relative contribution of import duties to Central tax revenues remained steady.

17. By 1948-49, the incidence of import duties had decreased to 18 per cent. from 26 per cent. in 1938-39 and the contribution of import duties to Central tax revenues was reduced from 49 per cent. to 25 per cent. between the two years. This was due both to rate changes

CHANGES IN THE COMPOSITION OF IMPORT TRADE



(a) Foodgrains

(b) Industrial requirements

(i) Raw cotton and machinery

(ii) Other industrial requirements

(c) Commodities other than (a), (b), (i) & (ii).

made with a view to promoting industrialisation, which have been referred to earlier, and to changes in the composition of imports. The rate increases for luxury items could not make up for reductions in duty on commodities which formed a steadily greater part of India's imports. Also, the scope for increases in rates of duty on consumer goods items was limited by obligations under GATT.

18. After 1948-49, the further surcharge of 5 per cent. and the increases in rates of duty for a variety of items, especially consumer goods, raised the incidence of import duties to 22 per cent. in 1953-54 and the contribution of import duties to Central tax revenue showed a slight improvement, being 29 per cent. in 1953-54 as compared to 25 per cent. in 1948-49.

19. Changes in the composition of import trade have been of importance in relation to the yield from import duties. Since the War, large foodgrain imports, which are free of duty, have tended to reduce the incidence of import duties. While in 1938-39 only 8·8 per cent. of the value of imports was accounted for by foodgrains, the corresponding percentages for 1948-49 and 1953-54 were 18·2 and 13·1. More significant has been a steady increase since World War I in the importance of industrial requirements as opposed to finished goods in India's import trade. Industrial requirements constitute a large variety of items such as raw cotton, motor spirit (excluding a small portion used by motor cars), machinery, building and engineering materials and tools and implements. Imports of industrial requirements as a percentage of the total value of imports have risen from 41 in 1920-21 to 50 in 1931-32, 54 in 1938-39 and 68 in 1953-54. As the level of duties on industrial requirements must necessarily be lower than the level of duties on finished goods, the increased share of industrial requirements in the import trade has meant a reduction in the total import duty revenue as a percentage of value of imports obtained with any given import tariff. The increase in imports of machinery and raw cotton, which have always been low-duty items, is specially significant. Their share in imports has gone up steadily from 7·4 per cent. in 1925-26 to 24·5 per cent. in 1953-54. The diagrams facing this page indicate the changes in the composition of trade.

20. The revenue from consumer goods has been affected not merely by rate changes but also by changes in composition within the group. Thus the increased importance of sugar in 1930-31 in imports resulted in one-third of the total import duty revenue being derived from that article. Again, between 1931-32 and 1938-39, there was a shift within the consumer goods group away from items bearing high rates of duty such as spirits and liquors and manufactured tobacco towards general utility goods carrying moderate rates of duty like domestic appliances, drugs, medicines, cycles, etc.

Export duty

21. The revenue from export duties was fairly constant in the pre-war period and their contribution to total tax revenue, therefore, declined somewhat. After the War export duties acquired a new importance. The role of export duties is discussed in detail in another chapter.

Salt duty

22. Salt constituted an important source of revenue until the second World War and the revenue from it was realised mainly through an excise duty on indigenous salt and partly through customs duty on imports. Its

share in total Central Government revenues remained fairly constant at about one-tenth. With the considerable development of direct taxation and the extension of excises during and after the War, its share declined and in the year before the duty was abolished (*viz.*, in 1946-47) it was only about 3 per cent.

The rate of duty remained at Rs. 1-4-0 per maund from 1917 to 1931, except for the single year 1923-24 when it was double. From 1931 till the abolition of the duty in 1947, the rate of duty was Rs. 1-9-0 per maund.

Evolution of Central excises

23. Apart from the salt duty, the first excise duty levied by the Government of India was in 1894 when cotton yarn of counts above twenties was subjected to an excise duty equivalent to the import duty. In 1896, this was changed into an excise duty on mill cloth. These excises were imposed as a result of pressure from U.K. and they were meant to improve the competitive position of Lancashire cloth in the Indian market. Consequently, public opinion was strongly opposed to these excises and the Government of India supported the public demand for the removal of these duties. The first Fiscal Commission (1921-22) reviewed the whole position and recommended the abolition of the excise duty on cloth. It also recommended that the rate of import duty necessary for the protection of the cotton textile industry should be considered by a Tariff Board, and that after the appropriate rate was fixed, the Central legislature should decide whether there was a case for retention of an excise duty. If continuance of the excise duty was decided upon, the import duty fixed with reference to the necessary level of protection, should be increased by the amount of the excise duty. The excise duty on cloth was abolished in 1926.

24. Of the present excises, the earliest was the levy on motor spirit introduced in 1917. The primary purpose of this excise was to bring down the consumption of petrol in India and to conserve the supply for war requirements. The excise duty on this article was retained as a permanent feature as it proved to be a good source of revenue.

25. The next item to be placed on the Central excise tariff was kerosene, which was subjected to duty in 1922.

26. The third article to be brought into the Central excise tariff was silver on which a duty was imposed in 1930. After the separation of Burma in 1937, no revenue has been realised from this article as the Indian production is negligible.

27. The year 1934 was a landmark in the development of Central excise because it was in that year that duties were imposed on sugar, matches and steel ingots. These were industries that had been established as a result of protection and their development had by 1934 reached a stage at which revenue could once more be derived through excise duties to replace the revenue from import duties that had been foregone. The imposition of a surcharge of Rs. 1-13-0 per cwt. on the protective duty of Rs. 7-4-0 in 1931 had led to a rapid expansion of sugar factories and the making of large profits by the manufacturers. An excise duty was therefore im-

posed, minimum prices being also fixed for sugar-cane in order to ensure that cane-growers derived some benefit from the grant of protection to the sugar manufacturing industry.

28. The excise duty on matches was also introduced in view of the expansion of the domestic industry.

29. The excise duty on mechanical lighters was introduced at the same time as the duty on matches. There was at that time no production of mechanical lighters in India. It was, however, expected that the revenue from matches would be affected by the establishment of a mechanical lighters industry or by the import of lighters; an excise duty was, therefore, imposed and the import duty enhanced by an equivalent amount.

30. The excise duty on steel ingots was introduced subsequently in 1934. The recommendations of the Tariff Board regarding the protection of the steel industry involved a very considerable reduction in the level of import duties with a resultant decline in customs revenue. It was, therefore, found necessary to impose an excise duty on the production of steel ingots in India with a countervailing customs duty.

31. During the second World War, Government explored various methods of increasing revenue and in 1941 an excise duty was imposed on tyres. This industry was also an example of loss of customs revenue through the replacement of imports by home production. In 1943, vegetable product was also brought under excise. That year, however, was more significant for the introduction of the excise duty on tobacco.

32. The excise duty on tobacco marked a departure in the Central excise system because so far excises had been levied only on the products of organised industries. The exigencies of war finance made it necessary to raise revenue from tobacco and an elaborate scheme of taxation was consequently introduced in 1943. This subject is dealt with in a separate chapter.

33. In the following year (1944), coffee, tea and betelnuts were brought into the excise tariff as further sources of revenue. The duty on betelnuts was abolished in 1948, primarily because of administrative difficulties and also because a considerable portion of the growing areas was lost on account of partition.

34. The next major addition to the Central excise tariff was in 1949 when it was extended to mill-made cloth. In justification, the Finance Minister stated that it was necessary to replace the heavy loss in revenue resulting from the abolition of the salt duty and that the proposed duty would not affect the mill industry and at the same time would help the handloom industry.

35. In 1954, duties were imposed on art silk, cement, soap and footwear.

36. The principles underlying the extension of excises from time to time are that indigenous industries which have developed under a protective tariff wall should be called upon to replace the loss

of customs revenue on imports and that the country's tax structure can be made stable only by broadbasing the excises.

Contribution of excise duties to Central tax revenue

37. The following table sets out the revenue from Central excise duties in certain years and the proportion of tax revenue of the Government of India derived from these duties:—

TABLE 3.—*Revenue from excise duties as percentage of total tax revenue*

Year	Gross Central excise revenue	Total gross tax revenue of the Government of India	Excise revenue as percentage of total tax revenue
	In crores of Rupees		
1920-21 . .	2·85	60·85	*4·7*
1925-26 . .	3·21	72·86	*4·4*
1931-32 . .	6·19	75·62	*8·8*
1938-39 . .	8·72	81·37	*10·7*
1948-49 . .	51·66	385·18	*13·4*
1953-54 . .	94·00	420·33	*22·4*

Factors affecting revenue from excise duties

38. Variations in the revenue from excises can be explained in terms of three factors—changes in rates, increase in quantities consumed and extension of the scope of taxation to cover new commodities. Of these three factors, it is the increase in coverage which has been most important. The increase in consumption has also been significant while the part played by changes in rates of duty is only a minor one.

39. Excise duty rates are mostly specific and were not adjusted from time to time in proportion to price changes. The effect on revenue of changes in rates of duty between two years can be estimated by calculating the yield in one year on the assumption that (a) the commodities taxed, *viz.*, the coverage of duties and (b) the output of various commodities which are dutiable remain the same as in the other year. Thus, in respect of the commodities subject to excise duty in 1953-54, which were also being taxed in 1938-39, the yield was Rs. 27 crores in 1953-54. Applying the rates of duty in force in 1938-39 to the quantities taxed in 1953-54, the yield would be Rs. 12 crores. Changes in rates alone thus account for an increase in revenue of the order of 125 per cent. between 1938-39 and 1953-54.

40. When account is taken of the rise in the price level over the period, it will be seen that the rise in rates of duty has been very moderate. Between 1938-39 and 1953-54, the price level

increased four-fold while the increase in revenue due to rate increases was only 125 per cent.; the rates of duty as percentages of the prices of articles taxed have thus declined substantially with a consequent reduction of the average burden of taxation on articles subject to duty between 1938-39 and 1953-54.

41. As remarked above, the extension of coverage was more significant than increase in rates of duty from the revenue standpoint. Thus, in 1953-54, only 29 per cent. of the revenue from excise duties was raised from articles which were subject to duty also in 1938-39 and 76 per cent. from articles which were taxed in 1948-49.

42. The increase in quantities consumed of articles subject to excise duties has also been a significant factor. In order to obtain a measure of the importance of the increase in consumption, the effect of changes in rates of duty and of extension of coverage has to be eliminated. The increase in revenue as a result purely of the rise in consumption between 1938-39 and 1948-49 is roughly 25 per cent. Between 1948-49 and 1953-54, there was a further increase of 27 per cent.

43. The increased importance of excise duties is, therefore, accounted for mainly by extensions of coverage and natural increases in consumption. The increases in specific rates of duty have been very moderate in relation to price increases.

44. It is of interest to examine the extent to which up to 1953-54 the expansion of excises has made up for the loss of revenue from import duties. An overall comparison of the extent to which revenue from excise duties has replaced import duty revenue is difficult. It can, however, be said that the coverage of excise duties has gone a considerable way towards meeting the revenue lost by the reduction of imports consequent on protection. In 1931-32 protective import duties yielded Rs. 15·2 crores out of a total import duty revenue of Rs. 36 crores. No less than Rs. 13·4 crores out of the Rs. 15·2 crores yielded by protective duties was collected on items subjected later to excise duties.

45. These commodities are listed below with the comparative incidence of customs and excise duties:—

TABLE 4.—*Comparative incidence of customs and excise duties*

Commodity	Import duty in 1925-26 as a percentage of value	Excise duty at present as a percentage of value
Sugar	41	10
Iron and steel	20	1
Cotton textiles	11	6 to 17
Matches	133	100

These figures indicate that excise duties have been imposed at comparatively moderate levels when domestic production has replaced imports.

46. There would appear to be scope for further utilisation of excise duties in order to maintain revenue from ccmmodity taxation. We suggest in another chapter the directions in which the scope of Central excise duties could be extended.

CHAPTER II

IMPORT DUTIES

Introductory

The evolution of import duties has been surveyed in the previous chapter. We now examine the revenue potential of import duties with reference to the composition of the import trade and the policies affecting imports.

By 1953-54, industrial requirements constituted an important part of India's imports. In that year, 13·1 per cent. of the value of imports was accounted for by foodgrains, 24·5 per cent. by raw cotton and machinery, 43·2 per cent. by industrial requirements other than raw cotton and machinery and 19·2 per cent. by other items. Import duty revenue formed 21·8 per cent. of the total value of imports. Revenue from import duties on industrial requirements was 19·9 per cent. of their value and revenue from other items (excluding foodgrains) was 43·5 per cent. of their value.

Possibility of increasing the revenue from import duties

2. An analysis of the current structure of import duties reveals that the possibilities of increasing the revenue from import duties through increase in rates are on the whole small. This becomes clear on an analysis of the list of import items the rates of import duties on which are not 'bound' under the General Agreement on Tariffs and Trade and which are subject to duties of less than 30 per cent. We have reviewed the 1952-53 import trade and revenue statistics from this point of view.

Free items

3. In the free list, imports of foodgrains accounted in 1952-53 for Rs. 153 crores out of a total of Rs. 260 crores. These imports are likely to become steadily less important. Raw cotton accounted for another Rs. 77 crores, but the present policy is not to tax imports of raw cotton but to tax cotton cloth through excise duties. The other items account for Rs. 30 crores. Of these, the main item is raw jute amounting to Rs. 17 crores. If jute is to be taxed, it would probably be preferable to levy an excise duty on manufactures. The remaining items such as trade catalogues, books and sulphur are insignificant.

Low duty items

4. The value of imports subject to duty at rates below 10 per cent. was Rs. 91 crores in 1952-53. The most important item in this category was machinery, accounting for Rs. 75 crores. The rate of duty on machinery is 5¼ per cent. and an increase in it is not to be recommended as this is an essential item for promoting industrialisation. The other important items in the 0—10 per cent. duty category are various iron and steel goods accounting for Rs. 8·9 crores. The iron and steel items are subsidised because of high import prices and no useful purpose would be served by enhancement of duty. The remaining items in the 0—10 per cent. duty category, of which the value of imports amounted to Rs. 7 crores, are aeroplanes and parts (Rs. 4·8

crores) and miscellaneous industrial requirements. The revenue potentialities of additional duties on these are of little significance.

Moderate duty items

5. The value of imports of items subject to duties above 10 per cent. and below 30 per cent. in 1952-53 was Rs. 77 crores. These are practically all industrial requirements, with the exception of kerosene oil. We suggest elsewhere that there is a case for enhancement of the rate of excise duty on kerosene oil and a corresponding adjustment of the rate of import duty would be necessary. Other items in the group are lubricating, batching and fuel oils which accounted for Rs. 27 crores, various iron and steel items the value of imports of which was Rs. 12 crores, and railway materials imported to the value of Rs. 11 crores. The remaining Rs. 5 crores were accounted for by miscellaneous industrial requirements. Increase in duty on railway materials and imported iron and steel would serve no purpose. The rate on lubricating, batching and fuel oils is already 15 3/4 per cent. It would appear, therefore, that enhancement in this category except for kerosene would not be justifiable.

6. The general conclusion is that no appreciable increase in revenue appears possible from articles subject to an import duty of 30 per cent. or less.

Thus, while some adjustments may be possible, there is little scope for an increase of rates in import duties. The loss in import duty revenue would have to be accepted. In some cases, such as motor spirit and kerosene, there will be an automatic compensating increase in excise duty revenue. In other cases suitable new excise duties might be imposed.

The composition of trade and revenue from import duties

7. An examination of the main items in the import trade of the country from the standpoint of the yield from import duties reveals the change that has occurred in the character of the import trade, in the direction of the growth of imports of industrial requirements and, in consequence, the probability of some further reduction in the revenue from import duties.

8. Sugar is expected to yield a revenue of Rs. 8 crores to Rs. 10 crores in the current year due to heavy imports. Such a contribution is, however, unusual, imports having been negligible since 1939-40 until their recent revival. This is an instance of a commodity the import duty from which has declined very considerably as a result of protection. The revenue from sugar as a percentage of total import revenue was 8·4 in 1919-20, 16·5 in 1925-26, 22·4 in 1931-32, 1·1 in 1938-39 and 1·1 in 1953-54.

9. The contribution of alcoholic beverages to import duty revenue has also been steadily falling due to successive increases in rates and latterly to import control and to the policy of prohibition. Ale, beer, wines, spirits and liquors between them contributed 8·1 per cent. of total import duty revenue in 1920-21, 4·9 per cent. in 1938-39 and 1·8 per cent. in 1953-54. The rates on some of these items have recently been substantially enhanced. From the revenue point of view, however, these items are unlikely to be of significance for the future.

10. Betelnuts have acquired importance for revenue since the War, their contribution to import duty revenue having increased from 1·9 per cent. in 1938-39 to 3·9 per cent. in 1953-54. Rates of duty have been increased sharply, the duty collection as a percentage of the value of imports being 39·2 in 1938-39 and 154·0 in 1953-54. The revenue of Rs. 4·65 crores in 1953-54 is thus of some significance as a tax on consumption.

11. Unmanufactured tobacco imports were of little significance before the War as there was not much manufacture of cigarettes in India. During the War and in the immediate post-war period, revenue from this source was substantial, amounting to 7·8 per cent. of total import duty revenue in 1948-49. Since then, the development of cigarette tobacco production in India has reduced imports. In spite of an increase in duty as a percentage of value from 258·9 in 1948-49 to 304·8 in 1953-54, the contribution of unmanufactured tobacco to import duty revenue declined to 1·6 per cent. in the latter year. This item is unlikely to regain its position as a fruitful source of revenue.

12. Kerosene contributed 5·0 per cent. of total import revenue in 1931-32. The separation of Burma raised the figure to 8·9 per cent. in 1938-39. There has been a decline, since, to 5·9 per cent. in 1953-54. The decline in revenue since before the War has been due largely to reduction in duty rates from four annas six pies to three annas per imperial gallon in 1946. The revenue as a percentage of value of imports has declined from 55·1 in 1938-39 to 26·2 in 1953-54. The duty in *ad valorem* terms is thus just half the pre-war figure. At this rate, kerosene yielded Rs. 7·19 crores of revenue in 1953-54. A large part of this revenue is likely to be obtained from the excise duty when the refineries in India go into full production.

13. Motor spirit acquired importance as a source of revenue after the separation of Burma, yielding 13 per cent. of total import duty revenue in 1938-39. The contribution of motor spirit to import duty revenue has increased considerably since then, being 23·0 per cent. in 1953-54. This was due primarily to the large increase that has taken place in the quantity of imports. Revenue as a percentage of the value of imports has declined considerably since before the War, being 89·1 in 1953-54 as against 164·0 in 1938-39. Motor spirit yielded Rs. 27·5 crores of import duty revenue in 1953-54. In due course, this revenue will be transferred to the excise head.

14. Fuel, batching and lubricating oils yielded about Rs. 3·5 crores per annum during the last three years and contribute about 2·5 per cent. of import duty revenue. The revenue from these items as a percentage of value of imports has risen slightly from 9·7 in 1938-39 to 12·2 in 1953-54.

15. The yield of the duty on machinery was the same in relation to total import revenue in 1953-54 as in 1938-39, being 5·6 per cent. Between the two years, there was a reduction in the revenue from machinery as a percentage of the value of imports from 12·2 to 7·9. The reason for the contribution of machinery to import duty revenue remaining constant in spite of its increased share in imports is the reduction in the rate of duty from 10 per cent. in 1938-39 to

5¼ per cent. at present. Revenue as a percentage of imports is slightly higher than the duty rate because certain types of machinery are charged at higher protective rates. The yield from duties on machinery may increase in future at the current rates of duty.

16. The revenue from duties on hardware, implements, tools, instruments, etc., has kept pace with the general rise in import duty revenue, the duty collected in 1953-54 being Rs. 7·3 crores which was 6·1 per cent. of total import duty revenue. The revenue as a percentage of value of imports has gone up from 23·0 in 1938-39 to 27·7 in 1953-54. While the composition of imports within the group may change, there is no reason why the present level of revenue should not continue.

17. Chemicals, drugs and medicines have been an increasingly important item in the import trade, yielding 5·6 per cent. of total import duty revenue in 1953-54 as against 2·6 per cent. in 1938-39. The revenue as a percentage of value of imports rose from 19·9 in 1938-39 to 26·7 in 1953-54. There are plans for the production of many of these items in India and the expansion of local manufacture may affect the revenue from import duties.

18. The contribution of metals to import duty revenue was 7·2 per cent. of the total in 1919-20, 11·6 per cent. in 1925-26, 6·1 per cent. in 1931-32, 4·4 per cent. in 1938-39, and 3·4 per cent. in 1953-54. The imports of iron and steel are by far the most important item in this group. The rise in 1925-26 was due to the grant of protection. In the case of iron and steel, the revenue as a percentage of value of imports was 2·2 in 1920-21, 20·0 in 1925-26, 25·0 in 1931-32, 15·2 in 1938-39 and 13·0 in 1953-54. While the grant of protection has led to the establishment of a flourishing domestic industry, there has still been demand for imports with revenue of Rs. 4·1 crores in 1953-54. The further projected expansion of production in India may affect the revenue from this source.

19. The contribution of wood pulp, paper and stationery has increased from 2·8 per cent. of the total import revenue in 1938-39 to 3·5 per cent. in 1953-54, revenue in the latter year being Rs. 4·1 crores. As an expansion of the paper industry in India is being planned, it may be necessary to increase imports of wood pulp. There may also be increased imports of newsprint. There is, therefore, no reason to expect a decline in the revenue from this group.

20. The revenue from motor vehicles and parts was 3·2 per cent. of import duty revenue in 1938-39, 8·2 per cent. in 1948-49, 8·8 per cent. in 1951-52 and 5·3 per cent. in 1953-54. There was an increase in revenue in 1948-49 due to large imports and a further increase in 1951-52 as a result of an increase in rates as a measure of anticipatory protection. In May 1953, rates were reduced as a result of the Tariff Commission's recommendations and in 1953-54 revenue was 51·5 per cent. of the value of imports as against 30·2 per cent. in 1938-39 and 63·5 per cent. in 1952-53. It is difficult to estimate the revenue potential of this item as the yield from the duties must depend on the progress made in local manufacture.

21. Raw cotton has been important in some post-war years, yielding revenue of Rs. 6·1 crores in 1951-52. The import duty on this item has now been abolished. Imports of raw cotton can conveniently be taxed through excise duties on fine and superfine cloth.

22. Imports of cotton piecegoods were an important source of revenue prior to protection. In 1919-20, they yielded 26·6 per cent. of import duty revenue and in 1925-26, 15·4 per cent. The grant of protection, resulting in an increase in revenue as a percentage of value of imports from 11·2 in 1925-26 to 25·2 in 1931-32, was accompanied by a decline in the yield. The revenue in 1931-32 was only Rs. 3·7 crores as against Rs. 6·1 crores in 1925-26, these amounts being 15·4 per cent. of import duty revenue in 1925-26 and 10·3 per cent. of revenue in 1931-32. By 1938-39, there was a further increase in the burden of duty, revenue as a percentage of value of imports being 35·0; the contribution of revenue from cotton piecegoods to import duty revenue was 9·0 per cent. Since the War, rates of duty have been substantially enhanced, in spite of withdrawal of protection. Revenue as a percentage of value of imports was 68·6 in 1953-54. Revenue was negligible, forming only 0·55 per cent. of total import revenue. This was partly the result of low import quotas.

23. With the development of the art silk industry in India since the War, imports of art silk yarn and thread have become of importance. Revenue from this source was 1·0 per cent. of total import revenue in 1938-39, the corresponding percentages for 1951-52 and 1953-54 being 4·5 and 3·8. Revenue in relation to value of imports has varied only slightly since 1938-39, being 35·4 per cent. in that year, 34·5 per cent. in 1951-52 and 36·2 per cent. in 1953-54. Increased local production of yarn will in due course reduce the yield from this item, but as an excise duty is levied on art silk fabrics, it may be possible to make up the revenue under the excise head.

24. The revenue from silk, art silk and mixed fabrics was at one time of importance, the yield in 1932-33 forming 7·2 per cent. of total import duty revenue. The grant of protection in 1934 reduced imports, revenue from these items in 1938-39 being 4·2 per cent. of the total. Since the War, imports have been restricted and the industry continues to be protected. In 1953-54, the yield from these items was only Rs. 0·55 crores, forming 0·5 per cent. of total import revenue. It is very unlikely that any revenue will be derived from this source in future.

25. Imports of coal-tar dyes have increased considerably since before the War. The duty was 'bound' at 12 per cent. *ad valorem* under GATT and revenue in 1953-54 was Rs. 1·93 crores, forming 1·6 per cent. of total import revenue. The item has been renegotiated recently and the 'bound' level has been raised to 20 per cent. If protection is granted, revenue will, at any rate, not increase.

26. Fruits contributed Rs. 1·8 crores of revenue in 1953-54, forming 1·5 per cent. of total import revenue. Revenue was 17·4 per cent. of the value of imports.

27. Revenue from oilseeds and oils was only 11·1 per cent. of the value of imports in 1953-54 as against 29·3 per cent. in 1938-39. The contribution of these items to total import revenue was, however, less than 1 per cent. in both years. Rates are maintained at a low level because oils are either articles of food consumption or raw materials of essential industries.

28. The commodity-wise analysis indicates a substantial probable decrease in revenue from import duties, most of it being on account of an expected decline in imports of motor spirit and kerosene which should be made up through increased revenue from the excise duties on the same articles. The loss of revenue from raw cotton could be made up through the excise duty on cotton textiles. After allowing for this, there is still likely to be some decline in revenue from import duties.

Import control

29. We now examine the implications for revenue of certain items of commercial policy such as import control. Import control was instituted during World War II to ensure that available foreign exchange and shipping space were utilised for essential imports. The control has had to be continued even after the cessation of the War in view of the unsettled post-war trading conditions and the need for large imports of commodities needed for the development programme and of foodgrains. Import control is of relevance to the revenue from import duties partly because it affects the composition of imports; the pattern of imports must, however, be determined largely by the needs of the country's economy, and revenue considerations can play only a subordinate role in its determination. Import control can, however, affect revenue by placing greater reliance on quotas relatively to tariffs as a means of restriction of imports than the needs of the foreign exchange situation or the economy may warrant at any time. While we do not propose to express any opinion on the relative advantages of import control and tariffs as a means of granting protection, we wish to stress the need for keeping continuously under survey the possibility of modifications in the import control system with a view to securing additional revenue, consistently, of course, with the demands of the foreign exchange situation. The bulk of the import duty revenue is not affected by import control because it is derived from a few items which are permitted to be imported in substantial quantities; petroleum products, machinery, betelnuts, and motor vehicles and parts are instances of such commodities. There will, however, remain possibilities of marginal adjustments. The Government of India have in the recent past explored possibilities in this direction. Liberalisation of import quotas on consumer goods along with big increases in import duty rates was effected in 1953 and 1954. The value of licences issued for items liberalised in March 1953 increased from Rs. 2 crores in the second half of 1952 to Rs. 3·5 crores in the second half of 1953. It is estimated that the increased revenue as a result of these changes will amount to Rs. 1·5 crores in a full year. We welcome the decision recently announced by Government to liberalise the import of certain commodities simultaneously with the enhancement of the duties thereon as indicating their awareness of the revenue possibilities involved in such modifications. The possibility of further progress in this direction should continue to be explored.

30. Imports and import duty revenue have also been affected by international commercial agreements, such as the General Agreement on Tariffs and Trade and the Indo-British Trade Agreement, 1939. The value of such agreements from the commercial standpoint has to be balanced against the loss of revenue involved.

International commercial agreements

31. GATT is an agreement which was intended to be accompanied by a wider agreement concerning various aspects of international commercial policy. The Charter for an International Trade Organisation (Havana Charter) has not come into force, but GATT has continued. An international conference is currently being held to consider the desirability of continuing it for a further period.

General Agreement on Tariffs and Trade

32. India has agreed under GATT to reduce or 'bind' duties or preferences on commodities the value of imports of which was Rs. 85 crores in 1952-53. Imports of articles on which concessions have been granted, which may be termed 'conceded' were 19 per cent. of the value of total imports in that year. India has extended the concessions to non-GATT countries also, as the Indian tariff does not contain a 'most-favoured-nation' rate other than the Commonwealth Preference rate. The concessions have been granted mainly on machinery and consumer goods; concessions for raw materials are few. The rates which have been fixed by the Agreement for most types of machinery, above which increases may not be made, are above the rates actually in force; the effective concessions are, therefore, mainly on consumer goods.

Commercial aspects of GATT

33. The concessions received cover a large part of India's export trade; in 1952-53, the value of exports affected by concessions to all destinations was 79.6 per cent. of total exports. Concessions have been obtained directly on items the demand for which was deemed to be elastic and in particular in fields where there was considerable competition. Thus, U.S.A. reduced duties on mica, cashewnuts, various jute items, etc. The concessions obtained relate more to primary products than to manufactured articles.

34. A rough estimate has been made of the loss in revenue as a result of GATT, applying the difference between current and pre-GATT rates of import duty on conceded articles to values of imports in 1952-53. The revenue loss works out at Rs. 85 lakhs in relation to a total value of Rs. 120·4 crores for imports of conceded articles. This calculation does not, however, take account of the fact that in the absence of GATT, rates on a number of items could have been substantially enhanced. There are many consumer goods the rate on which has been pegged at 30 per cent. or less under GATT. If 40 per cent. duties were applied to GATT consumer goods items other than medicines, the increase of revenue on 1952-53 value figures would be about Rs. 35 lakhs. If quotas were liberalised to 100 per cent. and 40 per cent. duties applied, the gain in revenue from GATT consumer goods items other than medicines would be Rs. 1 crore. Again, duties may have been imposed on certain items of agricultural equipment used mainly by the richer farmers but for the obligation to permit duty-free entry. If it becomes possible

Revenue aspects of GATT

to liberalise imports, GATT will stand in the way of securing adequate revenue. The Government of India have had in the recent past to ask for release from obligations on a number of items both for revenue reasons and in order to grant protection.

View of the Fiscal Commission, 1949-50

35. The Fiscal Commission, 1949-50, was of the view that India should adhere to GATT, primarily in view of the need for international economic co-operation*. It laid down certain principles to guide negotiators†. The Commission did not, however, examine the revenue implications of the Agreement.

Conclusion

36. We have no doubt that in the present state of India's financial requirements, when GATT is reviewed, commercial factors would be carefully balanced against the revenue considerations involved. Much will depend on the probable trend of the balance of payments. If the foreign exchange position improves and imports of non-essential goods on a larger scale take place, the revenue loss may be considerable. If, on the other hand, imports continue to be restricted, the revenue significance of GATT may be small. We do not wish to venture a forecast on this matter, but would stress the need to attach due importance to the revenue aspect when the subject is reviewed.

Commonwealth Preference

37. The other major international commercial agreement to which India is a party is the Commonwealth Preference system. This was based on the Ottawa Agreement and later was revised by the U.K.-India, Trade Agreement, 1939. The system was introduced in the early 'thirties because of the desire to expand trade within the Commonwealth at a time when the volume and value of world trade had been declining rapidly owing to the depression. Continuance of the Agreement in 1939 was on a limited scale and was motivated chiefly by the need to ensure satisfactory arrangements regarding textiles. During the post-war period, the idea of Commonwealth trade has acquired new importance because of currency difficulties.

Commercial aspects of Commonwealth Preference

38. On the side of India, Commonwealth Preference takes the form of guaranteeing to the U.K. and certain Colonies margins between the rates of duty payable on their exports to India and duties levied on goods imported into India from other countries. The U.K. and certain Dominions and Colonies grant similar margins and have also guaranteed continued free entry for certain Indian products.

39. The value of imports of preferred items from U.K. in 1952-53 was Rs. 29·3 crores and from the Colonies, Rs. 10·9 crores. The total value of imports of preferred articles from all sources was Rs. 51 crores. The value of all commodity imports in 1952-53 was Rs. 633 crores, and the value of all commodity imports other than foodgrains was Rs. 480 crores. Imports of preferred commodities as a percentage of total imports declined from 10 in 1938-39 to 8 in 1952-53. Imports of preferred commodities as a percentage of

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*Report of the Fiscal Commission, 1949-50, paragraphs 301 and 310.

†*Ibid*, paragraph 310.

imports other than foodgrains rose from 10 to 11. Imports of preferred commodities from U.K. as a percentage of total imports of preferred commodities increased from 46 in 1938-39 to 57 in 1952-53. Thus, the importance of preferred commodities in India's imports has remained fairly constant and the share of U.K. in our market in preferred commodities has increased appreciably.

40. Only a small part of preference relates to consumer goods; imports of cloth, domestic refrigerators, sewing machines, wireless sets, gramophones and cycles were Rs. 7 crores in 1952-53. Chemicals, drugs and medicines accounted for Rs. 16·6 crores of imports. Motor lorries, etc., and vehicle parts accounted for Rs. 10·8 crores and various industrial requirements like miscellaneous instruments, electrical instruments, electrical control and transmission gear, and paints and colours accounted for Rs. 10 crores. The main items on which preferences are granted to the Colonies are betelnuts, dried fruits, oilseeds and oil and asphalt.

41. Turning to the export trade, we find that the total value of exports of preferred commodities to the U.K. was Rs. 81 crores and to all countries Rs. 344 crores in 1952-53. Exports to U.K. of preferred commodities as a percentage of total exports of preferred commodities was 23·5 in 1952-53. Exports of preferred commodities to all countries as a percentage of total exports was 61·8 in the same year. The preferences granted to India relate to jute manufactures, tea, coffee, woollens, biscuits, coir mats and various raw materials such as vegetable oils, bones and hides and skins.

42. The loss in revenue from preferences may be estimated at Rs. 3·5 crores—Rs. 2·6 crores on imports from U.K. and Rs. 0·9 crore on imports from the Colonies. This has been calculated by applying the preferential margin to the value of imports of preferred articles from U.K. and Colonies in 1952-53. Allowance should, however, be made for items of which the preferred areas supply less than 10 per cent. or more than 90 per cent. of India's requirements. In these cases, no real preference is granted as only either the preferential rate or the standard rate is effective and can be suitably adjusted. If such items are eliminated, the potential loss in revenue may be put at Rs. 2·1 crores on imports from U.K. and Rs. 0·2 crore on imports from the Colonies, making Rs. 2·3 crores in all; this is, of course, a very rough figure. In so far as the potential loss is compensated for by an equivalently low burden of duties on the consumer, there is no real disadvantage involved to the economy. We have not attempted to make precise estimates based on a study of relevant trade and market factors of the real cost of the preferences to the economy. This cost has to be balanced against the other advantages gained, primarily in the way of encouragement to the export trade.

Conclusion

43. We have suggested above that the revenue from import duties is likely to decline as a result of various factors. At the same time, the fact that the bulk of the import duty revenue is derived from a few major commodities which will continue to yield sizeable amounts of revenue has to be noted. In 1953-54, two-thirds of the import duty revenue was derived from eleven major groups of items, such as machinery, motor vehicles and parts, betelnuts and petroleum products. These commodities

will be of major revenue significance in the future also. While a careful watch needs to be kept over the revenue implications of commercial policies, such implications are unlikely to be of major significance.

44. Further, the decline in revenue from import duties as a result of an increase in the share of imports accounted for by industrial requirements is likely to be temporary. A decline in the imports of consumer goods usually takes place during the early stages of industrialisation. In due course, however, the increase in the level of national income as a result of economic development will once more stimulate imports of consumer goods. A decline in the revenue from import duties as a result of a shift towards import of industrial requirements bearing relatively low rates of import duty is thus a transitional feature of economic development.

CHAPTER III

EXPORT DUTIES

Introductory

Export duties constitute a well-known feature of the Indian fiscal system, having been levied on different commodities from time to time. During the early part of the British rule, export duties were levied at small *ad valorem* rates on many articles of export. On occasions, the duties affected exports seriously, as, *e.g.*, duties on indigo and salt-petre. This phase ended in 1867, after which most of the export duties were abolished. In 1914, only rice was charged to duty. In 1916, an export duty was imposed on jute and this item has formed part of the tariff ever since. A duty on raw hides and skins at 5 per cent. *ad valorem* was imposed in 1919 but was abolished in 1935. During the second World War, an export duty at 3 per cent. *ad valorem* was imposed on cotton cloth and yarn, but this was converted into an export cess in 1945. The yield from export duties was between Rs. 4 crores and Rs. 6 crores a year between 1919-20 and 1945-46. Between 1920-21 and 1938-39, the yield from export duties showed a small decline from Rs. 4·9 crores to Rs. 4·1 crores while total customs revenue increased from Rs. 29·1 crores to Rs. 40·5 crores. The yield from export duties did not vary perceptibly in relation to trade conditions; the revenue in 1931-32 was practically the same as in 1920-21 or 1938-39.

2. Since 1946, export duties have acquired new importance; duties have been imposed on a number of new articles and old duties have been raised. The level of yield has been greater in relation to both the net customs revenue and the value of exports. In no year since 1948-49 has the collection of export duties as a percentage of customs revenue or of the value of exports been less than double the corresponding percentage for 1938-39. Moreover, the levels of duties have been varied considerably in the post-war period to take account of changes in trade conditions, abolition of some duties and appreciable reduction in others having been effected in the last two years or so. The export duty revenue as a percentage of value of exports has fluctuated between 5·3 and 12·9 in the years after 1947-48. The following table gives the relevant statistics:—

TABLE 1.—*Export duty revenue in relation to total customs revenue and value of exports*

Year	Export duty revenue	Gross customs revenue	Value of exports	Export duty revenue as percentage of gross customs revenue	Export duty revenue as percentage of value of exports
1	2	3	4	5	6
		(*In crores of Rupees*)			
1938-39	4·10	44·51	163	*9·2*	*2·4*
1946-47	7·14	99·59	298	*7·2*	*2·4*
1948-49	26·44	130·42	421	*20·3*	*6·3*
1949-50	25·19	129·75	472	*19·4*	*5·3*
1950-51	47·32	161·43	579	*29·3*	*8·2*
1951-52	90·74	237·09	702	*38·3*	*12·9*
1952-53	55·38	178·63	551	*31·0*	*10·1*
1953-54	38·51	161·33	516	*23·9*	*7·4*

The yield from export duties reached the peak figure of nearly Rs. 91 crores in 1951-52, when it formed about 40 per cent. of the total customs revenue. By 1953-54, the export duty revenue had been reduced to Rs. 38·5 crores, but it still formed more than a quarter of the customs revenue which was also significantly lower as compared to 1951-52. Export duties have not only been an important source of revenue in the recent past but have also been used for certain economic purposes. We, therefore, propose to study in this chapter their place in the Indian fiscal system in the light of recent developments.

Levy of export duties for revenue purposes

3. Export duties are levied for various purposes. The pre-war export duties were primarily imposed for producing moderate revenue receipts from commodities which had a comparatively strong position in export markets. The Fiscal Commission, 1921-22, did not disapprove of export duties as a source of revenue, but it urged caution in using them for this purpose. The test laid down by it was that export duties for revenue purposes would be justified if they would fall mainly on foreigners and in the circumstances in which there was little danger of the production of the commodity in India being affected. In other words, an export duty should be imposed primarily on articles in which India had a monopoly or semi-monopoly and the level of the duty should be moderate.* The general statement, that in normal circumstances, only moderate duties should be levied, and that these should be restricted to monopoly and semi-monopoly exports seems unexceptionable as such. The further argument of the Fiscal Commission, however, that a duty should not be imposed when the burden might fall on the Indian producer cannot be accepted without some qualification. It may well be that the Indian producers who pay the tax are relatively lightly burdened by other forms of taxation. The export duty would then ensure a suitable distribution of the total tax burden. Thus, it may be that producers of commercial crops pay less land revenue in relation to income than producers of food crops. If the crops or manufactures from them are sold abroad in a competitive market, an export duty could not ordinarily be shifted to foreigners. The question is primarily one to be decided on the facts of each individual case, including the type of product, the nature and extent of competition in the export markets, the relative importance of domestic and foreign demand for the product and other factors. We recognise that the levy of an export duty may create specially difficult problems in uncertain conditions of international trade and the psychological reactions of the importers in other countries to such duties needs to be taken into account. This does not, however, rule out the judicious use of export duties for revenue purposes.

4. In the post-war period in India, export duties have also been levied for purposes other than revenue. Many duties fulfil different secondary economic purposes, the significance of which has varied from time to time. Thus several duties have been imposed for preventing the impact on domestic markets of inflationary conditions abroad, or for stabilising domestic prices, while other duties have been imposed for protective purposes. Tables 2 and 3 at pages 273 and 274 show (1) the exports since 1948-49 of commodities subject to

*Report of the Indian Fiscal Commission, 1921-22, page 104.

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TABLE 2.—*Value of exports of commodities subject to export duties and duty realised therefrom*

(In crores of Rupees)

Year		Tea	Manganese ore	Cigars and cigarettes	Jute manufactures	Cotton textiles	Black pepper	Iron and steel	Vegetable oils	Coffee	Raw wool	Oil seeds	Raw cotton	Cotton waste	Raw jute
1948-49	Value	63·7	1·8	1·5	146·6	36·3	2·7	0·7	10·9	..	1·1	6·4	14·0	5·1	24·0
	Duty	10·8	0·4	No duty	6·4	4·0	No duty	No duty	0·9	..	No duty	0·6	1·8	No duty	1·2
	Percentage	*17·0*	*21·7*	..	*4·3*	*11·1*	..	..	*8·4*	..	..	*9·4*	*12·9*	..	*5·0*
1949-50	Value	72·4	5·8	0·5	127·0	59·1	14·5	0·7	7·6	1·3	3·7	14·1	10·6	8·2	16·7
	Duty	10·3	0·9	0·2	8·8	0·4	0·6	..	..	..	No duty	No duty	2·2	No duty	1·3
	Percentage	*14·3*	*14·7*	*40·0*	*6·9*	*0·6*	*4·4*	..	..	..	..	..	*20·8*	..	*7·8*
1950-51	Value	80·0	8·0	0·6	114·0	106·0	20·4	0·5	23·2	1·3	7·9	16·1	4·9	12·4	..
	Duty	11·2	1·3	..	23·9	0·3	4·3	0·2	..	..	2·0	No duty	2·2	1·2	..
	Percentage	*14·0*	*16·5*	..	*21·0*	*0·3*	*20·9*	*40·0*	..	..	*25·2*	..	*44·9*	*9·7*	..
1951-52	Value	82·8	13·6	1·1	210·7	39·2	18·6	0·24	20·2	0·6	3·6	5·5	8·8	4·7	..
	Duty	10·2	2·1	..	59·3	3·3	4·6	0·16	0·5	..	1·3	1·0	4·9	2·6	..
	Percentage	*12·3*	*15·3*	..	*28·2*	*8·5*	*24·5*	*66·7*	*2·5*	..	*37·3*	*18·4*	*55·7*	*55·3*	..
1952-53	Value	69·5	17·6	0·1	109·6	46·6	12·5	0·7	23·4	1·4	8·4	2·4	11·9	7·0	..
	Duty	10·5	2·8	..	19·4	6·0	3·5	0·3	0·6	..	Exempt	1·5	7·4	2·6	..
	Percentage	*15·1*	*18·1*	..	*17·7*	*12·8*	*27·8*	*42·9*	*2·6*	..	..	*62·5*	*62·2*	*37·1*	..
1953-54	Value	89·9	20·8	..	103·5	50·3	9·9	0·6	4·4	1·1	5·9	1·2	6·7	7·2	..
	Duty	11·6	3·5	..	10·4	2·9	2·8	0·2	0·4	0·3	Exempt	0·3	2·7	2·6	..
	Percentage	*12·9*	*16·8*	..	*10·0*	*5·8*	*28·3*	*33·3*	*9·1*	*27·3*	..	*25·0*	*40·3*	*36·1*	..

NOTE.—The value figures for exports are ex-duty.

TABLE 3.—*Indices of value of exports and duty realised*

Year		Tea	Manganese ore	Cigars and cigarettes	Jute manufactures	Cotton textiles	Black pepper	Iron and steel	Vegetable oils	Coffee	Raw wool	Oil seeds	Raw cotton	Cotton waste	Raw jute
1948-49	Value	100	100	100	100	100	19	140	100	1	14	100	100	41	100
	Duty	100	100	..	100	100	..	..	100	..	..	100	100	..	100
1949-50	Value	114	322	33	87	163	100	140	70	100	47	220	76	66	70
	Duty	95	225	..	138	10	100	..	0	..	..	0	122	..	108
1950-51	Value	126	444	40	78	292	141	100	213	100	100	252	35	100	0
	Duty	104	325	..	373	8	717	100	0	..	100	0	122	100	0
1951-52	Value	130	756	73	144	108	128	48	185	46	46	86	63	38	0
	Duty	94	525	..	927	83	767	80	56	..	65	167	272	217	0
1952-53	Value	109	978	7	75	128	86	140	215	108	106	38	85	56	0
	Duty	97	700	..	303	150	583	150	67	..	0	250	411	217	0
1953-54	Value	141	1,156	0	71	139	68	120	40	85	75	19	48	58	0
	Duty	107	875	..	163	73	467	100	44	..	0	50	150	217	0

NOTE.—In the case of commodities which were not subject to duty in 1948-49, the year of imposition of duty has been taken as the base year both for value and duty indices. The following base years have accordingly been taken for different commodities :—

1948-49 for tea, manganese ore, cigars and cigarettes, jute manufactures, cotton textiles, vegetable oils, oilseeds, raw cotton and raw jute.

1949-50 for black pepper and coffee (exports of the latter commodity being negligible in 1948-49.)

1950-51 for iron and steel, raw wool and cotton waste.

export duties, the duty realised from them and the relative contribution of various export items to the total revenue from export duties, and (2) indices of value of exports and duty realised thereon, since 1948-49.

