GOVERNMENT OF INDIA

MINISTRY OF FINANCE

FINAL REPORT

ON

RATIONALISATION AND SIMPLIFICATION OF THE TAX STRUCTURE

By

Shri S. BHOOTHALINGAM

Formerly Secretary in the Ministry of Finance

Government of India

Price: *Rs.* 2·10 *P. or* 4 *sh.* 11 *d. or* 76 *cents.*

CONTENTS

I. GENERAL

1. Introduction

1.1 I now submit my final report on the rationalisation and simplification of the tax structure. It is obviously impossible, in the course of eight or nine months, to study and discuss all the problems in the entire field of taxation. I have therefore not attempted to do so. I have chosen what I regard as important areas in which improvement is desirable and practicable. In the main, I have devoted attention to substantive problems relating to the tax structure. I have dealt with procedural and administrative problems only in so far as they are germane and necessary. I have again devoted the greater part of my time—and therefore a greater part of my report—to income and corporation taxes. On indirect taxation I have mainly confined myself to the discussion of certain important general considerations which have led me to recommend a far reaching change in the concept and levy of excise duties by the Centre. Problems of administration and procedure have been already dealt with in large measure by the Central Excise Reorganisation Committee and what remains is being dealt with by several other Committees.

1.2 My interim report was published in May, 1967 and many of the recommendations were immediately implemented. The others are now being considered by Government. The report has, as I hoped, stimulated thought and discussion both on the specific recommendations made and the general approach outlined in it. I followed this up by writing to a large number of organised Associations of those concerned with and interested in the subject, outlining the points for consideration and discussion. I have received many written memoranda on a wide variety of subjects ranging from discussion of first principles to details of procedure. I have also discussed many of the problems with representatives of these Associations. I have tried to give attention to all matters emerging out of these memoranda and discussions, but more as an aid to my own study of the problem than with a view to ascertain the consensus, if one exists, on what is generally felt or desired. In this process I have received invaluable help from the officers of the Departments both in headquarters and in the "field". They have helped me a great deal both in studying the many valuable contributions from organised Associations and in visualising the administrative and practical implications of my recommendations.

2. Some general considerations

2.1 At the outset, I must repeat that any worthwhile rationalisation or simplification will be possible only if certain changes in policy are made. At any given time the tax structure and procedures reflect the result of a series of policy decisions of varying importance taken in the past. The tax system as a whole is designed to draw off a portion of the national income for purposes of public consumption and investment. In economic terms this system would include not only all taxation by the Centre, the States and the local bodies, but also the price system of public undertakings I refer to that part of the price which is as a matter of policy designed to transfer resources from private to public hands and which, therefore, is indistinguishable from excise or sales taxes. The central problem of public finance is to design and construct this system in such a way that the economic effects are the most desirable (or the least undesirable) in relation to the objectives of society as interpreted by Government. In this context, it would be well not to forget that objectives themselves, and the relative priorities among them, change from time to time, partly because of fulfilment and partly because of insufficient achievement. But the facts of life, however, bear no close resemblance to this theoretical ideal By and large the tax system at any given time is what it has grown into. A good deal of growth is bound to be haphazard. Often the reasons for which any particular tax or tax method was introduced get lost in a mist of fading memory; yet they exhibit great survival value. More often than not new taxes or other types of fiscal changes are introduced to subserve the needs of the moment and are grafted on to the existing body without enough regard for compatibility or consistency. All the time the never ending struggle against legal avoidance and evasion leads to change after change in methods and procedures. In the process some pull in different directions while others even tend to cancel each other out. To a large extent this kind of automatic growth is inevitable. The remedy for this, as I have said in the interim report, is periodical spring cleaning. But this alone will not be enough. A reappraisal of the numerous policy objectives embodied in the existing system is equally necessary. Some of them may have ceased to be valid or become relatively unimportant and others may now require instruments stronger than or different from what may have remained essentially unchanged for a long time.