5. It appears from the table of indices of exports and duty thereon that some export commodities yield comparatively stable revenue, while the receipts from other items have been highly fluctuating. The fluctuations would be still more in evidence if figures for 1954-55 were available, since several export duties have been further reduced or abolished during the current year.

Tea

6. The choice of suitable commodities for the levy of export duties chiefly for revenue purposes may be examined in relation to the items of this type already on the tariff schedule. Tea is a commodity, for example, the exports of and the revenue from which have been relatively stable. The export duty on tea is a good illustration of a duty which has been levied primarily for revenue reasons. The revenue yield shows a slight upward trend but not of the same magnitude as the value of exports since the duties have not been adjusted to take account of trade variations. In 1950-51, 1951-52 and 1953-54, which have been good years for tea, the duty as a percentage of value has been slightly less than in the other years. The Official Team on the Tea Industry examined the export duty on tea and came to the conclusion that the duty was primarily paid by foreign buyers and that the position of the Indian industry was not adversely affected. It was of the view that Indian tea had special features in regard to flavour, appearance, cup quality etc., and there was little direct competition between tea of various countries. Quantities exported would not, in its opinion, vary significantly as a result of price changes. On the basis of the Team's conclusion, the export duty on tea may be regarded as an instance of a revenue duty the burden of which falls primarily on foreign buyers. In these circumstances, the duty may be held to ensure revenue without detriment to the trade.

Manganese ore

7. Manganese ore is not a commodity of which India has a monopoly. But there has, at any rate, till recently, been a sustained demand in foreign markets. The quantities exported, the total value of exports and the unit value rose every year from 1948-49 to 1952-53. Comparing 1948-49 and 1952-53, the quantity exported went up from 3·1 lakh tons to 13·7 lakh tons, the value of exports from Rs. 1·8 crores to Rs. 17·6 crores and the unit value from Rs. 58 per ton to Rs. 129 per ton. A sharp decline in prices and exports has taken place during the current year and the duty has been abolished.

Cigarettes, cigars and cheroots

8. The duties on cigarettes, cigars and cheroots were also levied mainly for revenue reasons while they were in force, but they were never of any significance. It was only in 1949-50 when receipts amounted to Rs. 17 lakhs that revenue worth mentioning was obtained from this source.

9. The duties on manganese ore and on cigarettes, cigars and cheroots illustrate the possibility of imposing export duties for the purposes of revenue on commodities which are not monopolies, but which are the products of industries with good markets abroad

There may be increased scope for such duties as the range of exports gets diversified. The revenue from such commodities cannot be as stable as from commodities of which India has a relatively steady export market. It is necessary to ensure that a suitable adjustment in rates is carried out from time to time in the light of changing circumstances.

Levy of export duties for purposes other than revenue.

Anti-inflationary duties

10. Export duties not levied primarily for revenue reasons may now be considered. The revenue consideration may, however, be said to exist in all cases and is often an important one. The occasion for levy of most of the new export duties or for very considerable enhancement of the older duties, it might be recalled, was the devaluation of the rupee in September 1949, followed by the boom that accompanied the Korean war a year later, though it was not until the boom had continued for some time that some export duties were imposed or enhanced, in the early summer of 1951. Thus many export duties were levied in order to prevent sudden price increases abroad being reflected in India. The devaluation of the rupee and the reaction on commodity markets of the Korean war increased considerably the demand for India's exports. It was necessary to keep within limits the prices of export commodities in order to avoid a general rise in prices in India as well as to secure for the State a share of the greatly favourable turn in the terms of trade. In common with several other countries, India imposed export duties increasingly as a means of intercepting the inflationary influence of external factors.

11. The export duties most significant from this point of view were those on jute manufactures, cotton textiles and black pepper. These are commodities the exports of which increased in value in 1950-51 and 1951-52, primarily due to rise in prices. Substantial enhancements were made in rates of duty in order to absorb for Government a part of the increased proceeds of exports. It will be seen that between 1948-49 and 1951-52, the revenue from export duties on these items, taken together, increased by over five times while the value of exports went up by barely one-half of their level in the earlier year. Between 1951-52 and 1953-54 the value of their exports declined by two fifths and the revenue in 1953-54 remained barely one-quarter of what it was in 1951-52. Revenue collection as a percentage of the value of exports of these articles has fluctuated considerably, the decline being only somewhat less steep than the proportionate rise in collections. Variations in the rate of duty have had no corresponding effect on the volume of exports. There is another way to look at the role of these export duties. Of the increase in value of exports of these commodities between 1948-49 and 1951-52, Rs. 57 crores was absorbed by Government and Rs. 83 crores was left to the trade.

Jute manufactures

12. A separate examination of each of these commodities reveals some interesting features. In the case of jute manufactures, the quantities exported did not respond to the price increases. In 1950-51 and 1951-52, the quantities of exports were less than in 1947-48 and 1948-49. The increased value of exports was entirely due to price increases. The supply was, therefore, highly inelastic. The duties on jute

manufactures were adjusted fairly closely in line with the price changes. The revenue from these export duties, expressed as a percentage of value of exports, was 21·0 in 1950-51 and 28·2 in 1951-52, when prices were high. The corresponding percentages for other years were 6·9 in 1949-50, 17·7 in 1952-53 and 10·1 in 1953-54.

Cotton piecegoods

13. The position regarding cotton piecegoods was somewhat more complicated. There were many rate changes, and duty as a percentage of value of exports was 11·1 in 1948-49, 8·5 in 1951-52, 12·8 in 1952-53 and 5·7 in 1953-54. In 1950-51, which was a boom year, no duty was imposed; however, there was a substantial increase in quantities exported and prices were high. The quantity exported in 1950-51 was 1,210 million yards as against only 384 million yards in 1951-52 and 560 million yards in 1952-53. In 1951-52 when prices went up further, a duty was imposed, and the quantities exported declined.

Black pepper

14. Black pepper is a commodity the price of which has varied considerably in response to changes in foreign demand. The unit values of exports rose from Rs. 484·4 per cwt. in 1949-50 to Rs. 802·9 per cwt. in 1950-51 and declined to Rs. 778·5 per cwt. in 1951-52, Rs. 647·3 per cwt. in 1952-53 and Rs. 512·1 in 1953-54. The duties have been adjusted to take account of this factor and of the change in export demand, but in view of the highly speculative nature of the trade, the variations have not been completely in line with trends in the value of exports. Revenue expressed as a percentage of value of exports was 20·9 in 1950-51, 24·5 in 1951-52, 27·8 in 1952-53 and 28·3 in 1953-54.

Levy of export duties to stabilise prices of essential commodities

15. Export duties may serve other purposes also. The attempt to stabilise domestic prices is a purpose which is essentially similar to the anti-inflationary purpose which we have just considered. This object has, however, had a certain distinctive significance in relation to some commodities which have been sold in India at prices well below world levels. Although the existence of different price ratios between commodities in different countries is generally undesirable, a large rise in prices of some essential commodities is liable to raise the general level of internal prices and may, therefore, call for preventive measures. In such cases careful consideration is necessary of the relative advantages of export control and export duties. A system of restriction through duties has advantages in so far as it makes clear the degree of restriction imposed by Government action, and, to the extent that exports actually take place, it enables some revenue to be raised. In practice, however, a judicious combination of the two methods, wherever possible, will provide a more satisfactory solution of the problem. Commodities on which export duties for this purpose have been levied in India are iron and steel, vegetable oils and coffee. The duty on coffee is of recent origin, having been imposed only in October 1953. The revenue from these items has never even reached Rs. 1 crore.

Levy of export duties for protective purposes

16. Export duties may also be used for protective purposes. Export duties may be imposed on raw materials in order to give an advantage to the Indian industries using those raw materials. The Fiscal Commission, in 1921-22, considered this

matter in relation to the competition between foreign and Indian manufacturers for supply to the Indian market. It expressed itself against the levy of export duties of such a type on the ground that they caused more resentment than protective import duties on the manufactured articles.* Such duties would place all foreign output of the finished article at a disadvantage and not merely that part of the foreign output which was exported to India. The rates would have to be very high because raw material costs form only a part of the cost of the finished articles.

17. It might be considered undesirable in general to levy an export duty on raw materials in order to give the industries using the raw materials a protected market in India in relation to foreign industries. It might be held that the objective could be better achieved directly through use of import duties and import control on the foreign manufactured articles. There are, however, other aspects to the question. Export duties on the raw materials will reduce prices in India and thereby place Indian industries using the raw materials in a favourable position in export markets. It is not a necessary condition that the corresponding foreign industries draw their raw materials from India. Thus, export duties which discourage the export of raw cotton benefit the Indian textile industry in its export trade, even though Lancashire may buy very little of its raw cotton in India. Export duties may merely be a device to transfer resources from Indian producers of the raw material to Indian manufacturers of exportable goods. Exports will take the form of the finished article rather than the raw material. This result could not be achieved through import control or import duties. Whether or not action of this kind is justified depends on the possibility of establishment of an economical processing industry in India. The considerations involved are broadly the same as those relevant in deciding on the grant of protection through import duties. In such cases also, export controls may be a necessary supplement to export duties. Thereby effective determination of the quantities to be exported is rendered possible, a result which export duties by themselves cannot achieve. Duties of this type levied in India are those on raw wool, oilseeds, raw cotton, cotton waste and raw jute.

18. The revenue derived is substantial in respect of these duties, having reached the figure of Rs. 11·5 crores in 1952-53. The main revenue-yielding items have been raw cotton and cotton waste. All these commodities are subjected also to export control and export duties have played a supplementary part in the general fiscal policy. Some cyclical variations can, however, be discerned in the figures for revenue as a percentage of value of exports. The maximum value was reached in 1951-52, the boom year. The values of exports were, however fairly low in that year, presumably because Indian industries required practically all the supply of these raw materials.

Raw wool

19. Raw wool was subjected to a 30 per cent. duty from the middle of 1950 to March 1952. There had been a steep rise in unit value from Rs. 1·3 in 1949-50 to Rs. 3·1 in 1950-51. After the abolition of the duty, there has been an increase in the quantities and the prices of exports, but the

*Report of the Indian Fiscal Commission, 1921-22, page 102.

importance of keeping in line with export duties in foreign countries was great in the case of this commodity.

Oilseeds

20. Regarding oilseeds, the policy has varied for different varieties. The revenue statistics do not distinguish between the varieties of oilseeds subject to duty and an analysis of the duty charged in relation to value of exports is not practicable. The object of the duty has been largely to encourage the processing of oilseeds in India.

Raw cotton and cotton waste

21. The policy regarding raw cotton and cotton waste has been determined primarily in relation to the requirements of the domestic textile industry. Quantities exported have varied considerably from year to year, export quotas being adjusted in the light of varying trade conditions. For raw cotton, prices were high in 1950-51 and 1951-52. Unit values were Rs. 853 and Rs. 673 per bale in these years, as against Rs. 362 in 1948-49, Rs. 388 in 1949-50, Rs. 293 in 1952-53 and Rs. 324 in 1953-54. The duty was high in 1950-51 and 1951-52, revenue as percentage of price being 45·5 and 55·2. In 1952-53, there was no downward adjustment in duty. In 1952-53 and 1953-54 duty as percentage of value of exports was, respectively, 62·6 and 40·3. In 1952-53, there was a very large quantity exported and exports on this scale were presumably not considered desirable. The duty on cotton waste was high in 1951-52, a year of high prices. There was a downward adjustment in 1952-53 when prices declined. As regards this group of commodities, therefore, somewhat greater use has been made of export duties with benefit to the revenue.

Mercury

22. The varied use of export duties is illustrated by the duty on mercury. This yielded a revenue of Rs. 15 lakhs in 1952-53. The levy was imposed because traders indulged in speculative import of mercury and then wished to re-export.

Relative importance of different types of export duties

23. We have surveyed above the various purposes for which export duties can be used and have mentioned considerations relevant to each. The following table will be of interest in showing the relative importance of export duties in India for different purposes over the last few years. There is a degree of over-lapping in the various purposes, and it is to be understood that a certain over-simplification is involved in this classification, which is nevertheless interesting.

TABLE 4.—*Revenue from export duties levied for different purposes* (a)

Year	Duties primarily for revenue purposes (b)		Duties for protective purposes (c)		Duties to remove price disparities (d)		Anti-inflationary duties (e)		Total (f)
	In crores of Rupees								
1948-49	11·2	*42·9*	3·6	*13·8*	0·9	*3·4*	10·4	*39·9*	26·1
1949-50	11·4	*46·1*	3·5	*14·2*	*Nil*	*Nil*	9·8	*39·7*	24·7
1950-51	12·5	*26·8*	5·4	*11·6*	0·2	*0·4*	28·5	*61·2*	46·6

TABLE 4—*contd.*

Year	Duties primarily for revenue purposes (b)		Duties for protective purposes (c)		Duties to remove price disparities (d)		Anti-inflationary duties (e)		Total (f)
1951-52 . .	12·3	*13·7*	9·8	*10·9*	0·7	*0·8*	67·2	*74 6*	90·0
1952-53 . .	13·3	*24·4*	11·5	*21·1*	0·9	*1·6*	28·9	*52 9*	54·6
1953-54 . .	15·1	*40·0*	5·6	*14·9*	0·9	*2·4*	16·1	*42·7*	37·7

NOTE:—(a) Figures in italics give revenue from duties in the category as percentage of the total export duty revenue in the year.

(b) Duties on tea, manganese and cigarettes.

(c) Duties on raw wool, oilseeds, raw cotton, cotton waste and raw jute.

(d) Duties on iron and steel, vegetable oils and coffee.

(e) Duties on jute manufactures, cotton textiles and black pepper.

(f) The totals in this column are in each case less than the figures for gross revenue from export duties given in Table 1 as the latter include miscellaneous receipts.

The 'anti-inflationary' duties are the most important revenue yielding items. The 'revenue' duties come next. The 'protective' duties are of less importance and the duties for removal of price disparities are of negligible significance from the revenue standpoint.

Export control and export duties

24. We may consider at this stage an issue analogous to the one we have considered in respect of import duties, *viz.*, the respective role of export control and export duties as means of preventing import of inflation. The problem is not merely to restrict the quantity of exports but to absorb a part of the high prices obtained by exporters. The quantity of exports index with 1948-49=100 was 105 in 1949-50, 110 in 1950-51, 89 in 1951-52 and 94 in 1952-53 and 1953-54. Thus in 1951-52, the year of maximum revenue from export duties, the quantity of exports was at the lowest level during the entire period. Export control by itself would have been ineffective and export duties were necessary. As indicated earlier, the two methods supplement each other.

Levy of export duties in other under-developed countries

25. The advantages of export duties as a means of keeping out inflation abroad, especially when supplies of export goods are inelastic, have been realised by many Asian as by other under-developed countries. In most of these countries, the peak of the Korean boom was touched in the first quarter of 1951, earlier than in India. In that quarter, the unit value of exports with January—June 1950 as 100 was 128 in Burma, 143 in Ceylon, 154 in Indo-China, 236 in Indonesia, and 235 in Malaya*. The situation was met by imposition of fresh export duties or increases in the rates of already existing duties. Malaya replaced with effect from 1st January 1951 the 5 per cent. *ad valorem* export duty on rubber by a sliding scale in which the rate varied from 3 cents per pound with a price of 60 cents to 82 cents per pound with a price of 200 cents. Ceylon increased the duty on rubber by 43 per cent., the duty on tea by 13·2 per cent., on copra by 33·3 per cent., on coconut oil by 33·2 per cent., on coconut *poonac* by 100 per cent., and on pepper

*Bulletin of the Economic Commission for Asia and the Far East, Second quarter 1951, page 9, and Third quarter 1951, page 6.

by 25 per cent., and fresh duties were imposed on cocoa, cardamom and *citronella* oils. Even these duties were expected to absorb only 30 per cent. of the windfall profits being obtained. Thailand increased the duty on rubber by 50 per cent. The revenue from the export duties was of great importance in the budgets of many of these countries.

Machinery for ensuring prompt adjustments in rates of export duties

26. When export duties are used as a weapon against inflation, prompt adjustment of rates in the light of changing economic conditions is a matter of importance. Undue delay in the adjustment of duties will have serious consequences both for Government and for the trade. We recognise that determination of appropriate rates of duty is a delicate and complicated task. There is an inevitable time-lag in the availablity of statistics regarding trade, and their interpretation and application to policy requires considerable experience and judgment. We, however, consider it a matter of great importance that there should be proper machinery—in the country as well as in overseas trade centres where we have Consular and other organisations—for the prompt and systematic collection of accurate information regarding prices and trade trends, and the supplying of the necessary information to the Government of India. We have not been able to make a detailed study of the existing organisation which is entrusted with this task, and are not, therefore, in a position to say definitely whether it is working on satisfactory lines. Apart from the question of methods of work, there is also the question whether the existing organisation has an adequate staff who are properly trained in this rather specialised field. We are inclined to think in the light of such evidence as we have received that there is scope for considerable improvement in various directions. We would, therefore, recommend that the Ministry of Commerce and Industry (which is primarily the authority concerned) should have a thorough investigation made of the existing organisation with a view to making it fully effective. Such investigation will, we trust, cover not merely the purely administrative and organisational aspects of the problem but also the scope for extending and strengthening contacts with trade interests in India as well as abroad.

Funding of proceeds of export duties

27. The suggestion has been made to us that the proceeds of export duties should be put into a special fund for the development of the industries concerned. This has special relevance to the proceeds of anti-inflationary export duties. We are aware that in many countries governmental action has been taken to absorb part of the high prices of export commodities during boom years, the amounts being returned to the industries concerned in one form or another in bad years. This has been true especially for primary products. It is arguable that unless such a course of action is adopted, export industries will be taxed at a heavier rate than other industries over the average of good and bad years, and, therefore, will be prevented from undertaking necessary investment. We are unable, however, to support the suggestion, because, in our opinion, the earmarking of tax-revenues, except in special cases such as the distribution of part of the proceeds of the export duty on jute to certain States, is open to objection and also because various types of machinery are available whereby finance is provided to industries for necessary investment.

CHAPTER IV

PROBLEMS OF ASSESSMENT IN CUSTOMS DUTIES

I. Valuation

General factors determining valuation

Customs duties are of two types *viz., ad valorem* and specific. In respect of articles subject to *ad valorem* duties, the values put on them determine the amounts of duty payable. The adoption of suitable valuation methods is, therefore, of importance from the points of view of both the revenue and the trade if evasion is to be prevented and unfairness among different classes of traders avoided. The dutiable value is fundamentally a legal concept, but it has economic and administrative consequences. As such, there are a number of component factors which are taken into account in framing the official definition of value. These may be classified as follows:—

(i) items of cost included in dutiable value;

(ii) places or markets to be considered in determining value;

(iii) date for basing valuation;

(iv) basis for currency conversion;

(v) criteria for selection of representative markets and prices; and

(vi) requirements of documentation and proof.

The contents of the official definition are thus likely to vary from country to country depending on the emphasis given to one or the other of the factors listed above. This renders the task of valuation difficult and complicated.

Attempts at international standardisation of principles of valuation

2. Attempts have been made for many years to secure international agreement on the principles of valuation. The latest of such attempts is the definition of 'actual value' in Article 35 of the Charter for the International Trade Organisation. This definition has also been incorporated in the General Agreement on Tariffs and Trade. It runs as follows:—

"(a) The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.

(b) 'Actual value' should be the price at which at a time and place determined by the legislation of the country of importation, and in the ordinary course of trade, such or like merchandise is sold or offered for sale under fully competitive conditions. To the extent to which the price of such or like merchandise is governed by the quantity in a particular transaction, the price to be considered should uniformly be related to either (i) comparable quantities, or (ii) quantities not less favourable to importers than those in which the greater volume of the merchandise is sold in the trade between the countries of exportation and importation.

(c) When the actual value is not ascertainable in accordance with sub-paragraph (b) of this paragraph, the value for customs purposes should be based on the nearest ascertainable equivalent of such value".

Indian practice: section 30 of Sea Customs Act

3. The law regarding valuation of goods for duty purposes in India is stated in section 30 of the Sea Customs Act, which reads as follows:—

"For the purposes of this Act, the real value shall be deemed to be—

(a) the wholesale cash price, less trade discount, for which goods of the like kind and quality are sold or are capable of being sold, at the time and place of importation or exportation, as the case may be, without any abatement or deduction whatever except (in the case of goods imported) of the amount of the duties payable on the importation thereof; or

(b) where such price is not ascertainable, the cost at which goods of the like kind and quality could be delivered at such place, without any abatement or deduction except as aforesaid".

Thus in India, valuation is on the basis of competitive wholesale price at the place of import or export where ascertainable, and in other cases on competitive landed cost of the commodities concerned. The Indian law is in essential respects in conformity with the provisions in the General Agreement on Tariffs and Trade; both recognise that competitive prices should form the basis of valuation.

4. It is mandatory under the Indian law to apply the market value criterion as contained in section 30(a) of the Sea Customs Act unless circumstances render it difficult to do so; in the latter event, section 30(b), *i.e.*, valuation based on invoices, comes into operation. One of the criticisms made is that in prescribing this order for assessment, the wholesale profits earned in India are in a majority of cases included in the assessable value. This is considered to be unfair. It has, therefore, been represented that section 30 of the Sea Customs Act should be so amended as to reverse the order of the application of clauses (a) and (b) respectively.

5. Reversal of the order of clauses (a) and (b), in the manner suggested would not, however, ensure the valuation of dutiable articles on the basis of invoices. Clause (b) provides for ascertainment of a competitive price where no competitive market exists. When this clause is applied, invoice values have to be adjusted so that no special elements are included or excluded. Where importers buy at varying prices because of different degrees of bargaining power or of other factors, an attempt has to be made to arrive at a single c.i.f. price as close as possible to the price which would prevail under free competitive conditions. Even where genuine invoices are produced, a valuation under clause (b) would involve

adjustment of the invoice values in order to arrive at what may be regarded as a normal competitive price.

6. Valuation in accordance with clause (a) of section 30 is thus more logical and, therefore, preferable to clause (b), and no useful purpose would be served by reversing the order of the clauses. A valuation under clause (a) ensures fairness as between different importers, and we think that this method should be employed wherever practicable. It is true that this entails a portion of the wholesale profits made in India being charged to duty. This criticism has, however, practically no validity as the exclusion of wholesale profits from assessable value would involve an upward readjustment of the rates of customs duties if the same amount of revenue is aimed at.

Increased importance of section 30 (b) in recent years

7. The task of valuation has been complicated in recent years by the greatly growing import of articles for which no competitive wholesale prices are available in India. An analysis of the records of the Bombay Custom House for the year 1952-53 indicates that 94 per cent. of the imports subject to *ad valorem* duties were valued under section 30(b) and only 6 per cent. under section 30(a). It is clear that practically no competitive wholesale prices exist for a substantial part of imports into India.

8. The absence of competitive wholesale prices is the result of the considerable diversification of the composition of imports and the increased volume of goods imported largely or exclusively by firms having special connections with foreign suppliers. The importing firm may be a branch of a foreign supplier, or may be a company registered under the Indian Companies Act, but owned by the foreign supplier. Again, the importer may be an Indian manufacturer having an agreement with a foreign manufacturer for supply of raw materials, designs, technical advice, etc. Independent importers may find it virtually impossible to import goods which are covered by such special arrangements.

Problems raised by increased importance of section 30 (b)

9. In these circumstances, the invoice prices lack significance and cannot obviously be accepted at their face value. It is the duty of the Customs authorities to arrive at an approximation to competitive prices in terms of clause (b) of section 30 of the Sea Customs Act, *i.e.*, the prices at which "goods of the like kind and quality could be delivered". The necessity of this provision will be appreciated from the fact that, unless a uniform criterion could be employed, there is a possibility of the same type of goods being valued differently, thus upsetting trade equilibrium. The only reliable guide in such circumstances is the local selling price of the goods which can be ascertained easily. It could be used as a starting point, by reasonable adjustments of post-importation charges, to arrive at the fair and true cost of importing goods. The 'deduced value' method, in our opinion, is fully in accord with the present provisions of clause (b) of section 30 of the Sea Customs Act. We would suggest that the Central Board of Revenue should issue detailed instructions, which should be made public, as regards the manner in which the various post-importation charges should be regulated so that there is uniformity in the practice followed at all Custom Houses.

10. It is but fair that the methods of valuation adopted by the Customs authorities should be given adequate publicity so that importers are aware of their commitments at the time of ordering goods. We understand that it is the practice in the Customs Department to notify for public information periodically the goods that are valued under section 30(a) of the Sea Customs Act. The interpretations regarding section 30 given by the Government of India and the Central Board of Revenue are, we understand, not published for general information. We would suggest that the latter should also be made accessible to the trade; and as far as the former is concerned, the Central Board of Revenue may review its present arrangements in this matter to see if greater facilities than at present could not be afforded to the public.

Need for publicity for methods of valuation

II. Tariff values

11. 'Tariff value' is the value determined by the Government of India in respect of certain articles for the purposes of assessment of customs duties on an *ad valorem* basis under section 22 of the Sea Customs Act. The fixation of a tariff value is intended to facilitate speedy valuation of articles whose market prices are difficult to determine for one reason or another. It could be applied with advantage to staple goods of uniform quality imported in sufficiently large quantities, which have a reasonably steady and continuous market. The fixation of a tariff value in practice amounts to the adjustment, at a fixed figure, of a duty payable *ad valorem* for a limited period, generally a year.

Definition and objects

12. The present procedure for the fixation of tariff values is for the Director-General of Commercial Intelligence and Statistics to compute these values on the basis of ex-duty average wholesale market monthly prices at the main importing centres in India during a year, weighted by the relative importance of the trade in each particular article in each of the principal importing centres, and modified, where necessary, in consideration of the probable future trend in prices. It has been suggested that this method is not objective enough, and that tariff values should be fixed purely on the basis of prices prevailing in the past two or three years and that no element of judgment of future price trends should enter into their determination. It is argued that the present practice of taking into account likely price trends in the future brings into the picture too many subjective elements and, therefore, somewhat vitiates the process of value determination. We are not convinced that there is a case for modifying the present practice in the manner suggested. Tariff values are drawn up for application in the year following the one in which they are fixed, and it is, in our opinion, necessary that these values should not be completely divorced from an appraisal of future market conditions in so far as these can be foreseen with reasonable certainty.

Method of fixation

III. Types of Duties

13. There are in the Indian Customs Tariff, 405 *ad valorem* duty items, 34 specific duty items, 79 specific or *ad valorem* items, and 35

specific and *ad valorem* items. Of the 405 *ad valorem* items, 123 are in effect specific, because of fixation of tariff values. Of the duty collected in 1951-52, 53 per cent. was from *ad valorem* duties, 34 per cent. from specific duties, 8 per cent. from alternative duties, and 1·6 per cent. from composite duties. The importance of specific duties is much less than the above figures would indicate. Receipts amounting to Rs. 35 crores out of the total amount of Rs. 48 crores raised from specific duties were from three items—motor spirit, kerosene and betelnuts. For the rest, the specific duty items are unimportant. Tariff value articles are also not significant from a revenue standpoint, the total yield in 1951-52 being only Rs. 7·8 crores. The following table shows the relative importance of each type of duty; the figures are for the year 1951-52.

TABLE 1.—*Revenue from import duties by types of duties*

Serial No.	Type of duty	Value of imports (Rs. '000)	Percentage of total value	Total amount of duty (Rs., '000)	Percentage of total amount of duty
1.	*Ad valorem*	2,59,55,94	*30·2*	74,86,71	*53·0*
2.	Specific	1,91,22,04	*22·2*	48,20,55	*34·1*
3.	Composite	3,38,31	*0·4*	2,29,24	*1·6*
4.	Alternative	14,93,00	*1·7*	11,28,42	*8·0*
5.	Free or exempt	2,28,03,19	*26·5*	..	
6.	Unsegregated	Not available			
	Total . .	8,60,14,08		1,41,27,97	

NOTE.—The figure given as 'Total' under column 3 represents the total value of imports as distinct from the total of amounts mentioned in column 3 which comes to Rs. 6,97,12,48 (000). The difference is explained by the fact that the value mentioned in column 3 in respect of serial numbers 2 to 5 excludes the value of a number of items which is not ascertainable. The value mentioned against serial No. 1 is, however, fairly accurate.

The duties under the Indian Import Tariff are thus seen to be primarily *ad valorem*.

14. There has been much discussion as to the relative advantages of specific, *ad valorem* and composite duties, but practically no suggestions have been received regarding the changes, if any, necessary in the present system. The Fiscal Commission of 1921-22 suggested a cautious extension of the field of specific duties and tariff values, while the Fiscal Commission of 1949-50 was inclined to the view that such an extension would be undesirable. The general considerations for and against specific duties, *ad valorem* duties and composite rates are well-known. Specific duties give the trader certainty as to the amount of duty he will have to pay and simplify administration when the product is clearly identifiable. They also make for greater certainty in budgeting for customs revenue. Tariff values give the same advantages and can also be adjusted more frequently than specific duties. *Ad valorem* duties keep the burden of tax steady, give the Exchequer a share

in the long-term increase in prices and incomes and express the burden of duty in a form that is readily comprehensible. From the point of view of protection, specific duties would be preferable as the quantum of protection increases when prices fall and diminishes when prices rise.

15. There is little scope for reducing the number of specific items in the existing Customs Tariff. The main items, *viz.*, betelnuts, motor spirit and kerosene will have to remain specific, because of the difficulty of obtaining correct price data. Possibly in the case of beer and wines, a change to an *ad valorem* basis is practicable, but at a time of falling prices this will react adversely on revenue and may defeat one object of specific duties, *viz.*, to discourage the import of cheap but harmful varieties.

16. A shift from *ad valorem* to specific duties will be difficult because of the change in the character of India's imports. Items like machinery, electrical goods, etc., cannot be assessed on a specific basis because of the great variety of products falling within even a narrow definition. If it is considered necessary to protect revenue against temporary price falls, the solution must lie in variation of rates from time to time rather than resort to specific duties.

17. Alternative and composite rates play only a small part in the Indian tariff. On certain goods they have been imposed on the recommendation of the Tariff Board, *e.g.*, silk yarn, silk fabrics, lead pencils. On other goods they were imposed during the inter-war period to safeguard industries against Japanese dumping or to safeguard revenue, as in respect of certain chemicals, paints, cigarettes and silk goods. It is desirable to eliminate such rates except where specifically recommended by the Tariff Commission.

Assessment of constituent parts at higher rates than those applicable to finished products

18. Various instances of constituent parts being charged to duty at a higher rate than the finished articles of which they form part have been reported to the Commission. Apart from tariff anomalies, situations of this type arise owing to:

(i) grant of protection; or

(ii) obligations imposed by GATT.

The duty on steel bits is higher than on machine tools in the manufacture of which steel bits are used, because steel bits fall under the protective tariff head 'steel bars'. The duty of $5\frac{1}{4}$ per cent. on machine tools cannot be raised to $44\frac{1}{10}$ per cent. which is the protective rate for steel bars. As instances of the effect of GATT, it may be noted that the rates for vitamin preparations (20 per cent. standard and 14 per cent. preferential), refrigerators (30 per cent. standard and 24 per cent. preferential), fountain pens (30 per cent.) and alarm clocks (50 per cent.) are 'bound' under GATT. The rates on various raw materials used in the manufacture of these articles are higher; vitamins used for vitamin preparations are charged 30 per cent. standard and 24 per cent. preferential, gases used for fuelling refrigerators are charged $37\frac{4}{5}$ per cent. standard and $27\frac{3}{10}$ per cent. preferential, copper tubes used for refrigerators are charged $37\frac{4}{5}$ per cent. standard and $25\frac{1}{5}$ per cent. preferential, gold or gold-plated pen nibs used to manufacture fountain pens are charged 62½ per cent., other types of nibs used for fountain pens are charged 39⅜ per cent., and parts of alarm clocks are charged 78¾ per cent.

19. These anomalies have no serious effect at present because imports of practically all the finished articles mentioned are severely restricted through import control. Local manufacturers would, however, encounter severe unfair competition if import control was relaxed. In the case of industries affected by the grant of tariff protection to suppliers of constituent parts, the remedy available is by way of appeal to the Tariff Commission. The Tariff Commission can either grant protection to the industry producing the finished article also or prescribe that refund of duty on imports used by particular industries be granted. For industries affected by GATT or by other tariff anomalies, the remedy available at present is to ask Government for facilities for manufacture in bond and exemption from duty on raw materials under section 3, clause 4 of the Sea Customs (Amendment) Act, 1953. Where a higher duty on the raw materials cannot be avoided because of the grant of protection or by reason of international obligations, this procedure would be adequate. In other cases, if necessary, tariff rates may have to be revised appropriately.

Facilities for processing and re-export of imports

20. With the growing importance of manufactured goods in India's export trade, it is necessary to ensure that the import duties on industrial requirements do not impede exports. There has always been a provision for the grant of drawback of import duty when re-exports take place. Till recently, however, drawback was granted only if goods were exported in the same condition in which they had been imported. This precluded the grant of drawbacks on imported material used in the manufacture of export goods. Under the Sea Customs (Amendment) Act, 1953, such drawbacks are, however, now permitted. Provision also exists for manufacture in bond with imported raw materials, import duty being waived in the case of goods shipped ex-bond. We understand that discussions are in progress with the trade with a view to implementing these provisions of the Sea Customs Act, and that in many cases rules have been issued. We attach importance to the provision of adequate facilities to the trade for duty-free re-export of imported goods after manufacture and wish to stress the need for prompt implementation of the new provisions of the Sea Customs Act regarding this matter.

IV. Tariff Classification

21. The successful working of a tariff depends, to a large extent, on suitable classification. The classification in the Indian Customs tariff is practically indentical with Standard International Trade Classification prepared by the European Customs Union Study Group. It has been represented to us that a revision and enlargement of the Indian Customs tariff is necessary. A few specific suggestions have also been made. It is obviously not possible for us to go into these detailed suggestions which involve technical examination. The Central Board of Revenue has admitted the need for

revising the tariff classifications and we have no doubt that the suggestions made to us will be taken into consideration when revision is undertaken. We need hardly emphasise the importance of periodical examination of the suitability of tariff classification having regard to the changing patterns of trade.

Correlation of Import Trade Control Schedule and Indian Customs Tariff Classification

22. It has been represented that frequent classification disputes arise because of lack of uniformity between the Import Trade Control and Customs classifications. This lack of uniformity, it is alleged, leads to the Import Control classification being interpreted unreasonably by the officers of the Custom Houses who enforce the Import Trade Control regulations. Administrative action has, however, been taken recently to remove these difficulties. Customs Advisory Committees have been set up at the ports with a membership consisting of representatives of the Customs Department, the Chief Controller of Imports, the Port Trust, the Reserve Bank of India and the trade. These Committees meet every month and discuss difficulties of the trade not involving large questions of policy. We understand that difficulties regarding classification no longer cause serious inconvenience. It is, therefore, not necessary to undertake a major reclassification, which would lead to considerable dislocation for a transitional period.

CHAPTER V

EXCISE DUTY ON TOBACCO

Importance of tobacco

The area under tobacco cultivation has recorded a rapid rise in recent years. It rose from 5·7 lakh acres in 1946-47 to 10·2 lakh acres in 1952-53 and India is now the third largest producer of tobacco in the world ranking next after U.S.A. and China.

Tobacco occupies an important place in Indian economy although the area under cultivation constitutes only 0·3 per cent. of the total area under agriculture and the value of the output of tobacco represents only 1·5 per cent. of the total value of crops. According to the Final Report of the National Income Committee, the value of the output of tobacco was Rs. 71 crores in 1950-51. Tobacco thus was fourth in order of importance among cash crops, ranking after sugarcane, groundnuts, and cotton. Tobacco is also an important item of export, being eighth in order of value.

Zones of cultivation

2. Tobacco is cultivated in all parts of India, but there are only four zones of concentrated cultivation, *viz.*, Guntur (Andhra), Charotar (Gujerat), Nipani (Bombay) and Tirhut (North Bihar). Of all the States, Andhra has the largest area under tobacco cultivation representing 35 per cent. of all-India acreage and accounting for 95 per cent. of the total production of virginia tobacco.

Pattern of consumption and organisation of production

3. Tobacco is consumed in numerous forms, the more important being cigarettes, biris, snuff, cigars and cheroots, hookah and chewing. Cigarettes are made in organised factories using mechanised processes. There are in all nineteen factories situated at Bangalore, Bombay, Calcutta, Hyderabad, Monghyr and Saharanpur.

4. As regards biris, there is practically no part of India where they are not manufactured to some extent, but Madhya Pradesh, Bombay, Madras and West Bengal account for more than three-fourths of the total production (77 per cent.). Madhya Pradesh is the largest producing State with 25 per cent. of the output, Bombay being a close second with 21 per cent. The biri industry is not organised on factory lines. There are numerous small-scale producers of biris who employ their own labour and the labour of the members of their household for rolling biris. Biris are not manufactured by large-scale manufacturers by assembling workers under a factory roof. It is the domestic system of manufacture that is largely in vogue. The raw materials, *viz.*, tobacco, *tendu* leaf, etc., are issued to out-workers living scattered about in a town or city or in villages and they manufacture the biris and deliver them at the factory. Recently, mechanical processes have begun to be employed in the manufacture of biris.

5. The manufacture of snuff is concentrated in Madras city and Mangalore in South India and parts of Bombay State. Except for a few large scale producers who use machinery, the production is organised only on cottage scale.

6. The manufacture of cigars and cheroots is confined to a few places in Madras and Andhra States. This is also essentially a cottage industry. A special feature of the consumption of cheroots is that the bulk of the consumption is in Andhra State where it is in the form of cheroots rolled by the consumers themselves. Thus, out of a total quantity of 39 million lbs. cleared for duty under this class, only 9 million lbs. pass into commercial manufacture.

7. The manufacture and consumption of hookah tobacco is almost entirely confined to North India—Punjab, Delhi, U.P., Bihar, West Bengal, Assam and parts of Rajputana and Central India. This is also essentially a cottage industry.

8. The main areas of consumption of chewing tobacco are in South India where it is mostly used in the raw form without any process of manufacture. It is estimated that more than four-fifths of the total consumption of chewing tobacco in India is in the raw form. Uttar Pradesh and Delhi and to a smaller extent Hyderabad are areas where there is manufacture of chewing tobacco called *zarda* on a large scale.

Trends in consumption

9. Below are given figures regarding the consumption of tobacco as indicated by the quantities cleared for the central excise duty under various categories.

TABLE 1.—*Clearance of tobacco by tariff classes*

	43-44	44-45	45-46	46-47	47-48	48-49	49-50	50-51	51-52	52-53	53-54
						(Million lbs.)					
Cigarettes : Flue-cured	24·5	25·3	30·4	29·1	27·4	21·9	25·0	28·2	24·0	21·3	24·4
Non-flue cured.	11·2	14·0	19·0	14·9	11·1	9·0	11·4	20·4	22·1	21·6	21·8
Total cigarettes.	35·7	39·3	49·4	44·0	38·5	30·9	36·4	48·6	46·1	42·9	46·2
Biris.	54·5	61·3	62·9	66·7	76·5	93·9	90·4	105·9	116·7	121·3	117·7
Snuff.	3·1	3·6	6·0	7·8	4·3	4·4	5·6	5·6	8·8	7·8	8·9
Cigars and Cheroots.	27·4	37·6	46·0	49·6	48·2	51·5	49·1	52·2	43·7	41·4	38·8
Hookah.	181·3	142·6	178·7	174·2	93·4	107·3	111·2	120·9	118·8	126·7	119·1
Chewing.	88·3	93·0	127·1	117·9	116·4	127·3	127·6	129·3	114·0	111·2	111·0
Total (other than cigarettes).	354·6	338·1	420·7	416·2	338·8	384·4	383·9	413·9	402·0	408·4	395·5
Grand Total	390·3	377·4	470·1	460·2	377·3	415·3	420·3	462·5	448·1	451·3	441·7

NOTE.—The figures up to 1946-47 relate to undivided India.
The figures pertaining to Part B States are included only from 1950-51.

10. The manufacture of cigarettes and biris has recorded a rapid rise in recent years. According to the Report on the Marketing of Tobacco in India and Burma (1938), the annual production of cigarettes was 7,500 million and the quantity of tobacco used in the manufacture of biris was 70 million lbs.

These figures have subsequently been far exceeded despite the partition of the country and the consequent partial loss of large markets. In 1950-51, the production of cigarettes totalled 23,364 million, and although since then there has been a decline, the figure for 1953-54 stood at 19,849 million. The biri industry has also recorded a substantial rise and the quantity of tobacco used for the manufacture of biris was 121 million lbs. in 1952-53 and 118 million lbs. in 1953-54 as compared to 55 million lbs. in 1943-44.

Taxation Enquiry Committee's findings

11. The Taxation Enquiry Committee (1924-25) observed that "the absence of any internal taxation on tobacco is a feature which distinguishes the fiscal system of India from that of almost every other civilised country in the world". The Committee considered that the use of tobacco in India was even more widespread than in many of the countries which subjected it to taxation and expressed the view that there was a strong case for the taxation of tobacco in India.

12. The possibility of taxation of tobacco was examined on numerous occasions, but the administrative difficulties of evolving a suitable system prevented the imposition of the tax. The Taxation Enquiry Committee considered that the possible methods by which tobacco could be taxed in India were the following:—

(a) a Government monopoly,

(b) an acreage fee,

(c) a regular excise system, and

(d) a system of licences.

13. A Government monopoly was ruled out as too vast an undertaking to be considered. A system of acreage fee was considered to be administratively difficult because of scattered cultivation and large variations in yield. The Committee, therefore, suggested a combination of a regular excise system for cigarettes, smoking tobacco and cigars manufactured in organised factories and a system of licensing for the taxation of other forms of tobacco.

Constitutional position

14. Prior to the enactment of the Government of India Act, 1935, the taxation of tobacco was not a central subject. The provinces (now States) were, therefore, "encouraged to derive what revenue they could from the control of taxation of retail vend and generally to develop this field of taxation in the hope that experience of the various schemes suggested might lead to the evolution of a practicable general excise system".* Under the Government of India Act, 1935, however, the power to levy a tobacco excise was allocated to the Central Government (*vide* item 45 of List I—Federal Legislative List—Seventh Schedule).

Imposition of the excise in 1943

15. The compelling need for additional revenue during the War led to the imposition of an excise duty on tobacco with effect from 1st April 1943. The levy was imposed under the Tobacco (Excise

*Budget Speech, 1943.

Duty) Act, 1943 which was subsequently merged in the consolidated Central Excises and Salt Act, 1944.

Evolution of the tariff and the effect on revenue. Pattern of the tariff

16. The rates of duty were designed on a progressive scale. Graduated rates were fixed for flue-cured tobacco used in the manufacture of cigarettes depending on the imported tobacco content of the blends. They ranged from eight annas per lb. to Rs. 1-12-0 per lb. For non-flue-cured tobacco used in the manufacture of cigarettes the rate of duty was fixed at six annas per lb. and the same rate was also fixed for tobacco used for biris and snuff. A lower rate of two annas per lb. was fixed for cigar and cheroot tobacco and a still lower rate of one anna per lb. was fixed for hookah and chewing tobacco and stalks. In addition to the duty on the tobacco used in the manufacture of cigars and cheroots, a graduated duty on the basis of value slabs was imposed on the higher grades of the manufactured cigars and cheroots.

The growers are permitted to retain without payment of duty tobacco required up to specified limits for their personal consumption (including the requirements of the members of their household).

Tobacco used for agricultural purposes is exempt from duty. Exports are also duty-free.

The revenue realised from tobacco in the first year of the excise *viz.*, 1943-44 was Rs. 9·65 crores.

Gradual increase in rates

17. With the building up of the organisation necessary for the operation of the tobacco excise, the rates of duty were stepped up in 1944. The rates of duty on flue-cured tobacco used for the manufacture of cigarettes were doubled, ranging from Re. 1-0-0 to Rs. 3-8-0 per lb., the rates for non-flue-cured tobacco used for cigarettes as well as biri and snuff tobacco were raised by 50 per cent. to nine annas per lb. and the rates for cigar and cheroot, hookah and chewing tobacco were raised to a uniform level of three annas per lb. As a result of these changes, the revenue from tobacco rose to Rs. 17·28 crores in 1944-45.

18. In 1945, the rates of duty on flue-cured tobacco used in the manufacture of cigarettes in admixture with imported tobacco were graduated further and rates of Rs. 7-8-0 and Rs. 5-0-0 per lb., were imposed on the classes of cigarettes containing over 60 per cent. and between 40 per cent. and 60 per cent. respectively, of imported tobacco in the blends. These changes raised the revenue to Rs. 20·82 crores in 1945-46.

19. The next changes made in the tobacco tariff were in 1948 when an excise duty was imposed on cigarettes and the rates of duty on other tobacco were raised. The tariff for cigarettes followed the same pattern as the tariff for cigars and cheroots *viz.*, value slabs for fixation of rates, but there was no exemption of any class of cigarettes unlike the exemption of the cheaper classes of cigars and cheroots. The rates of duty on biri and snuff tobacco, and cigar and cheroot, hookah and chewing tobacco were raised by one-third to twelve annas and four annas respectively. The effect of these changes was to raise the revenue to Rs. 25·30 crores in 1948-49.

20. In 1951, the rate of duty on biri tobacco was raised to fourteen annas per lb., and the rate for cigar and cheroot, hookah and chewing tobacco was raised to six annas per lb. Snuff tobacco was also classified with the latter and, consequently, the rate of duty for it was reduced from twelve annas to six annas per lb. Surcharges at rates of one pice and two pice per ten cigarettes were also imposed on cigarettes with retail price for ten cigarettes between two annas and five annas six pies, and exceeding five annas six pies respectively.

These changes led to a rise in the revenue from tobacco excise to Rs. 35·39 crores in 1951-52. As a result of fluctuations in production and consumption, there was a slight decline in 1952-53 to Rs. 33·94 crores and in 1953-54 to Rs. 33·23 crores.

Temporary relief in 1954

21. With effect from 10th April 1954, the rate of duty on all non-flue-cured tobacco warehoused or deposited in curers' bonded storerooms prior to 1st January 1954, has been reduced by 25 per cent. as a measure of relief to the trade which was faced with the problem of accumulated stocks. The rate of duty on certain specified inferior grades of flue-cured tobacco used for cigarettes has also been reduced from Re. 1 per lb. to nine annas per lb. subject to certain conditions.

22. Under the Central Excises and Salt (Amendment) Ordinance, 1954, which came into force on 29th July 1954, a duty of Rs. 3 per 1,000 has been imposed on biris in the manufacture of which any process is conducted with the aid of machines operated with or without the aid of power. The purpose of this duty is not to raise revenue but to discourage mechanisation and to sustain the present level of employment in the industry.

Working of the tariff

23. In a system of tariff classification which involves gradation of the commodity into different varieties according to their utility, it is a difficult task to ensure equity and compliance to the satisfaction of all concerned. The history of the tobacco tariff is an excellent example of the difficulties involved. Until 1951, the criterion employed was 'intended use'—the intention was to be expressed by the tax-payer in the form of a declaration before clearance for duty. It was in the nature of self-assessment with safeguards by Government to ensure that the declaration made was honoured. The preventive measures extended even to the scrutiny of the accounts of the biri manufacturers although biri was not subject to excise duty on its manufacture. The system was criticised on the ground that it involved the follow up of duty-paid tobacco and led to the harassment of the honest tax-payer. The system lent itself to exploitation by the dishonest tax-payer as preventive machinery could ensure compliance with declaration only at a disproportionate cost.

24. The system was discarded for a short period in 1951 in favour of a flat rate of duty on all varieties of tobacco other than those used for cigarettes, with a further duty on manufactured biris and snuff. As a result of discussions in the Lok Sabha and the Select Committee, the measure was withdrawn on the ground that it would be a source of hardship to a large section of the community if biri,

snuff, chewing tobacoó (sic) etc., were to be taxed both in the manufactured form and also unmanufactured form. Government, while withdrawing this scheme, were able to secure for the application of the various tariff rates the substitution of the criterion of 'intended use' by that of 'capable of being used' for biris.

25. The new criterion reverses the roles of the tax-payer and the Excise Department from what obtained under the old system. The system of self-assessment with safeguards by Government for revenues has given way to assessment at the discretion of the Central Excise Department. The new system has obviously not been taken to kindly by the trade, judged from the large number of representations received by us. The main points of criticism are that similar varieties are being taxed differently in different areas, that classification of varieties made as to their utility is faulty, and that frequent revisions are being made in the classification involving uncertainty and risk to business.

26. The only alternative arrangement that the trade interests could suggest was the one that was abandoned in 1951. The sector of the trade interested in the biri industry showed preference for a flat rate of duty on unmanufactured tobacco but without a duty on the manufacture of biris. We have, however, carefully examined the working during the past three years of the 'capability' criterion. The procedure followed for implementation of the criterion is that the Collectors of Central Excise have been authorised to classify varieties of tobacco for the purposes of assessment based on their relative use for the manufacture of biris within different zones in their jurisdictions. These varieties may be either in minor use or negligible use or not used at all for biri manufacture in such zones. Those not covered by the above three classifications are varieties which are regarded as in major use for biri manufacture. The test applied for classifying varieties into these various degrees of uses for biri manufacture are:—

(i) major use—25 per cent. or more of the total quantity of the variety used in the particular zone should be for biri manufacture.

(ii) minor use—5—25 per cent. of the total quantity of the variety used in the particular zone should be for biri manufacture.

(iii) negligible use—less than 5 per cent. of the total quantity of the variety used in the particular zone should be for biri manufacture.

The local assessment within the zone, of any given variety of tobacco is as follows:—

Classification of tobacco	*Rate of duty charged*
Not used for manufacture of biris.	Charged at six annas per lb. without any restriction.
Used to a negligible extent for the manufacture of biris in specified zones.	Charged at six annas per lb. except when moved outside the specified zones.
Used to a minor extent in the manufacture of biris in the specified zones.	Charged at six annas per lb. in the specified zones after denaturing ; otherwise charged at fourteen annas per lb.
Varieties of which the major use is for biri manufacture.	Charged at fourteen annas per lb.

27. The figures for the clearance of tobacco for various purposes for the two years preceding the adoption of the present criterion and the three years of its implementation are compared below.

TABLE 2.—*Clearances of tobacco for biri and other purposes*

Quantity assessed at the biri rate

'Intention' criterion		'Capability' criterion	
Year	Quantity (million lbs.)	Year	Quantity (million lbs.)
1949-50	90	1951-52 .	117
1950-51	106	1952-53 .	121
		1953-54 .	118
Quantity assessed for cigars, cheroots, snuff, chewing and hookah			
1949-50	294	1951-52 .	285
1950-51	308	1952-53 .	287
		1953-54 .	278

There has been a fall of 20—30 million lbs. in the clearance of lower rated tobacco and an increase of about 11—15 million lbs. in the clearance of higher rated tobacco. It is possible to argue from these figures that the new criterion has had the effect of some lower rated tobacco being charged at a higher rate. It is, however, doubtful if a positive conclusion of this nature could be drawn from these figures. There has been a progressive increase in the clearance of tobacco for biris since the duty came into force. The above figures also show an increase of nearly sixteen million lbs. as between 1949-50 and 1950-51 which is largely attributable to the integration of the former Indian States. The increase in the clearance of tobacco for biris after the enforcement of the 'capability' criterion can perhaps be partly attributed to the natural increase that would have taken place in any case especially as the requisite administrative arrangements in Part B States improved. It is possible that a part of the increase might have resulted from the adoption of the new criterion. The percentage of increase is, however, so small that no definite conclusions can be drawn but we can appreciate that there would have been initial difficulties in the implementation of a totally new procedure and it might have led to hardship in some cases.

28. A tariff classification that is based on the ultimate utilisation of the different varieties of the commodity for particular purposes, can be equitable only if the payment of duty is related to their 'actual' use, which is almost impossible to enforce, rather than to their 'intended' or 'potential' use. In the latter event, there is room for the exercise of personal discretion in the implementation of the criterion. Out of the two, it would seem that the 'capability' criterion has greater chance of being applied objectively as far as practicable, provided the initial classification is made scientifically, subsequent changes are made after careful investigation at a level which will inspire public confidence and a procedure is devised for the prompt disposal of the representations made. As there is no other workable alternative except charging a flat rate of duty, it appears to us necessary that all possible steps should be taken, now that the working of the criterion has been known for three years, to carry out an exhaustive review of the procedure adopted. We recommend the appointment of an expert committee which should include a marketing expert in tobacco and a representative of the trade to go into the question fully.

29. The principal ground urged for a flat rate is the ease with which it can be administered. On the other hand, assuming that it is not possible to sacrifice any revenue in the process, the rate will have to be fixed, on present trends, at about nine annas per lb. It will mean an additional burden of 50 per cent. on the lower rated varieties raising the percentage of the duty to value from nearly 66 to 100. The issue, therefore, is whether the differential rates for unmanufactured tobacco serve any economic purpose. It is argued that the justification for imposing a higher rate of duty on biri tobacco is that it provides a smoke for more sophisticated people and is consumed largely by working classes in urban areas who may be presumed to have larger income than the working classes in rural areas. On the other hand, it has been impressed upon us by some trade interests that if the differential tariff involves any economic principle of ability to pay, it is entirely misplaced in the case of tobacco. The use of a particular form of tobacco for consumption depends more on habit than on price.

Flat rate of duty

30. It is not possible to endorse or to reject either point of view as no scientific investigations have been carried out regarding the class by class consumption of the various forms of tobacco. It is, however, difficult to agree that in a poor country where tobacco is consumed extensively by all classes, the price of the form of tobacco chosen for use will be entirely irrelevant. A proper consideration, in our opinion, will be the proportion of the duty to price in the case of cheap and costly varieties. At the present rates of duty the proportion of duty to value is 60 per cent. for biri tobacco and 66 per cent. for hookah and other tobacco. With a flat rate of nine annas per lb. the percentage will go up to 100 for the latter and go down to 38 for the former. The effect of a flat rate will be felt particularly in a period of falling prices when the duty may have to be reduced. With a differential tariff it will be possible to adjust the burden for the use of different varieties on the basis of the trends of their consumption. With a flat rate, the reduction, in such circumstances, has to be uniform for all varieties.

31. The other alternative is that a low rate of duty which does not bear heavily on cheap varieties of tobacco should be imposed along with a duty on manufactured biris. Assuming that the present rate of six annas per lb. will continue, the tariff for biri manufacture will have to be pitched at least at eight annas per lb. in order to secure revenue of the same order as at present. If small biri manufacturers were exempted from the duty on economic and other considerations, the loss of revenue so caused will have to be made up by a further increase in the rate of duty on manufactured biris. This is likely to disturb the present balance between biris and cigarettes in regard to excise duty. It is difficult to visualise its effect on the consumption of biris. The biri manufacturing trade gives employment to a large number of persons and the possibility of the cheap varieties of cigarettes encroaching on the biri market has to be carefully investigated before a duty on manufactured biris is levied. The trade is organised on the basis of the out-worker system. The administrative control will, therefore, have to extend to lakhs of small scale operators which besides imposing a heavy burden on administration is also likely to cause harassment to these

operators. The only way in which an excise duty on manufactured biris can be successfully operated is by exempting small scale units which, however, represent much the greater part of the industry. The recent Ordinance, since replaced by an Act of Lok Sabha, that has been issued to discourage the use of machinery in rolling biris with a view to maintaining employment in the industry is an indication of the economic importance of the industry as carried on in cottages. At the present stage, we would deprecate any experiment which seeks to make radical changes in the system of excise on biris.

We recommend that the present differential tariff should continue and improvements should be made in the criterion of capability of use for biris as suggested in paragraph 28.

Cigarettes—Duty on the unmanufactured tobacco

32. The tariff on cigarettes has been evolved in various stages. The progressive tariff on unmanufactured tobacco based on imported tobacco content was introduced in 1943 followed in 1948 by a progressive rate schedule on manufactured cigarettes based on value slabs related to wholesale cash price. A surcharge was imposed at two rates of one pice and two pice for every ten cigarettes on the basis of retail prices. The present rate structure may be seen at a glance in the table given below:—

TABLE 3.—*Rates of duty on cigarette tobacco and cigarettes*

I. *Unmanufactured tobacco.*	*Per lb.*
(1) If flue-cured and used in the manufacture of cigarettes containing—	
(i) more than 60 per cent. weight of imported tobacco.	Seven rupees and eight annas.
(ii) more than 40 per cent. but not more than 60 per cent. weight of imported tobacco.	Five rupees.
(iii) more than 20 per cent. but not more than 40 per cent. weight of imported tobacco.	Three rupees and eight annas.
(iv) 20 per cent. or less than 20 per cent. weight of imported tobacco.	Two rupees and eight annas.
(v) No imported tobacco.	One rupee.
(2) If flue-cured and used for the manu acture of smoking mixtures for pipes and cigarettes.	Seven rupees and eight annas.
(3) If other than flue-cured and used for the manufacture of (*a*) cigarettes or (*b*) smoking mixtures for pipes and cigarettes.	Nine annas.
II. Cigarettes of which the value—	*Per thousand*
(i) exceeds Rs. 50 a thousand.	Twelve rupees and eight annas.
(ii) ex eeds Rs. 40 a thousand but does not exceed Rs. 50 a thousand.	Ten rupees.
(iii) exceeds Rs. 30 a thousand but does not exceed Rs. 40 a thousand.	Seven rupees and eight annas.
(iv) exceeds Rs. 25 a thousand but does not exceed Rs. 30 a thousand.	Six rupees and four annas.
(v) exceeds Rs. 20 a thousand but does not exceed Rs. 25 a thousand.	Five rupees.

(vi) exceeds Rs. 15 a thousand but does not exceed Rs. 20 a thousand.	Three rupees and twelve annas.
(vii) exceeds Rs. 10 a thousand but does not exceed Rs. 15 a thousand.	Two rupees and twelve annas.
(viii) exceeds Rs. 7-8-0 a thousand but does not exceed Rs. 10 a thousand.	One rupee and eight annas.
(ix) does not exceed Rs. 7-8-0 a thousand.	One rupee.

33. The double decker progression with a surcharge, which is also graded, makes the system look somewhat complicated and is therefore a subject for criticism. There is a general demand that a simple system should be evolved.

34. It is necessary to appreciate, before any steps are taken to modify the present system, what its main functions are. The first is obviously the maximisation of the revenues; the others are that the duty is levied both on the raw material and on the manufactured product; that consistently with the maximisation of revenue it attempts to distribute the burden equitably among different classes of consumers; and that the duty on the lowest class of cigarette is higher than the duty on biri. It is not clear whether the last consideration was consciously in the mind of Government, but it has been given considerable importance in the evidence tendered before us.

35. We have no doubt that any alternative rate structure that is devised should be such as to secure at least the present revenue and should embody, to the extent practicable, the same equitable distribution of the burden among different classes of consumers. Unmanufactured tobacco, as a raw material, is distinguishable from other raw materials in that it carries a duty in whatever form it is used. We are unwilling to recommend any departure from this practice and to base the duty in respect of cigarettes entirely on the finished product. We anticipate that difficult problems of equity as well as administration will arise if such a change is made. Unmanufactured tobacco when used for manufacturing cigarettes is blended with imported tobacco and forms an intermediate product which is easily recognisable for tariff classification and whose end-use can, reasonably, be estimated. It is, therefore, not difficult, technically and administratively, to work out progression at this stage. When progression was introduced on unmanufactured tobacco, there was no duty on the manufactured product. It has been argued that with the introduction of the latter on a graduated scale the former has become in a sense unreal, on the assumption that in future the mainstay of the revenue will be the indigenous virginia tobacco whose quality has improved considerably. One of the leading manufacturers has, however, argued that the trends of the market still suggest the continued use of imported tobacco; the clearances in respect of the quality of cigarette costing between Rs. 40 and Rs. 50, which presumably use the highest types of blends, indicate that its sales are going up. It is true that the intermediate qualities of cigarettes, using blends with moderate admixture of imported tobacco, are going out of use and a tariff that consists of a number of grades is in practice working as a two or three point tariff in respect of unmanufactured tobacco and also of the manufactured product. We do not, however, favour a single point tariff. We presume that for some time to come imported tobacco will continue to be used. The yield of revenue depends

on the blends used, the import duty on tobacco and the rate of excise duty. It is possible to vary the blends in such a way as to reduce the offtake of the indigenous tobacco, to secure better quality and to pay comparatively less duty if only a single point tariff is adopted for unmanufactured tobacco. The following illustrations will make this point clear:—

TABLE 4.—*Comparative amounts of duty payable under the existing tariff and the alternative structure suggested*

Illustration 1

(a) *Assumptions* :
- (1) blend : imported tobacco 75%
  - indigenous „ 25%
- (2) No change in import duty . . .
- (3) Excise duty . . . . . . Rs. 2

Duty per lb. paid at present		*Duty per lb. payable if the suggestion is accepted.*	
$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 75 + 7\text{-}8 \times 25}{100}$ =	Rs. 9-4-2	$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 75 + 2 \times 25}{100}$ =	Rs. 7-14-2
		Loss	Rs. 1-6-0

(b) *Assumptions*:
- (1) blend : same
- (2) Import duty 12-0-0
- (3) Excise duty on unmanufactured tobacco 1-0-0

$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 75 + 7\text{-}8 \times 25}{100}$ =	Rs. 9-4-2	$\frac{\text{Rs. } 12 \times 75 + 1 \times 25}{100}$ =	Rs. 9-4-0
		Loss	Re. 0-0-2

Illustration 2

(a) *Assumptions* :
- (1) blend : imported tobacco . . . 50%
  - indigenous „ . . 50%
- (2) No change in import duty.
- (3) Excise duty. . . . 2-0-0

$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 50 + 5 \times 50}{100}$ =	Rs. 7-6-9	$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 50 + 2 \times 50}{100}$ =	Rs. 5-14-9
		Loss	Rs. 1-8-0

(b) *Assumptions* :
- (1) blend : same
- (2) Import duty . . . 12-0-0
- (3) Excise duty . . . 1-0-0

$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 50 + 5 \times 50}{100}$ =	Rs. 7-6-9	$\frac{\text{Rs. } 12 \times 50 + 1 \times 50}{100}$ =	Rs. 6-8-0
		Loss	Re. 0-14-9

Illustration 3

(a) *Assumptions* :
- (1) blend : imported tobacoo . 20%
  - indigenous. „ 80%
- (2) No change in import duty
- (3) Excise duty . . . 2-0-0

$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 20 + 2\text{—}8 \times 80}{100}$ =	Rs. 3-15-6	$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 20 + 2 \times 80}{100}$ =	Rs. 3-9-1
		Loss	Re. 0-6-5

(b) *Assumptions*:
(1) blend : same
(2) Import duty . . . 12-0-0
(3) Excise duty . . . 1-0-0

$\frac{\text{Rs. } 9\text{-}13\text{-}6 \times 20 + 2 - 8 \times 80}{100}$ =	Rs. 3-15-6	$\frac{\text{Rs. } 12 \times 20 + 1 \times 80}{100}$ =	Rs. 3-3-2
		Loss	Re. 0-12-4

These are purely illustrative examples, but they suggest that there is a possibility in certain cases of a squeeze on indigenous tobacco by reviving some of the blends with a moderate admixture of imported tobacco unless the customs duty on the latter is also raised simultaneously. It is perhaps possible to offset this eventuality by changing suitably the tariff structure for the manufactured commodity. We are, however, inclined to think that the better course would be to continue the present progressive structure in respect of duty on unmanufactured tobacco.

Biri *versus* Cigarette

36. We have no evidence to indicate the exact degree of competition between the biri and cigarette trades. But we think, in view of the vast number of persons employed in the biri industry, that no attempt should be made at present to reduce the differential between the two.

Duty on manufactured products

37. The only suggestion* that has been received by us regarding the tariff structure of the manufactured product is that the present nine value slabs should be replaced by two slabs; and the duty should be converted from the present specific rates based on value slabs related to wholesale cash price to two *ad valorem* rates of 10 per cent. and 20 per cent. The burden of the present duty ranges from 13 per cent. in the case of cigarettes whose value does not exceed Rs. 7/8/- per thousand to 25 per cent. in practically most of the cases except in one case where the burden is 27½ per cent. The effect of the suggestion would be to reduce the burden on almost all varieties of cigarettes. The loss of revenue is estimated at Rs. 3 crores or so. Another consequence of the reduction of *ad valorem* incidence on the lowest priced cigarettes would be to increase their competitive capacity as compared to the biris. For these reasons we do not recommend a revision of the present tariff on manufactured products.

38. We notice that in one case, *i.e.*, cigarettes costing between Rs. 10 and Rs. 15 per thousand, the *ad valorem* incidence is the highest in the value slabs. We understand that cigarettes so priced are largely prepared from flue-cured and non-flue-cured tobacco of indigenous origin. The trends of clearances show that this variety has lost ground heavily during the last few years. There is a case, in our opinion, for a review of the duty on this variety possibly by abolishing the surcharge.

39. We would also recommend that the surcharge referred to in paragraph 32 should be amalgamated with the ordinary rates and that in order to give relief in the slab referred to above, the surcharge on cigarettes of the value of Rs. 40—50 should be increased to compensate for the loss of revenue that may be involved.

Rates of duty

40. The rates of duty for various varieties of tobacco have been increased from time to time and the following

table shows the duties expressed as percentages of wholesale prices including duty from year to year:—

TABLE 5.—*Rates of duty as percentages of wholesale prices*

Variety of tobacco.	1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
Cigarette :										
Flue-cured	*55·4*	*59·3*	*55·6*	*53·8*	*51·9*	*NA.*	*47·6*	*37·8*	*35·9*	*28·6*
Aircured	*47·7*	*58·6*	*52·1*	*38·8*	*65·4*	*N.A*	*N.A*	*N.A.*	*N.A.*	*N.A.*
Biri	*30·4*	*26·8*	*27·6*	*26·0*	*35·7*	*34·2*	*31·8*	*34·8*	*32·1*	*42·9*
Snuff	*37·8*	*32·0*	*37·0*	*23·7*	*32·5*	*36·7*	*44·1*	*24·4*	*17·9*	*15·9*
Hookah & Chewing	*15·8*	*19·7*	*19·5*	*16·7*	*23·4*	*30·4*	*32·3*	*43·3*	*37·5*	*39·5*
Cigar and cheroot	*16·7*	*15·1*	*19·1*	*27·2*	*31·6*	*21·0*	*19·9*	*27·4*	*29·5*	*31·2*

The price data for flue-cured cigarette tobacco relate only to two top grades and the fall in percentages in recent years has been due to the decline in overall average duty following the reduced intake of imported tobacco.

The substantial decline in prices in 1953-54 necessitated the grant of temporary relief in rates of duty which, as mentioned earlier, was announced on 10th April 1954. The demand that was made to us before the announcement of the relief, was generally for reduction in the duties for different varieties. We do not think the change in production, prices and market conditions is sufficiently clear to justify a reduction in the normal rates of duty.

CHAPTER VI

SCOPE FOR EXTENSION OF CENTRAL EXCISE DUTIES

We propose to review in this chapter in broad terms the suitability of the rates of excise duties on commodities other than tobacco; we have dealt with tobacco in the previous chapter. We also discuss in this chapter the feasibility of levying excise duties on certain articles which are not at present subject to duty.

Coffee

2. The excise duty on coffee was introduced in 1944 when the rate of duty was fixed at 2 annas per lb.; it was raised to 3 annas per lb. in 1948. The quantity cleared for consumption has increased from 27 million lbs. in 1945-46 to 42 million lbs. in 1953-54; revenue has increased from Rs. 34 lakhs to Rs. 79 lakhs.

3. It has been represented to us that the present rate of duty (3 annas per lb.) is excessive from the point of view of the consumer as it makes the incidence of the duty per cup of coffee higher than that on tea. The duty on coffee, however, bears about the same percentage to wholesale price as the duty on package tea; and on this basis we do not consider that there is a case for reduction of the rate of duty on coffee.

Motor spirit

4. The excise duty on motor spirit was introduced in 1917. The rate of duty was 6 annas per imperial gallon from 1917 to 1925 and the revenue derived rose steadily from Rs. 24 lakhs in 1917-18 to Rs. 79 lakhs in 1924-25. The duty was reduced to 4 annas per imperial gallon in 1925 when the customs import duty was also equalised with the excise duty. This rate remained in force from 1925 to 1929. Except for a slight drop to Rs. 77 lakhs in 1925-26, the improvement in revenue continued as a result of increased output and consumption, and in 1928-29, the revenue went up to Rs. 1·55 crores. The duty was raised to 6 annas per gallon in 1929 which resulted in the revenue going up to Rs. 2·81 crores in 1929-30. With the further enhancement of the duty to 8 annas per gallon from 1st April 1931 and to 10 annas per gallon from 20th September 1931 the revenue reached the peak figure of Rs. 5·59 crores in 1936-37. The separation of Burma resulted in the reduction of revenue to Rs. 1·36 crores in 1937-38, and thereafter customs revenue became more important than the excise revenue. In 1940, the rate of duty was raised to 12 annas per gallon and in 1942 it was raised further to 15 annas per gallon. These increases were made for revenue reasons. In 1946, the rate was reduced to 12 annas per gallon, but in 1948 the rate of 15 annas per gallon was restored. The application of the customs surcharge of 5 per cent. in 1951 resulted in the duty being raised to 15 annas 9 pies per gallon. The excise revenue realised in 1953-54 from motor spirit was Rs. 2·62 crores as against Rs. 27·53 crores realised from the customs revenue on imports.

5. The total consumption of motor spirit during 1953-54 amounted to 296 million gallons, of which indigenous production accounted

for 26 million gallons and the balance of 270 million gallons was imported. When the new refineries go into full production, the indigenous output is expected to rise substantially. The Central revenue from motor spirit will be derived thereafter mainly in the form of excise duty instead of customs duty.

6. Certain interests representing motor transport have suggested that the excise duty should be reduced. The excise duty as a percentage of wholesale price has, however, gone down from 50 in 1940-41 to 35 in 1953-54. With regard to imported motor spirit, import duty as a percentage of landed cost has fallen from 164 in 1938-39 to 89 in 1953-54. Besides, the quantity consumed has increased considerably. There is, therefore, no case at present for a reduction in the rate of duty. The question of the appropriate rate of duty for motor spirit will no doubt be investigated in detail after refining in India is firmly established.

Kerosene

7. The excise duty on kerosene was imposed in 1922 at the rate of 1 anna per gallon. In 1930, the rate was raised to Re. 0-1-6, in 1931 to Re. 0-2-3 and again from 20th September 1931 to Re. 0-2-9¾ per gallon. The next change was in 1942 when the rate was increased to Re. 0-4-6 per gallon. From 1946, the rate was reduced to 3 annas as a measure of relief to the poorer sections of the population.

8. Substantial revenue was realised from the excise duty on kerosene before the separation of Burma; the revenue derived in the pre-separation year (1936-37) was Rs. 3·01 crores. In consequence of separation of Burma, the major part of the revenue from this article was derived from the customs duty. In 1947-48, there was a further drop in excise revenue as a result of partition which led to the loss of the Attock oil fields. The revenue from excise duty will go up in future as a result of the establishment of refineries in India.

9. The incidence of the customs import duty (which is at the same rate as the excise duty) has fallen from 55 per cent. in 1938-39 to 26 per cent. in 1953-54. As the major part of the consumption is met by imports, this trend indicates a fall in the burden of duty.

10. We, therefore, consider that there is justification for increasing the duty by a substantial measure. The rate increase should fit the currency unit for retail sale which is in terms of 'bottles' (6 to a gallon) in order to avoid unearned profit accruing to dealers.

Sugar

11. The import duty on sugar was an important source of customs revenue, collections in 1930-31 amounting to Rs. 10·8 crores. With the development of the indigenous industry under a protective tariff, the revenue from the import duty declined and in order to recoup the consequent loss of revenue, an excise duty was imposed in 1934. The rate of duty was Rs. 1-5-0 per cwt. from 1934 to 1937 when it was raised to Rs. 2-0-0 per cwt. In 1940, it was raised to Rs. 3-0-0 and in 1949 to Rs. 3-12-0.

12. The excise revenue from sugar has risen steadily with the increase in production and enhancement of the rate of duty. From Rs. 1·53 crores in 1935-36, it rose to Rs. 14·33 crores in 1953-54. As

a result of a fall in production, however, the budget estimate for 1954-55 has been placed at Rs. 12·00 crores.

13. Certain interests representing the sugar industry have argued that, as the major part of the consumption of sugar is by the middle class, the duty adds to their already heavy burden of taxation and has a restrictive effect on consumption. They have urged that, as sugar is an item of food with high calorific value, the excise duty on it should be kept at the lowest possible level to encourage consumption.

14. There is no evidence that the rate of excise duty has affected consumption. On the contrary, consumption, as indicated by clearance on payment of excise duty plus import, has been rapidly increasing. It rose from 7·2 lakh tons in 1947-48 to 15·7 lakh tons in 1953-54. Further, the duty expressed as a percentage of wholesale price has fallen from 21 in 1940-41 to 9 in 1953-54. We, therefore, consider that there is a case for a substantial enhancement of the duty, rather than for a reduction.

Matches

15. The match industry in India had developed as a result of the high revenue duty on imports and the Taxation Enquiry Committee of 1924-25 considered that there was, therefore, a case for the levy of an excise duty on this article. The excise duty on matches was imposed in 1934 at the rate of Re. 1 per gross for boxes of 40s (*i.e.*, on a box of 40 match sticks), Rs. 1-8-0 for 60s and Rs. 2/-/- for 80s.

16. To safeguard the position of cottage factories, units producing not more than 100 gross boxes per day were given a rebate of 10 pies for 40s, 15 pies for 60s and 20 pies for 80s. These concessions were, however, less than the rebate of 2 annas recommended by the Tariff Board.

17. The rates of duty fixed in 1934 remained in force upto 1941, when they were doubled for raising additional revenue. At the same time, a new tariff class of 50s was introduced on which duty was charged at Rs. 2-8-0 per gross.

18. The intention in creating a tariff class of 50s was to enable a match box to sell for 2 pice, but this was not found practicable. The duty was, therefore, reduced on 50s to Rs. 1-12-0 per gross from 1st August 1946, leaving the rates on other classes unaltered. This meant a higher rate of duty (Rs. 2-0-0) on a box of 40s than on a box of 50s (Rs. 1-12-0) and the effect of this was to encourage the standardisation of production at 50s. The object of the concession, *viz.*, to make available a two-pice box did not, however, materialise because even with the concession, 50s could not be sold at 2 pice. From 1st March 1948, the rate of Rs. 2-8-0 per gross for 50s was therefore restored.

19. In 1948-49, the question of the standardisation of match production at a uniform size was examined. Government found that the existence of boxes with varying match content led to the exploitation of the consumer, boxes with smaller match content being passed off as boxes containing a higher number of sticks. Once more, the possibility of retailing a 50s box at 2 pice was examined. After a cost survey, however, it was found that a 50s box could not be sold

at 2 pice without unduly lowering the rate of excise duty. Also, units other than the Western India Match Company Limited were unwilling to adopt the same size as WIMCO. It was considered by these factories that they would have an advantage if they marketed a smaller match box. It was, therefore, decided that there should be two sizes of boxes, WIMCO concentrating on the production of 60s for which their machinery was suitable and other units producing 40s. 60s would be marketed at 3 pice and 40s at 2 pice.

20. It was, however, found that the medium size factories could not market products at these prices if they had to pay the full excise rates. A second preferential category was, therefore, provided for in the tariff. Factories whose output did not exceed 500,000 gross boxes per year but exceeded 100 gross boxes per day, were granted rebates of 6 pies for 40s and 9 pies for 60s and factories with output not exceeding 100 gross per day were given rebates of 1 anna for 40s and 2 annas for 60s. These rates came into force in 1949.

21. The revised concessions introduced in 1949 were further liberalised in 1950 at the Select Committee stage of the Indian Finance Bill, 1950. With these rates which are still in force are granted rebates of 1 anna for 40s and 1 anna 6 pies for 60s in respect of factories with the intermediate range of output and 2 annas for 40s and 3 annas for 60s in respect of the low-output factories.

22. The excise revenue from matches which was about Rs. 2 crores in 1935-36 reached the peak figure of Rs. 9·35 crores in 1952-53. In 1953-54, the revenue was Rs. 8·78 crores.

23. A number of representations have been made to us for enlarging the scope of the preferential tariff for match factories working on a cottage scale. An issue of this character can only be decided after a more detailed enquiry into the circumstances of the industry and the relative costs of production of all types of factories than we have been able to make in the short time at our disposal. We, however, find that the units granted concessions at present have been able, over the last few years to increase their share of the market. The following table sets out the variations in the relative output of the three classes of units:—

TABLE 1.—*Variations in the relative output of the three classes of units*

Year	*Percentage share of production* Factories with output: Exceeding 500,000 gross boxes per year	Not exceeding 500,000 gross boxes per year but exceeding 100 gross boxes per day	Not exceeding 100 gross boxes per day
1949-50	*81·6*	*17·4*	*1·0*
1950-51	*75·6*	*22·7*	*1·7*
1951-52	*74·4*	*23·8*	*1·8*
1952-53	*71·3*	*27·1*	*1·6*
1953-54	*68·4*	*30·1*	*1·5*

Apart from other factors, it is possible that the preferential tariff may also have been of assistance to small factories. We, therefore, suggest that the Government of India should make enquiries into the cost of production of the small units to determine the amount of preference that should be given to them. We understand that a new category of factories with output not exceeding 25 gross boxes per day has been created with effect from 11th September 1954 and rebates of 4 annas per gross of 40s and 6 annas per gross of 60s have been granted for this class of factories.

24. The level of the standard rate of duty needs to be considered. The duty of Rs. 2-0-0 per gross of 40s and Rs. 3-0-0 per gross of 60s forms approximately 49 per cent. of the wholesale and 44 per cent. of the retail prices. Although this may appear to be high, the *per capita* incidence of the duty is hardly 4 annas. Further, as the bulk of the consumption is for smoking it should be possible for the consumers to bear a reasonable additional charge. The rate of duty was raised only once in 1941 since the imposition of the duty in 1934. Enhancement of duty for raising revenue for development purposes is, therefore, justifiable.

25. We consider that there is scope for a considerable increase in duty, and suggest that the precise measure of increase should be determined on a careful investigation of the position regarding actual retail prices, profit margins, and sales taxation in the various States so as to see that the increase fits the currency unit and does not unduly inflate middlemen's profits.

Mechanical lighters

26. The duty on mechanical lighters was introduced in 1934. The Select Committee which examined the Bill for the levy of an excise duty on matches expressed the view that there was a very real danger that the revenue expected from matches might be adversely affected if, as a result of the imposition of the duty on matches, the use of mechanical lighters increased considerably. They, therefore, recommended the imposition of a suitable excise duty on mechanical lighters although there was at that time no indigenous manufacture of mechanical lighters.

27. The duty was imposed in 1934 at the rate of Rs. 1-8-0 per lighter and when the rates of duty on matches were doubled in 1941, the duty on mechanical lighters was also doubled being raised to Rs. 3 per lighter.

28. There is at present no production of mechanical lighters and consequently no revenue is realised from the excise duty on this article.

29. It is difficult to foresee the extent to which the consumption of matches will be affected if mechanical lighters come into the market at low prices. The present rate of duty is, however, prohibitive. We, therefore, recommend relief in excise duty (by fixation of the rate at 8 annas or 12 annas) retaining the present licence fee of Rs. 100. As the industry develops, its effect on the revenue from matches should be kept under review.

30. The import duty on mechanical lighters is 78¾ per cent. *ad valorem* plus the excise duty. This provides a substantial margin over the excise duty and no consequential adjustment in import duty is considered necessary.

31. The excise duty on steel ingots was introduced in 1934 with a view to recouping the loss of customs revenue from steel as a result of the recommendations of the Tariff Board which involved a considerable reduction in the level of import duties. The duty was imposed at Rs. 4 per ton at which rate it is still maintained.

Steel ingots

32. With the steady growth of the iron and steel industry, the revenue has increased from Rs. 35 lakhs in 1935-36 to Rs. 63 lakhs in 1952-53 but there was a slight decline to Rs. 60 lakhs in 1953-54.

33. It has been suggested that steel is not a suitable article for the levy of an excise duty as it is a basic raw material for several industries. We do not consider that the present rate of duty which is only 1·4 per cent. of the wholesale price is harmful in any way, particularly when the price of indigenous steel is lower than that of imported steel. We do not, however, recommend any increase in duty in view of the price pooling arrangements under which the difference between the two prices is retained in a fund and is in the nature of an additional excise duty on indigenous steel.

34. The excise duty on 'tyres' was introduced in 1941 in order to recoup the loss of customs revenue as a result of the growth of the industry in the country. The duty was at a flat rate of 10 per cent. *ad valorem* from 1941 to 1948, when it was raised to 15 per cent. *ad valorem*. From 1949, a higher rate of 30 per cent. *ad valorem* was fixed for motor tyres. The revenue has risen steadily from Rs. 35 lakhs in 1941-42 to the peak figure of Rs. 6·10 crores in 1951-52 as a result of the expansion of output and enhancement of rates of duty. There was a decline to Rs. 4·38 crores in 1952-53 owing to reduction in output. In 1953-54 there was a recovery to Rs. 4·95 crores.

Tyres

35. Certain transport interests have advocated reduction of duties for bus and truck tyres. The overall taxation of motor vehicles was recently reviewed by the Motor Vehicles Taxation Enquiry Committee which did not recommend any reduction. We too do not suggest any change.

36. The excise duty on vegetable product was imposed in 1943 for revenue reasons. The rate of duty was Rs. 5 per cwt. up to 1948 when it was raised to Rs. 7 per cwt. or 1 anna per lb. The excise revenue has risen steadily from Rs. 94 lakhs in 1943-44 to Rs. 2·81 crores in 1953-54 with the expansion of production and enhancement of the rate of duty.

Vegetable product

37. The manufacturing interests have suggested reduction of the excise duty in view of the fact that they have also to pay sales tax on raw materials and the finished product as also octroi duties.

38. The excise duty forms only 5 per cent. of the wholesale price and we do not, therefore, consider that there is any case for reduction. We do not recommend any increase at this stage because the industry is working only to 53 per cent. of its rated capacity. At the same time, if vegetable oil is taxed, no exemption is recommended for the quantities used for the manufacture of vegetable product because it is desirable to maintain the existing differential between oil and vegetable product.

Tea

39. The excise duty on tea was introduced in 1944 in order to broaden the basis of indirect taxation and to raise further revenue. The rate of duty from 1944 to 1948 was 2 annas per lb. and was then raised to 3 annas per lb. As a result of the steep fall in prices the tea industry was affected by a crisis in 1952 and towards the end of May 1952 the Government of India appointed a team of officials to make a thorough investigation and report early on the position of the industry. This Committee submitted its report in September 1952 suggesting various measures of relief for the industry including deferred payment of excise duty but it did not recommend any reduction of excise duty.

40. The question of readjustment of excise duty, was, however, examined by the Government of India. After detailed examination, it was considered that a flat reduction of even one anna per lb. would cause a loss of revenue of as much as Rs. 1·33 crores and confer a benefit not only on the primary producers of medium and inferior tea who were most hit by the slump in prices but also on the firms which purchased tea from the garden and then blended and sold it in retail packages, and whose business had not been affected at all. For these reasons a flat reduction in duty was not considered desirable.

41. It was accordingly decided to readjust the pattern of duty by imposing a low rate of one anna per lb. on loose tea when it left the producing factories in the gardens and a further and higher levy of 3 annas per lb. at the stage of issue from packing factories after blending and packing into retail sizes. This change was introduced from 15th April 1953. The effect of this change was to confer upon the tea gardens a saving of 2 annas per lb. on all tea issued by them in loose form, which was defined as "issues in containers exceeding 60 lbs.". Where such tea is consumed without being repacked by the packing concerns, the consumer gains this amount of 2 as. per lb. Where the tea passes into consumption after repacking by the packing factories the total amount of duty paid would be 4 annas a pound which means that this class of consumer will pay an extra one anna per lb.

42. The revised pattern of duty caused a loss of revenue to the extent of over Rs. 1 crore in 1953-54. The actual excise revenue in 1953-54 was Rs. 2·11 crores as against Rs. 3·38 crores in 1952-53. The loss in 1953-54 was high because of the carry-over of pre-15th April 1953 stock of tea which paid duty only at the rate of 1 anna per lb. on conversion into package tea. The loss in future years may perhaps be only of the order of Rs. 40 lakhs.

43. The present duties of 1 anna and 4 annas per lb. on loose and package tea, respectively, represent 4·2 per cent. and 8·6 per cent. of wholesale price. We consider there is scope for an increase in the duty on both.

Cloth

44. The present excise duty on cloth was introduced in 1949. A duty of 25 per cent. *ad valorem* was imposed on superfine cloth (*i.e.*, cloth with warp counts 48s or finer) with effect from 1st January 1949 as one of the measures to

combat inflation. This was later extended to cover fine, medium and coarse varieties through the Indian Finance Act, 1949, the rate of duty being 6¼ per cent. *ad valorem* on fine cloth (*i.e.*, cloth with warp counts 35s—47s) and 3 pies per yard on medium (*i.e.*, cloth with warp counts 17s—34s) and coarse (*i.e.*, cloth with warp counts not exceeding 16s) varieties.

45. The duty is confined to mill made cloth and is not applicable to cloth woven on handlooms. Similarly the cloth produced on power-looms *i.e.*, in mills which do not have spinning departments, is also not subject to duty.

46. With effect from 1st February 1950 the rates of duty on superfine and fine varieties were reduced to 20 per cent. *ad valorem* and 5 per cent. *ad valorem* respectively. Under the Indian Finance Act, 1953, the rates of duty were revised and fixed at 3 annas 3 pies per yard on superfine cloth and 1 anna 3 pies per yard on fine cloth. No change was made in the rates of duty on medium and coarse varieties which continued at 3 pies per yard.

47. Apart from these excise duties proper, an additional flat rate of duty of 3 pies per yard on all dutiable varieties of cloth was imposed from 15th February 1953, and the proceeds were earmarked for the development of khadi and other handloom industries.

48. The duty on superfine cloth was reduced from 3 annas 3 pies to 2 annas per yard from 25th October 1953. In 1954, the rate of duty on superfine cloth was raised to 2 annas 6 pies per yard, that on fine to 1 anna 6 pies per yard and that on medium and coarse to 6 pies per yard.

49. To enforce the restriction on the output of dhoties by mills, graduated additional excise duties are levied on mill-made dhoties at rates ranging from 2 annas to 8 annas per yard from 26th October 1953.

50. The excise revenue from cloth which amounted to Rs. 13·21 crores in 1949-50 fell to Rs. 9·81 crores in 1950-51 owing to the substantial drop that occurred in the clearance of superfine, and, to a lesser extent, of fine and medium varieties. There was a recovery in 1951-52 and revenue rose to Rs. 16·33 crores, but in 1952-53 again there was a sharp fall in the clearance of superfine and fine varieties (although the quantity of medium cloth cleared recorded an increase) and consquently the revenue fell to Rs. 13·43 crores. In 1953-54, there was a recovery under all varieties except 'fine' and the revenue rose to Rs. 15·01 crores excluding the realisation of Rs. 6·57 crores from the additional levy. The budget estimate for 1954-55 is Rs. 20·00 crores (excluding the additional duty) and this takes account of the enhancement of rates made in 1954.

51. Certain textile interests have represented that the excise duty is a burden on the industry and that after the change-over from a sellers' to a buyers' market, the duty is contributing to consumer resistance and accumulation of stocks.

52. The average wholesale prices of the various varieties of cloth and the duty expressed as percentages thereof are given below:—

TABLE 2.—*Average wholesale prices of cloth and duty as percentages thereof*

Description	Wholesale price per yard	Rate of duty per yard including additional levy	Percentage of duty to price*
	Rs. as. ps.	Rs. as. ps.	
Superfine	1 0 2	0 2 9	16·9
Fine	0 13 4	0 1 9	13·1
Medium	0 11 9	0 0 9	6·4
Coarse	0 11 3	0 0 9	6·7

These figures indicate that the incidence of the duty is not high.

53. Since the imposition of the duty, there has been a steady increase in the production of cloth. From 3,384 million yards in 1949-50 it rose to 4,900 million yards in 1953-54. The relative share of cloth in the various tariff classes has, however, changed substantially as indicated below:—

TABLE 3.—*Relative share of various tariff classes in total production and clearance of cloth*

Description	Percentage share in production					Percentage share in clearance for home consumption				
	1949-50	50-51	51-52	52-53	53-54	49-50	50-51	51-52	52-53	53-54
Superfine	10	5	7	4	6	11	6	7	5	6
Fine	25	32	30	25	16	25	27	29	23	16
Medium	56	52	55	59	66	57	55	56	63	68
Coarse	9	11	8	12	12	7	12	8	9	10

The output of 'superfine' cloth declined sharply from 321 million yards in 1949-50 to 186 million yards in 1950-51; there was a recovery to 294 million yards in 1951-52, but there was again a sharp fall to 201 million yards in 1952-53. In 1953-54, production increased considerably to 291 million yards. The readjustment of duty might have helped the recovery of production.

The production of 'fine' variety of cloth improved from 845 million yards in 1949-50 to 1,193 million yards in 1950-51 and to 1,276 million yards in 1951-52. The level of production was fairly maintained at 1,148 million yards in 1952-53 but there was a sharp fall in 1953-54 to 758 million yards. This was apparently due to the enhancement of duty. The rate of duty on this variety of cloth was changed from 5 per cent. *ad valorem* to 1 anna 3 pies per yard, the latter rate amounting to 9·4 per cent. *ad valorem.*

The output of medium variety of cloth has expanded from 1,901 million yards in 1949-50 to 3,249 million yards in 1953-54. Production of the coarse variety has also increased from 317 million yards to 602 million yards during the same period.

54. The import duty on raw cotton which yielded a revenue of about Rs. 4 crores was abolished in 1954 and the rates of excise duties were simultaneously increased. Applying the rate increases in the

1954-55 budget to final figures of clearances in 1953-54, the category-wise increase in revenue is as under:—

		(Rs. crores)
Superfine	...	0·7
Fine	...	1·1
Medium	...	4·4
Coarse	...	0·7
		6·9

The increase in revenue is mainly from coarse and medium varieties which are not manufactured from imported cotton. If the raw cotton import duty and the excise duties on fine and superfine cloth made from imported raw cotton are considered, a revenue loss of Rs. 2·2 crores would result from the abolition of the import duty on raw cotton on the basis of 1953-54 clearances. A qualification is, however, necessary relating to refund of taxes on exports. If it is assumed that the import duty on raw cotton used to make exported cloth would have been refunded, the revenue loss could be reduced by about Rs. 1 crore, because the net revenue from raw cotton import duty would be reduced from Rs. 4 crores to Rs. 3 crores. The revenue loss as a result of the abolition of import duty on cotton and the change effected in the taxation of fine and superfine cloth in the 1954-55 budget would be Rs. 1·2 crores on the basis of 1953-54 production and clearance figures. This indicates that the superfine and fine varieties have been given some relief.