2.2 I have tried to indicate in the appropriate context the kind of policy changes involved in my specific recommendations. At this stage I would only emphasize the need to bear in mind that, while every fiscal measure will have an economic effect whether specifically desired or not, the fiscal instrument is neither the only nor the best method available to bring about the desired economic changes. There is always a tendency, hard to resist in practice, to use this method somewhat indiscriminately. Taxation is and should be one of the major instruments of policy. But its value in this role will be enhanced rather than diminished by using it only for major policies. Too wide or too indiscriminate use only tends to blunt the instrument. One is often tempted to use the tax instrument as an escape from the right though harder way, ignoring the fact that after all it may prove ineffective. To cite an imaginary example. I will not be surprised if for encouraging family planning it is suggested that doctors should be taxed less on what they earn by assisting in family planning. Having given a tax concession of this nature as an incentive one can comfortably feel that the day's duty is done. But while its value as an incentive may prove extremely doubtful in practice, what is certain is that it will become a fruitful source of dispute between doctors and the tax authorities and these in turn pay lead to further refinements causing further disputes. I would, therefore, urge that every time the fiscal method is considered for gaining any policy objective, one should invariably ask, "Is this the right method? Does a better one exist? Will the administrative and procedural complications that must ensue be more than counter-balanced by the gains?" Unless these questions are consciously and satisfactorily answered, the fiscal instrument should not be used. On a somewhat lower plane I must also say that a passion for change if given vent to indiscriminately may also do more harm than good. I know of a number of small changes, and many have been suggested to me, which taken in isolation can be considered reasonable and even necessary. Yet, I have not recommended changes of this character on the test that any change must be clearly worthwhile.

2.3 Any attempt at rationalisation of the tax structure as a whole will lose value and significance unless it is done with a sense of direction towards clear objectives however remote or difficult to achieve. Mere "rationalisation" of the past can at best impart a little more order and method or remove superficial anomalies and irritations. The effects will not last long. One should therefore first seek an answer to the question "what should be the ideal system to aim at and why?" Every change can then be judged on the test whether it helps to move towards such a system. I believe that ideally a tax system should be built in such a way that the growth in national income will be automatically reflected in the revenues of the State. The various parts of the system should support and strengthen one another. Such reflection of the growth in national income is now imperfect. Stable import duties will no doubt accurately reflect total imports but in a large country with varied resources capable of providing a high degree of self-sufficiency it cannot be predicted that imports will rise at the same rate as the national income. Rather the reverse should be expected. Export duties are likely to be unreliable revenue yielders in the future as in the past. A stable corporation tax on profits will automatically reflect growth in the corporate sector. But the corporate sector itself, though growing, provides a relatively small part of total national income. Personal taxation of incomes would have provided an adequate answer but for two important factors. One is that the entire agricultural sector in which is generated nearly half the national income has to remain outside its purview until the Constitution is amended. The second is that with incomes distributed as at present and likely to be so for some years to come, its extensive use is administratively difficult, wasteful and therefore clearly not worthwhile. The other direct taxes—Wealth tax, Estate Duty and the Gifts tax—while being essential parts of the system, are obviously not designed for this purpose. A universal sales tax will be an adequate and suitable instrument, but it is reserved for the States. A universal Expenditure tax could theoretically be regarded as almost an ideal single tax, but this is equally ruled out for practical reasons. The Excise duty remains. This is an instrument available for the Central Government except in the very narrow area of alcoholic beverages. Fortunately, this can be the best of available instruments by the use of which stability can be combined with automatic reflection of growth in the national income of a large and growing sector. I propose, therefore, to devote some attention to this subject first.