55. We consider there is a case for enhancement of rates of duties to a moderate extent on all varieties of cloth.

56. It may also be mentioned that rate differentiation on the basis of counts of yarn alone is illogical. The purpose of providing for progression on this basis is defeated by the fact that coarse varieties include only 6 per cent. of dhoties and sarees used by the poorer sections of the community out of the total consumption and the greater part of the production consists of furnishing fabrics, sheeting, etc., which are used by the richer classes. The present tariff classification applies the same rate of duty to all these descriptions of cloth. The possibility of formulating a tariff fixing different rates of duty for different varieties of cloth such as dhoties, long cloth, sheeting, furnishing fabrics, etc. in addition to the present tariff classes based on warp count may be considered.

57. As regards the additional excise duty on dhoties, its levy at a uniform rate irrespective of the variety of cloth operates to the disadvantage of the cheaper varieties. The possibility of graduating the levy should also be considered.

Rayon or artificial silk fabrics

58. In the 1954-55 Budget, excise duties were imposed for the first time on rayon or artificial silk fabrics. The justification for the levy of excise duty on rayon or artificial silk fabrics was that the use of these fabrics was widespread and that they competed, to some extent, with cotton cloth which was subject to an excise duty. The rate of duty is 6 pies per square yard. There is also in addition the levy of 3 pies per yard for the benefit of khadi

and other handloom industries. The products of handlooms as well as units with less than twenty-five power looms are exempt from duty. The manufacturers are also provided with the alternative of payment of duty calculated at the rate of Rs. 22-8-0 per loom per month inclusive of the additional levy. The duty forms about 7 per cent. of the wholesale price.

59. The actual revenue from this excise duty is estimated at Rs. 50 lakhs during the current year as against the estimate of Rs. 1·60 crores given in the budget speech. This difference has been due to the reduction of the rate of duty from 1 anna 6 pies per yard to 6 pies per square yard and the raising of the exemption limit from 9 looms to 24 looms.

Cement

60. The excise duty on cement, which was also imposed for the first time in the 1954-55 Budget, is Rs. 5 per ton and the revenue yield is estimated at Rs. 2 crores during the current year. The duty forms about 5 per cent. of the wholesale price.

Soap

61. The duty on soap was another of the new excise duties imposed in the 1954-55 Budget. A rate of Rs. 14 per cwt. has been fixed for toilet soap and lower rates of Rs. 5-4-0 per cwt. and Rs. 6-2-0 per cwt. have been imposed on household and laundry soap in 'plain bars of not less than one pound in weight' and 'other sorts' respectively. The products of factories not using power as well as of factories using power but whose output during a financial year does not exceed 100 tons of household and laundry soap and 50 tons of other soap are exempt from duty. Further, the first 125 tons of household and laundry soap and the first 25 tons of toilet soap cleared for home consumption during each financial year are also exempt from duty. The revenue from the excise duty on soap is estimated at Rs. 1·35 crores. The duty forms 7 to 10 per cent. of the wholesale price.

Footwear

62. The duty on footwear which is the last of the four new items of excise duty introduced in 1954-55 is at 10 per cent. *ad valorem*. The products of factories not using power as well as of factories using power not exceeding 2 horse-power and employing less than 50 workers are exempt from duty. The revenue expected from this head is Rs. 82 lakhs.

63. As it is too early to assess the effects of the newly imposed excise duties on the four commodities mentioned above, we do not recommend any change in the rates of duty.

Exemption or differentiation in respect of small-scale production

64. One of the features which has been noticed in respect of a number of excise duties is the exemption of small-scale production, *e.g.*, in respect of handloom cloth, soap, foot-wear and rayon; in respect of matches there are different grades of duties varying according to the size of the factory, with the lowest rates for the cottage factories so-called.

65. These concessions and exemptions are granted on varying bases, such as non-use of power or machinery, number of workers employed in a factory, type or size of organisation, differentiation of product and scale of output. Non-use of power is a basis for exemption of output of sugar, cotton and rayon and artificial silk fabrics,

soap and footwear. Biris in the manufacture of which machinery is used are subject to duty, while hand-made biris are not taxed at the manufacturing stage. The number of workers employed in a factory is utilised as a criterion in the levy of excise duty on footwear; thus, the output of units using not more than 2 horse-power and employing less than 50 workers is exempt. The type or size of the organisation may be taken into account; thus, cotton cloth manufactured in power-loom factories (*i.e.*, factories without a spinning plant), rayon or art silk fabrics manufactured in units with less than 25 power looms, and soap produced in factories with capacity not exceeding 100 tons of household and laundry soap and 50 tons of other soap are exempt. The exemption of khandsari and palmyra sugar illustrates differentiation on the basis of type of product. The scale of output of the factory determines the rate of duty payable in the case of matches. The exemption of an initial slab of output from the excise duty on soap amounts to the grant of a concession to units with low outputs.

66. One of the reasons for exemption, which, however, does not apply to all cases, is the administrative problem of keeping a check on the production of scattered small-scale producers. This reason has particular force, *e.g.*, in respect of soap and footwear which form the output of the smallest producers. Even in respect of these articles however, the exemption is not restricted to the smallest producers who present the greatest administrative problem. There are two other economic considerations which enter into the determination of exemption, and more particularly of differentiation, *e.g.*, in the case of the cottage match industry. One is the higher cost of production of the smaller producer and his relatively lower ability to bear taxation. The other is the desirability of encouraging production by labour-intensive methods, *i.e.*, of methods which promote greater employment.

67. We have already made it clear (*cf.* Volume I, Chapter VI) that from the point of view of the Indian economy, there is a strong case for the special encouragement of small-scale and cottage industries. The tax system may be used for this purpose, but in a judicious manner. We would suggest a periodic review of the working of these concessions, so that policy in this respect may keep in step with the changing needs of the economy.

Possibility of extension of excises

68. We now come to the consideration of possible avenues of fresh taxation in the field of central excises. We give below a list of articles the production of which within the country has developed sufficiently to justify, in our opinion, the imposition of an excise duty in the interests of raising much needed revenue for financing further development.

69. It is obviously not possible for us to indicate the exact rates of duty that should be applied to these articles. We also realise that it may be necessary for Government to make more detailed investigations than we have been able to attempt into the circumstances of each industry before actually imposing the duties. The general justification for the extension of central excise tariff and an enhancement in the rates of existing excise duties is contained in Vol. I of our Report and in the first chapter of this Volume. The analysis

made here is intended to indicate the limits up to which it should be possible to expand the existing revenue from central excise duties.

Sewing machines

70. The industry has developed as a result of protection and the present level of production is adequate to meet the country's requirements, except in respect of industrial sewing machines. The number of sewing machines manufactured rose from 5,860 in 1947 to 64,139 in 1953 and the industry is reported to be working almost to its full capacity. The value of the output is about Rs. 1·5 crores and a moderate rate of duty appears feasible. The cost of collection will be relatively small in view of the fact that there are only two units manufacturing complete machines.

Vegetable oils

71. Similar agricultural products such as cotton and tobacco are subject to excise duty at some stage or the other and we consider that a levy on vegetable oil will be justifiable. The total quantity of vegetable oil produced in India is estimated at 1·41 million tons of which 0·36 million ton constitutes the production of *ghanis*. There are about 1,050 large mills, 8,600 small mills using power-driven *ghanis* and screw-presses and about 4 lakhs of *ghanis*. The total number of units registered under the Industries (Development and Regulation) Act, 1951, is, however, only about 2,100. The quantities of vegetable oil used in the manufacture of 'vegetable product' and soap are 0·25 and 0·05 million ton, respectively, and exports account for 0·03 million ton.

We consider that the production of *ghanis* should be exempted.

The Central Excise Department is already entrusted with the work of collection of the cess under the Indian Oil Seeds Committee Act. With this experience it will not be difficult to build up an organisation necessary for the collection of an excise duty and the cost of collection, will not, therefore, be high.

We consider that a relatively low rate of duty would be appropriate on this commodity.

Woollen textiles

72. As cotton cloth and art silk are subject to excise, the taxation of woollen textiles will be justifiable, as only comparatively well-to-do persons use them. There will be a further justification because there is no import duty on raw wool and wool tops (unlike in the case of the raw material of the art silk industry). The coarser rugs and similar articles used by the poorer people may be exempted.

There are 20 large and 122 small mills with an estimated production of 20 million lbs. valued at Rs. 10 crores. A moderate rate of duty appears feasible for this article.

Biscuits

73. We consider biscuits as a suitable article for taxation. The indigenous production now meets almost the entire requirements and imports have steadily declined and in 1953-54 only 204 tons valued at Rs. 9 lakhs were imported as against 2,393 tons valued at Rs. 74 lakhs in 1948-49. The present production is of the order of 11,000 tons. On this article also a moderate rate of duty would appear appropriate.

Paper

74. The industry has developed as a result of tariff protection, and this provides justification for the levy of an excise duty on paper.

There are 20 mills manufacturing paper and paper board. The production of paper and paper board rose from 106,000 tons in 1946 to 138,200 tons in 1953. We consider that a moderate rate of duty could be levied, with exemption for hand-made paper.

Dry batteries and storage batteries

75. The production of dry and storage batteries has developed as a result of protection. There are now 5 units manufacturing dry batteries and 13 units manufacturing storage batteries. Production has expanded considerably in recent years and is estimated at 153 million cells of dry batteries and 171,000 storage batteries, and we consider that a moderate rate of duty is feasible.

Electric lamps

76. The indigenous production has replaced imports in respect of certain varieties and there is, therefore, a case for the imposition of duty. There are 11 units, and output rose from 9·2 million pieces in 1948 to 19·7 million pieces in 1953. A moderate rate of duty would, we think, be appropriate.

Aerated waters

77. The Taxation Enquiry Committee of 1924-1925 considered that a tax on 'aerated waters' would be a comparatively unobjectionable way of raising revenue but that it should be given a low place in the order of preference. It thought that the tax would fall largely on the upper and middle classes. One objection to taxing this commodity which it mentioned was the possibility that it might drive people, who would otherwise avoid it, to the use of impure water. The Committee suggested a tax on cylinders of carbonic acid gas as a simple plan for taxing aerated water.

Definite data regarding the number of organised and unorganised units and their output are not available. A rough estimate of total output in India is 240 million bottles.

We consider that this is a suitable article for taxation because it is of the nature of a semi-luxury. There is no serious risk of fall in consumption as a result of the imposition of an excise duty. We do not think that the tax should be levied as an impost on carbon dioxide gas cylinders because such a levy will not permit of selectivity of rates on aerated waters of different specifications.

We, therefore, recommend the levy of a small duty on the products of the large factories with exemption for small units as necessitated by administrative considerations. It may be possible to apply the duty at graduated rates because of the wide range of prices.

Electric fans

78. This industry has developed as a result of the high rate of import duty and restriction of imports. The production of electric fans increased from 158,800 in 1948 to 206,000 in 1953. There are 18 units manufacturing electric fans, and we consider there is a case for a moderate duty.

Glass and glassware

79. The glass industry has seen much expansion as a result of the protection granted for sheet-glass and the high revenue duty on other varieties. The production of sheet glass increased from 6·3 million sq. ft. in 1948 to 22·8 million sq. ft. in 1953. The production of 'blown and pressed ware' increased from 65,436 tons in 1948 to 69,168 tons in 1953. The value of the total production of glass and glassware is estimated at Rs. 5·20 crores.

There are 109 units in the industry. A fairly substantial rate of duty would, we feel, be justified.

Paints and varnishes

80. The production of paints and varnishes has been fairly steady during the last few years and the output is about 31,000 tons. There are 150 units in the industry of which about 100 are of small size. The aggregate value of output is estimated at Rs. 6·0 crores and we recommend a moderate rate of duty.

Ceramics

81. Substantial progress has been made in the manufacture of good quality crockery and other ceramic products in the country in recent years and imports have been reduced. There are at present 67 factories of which 5 are big units. The production is estimated at 10,400 tons of 'white wares', 600 tons of 'sanitary wares', 33,600 tons of 'stone wares' and 228,000 tons of 'refractories'. About 374,000 doz. of 'glazed tiles' are also produced. The total value of output is about Rs. 3·50 crores. We are of opinion that there is a case for a substantial rate of duty on this commodity.

82. We estimate that the proposals we have made in this chapter for (a) the enhancement of existing duties and (b) the imposition of new duties would, if implemented, result in the existing receipts from Central excises going up by roughly 40—45 per cent.

CHAPTER VII

ADMINISTRATIVE PROBLEMS IN REGARD TO CUSTOMS AND EXCISE DUTIES

Part I—Customs Administration

Introductory

The Sea Customs Act, 1878, the Land Customs Act, 1924, and the Indian Tariff Act, 1934, are the principal statutory enactments, which are administered by the Customs Department. The Land Customs Act is administered by the Central Excise Department whose activities in this regard are, therefore, dealt with in this chapter as part of the Customs administration.

2. In addition to the enforcement of the enactments mentioned above, which pertain to the collection of revenue and the working of the tariff, the Customs organisation is entrusted also with the administration of all import and export control regulations and with the implementation of certain prohibitory orders. These cover a wide range of enactments such as the Import and Export Trade Control Act, the Foreign Exchange Regulation Act, the Petroleum Act, the Destructive Insects and Pests Act, the Agricultural Produce Cess Act, the Dangerous Drugs Act, the Indian Arms Act, etc. These functions now account for an appreciable part of the activities of the Customs organisation.

3. The Ministry of Finance, through the Central Board of Revenue, controls the administration of Customs. The Central Board of Revenue is designated the 'Chief Customs Authority' for the purposes of the Sea Customs Act. At each of the principal ports there is a Collector of Customs, assisted by Deputy and Assistant Collectors of Customs, and other subordinate staff for appraisement work and the collection of revenue, and for enforcing such preventive measures as are necessary to safeguard revenue.

Appellate procedure

4. One of the important suggestions made to us in connection with the administration of Customs is that the present appellate machinery should be radically altered so as to make the appellate authority completely independent of the Ministry of Finance.

5. All orders passed by Assistant Collectors or other Customs officers of lower rank are appealable to the Collectors of Customs, while initial orders passed by Deputy Collectors and Collectors are appealable to the Central Board of Revenue. A party dissatisfied with the decision on appeal of the Central Board of Revenue or of the Collector of Customs can file a revision application with the Government of India. We understand that in accordance with long-standing practice, revision applications filed with the Government of India are actually disposed of, on behalf of Government, by a Joint Secretary to the Government, who is invariably a Member of the Central Board of Revenue, other than the Member who had decided the appeal in the same case.

6. It has been pointed out to us that the existing procedure has two fundamental defects, *viz.*,

(i) that there is no statutory bar to the Collector of Customs, in his capacity as first appellate authority, from seeking the instructions of the Central Board of Revenue to whom he is subordinate on any point arising from an appeal presented to him, and the Board issuing the necessary directives to him; and

(ii) that the Central Board of Revenue, which is the Chief Customs Authority under the Sea Customs and the Land Customs Acts, can hardly be expected to take so totally detached and objective a view in dealing with appeals made to them as to ensure that not only justice is done to the appellant but that it also clearly seems to be done.

We consider that the criticism of the existing procedure conveyed in the two points mentioned above is justified. At the same time, we are aware of the fact that if the administration of Customs is to be carried on in an efficient manner, from the point of view of the public as well as of the revenue, the entire administrative machinery must be essentially a swift-moving and effective one unhampered by cumbrous procedures which involve long drawn out proceedings mainly of a judicial character. In this respect, Customs administration is clearly distinguishable from Income-tax administration.

7. Having examined the matter from the point of view of the need for moderating the claims of abstract justice by practical considerations of administrative efficiency, we think that it is not expedient to introduce in the Customs administration exactly the same type of appellate machinery as exists in income-tax. We would leave the present appellate powers of the Central Board of Revenue as they are, but suggest that revision petitions against the orders of the Central Board of Revenue or the Collectors of Customs should be disposed of by a Tribunal which should be independent of the Ministry of Finance and should consist of at least one judicial member who should be either a serving or a retired High Court Judge, and one member who has had experience of Customs administration.

Review of orders

8. Another feature of the existing procedure which, in our opinion, calls for modification, is that there is no provision at present for amendment of orders prejudicial to revenue passed by officers. We consider that the Collector of Customs should have authority to revise orders where necessary, but such powers should be exercised in a manner prejudicial to the assessee only after giving him an opportunity to be heard. Such orders should be subject to appeal.

Clearance of goods in disputed cases

9. One of the suggestions made to us in regard to settlement of disputes arising from Customs appraisement is that the difference of opinion involved should not be allowed to result in the clearance of goods being held up, particularly where the dispute relates to a small part of a large consignment. We understand that under the existing law it is open to the party concerned in such

cases to clear the goods on payment of duty as assessed, under protest, and on depositing with the Customs representative samples, if necessary. This involves locking up of the party's funds in cases where his contention is ultimately upheld. To avoid this hardship, the only alternative is the introduction of a system of bonds to cover the amount of duty. We are aware of the administrative difficulties attendant on enforcing the terms of such bonds ultimately. We are not therefore inclined to recommend the adoption of this system as a matter of course. Departmental instructions should, however, be issued to the effect that where there is a *bona fide* difference of opinion, Assistant Collectors of Customs should seek the orders of the Collector who may, at his discretion, allow the goods to be cleared on payment of duty at the lower rate on the execution of a bond equal in value to the difference between the higher and the lower rates of duty.

Provisional duty procedure

10. The Sea Customs Act as it now stands contemplates duty being finally assessed before the goods are cleared out of Customs control. We understand that this condition is difficult to fulfil if the supporting documents and such other evidence as is necessary are not available at the time of assessment. Similar difficulty arises when plant and machinery covered by one single contract is broken up into several consignments and imported by different vessels. We understand that in order to avoid hardship to the importers, a practice has grown under which such goods are assessed on a provisional basis subject to necessary adjustments being made later when documents are available or when importation of the entire plant is completed. This practice does not, however, have the force of law, and is followed at the discretion of the executive. We would recommened that the law should be amended to make a suitable provision, subject to safeguard for revenue, in the Sea Customs Act in this behalf.

Smuggling

11. Smuggling now constitutes not only a loophole for escaping duties but also a threat to the effective fulfilment of the objectives of foreign trade control. The existence of foreign pockets in the country accentuates the danger. The extent of the leakage of revenue that takes place through this process cannot be estimated even roughly, but, we understand, it is not unlikely that it is substantial. Apart from its deleterious effect on legitimate trade, it also entails the outlay of an appreciable amount of public funds on patrol vessels along the sea coast and permanent works along the land border, and watch and ward staff on a generous scale. It is, therefore, necessary, in our opinion, that stringent measures, both legal and administrative, should be adopted with a view to minimising the scope of this evil. The elimination of foreign pockets will, of course, make for considerable improvement in this direction. We would also recommend the amendment of the Sea Customs Act so as:

(i) to make smuggling a criminal offence,

(ii) to empower Customs Officers

(a) to search premises, and, on production of a warrant from a Magistrate, to seize documents, papers and accounts suspected to be connected with the smuggling of goods,

(b) to issue summons to any person reasonably believed to be in possession of material evidence to appear in person or through representatives for production of documents or books of accounts, for furnishing of information and for answering questions, and

(c) to interrogate smugglers, and

(iii) to transfer the onus of proof in respect of offences relating to smuggling to the person in whose possession any dutiable, restricted or prohibited goods are found.

Disclosure of information

12. The Sea Customs Act imposes a penalty [*vide* section 167 (79)] on any officer of Customs who, except in the discharge in good faith of his prescribed duties, discloses any information gathered by him in his official capacity in regard to any goods. There is a similar provision in regard to Central Excise in the Central Excise Rules. This provision is intended to prevent departmental officers from acting in a manner prejudicial to the interests of the owner of the goods *vis-a-vis* his trade rivals. While we agree that this is sound policy, we see no justification for carrying this so far as to preclude the information being utilised in legal proceedings against the owner or in the institution of necessary enquiries in connection with his liability to other taxes, such as income-tax, sales tax, etc. No such restriction is imposed in regard to the divulging, for these purposes, of information gathered in the course of income-tax proceedings (*vide* section 54 of the Income-tax Act), and we, therefore, recommend that a similar provision be introduced in the Sea Customs Act and the Central Excise Rules also.

Part II—Central Excise Administration

Appellate procedure

13. Before we discuss other administrative problems relating to central excise, we shall deal with the appellate procedure in central excise matters as in a number of representations it has been suggested that an independent authority should hear appeals. *Mutatis mutandis* the same appellate procedure exists on the central excise side as on the customs side. We would, therefore, recommend that revision applications to the Government of India should be heard by an Appellate Tribunal in the same way as would be provided for on the customs side. As, however, the volume of work involved on the central excise side will not justify the setting up of a separate Tribunal, we suggest that the proposed Appellate Tribunal for customs should deal with the central excise cases also.

System of control in Central excise

14. It will be convenient to deal with central excise administration under two broad heads, *viz.*, as affecting manufactured articles and unmanufactured articles. Except tobacco and coffee, all other centrally excised articles come under the category of manufactured articles.

15. In regard to manufactured articles, the excise control commences with the licensing of the factories concerned. A bond has to be executed by a factory which provides that the entire output of articles subject to central excise duties would be produced for the charging of duty and that they would be satisfactorily accounted and this is supported by adequate security. The amount of the bond is the equivalent of the duty on a fortnight's output or on the maximum quantity of goods likely to be in storage at any time, whichever is less. The maximum amount of the bond is ordinarily Rs. 50,000. The amount of the security is decided by the Collector with reference to the standing of each factory. It is usually Rs. 10,000 for a big factory and for smaller factories it may be as low as Rs. 100.

Manufactured articles

16. Excise control is exercised by the officer of the Central Excise Department who is posted at the factory. He is charged with the duty of keeping a watch over the operations in the various departments of the factory so as to prevent illicit disposal of the commodities manufactured. Although the articles produced become liable to levy of duty as soon as they are produced, the manufacturers are permitted to store them without payment of duty in approved store rooms within the factory premises and duty is collected only at the time of the removal of the goods outside the factory. Obviously, therefore, clearance can take place only under excise supervision and after payment of duty. Manufacturers are required to maintain detailed accounts of production, quantity deposited in the store room and the quantity issued out of the factory. These accounts are checked by the Central Excise Officer in charge and also by supervising officers. The manufacturer is required to provide, free of cost, office accommodation for the central excise staff posted at the factory and where so required, residential accommodation for this staff near the factory at a rent not exceeding 10 per cent. of the pay of the officer concerned.

17. The method of control exercised under the Central Excise Rules on the production and clearance of goods from factory premises has come in for a certain amount of criticism from the interests affected. It was urged before us that it interferes with manufacturing processes, it is expensive for Government and is irritating to the manufacturers. It was also alleged that it does not fully serve the purpose for which it is intended, *viz.*, to prevent loss of revenue through pilferage. A suggestion was, therefore, made that the procedure should be considerably simplified by making it possible for excise duty being collected on the basis of audited accounts, subject to such conditions as Government may lay down regarding the form in which they should be kept.

Criticism of excise procedure

18. Two important features of the present system are that accounts have to be maintained of production and storage, and that clearances from the factory premises should be verified personally by the Central Excise Officer posted at the factory. There is no doubt that both for the factory and for the administration it is more convenient for the duty to be collected at the time of the clearance of goods. It facilitates the removal of finished goods from the factory to godowns and thus avoids interference by central excise

officers during manufacture. Since clearances are normally made for the purpose of sale the present system also helps the factory owners to make payment of duty practically at the same time as they recoup it from their agents and dealers. As central excise duty is levied on goods and not on persons, the point at which it should be collected is when the goods are manufactured, but since practical difficulties do not make that possible, the next best course is to collect it at the time of clearance from the factory premises. It seems to us reasonable for Government to ensure that for the period intervening between production and clearance the goods should be kept in a proper place and under adequate supervision. The procedure followed in India in this regard is also practically the same as that obtaining elsewhere. Physical supervision is considered to be necessary in such cases in almost every country. For instance, the following extract from a standard work on Canadian taxation will be of interest:—

> "The habitat of the exciseman is the brewery, the distillery, and the cigar, tobacco and cigarette factory. Not only are these his native surroundings but in many instances they provide his abode during his working hours...... The exciseman is less a tax collector than a combination of policeman, accountant and chemist. He rules this field of manufacturing with almost undisputed sovereignty. No person may enter on any of the activities subject to excise without first obtaining a licence....the granting of which is by no means automatic."*

19. Another argument advanced against the existing system is that it is too costly. The entire cost of collection of central excise duties in India works out to 4·5 per cent. of the total duties collected. This includes the cost of collection of duty on commodities such as tobacco, which entail complicated administrative arrangements that are relatively more expensive. We do not think that this cost is high considering the responsibilities that the Department has to discharge. We are, therefore, unable to accept the argument that physical supervision by central excise officers is too expensive a mode of collection of duty on manufactured articles. We are of the opinion that the existing system is advantageous both to the manufacturers' interests and to the administration alike, and that even the provision in regard to the compulsory allotment of quarters to the central excise staff (on payment of rent, of course) will, if viewed in this light, be accepted as salutary.

Difficulties of match factories

20. It has been represented to us that the present central excise rules cause hardship for the small scale manufacturers of matches. The main points of complaint relate to:

(a) the requirement of security for the bonds and (b) prepayment of duty.

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*J. Harvey Perry: Taxation in Canada (P. 344).

21. It has been stated that there was no provision in the Matches (Excise Duty) Act and Order of 1934 for the deposit of security by the manufacturers of matches. There were special safeguards such as the requirement that the store room for the deposit of matches pending payment of duty would be under Government lock and that receipts and issues would be made only under the excise officer's supervision. While retaining these special features for matches, the consolidated Central Excise Act and Rules, 1944, which replaced the special enactment for matches also extended to it the requirement of security which was of a general character applicable to other excisable goods where the store rooms were not under Government lock. The interests representing the small scale match factories have represented that this imposes a severe strain on the financial resources of small units and deters persons of small means from setting up factories. They have argued that Government revenue is adequately safeguarded by the fact that the store rooms for finished matches are under Government lock, and matches cannot be removed except under the excise officer's supervision. They have, therefore, urged the withdrawal of the provision in the rules requiring security to be furnished by manufacturers of matches.

Withdrawal of security deposit

22. We observe that the contention that there was no provision for demanding security under the old excise procedure is incorrect. Section 25 of the Matches (Excise Duty) Order, 1934, provides that every holder of a licence for the manufacture of matches or splints and veneers shall furnish such security as may be demanded by the Collector for the observance of the conditions of the licence and for the payment of duty. Nevertheless, there is force in the contention that adequate safeguard for revenue is provided by the fact that matches have to be stored, pending payment of duty only in godowns which are under excise custody. Further, we observe that for similar bonds to be executed by licensees of warehouses for the storage of tobacco, there is provision for a bond with surety even though the warehouses are in the custody of the owners and there is no continuous excise supervision as in the case of matches. We, therefore, recommend that the alternative of a bond with surety should be provided for the manufacturers of matches as a measure of relief for the small units.

23. The excise duty on matches is realised in the form of banderols which are required to be affixed to boxes of matches before removal from factories. The banderols are purchased from treasuries either on payment of cash or on credit. For purchase on credit, a bond is required and payment of the value of the banderols in cash is insisted on before removal of the matches from the factories.

Deferred payment of duty

24. It has been represented that the excise duty on matches amounts to 50 per cent. of the wholesale price and it is a hardship to small units with slender resources to find the funds for payment of the duty before sale of the matches, and a suggestion has been made for a system of deferred payment of excise duty in such cases.

25. We appreciate this difficulty experienced by cottage factories. The necessity for replenishment of the funds locked up in payment of excise duty before removal of matches from the factories makes

them accept whatever prices are offered, and this reduces their bargaining power. We, therefore, recommend that a system of payment of excise duty in arrears may be introduced as a measure of relief to the cottage factories. We understand that a similar concession was granted to the tea industry as a temporary measure when it was faced with a crisis. It may be laid down as a condition of the concession that a bond with security or surety to cover the outstanding amount should be executed and the factories may be required to deposit the duty in respect of all removals during a month not later than the last day of the following month.

Unmanufactured articles

26. In the case of unmanufactured articles excise control commences at the stage of cultivation. Every grower is required to make a declaration in respect of all land upon which the products are to be grown before making use of any land for growing such products. Those who cultivate ten acres or more are required to make this declaration in writing and those who cultivate less are permitted to furnish the particulars orally to the central excise officer who visits him for the purpose. The growers are not required to obtain any licence in their capacity as growers but have to obtain a licence if they intend to cure the tobacco or coffee cultivated by them. The small scale growers who cultivate solely for personal consumption are not required to obtain a licence for curing because such products are exempt from duty. At the end of the harvesting season the growers are required to make a declaration of the products grown by them and here again the requirement of a written declaration is confined to those who cultivate ten acres or more.

27. Those who cure the products grown by them as well as those who are not growers but purchase the tobacco or coffee in the uncured state for curing are required to obtain a licence for curing. Those who cure less than 100 standard maunds are issued free licences whereas those who cure more have to pay a licence fee of Rs. 5 per year. The curers are required to furnish returns of the quantities actually cured by them and here again those who cure less than 100 standard maunds are permitted to make oral returns. As soon as the products are cured, they have to be cleared by the curers either on payment of duty or by transfer to a private or public bonded warehouse. Where, however, a curer is not able to dispose of the products in this manner and prefers to retain the products with him awaiting an opportunity for good prices, he may do so by obtaining a licence for a curer's bonded store room.

28. All those who deal in unmanufactured tobacco, *i.e.*, wholesale and retail dealers, brokers and commission agents, manufacturers of tobacco products, and owners of bonded warehouses for the storage of tobacco pending payment of duty are licensed and are required to maintain accounts. Persons licensed to keep warehouses are required to execute bonds with surety or security for the due payment of duty. The amount of the bond is fixed on the basis of the capacity of the warehouse. The movement of unmanufactured tobacco exceeding two seers can take place only under a prescribed transport document.

Representations from the trade

29. The representations made to us in regard to unmanufactured articles are mainly concerning tobacco, and we proceed to discuss the important suggestions and complaints.

Disposal of tobacco by growers

30. It has been suggested to us by certain interests representing tobacco merchants that the growers should be required to dispose of their crop immediately after curing instead of permitting them to retain it up to the end of June of the following year. The main reason given for this suggestion is that it will reduce the chances of defrauding revenue.

31. As indicated earlier, the Central Excise Rules do require that the tobacco should be cleared on payment of duty or by transfer to a private or public bonded warehouse immediately after curing. There is, however, a provision permitting growers to retain their crop up to the thirtieth day of June in the year following that in which it was harvested, on obtaining a licence for a 'curer's bonded store room'. The object of this provision is to safeguard the interests of the growers and it enables them to look for an opportunity of getting good prices. We do not support the suggestion for withdrawing this facility because it would throw the growers at the mercy of the merchants.

Restrictions regarding warehouses

32. A general complaint that has been made to us is regarding the elaborate accounts prescribed for warehouse licensees and restrictions placed on processing and blending and the collection of duty on losses incurred in various operations. We recommend that a simplified procedure should be evolved and account should be taken of the losses that have occurred in transport, storage and in processing.

Transport control

33. The system of transport control in respect of tobacco has come in for a good deal of adverse criticism. It has been represented that the procedure for transport permits needs overhauling and simplification; that transport permits issued by Central Excise Officers should not be insisted on in areas which do not produce tobacco; and that expensive measures for controlling the movement of duty paid tobacco are unnecessary and that control should not go beyond the limit of identification of the duty paid character of the consignments.

34. We observe that the prohibition of transport of unmanufactured tobacco without a valid transport document is an important safeguard against evasion of excise duty. Tobacco is consumed in some form or other in all parts of the country and the only means of identification of licit and illicit tobacco is the prescribed transport document. We observe that no fee is charged for the issue of these transport documents and that, to facilitate trade, movement of tobacco is permitted in certain circumstances under the transport certificates and sale notes issued by dealers.

35. We do not consider that any radical simplification of the system of transport control is necessary or possible. In fact, the system cannot be said to be to the disadvantage of the trade; on the contrary, by helping to identify licit transport, it saves the trade from harassment.

CENTRAL TAXES

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Taxes on Income

CHAPTER II.—BASIS OF LIABILITY TO TAX

1. It is not possible to accept the suggestion that income arising to a resident outside the taxable territories should be exempted from income-tax. Some arrangements are, however, necessary under which the remittances of foreign income are relieved of the higher burden of taxation in case the Indian rates of income-tax are higher than the rates applicable in the country in which foreign income arises. The following scheme is recommended, which achieves this object, simultaneously with the taxation of foreign income on an accrual basis as at present:—

(i) the foreign income of a resident should continue to be taxed as hitherto in the year of accrual;

(ii) unilateral relief should also continue to be extended to such income if it has suffered tax abroad;

(iii) in the year in which the assessee remits the earnings so taxed to India, he should be given a refund of the actual tax borne by him. This will be regulated as follows:—

(a) there will be no refund if the Indian and foreign tax rates are the same;

(b) the refund will equal the difference between Indian and foreign rates if the former is higher; and

(c) no refund will be involved if the Indian rate is lower than the foreign rate. Transitional provisions would be necessary in respect of income which had accrued before the system of full unilateral relief came into force, or in respect of which double income-tax relief had been granted on some other basis. (Paragraph 10.)

2. The category of 'resident but not ordinarily resident' persons should be abolished and such consequential changes made in the tests for residence as contained in section 4A(a) of the Income-tax Act as are necessary to avoid hardships to some of the assessees, who are at present 'resident but not ordinarily resident'. (Paragraphs 11—13.)

3. Income of a foreign technician during the financial year in which he arrives in India should be completely exempted from income-tax and super-tax. His income in the second financial year should also be completely exempted provided the total period of his stay in India does not exceed 365 days. If, however, the period of stay exceeds 365 days, he should be charged to tax on the income of the second financial year either as a resident or as a non-resident according to the application of the ordinary law. (Paragraph 16.)

4. The income-tax law should be amended so as to subject to tax remuneration received by Indian citizens employed in India by the United Nations and allied international organisations. (Paragraph 17.)

5. The income criterion for determining the residence of companies as contained in section 4A(c)(b) of the Income-tax Act should be abandoned. (Paragraph 21.)

6. Power should be conferred on the Central Board of Revenue to extend, in cases of hardship, the period of exemption of tax on remittances of foreign profits received by a person who has previously been non-resident, and who comes to India to take up residence. (Paragraph 25.)

7. The concession regarding exemption of remittances by residents to India from abroad between 2-9-1951 and 31-3-1956 should be continued for an indefinite period. (Paragraph 26.)

8. With a view to securing uniformity regarding the taxation of non-residents on income deemed to accrue or arise in India through 'business connection', the Central Board of Revenue should issue a comprehensive set of instructions, after taking into consideration the judicial decisions on the subject and as many as possible of the types of transactions that are likely to arise in practice. These instructions should also be made available to the public. The assessees should be encouraged to bring freely to the notice of the Central Board of Revenue any cases which, in their opinion, are not being handled in accordance with instructions that may be issued or where the instructions themselves operate harshly in a particular case. (Paragraph 31.)

9. It should be explicitly laid down in the Income-tax Act that no profit should be deemed to accrue or arise in India:—

(i) where the transactions between a resident and a non-resident are on a principal-to-principal basis, and where the ownership of the goods passes from the non-resident to the resident outside the taxable territories; and

(ii) in respect of goods purchased in India whether through a regular agency or otherwise provided such goods are not subjected to any manufacturing or other process before export. (Paragraphs 32-33.)

10. Where goods are manufactured outside India and only the sale of goods takes place in India, the principles governing the allocation of profits between the selling operations and other operations should be laid down in the Income-tax Act on the model of similar provisions in the Australian Income-tax Act. (Paragraph 35.)

11. The Central Board of Revenue should issue instructions for the prompt disposal of applications under the second proviso to section 42(1) of the Income-tax Act for certificates showing the amount which an agent of a non-resident should retain out of the moneys of the latter in order to discharge the tax liability which may fall on him under section 42 of the Act. (Paragraph 37.)

12. (i) The model agreement suggested by the Fiscal Commission of the League of Nations is suitable only for countries which have developed economically to the same

extent. Where considerable differences exist in the economic development of different countries, suitable adjustments will have to be made to safeguard the interests of the comparatively less developed countries especially in regard to the profits of aviation and shipping;

(ii) any hardship caused by the non-availability of relief in respect of income deemed to accrue or arise under the Income-tax Act should be rectified as a part of the agreement for double income-tax avoidance or relief;

(iii) the model of Indo-Pakistan agreement on double income-tax avoidance is preferred. (Paragraphs 43—48.)

CHAPTER III.—TAXABLE INCOME—I

13. It is not practicable to define 'income' in the income-tax law. Guidance in this matter should continue to be drawn in the future, as heretofore, from the case law on the subject. (Paragraph 3.)

14. The following receipts should be made chargeable to income-tax, to the extent and in the manner indicated below:—

(i) premium on leases,

(ii) sale proceeds of patent rights and copyrights,

(iii) compensation received for termination of managing agency agreements or similar business agreements, and

(iv) compensation for loss of employment, except when it is in the nature of damages awarded by a court in consequence of the repudiation of service agreement by an employer or for wrongful discharge or dismissal of an employee.

The lump sum receipts from the sale of patent rights should be spread over a maximum period of six years; those from premia on leases over a maximum period of twenty years; and those from compensation for loss of managing agency commission and from compensation for loss of employment over a period that may be considered appropriate by the income-tax authorities depending upon the nature of the agreement or the contract from which they arise. The receipts should be spread backwards, except those arising from premia on leases which should be spread forwards. (Paragraphs 6—10.)

15. The present provision in the Indian Income-tax Act for the exemption of casual and non-recurring receipts should not be disturbed. However, certain types of casual receipts which are obviously an addition to one's ability to pay, such as the winnings of cross-word puzzles, lotteries, etc., should be charged to tax at a flat rate through a separate tax levied under item 97 of the Union Legislative List in the Seventh Schedule to the Constitution of India. (Paragraphs 11—15.)

16. The full value of any benefits granted to an employee by his employer and any sum paid by the employer in respect of any charge or other obligation which but for such payment would have been paid by the employee, should be treated as taxable income in the latter's assessment. For the present, however, the liability should be confined to employees whose total emoluments (including the value of the perquisites) exceed Rs. 24,000 in a year and to directors of companies irrespective of their emoluments. The Central Board of Revenue should issue executive instructions to ensure that no attempt is made to evaluate or tax petty items. It is also suggested that section 4(3)(vi) of the Indian Income-tax Act should be amended to bring it in line with the recommendation made above. (Paragraphs 16—22.)

17. The distinction between agricultural and non-agricultural income should be done away with, and both incomes should be treated as one eventually for purposes of taxation. Until that is done, income from such forms of dairy, farming and poultry raising which are undertaken as a commercial venture and income from usufructuary mortgages should be brought to charge under the Indian Income-tax Act. No change is, however, recommended in respect of the practice followed regarding the taxation of receipts from forests. (Paragraphs 23—27.)

18. Debts foregone by a creditor should be treated as income of the debtor if the amount of the debt has been allowed as a deduction in the debtor's assessment in an earlier year. Executive instructions should, however, be issued to prevent detailed enquiries in cases involving small sums. (Paragraph 28.)

19. Unclaimed wages and other balances should be treated as taxable income after the expiry of three years from the year in which they were allowed as revenue expenditure to the assessee. (Paragraph 29.)

20. The executive instructions recently issued by the Central Board of Revenue regarding the tax treatment of managing agency commission surrendered appear to be sufficient to cover any cases of genuine hardship that may arise in this connection. (Paragraphs 31—34.)

21. The excess of the sale proceeds of a depreciable asset, which is now brought to charge under section 10(2)(vii) of the Income-tax Act, should be excluded from tax provided the sale proceeds are utilised for replacement of the asset and certain other conditions are fulfilled. These conditions are discussed in Chapter V (*vide* item 53 of the Summary of Conclusions and Recommendations.

Compensation received from an insurance company on account of the destruction or loss of a building, machinery or plant should be treated in the same way as sale proceeds, for the purposes of the balancing charge under section 10(2)(vii) of the Income-tax Act. (Paragraphs 35-36.)

22. Lump sums received by a single-picture producer for the sale of distribution rights may be spread backwards over a period of two years, if the production of the picture takes more than eighteen months.

The cost of films may be amortised for income-tax purposes by being spread over a period of two years, according to the formula suggested for the purpose by the Film Enquiry Committee. (Paragraphs 43-44.)

23. Interest on long-term cash certificates issued by banks may be allowed to be spread backwards over the period of the certificate (subject to a maximum of four years), if the cash certificates held do not exceed Rs. 25,000. (Paragraph 47.)

24. Income from 'Nidhis' and 'Chit funds' should be spread backwards over a period of three to five years at the maximum. (Paragraph 48.)

25. The suggestion that assessees should be required to furnish a certificate every year to the effect that the method of valuation of stock followed is the same as adopted by them originally, could be met by suitably amending the form of return of income. (Paragraph 5.)

26. Assessees, who consistently follow the 'pick-and-choose' method of valuing stock, should not be compelled to change over to the 'global' method. (Paragraph 6.)

27. Clause (xv) of sub-section (2) of section 10 of the Income-tax Act should be taken as applicable only to the 'residue' of expenditure outside the expenses covered by clauses (i) to (xiv) of the above sub-section. (Paragraph 13.)

28. The right of the income-tax authorities to question the reasonableness of remuneration paid to employees, which has been recognised by judicial decisions, should be specifically provided for in the statute insofar as the employment of relations etc. is concerned. (Paragraph 18-19.)

29. The following items of expenditure of a capital nature should be treated as admissible deductions:—

(i) cost of acquisition of patent rights and copyrights, and premium on leases;

(ii) legal costs and other expenditure in connection with the acquisition of a lease for a period exceeding one year.

The payment made for the acquisition of patent rights should be spread over the number of years for which the rights are acquired, up to a maximum period of sixteen years. The period for the premium on leases should be a maximum of twenty years, and for copyright the period should depend on the nature of agreement under which it is acquired. (Paragraph 23.)

30. A specific provision should be inserted in the law for allowing costs of income-tax appeals in certain circumstances. The provision may be to the effect that, if the Appellate Assistant Commissioner or the Appellate Tribunal is satisfied that an appeal was *prima facie* a wholly justifiable one, or a partially justifiable one, the appellate authority could order the payment to the assessee of an amount equivalent to the refund that he would be entitled to if either the whole or a portion (as may be decided upon by the appellate authority) of the actual expenses incurred by him on the appeal proceedings is treated under section 10(2)(xv) as a deductible expenditure in his assessment. (Paragraph 27.)

31. The practice of disallowing a portion of the travelling expenditure, as representing personal boarding and lodging expenses of the assessee, should be given up. (Paragraph 29.)

32. The provisions for a balancing charge or balancing allowance contained in section 10(2) (vii) of the income-tax Act, should be

made applicable to buildings constructed on leased land, and also to machinery and plant which are compulsorily acquired by Government. (Paragraphs 34-35.)

33. The scope of Section 10(2)(xiii) of the Income-tax Act should be enlarged so as to allow the deduction, for income-tax purposes, of any sum paid to a university or college or any other institution, which is approved by the prescribed authority, to be used for research in statistical and social sciences, provided it relates to the class of business carried on by the assessee. The prescribed authority for this purpose should be the Planning Commission. (Paragraph 41.)

34. The Central Board of Revenue should make an analysis of a sample of bad debts that have not been accepted by the Income-tax Department and should make its findings public. (Paragraph 43.)

35. Persons chargeable to tax on income from 'salaries' should be allowed the amount actually expended by them on the purchase of books and periodicals up to the extent that they are required for study and reference in the pursuit of their vocations. The concession should be limited to a maximum of Rs. 500 a year. (Paragraph 47.)

36. The cost of collecting interest on securities and dividends should be made an admissible deduction by a suitable amendment of sections 8 and 12 of the Income-tax Act. (Paragraphs 48-49.)

37. The carry-back of losses should be allowed, with proper safeguards, only in cases where it may be impossible to adjust losses against future years owing to the cessation of business, profession or vocation. It should not be extended to a company unless it is wound up compulsorily under the orders of a court, nor should it apply to a Hindu undivided family on partition. As regards individuals, it should apply when the business, profession or vocation is permanently discontinued and where such discontinuance is brought about by circumstances outside the control of the assessee, *e.g.*, at the time of his death.

Such losses should be carried backwards for one year and should be set off against profits arising from any source in the preceding year. (Paragraph 61.)

38. The existing six-year limit for carry forward of losses should be removed so as to allow them to be carried forward indefinitely, *i.e.*, until they are fully absorbed. (Paragraph 63.)

39. The restriction for loss offsets against the same business should be removed, subject to the safeguard that the business in which the loss is occasioned is carried on by the same assessee in subsequent years. The working of this recommendation should be reviewed after five years. (Paragraph 64.)

40. Carried forward loss from a business, profession or vocation may be allowed to be set off against 'non-business' income of the year next following the year in which the loss arises, provided that the business, profession or vocation, in respect of which the loss arises, continues to be carried on by the assessee in subsequent year. (Paragraph 65.)

41. The recent amendment made to section 24 of the Income-tax Act by section 2 of the Finance Act, 1953, which makes differentiation between losses from speculation and other losses is justified. The recommendation made above for the removal of the present time-limit of six years for the carry-forward of losses should also apply to speculative losses, except that they would be available only for being set off against income from speculative transactions. (Paragraphs 66—72.)

42. A company in which the public are not substantially interested should be allowed to have the loss carried forward from one year and set off against the profits of a subsequent year only if the shareholders in the year when income is earned are substantially the same as those in the year when loss occurs. (Paragraph 73.)

43. The principle of revalorisation or continuous revaluation of fixed assets for the purpose of allowing depreciation is not merely defective in theory, but also unworkable in practice. (Paragraph 9.)

44. The system of initial and additional depreciation allowances instituted in 1946 and 1949 respectively should be continued for another period of five years for industries to which 'development rebate' as suggested in Chapter VII is not applicable. After five years, the need for it should be reviewed in the light of the position existing at that time. (Paragraph 14.)

45. The proviso to clause (via) of sub-section (2) of section 10 of the Income-tax Act requiring the recalculation of depreciation allowance on machinery and plant after five years, on the basis of its market value, should be deleted. (Paragraph 15.)

46. Initial depreciation allowance in respect of plant and machinery should be raised from 20 per cent. to 25 per cent. of the original cost of the asset and it should be taken into account for determining the 'written down value' of the asset. (Paragraph 15.)

47. No initial depreciation allowance should be allowed to those industries which have been granted a development rebate as recommended in Chapter VII of this Volume. (Paragraph 16.)

48. The adoption of 'free method'. of depreciation is not recommended. (Paragraph 17.)

49. If the method of depreciation prescribed in the Income-tax Act for a particular industry is different from that statutorily provided for in the special laws applicable to that industry, the latter method should be adopted for income-tax purposes also. (Paragraph 20.)

50. The Central Board of Revenue should undertake a comprehensive revision of the schedule classifying the assets for depreciation with a view to taking into account the latest technical developments. It should also make an overall examination of the rate schedule. (Paragraphs 22 and 28.)

51. The practice of allowing depreciation in proportion to the number of months for which the asset is used in a year should be abandoned. (Paragraph 31.)

52. The balancing charge and balancing allowance provided for in section 10(2) (vii) of the Income-tax Act should be made applicable to furniture also by a suitable amendment of the law. (Paragraph 32.)

53. Subject to the following conditions, the excess of sale proceeds of an asset over its written down value, which is now brought to charge to the extent provided for under clause (vii) of sub-section

(2) of section 10 should be excluded for purposes of taxation, if the sale proceeds are utilised for financing the replacement of that asset. The conditions are:—

(i) the amount saved from taxation is set off against the original cost of the new asset before depreciation is charged on it, and

(ii) the new asset is purchased within two years of the sale of the old asset. (Paragraph 32.)

54. Royalty, even where it is held to be an appropriation of profits, should be allowed as an admissible expenditure to the extent of the amount which would be admissible had it been calculated as prescribed in the Mineral Concession Rules, 1949. (Paragraph 25.)

55. Abortive expenditure on exploration should be allowed as a revenue expenditure in the year in which such expenditure is incurred. (Paragraph 25.)

56. The mineral industry in India is yet in an undeveloped state and requires encouragement. Special provisions are necessary to provide for the treatment of expenditure which is essential for the working of mines. It is recommended that:—

(i) capital expenditure incurred for acquiring minerals or the rights to work minerals,

(ii) expenditure on successful exploration,

(iii) expenditure on development of mines, and

(iv) at the option of the assessee, the cost of the buildings, plant or machinery used for exploration or mining purposes

should be allowed to be charged against profits. Expenditure on tangible assets should be admissible for depreciation and that incurred on intangible assets should be amortized. The amount of expenditure admissible for any one year should be computed on the basis of "out-put" formula or one-twentieth of the total admissible expenditure, whichever is greater. The fixation of the number of years over which the expenditure should be spread under the latter formula is a technical matter which calls for further examination. Mining concerns should not be allowed the freedom to write off a larger proportion of the total admissible expenditure during periods of high profits. Specific provision for regulating the quantum of the expenditure admissible in the last year of the working of a mine on the lines of clause (vii) of sub-section (2) of section 10 of the Income-tax Act should also be incorporated in the law. (Paragraph 25.)

These concessions are being recommended subject to the following reservations:—

(i) Government of India should, in consultation with the Bureau of Mines, consider the desirability of imposing maximum limits for each industry separately beyond which expenditure on exploration will not be allowed;

(ii) abortive expenditure on exploration should only be allowed to be set off against profits from other mineral undertakings worked by the assessee and not against profits from any other kind of business that may be carried on by the assessee;

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(iii) the concessions recommended should be available only to undertakings which are engaged in the exploration of minerals (a) which are of the non-bedded variety, (b) which lie at a deep level and (c) the prices of which are subject to significant fluctuations in the export market; and

(iv) the continuance of these concessions should be subject to a periodical review to determine whether the object with which these concessions have been recommended, *viz.*, to stimulate the mining production in the country, is actually being fulfilled. (Paragraph 25.)

57. In view of the amortization of practically the whole of the capital expenditure invested, the additional incentive, if any, which may be allowed, and the consequent loss of revenue, must be fully justified on the score of being absolutely necessary in the sense that it is expected that the exploration and production of minerals are not likely to develop without such incentives. Special tax incentives should, therefore, be restricted to selected minerals only. They should be admissible only to undeveloped minerals or to those which are in the initial stages of development and the development of which is considered essential for economic or strategic reasons. Even among such minerals, there is a stronger case for the grant of tax concessions to non-bedded minerals which lie deep under the surface of the earth. The concessions may also be restricted to those concerns only which undertake to convert the minerals into finished or semi-finished products before their export to foreign countries. A special tax incentive may be allowed to stimulate the extraction of the lower grades of ore resulting in the fuller utilisation of mineral resources and lengthening the life of the mines. It may take the form of a rebate of income-tax based on the tonnage of sub-economic grades of ore mined in any year. It is, however, not possible to lay down a general rule for the grant of incentives, if any, in respect of all minerals. Differentiation will have to be made on the basis of the special circumstances and features of each mineral. (Paragraph 27.)

58. Depletion allowance, whether based on discovery value or on percentage of gross profits, is not considered suitable in the context of the present state of the Indian mineral industry. (Paragraph 28.)

59. Such mineral industries as fulfil the tests mentioned in recommendation No. 57 above should be eligible for either the development rebate or the concession under section 15C of the Income-tax Act on the lines mentioned in Chapter VII. (Paragraph 29.)

CHAPTER VII.—INCENTIVES TO DEVELOPMENT OF PRODUCTIVE ENTERPRISE

60. The rebate of one anna in the rupee at present given to all companies on their undistributed profits should be continued. (Paragraph 5.)

61. Companies, individuals, partnerships and other proprietary concerns engaged in selected industries should be granted a 'development rebate' by being allowed to charge to revenue 25 per cent. of the cost of new fixed assets in the year of installation of the assets. This development rebate will be in lieu of the present initial depreciation allowance and it should be available for purchase of fixed assets, whether intended for replacement or for expansion, and to new as well as existing concerns in the industries selected. The additional depreciation allowance should be continued as at present. (Paragraph 6.)

62. The selection of the industries eligible for the development rebate should be made on the basis of (1) the importance of the industries concerned from the point of view of national development, and (2) the extent to which they are unlikely to be developed—either by way of expansion of existing concerns or establishment of new concerns—if left to the voluntary effort of private enterprise and without any special stimulus by way of tax relief. The actual selection should be made by an appropriate body constituted by Government such as the Planning Commission. (Paragraph 8.)

63. Adequate measures should be worked out by an expert committee of officials for preventing abuse of the tax relief that will be afforded by the proposed development rebate. Thus, the development rebate should not be given either in respect of renovated plant and machinery or on such assets bought second hand. Nor should it be applicable to assets other than plant and machinery or to motor cars and such other transport as may be considered by Government to be capable of being used for private as well as for business purposes. Where the development rebate is granted on new plant and machinery, it must be provided (i) that the sale of such plant and machinery will not be allowed if it is made to a person or a corporation or any other taxable entity the major portion of whose business income is not subject to Indian income-tax; (ii) that the rebate will not be allowed if the asset is utilised for a purpose other than that for which it was acquired unless it would have qualified for the development rebate even for the latter purpose at the time it was purchased. (Paragraph 9.)

64. Section 15C of the Income-tax Act should be recast on the following lines:—

(i) a complete tax holiday, (*i.e.*, exemption from tax) should be given to all the new concerns in the selected industries of 'special national importance';

(ii) the period of tax holiday should be six years, commencing from the accounting year in which manufacture or production begins;

(iii) during the period of six years for which the concession lasts, the calculation of profits which are exempted should be based on normal depreciation allowance. From the seventh year onward, when the profits of a concern become subject to tax, double the normal annual depreciation should be allowed for a (further) period of five years;

(iv) an industry should get the benefit either of the development rebate or of the proposed tax exemption for a period of six years, whichever is higher, but not of both. If, therefore, the profits during the period of six years for which the concession lasts, computed after taking normal depreciation into account, fall short of the admissible development rebate, the excess of the development rebate over such profits should be adjusted against the profits of the seventh and subsequent years until the development rebate is worked off in full;

(v) the dividends received from companies falling within this category to the extent they are attributable to the exempt income of the companies concerned should be exempt from income-tax in the hands of the shareholders; and

(vi) the concern should submit regular returns of income during the period of the tax holiday to enable, among other things, a record to be kept of the tax relief thus afforded. (Paragraphs 13—18.)

65. The actual choice of the small number of selected producers' goods and capital goods industries which should enjoy the benefit of the revised section 15C should be made on the recommendation of an appropriate body constituted by Government, such as the Planning Commission, and it should be open to this authority to suggest changes in the list of the selected industries in the light of the working of the concessions and according to changing national requirements in the context of planned development. (Paragraph 21.)

66. A review should be made of the working of the above concessions at the end of five years from their inception and the results placed before Parliament. (Paragraph 22.)

67. The power of the Central Board of Revenue to exempt from tax the income of a trust applied to religious or charitable purposes outside the taxable territories, which can now be exercised only in favour of trusts established before 1st April 1952, should be extended to cover also trusts established after that date, if the funds of the trust were devoted to the promotion of objects of international appeal in which India is interested, *e.g.*, approved schemes of medical and humanitarian research which cannot be carried out without international co-operation but which are conceived in the general interests of the country. (Paragraph 5.)

68. In order to provide for the control and supervision of charitable trusts, legislation should be enacted in the various States on the lines of the Bombay Public Trusts Act, 1950. The charitable and religious trusts should also be required to send returns of income to the income-tax authorities once in three years. (Paragraph 7.)

69. The Indian law relating to the taxation of trustees and guardians (Sections 40 and 41 of the Income-tax Act) needs no modification. (Paragraph 11.)

70. Neither any further reduction in the rates of tax nor is any further increase in the present differential in favour of the profits of life insurance business called for. (Paragraph 14.)

71. In making an assessment on life insurance business on the 'valuation surplus' basis, the deduction of 80 per cent. of the surplus reserved for policyholders is, on the whole, fair. No further increase in this proportion is necessary. (Paragraph 17.)

72. Where a life insurance business is assessed on the 'external incomings' basis, no modification is necessary in the maximum limits to the management expenses admissible. (Paragraph 18.)

73. No further tax concessions in favour of mutual life insurance companies is called for. (Paragraph 23.)

74. The present exemption of the profits of co-operative insurance business should be withdrawn. (Paragraph 24.)

75. Companies carrying on general insurance business should be allowed to add five per cent. of their annual premia to the reserves every year free of tax, until the reserves reach 75 per cent. of annual premia in respect of fire and miscellaneous business, 100 per cent. in respect of marine cargo business and 150 per cent. in respect of marine and aviation hull business. (Paragraph 27.)

76. Transactions of re-insurance placed by Indian insurers with insurance companies abroad should not be taken to establish a 'business connection' within the meaning of Section 42 of the Income-tax Act. No amendment of the law is necessary to bring about this result which could be secured by the issue of suitable executive instructions. (Paragraph 29.)

77. Standing arrangement on the following lines may be made with trade and professional associations which are prepared to accept it:—

(a) the association would be taxed on the entire surplus of receipts over outgoings;

(b) the members would get the entire annual subscriptions allowed in their assessment; and

(c) any sums distributed by the association to its members would be allowed as a deduction from its income and taxed in the hands of recipients. (Paragraphs 32-33.)

78. It is not necessary to extend the concession of exemption from super-tax on inter-corporate dividends, now available to investment trust companies which fulfil the conditions laid down in Notification No. 47 dated the 9th December, 1933, so as to cover *all* types of investment companies without any restriction on the nature of their business and their investment policies. It is also not necessary to embody the present concession in the statute. (Paragraphs 35—37.)

79. The difficulties experienced by electricity undertakings through different methods of calculating depreciation provided for in the Income-tax Act and the Electricity (Supply) Act, 1948, respectively, could be removed by permitting the undertakings to put into reserve any extra surplus that they get from tax relief on account of initial and extra depreciation allowances. (Paragraph 42.)

80. It would be inexpedient to make any far-reaching changes in the tax treatment of the Hindu undivided family at the present moment, especially when the Hindu Code Bill is pending before the Parliament. (Paragraph 48.)

81. However, as a measure of further relief, Hindu undivided families with four or more members entitled to claim partition should be allowed an exemption limit for income-tax equal to three times the general exemption limit. (Paragraph 50.)

82. The requirement that a firm should produce a written partnership deed, and furnish certain prescribed particulars, in order to obtain registration for income-tax purposes should continue. A time-limit should also continue to be laid down for the purpose, but applications should not be rejected merely because they are belated, or because they contain certain formal defects. (Paragraphs 57—60.)

83. The procedure for applying for registration should be simplified, by dispensing with a separate application and incorporating the relevant particulars and certificates (both for initial registration and for renewal of registration) in the form of return of income. The return of income should be signed by all the partners (or, if the firm has been dissolved, by all persons who were partners in the firm immediately before dissolution and by the legal representatives of any deceased partner). (Paragraphs 61—63.)

84. There should be no diminution in the existing tax concessions available to co-operative societies. (Paragraph 64.)

85. Interest on securities and income from property received by co-operative societies, including State co-operative banks, central or district co-operative banks etc. (but excluding housing societies, transport societies, co-operative insurance societies and urban consumers' societies), of which the total annual income is below Rs. 20,000, should be exempted from tax. (This concession will be in addition to the exemption of business profits now enjoyed by all co-operative societies and to the concession recommended in item 86 below.) (Paragraph 67.)

86. Income by way of interest or dividend received by a co-operative society on its investments with another co-operative society should be exempted from tax, even if the total income of the former exceeds Rs. 20,000. Moreover, the entire amount of dividends received by members of co-operative societies from the societies should be exempted from tax in their hands. (Paragraph 67.)

87. Income from godowns and warehouses, received by co-operative societies (including banks, marketing societies, etc.), and by statutorily constituted market committees which provide warehousing or godown facilities, should be exempted from tax, even if the yearly income of the societies exceeds Rs. 20,000. (Paragraph 67.)

88. The proportionate annual value of the property occupied by each member of a co-partnership housing society should be taxed in his hands and not as income of the society. (Paragraph 67.)

89. The State Government should ensure, through adequate supervision that no improper use is made of tax concessions by different forms of co-operative societies. On a society furnishing a certificate from the State Government to the effect that its constitution and working conform to the prescribed tests, the Income-tax Officer should ordinarily grant the concession without further examination. Should, however, the Income-tax Officer find that a particular society whose total income exceeds Rs. 20,000, and which has produced a certificate of the kind mentioned above from the State Government, has had an unduly large proportion of its dealings with non-members, he should bring the matter to the notice of the Central Government, through his Commissioner of Income-tax, and a final decision regarding the admissibility of the concession should not be taken till after consultation between the Central Government and the State Government has taken place. (Paragraph 67.)

90. There should be a review of the above concessions at the end of ten years from the time, they are implemented. In particular, the review should aim at assessing (a) the results achieved by way of co-operative development; (b) the extent of revenue foregone; and (c) whether the safeguards have operated substantially to prevent the abuse of the concessions. On the basis of this review, and of periodical reviews thereafter, if necessary, further lines of policy in regard to both concession and safeguards could be formulated. (Paragraph 64.)

91. Section 4(3)(vi) of the Income-tax Act, should be amended so as to make it clear that allowances granted to an employee to meet expenses wholly and necessarily incurred in the performance of the duties of his office will be exempt only to the extent that expenses are *actually* incurred for the purpose. In order to avoid

unduly detailed enquiries, taxing authorities should be instructed not to call for details of expenses except in cases where the allowances are *prima facie* unreasonably high. (Paragraphs 69-70.)

92. Entertainment allowances paid in cash should in all cases be treated as taxable receipts in the employee's assessment. (Paragraph 71.)

93. The practice of paying salaries expressed as 'tax-free' should be discouraged. (Paragraph 72.)

94. The practice of taxing income from property on the basis of its '*bona fide annual value*' does not need modification. However, in those States where a State-wide agency has been established for the assessment of property taxes on behalf of all the local bodies in the State, income-tax authorities should normally adopt the same annual value as that determined for municipal assessments. No legislative provision will be necessary to achieve co-ordination on these lines, but the matter could be covered by executive instructions to be issued by the Central Board of Revenue. (Paragraph 75.)

95. No modification is called for in the existing provisions for allowance of repairs and collection charges in respect of property. (Paragraphs 76-77.)

96. No modification of the law is necessary in regard to the deduction of municipal taxes in the computation of the annual value of property with reference to rental receipts. However, the limit of one-eighth of annual value for such deduction should be deleted, as it is possible that it might lead to a denial of the 50 per cent. of total amount of tax in some local bodies. The Central Board of Revenue should also examine, in consultation with the Ministry concerned, whether this percentage could be raised. (Paragraph 79.)

97. The suggestion for a depreciation allowance in respect of residential buildings is not acceptable. (Paragraph 81.)

98. The annual value of owner-occupied property, as determined in accordance with section 9 of the Income-tax Act, should be reduced by one half or Rs. 1,800 whichever is less. If such reduced annual value exceeds ten per cent. of the assessee's total income, the assessee should be given the benefit of a further reduction of the annual value to ten per cent. of total income as at present. (Paragraph 83.)

99. The exemption from tax now available for two years, under section 4(3)(xii) of the Income-tax Act, in favour of income from newly constructed properties should be withdrawn. (Paragraph 84.)

CHAPTER IX.—THE RATE STRUCTURE OF INCOME-TAX OTHER THAN CORPORATION TAX

100. It is desirable to achieve a more equitable differentiation in the tax liability of large numbers of assessees in certain income brackets by introducing a larger number of slabs into the income-tax and super-tax rate structure. (Paragraph 9.)

101. It would be inappropriate to increase the burden of direct taxation on the lowest income ranges appreciably, particularly, in view of the Commission's recommendations to increase indirect taxes. While a certain increase in the schedule of rates including the highest seems necessary having regard to the objectives of tax policy, the proportionate room for increase in respect of the topmost brackets is correspondingly smaller than for upper-middle brackets. (Paragraph 10.)

102. Broadly speaking a maximum marginal rate of 13½ annas in the rupee or 85 per cent. on incomes above Rs. 1½ lakhs seems to us to be as far as one can go in present circumstances. (Paragraph 10.)

103. The exemption limit should be reduced from Rs. 4,200 to Rs. 3,000. (Paragraph 10.)

104. The introduction of a regular system of family allowances is recommended. This may not be practicable of immediate adoption owing to administrative and other difficulties. Necessary steps should, however, be taken from now onwards with a view to introducing an appropriate system of family allowances not later than three years. Meanwhile, to begin with, the present tax-exempt slice of Rs. 1,500 may be increased to Rs. 2,000 for married assessees and reduced to Rs. 1,000 for unmarried persons. (Paragraph 15.)

105. The method of giving a tax rebate on a portion of income at the average rate of tax appropriate to total income, subject to a maximum tax rebate, should be followed for the purpose of giving family allowances. (Paragraph 16.)

106. It is both equitable and necessary for effective administration of the Income-tax Act to aggregate the incomes of husband and wife, and indeed, of the whole family, at least coincidently with the introduction of a system of family allowances. (Paragraph 21.)

107. Earned income allowance should be given only in respect of incomes which are below a specified limit, say, Rs. 24,000, and all incomes above that limit should be deemed to be virtually unearned. To obviate the inequity of (earned) income just above this limit being subject to a tax liability which leaves an income after tax which would be lower than the income after tax for earned income of this level, marginal adjustments may be necessary and should be provided for. (Paragraph 24.)

108. Four illustrative schedules incorporating substantially all the above recommendations are furnished. (Paragraph 25.)

109. Changes in the general level of income taxation from time to time should be effected preferably by an adjustment of rates rather than of slabs. (Paragraph 25.)

110. The benefit of some reduction in the tax liability of non-residents incidentally resulting from the lowering of the rate of super-tax on the first slab in the illustrative schedules may be allowed to remain. (Paragraph 26.)

111. Contributions made by employers maintaining a recognised provident fund should not be treated as part of the total income of their employees; consequently, it will not be necessary to give abatements on these contributions but only on the contributions of the employees themselves. The interest credited to the individual account of each employee should also be completely excluded from consideration for the purpose of assessment. (Paragraph 32.)

112. The maximum amount for abatement in respect of insurance premia and provident fund contributions may be increased to one-fifth of the total income, subject to a maximum of Rs. 16,000 for Hindu undivided families and Rs. 8,000 for other assessees. The present limit of ten per cent. of the sum assured for the insurance premium on each policy should also continue. In view of the recommendation for excluding employers' contributions to provident fund from consideration, it is not necessary to prescribe separate maxima for insurance premia and provident fund contributions. (Paragraph 33.)

113. Besides what can be achieved at present through an increase in direct taxation, means should be found to bring about a reduction in the volume of disposable income in the hands of private individuals in the higher income brackets. For this purpose a scheme of a surcharge-*cum*-compulsory deposit in respect of incomes of over Rs. 25,000 (as detailed in paragraphs 36 and 37 of the Chapter) is recommended. The main features of this scheme are:—

(i) the levy of a special surcharge of tax on all incomes over Rs. 25,000, at graded rates, subject to the condition that the assessee will be entitled to have from Government a long-term loan, say for 45 years, at a nominal rate of interest, of an equivalent amount for being invested in any manner specifically approved by Government;

(ii) the collection from each assessee with an income of over Rs. 25,000 of a compulsory deposit, at graded rates, subject to the condition that it will be refunded to him only on the expiry of 20 years (with interest at a nominal rate), and even then, only in the form of Government bonds which will be encashable only after the expiry of 25 years thereafter. (Paragraphs 35—37.)

114. The term 'super-tax' on companies should be changed to 'corporation tax' and it should be appropriately defined in the Income-tax Act in the light of the definition of the latter in Article 366(6) of the Constitution. (Paragraph 4.)

115. A company is a separate legal and economic entity and enjoys substantial advantages as compared to a partnership or proprietary concern. These advantages justify the levy of a special tax on the corporation. (Paragraphs 5—9.)

116. Consequently, there is not only no case for the refund of the corporation tax to shareholders, but there is justification for scrapping the existing system of refunds of income-tax as well. However, on considerations of practical policy in regard to the promotion of equity investment in corporate undertakings, the continuance of the existing system of giving credit to shareholders for income-tax paid by the companies is recommended. (Paragraphs 10—12.)

117. In order to get over administrative and other difficulties involved in the existing method of granting refund of income-tax paid by a company to its shareholders, the following method of taxing companies and their shareholders is suggested:—

(i) when a company declares dividends, it will deduct income-tax at the maximum rate from the gross dividends, distribute the net amount to the shareholders and pay the tax to the credit of Government;

(ii) the company will pay corporation tax on its total income as at present;

(iii) the income-tax payable by the company will be calculated on its total income as reduced by the gross dividends;

(iv) when a part of the income of the company is derived from sources exempt from tax, it will still deduct income-tax at the maximum rate from gross dividends, and pay the tax so deducted to the credit of Government; such a company will also pay corporation tax on the entire taxable income;

(v) income-tax will be demanded from the company on its income from taxable sources as reduced by the portion of the gross dividends attributable to its taxable income. For this purpose, the gross dividend will be allocated proportionately to taxable and non-taxable sources of income;

(vi) when the gross dividends exceed the total income of the year, and the excess comes out of the taxed profits of earlier years, an adjustment will be made in the company's assessment by deducting the income-tax on such profits from the total demand on the company. For deciding the amounts of prior years' profits available, the excess of gross dividends over total income will, in the first place, be attributed to the undistributed profits of the immediately preceding year which have been carried forward unappropriated; and the balance (if any) to the year preceding that year; and so on. (Paragraphs 18—21.)

118. A system of exemption certificates, authorising companies not to deduct tax at all or to deduct tax at a lower rate than the maximum when the total income of the shareholder is below the taxable limit or is in the lower brackets, is recommended. (Paragraph 25.)

119. Bonus shares are not income in any sense of the word as understood in income-tax. Also there is not sufficient validity in the argument that non-taxation of bonus issues as income in the hands of shareholders leads to a loss of public revenues. (Paragraphs 31—33.)

120. The existing power of control on the issue of bonus issues (as part of the control of capital issues) should be exercised by Government in such a way as to ensure that there is no over-capitalisation of company and that any other misuse of the facility is prevented. (Paragraph 34.)

121. The income-tax law should be amended so as to empower the income-tax authorities to treat loans and advances made by companies in which the public are not substantially interested to their directors and shareholders, as dividends, where they are satisfied that the loans and advances are made out of the accumulated profits of the company. When such loans and advances are set off against dividends subsequently declared, they should not be taxed as dividends a second time. (Paragraph 37.)

122. Amounts distributed in the form of deposit certificates should be made taxable. (Paragraph 38.)

123. There is no justification for excluding bonus debentures from the definition of 'dividend'. (Paragraph 39.)

124. Distributions out of accumulated profits on the liquidation of a company should be treated as dividends in all circumstances, and the existing limitation that only distributions out of six years' profits should be taxed should be removed. (Paragraph 41.)

125. The second proviso to section 2(6A) of the Income-tax Act, should be recast to make it clear that dividends should be fully taxable in the assessment of the shareholder, irrespective of the nature of the profit fund of the company. (Paragraph 45.)

126. The extension of the existing exemptions of certain inter-corporate dividends from corporation tax is not favoured. (Paragraphs 47—49.)

127. Companies which have made the prescribed arrangements for the declaration and payment of dividends in India, and for deduction of super-tax at source, and which are public companies within the meaning of section 23A of the Income-tax Act as may be recast

in consequence of the recommendations made in the next chapter, may be subjected to corporation tax as follows:—

On the first Rs. 25,000 of total income ..	1 anna in the rupee.
On the balance	2 as. 9 ps. in the rupee.

(Paragraph 55.)

128. The lower rate of tax on the first slab of income, as recommended above for public 'Indian' companies should be made available to public 'non-Indian' companies also by a suitable adjustment of the rates. (Paragraph 56.)

129. Personal super-tax can be avoided by the controlling shareholders of a closely held company by retention of profits with the company instead of distributing them as dividends. This also leads to inequities as between shareholders of different companies. It is necessary to have in the Income-tax law some means of regulating the distribution of profits by such companies. It is, therefore, not possible to accept the suggestion for the abolition of section 23A of the Income-tax Act which is designed to counter this method of super-tax avoidance. (Paragraphs 1 and 14.)

130. The definition of what constitutes substantial public interest, requires reconsideration in view of the findings of an enquiry into the ownership of shares of private limited companies. The main ingredients of such a definition should be:—

(i) shares carrying more than 50 per cent. of the voting power, *i.e.*, a clear majority, should be in the hands of the public;

(ii) this voting power should be held not only on a particular day in the year but at any time throughout the year;

(iii) the majority of the shares (*i.e.*, over 50 per cent.) should not be held by less than six persons; and

(iv) the word 'person' itself should be defined in the Act in order to prevent the possibilities of dispersing shares among close relatives with a view to retaining *de facto* control on the company.

The explanation to sub-section (1) of section 23A of the Income-tax Act should be suitably modified to include the specific suggestions made above. (Paragraph 18.)

131. The proposal that the test of distribution based on a precentage of assessable profits *less* tax (distributable profits) should be replaced by a distribution based on the 'reasonable needs of a business' is not acceptable. (Paragraph 19.)

132. There is no case for the abolition of the first proviso to section 23A(1) requiring the distribution of the entire distributable profits when the reserves exceed the paid-up capital plus the loan capital which is the property of the shareholders, or the actual cost of the fixed assets whichever is greater. (Paragraph 20.)

133. Loss arising in a subsequent year need not be adjusted against the profits of a previous year for the purposes of action under section 23A in respect of the latter year. (Paragraph 21.)

134. Some of the difficulties faced by the companies because the 60 per cent. distribution required is based on the assessable profits and not on the book profits are genuine. The following specific provisions are necessary to remedy the present position:—

(i) The amount of 'distributable profits' under section 23A should be determined by deducting from the assessable income not only the income-tax and corporation tax payable, but also the amount of any tax levied by the Government of State or by a local authority, whether or not such tax is wholly or partly an admissible deduction under section 9 or section 10 of the Income-tax Act. (Paragraph 22.)

(ii) The 'distributable income' of banking companies should be determined by deducting from the assessable income, *inter alia,* the amount transferred to a reserve fund under section 17 of the Banking Companies Act, 1949. (Paragraph 23.)

(iii) The Central Board of Revenue should issue instructions to the effect that although foreign profits, the remittance of which is blocked, are taken into consideration for the purposes of the application of section 23A, the tax liability in respect of them may be kept in abeyance till the restrictions on the remittance of such profits are relaxed or removed. (Paragraph 24.)

(iv) The words 'smallness of the profits', used in sub-section (1) of section 23A should be amplified to provide that it is assessable profits as reduced by charges of the types referred to in (i) to (iii) above that should be taken into account in determining the applicability of section 23A to a company in a particular year. (Paragraph 25.)

135. The second proviso to section 23A, which requires the Income-tax Officer to give a three months' notice to a company which has distributed not less than 55 per cent. of the distributable profits before taking action under section 23A, may be enlarged so as to give *locus paeniteniae* to a company for escaping the penal order under that section in cases where the distribution actually made has fallen short of 60 per cent. of the distributable income by reason of the assessing officer determining the assessable income to be greater than it was according to the calculations made by the company. (Paragraph 26.)

136. Exemption from the application of section 23A available at present to 100 per cent. subsidiaries of companies in which the public are substantially interested cannot be extended to subsidiaries which are not 100 per cent. subsidiaries of such companies. (Paragraph 27.)

137. If, in any year, distribution of profits made by a section 23A company exceeds the requisite 60 per cent. of 'distributable profits', the excess should be carried forward to subsequent years and taken into account before any orders are passed under section 23A. The period of such carry-forward should be fixed at three years. (Paragraph 29.)

138. Delays in the completion of proceedings under section 23A should be avoided. The Central Board of Revenue should issue strict instructions to Income-tax Officers that action under section 23A in respect both of companies and shareholders should be initiated and completed with the least possible delay. The Central Board of Revenue should further ensure that these instructions are complied with in practice by prescribing an appropriate periodical return on the subject. (Paragraph 30.)

139. The requirement of 100 per cent. distribution can be avoided by a company by issuing bonus shares out of the 40 per cent. of the distributable profits which are allowed to be retained every year. The first proviso to section 23A(1) needs amendment to cover up this lacuna. The expression 'paid-up capital' in the said proviso should be defined so as to exclude capitalised reserves. Also, the words 'reserves representing accumulation of past profits' should be deemed to include any portion of the profits which has in the past been capitalised by the issue of bonus shares. (Paragraph 32.)

140. Section 23A should be amended so as to require investment companies in which the public are not substantially interested, to distribute 100 per cent. of their distributable profits. (Paragraph 36.)

141. The present procedure embodied in section 23A leads to several difficulties in practice which have the effect of rendering this section infructuous. Some alternative scheme is necessary which, while tackling the problem on a rational basis from the point of view of the assessees, will, at the same time remove most of the practical difficulties. It is, therefore, recommended that instead of including the 'deemed' distribution in the assessment of individual shareholders, an additional tax should be levied on the company itself calculated on the basis of a flat rate on the undistributed portion of the 'distributable profits'. (Paragraph 44.)

142. The existing arrangements for 'external survey' work should continue and should be carried out with vigour. The Committee, the appointment of which is suggested in the next Chapter (Recommendation No. 196) should examine also the methods of work and the adequacy of the survey staff, particularly of the clerical staff engaged on the tabulation and communication to the Income-tax Officers of the information gathered by the surveyors. (Paragraph 8.)

143. The survey work should be legalised by making a specific provision for it in the Income-tax Act. A responsible official of the survey team should be given the statutory power to place marks of identification on the books of accounts, documents, etc. which are examined by him, and to prepare an inventory of such books of accounts and documents and get it signed by the person in charge of or present on the premises, and also, if necessary, to take duly certified extracts from these books and documents. (Paragraph 9.)

144. The question of internal survey or exchange of information on record as among Income-tax Officers should also be examined by the Committee referred to in Recommendation No. 142 above, with a view to making the system more effective than it is at present. (Paragraph 10.)

145. There is considerable scope for improvements in the working of arrangements for obtaining information from outside sources. The question of providing additional staff in order to enable the Department to carry out this work systematically and effectively should be reviewed. In particular, greater attention should be paid to the question of organising economic intelligence at the level of the Commissioners of Income-tax and the Central Board of Revenue for checking returns comprising particular types of transactions and trading activities. (Paragraph 11.)

146. The extent to and the manner in which various types of information can be usefully gathered from outside sources should be investigated by the Committee referred to in Recommendation No. 142 above. (Paragraph 12.)

147. The Sea Customs Act, 1878, and the Central Excise Rules, which prohibit disclosure of information by customs and central excise officers to Income-tax Officers, should be suitably modified. With a view to making the investigations fully effective, there should be frequent personal contacts among tax authorities of the States and Central Governments. (Paragraph 13.)

148. The system of granting rewards to informers in income-tax matters has not been in operation long enough to enable a proper appraisal of its merits and demerits to be made. Certain dangers inherent in the system, such as the possibility of the informers blackmailing the assessees, and of the infringement of the secrecy provisions should not be overlooked when the question of continuing or modifying the system is taken into consideration. (Paragraph 17.)

149. The work done in the Collation Branch, working under the Director of Inspection, is quite useful and its activities should be extended in the following directions:—

(i) banks and insurance companies should be required, by a suitable amendment of section 38 of the Income-tax Act, to forward to this branch (which should be designated the prescribed authority) information relating to deposits, loans, remittances, overdrafts and policies exceeding a specified amount. Such amount could be fixed high enough to throw as small a burden on the authorities concerned as possible in the circumstances of each case;

(ii) the limit of Rs. 5,000 fixed in rule 42 of the Income-tax Rules, regarding the information to be supplied about dividends distributed by companies, should be removed. In future such information should be sent in respect of all dividends distributed by them in each year. (Paragraph 19.)

150. As the finding of the Supreme Court that certain sections of the Taxation on Income (Investigation) Act, 1947, are *ultra vires* is based on drafting defects in those sections and not on any inherent legal objection to the special powers and functions of the Income-tax Investigation Commission, this Act should be suitably amended to enable the Commission to complete the cases that remain to be investigated. (Paragraph 24.)

151. For investigating cases of substantial evasion, the balance of advantage lies in having an extra-departmental body such as the Income-tax Investigation Commission, possessing special powers for investigation and settlement, and presided over by a High Court judge. A special organisation of this kind should be constituted and retained as a permanent feature of income-tax administration. All the cases which would otherwise be assigned to the two 'Central' Commissioners at Bombay and Calcutta should be referred to this newly constituted Commission for disposal, and these two Commissioners' charges abolished. (Paragraph 27.)

152. The system of 'Special Circles' should be extended gradually, so as to enable the more difficult cases in the charge of Commissioners of Income-tax to be dealt with effectively by officers specially selected for this purpose. Retired officers or officers on the verge of retirement should not be placed incharge of investigations in view of the nature of work involved. (Paragraph 29.)

153. Section 34 of the Income-tax Act, should be amended as follows:—

(i) there should be no time limit for reopening of cases where fraud is suspected, and

(ii) the provision for obtaining the previous approval of the Commissioner of Income-tax before reopening an assessment should be repealed. (Paragraph 32.)

154. Income-tax Officers should be authorised, subject to the previous sanction of the Commissioner of Income-tax, to enter business premises and inspect the accounts and documents kept there, place identification marks on them and make copies and, if the officer has reason to think that they may not be forthcoming when required, to impound them; and to make a search of the places where there are

reasonable grounds for believing that relevant books and records have been kept. (Paragraph 33.)

155. The power to inspect the contents of safe deposit vaults and lockers, subject to the previous approval of the Commissioner of Income-tax, should also be conferred on the Income-tax Officers. (Paragraph 34.)

156. The maximum limit of penalty should be increased to three times the amount of tax evaded. Abetment or instigation to evasion should also be made an offence punishable to the same extent as the offence itself. (Paragraph 37.)

157. It should be made obligatory on every assessee to submit a statement of his assets and liabilities ('net worth' statement) every three years along with the return of income. The power of the Income-tax Department to call for such a statement should continue as at present, in order to enable the Income-tax Department to carry out the scrutiny of individual cases of evasion. (Paragraph 38.)

158. It should be made the duty of the liquidator of a company to send information to the Income-tax Department within 30 days of the adoption of a resolution by the company for liquidation or winding up. (Paragraph 39.)

159. Any further relaxation of the secrecy provisions of section 54 of the Income-tax Act is not favoured. (Paragraph 40.)

160. The suggestion for setting up a system of nationalisation of Chartered Accountants is not practicable at present. However, in order to make better use of the services of Chartered Accountants, the normal procedure in dealing with assessees represented by them should be for the Income-tax Officer, after scrutinising the return of income and the audit statement and if necessary after a general examination of the accounts, to address a detailed set of questions to the Chartered Accountant. At this stage, the responsibility for furnishing full and correct information should be legally placed on the Chartered Accountant and a convention should also grow up that the Income-tax Department will, as far as possible, rely upon the statements certified by the Chartered Accountant. (Paragraphs 44 and 47.)

161. Assessees should be encouraged to come forward freely with confessions of concealments and evasions which they have been guilty of, by a suitable mitigation of the penalty leviable. (Paragraph 57.)

162. Tax demand raised against a company in liquidation on completion of its assessment should rank as a preferential debt against its assets. (Paragraph 62.)

163. Provision may be made in the law for recovering from the shareholders the tax due from a company in which the public are not substantially interested, on its going into liquidation, provided the Commissioner of Income-tax is personally satisfied that liquidation has been undertaken with a view to avoidance of tax. (Paragraph 65.)

164. Provision may be made in the law that the Registrar of Companies shall not strike off a company from the Register of Companies unless a tax clearance certificate is obtained from the Income-tax Officer. (Paragraph 66.)

165. The fact that a large proportion of the accounts of retail traders and other small business are rejected by the income-tax authorities warrants an enquiry by the Central Board of Revenue as regards the reasons for which proper accounts, acceptable to the Income-tax Department, cannot be maintained by such assessees. The possibility of changing the present assessment procedure should be considered in the light of the results of this enquiry. (Paragraph 9.)

166. With a view to expediting the disposal of refund applications, the form of the monthly progress report of the Income-tax Officer should be amended to indicate *inter alia* pending refund cases which are over one year old. The Commissioner of Income-tax should carry out surprise inspection of some selected cases and the Director of Inspection should make a sample audit of pending claims in some of the offices in each Commissioner's charge so as to find out the causes of delay and issue suitable instructions. (Paragraph 11.)

167. Wide publicity should be given to the system of granting exemption certificates and measures should be taken to see that this facility is availed of by as many assessees as possible. The system should also be extended, wherever feasible, to other sources of income such as dividends. (Paragraphs 12—14.)

168. The Central Board of Revenue should make a detailed enquiry into the outstanding claims as on a particular date for refunds due as a result of appellate decisions, and take necessary steps to prevent recurrence of delay, if any. It would be advisable to publish the results of this enquiry and the action taken thereon. (Paragraph 15.)

169. The problem of clearing the heavy arrears of assessment should be solved on the following lines:—

(i) for categories of assessments which do not involve any substantial revenue, the usual standards of examination of accounts should be relaxed;

(ii) in other cases too, such relaxation may be made subject to prior consultation with the Inspecting Assistant Commissioner, except where the Income-tax Officer having regard to the previous history of the case, thinks it necessary to make full investigation;

(iii) a scheme of sample audit of pending returns should be drawn up on the U.S.A. model so as to minimise the arrears of work in the Department;

(iv) the Central Board of Revenue should issue instructions to ensure that:

(a) when an officer is transferred, the case file contains exhaustive notes regarding the stages of work that have been completed and the type of investigations that were carried out as well as the results thereof;

(b) the Commissioner of Income-tax should not normally transfer an officer unless he has satisfied himself that the number of incomplete cases is not likely to be large at the time of his transfer; and

(v) inspecting officers should pick out cases in which avoidable delay has taken place owing to patently infructuous investigations conducted by the Income-tax Officers and take necessary steps to correct this tendency wherever it exists. (Paragraphs 19—23.)

170. The practice of following each cash credit to its ultimate source and scrutinising it with reference to all the relevant facts, cannot be abandoned. Matters will, however, improve if the suggestion made in Chapter XII regarding the submission of 'net worth' statement every three years is adopted. This statement should also indicate *stridhan* and the value of jewellery in the possession of the assessee's wife and of other members of an assessee's family. (Paragraph 24.)

171. The existing dual control of Income-tax Officers by the Commissioner of Income-tax and the Director of Inspection should be removed. They should be placed fully under the control of the Commissioner of Income-tax, and any opinion given by the Director of Inspection should be communicated to the Commissioner for being passed on to the Income-tax Officer after the Commissioner of Income-tax has given the assessee an opportunity to present his point of view. (Paragraph 26.)

172. Powers and functions now described in the Income-tax Act as those of the "Income-tax Officer" should be described as those of the "Commissioner". The latter term should be defined to include all authorities subordinate to the Commissioner of Income-tax, and powers and functions of the Commissioner should be delegated to them appropriately. This will enable the Commissioner to give the assessee an opportunity of being heard in cases where he interferes. The appeal in such cases should go direct to the Appellate Tribunal and not to the Appellate Assistant Commissioner. (Paragraph 26.)

173. Assessees should be allowed reasonable time, usually not less than eight days, for complying with statutory notices. The Central Board of Revenue should conduct a sample survey occasionally in order to ascertain the reasons, if any, for which a shorter period than eight days is allowed for the purpose. (Paragraph 27.)

174. Proper attention should be paid to the public relations aspect in dealing with the assessees. An honest assessee should be given the feeling that he is not necessarily suspected by the Income-tax Department. For this purpose, it is necessary that the Income-tax Officer should exercise his discretion intelligently in choosing the statements of the assessee that he should put to strict proof in the limited time at his disposal. Supervising officers of the Department should encourage this attitude of mind and make due allowance for any *bona fide* mistakes that may be made by the Income-tax Officer when judging his fitness for further advancement. (Paragraphs 28—30.)

175. The Central Board of Revenue should initiate a regular 'drive' for the improvement of public relations. This can be done by paying proper attention to such matters as the general department and behaviour of the departmental personnel towards assessees, the amenities provided for the latter in income-tax offices (in the form

of waiting rooms etc.) and the consideration shown for their convenience in the matter of granting adjournments, allowing payment of tax dues in instalments etc. Much good work in this direction could be done by giving the small assessees advice about the filling up of their returns of income, and, particularly, about any allowances or abatements they could legitimately claim, and any refunds to which they would be entitled. (Paragraph 31.)

176. The Central Board of Revenue should also issue strict instructions to the following effect:—

(i) all notices requiring the presence of assessees or their representatives in the income-tax offices on a particular date should invariably mention the time at which they should be present;

(ii) if, for any reason, a particular assessee or his representative cannot be accommodated at the time mentioned in the notice, he should be informed accordingly sufficiently in advance and given an alternative date and time in respect of which he should be given preference over others; and

(iii) Income-tax Officers should display outside their offices a daily 'cause-list' showing the names of assessees and the time at which their assessments are scheduled to be taken up.

Senior officers of the Income-tax Department should be particularly charged with the duty of surprise inspections of such arrangements. (Paragraphs 32—33.)

177. In order to make the scheme of public relations fully effective, a few young and energetic officers should be selected and given a short course of training in public relations. For drawing up a suitable scheme of training, an officer with the necessary background and experience should be sent on deputation to countries such as the U.K. and U.S.A. where the problem of public relations in income-tax work has received special attention.

There should also be a small advisory committee of non-officials attached to each Commissioner of Income-tax. These committees should discuss matters of general policy relating to administration, but should be precluded from discussing individual cases of assessments. (Paragraphs 34—35.)

178. The Central Board of Revenue should make arrangements, wherever they do not exist at present, with the State Government for the appointment of special revenue officers exclusively for income-tax collection work. The working of these arrangements should be reviewed after a couple of years. (Paragraph 39.)

179. It is not necessary to extend, to other payments than those already covered by the present law, the system of deduction of tax at the source. (Paragraph 42.)

180. The scheme of advance payment of tax should be continued with the following modifications:—

(i) the rate of interest payable under sub-section (5) of section 18A should be raised from 2 per cent. to 4 per cent;

(ii) income from dividends should be treated in the same manner as the other items of income for which special provision exists in sub-section (4) of section 18A; and

(iii) whenever an Income-tax Officer completes the assessment of a year subsequent to the assessment on the basis of which a demand under section 18A has been made, it should be made obligatory on the part of the Income-tax Officer to revise the demand accordingly. (Paragraph 53.)

181. The following further changes are suggested in the existing scheme:—

(i) it should be made obligatory for all assessees (both old and new) to make advance tax payments on the basis of their last completed assessment or on an estimated basis, voluntarily, and without notice from the Income-tax Officer;

(ii) provision should be made in the law for giving Income-tax Officers discretion in genuine cases of hardship to vary the dates of payment, within one month of the due date, in order to prevent the levy of penalties; and

(iii) appeal should be provided against the imposition of penal interest under Section 18A. (Paragraph 54.)

182. The system of provisional assessments under the Income-tax Act should continue. (Paragraph 55.)

183. Where any partner of a registered firm makes a default in the payment of tax, the Income-tax Department should be empowered by introducing a provision in the law to proceed against his interest in the properties of the firm. (Paragraph 56.)