II. INDIRECT TAXES

3. Excise Duties

3.1 A generation ago, an excise duty was levied by the Central Government only on a few commodities such as salt, tobacco, matches, tea, sugar and cotton textiles. During the last twenty years the scope of this tax has been considerably widened. Today excise duties are levied on more than sixty commodities which include many semi-processed as well as finished goods. It is, therefore, no longer true to say that excise duties are mainly applied to commodities of mass consumption. Most of the excise duties are specific, some *ad valorem* and some a combination of the two. Besides these which are called basic duties, there are "special duties" on twenty-nine of these commodities, the proceeds of which are not shared with the States but kept exclusively for Central use. Some "additional duties" were introduced in 1957 in replacement of sales tax levied by State Governments on some commodities. Another kind of combined additional duty of excise and customs was introduced on mineral oils in 1958. The effective rates of excise duty vary widely ranging from four per cent in the case of caustic soda and soda ash to over 300 per cent on motor spirit and high speed diesel oil. Generally speaking excise duties are multipoint levies although the range of exemptions designed to mitigate the multi-point effect has been increasing. Similarly, exemptions given from time to time either by way of reliefs or incentives or preferences to smaller units of production have tended to increase. The administrative processes have become quite elaborate. Manufacturers are "licensed" and are required to maintain daily accounts of production and despatches. Despatches are physically controlled by the excise authorities and the duty is collected at the time of "clearance". Normally all clearances are supposed to be made on gate passes countersigned by an excise officer. The strain on the administration caused by this type of control which visualises physical supervision over various stages of production and examination of goods before clearance and control of despatches by gate passes authorised by excise officers has naturally tended to increase greatly. To relieve the strain to some extent, what has come to be known as the "audit type of control" was initiated in 1962 and is now applied in eleven industries. These arrangements permit assessment by the manufacturer himself subject to a weekly check of accounts of production, deliveries and payments. These arrangements are regarded as experimental, the orthodox view still evidently being elaborate physical checks are necessary to ensure collection and prevent leakage. The experiment therefore has so far been confined to well organised industries where the number of factories is not very many and the tariff is relatively simple. Besides physical supervision, the administration has tended to become highly complex in other ways also. The commodities have to be precisely defined. Often the required precision is just not possible and, therefore, different interpretations come to prevail. The elaborate procedures and the numerous checks and cross checks require a variety of records to be maintained and returns to be submitted. Exemptions and reliefs, particularly those connected with the "end use" of the commodity result in further difficulties. The Department has had therefore to issue, apart from the basic manual, several commodity manuals. These in turn are supplemented by instructions and orders emanating from all levels and not always consistent.

3.2 The role of excise duties in the scheme of Central taxation has been steadily increasing in importance. In 1948-49 the total revenue from excise duties was Rs. 499 crores; it increased in 1966-67 to Rs. 1,027 crores representing 45 per cent of the total tax revenue of that year. It seems to me, however, that excise duties conceived and administered as at present are not likely to exhibit in future the kind of growth to which we have almost got accustomed in the recent past. The reasons are not far to seek. In the past the selection of commodities for levying excise duties has not been consciously planned on a long term basis. By and large, this has happened from time to time in response to the needs of the State. Other policy objectives like restriction of consumption in particular directions have played a relatively secondary role. One can however say that most of the commodities one can readily think of have already been subjected to excise duties. The search for more commodities on which excise duties can be conveniently levied (or at any rate without undue inconvenience) has already become more and more difficult and is bound to become still more so. With the present concept that the excise duty has to be levied on a named and precisely defined commodity and has to be administered largely through physical supervision, it is not surprising that this should be so. With economic growth, production is bound to become more and more diversified. If the objective of transferring a substantial percentage of the working population from agriculture to industry has to be achieved, there has to be very great, if not phenomenal growth, of industrial production in small establishments. In time this sector will contribute an ever increasing proportion of the national income. Because of the difficulties of administration inherent in the present nature and form of the excise duty, small establishments even in well established industries have had to be excluded. It would be all the more difficult to use this instrument effectively in a growing sector of small enterprises producing a great variety of goods. Until the production of any definable article reaches a level with a minimum revenue potential, levy of an excise duty becomes extremely difficult on valid practical considerations. Meanwhile, if the needs of the State whether for consumption or investment make it necessary to raise more revenue by excise duties, the tendency will be towards increasing the existing rates. But there is a clear limit to this process and in the case of many commodities, this has perhaps been reached already. The time has, therefore, come for changing the nature and form of excise duties, so that they can be more effectively and conveniently applied to a wide and growing base of production which does not easily respond to the present system. Only so will it be possible to advance significantly towards a system of excise duties which would reflect the growth of production fairly automatically and obviate the need for frequent changes in rates and an annual search for more and more specific commodities to tax.