184. With a view to facilitating recovery of taxes in those cases in which income from property transferred by an assessee to his wife or children has been, under the provisions of the Income-tax Act, included in his own assessment, Section 16 of the Act should be amended suitably to provide for the assessment made on the person concerned to be split up in proportion to the income attributable to the assets held by the wife and the children and a demand raised separately on each one of them. This demand may be made recoverable either from the person concerned or, failing that, by proceeding against the assets held by the wife and the children. (Paragraph 57.)

185. Also when income from property held by a *benamidar* is included in the assessment of the real owner, it should be made possible for the Income-tax Department by a suitable amendment of the income-tax law, to proceed against the property for recovery of any arrears of income-tax due from the real owner. (Paragraph 58.)

186. Effective steps should be taken to overtake the arrears of appeals and to prevent the work getting into arrears again. In order to achieve this objective, even extraordinary powers may be given to Commissioner of Income-tax (suitably assisted by an Assistant Commissioner wherever necessary) to compound the appeals where the amount of tax in dispute is small and no question of principle is involved. (Paragraph 61.)

187. The hearing of an appeal by an Appellate Assistant Commissioner is essentially of the nature of a departmental review and there is nothing inconsistent with either logic or equity in retaining the control of the Central Board of Revenue over Appellate Assistant Commissioners. (Paragraph 70.)

188. The scheme of associating non-officials with the appellate machinery has very little chance of being successful in the existing conditions in India. (Paragraph 73.)

189. The income-tax law should be suitably modified to allow appeals in the following cases:—

(i) order under Section 18A(6) levying penal interest on account of insufficient payment of advance tax;

(ii) order cancelling registration of a firm under Rule 6B of the Income-tax Rules;

(iii) order including 'deemed dividend' in the assessment of a shareholder as a result of action under Section 23A;

(iv) order under Section 35 rectifying mistakes in assessment orders; and

(v) order under Section 43 appointing a person as the agent of a non-resident. (Paragraph 74.)

190. The actual strength of Income-tax Officers should be raised as soon as possible, to the number required. The special recruitment procedure may be repeated for the purpose, if the normal intake through the Union Public Service Commission's competitive examination does not prove to be adequate. (Paragraph 75.)

191. Steps should also be taken as early as possible to replace unqualified officers by qualified ones. (Paragraph 76.)

192. It is necessary in the interest of public relations, to make the Income-tax Officers learn also the principal language of the region to which they are allotted at a somewhat higher standard than at present. (Paragraph 78.)

193. The lower staff in the Income-tax Department should be given training in elements of income-tax law, organisation and methods of work before being actually appointed to regular work. (Paragraph 79.)

194. There should also be an adequate provision for 'training reserve' in the Income-tax Department at all levels and regular instructors should be appointed in each charge of the Commissioners of Income-tax to train lower ranks for the appointments for which they are meant. (Paragraph 80.)

195. A small committee should be appointed to chalk out in detail the necessary training programmes and the manner in which instructions should be given. (Paragraph 81.)

196. With a view to utilising the existing personnel in the Income-tax Department to their best advantage by re-arrangement of methods of work and by instituting proper training programmes, a small committee should go into the 'organisation and methods' of the Department, if necessary with the help of experts who have

specialised in 'efficiency audit' of large-scale organisations. (Paragraph 83.)

197. The statistical side of the Central Board of Revenue should be over-hauled and improved and an expert committee should be appointed to make detailed recommendations in this regard. (Paragraph 87.)

CHAPTER XIV.—ESTATE DUTY

198. The exemption limit may be left for the present at Rs. one lakh. However, the feasibility of reducing this limit should be kept in mind by Government and all possible efforts should be made to increase the staff, in number as well as in quality, to the required level as early as practicable. (Paragraphs 12—14.)

199. It is not necessary at this stage to use estate duty as an instrument for the purpose of affording incentives to risk capital. (Paragraph 15.)

200. In view of the recommendation made in Chapter II regarding the deletion from the law of the test for determining the 'residence' of companies based on their income arising in India, the criterion used for the charge under Section 84(1) of the Estate Duty Act should be reviewed. (Paragraph 19.)

201. The introduction of a gifts tax in India at this stage is not favoured. (Paragraph 21.)

202. As the Estate Duty Act is a highly technical and complicated piece of legislation, there seem to be considerable advantages in retaining the appellate powers with the Central Board of Revenue for the time being. (Paragraph 22.)

203. As more experience is gained in the working of the Estate Duty Act, the rates of estate duty should be reviewed for the purpose of increasing them. (Paragraph 29.)

204. The period before death during which gifts *inter vivos* become liable to estate duty should be increased from two years as prescribed at present to five years. (Paragraph 29.)

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Central Commodity Taxes

CHAPTER I.—CENTRAL COMMODITY TAXES—A HISTORICAL REVIEW

205. Central Excise duties have been imposed only at moderate levels when domestic production has replaced imports and there is scope for utilisation of excise duties to maintain revenue from commodity taxation. (Paragraphs 45—46.)

CHAPTER II.—IMPORT DUTIES

206. An analysis of the current structure of import duties reveals that the possibilities of increasing the import duty revenue through increase in rates are negligible. (Paragraphs 2—6.)

207. If the case for enhancement of excise duty on kerosene recommended elsewhere is accepted, a corresponding adjustment of the rate of import duty would be necessary. (Paragraph 5.)

208. The possibility of modifications in the import control system with a view to securing additional revenue should be kept continuously under survey. The bulk of the import duty revenue is not affected by import controls, but there may be scope for marginal adjustments. The Government of India have in the recent past liberalised the import of certain commodities simultaneously with the enhancement of the duties thereon and the possibility of further progress in this direction may be explored. (Paragraph 29.)

209. In regard to international commercial agreements, due importance should be attached to the revenue aspect when the subject is reviewed, the aim being a careful balancing of the commercial factors against the revenue considerations involved. (Paragraphs 36 & 42.)

CHAPTER III.—EXPORT DUTIES

210. There may be increased scope for the levy of export duties for revenue purposes as the exports get diversified. (Paragraph 9.)

211. Export duties may be levied to prevent sudden price rises abroad being reflected in India. (Paragraph 10.)

212. Export duties may be utilised in conjunction with export control for stabilisation of internal prices of essential commodities and for protective purpose. (Paragraphs 15—17.)

213. It is a matter of great importance that there should be proper machinery in the country as well as in overseas trade centres for the prompt and systematic collection of accurate information regarding prices and trade trends and the supplying of the necessary information to the Government of India. The Ministry of Commerce and Industry should have a thorough investigation made of the existing organisation. Such investigation should cover not merely the purely administrative and organisational aspects of the problem but also the scope for extending and strengthening contacts with trade interests in India as well as abroad. (Paragraph 26.)

214. The suggestion that the proceeds of export duties should be put into a special fund for the development of the industry concerned cannot be accepted. The earmarking of tax revenues, except in special cases such as the distribution of part of the proceeds of the export duty on jute to certain States, is open to objection. (Paragraph 27.)

CHAPTER IV.—PROBLEMS OF ASSESSMENT IN CUSTOMS DUTIES

215. Valuation in accordance with clause (a) of section 30 of the Sea Customs Act is more logical and, therefore, preferable to that in accordance with clause (b), and no useful purpose would be served by reversing the order of the clauses as suggested by some witnesses. (Paragraph 6.)

216. In the case of imported goods where the invoice prices lack significance and cannot be accepted for the purpose of valuation, the local selling price of the goods is the only reliable guide and can be used as a starting point to arrive at the assessable cost. This 'deduced value' method is fully in accord with the present provisions of clause (b) of section 30 of the Sea Customs Act. The Central Board of Revenue should issue detailed instructions, which should be made public, as regards the manner in which such 'deduced value' should be arrived at. (Paragraph 9.)

217. Interpretations issued by the Government of India and the Central Board of Revenue of the rules regarding valuation should be made accessible to the trade, so that importers are aware of their commitments at the time of ordering goods. (Paragraph 10.)

218. The present procedure for determination of tariff values ensures that the values fixed for a particular year approximate as closely as possible to the price trends likely to prevail during that year. It is not necessary to change this procedure in favour of one requiring such values to be fixed purely on the basis of prices prevailing in the past two or three years. (Paragraph 12.)

219. It is desirable to eliminate alternative and complex rates of duty except where specifically recommended by the Tariff Commission. (Paragraph 17.)

220. Where import duty on a raw material is higher than that on the finished article in the manufacture of which it is used and remedies such as an appeal to the Tariff Commission or facilities for manufacture in bond are not adequate, tariff rates should be appropriately revised. (Paragraph 19.)

221. It is important to provide for adequate facilities to be granted to the re-export trade for obtaining drawback of import duty paid on imported raw materials used in the manufacture of goods for export. The provisions of the Sea Customs (Amendment) Act, 1953, which regulates the grant of such drawbacks, should be promptly implemented. (Paragraph 20.)

222. Tariff classification should be periodically reviewed so that the Indian Customs Tariff conforms to the changing patterns of trade. (Paragraph 21.)

223. In regard to interpretation of the Import Trade Control Schedule, difficulties regarding classification, it is understood, no

longer cause inconvenience. It is, therefore, not necessary to undertake a major reclassification of the Schedule with a view to correlating it with the Indian Customs Tariff Schedule. (Paragraph 22.)

CHAPTER V.—EXCISE DUTY ON TOBACCO

224. The present tariff based on capability of use for biri manufacture has greater chance of being applied objectively than the former criterion of 'intended use'. The only alternative is a flat rate which is not acceptable on the ground that it would disturb the present position under which the duty as a percentage of value is almost equal for biri and non-biri tobacco. The burden on non-biri tobacco would be increased and that on biri tobacco diminished. A low flat rate with a further duty on biris has also to be ruled out on the ground of administrative difficulty. The present tariff for unmanufactured tobacco should therefore continue, but the classification of varieties of tobacco made for the purpose of assessment should be reviewed by an Expert Committee which should include a marketing expert in tobacco and a representative of the trade. (Paragraphs 28—31.)

225. The present tariff for flue-cured tobacco used for cigarettes may continue as this is necessary in order to retain progression and to avoid a squeeze on indigenous tobacco by the increased use of imported varieties. (Paragraph 35.)

226. The exact degree of competition between biris and cigarettes is not known, but in view of the vast number of persons employed in the biri industry no attempt should be made to reduce the margin of duty between biris and cigarettes. (Paragraph 36.)

227. No change in the taxation of cigarettes is recommended except the abolition of surcharge on cigarettes of the value category of Rs. 10—15 per 1000 and replacement of the resultant revenue loss by an increased rate on cigarettes of the value category of Rs. 40—50. The surcharges may be amalgamated with the duty. (Paragraphs 37—39.)

228. The change in production, prices and market conditions is not sufficiently clear to justify a reduction in the normal rates of duty on unmanufactured tobacco. (Paragraph 40.)

CHAPTER VI.—SCOPE FOR EXTENSION OF CENTRAL EXCISE DUTIES

229. There is no case for reduction in the rate of duty on coffee. (Paragraph 3.)

230. There is no case at present for a reduction in the rate of duty on motor spirit. (Paragraph 6.)

231. There is justification for an increase in the rate of duty on kerosene. (Paragraph 10.)

232. There is a case for enhancement of the rate of duty on sugar. (Paragraph 14.)

233. The appropriate preferential rates for small-scale match factories should be determined on the basis of enquiry into the cost of production. (Paragraph 23.)

234. There is scope for an increase in the duty on matches. The precise measure of increase should be determined on a careful investigation of actual retail prices, profit margins and sales taxation in various States to ensure that the increase in duty fits the currency unit and does not inflate middlemen's profits. (Paragraph 25.)

235. The present rate of duty on mechanical lighters is prohibitive. Relief in excise duty by reducing it to Re. 0-8-0 or Re. 0-12-0 is recommended. As the industry develops, its effect on the revenue from matches should be kept under review. (Paragraph 29.)

236. No increase in the rate of duty on steel ingots is recommended in view of the existing price pooling arrangements. (Paragraph 33.)

237. No change in the rate of duty on tyres is suggested. (Paragraph 35.)

238. There is no case for any reduction or increase in the rate of duty on vegetable product. If vegetable oil is taxed, exemption of oil used for the manufacture of vegetable product is not recommended because it is desirable to maintain the existing differential between oil and vegetable product. (Paragraph 38.)

239. There is scope for an increase in the rate of duty on loose and package tea. (Paragraph 43.)

240. There is a case for a moderate enhancement of the rates of duty on all varieties of cloth. (Paragraph 55.)

241. The possibility of formulating a tariff on the basis of varieties of cloth such as dhoties, long cloth, etc. in addition to the present tariff classes based on warp counts may be considered. (Paragraph 56.)

242. The levy of the additional excise duty on dhoties at a uniform rate irrespective of variety operates to the disadvantage of the cheaper varieties. The possibility of graduating the levy should be considered. (Paragraph 57.)

243. It is too early to assess the effect of the recently imposed duties on art silk, cement, soap and footwear and no change is therefore recommended. (Paragraph 63.)

244. The tax system may be used for the special encouragement of small-scale and cottage industries, but in a judicious manner. A periodic review of the working of the concession is suggested so that the policy in this respect may keep in step with the changing needs of the economy. (Paragraph 67.)

245. The suitability of the articles suggested for the levy of excise duties and the exact rates of duty to be applied to each should be decided after a detailed examination of the facts regarding the industry concerned. (Paragraph 69.)

246. A moderate duty on sewing machines appears feasible. (Paragraph 70.)

247. Imposition of a low rate of duty on vegetable oil with exemption of *ghanis* will be justifiable. (Paragraph 71.)

248. Imposition of a moderate duty on woollen textiles with exemption of coarse rugs and other articles used by the poorer classes will be justifiable. (Paragraph 72.)

249. Imposition of a moderate duty on biscuits appears appropriate. (Paragraph 73.)

250. Imposition of a moderate duty on paper with exemption of hand-made paper will be justifiable. (Paragraph 74.)

251. Imposition of a moderate duty on dry and storage batteries is feasible. (Paragraph 75.)

252. There is a case for imposition of a moderate duty on electric lamps. (Paragraph 76.)

253. Aerated water is a suitable article for taxation. A small duty may be levied at graduated rates with exemption for small units. (Paragraph 77.)

254. There is a case for the imposition of a moderate duty on electric fans. (Paragraph 78.)

255. Imposition of a fairly substantial duty on glass and glassware will be justifiable. (Paragraph 79.)

256. Imposition of a moderate duty on paints and varnishes is recommended. (Paragraph 80.)

257. There is a case for the imposition of a substantial duty on ceramics. (Paragraph 81.)

Chapter VII.—Administrative problems in regard to Customs and Central Excise duties

258. The present appellate powers of the Central Board of Revenue should be left as they are, but revision petitions against the orders of the Central Board of Revenue or of the Collectors of Customs should be disposed of by a Tribunal which should be independent of the Ministry of Finance and should consist of at least one judicial member who should be either a serving or a retired High Court Judge, and one member who has had experience of Customs administration. (Paragraphs 4—7.)

259. Provision should be made under the Sea Customs Act for review of orders passed by officers of Customs. (Paragraph 8.)

260. Where clearance of goods is held up on account of *bona fide* differences of opinion in regard to appraisement, the goods may, at the discretion of the Collector of Customs, be allowed to be cleared on execution of a bond to cover the disputed amount of duty. (Paragraph 9.)

261. The Sea Customs Act should be amended to make suitable provision for assessment of import duty on a provisional basis under certain circumstances. (Paragraph 10.)

262. Stringent measures, both legal and administrative, should be adopted with a view to minimising the scope of smuggling. The Sea Customs Act should be suitably amended for the purpose. (Paragraph 11.)

263. There should be no bar to the information in the hands of the Customs or Central Excise officers relating to any goods being utilised in legal proceedings against the owner of the goods or in the institution of necessary enquiries in connection with his liability to other taxes. A suitable provision, similar to section 54 of the Income-tax Act should, therefore, be introduced in the Sea Customs Act and the Central Excise Rules. (Paragraph 12.)

264. The procedure recommended for disposal of customs revision applications should apply to Central Excise cases also. A common Tribunal could deal with both Customs and Central Excise cases. (Paragraph 13.)

265. The system of physical supervision under Central Excise and the rule regarding residential accommodation for excise staff on payment of rent should continue. (Paragraphs 17—19.)

266. As a measure of relief for small units, the manufacturers of matches should be given the option of executing a bond with surety instead of a bond with security being insisted on. (Paragraph 22.)

267. A system of deferred payment of excise duty should be introduced for the benefit of cottage match factories. (Paragraph 25.)

268. The present system of permitting growers to retain their crop up to the 30th June of the year following that in which it was harvested should be continued. (Paragraph 31.)

269. A simplified procedure should be evolved for warehouses and account should be taken of the losses. (Paragraph 32.)

270. No radical simplification of the system of transport control is recommended. (Paragraph 35.)

STATISTICAL APPENDICES

STATEMENTS RELATING TO TAXES ON INCOME

INCOME-TAX

STATISTICAL APPENDIX A

STATEMENT I

Analysis of Central Tax Revenue

(In lakhs of Rupees)

Year	Total tax revenue of Government of India	Corporation tax	Taxes on Income other than corporation tax	Total taxes on income
1	2	3	4	5
1920-21 . . .	60,85	..	22,19	22,19
1921-22 . . .	66,92	..	25,12	25,12
1922-23 . . .	72,61	..	22,58	22,58
1923-24 . . .	71,21	..	20,28	20,28
1924-25 . . .	74,17	..	17,20	17,20
1925-26 . . .	72,86	..	17,67	17,67
1926-27 . . .	72,58	..	17,54	17,54
1927-28 . . .	72,78	..	16,92	16,92
1928-29 . . .	76,58	..	18,76	18,76
1929-30 . . .	77,77	..	18,92	18,92
1930-31 . . .	72,60	..	17,85	17,85
1931-32 . . .	75,62	..	19,12	19,12
1932-33 . . .	83,36	..	19,66	19,66
1933-34 . . .	76,65	..	19,04	19,04
1934-35 . . .	82,32	..	19,90	19,90
1935-36 . . .	84,09	..	19,45	19,45
1936-37 . . .	82,36	..	17,77	17,77
1937-38 . . .	82,41	2,14	16,44	18,58
1938-39 . . .	81,87	2,50	17,73	20,23
1939-40 . . .	90,27	2,70	19,10	21,80
1940-41 . . .	86,77	4,28	23,44	27,72
1941-42 . . .	1,12,11	11,95	34,71	46,66
1942-43 . . .	1,51,66	33,98	58,62	92,60
1943-44 . . .	2,29,23	58,23	85,49	1,43,72
1944-45 . . .	3,57,90	93,68	1,17,04	2,10,72

STATISTICAL APPENDIX A—*contd.*

STATEMENT I—*contd.*

(In lakhs of Rupees)

Year	Total tax revenue of Government of India	Corporation tax	Taxes on income other than corporation tax	Total taxes on income
1	2	3	4	5
1945-46 . . .	3,87,27	95,18	1,05,97	2,01,15
1946-47 . . .	3,44,85	77,21	1,15,01	1,92,22
1947-48 . . .	3,32,19	46,37	1,06,24	1,52,61
1948-49 . . .	3,85,18	68,18	1,34,92	2,03,10
1949-50 . . .	3,89,01	51,51	1,39,22	1,90,73
1950-51 . . .	4,44,91	52,66	1,59,32	2,11,98
1951-52 . . .	5,12,30	41,41	1,46,19	1,87,60
1952-53 . . .	4,48,59	43,80	1,41,43	1,85,23
1953-54 . . .	4,20,33	38,40	1,26,60	1,65,00

Source : (1) Statistical Abstract up to 1950-51.
(2) Figures for and from 1951-52 are from Budget memoranda.

NOTE.—(1) The figures in all columns relate to gross revenue.

(2) The figures in columns 3, 4 and 5 from 1951-52 to 1953-54 relate to net figure, *i.e.*, excluding refunds but including States' share.

(3) The figures of total revenue shown in column 2 from 1951-52 onwards include net revenue in respect of corporation tax and income-tax and not gross revenue as in the previous years.

STATISTICAL

STATEMENT

Tax payable as percentage of Income in selected income

Total income	1938-39	1939-40	1940-41	1941-42	1942-43	1943-44	1944-45	1945-46		1946-47	
								On wholly earned income	On wholly unearned income	On wholly earned income	On wholly unearned income
2,500 .	3·4	1·9	2·0	2·5	3·1	3·1	3·1	2·4	3·1	1·2	2·5
3,000 .	3·4	2·3	2·5	3·1	3·9	3·9	3·9	3·1	3·9	1·9	3·1
3,600 .	3·4	2·7	3·0	3·6	4·6	4·6	4·6	3·8	4·6	2·4	3·6
5,000 .	3·4	3·3	3·6	4·4	5·5	5·5	5·5	6·7	5·5	3·1	4·4
7,200 .	5·1	4·7	5·1	6·2	7·6	7·8	7·8	7·2	7·8	4·4	6·9
10,000 .	5·1	5·6	6·0	7·4	9·0	9·2	9·2	8·0	9·2	5·9	8·4
15,000 .	6·8	7·9	8·5	10·5	12·6	13·1	13·5	11·3	13·5	8·5	12·9
25,000 .	10·7	11·0	11·9	14·6	16·9	18·3	19·3	19·1	19·9	15·3	10·3
40,000 .	14·2	15·8	17·1	21·1	24·4	27·0	28·0	28·4	29·9	26·7	32·2
50,000 .	16·1	18·3	19·8	24·4	27·7	31·2	33·7	33·6	34·8	32·0	37·6
70,000 .	18·0	22·5	24·3	29·9	33·8	38·0	41·3	41·6	42·5	39·8	45·6
1,00,000 .	18·9	26·0	28·2	34·7	39·2	43·8	47·6	48·4	49·0	47·9	53·8
1,50,000 .	20·0	29·8	32·6	39·8	44·9	49·9	54·2	55·2	55·6	56·5	62·5
2,00,000 .	24·4	32·5	35·3	43·4	48·9	54·0	58·6	59·7	60·0	62·7	68·8
3,00,000 .	25·6	37·3	40·4	49·8	56·0	61·4	65·1	66·4	66·6	71·5	76·6
4,00,000 .	28·8	40·5	43·9	54·0	60·8	65·8	69·1	70·5	70·6	76·7	81·3
5,00,000 .	32·0	43·0	46·6	57·4	64·5	69·1	72·2	73·6	73·7	80·1	84·4

1. The Statement covers income-tax, super-tax, and surcharge on income-tax and
2. The Statement applies to individuals, Hindu undivided families, unregistered firms

APPENDIX A—*contd.*

II

groups during the years 1938-39 *to* 1951-52

1947-48		1948-49		1949-50		1950-51		1951-52	
On wholly earned income	On wholly un-earned income	On wholly earned income	On wholly un-earned income	On wholly earned income	On wholly un-earned income	On wholly earned income	On wholly un-earned income	On wholly earned income	On wholly un-earned income
..	..	..	..	..	..	..	..	..	..
1·9	3·1	..	..	..	..	..	..	..	..
2·4	3·6	2·4	3·6	1·8	2·7	..	..	..	..
3·1	4·4	3·1	4·4	2·3	3·3	2·3	3·3	2·3	3·3
4·4	6·9	4·4	6·9	3·4	5·6	3·4	5·6	3·4	5·6
5·9	8·4	5·9	8·4	4·9	7·1	4·9	7·1	5·2	7·1
8·5	12·9	8·5	12·9	7·7	12·0	7·2	11·0	7·6	11·5
15·3	20·3	15·3	20·3	14·7	19·7	12·6	16·6	13·2	17·4
27·1	32·6	25·9	31·4	25·6	31·1	24·3	26·8	25·5	28·1
32·3	37·9	30·8	37·0	30·5	36·7	29·4	31·4	30·9	33·0
40·9	46·7	38·9	45·4	38·7	45·2	38·0	39·4	39·9	41·4
51·5	57·4	48·3	55·2	48·2	55·1	47·7	48·7	50·1	51·1
64·5	69·9	57·2	66·0	57·1	65·9	56·8	57·5	59·6	60·3
72·6	76·7	65·5	72·1	63·2	72·1	62·1	62·6	65·2	65·7
80·7	83·4	74·4	78·8	69·7	78·8	67·4	67·8	70·8	71·2
84·7	86·8	79·7	82·9	73·8	82·5	70·1	70·3	73·6	73·9
87·2	88·8	83·1	85·7	76·5	84·8	71·7	71·9	75·3	75·5

super-tax.
and other associations of persons.

STATISTICAL

STATEMENT

Number of Assessments, Total Income Assessed and Income-tax of Assessees during the Years 1940-41

1940-

Grade of total Income	Individuals: No. of assess-ments	Individuals: Total income assessed Rs.	Individuals: Income-tax including tax deducted at source Rs.	Hindu undivided families: No. of assess-ments	Hindu undivided families: Total income assessed Rs.	Hindu undivided families: Income-tax etc. Rs.
0— 5,000 .	190,450	41,36,73	91,78	52,617	12,72,20	26,09
5,001— 10,000 .	46,378	25,81,49	1,20,34	11,669	7,60,74	33,25
10,001— 25,000 .	25,262	29,12,75	2,39,94	5,188	7,36,94	60,15
25,001— 50,000 .	5,051	12,34,18	1,50,49	1,035	3,31,00	40,35
50,001—1,00,000 .	1,050	5,39,21	74,88	264	1,87,66	26,16
1,00,001—2,00,000 .	286	3,32,09	48,63	68	89,76	13,20
2,00,001 and over .	120	4,66,00	69,98	31	78,91	11,91
TOTAL .	268,597 (*73·9*)	122,02,45 (*56·5*)	7,96,04 (*43·5*)	70,872 (*19·5*)	34,57,21 (*16·0*)	2,11,11 (*11·6*)

1943-

Grade of total Income	Individuals: No. of assess-ments	Individuals: Total income assessed Rs.	Individuals: Income-tax etc. Rs.	Hindu undivided families: No. of assess-ments	Hindu undivided families: Total income assessed Rs.	Hindu undivided families: Income-tax etc. Rs.
0— 5,000 .	1,83,468	50,64,82	1,21,48	52,848	14,16,39	34,20
5,001— 10,000 .	53,540	37,28,45	1,73,07	16,982	11,60,42	55,23
10,001— 25,000 .	32,351	49,21,24	4,13,96	11,893	18,07,04	1,52,07
25,001— 50,000 .	7,829	26,28,12	3,16,90	3,232	10,81,30	1,33,35
50,001—1,00,000 .	1,731	11,58,25	1,61,20	888	5,84,09	81,13
1,00,001—2,00,000 .	540	7,29,80	1,07,61	174	2,31,30	34,14
2,00,001 and over .	234	9,89,22	1,48,72	53	1,67,62	25,58
TOTAL .	2,79,693 (*71·9*)	1,92,19,90 (*47·3*)	14,42,94 (*34·4*)	86,070 (*22·1*)	64,48,16 (*15·9*)	5,15,70 (*12·3*

APPENDIX A—*contd.*

III

Demanded According to Selected Grades of Income and Classes

943-44, 1946-47, 1948-49 *and* 1951-52

(Rupees in thousands)

41

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.
	Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
15,096	3,23,16	6,62	2,130	39,49	5,36	2,60,293	57,71,58	1,29,85
2,819	1,92,65	9,10	498	39,51	5,94	61,364	35,74,39	1,68,63
1,276	1,87,39	15,49	609	1,05,36	16,59	32,335	39,42,44	3,32,17
244	82,82	10,21	404	1,49,26	23,23	6,734	17,97,26	2,24,28
83	58,06	7,92	282	2,10,75	32,88	1,679	9,95,68	1,41,84
37	47,77	7,08	211	3,08,61	47,82	602	7,78,23	1,16,73
39	2,03,40	29,37	335	38,86,18	6,06,34	525	46,34,49	7,17,60
19,594 (*5·4*)	10,95,25 (*5·1*)	85,79 (*4·6*)	4,469 (*1·2*)	47,39,16 (*22·4*)	7,38,16 (*40·3*)	3,63,532	214,94,07	18,31,10

(Rupees in thousands)

44

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.
	Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
11,102	3,01,78	7,78	1,800	35,53	5,39	2,49,218	68,18,52	1,68,85
3,416	2,38,80	11,34	593	47,07	6,90	74,531	51,74,74	2,46,54
2,061	3,14,48	27,50	850	1,48,27	23,04	47,155	71,91,03	6,16,57
538	1,80,46	22,28	863	3,30,49	51,50	12,462	42,20,37	5,24,03
160	1,13,44	16,06	638	4,86,42	75,93	3,417	23,42,20	3,34,32
42	57,85	8,67	366	5,37,01	83,88	1,122	15,55,96	2,34,30
30	2,98,80	45,89	852	1,18,64,98	18,51,99	1,169	1,33,17,62	20,72,18
17,349 (*4·5*)	15,02,61 (*3·7*)	1,39,52 (*3·3*)	5,962 (*1·5*)	1,34,49,77 (*33·1*)	20,98,63 (*50·0*)	3,89,074	4,06,20,44	41,96,79

STATISTICAL

STATEMENT

	1946-						
	Individuals			Hindu undivided families			Unregis- associa-
Grade of total Income	No. of assess- ments	Total income assessed	Income- tax etc.	No. of assess- ments	Total income assessed	Income- tax etc.	No. of assess- ments
		Rs.	Rs.		Rs.	Rs.	
0— 5,000	2,17,054	63,78,99	1,63,03	40,978	12,31,12	36,25	8,348
5001— 10,000	81,229	57,32,32	2,91,60	16,011	11,24,99	67,15	3,102
10,001— 25,000	44,865	67,02,40	6,26,72	9,752	14,64,53	1,66,00	1,804
25,001— 50,000	9,800	32,70,68	4,69,93	2,547	8,69,06	1,45,65	535
50,001—1,00,000	2,327	16,09,02	2,68,12	818	5,45,94	96,89	175
1,00,001—2,00,000	830	11,29,71	1,94,55	203	2,73,02	45,79	72
2,00,001 and above	377	15,58,44	2,78,98	68	2,42,22	40,67	38
TOTAL .	3,56,482 (*79·7*)	263,81,56 (*54·6*)	22,92,93 (*33·2*)	70,377 (*15·7*)	57,50,88 (*11·9*)	5,98,40 (*8·7*)	14,074 (*3·1*)

	1948-						
	Individuals			Hindu undivided families			Unregis- associa-
Grade of total Income	No. of assess- ments	Total income assessed	Income- tax etc.	No. of assess- ments	Total income assessed	Income- tax etc.	No. of assess- ments
		Rs.	Rs.		Rs.	Rs.	
0— 5,000	2,21,764	68,89,02	2,13,29	32,761	10,81,56	36,54	6,597
5,001— 10,000	92,525	65,49,51	3,93,13	16,972	11,93,07	78,25	3,266
10,001— 25,000	52,095	77,60,95	9,44,21	10,612	16,08,48	2,10,74	1,887
25,001— 50,000	11,627	39,23,99	7,60,27	2,947	10,00,51	1,98,25	652
50,001—1,00,000	3,635	24,69,30	5,32,41	977	6,54,89	1,40,76	310
1,00,001—2,00,000	1,204	16,42,84	3,51,19	321	4,34,19	90,51	83
2,00,001 and over	590	24,58,43	5,23,03	173	7,35,63	1,42,65	81
TOTAL .	3,83,440 (*81·8*)	316,94,04 (*55·5*)	37,17,53 (*38·8*)	64,763 (*13·9*)	67,08,33 (*11·7*)	8,97,70 (*9·3*)	12,876 (*2·7*)

APPENDIX A—*contd.*
III—*contd.*

(Rupees in thousands)

47

tered firms and other tions of persons		Companies and other concerns assessable at company rate			Total		
Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.
Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
2,50,83	7,88	1,761	37,08	9,34	2,68,141	78,98,02	2,16,50
2,16,23	13,02	648	51,50	12,88	1,00,990	71,25,04	3,84,65
2,71,61	30,97	1,058	1,86,28	48,64	57,479	86,24,82	8,72,33
1,82,46	29,34	993	3,76,72	99,23	13,875	46,98,92	7,44,15
1,21,53	22,12	704	5,03,85	1,30,66	4,024	27,80,34	5,17,79
94,62	18,13	428	6,29,36	1,65,17	1,533	21,26,71	4,23,64
2,40,92	29,18	969	130,53,33	34,03,06	1,452	150,94,91	37,51,89
13,7[illegible],20 (*2·9*)	150,64 (*2·2*)	6,561 (*1·5*)	1,48,38,12 (*30·6*)	38,68,98 (*55·9*)	4,47,494	483,48,76	69,10,95

(Rupees in thousands)

49

tered firms and other tions of persons		Companies and other concerns assessable at company rate			Total		
Total income assessed	Income-tax etc.	No. of assess-ments	Total income assessed.	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax etc.
Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
2,12,89	8,46	2,191	44,28	10,02	2,63,313	82,27,75	2,68,31
2,32,88	15,95	871	67,64	15,57	1,13,634	80,43,10	5,02,90
2,90,54	38,35	1,222	2,06,08	45,19	65,816	98,66,05	12,38,49
2,30,64	45,20	857	3,12,56	83,24	16,083	54,67,70	10,86,96
2,17,41	46,10	721	5,19,26	1,48,99	5,643	38,60,86	8,68,26
1,18,36	24,07	525	7,50,63	2,17,28	2,133	29,45,02	6,83,05
4,87,19	1,26,56	1,113	1,50,46,17	41,84,62	1,957	1,87,27,42	49,76,86
17,89,91 (*3·1*)	3,04,69 (*3·2*)	7,500 (*1·6*)	1,69,46,62 (*29·7*)	47,04,91 (*48·9*)	4,68,579	5,71,37,90	96,24,83

STATISTICAL

STATEMENT

Grade of total Income	1951- Individuals No. of assess-ments	Total income assessed Rs.	Income-tax etc. Rs.	Hindu undivided families No. of assess-ments	Total income assessed Rs.	Income-tax etc. Rs.	Unregis- associa- No. of assess-ments
0— 5,000	2,56,579	94,27,11	2,39,39	12,820	4,71,93	13,56	10,696
5,001— 10,000	1,87,191	1,28,76,53	6,24,72	30,873	22,02,27	1,10,70	7,458
10,001— 25,000	79,674	1,16,58,21	13,03,85	16,848	25,12,63	2,91,31	3,595
25,001— 50,000	17,025	57,43,04	11,26,83	3,734	12,61,26	2,44,91	924
50,001—1,00,000	5,062	34,03,54	8,00,61	1,043	6,95,34	1,62,66	331
1,00,001—2,00,000	1,417	18,84,23	4,92,80	304	4,09,04	1,04,64	151
2,00,001 and above	591	25,55,88	7,09,33	128	4,73,96	1,29,60	171
TOTAL	5,47,539	4,75,48,54	52,97,53	65,750	80,26,43	10,57,38	23,326
	(84·6)	*(60·7)*	*(45·4)*	*(10·2)*	*(10·3)*	*(9·1)*	*(3·6)*

SOURCE.—All India Statement No. 5 appearing in All India Income-tax Revenue

NOTE.—(1) The figures for total income are shown after deduction of earned income

(2) The figures of total demand of income-tax are gross amounts without taking

(3) Changes made due to revisions, appeals etc. also are not included in the

(4) The figures of total tax demanded do not include surcharge and tax paid

(5) Figures in brackets indicate percentages to total.

APPENDIX A—*contd.*

III—*contd.*

(Rupees in thousands)

52

tered firms and other tions of persons		Companies and other concerns assessable at company rate			Total		
Total income assessed	Income-tax etc.	No. of assess-ments	Total income-assessed	Income-tax etc.	No. of assess-ments	Total income assessed	Income-tax, etc
Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
3,85,37	11,87	3,505	64,18	16,40	2,83,600	1,03,48,59	2,81,22
5,21,04	29,91	1,300	97,02	24,41	2,26,822	1,56,96,86	7,89,74
5,38,96	65,46	1,741	2,88,95	73,69	1,01,858	1,49,98,75	17,34,31
3,13,01	61,37	1,182	4,27,02	1,10,27	22,865	77,44,33	15,43,38
2,29,30	53,40	1,058	7,61,12	1,99,88	7,494	50,89,30	12,16,55
2,04,55	50,22	742	10,17,14	2,70,12	2,614	35,14,96	9,17,78
5,23,27	1,38,53	1,233	1,73,43,65	42,15,03	2,123	2,08,96,76	51,92,49
27,15,50	4,10,76	10,761	1,99,99,08	49,09,80	6,47,376	7,82,89,55	1,16,75,47
(3·5)	*(3·5)*	*(1·6)*	*(25·5)*	*(42·0)*			

Statistics.

relief, B.P.T. & E.P.T. where applicable.
into consideration rebates and refunds.
income and demand figures.
under Sections 18A and 23B of the Income-tax Act.

STATISTICAL

STATEMENT

Number of Assessments, Total Income Assessed
Grades of Income and Classes
1946-47, 1948-49

1940-

Grade of Total Income	Individuals: No. of assess-ments	Individuals: Total income assessed Rs.	Individuals: Super-tax includ-ing tax deduct-ed at source Rs.	Hindu undivided families: No. of assess-ments	Hindu undivided families: Total income assessd Rs.	Hindu undivided families: Super-tax etc. Rs.
0 — 25,000	354	32,38	1,50	30	6,10	35
25,001 — 55,000	5,112	12,81,52	29,02	994	3,46,90	7,92
55,001 — 1,00,000	841	4,55,50	37,90	207	1,44,28	13,30
1,00,001 — 2,00,000	276	3,20,21	43,55	78	91,76	12,26
2,00,001 — 3,00,000	57	1,13,14	19,40	13	31,68	5,53
3,00,001 — 4,00,000	27	81,80	16,25	8	24,24	5,07
4,00,001 — 5,00,000	10	30,79	6,54	3	12,60	2,65
5,00,001 and over	21	2,12,78	60,23	1	5,79	4
TOTAL	6,698 (*54·8*)	25,28,12 (*30·3*)	2,14·39 ((*34·3*)	1,334 (*10·8*)	6,63·35 (*7·9*)	47,12 (*7·5*)

1943-

Grade of Total Income	Individuals: No. of assess-ments	Individuals: Total income assessed Rs.	Individuals: Super-tax etc. Rs.	Hindu undivided families: No. of assess-ments	Hindu undivided families: Total income assessed Rs.	Hindu undivided families: Super-tax etc. Rs.
0 — 25,000	858	85,59	3,93	49	6,21	31
25,001 — 55,000	7,891	26,81,05	65,96	3,402	11,15,02	29·35
55,001 — 1,00,000	1,373	9,49,16	85,27	653	4,65,24	39,82
1,00,001 — 2,00,000	530	7,58,44	1,05,11	164	2,31,59	32,23
2,00,001 — 3,00,000	130	2,77,90	55,77	33	79,53	15,23
3,00,001 — 4,00,000	43	1,50,97	34,26	13	40,84	9,38
4,00,001 — 5,00,000	27	1,23,37	33,23	2	8,72	2,37
5,00,001 and over	46	4,03,93	1,26,13	5	38,98	13,01
TOTAL	10,898 (*50·0*)	54·30,41 (*25·3*)	5·09,66 (*22·6*)	4·321 (*19.7*)	19·86,13 (*9·2*)	1,41,70 (*6·2*)

APPENDIX A—*contd.*

IV

and Super-tax Demand According to Selected of Assessees During the Years 1940-41, 1943-44 *and* 1951-52

(Rupees in thousands)

41

Unregistered firms and other associations of pesons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed	Super-tax etc.	No. of assess-ments	Total income assessed	Super-tax etc.	No. of assess-ments	Total income assessed	Super-tax etc.
	Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
43	2,60	30	2,641	1,71,42	10,73	3,068	2,12,50	12,88
233	84,79	2,86	438	1,74,05	10,66	6,777	18,87,26	50,46
58	42,49	3,33	225	1,87,69	11,59	1,331	8,29,96	66,12
33	43,70	5,79	202	3,06,73	18,98	589	7,62,40	80,58
13	32,10	4,75	82	2,10,90	12,98	165	3,87,82	42,66
7	23,13	3,85	47	1,91,58	11,94	89	3,20,75	37,11
6	22,53	4,84	40	1,76,63	11,02	59	2,42,55	25,05
9	1,17,27	41,17	154	33,51,77	2,09,55	185	36,87,61	3,10,99
402	3,68,61	66,89	3,829	47,70,77	2,97,45	12,263	83,30,85	6,25,85
(3·3)	*(4·4)*	*(10·7)*	*(31·3)*	*(57·4)*	*(47·5)*			

44

(Rupees in thousands)

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed	Super-tax etc.	No. of assess-ments	Total income assessed	Super-tax etc.	No. of assess-ments	Total income assessed	Super-tax etc.
	Rs.	Rs.		Rs.	Rs.		Rs.	Rs.
51	3,77	49	3,056	2,24,12	25,13	4,014	3,19,69	29,86
556	1,92,78	5,40	945	3,90,20	43,69	12,794	43,79,05	1,44,40
129	98,91	8,06	550	4,30,69	49,09	2,705	19,44,00	1,82,24
47	53,48	7,77	382	5,30,10	59,01	1,139	15,73,61	2,04,12
10	23,89	4,72	187	4,48,56	50,36	344	8,29,88	1,26,08
6	19,62	4,73	119	4,18,23	46,10	181	6,29,66	94,47
3	13,42	3,55	102	4,56,83	51,40	134	6,02,34	90,55
9	2,34,02	53,84	473	104,95,58	12,00,90	533	111,72,51	13,93,88
811	6,39,89	88,56	5,814	133,94,31	15,25,68	21,844	214,50,74	22,65,60
(3·7)	*(3·0)*	*(3·9)*	*(26·6)*	*(62·5)*	*(67·3)*			

STATISTICAL

STATEMENT

	1946-					
	Individuals			Hindu undivided families		
Grade of total Income	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.
0— 25,000 . .	887	94,08	5,11	69	14,25	1,73
25,001 — 55,000 . .	11,430	39,19,47	1,19,43	3,186	11,27,75	39,12
55,001 — 1,00,000 . .	1,921	14,07,61	1,60,94	678	4,85,38	52,68
1,00,001 — 2,00,000 . .	857	11,61,31	2,02,28	207	2,80,67	45,02
2,00,001 — 3,00,000 . .	163	3,81,55	92,78	34	82,07	20,26
3,00,001 — 4,00,000 . .	98	3,26,66	92,78	17	55,15	12,40
4,00,001 — 5,00,000 . .	44	1,96,58	66,70	7	31,36	6,93
5,00,001 and over . .	78	6,63,86	2,49,50	9	72,35	22,38
TOTAL . .	15,478 (*56·7*)	81,51,12 (*31·9*)	9,89,52 (*38·2*)	4,207 (*15·4*)	21,48,98 (*8·4*)	2,00,52 (*7·9*)

	1948-					
	Individuals			Hindu undivided families		
Grade of total Income	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.
0— 25,000 . .	969	1,07,57	10,72	84	15,22	1,12
25,001— 55,000 . .	14,828	51,71,24	2,14,85	3,893	13,73,21	55,76
55,001— 1,00,000 . .	3,064	22,01,50	2,99,42	841	5,98,08	79,06
1,00,001— 2,00,000 . .	1,254	17,09,96	3,84,85	324	4,46,31	95,00
2,00,001— 3,00,000 . .	282	6,95,52	2,06,23	60	1,43,83	41,46
3,00,001— 4,00,000 . .	144	4,95,10	1,58,20	33	1,13,63	38,85
4,00,001— 5,00,000 . .	50	2,26,04	87,08	30	1,37,86	44,40
5,00,001 and over . .	110	10,18,35	4,57,62	44	3,46,13	1,21,35
TOTAL . .	20,701 (*59·7*)	116,25,28 (*35·6*)	18,18,97 (*38·2*)	5,309 (*15·3*)	31,74,27 (*9·7*)	4,77,60 (*10·0*)

APPENDIX A—*contd.*

IV—*contd.*

(Rupees in thousands)

47

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed Rs.	Super-Tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.
75	9,62	1,64	3,346	2,76,40	24,57	4,377	3,94,35	33,05
634	2,25,12	7,82	1,143	4,57,28	42,53	16,393	57,29,62	2,08,90
138	1,03,99	12,38	586	4,53,92	41,33	3,323	24,50,90	2,67,33
70	93,27	15,72	437	6,32,50	55,93	1,571	21,67,75	3,18,95
13	30,83	6,24	230	5,69,77	52,06	440	10,64,22	1,71,34
7	24,96	6,80	121	4,25,16	40,25	243	8,31,93	1,52,23
3	13,06	2,38	83	3,81,12	36,00	137	6,22,12	1,12,01
13	1,19,85	32,35	692	114,46,88	9,73,37	792	123,02,94	12,77,50
953 (3·6)	6,20,70 (2·4)	85,33 (3·4)	6,638 (24·3)	146,43,03 (57·3)	12,66,04 (49·8)	27,276	255,63,83	25,41,41

(Rupees in thousands)

49

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.
94	8,77	1,22	4,155	3,11,53	40,30	5,302	4,43,09	53,36
789	2,87,46	13,60	979	3,80,99	47,86	20,489	72,12,90	3,32,07
264	1,95,18	27,03	610	4,62,99	58,43	4,779	34,57,75	4,63,94
86	1,22,91	25,62	512	7,33,48	91,84	2,176	30,12,66	5,97,31
34	80,10	25,44	230	5,62,54	70,90	606	14,81,99	3,44,03
17	60,18	21,12	179	6,30,08	80,73	373	12,98,99	2,98,90
6	26,09	11,83	94	4,19,87	50,36	180	8,09,86	1,93,67
21	3,19,83	1,78,30	598	132,71,29	17,25,52	773	149,55,60	24,82,79
1,311 (3·8)	11,00,52 (3·4)	3,04,16 (6·4)	7,357 (21·2)	167,72,77 (51·3)	21,65,94 (45·4)	34,678	326,72,84	47,66,07

STATISTICAL

STATEMENT

	1951-					
	Individuals			Hindu undivided families		
Grade of Total Income	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assess-ments	Total income assessed Rs.	Super-tax etc. Rs.
0 — 25,000 . .	1,397	1,62,05	13,40	79	8,76	41
25,001 — 55,000 . .	22,134	77,00,31	3,96,79	5,101	17,67,72	89,76
55,001 — 1,00,000 . .	4,424	31,35,53	5,35,28	942	6,69,87	1,11,52
1,00,001 — 2,00,000 . .	1,520	20,24,82	6,15,62	315	4,24,05	1,30,45
2,00,001 — 3,00,000 . .	307	7,48,14	3,08,55	77	1,84,30	76,53
300,001 — 4,00,000 . .	113	3,83,75	1,76,02	26	89,65	40,49
4,00,001 — 5,00,000 . .	62	2,79,96	1,29,25	12	52,48	22,51
5,00,001 and over . .	109	11,35,84	5,62,44	16	1,52,35	81,56
TOTAL . .	30,066 (*61·2*)	155,70,40 (*38·7*)	27,37,35 (*34·6*)	6,568 (*13·4*)	33,49,18 (*8·3*)	5,53,23 (*6·9*)

SOURCE.—All India Statement No. 6 appearing in All India Income-tax Revenue

NOTE.— (1) The figures for total income are shown after deduction of Business Profit Tax

(2) The figures of total demand of Super-tax are gross amounts without taking

(3) Changes made on account of revisions, appeals etc. are also not included in

(4) The figures of total tax demanded do not include surcharge and tax paid

(5) Figures in brackets indicate percentages to total.