3.3 It is in this context that I would recommend the introduction of what may be called a "General Excise Duty" on all production on which the Centre is competent to levy such a duty under the Constitution. This will be different from the present type of excise duties in several ways. Firstly, it will be applicable in law to the entire production of a unit, whatever be the number and variety of the goods it produces from time to time. There will be no need to specify or define commodities as the tax will apply to the value of the whole production with such adjustments as are prescribed. Problems of interpretation to which so much ingenuity and resourcefulness are now devoted will not arise at all. By definition therefore the duty will have to be *ad valorem*. The tax base should be the value of production minus the value of all *materials* bought for the purpose of production but not the value of equipment or services. There will be no cumulative taxation or what is commonly known as the cascade effect. A further advantage of excluding the value of materials bought will be that it will not influence or distort economic decisions by each unit regarding the nature of its manufacturing activity. The existence of the tax should make no difference to decisions about what is to be bought and what is to be processed. By definition most bought out materials would already have been subjected to tax at an earlier stage. The only exceptions will be materials which the Centre has no power to tax and material produced by units which may have to be exempted for administrative reasons. In concrete terms, the tax base can be ascertained as follows:—

Total of—

(i) value of products and by-products,

(ii) addition in stocks of finished and semi-finished products (plus or minus) diminished by total of,

  (i) fuel, electricity, libricants, etc. consumed to the extent bought out, and

  (ii) material bought out and consumed.

3.4 With such a tax base it follows that the administration of the tax will essentially be by assessment rather than by any type of physical control, full or diluted. The right of the tax authorities to inspect production as well as records must remain for helping to assess the value of production correctly. But in the main, the assessment will be based on accounts and records. For ascertaining the value of production the actual sale or saleable value will have to be taken. For facility of collection, the tax will be payable when the unit is able to pay, *i.e.* a little after sale. But this will not affect the position that the tax liability is related to production and not to the sale. Although the tax liability will be determined finally from year to year, the tax should be collected at regular shorter intervals, say, two or three months.

3.5 I have stated earlier, that in law the General Excise Duty should be applicable to all units of production. Theoretically, this will include even production by a single individual. But for quite some time to come it will be impracticable to levy the tax on very small establishments. Therefore establishments up to a certain size will have to be exempted by means of a general dispensation Where the line should be drawn must be related to administrative capacity. Initially, establishments with less than ten people employed may have to be exempted. When ten or more people are employed one can take it that accounts and records enough to provide the comparatively simple data required for determining the tax base will be maintained in the ordinary course. One has to accept the position that for some time to come at least there will be some loopholes, but I do not think that the position will be any worse than at present even with the long established and elaborate system of physical checks. If anything, the position should be better because sales by some units will be to other units and in this large area considerable cross checking is possible. Whether, in addition to the test of number of people employed, an additional test of minimum equipment used should be introduced is a matter of administrative detail. For an entirely different reason the production of agricultural raw materials cannot be taxed, but there is no reason why establishments processing agricultural raw materials should be exempted. In fact, the concept of the General Excise Duty requires that there should be no exceptions at all other than for Constitutional or unavoidable administrative reasons. Further, the rate of tax must be uniform as without a specific commodity link there will be no room for discrimination for any kind of purposes.