APPENDIX A—*contd.*

IV—*contd.*

(Rup.es in thousands)

52

Unregistered firms and other associations of persons			Companies and other concerns assessable at company rate			Total		
No. of assessments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assessments	Total income assessed Rs.	Super-tax etc. Rs.	No. of assessments	Total income assessed Rs.	Super-tax etc. Rs.
88	6,79	1,34	6,406	4,38,24	99,21	7,970	6,15,84	1,14,36
1,166	4,12,65	22,15	1,362	5,09,30	1,17,34	29,763	103,89,98	6,26,04
284	2,07,47	34,62	896	6,68,19	1,59,99	6,546	46,81,06	8,41,41
146	1,99,66	52,65	747	10,18,52	2,35,28	2,728	36,67,05	10,34,00
51	1,23,73	48,33	312	7,81,33	1,78,90	747	18,37,50	6,12,31
23	80,00	30,12	180	6,28,96	1,45,26	342	11,82,36	3,91,89
17	75,43	31,04	129	5,76,67	1,35,32	220	9,84,54	3,18,12
26	2,50,17	1,22,63	612	153,46,88	32,08,04	763	168,85,24	39,74,67
1,801 (*3·7*)	13,55,90 (*3·4*)	3,42,88 (*4·4*)	10,644 (*21·7*)	199,68,09 (*49·6*)	42,79,34 (*54·1*)	49,079	402,43,57	79,12,80

Statistics.

and Excess Profits Tax where applicable.

into consideration rebates and refunds.

the income and demand figures.

under sections 18A and 23B of the Income-tax Act.

STATISTICAL

STATEMENT

Number of Assessments, Total Income Assessed and Total Tax Demanded during the Year

Classification	Number of		
	1941-42	1942-43	1943-44
1 .Mines, Quarries, etc.	1,999	2,438	2,770
2. Textile Manufacture	2,401	3,002	3,290
3. Manufacture of Metal & metal goods	1,899	2,482	2,862
4. Food Manufacture etc.	4,939	6,201	7,383
5. Manufacture of Chemicals, Leather, Paper, etc.	3,211	3,808	4,403
6. Building and Manufacture of Miscellan.ous goods.	5,452	6,404	8,425
7. Distribution & Communication	73,168	98,458	1,44,669
8. Finance	35,792	35,912	37,628
9. Professions etc.	21,853	25,129	29,734
GRAND TOTAL	1,50,714	1,83,834	2,41,164

Classification	Total			
	1940-41	1941-42	1942-43	1943-44
1. Mines, Quarries, etc.	6,13	7,46	8,92	9,24
2. Textile Manufacture	4,95	7,59	21,00	30,77
3. Manufacture of Metal & metal goods	6,65	11,43	13,41	12,53
4. Food Manufacture etc.	6,33	7,27	12,56	17,33
5. Manufacture of Chemicals, Leather, Paper etc.	3,59	4,03	6,11	8,96
6. Building & Manufacture of Miscellaneous goods	3,93	4,53	4,96	12,60
7. Distribution & Communication	39,13	47,78	68,28	1,12,50
8. Finance	17,04	14,61	17,03	26,18
9. Profession etc.	10,36	12,44	12,96	18,55
GRAND TOTAL	98,11	1,17,14	1,65,23	2,48,66

APPENDIX A—*contd.*

V

on the Different Types of Business and Professional Income 1940-41 to 1951-52

assessments

1944-45	1945-46	1946-47	1947-48	1948-59	1949-50	1950-51	1951-52
2,859	2,930	2,861	2,513	3,440	3,537	4,587	5,841
2,827	2,795	2,754	2,552	2,789	2,996	4,537	5,821
2,770	2,447	1,897	1,644	2,119	2,356	4,094	6,118
6,259	5,333	4,730	3,791	4,855	5,014	6,842	9,037
3,835	3,395	3,386	2,794	4,222	4,392	6,647	9,822
7,103	6,879	6,863	4,467	6,404	6,556	9,555	13,438
1,27,618	1,29,870	1,43,329	1,21,622	1,51,803	1,57,559	1,57,236	236,106
31,234	26,607	24,029	19,906	22,345	24,126	25,850	41,240
31,096	36,985	35,230	24,138	25,360	29,035	33,431	41,445
2,15,601	2,17,241	2,25,979	1,83,427	2,23,337	2,35,571	2,52,779	3,68,868

(In lakhs of Rupees)

Income assessed

1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52
11,77	11,93	10,90	10,22	10,80	10,56	14,15	17,42
47,59	44,47	34,00	37,32	31,58	41,11	29,03	26,46
8,39	6,97	13,26	11,86	12,63	14,98	17,06	20,12
22,93	17,99	18,71	19,01	16,00	19,66	20,34	27,41
9,50	10,83	8,57	9,34	12,93	11,86	12,68	17,64
9,80	9,01	13,55	10,69	13,70	12,01	13,18	20,65
1,23,96	1,21,95	1,15,31	1,30,46	1,65,19	1,86,34	1,63,19	2,35,86
24,59	27,15	27,00	27,85	31,47	33,59	32,66	53,69
25,64	43,66	30,50	23,35	31,48	31,62	35,43	36,68
2,84,17	2,93,96	2,71,80	2,80,10	3,25,72	3,61,73	3,37,72	4,55,93

STATISTICAL

STATEMENT

Classification	Total tax			
	1940-41	1941-42	1942-43	1943-44
	Rs.	Rs.	Rs.	Rs.
1. Mines, Quarries etc.	1,30	1,56	1,95	220
2. Textile Manufacture	97	1,53	4,06	8,34
3. Manufacture of Metal & metal goods	1,36	2,35	3,31	3,25
4. Food Manufacture etc.	1,17	1,34	2,56	4,07
5. Manufacture of Chemicals, Leather, Paper, etc.	60	71	1,20	2,00
6. Building & Manufacture of Miscellaneous goods	48	63	68	2,24
7. Distribution & Communication	4,53	5,76	8,88	15,01
8. Finance	2,10	1,57	2,18	4,17
9. Profession etc.	1,50	2,01	1,85	2,78
GRAND TOTAL	14,01	17,46	26,67	44,06

SOURCE.—All India statement No. 4 of All India Income-tax Revenue Statistics.

NOTE.—(1) The figures of total income and total amount of tax do not include amounts

(2) The figures of total tax demanded are gross amounts, *i.e.*, without taking

(3) The figures of total tax demanded do not include surcharge and tax paid

(4) The figures of total income are shown after deduction of earned income applicable.

(5) Details of the classification of business and professional income are given

(6) Figures of number of assessments for 1940-41 are not available in the pub-

APPENDIX A—*contd.*

V—*contd.*

(In lakhs of Rupees)

(Income-tax & Super-tax)

1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52
Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
3,01	3,08	3,55	3,76	4,23	3,94	5,59	6,70
13,80	12,63	11,72	15,08	12,33	16,25	13,48	11,89
2,04	1,75	4,54	4,75	4,98	5,93	7,35	8,51
5,83	4,54	6,24	7,23	6,02	8,49	8,03	11,53
2,25	2,69	2,70	3,41	4,34	4,45	4,40	6,55
1,81	1,58	3,66	3,66	4,05	3,67	4,07	5,73
18,51	18,96	20,05	31,18	41,10	40,84	40,82	56,50
4,10	4,98	6,21	7,59	9,75	10,18	10,49	16,77
4,07	8,44	6,57	5,76	8,52	8,59	11,01	8,48
55,42	58,65	65,24	82,42	95,32	1,02,34	1,05,24	1,32,66

relating to assessments done under Section 34.
into consideration rebates and refunds.
under Section 18A and 23B of the Income-tax Act.
relief, and amounts of Excess Profits Tax and Business Profits Tax where

in statement VI.
lished statistics.

STATISTICAL APPENDIX A—*contd.*

STATEMENT VI

Trade classification of business and professional incomes assessed to Income-tax and Super-tax

Group 1 (*Mines, Quarries, etc.*)

Class 1. Coal Mines and Gas Works.
„ 2. Iron Mines.
„ 3. Other Mines.
„ 4. Quarries.
„ 5. Water Works.
„ 6. Petroleum Works.
„ 7. Hydro-Electric Power Works and Electric Power supply.
„ 8. Fishing, Salt Works.
„ 9. Timber (Cutting and logging).

Group 2 (*Textile Manufacture*)

Class 1. Cotton (Spinning, weaving, etc.).
„ 2. Wool (Spinning, weaving, alpacamohir, carpets, etc).
„ 3. Silk (Throwing, spinning, weaving, saries, etc).
„ 4. Jute (Baling, manufacture).
„ 5. Hemp, Flax.
„ 6. Artificial Silk.
„ 7. Bleaching, Dyeing, Printing and Finishing (wherever done separately or for textiles generally).
„ 8. Miscellaneous (*e.g.* elastic webbing, cocoanut fibres, bristles, horse-hair, feathers, flock and rag, other vegetable fibres).

Group 3 (*Manufacture of Metal and Metal Goods*)

Class 1. Iron and Steel Works.
„ 2. Railway Carriage and Wagon and Tram Car Building.
„ 3. Motor Car, Lorry, Cycle and Aeroplanes.
„ 4. Ship Building and Marine.
„ 5. Other Machinery, Engineering and Tool Manufacture.
„ 6. Large Iron and Steel Combinations covering several or all of the above.
„ 7. Copper, Brass, Lead, Zinc, Tin and other metals.
„ 8. Electrical Goods.
„ 9. Miscellaneous metal manufacture.

STATISTICAL APPENDIX A—*contd.*

STATEMENT VI—*contd.*

Group 4 (*Food Manufacture, etc.*)

Class. 1. Sugar.
" 2. Tea.
" 3. Rice Milling.
" 4. Grain Milling.
" 5. Breweries.
" 6. Mineral Waters.
" 7. Tobacco and Bidi Manufacture.
" 8. Canning and Preserving (Fruit, Meat, etc.)
" 9. Other Food Industries (Ice, Dog Foods, etc.)

Group 5 (*Manufacture of Chemicals, Leather, Paper, etc.*)

Class 1. Patent Medicines.
" 2. Chemicals (*a*) Soap, Candles, Drugs, Perfumery.
" 3. Chemicals (*b*) Matches, Fire-works, explosives, seed crushing, Oil (other than Petroleum products).
" 4. Leather Goods, including boots and shoes.
" 5. Rubber goods.
" 6. Miscellaneous clothing (Hats, Umbrella, Artificial Flowers etc.)
" 7. Paper making.
" 8 Printing, Book-binding, Type-founding, Engraving, Dye-sinking and miscellaneous.
" 9. Newspapers and other periodicals and Publishing Trades.

Group 6 (*Building and Manufacture of Miscellaneous Goods*)

Class. 1. Building and Works Contracting.
" 2. Manufacture of Building Accessories (Bricks, Fire-clay, Cement etc.)
" 3. Pottery, China and Earthenware.
" 4. Glass and Glassware.
" 5. Musical and Scientific Instruments, Sports requisites.
" 6. Ivory Goods, bone goods, games toys and fancy articles.
" 7. Photographic supply, Film production.
" 8. Miscellaneous manufacturing and productive industries not included under any other head.

STATISTICAL APPENDIX A—*contd.*

STATEMENT VI—*contd.*

Group 7 (*Distribution and communication*)

Class 1. Wholesale Merchants, Warehousemen, Agents, etc., connected with the distribution of goods, produce or merchandise but who do not carry on any manufacturing process other than sorting, packing and blending.

" 2. Retail (*a*) : Hotel, Refreshment houses and retailers of Beers, Wines, Spirits, Liquors and Mineral waters.

" 3. Retail (*b*) : Retailers who render some service other than distribution (*e.g.* Grocer, Green-grocer, Tobacconist, Butcher, News-agent, Draper, etc.)

" 4. Retail (*c*) : Retailers who render some service other than distribution or do some productive process (*e.g.*, Carpenter, Blacksmith, Laundry, Baker, Tailor, etc.)

" 5. Special distribution : Large concerns which exist mainly or solely for the widespread distribution of a standardised produce (*e.g.*, petrol).

" 6. Shipping (including Docks, Bridges, etc.).

" 7. Managing Agents.

" 8. Railways.

" 9. Road and Air Transport (Tramways, Omnibuses, Lorries, Removers, Taxies, etc.)

Group 8 (*Finance*)

Class 1. Non-Indian Banks.

" 2. Indian Banks.

" 3. Non-Indian Insurance Companies.

" 4. Indian Insurance Companies.

" 5. Money lenders.

" 6. Stock and share brokers and jobbers.

" 7. Finance Companies and Agents, Bills and Discount Brokers and Investment Trust Companies.

" 8. All other brokers and Agents.

" 9. Hire of Machinery, Furniture, etc.

Group 9 (*Professions, etc.*)

Class 1. Law.

" 2. Medicine (including Dentistry.)

" 3. Literature and Art.

STATISTICAL APPENDIX A—*contd.*

STATEMENT VI—*contd.*

Group 9 (*Professions, etc.*)—*contd.*

Class 4. Music and Drama.

" 5. Accountant and Actuaries.

" 6. Engineering and Land Surveying and Architecture.

" 7. Cinemas, Theatres and other public amusements (Sports, etc.).

" 8. Teaching.

" 9. All other businesses and professions (not classed under any other head).

STATEMENTS RELATING TO CENTRAL COMMODITY TAXES

CUSTOMS AND

STATISTICAL

STATEMENT

Analysis of Central

Year	Total tax revenue of Government of India	Customs Revenue				
		Import duties	Export duties	Miscellaneous	Total	Percentage to Col. (2)
1	2	3	4	5	6	7
1920-21 . .	60,85	23,08	4,89	1,08	29,05	*47·7*
1921-22 . .	66,92	27,70	4,50	36	32,56	*48·7*
1922-23 . .	72,61	33,66	5,24	38	39,28	*54·1*
1923-24 . .	71,21	31,78	5,51	35	37,64	*52·9*
1924-25 . .	74,17	39,01	5,76	39	45,16	*60·9*
1925-26 . .	72,86	39,32	5,89	40	45,61	*62·6*
1926-27 . .	72,58	39,96	5,94	39	46,29	*63·8*
1927-28 . .	72,78	40,46	6,05	49	47,00	*64·6*
1928-29 . .	76,58	40,92	5,58	1,19	47,69	*62·3*
1929-30 . .	77,77	40,73	6,22	1,32	48,27	*62·1*
1930-31 . .	72,60	37,29	4,60	1,66	43,55	*60·0*
1931-32 . .	75,62	36,08	4,26	1,19	41,53	*54·9*
1932-33 . .	83,36	41,90	3,97	74	46,61	*55·9*
1933-34 . .	76,65	35,68	4,35	1,29	41,32	*53·9*
1934-35 . .	82,32	38,84	4,32	74	43,90	*53·3*
1935-36 . .	84,09	39,01	4,35	53	43,89	*52·2*
1936-37 . .	82,36	36,59	4,90	38	41,87	*50·8*
1937-38 . .	82,41	42,52	4,44	33	47,29	*57·4*
1938-39 . .	81,87	39,80	4,10	61	44,51	*54·4*
1939-40 . .	90,27	45,42	4,07	94	50,43	*55·9*
1940-41 . .	86,77	37,56	3,36	45	41,37	*47·7*
1941-42 . .	112,11	37,51	3,56	68	41,75	*37·2*

CENTRAL EXCISE

APPENDIX B

I

Tax Revenue

(In lakhs of Rupees)

			Salt Revenue		Central Excise revenue		Total customs, salt and central excise revenue	
Excise duties	Customs duties	Mis-cella-neous	Total	Percen-tage to Col. (2)	Amount	Percen-tage to Col. (2)	Amount	Percen-tage to Col. (2)
8	9	10	11	12	13	14	15	16
4,65	1,55	56	6,76	11·1	2,85	4·7	38,66	63·5
4,09	1,78	57	6,44	9·6	2,80	4·2	41,80	62·5
4,58	2,07	66	7,31	10·1	3,44	4·7	50,03	68·9
6,98	2,32	82	10,12	14·2	3,17	4·5	50,93	71·6
4,69	2,67	50	7,86	10·6	3,95	5·3	56,97	76·8
3,89	2,02	46	6,37	8·7	3,21	4·4	55,19	75·7
4,14	2,07	52	6,73	9·3	2,02	2·8	55,04	75·9
4,19	1,97	52	6,68	9·2	2,19	3·0	55,86	76·8
4,90	2,08	68	7,66	10·0	2,47	3·2	57,82	75·5
4,14	2,16	51	6,81	8·8	3,77	4·8	58,85	75·7
4,04	2,37	50	6,91	9·5	4,29	5·9	54,75	75·4
5,27	2,95	56	8,78	11·6	6,19	8·2	56,50	74·7
6,41	3,29	68	10,38	12·5	6,71	8·1	63,70	76·5
5,65	2,82	59	9,06	11·8	7,23	9·4	57,61	75·1
5,18	2,46	53	8,17	9·9	10,35	12·6	62,42	75·8
5,43	2,65	53	8,61	10·2	12,14	14·4	64,64	76·8
5,77	2,78	53	9,08	11·0	13,64	16·6	64,59	78·4
5,73	2,40	51	8,64	10·5	7,90	9·6	63,83	77·5
5,42	2,48	51	8,41	10·3	8,72	10·7	61,64	75·4
7,88	2,49	87	11,24	12·5	6,80	7·5	68,47	75·9
5,28	2,39	39	8,06	9·3	9,62	11·1	59,05	68·1
7,58	2,02	77	10,37	9·3	13,33	11·9	65,45	58·4

Year	Total tax revenue of Government of India	Customs Revenue				
		Import duties	Export duties	Miscellaneous	Total	Percentage to Col. (2)
1	2	3	4	5	6	7
1942-43 . .	1,51,66	31,63	2,63	64	34,90	23·0
1943-44 . .	2,29,23	45,52	2,44	1,05	49,01	21·4
1944-45 . .	3,57,90	91,07	2,52	2,59	96,18	2 ·9
1945-46 . .	3,87,27	1,23,44	3,76	1,52	1,28,72	33·2
1946-47 . .	3,44,85	89,29	7,14	3,16	99,59	28·9
1947-48 . .	3,32,19	1,03,60	25,12	9,40	1,38,12	41·6
1948-49 . .	3,85,18	97,98	26,44	6,00	1,30,42	33·9
1949-50 . .	3,89,01	1,00,34	25,19	4,22	1,29,75	33·4
1950-51 . .	4,44,91	1,06,83	47,32	7,28	1,61,43	36·3
1951-52 . .	5,12,30	1,41,75	90,74	4,60	2,37,09	46·3
1952-53 . .	4,48,59	1,18,43	55,97	4,23	1,78,63	39·8
1953-54 . .	4,20,33	1,20,29	38,51	2,53	1,61,33	38·4

SOURCE.— (1) Statistical Abstract upto 1950-51.

(2) Figures for 1951-52 and 1952-53 are from Budget Memoranda.

(3) 1953-54 figures are from Revenue Bulletin for March, 1954 published by the

NOTE.—(1) The figures in all columns relate to gross revenue.

(2) Central excise revenue from 1939-40 onwards includes cess on coal and coke 1946.

(3) The figures of total revenue shown in column 2 from 1951-52 onwards include the previous years.

APPENDIX B—*contd.*

I—*contd.*

(In lakhs of Rupees)

Salt Revenue					Central Excise revenue		Total customs, salt and central excise revenue	
Excise duties	Customs duties	Mis-cellaneous	Total	Percent-age to Col, (2)	Amount	Percent-age to Col. (2)	Amount	Percent-age to Col. (2)
8	9	10	11	12	13	14	15	16
8,84	1,66	75	11,25	*7·4*	12,91	*8·5*	59,06	*38·9*
6,88	1,26	67	8,81	*3·8*	27,69	*12·1*	85,51	*37·3*
6,88	2,06	77	9,71	*2·7*	41,29	*11·5*	1,47,18	*41·1*
8,03	1,59	86	10,48	*2·7*	46,92	*12·1*	1,86,12	*48·0*
6,92	1,54	88	9,34	*2·7*	43,70	*12·7*	1,52,63	*44·3*
27	..	2,30	−2,57	*0·8*	38,89	*11·7*	1,79,58	*54·1*
					51,66	*13·4*	1,82,08	*47·3*
					68,53	*17·6*	1,98,28	*51·0*
					71,50	*16·1*	2,32,93	*52·4*
					87,61	*17·1*	3,24,70	*63·4*
					84,73	*18·9*	2,63,36	*58·7*
					94,00	*22·4*	2,55,33	*60·8*

D.G.C.I. & S. and from the Budget Memorandum.

and collections under Sugar (Additional excise duty) Ordinances 1943, 1944 and

net revenue in respect of Corporation tax and income-tax and not gross revenue as in

STATISTICAL APPENDIX C

STATEMENT I

Revenue from Import Duties in relation to Value of Imports

(In crores of Rupees)

Year	Value of imports	Total revenue from import duties	Col. 3 as percentage of Col. 2
(1)	(2)	(3)	(4)
1920-21	335·6	23·1	7·1
1921-22	281·6	27·7	9·8
1922-23	246·2	33·7	13·7
1923-24	237·2	31·8	13·4
1924-25	253·4	39·0	15·4
1925-26	236·0	39·3	17·5
1926-27	240·8	40·0	16·6
1927-28	261·5	40·5	15·5
1928-29	263·4	40·9	15·5
1929-30	249·7	40·7	16·3
1930-31	173·1	37·3	21·6
1931-32	126·4	36·1	30·8
1932-33	135·0	41·9	31·0
1933-34	117·3	35·7	30·4
1934-35	132·3	38·8	29·4
1935-36	134·4	39·0	29·0
1936-37	125·2	36·6	29·2
1937-38	173·8	42·5	24·5
1938-39	155·6	39·8	25·6
1939-40	165·3	45·4	27·5
1940-41	156·9	37·6	23·9
1941-42	173·3	37·5	21·6
1942-43	110·4	31·6	28·6
1943-44	117·8	45·5	38·7
1944-45	203·6	91·1	44·7

STATISTICAL APPENDIX C—*contd.*

STATEMENT I—*contd.*

Revenue from Import Duties in relation to Value of Imports

(In crores of Rupees)

Year	Value of imports	Total revenue from import duties	Col. 3 as percentage of Col. 2
(1)	(2)	(3)	(4)
1945-46	245·8	123·4	*50·2*
1946-47	288·4	89·3	*31·0*
1947-48	408·7	103·6	*25·4*
1948-49	557·2	98·0	*17·6*
1949-50	609·2	100·3	*16·5*
1950-51	581·2	106·8	*18·4*
1951-52	862·8	141·8	*16·4*
1952-53	633·0	118·4	*18·7*
1953-54	551·0	120·3	*21·8*

SOURCE.—Accounts relating to the Foreign Trade and Navigation of India, and the Customs and Central Excise Revenue Statement of the Indian Union.

STATISTICAL APPENDIX C—*contd.*

STATEMENT II

Value of Imports into India

(In lakhs of Rupees)

S. No.	Description of commodities	1920-21	1925-26	1931-32	1938-39	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
1	2	3	4	5	6	7	8	9	10	11	12	13
1	Fruits, fresh or preserved	7	14	16	11	15	10	22	9	20	28	38
	Fruits dried	1,59	1,40	1,08	88	3,96	5,15	6,34	9,55	9,98	9,31	9,89
2	Ale, Beer, Porter, Cider etc.	1,02	86	77	74	41	72	44	40	58	57	60
3	Spirits and Liquors	3,24	2,19	1,35	1,20	2,75	1,32	1,30	99	1,95	1,75	1,66
4	Wines	64	29	15	14	48	7	6	5	13	18	12
5	Milk	45	62	57	20	1,51	2,82	2,52	3,11	4,00	2,81	4,34
	Butter	3	2	5	9	3	14	35	33	54	20	43
	Cheese	19	12	6	7	8	8	19	16	21	12	23
6	Biscuits and cakes	47	42	30	25	7	74	43	2	9	1	10
	Farinaceous and patent foods	71	89	72	77	1,13	2,00	2,25	1,61	3,29	143	3,04
7	Miscellaneous provisions	1,76	2,45	1,71	1,10	70	1,33	1,98	59	2,68	1,13	1,28
8	Spices excluding betelnuts	45	75	63	67	1,77	1,95	1,13	2,07	3,64	50	2,58
9	Betelnuts	1,46	2,53	1,45	1,96	3,05	2,45	2,41	3,43	4,66	3,27	3,02

10	Sugar	18,50	15,83	6,17	46	(—)	66	(—)	4,34	85	(—)	1,57
11	Tobacco unmanufactured . . .	9	34	30	58	2,77	2,95	2,28	2,59	1,85	1,67	62
12	Tobacco manufactured	2,87	1,80	64	47	82	67	12	16	12	12	17
13	Gums and Resins	28	26	24	30	90	1,32	60	79	1,03	84	94
	Lacs	20	1	2	8	16	1,04	69	65	35	1	48
14	Kerosene oil	4,31	5,17	4,33	6,46	8,54	6,49	15,11	17,65	19,21	21,75	27,48
15	Motor spirit	(—)	(—)	1,05	3,14	8,35	10,68	16,33	17,87	24,37	25,18	30,90
16	Batching oils	66	52	37	65	84	51	1,19	88	1,17	1,79	1,23
	Lubricating oils	1,98	1,56	1,11	1,55	4,00	7,86	6,94	6,07	9,79	11,32	4,76
	Fuel oils	1,23	2,12	2,04	1,98	7,35	6,94	12,82	11,80	14,82	14,91	18,86
17	Copra	36	12	5	65	24	31	1,02	1,14	1,59	2,04	3,60
	Other non-essential oilseeds . .	6	1	3	3	(—)	46	57	91	57	3	1
	Coconut oil	7	30	43	55	1,33	1,01	4,33	3,17	6,04	3,08	3,90
	Other non-essential vegetable oils .	18	27	7	10	1	5	50	16	14	57	2,75
18	Building materials other than steel . .	2,35	1,24	18	60	92	3,14	4,30	1,99	2,36	2,39	1,88
	Building materials Earthenware, China and Porcelain	89	77	38	39	58	27	59	27	73	43	35
19	Asphalt	9	13	21	26	37	77	1,11	84	94	5,28	2,29
20	Wood and Timber	2,48	1,50	1,09	3,77	1,66	7,07	4,29	3,55	7,43	3,18	2,60
21	Machinery	22,38	14,89	10,92	18,97	29,80	77,30	1,03,08	90,35	1,00,38	85,16	83,80
22	Hardware and Cutlery	9,63	5,53	2,82	2,83	4,57	6,39	6,66	4,85	7,43	4,87	4,99

STATISTICAL APPENDIX C—*contd.*

STATEMENT II—*contd.*

(In lakhs of Rupees)

1	2	3	4	5	6	7	8	9	10	11	12	13
23	Electrical goods—Wires and cables	1,22	77	27	1,32	1,62	4,24	5,53	4,12	3,09	7,07	7,19
	Electrical goods—Instruments etc.	2,96	1,48	1,96	1,99	4,34	7,16	8,27	5,55	7,27	6,74	5,85
24	Wireless Reception Instruments	(—)	6	9	41	201	1,26	1,43	1,38	2,07	1,50	1,18
25	Cinema films (Raw)	.. }	21	9	25	54	77	95	1,26	1,36	1,66	1,56
	Cinema films (Exposed)	.. }		17	38	25	32	38	36	28	4	30
26	Instruments, apparatus, appliances, others	1,63	1,02	1,11	1,50	3,61	5,04	4,89	5,14	6,37	4,840	5,48
27	Glass and glassware	3,38	2,60	1,22	1,25	1,47	1,65	1,93	59	2,15	1,28	1,36
28	Watches and clocks	48	25	11	43	75	2,59	1,43	1,35	2,15	83	1,49
29	Chemicals, Drugs and Medicines	4,77	3,86	4,19	5,26	13,20	28,49	15,54	19,11	34,97	24,00	24,98
30	Coal-tar dyes	3,37	1,43	2,33	2,63	8,80	12,30	7,95	11,98	14,27	7,51	15,45
31	Paints and Painters' material	1,95	1,30	88	89	1,45	2,25	1,77	1,09	2,62	1,35	1,77
32	Toilet Requisites	55	50	48	66	2,92	42	1,13	7	31	39	64
33	Essential oils, Perfumery etc.	46	35	41	40	1,22	1,00	72	1,04	2,18	90	1,07
34	Iron and steel	31,30	18,07	6,33	6,66	4,68	12,31	18,25	17,71	22,52	23,71	23,57
35	Non-ferrous metals	9,34	7,28	3,44	4,16	15,93	22,33	19,16	27,74	20,92	19,37	14,51
36	Wood pulp	50	26	36	26	23	45	63	41	103	91	1,07
	Paper and pasteboard	7,30	2,81	2,50	3,23	7,27	14,21	8,66	9,92	13,96	11,72	11,57
	Stationery	1,82	89	68	67	2,76	1,11	1,09	52	92	1,07	1,17
37	Motor cars, Taxi cabs	7,82	2,82	1,48	2,17	4,39	7,63	3,21	3,24	4,79	2,96	2,82
	Omnibuses, Vans & Lorries, complete	} 2,23	15	20	6	21	52	70	47	9	8	1,12
	Omnibuses, Vans & Lorries, Chassis	}	73	47	1,13	3,02	8,92	5,38	2,65	2,87	2,88	2,15

	Parts of mechanically propelled vehicles	1,75	68	3,63	88	1,27	4,54	4,46	9,80	14,75	7,79	6,30
38	Railway plant and Rolling stock . .	6,54	5,00	70	1,04	3,42	2,44	1,40	2,24	2,96	3,69	3,79
39	Cotton Raw	1,70	3,65	7,03	8,51	25,93	64,23	63,28	1,00,76	1,37,13	76,67	52,71
40	Cotton yarn and thread . . .	14,49	8,61	3,05	3,33	1,32	6,54	7,14	78	3,65	3,30	2,10
	Cotton Piece goods	83,78	5,451	14,67	10,27	2,39	9,30	10,70	1,31	2,37	1,25	1,02
	Cotton Hosiery	9	1,40	48	18	14	1	2	(—)	(—)	(—)	(—)
41	Woollen yarn and knitting wool . .	25	37	23	64	193	152	1,93	1,08	1,72	96	1,30
	Woollen Fabrics and manufactures .	5,28	3,87	1,08	1,56	3,70	5,70	4,05	57	6,51	5,76	8,59
42	Art silk yarn and thread and staple fibre yarn	6	75	82	1,16	3,99	13,03	11,24	15,04	18,51	8,60	1,250
43	Textile materials, others, raw or manufactured*	16,19	8,88	18,63	4,98	14,03	7,61	10,27	9,50	18,73	3,92	8,00
44	Arms and ammunition . . .	47	69	49	24	32	36	74	1,33	33	1,28	65
45	Explosives	17	21	20	26	58	71	58	1,05	1,42	1,93	1,34
	Protected items †											
4	Raw Silk and Cocoons . . .	1,63	94	62	62	2,17	1,71	21	2,41	1,56	67	59
6	Sewing machines and parts . .	68	80	52	54	1,15	1,50	1,31	1,50	1,11	79	59
7	Cycles and parts	91	1,01	65	96	2,78	3,99	4,11	2,43	4,26	3,45	1,91
	Total of listed items . . .	2,95,76	2,03,26	1,23,65	1,22,88	2,35,09	4,12,92	4,32,59	4,57,93	5,94,32	4,47,41	4,48,54
	Total imports excluding foodgrains	3,35,55	2,35,34	1,25,19	1,41,80	2,69,61	4,55,64	4,75,33	5,00,76	6,34,73	4,79,85	4,78,64
	Grain, pulse and flour . . .	5	66	1,18	13,76	18,82	1,01,53	1,33,85	80,41	2,28,11	1,53,10	72,38
	Grand total imports . . .	3,35,60	2,36,00	1,26,37	1,55,56	2,88,43	5,57,17	6,09,18	5,81,17	8,62,84	6,32,95	5,51,02

(—)Nil or negligible.
. . Not available.
*That is, other than those specified and also excluding raw silk.
†These are important currently protected items, and were not protected throughout the period.
SOURCE.—" Accounts relating to the Foreign Trade and Navigation of India".
NOTE.—Data cover sea and air-borne trade only.

STATISTICAL APPENDIX C—*contd.*

STATEMENT III

Revenue from Import Duties

(In lakhs of Rupees)

S. No.	Description of commodities	1920-21	1925-26	1931-32	1938-39	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	
1	2	3	4	5	6	7	8	9	10	11	12	13	
	Imports—Revenue duties												
1	Fruits, fresh, preserved, dried	16*	26*	36*	25	96	1,26	1,35	1,66	2,08	1,67	1,79	
2	Ale, Beer, Porter, Cider etc.	9	18	32	36	9	23	18	15	26	24	26	
3	Spirits and Liquors	1,70	2,22	1,48	1,48	4,27	1,65	1,54	1,52	2,27	2,03	1,86	
4	Wines	9	14	11	10	24	4	3	3	4	6	4	
5	Milk, Butter and Cheese				9	27	64	52	69	83	47	63	
6	Biscuits, cakes and patent foods etc.	28	75	76	19	24	56	62	40	77	28	79	
7	Miscellaneous provisions				9	12	46	46	33	129	57	40	
8	Spices	15	45	21	19	67	75	43	42	90	21	88	
9	Betelnuts			60	77	2,54	2,79	3,99	4,45	4,75	3,67	4,65	
10	Sugar	1,09	6,48	8,08	45	—	24	—	1	83	—	1,35	Protected 1932 Deprotected 1950
11	Tobacco unmanufactured	1	49	41	1,04	7,87	7,61	4,68	4,45	3,43	3,21	1,89	

12	Tobacco manufactured	1,30	1,07	65	50	96	1,16	21	25	18	13	13
13	Gums, Resins, Lacs etc.	4	5	6	9	24	38	18	21	30	27	29
14	Kerosene oil	52	1,27	1,80	3,56	3,20	2,41	4,06	5,66	6,11	6,75	7,19
15	Motor spirit	—	—	67	5,15	11,81	9,67	14,09	19,49	26,04	27,49	27,53
16	Mineral oils, others, *viz.*, batching, lubricating, fuel	26	28	31	41	1,18	1,37	1,88	2,05	3,38	3,99	3,04
17	Oil seeds and vegetable oils, non-essential	8	19	22	39	52	58	1,64	1,19	1,70	1,28	1,14
18	Building and engineering materials, earthenware etc.	20	26	25	23	27	60	89	30	58	42	53
19	Asphalt				7	12	24	30	29	26	96	84
20	Wood and Timber	19	24	27	35	57	67	52	30	65	30	13
21	Machinery	62	60	67	2,31	4,61	7,03	6,12	5,43	6,63	5,64	5,35
22	Hardware, cutlery etc.	85	94	64	76	1,29	1,76	1,73	1,28	2,07	1,42	1,66
23	Electrical goods	44	5	12	62	1,57	2,55	2,94	2,77	2,59	3,26	3,26
24	Wireless Reception instruments		..	1	15	94	52	63	51	93	69	45
25	Cinema films		4	8	13	41	45	52	51	51	62	52
26	Instruments, apparatus, appliances, others		38	62	34	87	1,25	1,12	1,37	1,79	1,33	1,46
27	Glass and glassware	35†	70†	46†	39	46	53	60	26	95	58	74
28	Watches and clocks	4	8	5	20	36	1,30	1,09	1,00	1,54	59	1,07
29	Chemicals, Drugs and Medicines	34	55	85	1,05	3,13	5,52	4,06	4,89	8,54	5,46	6,13
30	Coal-tar dyes	..	..	11	30	1,03	1,29	79	1,27	1,65	90	1,93

STATISTICAL APPENDIX C—*contd.*

STATEMENT III—*contd.*

(In lakhs of Rupees)

1	2	3	4	5	6	7	8	9	10	11	12	13	
31	Paints and Painters' material .	48‡	45‡	25‡	24	38	66	56	36	87	46	56	
32	Toilet Requisites . . .	4	7	11	17	90	21	38	3	12	15	39	
33	Essential oils, perfumery etc. .	..	..	7	16	38	35	26	36	77	32	40	
34	Iron and Steel . . .	70	49	40	42	66	1,58	2,25	3,51	4,14	3,21	2,86	Protected 1924 Deprotected '47
35	Non-ferrous metals . . .	70	96	62	74	2,64	1,58	59	9	10	12	11	
36	Woodpulp, Paper and Stationery.	71	67	83	1,12	2,24	3,57	2,79	2,41	3,99	3,60	4,14	Protected 1925 Deprotected '47
37	Motor vehicles and parts . .	1,13§	1,37§	98§	1,28	3,11	8,04	5,24	9,44	12,38	8,70	6,38	Protected 1950
38	Railway plant and Rolling stock	34	65	13	18	1,87	48	1,04	75	80	2,21	2,21	
39	Cotton, raw	..	..	23	82	2,97	2,40	4,66	5,75	6,15	4,92	3,13	
40	Cotton yarn, thread, fabrics and hosiery	6,69	6,63	4,17	4,01	1,12	2,40	3,36	41	81	57	76	Deprotected '47
41	Woollen yarn, fabrics and other manufactures . . .	38	59	27	48	1,44	1,59	1,24	46	73	67	72	
42	Art silk yarn and thread and staple fibre yarn . . .	..	..	12	41	1,27	4,07	4,22	5,18	6,39	3,10	4,53	
43	Textile fabrics, others, raw or manufactured ‖ . .	74	1,17	1,21	71	1,44	1,42	1,20	90	3,03	78	1,68	
44	Arms and ammunition . .	11	14	13	9	14	32	40	51	25	56	39	

45	Explosives	1	4	4	6	15	19	16	27	37	42	36	
	TOTAL—Revenue duties	18,06	30,78	33,75	31,66	79,60	91,92	92,13	98,53	1,30,97	1,11,00	1,13,92	
	Protective Duties ¶												
1	Heavy chemicals	—	—	3	—	—	1	4	28	95	76	54	Protected 1931 and 1950.
2	Iron and steel		3,13	1,18	59	30	24	14	14	39	42	21	Special steels protected 1948.
3	Metals other than Iron and Steel	—	—	—	—	—	52	81	1,14	1,59	97	93	Protected 1947
4	Raw silk	10	14	16	29	76	90	29	1,94	1,05	33	30	Protected 1934
5	Other textile materials	—	—	—	2,20	4,91	1,44	2,10	55	69	42	57	Protected 1934
6	Sewing machine and parts	..	..	..		—	31	30	35	26	19	14	Protected 1947
7	Cycles and parts	..	..	..	—	—	1,01	2,24	1,53	2,70	2,21	1,28	Protected 1947
8	Machinery other than sewing machines	—	—	—	—	—	17	51	77	64	1,09	1,17	Protected 1948 and 1950.
	Total protective duties	6,58	10,51	5,20	8,14	7,55	5,32	7,53	7,85	10,51	7,35	6,15	
	Total of listed items	20,93	34,17	31,10	35,98	77,49	88,97	91,95	1,00,27	1,33,02	1,10,67	1,11,69	
	Total import duties	24,64	41,29	38,95	39,80	89,29	97,98	1,00,34	1,06,83	1,41,75	1,18,43	1,20,29	

—Nil or negligible.
..Not available.
*Includes duty collected on vegetables also.
†Includes duty collected on lacqueredware, Chinaware, etc.
‡Includes dyeing and tanning substances.
§Includes duty collected on *all* types of conveyances including trams, cycles, carriages, etc.
||Liable to 'revenue' duties only.
¶These are currently protected items, not necessarily protected throughout the period.
SOURCE.—"Customs and Excise Revenue Statement of the Indian Union".
NOTE.—Revenue from Sea and Air-borne imports only is covered, as detailed commodity-wise breakdown of revenue from overland trade is not available. In some cases, revenue has been calculated by applying appropriate tariff rates to value of imports data.

STATISTICAL APPENDIX C—*contd.*

STATEMENT IV

Duty as Percentage of Value of Imports

S. No.	Description of commodities	1920-21	1925-26	1931-32	1938-39	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
1	2	3	4	5	6	7	8	9	10	11	12	13
1	Fruits, fresh, preserved or dried	9·6	17·0	29·0	25·2	23·5	24·0	20·6	17·2	20·4	17·4	17·4
2	Ale, Beer, Porter, Cider, etc.	9·0	20·9	41·6	48·6	21·9	31·9	40·8	37·5	44·8	42·1	43·3
3	Spirits and Liquors	52·3	101·4	109·6	123·3	154·9	125·0	118·4	153·5	116·2	116·0	112·0
4	Wines	14·1	48·3	73·3	71·4	50·0	57·1	50·0	60·0	30·7	33·3	33·3
5	Milk, Butter and Cheese				25·0	16·6	21·0	16·9	19·2	17·4	14·9	12·6
6	Biscuits, cakes and patent foods etc.	7·7	16·6	22·3	18·6	20·0	20·4	23·3	24·5	22·8	19·6	25·2
7	Miscellaneous provisions				Coverage of revenue varies from year to year.							
8	Spices	7·8	13·7	33·3	28·3	37·8	38·4	38·0	20·3	24·7	42·0	34·1
9	Betelnuts			41·4	39·2	83·2	115·8	165·5	129·7	101·9	115·3	154·0
10	Sugar	5·9	40·9	130·9	97·8	Considerable time-lag between time of importation and payment of duty.						
11	Tobacco, unmanufactured	11·1	144·1	136·7	179·3	284·1	258·9	205·2	171·8	185·4	194·0	304·8
12	Tobacco, manufactured	45·3	59·4	101·6	106·3	117·1	174·0	175·0	156·3	150·0	108·5	76·5
13	Gums, Resins, Lacs, etc.	8·3	18·5	23·1	23·9	22·6	16·1	13·9	14·5	21·7	31·7	20·4
14	Kerosene Oil	12·1	24·6	41·5	55·1	37·4	37·1	26·8	32·0	31·8	31·0	28·2

15	Motor Spirit	(—)	(—)	63·8	164·0	141·4	90·9	86·2	109·6	106·9	109·1	89·1
16	Mineral oils others, *viz.* batching, lubricating, fuel	6·7	6·7	8·8	9·7	9·6	8·9	8·9	10·8	13·1	14·2	12·2
17	Oilseeds and vegetable oils, non-essential	12·0	27·1	38·0	29·3	32·5	31·7	25·5	22·1	20·3	22·4	11·1
18	Building materials and earthenware etc.	6·0	12·2	18·0	23·1	18·0	17·6	18·2	13·3	18·8	14·9	23·8
19	Asphalt				26·9	32·4	31·1	27·0	34·5	27·6	18·2	36·7
20	Wood and Timber	7·6	16·0	24·8	9·3	34·2	9·6	12·1	8·5	8·7	9·4	5·0
21	Machinery	2·7	4·0	Dutiable only for a part of the year.	12·2	15·5	9·8	6·7	7·2	7·5	8·1	7·9
22	Hardware, cutlery, etc.	8·8	17·0	22·7	26·9	28·2	27·5	26·0	26·4	27·8	29·2	33·2
23	Electrical goods	7·6	..	..	18·7	26·4	22·4	21·3	28·7	25·0	23·6	25·0
24	Wireless Reception Instruments		..	11·1	36·6	46·7	41·6	44·0	36·9	44·9	46·0	38·1
25	Cinema films		16·7	30·7	20·6	51·8	41·3	39·0	31·5	31·1	30·1	28·0
26	Instruments, apparatus, appliances, others.		12·9	22·2	22·7	24·0	24·6	22·9	26·7	28·1	27·5	26·6
27	Glass and Glassware	..	..	..	31·2	31·3	32·1	31·1	44·0	44·2	45·3	54·4
28	Watches and clocks	8·3	32·0	45·6	46·5	48·0	50·2	76·2	74·1	71·7	71·1	71·8
29	Chemicals, Drugs and Medicines	7·1	14·3	21·0	19·9	23.7	19·4	26·4	27·0	27·1	26·0	26·7
30	Coal-tar dyes	9·0	16·5	11·3	11·4	11·7	10·4	9·9	10·6	11·5	12·0	12·5
31	Paints and Painters' material				27·0	26·1	29·3	31·6	33·0	33·2	34·1	31·6

STATISTICAL APPENDIX C—*concld.*

STATEMENT IV—*contd.*

S. No.	Description of commodities	1920-21	1925-26	1931-32	1938-39	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
1	2	3	4	5	6	7	8	9	10	11	12	13
32	Toilet requisites	7·3	14·0	22·9	25·7	30·9	50·0	33·6	42·8	38·7	38·5	60.9
33	Essential oils, Perfumery, etc.	*	*	*	40·0	31·3	35·0	36·1	34·6	35·3	35·6	37·4
34	Iron and Steel	2·2	20·0	25·0	15·2	20·5	14·8	13·1	20·6	20·1	15·3	13·0
35	Non-ferrous metals	7·5	13·2	18·0	17·8	16·6	9·4	7·3	4·4	8·1	5·6	7·2
36	Wood pulp, paper and stationery	7·4	16·7	23·4	27·0	21·9	22·6	26·8	22·2	25·1	26·3	30·0
37	Motor vehicles and parts	†	†	†	30·2	35·0	37·2	38·1	58·4	55·0	63·5	51·5
38	Railway plant and rolling stock	Considerable time lag between time of importation and payment of duty.										
39	Cotton, raw	(—)	(—)	‡	9·7	11·4	3·7	7·3	5·7	4·5	6·4	5·9
40	Cotton yarn, thread, fabrics & hosiery	6·8	10·3	22·9	29·1	29·1	15·1	18·9	19·6	13·4	12·5	24·4
41	Woollen yarn, fabrics & other manufactures	6·9	13·9	20·6	21·8	25·6	22·0	20·7	27.9	8·9	10·0	7·3
42	Art silk yarn and thread and staple fibre yarn	..	..	14·6	35·4	31·8	31·2	37·5	34·4	34·5	36·1	36·2
43	Textile fabrics, others	Coverage varies from time to time.										
44	Arms and ammunition	Proportion of non-dutiable stores to total imports varies from time to time.										
45	Explosives	6·0	19·0	20·0	23·1	23·8	26·7	27·6	25·7	26·0	21·7	26·9
	Protected Items §											
4	Raw silk and cocoons	6·1	15·0	26·0	46·8	35·0	52·6	138·1	80·5	67·3	50·0	50·8

6 Sewing machines and parts . .	(—)	(—)	(—)	(—)	(—)	20·7	23·0	23·3	23·4	24·0	23·7
7 Cycles and parts	(—)	(—)	(—)	(—)	(—)	25·4	54·5	63·0	63·4	64·0	67·0
Total imports, excluding foodgrains.	7·3	17·5	31·1	28·1	33·1	21·5	21·1	21·3	22·3	24·7	25·1
Grand total of imports . .	7·3	17·5	30·8	25·6	31·0	17·6	16·5	18·4	16·4	18·7	21·8

(—) Nil or negligible.