3.6 I must say at this stage that the General Excise Duty which I have proposed is not meant as a complete substitute for all existing excise duties. The continuance of some of the existing excise duties is required both for revenue and policy reasons. Thus, compelling revenue considerations as well as some policy objectives would justify the retention of the excise duty on mineral oil and products. Similarly, the objective of restraining consumption may require the continuance of other excise duties so long as the need for such restraint exists. When other policy considerations play a part, care should be taken to ascertain from time to time whether the desired policy effects are in fact produced. Revenue considerations should, however, be taken into account only when the revenue involved is substantial and not of a fringe character. On these grounds I would suggest that the existing system of excise duties may be continued, on a more or less long term basis, on the following types of commodities:—

(1) Tea

(2) Coffee

(3) Unmanufactured tobacco

(4) Sugar

(5) Mineral oils and their products

(6) Cotton textiles (yarn & fabrics)

(7) Rayon (yarn and fabrics)

(8) Cigarettes

(9) Matches

(10) Iron & Steel

(11) Motor Vehicles

(12) Tyres & tubes

(13) Cement

(14) Paper.

All other existing excise duties may be substituted as soon as possible, at least in the course of five years, by the General Excise Duty. The latter would, of course, apply to all production to which at any given time other excise duties do not apply. A tidy way of legislating for this would be to provide that the General Excise duty will, in law, apply to all production, but commodities subject to the present type of excise duties which for the sake of convenience I shall call Commodity Excise Duties will be exempt from the General Excise Duty. This will mean that when any Commodity Excise Duty is abolished on any article, it will automatically attract the General Excise Duty.

3.7 The rate of General Excise Duty has to be expressed as a percentage of the base. As it will be of universal application, it is desirable that the rate should be relatively low. I would recommend ten per cent. As the base to which the rate will be applied will, on the average, be between thirty and forty per cent of the gross value of articles produced, a rate of ten per cent would be roughly equivalent to three to four per cent of the gross value. By and large, this rate should remain stable. Even so, the revenue will increase steadily and substantially with the increase in production and the extension of the tax to the whole range of production. The need for revision should not normally arise as the tax by its very nature will not (and is not meant to) lend itself to changes related to the situation of particular commodities. It is only when it becomes essential to increase the revenues of the State as a whole that the use of this instrument should be considered along with others. In that case, it will provide a very convenient lever to operate. Relatively small changes will bring in substantial revenues.

3.8 It is difficult to forecast with accuracy (as paragraph 3.10 will show) the yield of a General Excise Duty on all commodities except the fourteen listed above. On a broad judgment based on trends revealed by available data, I am convinced that even in the first year, the yield will be more than the Rs. 100 crores or so which is the present difference between total excise revenue realised and the revenue realised from the fourteen commodities. Nevertheless, it may be better, instead of taking one deep plunge, to err on the side of extra prudence. I would, therefore, suggest that in the first year the present system may be retained in the case of the following twelve commodities also (which brought in about Rs. 50 crores per year in the last two years). It should, however, be possible to do away with them all in stages within a period of five years. The twelve commodities I would suggest are:—

(1) Woollen textiles (yarn & fabrics).

(2) Patent and proprietary medicines.

(3) Synthetic and organic dye-stuffs.

(4) Cosmetics.

(5) Soap.

(6) Paint and Varnishes.

(7) Aluminium.

(8) Copper and copper alloys.

(9) Refrigerators and air conditioners.

(10) Batteries.

(11) Electric wires and cables.

(12) Electric motors.