.. Not available.

* Separate revenue figures for essential oils and camphor not available.

† Revenue figures include duty collected on *all* types of conveyances, including trams, cycles, carriages, etc.

‡ Dutiable only for a part of the year.

§ For protected items in the previous statement other than 4, 6 and 7, separate value of imports data are not available and revenue as a percentage of value of imports cannot be obtained.

NOTE.—Statistics regarding revenue have been derived from the "Customs and Excise Revenue Statement of the Indian Union". Overland trade has not been taken into account as a commodity-wise breakdown of revenue from overland imports is not available. The value of imports figures are from the "Accounts relating to the Foreign Trade and Navigation of India". A uniform commodity classification has been adopted from the published trade and revenue statistics.

STATISTICAL

STATEMENT

Imports of Industrial Requirements (i.e., *Capital*

S. No.	Description of commodities	1920-21 Value	1920-21 Duty	1925-26 Value	1925-26 Duty
1	Asbestos	19	..	19	..
2	Belting for machinery	1,46	*	82	*
3	Bobbins	62		39	*
4	Bristles and fibres for brushes and brooms	0·5	..	0·4	..
5	Building and Engineering materials	2,26	17·3	1,19	22·7
6	Chemicals and chemical preparations	2,66	19·7	2,03	29
7	China clay	28	—	16	—
8	Coal and coke	30	0·5	98	2
9	Coir unmanufactured	0·2	..	1	..
10	Cork manufactures	6	..	3	..
11	Dyeing and tanning substances	3,74	†	1,82	†
12	Earthenware and porcelain	89	‡	77	‡
13	Raw cashewnuts	..	..	..	..
14	Gelatine	0·7	..	0·7	..
15	Scientific glassware and sheet and plate glass	73	7·3	31	3·6
16	Glue	3	..	4	..
17	Graphite crucibles	2	..	2	..
18	Gums and resins	28	4	26	4·6
19	Hardware (excluding domestic, etc.)	7,20	81	3,47	90
20	Hides and skins, raw	11	—	17	—
21	Hops	2	—	2	—
22	Instruments, apparatus, etc. (excluding domestic).	4,79	44	2,45	36
23	Ivory, unmanufactured	22	1·5	22	2·6
24	Lacs	20	—	1	—
25	Leather, unwrought	1,14	4	51	*2·5
26	Denatured spirit	3	0·4	7	0·6

APPENDIX D

I

Goods and Producers' Goods)

(In lakhs of Rupees)

1931-32		1938-39		1946-47		1948-49		1953-54	
Value	Duty	Value	Duty	Value	Duty	Value	Duty	Value	Duty
15	..	21	3	58	7	1,02	13	1,06	16
50	*	49	2	1,23	5·4	2,12	10	1,08	4
32	*	38	*	90	*	1,26	*	14	*
—	—	—	—	0·5	—	0·8	—	0·6	—
84	23	62	16	65	18·4	2,81	56	3,05	97
2,57	54	3,06	61	7,46	1,77	20,57	3,99	12,69	3,39
9	—	15	—	0·6	—	4·4	—	16	—
14	—	8	—	5	—	—	—	3	—
0·6	..	1	—	2	—	—	—	—	—
3	..	5	2	44	12·4	26	7·7	34	11
2,68	11	3,12	33	10,21	1,09	13,46	1,37	17,09	2,02
38	‡	39	6	58	8·6	27	7·2	35	20
..	..	16	—	1,21	—	1,53	—	4,23	—
1	..	0·5	—	4	..	4	..	3	..
21	4·4	26	6·5	43	13	1,05	39·4	70	34
6	..	6	2	3	0·8	1·4	—	1	—
2	..	2	—	6	..	11	..	3	..
24	5·7	30	9	90	24	1,32	38	94	29
1,93	60	1,90	57	3,41	1,02	5,45	1,63	1,76	55
14	—	16	—	17	—	50	—	36	—
1	—	1	—	1	—	—	—	1	—
2,58	59	4,36	81	9,60	2,15	15,06	3,39	19,42	4,74
10	2	10	2	43	10·4	32	6·3	26	6
2	—	8	—	16	—	1,04	—	48	—
44	2·4	51	7	74	7·5	84	5·7	30	
10	1	3	0·3	0·2	—	0·4	—	0·5	—

STATEMENT

S. No.	Description of commodities	1920-21 Value	1920-21 Duty	1925-26 Value	1925-26 Duty
27	Machinery and mill work (except refrigerators, sewing and knitting machines and typewriters)	21,30	62	13,91	60
28	Manures	13	—	33	—
29	Metals—Iron and steel	31,30	70	18,07	3,62
	Metals—Non-ferrous	934	70	7,28	96
30	Ores	11	—	2	—
31	Mica	—	—	6	—
32	Oils except kerosene and motor spirit .	4,45	32	5,56	46
	Motor spirit (4/5th of the total imports) .	—	—	—	—
33	Packing, Engine and Boiler	6	1	6	1·5
34	Paints and Painters' materials . . .	1,95	48	1,30	45
35	Paper and pasteboard excluding writing paper	5,27	39	2,29	38
36	Paper making materials	50	..	26	..
37	Pitch and tar	12	1·2	6	1·8
38	Plastics except finished goods . . .	—	—	—	—
39	Polishes and compositions	43	3	22	3·4
40	Printing and lithographic materials . . .	45	§	30	§
41	Rubber, raw	—	—	1	—
42	Seeds	52	1·2	17	11·0
43	Starch, dextrine and farina . . .	17	0·5	28	2·6
44	Stone and marble	13	1·2	10	1·4
45	Tallow and stearine	48	3·5	29	6
46	Tea chests	1,02	2·6	85	..
47	Cotton, raw	1,70	—	3,65	—
	Cotton twist and yarn	13,57	—	7,76	38·8
	Flax raw, twist and yarn . . . . . } Hemp raw . . . . . . }	10	0·5	11	2·1
	Silk, raw and cocoons	1,63	10	94	14

APPENDIX D—*contd.*

I—*contd.*

(In lakhs of Rupees)

1931-32		1938-39		1946-47		1948-49		1953-54	
Value	Duty	Value	Duty	Value	Duty	Value	Duty	Value	Duty
10,28	67	18,24	2,28	28,74	4,28	73,79	7,05	82,14	6,30
36	—	1,05	—	3,02	—	4,93	—	3,41	—
6,33	1,58	6,66	1,01	4,68	96	12,31	1,82	23,57	3,07
3,44	62	4,16	74	15,93	2,64	22,33	2,10	14,51	1,04
1	—	3	—	10	—	21	—	25	—
1	—	2	—	—	—	13	—	6	—
4,34	51·5	5,31	66	15,66	2,05	20,73	2,79	33,93	4,72
84	53·6	2,51	4,12	6,68	9,45	8,54	7,74	24,72	22,02
3	1·6	4	1	6	2·2	9	3·4	6	2
88	25	89	24	1,45	38	2,25	66	1,77	56
2,06	48	2,78	69	6,17	1,85	11,72	2,08	10,47	2,86
36	..	27	7	23	7	48	9	1,09	15
3	1·7	2	0·6	1	0·3	2	0·8	2	0·8
—	—	—	—	—	—	—	—	2,36	59
19	4·6	23	6	48	15	55	18	22	7
28	§0·4	37	§1	84	§2·1	2,77	§2·3	1,70	§2
1	—	11	—	3	—	1,02	—	9	—
12	1·6	71	19	36	9	1,20	26	3,83	21
35	..	48	10	1,69	13	2,61	25	6	2
4	1	9	3	6	3	9	4	7	1
21	2·2	32	..	33	0·5	56	0·5	1,05	—
50	..	90	23	1,39	41	1,89	56·4	19	5
7,03	23	8,51	82	25,93	2,97	64,23	2,40	52,71	3,13
2,99	20	2,93	29	9	0·5	4,50	24	1,32	—
3	1·8	4	1	3	—	7	2·7	52	0·3
62	16	62	29	2,17	76	1,71	90	59	30

S. No.	Description of commodities	1920-21 Value	1920-21 Duty	1925-26 Value	1925-26 Duty
	Silk yarn	83	12·5	35	13·6
	Art silk yarn	6	..	75	..
	Raw wool, yarn and knitting wool	31	..	80	..
	Staple fibre ¶	—	—	—	—
48	Tobacco, unmanufactured	9	1	34	49
49	Umbrella fittings	20	3	41	6
50	Vehicles (except cycles, motor cars and motor cycles)	11,56	77	6,82	94
51	Wax	1	—	1	—
52	Wood and Timber (except manufactures)	1,08	10	52	7·5
	TOTAL OF ABOVE ITEMS	13611·4	628·9	8983·1	1083·3
	Total of non-industrial goods: Excluding food-grains	19943·6	1835·1	14550·9	3045·7
	Total of non-industrial goods: Including food-grains.	19948·6		14616·9	
	Total imports, excluding foodgrains	33555	2464	23534	4129
	GRAND TOTAL OF IMPORTS	33560		23600	

—Nil or negligible.
.. Not available.
*Included in serial No. 26.
†Included in serial No. 34.
‡Included in serial No. 5.
§Wholly/mostly included in Serial No. 27.

APPENDIX D—*contd.*

I—*concld.*

(In lakhs of Rupees)

1931-32		1938-39		1946-47		1948-49		1953-54	
Value	Duty	Value	Duty	Value	Duty	Value	Duty	Value	Duty
51	11·4	32	17	54	19	..	8·4	3	1
82	12	96	41	3,99	1,27	12,83	4,07	12,04	4,53
54	..	1,26	18	3,97	59¶	4,71	45	9,78	35
—	—	22	0·4	36	11	21	0·2	4,24	95
30	41	58	1,04	2,77	7,87	2,95	7,61	62	1,89
28	4·2	14	4	32	5	52	7·8	31	10
5,63	45	3,50	76	9,10	1,79	21,02	4,09	18,32	8,21
1	—	4	1	2	—	4	1·2	13	4
49	11·3	2,71	9	20	3·2	5,05	10	2,06	13
6348.6	886.4	8353.7	1743.8	17671.9	4528.3	35516.0	5797.0	37280.1	7427·1
6170.4 6288.4	3008·6	5826.3 7202.3	2236·2	9289.1 11171.1	4400·7	10048 20201	4001	10583.9 17821.9	4601·9
12519 12637	3895	14180 15556	3980	26961 28843	8929	45564 55717	9798	47864 55102	12029

¶ Value figures include raw fibre and yarn, but duty figures relate to raw fibre only, duty on yarn being included in art silk yarn.

NOTE.—The data cover sea and air-borne imports only. Value figures are from the "Accounts relating to the Foreign trade and Navigation of India". Duty figures are from "Customs and Excise Revenue Statement of the Indian Union". In certain cases, duty figures have been calculated by applying the appropriate rates of import duties to the value figures.

STATISTICAL

STATEMENT

Share of Industrial Requirements in Total Imports and the Revenue requirements

S. No.		1920-21		1925-26		1931-32	
		Excluding food-grains	Including food grains	Excluding food grains	Including food-grains	Excluding food-grains	Including food-grains
1	Value of industrial goods as percentage of total imports.	40·6	40·6	38·2	38·1	50·7	50·2
2	Duty on industrial goods as percentage of total import revenue.	25·5		26·2		22·8	
3	Duty on industrial goods as percentage of their value of imports.	4·6		12·1		14·0	
4	Duty on non-industrial goods as percentage of their value of imports.	9·2	9·2	20·9	20·9	48·8	47·9
5	Total import revenue as percentage of total value of imports .	7·3	7·3	17·5	17·5	31·1	30·8

APPENDIX D—*concld.*

II

from Import Duties in relation to value of Imports of Industrial and other Items

1938-39		1946-47		1948-49		1953-54	
Excluding food-grains	Including food-grains	Excluding food-grains	Including food-grains	Excluding food-grains	Including food-grains	Excluding food-grains	Including food-grains
58·9	53·7	65·5	61·3	77·9	63·7	77·9	67·7
43·8		50·7		59·2		61·7	
20·9		25·6		16·3		19·9	
38·4	31·0	47·4	39·4	39·8	19·8	43·5	25·8
28·1	25.6	33·1	31·0	21·5	17.6	25·1	21·8

STATEMENT

Central Excise Revenue Realisations by

Commodities	1920-21	1921-22	1922-23	1923-24	1924-25	1925-26	1926-27
1. Cotton piece-goods	2,31	2,19	1,87	1,57	2,18	1,47	..
2. Motor spirit (including power alcohol)	54	61	65	65	79	77	96
3. Kerosene	..	..	92	95	98	98	1,05
4. Silver	..	..	..	..	..	..	..
5. Sugar (including khandsari).	..	..	..	..	..	..	..
6. Matches	..	..	..	..	..	..	..
7. Mechanical lighters	..	..	..	..	..	..	..
8. Steel ingots	..	..	..	..	..	..	..
Total Gross Receipts	2,85	2,80	3,44	3,17	3,95	3,22	2,01
Refunds and drawbacks	2	9	13	18	7	11	2
Total net receipts	2,83	2,71	3,31	2,99	3,88	3,11	1,99

APPENDIX E

I

Commodities (Excluding Salt)

(In lakhs of Rupees)

1927-28	1928-29	1929-30	1930-31	1931-32	1932-33	1933-34	1934-35	1935-36	1936-37
..	..	..	..	..	..	..	..	..	..
1,21	1,55	2,81	2,68	3,48	3,94	4,43	4,91	5,32	5,59
97	92	96	1,44	2,48	2,77	2,81	2,97	2,84	3,01
..	..	..	17	23	1	..	..	..	
..	..	..	..	..	..	..	97	1,59	2,59
..	..	..	..	..	..	..	1,37	2,03	2,05
..	..	..	..	..	..	..	..	..	..
..	..	..	..	..	..	..	12	35	34
2,18	2,47	3,77	4,29	6,19	6,72	7,24	10,34	12,13	13,63
1	1	2	6	6	14	18	20	31	29
2,17	2,46	3,75	4,23	6,13	6,58	7,06	10,14	11,82	13,34

STATISTICAL

STATEMENT

Commodities	1937-38	1938-39	1939-40	1940-41	1941-22	1942-43	1943-44
1. Motor spirit (including power alcohol).	1,36	1,25	1,13	1,88	1,78	2,63	2,93
2. Kerosene . .	82	68	50	71	65	70	54
3. Silver . . .	..	..	..	..	..	..	..
4. Sugar (including khandsari).	3,34	4,24	2,49	3,93	6,73	4,91	6,69
5. Matches . .	2,01	2,18	2,25	2,29	2,96	3,32	4,73
6. Mechanical lighters .	..	..	..	..	..	..	..
7. Steel ingots . .	37	38	42	50	54	51	59
8. Tyres . . .	..	..	..	..	35	56	83
9. Tobacco . .	..	..	..	..	..	2	9,65
10. Vegetable product .	..	..	..	..	..	..	94
11. Betelnuts . .	..	..	..	..	..	..	..
12. Coffee . . .	..	..	..	..	..	..	..
13. Tea . . .	..	..	..	..	..	..	..
14. Cloth . . .	..	..	..	..	..	..	..
15. Cement . .	..	..	..	..	..	..	..
16. Soap . . .	..	..	..	..	..	..	..
17. Rayon or art silk .	..	..	..	..	..	..	..
18. Footwear . .	..	..	..	..	..	..	..
19. Miscellaneous .	..	..	..	..	..	..	..
Total gross receipts .	7,90	8,73	6,79	9,31	13,01	12,65	26,90
Refunds and drawbacks .	23	7	28	13	17	11	2,75
Total net receipts .	7,67	8,66	651	9,18	12,84	12,54	24,15

SOURCE.—(1) Combined Finance and Revenue accounts upto 1945-46.

(2) Central Board of Revenue thereafter.

NOTES.—(1) Total receipts from 1940-41 onwards do not include cess on coal and coke and 1946.

(2) The figures upto 1946-47 relate to undivided India. The figures

APPENDIX E—*contd.*

I—*contd.*

(In lakhs of Rupees)

1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
2,90	2,33	1,81	1,27	1,33	1,68	1,98	2,03	1,96	2,62
44	35	26	25	20	22	28	26	24	33
..	..	..	..	..	..	..	..	..	..
6,41	5,70	4,79	4,43	6,31	7,10	6,58	8,49	9,91	14,33
5,56	6,52	4,44	4,82	7,29	7,44	8,04	8,61	9,35	8,78
2	..	..	..	..	..	..	..	..	..
52	52	46	48	46	52	54	61	63	60
1,15	1,27	75	1,05	1,99	3,58	4,05	6,10	4,38	4,95
17,28	20,82	18,95	18,72	25,30	25,88	31,79	35,40	33,95	33,24
1,11	1,33	1,29	1,01	1,94	2,18	2,19	2,49	2,78	2,81
1,31	1,84	85	29	..	..	..	..	..	..
17	34	38	28	49	50	80	77	64	79
1,50	1,90	2,10	3,05	3,65	2,50	3,40	4,32	3,38	2,12
..	..	..	..	89	13,21	9,81	16,33	13,43	21,58
..	..	..	..	..	..	..	..	..	17
..	..	..	..	..	..	..	..	..	7
..	..	..	..	..	..	..	..	..	2
..	..	..	..	..	..	..	..	..	7
22	37	18	12	25	27	37	32	40	44
38,59	43,29	36,26	35,77	50,09	65,08	69,83	85,73	81,05	92,92
3,15	55	80	51	18	66	1,51	2,05	1,45	1,00
35,44	42,74	35,46	35,26	49,91	64,42	68,32	83,68	79,60	91,92

and collections under sugar (Additional excise duty) Ordinances 1943, 1944 for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F

STATEMENT I

Tobacco—Unmanufactured: Acreage and Production

Year (September-August)	No. of growers	Acreage	Production	Quantity allowed for retention by growers free of duty
1	2	3	4	5
		Acres	lbs. (000)	lbs. (000)
1943-44		476,739	405,259	
1944-45		765,655	693,643	
1945-46		784,326	697,563	
1946-47		515,269	420,097	
1947-48		506,965	426,534	
1948-49		572,923	525,622	
1949-50		801,132	667,224	
1950-51	1,207,677	852,787	680,905	25,668
1951-52	1,240,112	728,361	671,276	30,044
1952-53	1,491,784	1,002,572	842,757	35,194

SOURCE.—Central Board of Revenue.

NOTE.—Figures up to 1945-46 relate to undivided India. The figures for Part B States are included only from 1949-50.

STATISTICAL APPENDIX F

Statement II

Clearances of unmanufactured Tobacco for Duty

(In million lbs.)

Tariff Class	1943-44	1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54	
(1) Flue cured tobacco used in the manufacture of cigarettes containing the following percentage by weight of imported tobacco :— Exceeding / Not exceeding												
(i) 60% ..	13·3	..	1·8	0·9	1·0	0·5	0·4	0·5	0·5	0·3	0·2	
(ii) 40% 60%		0·1	1·8	1·6	0·6	0·7	1·1	1·5	1·3	1·0	1·1	
(iii) 20% 40%		7·3	8·6	7·9	9·1	7·7	4·9	2·9	0·7	0·5	0·1	
(iv) .. 20%	2·6	6·1	6·3	7·6	8·1	4·6	5·5	5·1	5·1	4·4	0·2	
(v) No imported tobacco	5·8	11·2	9·4	8·5	6·8	6·0	12·2	16·6	16·4	14·9	22·8	
(2) Flue cured tobacco used for the manufacture of smoking mixtures for pipes and cigarettes	2·7	..	..	..	..	..	..	..	..	..	..	
(3) (a) Flue cured scrap choora (from 1-3-51)	..	..	..	..	..	..	..	..	0·6	1·1	1·4	
(b) Exempted under notification (from 1-3-51)	..	..	..	..	..	..	..	..	2·3	5·6	4·9	(F.C.)
									0·7	1·1	..	(Other than F.C.)
(c) Gulla tobacco (upto 28-2-51)	..	0·6	2·4	2·5	1·8	2·4	0·9	1·6	..	..	..	

STATISTICAL APPENDIX F

STATEMENT II—*contd.*

Clearances of unmanufactured Tobacco for Duty

(In million lbs.)

	1943-44	1944-45	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
(4) (a) Other than flue cured and used for the manufacture of cigarettes or smoking mixtures for pipes and cigarettes . .	11·2	14·0	19·0	14·9	11·1	9·0	11·4	20·4	22·1	21·6	21·8
(b) Any other purpose (upto 28-2-51)	1·9	2·1	1·2	0·9	0·3	0·3	0·4	0·4	..	..	..
(5) Other than flue cured not ordinarily used for smoking mixtures for pipes and cigarettes but used for manufacture of biris .	52·6	59·2	61·7	65·8	76·3	93·5	90·0	105·5	116·1	120·2	116·4
(6) Other than flue cured and not otherwise specified :—											
(i) Snuff	3·1	3·6	6·0	7·8	4·3	4·4	5·6	5·6	8·7	7·6	8·7
(ii) Cigar and cheroot . .	27·4	37·6	46·0	49·0	48·2	51·5	49·1	52·2	43·2	40·4	38·1
(iii) Hookah	181·3	142·6	178·7	174·2	93·4	107·3	111·2	120·9	117·5	123·7	117·1
(iv) Chewing	88·3	93·0	127·1	117·9	116·4	127·3	127·6	129·3	112·8	108·6	109·0
(7) Free of duty for											
(i) Agricultural purposes .	0·6	1·5	6·3	24·8	34·7	33·3	23·8	36·0	30·0	37·0	48·1
(ii) Destruction . .	..	0·8	1·5	3·8	5·5	3·1	3·8	5·7	4·7	4·2	5·9
(iii) Industrial purposes .	..	..	..	..	..	..	..	..	..	..	..
(8) Stalks	17·5	57·9	31·6	28·3	19·0	20·7	23·9	24·5	27·3	30·1	33·6
TOTAL . .	408·3	437·6	509·4	517·0	436·6	472·3	471·8	528·7	510·0	522·3	529·4

SOURCE.—Central Board of Revenue.

NOTE.—The figures upto 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F—*contd.*

STATEMENT III

Clearance of Excisable Manufactured Tobacco for Duty

I. Cigars and Cheroots

Tariff Class: Cigars and cheroots of which the value per hundred — Exceeds Rs. A. P.	Does not exceed Rs. A. P.	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
				Nos. (00)			
30 0 0	..	330	322	219	147	60	66
25 0 0	30 0 0	404	287	380	525	201	51
20 0 0	25 0 0	761	727	1029	807	602	603
15 0 0	20 0 0	2732	1985	2249	2199	2121	1873
10 0 0	15 0 0	5801	4349	5416	6877	6543	6219
5 0 0	10 0 0	2,8533	2,2016	2,2391	3,5204	3,3620	3,1947
2 8 0	5 0 0	12,5724	8,7943	8,2646	8,7350	8,5316	8,0008
1 4 0	2 8 0	43,4853	36,9553	38,1762	77,7282	77,5445	58,7517
0 14 0 from 1-3-51; 0 12 0 from 1-3-44; 0 10 0 from 1-4-43	1 4 0	492,8219	528,9300	556,2609	620,5751	541,5747	401,0347
TOTAL .		552,7357	577,6482	605,8701	711,6142	631,9655	471,8631

II. Cigarettes

Cigarettes the value of which per thousand — Exceeds Rs. A. P.	Does not exceed Rs. A. P.	1948-49	1949-50	1950-51	1951-52	1952-53	1953-54
				Nos. (millions)			
50 0 0	..	26	60	62	48	51	46
40 0 0	50 0 0	85	192	530	1438	1329	1296
30 0 0	40 0 0	1434	1240	864	14	3	31
25 0 0	30 0 0	682	407	374	268	223	162
20 0 0	25 0 0	4813	4379	4572	4983	4006	4189
15 0 0	20 0 0	2733	1518	162	337	284	367
10 0 0	15 0 0	2422	4037	5894	2691	1973	2061
..	10 0 0	4895	4811	8439			
7 8 0	10 0 0			280	5918	4408	5116
..	7 8 0*			426	5258	6250	6507
TOTAL .		17090	16644	21603	20955	18527	19775

SOURCE.—Central Board of Revenue.

NOTE.—The figures upto 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

*From 1-3-51; prior to which date the lowest slab was 'not exceeding Rs. 10.'

STATISTICAL APPENDIX F—*contd.*

STATEMENT IV

Coffee : Acreage, Production and Clearance for Duty

Year	Acreage	Production	Clearance for duty	Rate of duty
1	2	3	4	5
	Acres	lbs. (000)	lbs. (000)	Re./lb.
1944-45	108,012	25,969	13,428	0 2 0
1945-46	107,677	33,781	26,996	0 2 0
1946-47	105,367	21,861	31,088	0 2 0
1947-48	106,926	21,739	20,036	0 2 0
1948-49	111,393	29,586	2[illegible],157	0 3 0
1949-50	116,088	30,886	28,441	0 3 0
1950-51	218,743	41,448	42,062	0 3 0
1951-52	224,366	48,287	33,212	0 3 0
1952-53	N.A.	52,895	36,923	0 3 0
1953-54	N.A.	64,960*	42,346	0 3 0

SOURCE.—Central Board of Revenue.

NOTE.—(1) The figures prior to 1947-48 relate to undivided India. The figures for Part B States are included only from 1950-51.

(2) There were 34,273 coffee estates and 33,975 growers in 1951-52.

*Estimates.

STATISTICAL APPENDIX F—*contd.*

STATEMENT V

Kerosene : Number of Units, Rate of duty, Production and Clearance

Year	Number of units	Rate of duty	Production	Clearance for duty
1	2	3	4	5
		Re./gal.	Gals (000)	Gals (000)
1940-41		0 2 9¾	41,774	
1941-42		0 2 9¾	36,115	
1942-43		0 4 6	24,660	
1943-44		0 4 6	18,940	
1944-45		0 4 6	17,004	15,832
1945-46		0 4 6	14,013	11,775
1946-47		0 3 0	13,945	13,531
1947-48		0 3 0	13,837	13,639
1948-49	3	0 3 0	11,120	10,863
1949-50	3	0 3 0	11,747	12,184
1950-51	4	0 3 0	14,905	14,730
1951-52	2	0 3 0	13,907	14,018
1952-53	1	0 3 0	14,402	13,194
1953-54	1	0 3 0	17,007	17,661

SOURCE.—Central Board of Revenue.

NOTE.—(1) The figures upto 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

(2) The 'number of units' figures in this and subsequent statements relate to units working in March.

STATISTICAL APPENDIX F—*contd.*

STATEMENT VI

Motor Spirit (including Power Alcohol) : Number of units, Rate of Duty, Production and Clearance

Year	Number of units			Rate of duty Rs./Gal.	Production Gals. (000)			Clearance for duty Gals. (000)		
	Motor spirit	Power alcohol	Total		Motor spirit	Power alcohol	Total	Motor spirit	Power alcohol	Total
1	2	3	4	5	6	7	8	9	10	11
1940-41	..	..	..	0 12 0	24,116	Included in col. 6.	24,116	..	..	..
1941-42	..	..	..	0 12 0	24,403		24,403	..	..	..
1942-43	..	..	..	0 15 0	25,398		25,398	..	..	..
1943-44	..	..	..	0 15 0	33,906		33,906	..	..	..
1944-45	..	..	..	0 15 0	31,543	135	31,678	20,872	124	20,996
1945-46	..	..	..	0 15 0	24,488	1,330	25,818	23,788	1,206	24,994
1946-47	..	..	..	0 12 0	21,176	1,924	23,100	22,461	1,956	24,417
1947-48	..	..	..	0 12 0	16,207	2,123	18,330	15,765	2,074	17,839
1948-49	4	9	13	0 12 0	14,393	3,011	17,404	14,640	2,997	17,637
1949-50	5	11	16	0 15 0	15,894	3,543	19,437	15,293	3,058	18,351

1950-51	5	15	20	0 15 0	16,748	4,420	21,168	17,594	4,458	22,052
1951-52	5	16	21	0 15 9	16,674	5,953	22,627	15,917	5,767	21,684
1952-53	5	16	21	0 15 9	16,121	6,769	22,890	15,054	6,744	21,798
1953-54		N.A.		0 15 9	17,548	9,001	26,549	N.A.	N.A.	26,594

SOURCE.—Central Board of Revenue.

NOTE.—The figures upto 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F—*contd.*

STATEMENT VII

Sugar : Number of units, Rate of Duty, Production and Clearance

Year	Sugar (Vacuum Pan)				Sugar (Khandsari)			
	No. of units	Rate of duty	Produc-tion	Clearance for duty	No. of units	Rate of duty	Produc-tion	Clearance for duty
1	2	3	4	5	6	7	8	9
		Rs./Cwt.	Cwt. (000)	Cwt (000)		Rs./Cwt.	Cwt. (000)	Cwt. (000)
1940-41	..	3 0 0	23,324	..	..	0 8 0	392	..
1941-42	..	3 0 0	19,767	..	..	0 8 0	558	..
1942-43	..	3 0 0	20,397	..	..	0 8 0	319	..
1943-44	..	3 0 0	21,522	..	..	0 8 0	428	..
1944-45	..	3 0 0	16,976	19,410	..	0 8 0	516	586
1945-46	..	3 0 0	19,125	19,581	..	0 8 0	342	357
1946-47	..	3 0 0	16,352	15,666	..	0 8 0	425	377
1947-48	..	3 0 0	16,540	14,438	..	0 8 0	381	391
1948-49	121	3 0 0	19,357	20,443	448	0 8 0	395	425
1949-50	130	3 12 0	19,521	19,144	434	0 8 0	432	432

1950-51	142	3 12 0	21,688	18,522	516	0 8 0	420	421
1951-52	141	3 12 0	25,859	22,161	618	0 8 0	572	548
1952-53	126	3 12 0 +1 6 0*	28,757	26,159	486	0 8 0†	156	181
1953-54	142	3 12 0	26,626	30,216	..	..	..	..

SOURCE.—Central Board of Revenue.

NOTE.—The figures upto 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

*From 6th November 1952 to November 1953.

†Abolished from 15th July 1952.

STATISTICAL APPENDIX F—*contd.*

STATEMENT VIII

Matches : No. of units, Rate of duty, Production and Clearance

(In thousand gross boxes)

Year	No. of units	Rate of duty per gross of boxes					Production			
		40's	50's	60's	80's	Bengal lights and others	40's	50's	60's	80's
		Rs. As. P.	Rs. As. P.	Rs. As. P.	Rs. As. P.	Rs. As. P.				
1940-41	N.A.	1 0 0	..	1 8 0	2 0 0	0 5 0 0 4 0	18,367	..	2,922	1,287
1941-42	Do.	2 0 0	2 8 0	3 0 0	4 0 0	0 10 0 0 8 0	8,915	..	6,462	950
1942-43	Do.	"	"	"	"	"	2,467	9,144	2,749	415
1943-44	Do.	2 0 0	2 8 0	3 0 0	4 0 0	"	624	2,462	9,203	257
1944-45	Do.	"	"	"	"	"	488	2,336	15,582	196
1945-46	Do.	"	"	"	"	"	508	2,094	19,747	143
1946-47	Do.	"	" from 1-8-46 1 12 0	"	"	"	183	14,879	5,686	118
1947-48	Do.	"	"	"	"	"	8	23,997	1,842	74
1948-49	Do.	abolished from 29-2-48	2 8 0	"	"	"	263	4,338	20,402	22

1949-50	232 Class	A 2 0 0	..	3 0 0	..	"	242	..	19,924	..
		B 1 15 6	..	2 15 3	..		4,489		1,285	..
		C 1 15 0	..	2 14 0	..		373		15	..
1950-51	238 "	A 2 0 0	..	3 0 0	..	"	492	..	20,190	..
		B 1 15 0	..	2 14 6	..		5,767		2,315	..
		C 1 14 0	..	2 13 0	..		663		22	..
1951-52	235 "	"	..	"	..	"	656	..	21,110	..
							6,582		2,495	..
							739		28	..
1952-53	189 "	"	..	"	..	"	605	..	22,385	..
							8,744		2,855	..
							717		22	..
1953-54	183 "	"	..	"	..	"	434	..	19,722	..
							10,508		1,818	..
							611		29	..

STATISTICAL APPENDIX F—*contd.*

STATEMENT VIII—*contd.*

(In thousand gross boxes).

Year	No. of units	Production			Clearance for duty						
		Others	Bengal lights	Total	40's	50's	60's	80's	Others	Bengal lights	Total
1940-41	N.A.	..	142	22,718	N.A.	..	N.A.	N.A.	N.A.	N.A.	N.A.
1941-42	Do.	..	128	16,455	"	N.A.	"	"	"	"	"
1942-43	Do.	26	29	14,830	"	"	"	"	"	"	"
1943-44	Do.	4	46	12,596	"	"	"	"	"	"	"
1944-45	Do.	71	..	18,673	431	1,658	15,091	198	70	..	17,448
1945-46	Do.	132	..	22,624	450	1,251	19,280	136	130	..	21,247
1946-47	Do.	..	275	21,141	158	14,265	5,983	127	..	273	20,806
1947-48	Do.	..	421	26,342	8	23,919	1,617	74	..	422	26,040
1948-49	Do.	..	150	25,175	176	4,388	20,358	22	..	138	25,082
1949-50	232	..	692	27,020	261 4,455 373	.. ..	19,980 1,222 15	.. ..	.. ..	450	26,756
1950-51	238	..	356	29,805	456 5,775 681	..	20,159 2,287 21	..	..	394	29,773

1951-52 . . .	235	..	268	31,878	657 6,655 736	..	21,151 2,412 29	..	..	276	31,916
1952-53 . . .	189	..	387	35,715	613 8,522 697	..	21,952 2,755 22	..	..	401	34,962
1953-54 . . .	183	1	484	33,607	445 10,591 617	..	19,732 1,935 29	..	1	481	33,831

SOURCE.—Central Board of Revenue.

NOTE.—(1) The figures up to 1946-47 relate to undivided India.

(2) Figures for Part B States are included only from 1950-51.

(3) A—Factories whose output exceeds 500,000 gross boxes per year.
B—Factories whose output does not exceed 500,000 boxes per year but exceeds 100 gross boxes per day.
C—Factories whose output does not exceed 100 gross boxes per day.

(4) There were 7 class A, 88 class B and 94 class C Factories in 1952-53.

(5) Matches of the type Bengal lights containing not more than 12 matches per box are charged 10 annas per gross from 1941-42. All other matches are charged 8 annas for every 1440 matches or fraction thereof from 1941-42.

(6) The figures of small units are not separately available prior to 1949-50. The concessional rates of duty for these units have therefore not been indicated for those years.

STATISTICAL APPENDIX F—*contd.*

STATEMENT IX

Steel Ingots : No. of units, Rate of duty, Production and Clearance

Year	No. of units	Rate of duty	Quantity Produced	Quantity Cleared for duty
1	2	3	4	5
		Rs./Ton	Tons (000)	Tons (000)
1940-41	..	4 0 0	1,285	..
1941-42	..	4 0 0	1,363	..
1942-43	..	4 0 0	1,299	..
1943-44	..	4 0 0	1,339	..
1944-45	..	4 0 0	1,193	..
1945-46	..	4 0 0	1,295	..
1946-47	.	4 0 0	1,200	1,053
1947-48	.	4 0 0	1,191	1,191
1948-49	7	4 0 0	1,162	1,162
1949-50	7	4 0 0	1,309	1,309
1950-51	8	4 0 0	1,402	1,377
1951-52	8	4 0 0	1,507	1,477
1952-53	8	4 0 0	1,560	1,549
1953-54	10	4 0 0	1,501	1,501

SOURCE.—Central Board of Revenue.

NOTE.—The figures up to 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F—*contd.*

STATEMENT X

Tyres and Tubes : No. of units, Rate of duty, Production and Clearance

Year	Tariff Class	No. of units	Rate of duty	Quantity	
				Produced Nos. (000)	Cleared for duty Nos. (000)
1	2	3	4	5	6
			Ad valorem		
1941-42 . .			10%	6,113	N.A.
1942-43 . .			,,	6,483	N.A.
1943-44 . .			,,	7,807	N.A.
1944-45 . .	Tyres . . .		,,	3,496	N.A.
	Tubes . . .		,,	4,349	N.A.
	TOTAL .			7,845	
1945-46 . .	Tyres . . .		10%	3,911	3,775
	Tubes . . .		,,	4,846	4,794
	TOTAL .			8,757	8,569
1946-47 . .	Tyres . . .		10%	3,952	3,514
	Tubes . . .		,,	5,093	4,547
	TOTAL .			9,045	8,061
1947-48 . .	Tyres . .		10%	4,152	3,943
	Tubes . .		,,	5,372	5,159
	TOTAL .			9,524	9,102
1948-49 . .	Tyres . . .		15%	4,893	4,777
	Tubes . . .		,,	4,907	5,010
	TOTAL .	6		9,800	9,787
1949-50 . .	Tyres . .	Motor tyres and tubes	30%	4,910	4,656
	Tubes . . .	Others	15%	3,920	3,740
	TOTAL .	7		8,830	8,396

STATISTICAL APPENDIX F—*contd.*

STATEMENT X—*contd.*

Year	Tariff class	No. of units	Rate of duty	Quantity	
				Produced Nos. (000)	Cleared for duty. Nos. (000)
1	2	3	4	5	6
			Ad valorem		
1950-51	Tyres		As in 1949-50.	4,551	4,405
	Tubes			5,872	5,472
	TOTAL	8		10,423	9,877
1951-52	Motor tyres		30%	872	825
	Motor tubes		30%	852	810
	Other tyres		15%	4,168	4,210
	Other tubes		15%	4,779	4,591
	TOTAL	7		10,671	10,436
1952-53	Motor tyres		30%	657	581
	Motor tubes		30%	583	532
	Other tyres		15%	4,276	4,012
	Other tubes		,,	4,039	4,120
	Total	7		9,555	9,245
1953-54	Motor tyres		30%	834	741
	Motor tubes		,,	709	649
	Other tyres		15%	4,867	4,802
	Other tubes		,,	5,218	[5,450
	Total	7		11,628	11,642

SOURCE.—Central Board of Revenue.

NOTE.—The figures up to 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F—*contd.*

STATEMENT XI

Vegetable Product : No. of units, Rate of duty, Production and Clearance

Year	No. of units	Rate of duty	Quantity	
			Produced	Cleared for duty
1	2	3	4	5
		Rs./cwt	cwt(000)	cwt(000)
1943-44		5 0 0	2,109	N.A.
1944-45		5 0 0	2,475	2,427
1945-46		5 0 0	2,773	2,763
1946-47		5 0 0	2,653	2,702
1947-48		5 0 0	1,987	1,909
1948-49	19	7 0 0	2,769	2,785
1949-50	34	7 0 0	3,300	3,122
1950-51	47	7 0 0	3,257	3,106
1951-52	43	7 0 0	3,868	3,571
1952-53	38	7 0 0	4,221	4,013
1953-54	48	7 0 0	4,112	4,011

SOURCE.—Central Board of Revenue.

NOTE.—The figures up to 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

STATISTICAL APPENDIX F—*contd.*

STATEMENT XII

Tea : No. of units, Rate of duty, Production and Clearance

Year	No. of licensees	Rate of duty	Production	Clearance for duty
1	2	3	4	5
		Re./lb.	lbs.(000)	lbs.(000)
1944-45		0 2 0	450,180	109,467
1945-46		0 2 0	488,279	139,613
1946-47		0 2 0	556,531	157,906
1947-48		0 2 0	538,877	203,296
1948-49		0 3 0	529,756	549,689
1949-50	1,924	0 3 0	543,692	537,222
1950-51	2,223	0 3 0	624,524	624,114
1951-52	2,069	0 3 0	651,193	627,576
1952-53	2,066	0 3 0	632,497	609,952
1953-54	2,179	L.T. 0 1 0 P.T. 0 4 0	633,845	624,297

SOURCE.—Central Board of Revenue.

NOTE.—(1) The increase in quantities in Col. 5 from 1948-49 has been due to the revised procedure under which tea meant for export was also required to pay excise duty which was later transferred to the Customs head on export.

(2) The figures up to 1946-47 relate to undivided India. The figures for Part B States are included only from 1950-51.

(3) 'L.T.' represents loose tea and 'P.T' represents package tea.

STATISTICAL APPENDIX F—*contd.*

STATEMENT XIII

Cloth : No. of units, Rate of duty, Production and Clearance

Year	Tariff class	No. of units (Composite mills).	Rate of duty	Quantity Yds. (000) Produced	Quantity Yds. (000) Cleared for duty
1	2	3	4	5	6
1949-50	Superfine		From 1-1-49 25% *ad valorem*	320,642	306,933
	Fine		From 1-3-49 6¼% *ad valorem*	845,406	734,259
	Medium		From 1-3-49 Re. 0-0-3 per yd.	1,901,063	1,664,978
	Coarse		From 1-3-49 Re. 0-0-3 per yd.	317,047	211,247
	TOTAL	225		3,384,158	2,917,417
1950-51	Superfine		From 1-2-50 20%	186,064	152,482
	Fine		,, 5%	1,192,617	678,232
	Medium		Re. 0-0-3 per yard	1,946,200	1,362,430
	Coarse		,, ,,	406,867	286,218
	TOTAL	263		3,731,748	2,479,262
1951-52	Superfine		20% *ad valorem*	293,533	272,617
	Fine		5% ,,	1,275,998	1,114,631
	Medium		Re. 0-0-3 per yard	2,352,059	2,117,807
	Coarse		,, ,,	372,395	316,425
	TOTAL	265		4,293,985	3,821,480
1952-53	Superfine		20% *ad valorem* or from 9-5-52 Re. 0-3-0 or Re. 0-3-6 per yd.	200,945	187,181
	Fine		5% *ad valorem* or from 9-5-52 Re. 0-0-7 to Re. 0-1-0 per yard.	1,147,566	966,985
	Medium		Re. 0-0-3 per yard.	2,759,006	2,675,984
	Coarse		,, ,,	533,446	390,217
	TOTAL	265		4,640,963	4,220,367

STATISTICAL APPENDIX F—*contd.*

STATEMENT XIII—*contd.*

Cloth : No. of units, Rate of duty, Production and Clearance

Year	Tariff class	No. of units (Composite mills)	Rate of duty	Quantity Yds. (000) Produced	Quantity Yds. (000) Cleared for duty
1	2	3	4	5	6
1953-54	Superfine		Re. 0-3-3 (Re. 0-2-0 from 25-10-53) per yd.	290,709	260,391
	Fine		Re. 0-1-3 per yard	757,736	662,004
	Medium		Re. 0-0-3 „	3,248,828	2,850,837
	Coarse		„ „	602,4[illegible]	443,833
	TOTAL	279	(plus additional duty of Re. 0-0-3 per yard on all varieties with effect from 15-2-53).	4,899,743	4,217,065

SOURCE.—Central Board of Revenue.

NOTE.—The figures for Part B States are included only from 1950-51.

GIPND—SS—317 MofF—19-2-55—12,000.

COVER DESIGNED AND PRINTED BY THE MANAGER,
GOVT OF INDIA PHOTO LITHO PRESS, NEW DELHI.