3.9 In paragraph 3.3 I have already indicated what the base of the General Excise Duty should be. This bears a resemblance to the base of the tax on value added which is widely prevalent in European countries. I must make it clear, however, that the General Excise Duty is not modelled on or meant to be a substitute for a tax on value added. The tax on value added, in its European form, loses much of its significance if the value added by transport, other services and sales is not taken into account. Under the Indian Constitution, sales taxes are reserved exclusively for the States. So long as this is the case, the full application of the principle of value added in Central taxation has necessarily to be ruled out. The General Excise Duty I have recommended is nothing more than what the words mean. It differs from the type of excise duty to which we are accustomed only in two ways: (i) it has no direct link with specific and defined commodities; and (ii) it has to be administered by the method of assessment rather than by the method of physical control and supervision. These two differences, however, do not make it less of an excise duty.

3.10 I shall now attempt an estimate of the revenue likely to be yielded by a General Excise Duty of ten per cent on the base suggested. With the limitations of the data available only a rough estimate is possible. For a correct estimate detailed information is required not only of the value (and the ingredients thereof) of production of all kinds but also of the contribution of various industries and within them of various sectors (large scale, small scale, etc., *i.e.* depending on the size of establishments). Information in such detail is not available. The only possible way of making an estimate is therefore to combine, as best as possible, the National Income data for 1966-67 with the latest Annual Survey of Industries 1963.

According to the National Income Statistics of 1966-67, the "net domestic product of large scale and small scale manufacture" was Rs. 3,378 crores. In the computation of National Income "large scale manufacture" includes all establishments which are factories within the definition of the Factories Act, *i.e.* employing more than ten people with the use of power or more than twenty people with or without the use of power. The contribution of "large scale manufacture" so defined was Rs. 2,051 crores in 1966-67. "Small scale manufacture" means production in all establishments other than factories and includes the production of what is called the "household sector". The contribution of small scale manufactures in 1966-67 was Rs. 1,327 crores.

The production of all factory establishments is meant to be subject to the General Excise Duty except what is separately subjected to Commodity Excise Duties. To determine the total base of the General Excise Duty in the sector of "large scale manufacture", it is therefore necessary to deduct the value of the products which will be subject to the twenty-six Commodity Excise Duties. This is not directly ascertainable from the National Income statistics of 1966-67. The latest available data on the product of the "large scale sector" with industry-wise details are found in the Annual Survey of Industries, 1963. This Survey embraces the same area as the "large scale sector" in the National Income statistics. In 1963 the contribution of the twenty six types of commodities which I have listed was Rs. 773 crores which was approximately 52·3 per cent of the total net value of output in all manufacture. On the assumption that this proportion remained unchanged in 1966-67, their contribution would be Rs. 1,075 crores. The difference of Rs. 976 crores would therefore represent the net value of products on which the General Excise Duty would be levied. The "net value added" as adopted in these statistics closely resembles the tax base I have suggested. The only significant difference is that it does not include the element of "depreciation and other charges" which is estimated at about ten per cent, but this will be included in the tax base of the General Excise Duty. An addition will, therefore, have to be made on this account to arrive at the base of the General Excise Duty. A further addition will also have to be made on account of "mining and quarrying" the products of which are not included in the figures so far quoted. As against this, some allowance will have to be made for exports which, at a guess on the high side, may be put at Rs. 100 crores. By and large, therefore, the base of the General Excise Duty applied to all establishments classifiable as factories will be about Rs. 1,000 crores.

It remains to estimate on how much of the production of the "small scale manufacturing" sector it will be practicable to levy the General Excise Duty. The "household sector" which perhaps contributes about forty per cent has to be left out. From the balance of about Rs. 777 crores, a deduction has to be made on account of products which would continue to attract Commodity Excise Duties, *e.g.*, textiles, matches, soap etc. No reliable information is available, but on a rough guess the contribution of these commodities is not likely to be more than one third of the total output of the sector. The balance will now be about Rs. 518 crores which would represent the net value of the product of all "non-household" "non-factory" establishments which could, if administratively feasible, be subjected to the General Excise Duty. I have, however, suggested that to begin with establishments employing less than ten people may have to be exempted. There is no way of ascertaining the value of the product of establishments so exempted. Assuming that this would be even as high as two-thirds or three-fourths, the base of the General Excise Duty levied on establishments employing ten or more people would be about Rs. 150 crores.

It would thus appear that the base of the General Excise Duty would be at least Rs. 1,150 crores; I say at least because the National Income statistics are themselves generally regarded as under-estimates.

3.11 I think it should be administratively possible from the beginning to extend the General Excise Duty to all establishments employing ten or more people. The number of establishments to be dealt with will be, in my view, well within the administrative capacity of the Revenue Department as a whole. The total number of factories registered under the Factories Act was 46,828 in 1964. This may have increased to about 50,000 now. About a quarter of this number will be establishments employing fifty or more workers with the aid of power or hundred or more workers without the aid of power, the census sector of the Annual Survey of Industries. The rest would be those employing between ten and fortynine workers with the aid of power and twenty to ninetynine workers without the aid of power, the sample sector of the Annual Survey of Industries. I have suggested in addition the inclusion of establishments employing ten to twenty people without the aid of power. How many they are is difficult to estimate, but I should guess not more than 20,000 at the outside. All these establishments even now have, for one reason or another, to maintain the minimum accounts required for the General Excise Duty. As the administration of this tax will be essentially by assessment, the right to physical supervision being retained only for selective use when called for, this is by no means too large a number. The assessment itself will be relatively a simple matter. It will be simpler, if anything, than the average low or middle income assessment for income tax. The collection of the tax in periodical instalments will, however, involve about the same work as in the collection of income tax in the relatively larger income groups subject to advance payments. Allowing for this factor, I would say that the administrative effort involved in a General Excise Duty assessment and collection will be about twice or, at the most, thrice the effort involved in an Income-tax assessment. On a rough estimate, the tax payable by even the smallest establishment will be more than the tax now collected from large numbers of small Income tax assessments.

3.12 A General Excise Duty at the rate of ten per cent extended to the area I have recommended can, therefore, be expected to yield about Rs. 115 crores right from the beginning. The revenue which will be foregone by abolishing the existing type of excise duties can be judged from the following figures:—

	Revenue (in crores of rupees)	
	1965-66	1966-67
1. Tea	17·01	17·50
2. Coffee	2·10	2·05
3. Unmanufactured tobacco	62·98	67·67

	Revenue (in crores of rupees)	
	1965-66	1966-67
4. Sugar	75·00	110·04
5. Mineral oils and their products	281·51	328·37
6. Cotton textiles (yarn and fabrics)	94·37	104·61
7. Rayon textiles (yarn and fabrics)	22·97	25·10
8. Cigarettes	46·69	58·16
9. Matches	23·18	25·78
10. Iron and Steel	77·13	76·49
11. Motor vehicles	20·77	22·70
12. Tyres and tubes	28·85	36·28
13. Cement	30·97	30·61
14. Paper	18·21	18·83
Sub total for 14 commodities	801·74	924·19
15. Woollen textiles (yarn and fabrics)	4·79	5·20
16. Patent and proprietary medicines	7·21	8·14
17. Synthetic and organic dye-stuffs	2·94	3·30
18. Cosmetics	2·39	2·73
19. Soap	4·78	5·23
20. Paint and varnishes	4·32	4·51
21. Aluminium	3·85	4·70
22. Copper and copper alloys	4·66	4·04
23. Refrigerators and air-conditioners	3·37	4·31
24. Batteries	3·67	4·59
25. Electric Wires and Cables	5·06	5·54
26. Electric motors	2·83	3·52
Sub total for 12 commodities	49·87	55·81
Total for 26 commodities	851·61	980·00
Total gross revenue	902·44	1033·87
Less refunds	8·13	6·82
Net total excise revenue	894·31	1027·05

(NOTE :—These are figures of actual realisations according to departmental accounts and are not therefore exactly the same as figures in budget statements).

It will be seen that if Commodity Excise Duties are retained only for the first fourteen commodities, the revenue foregone would still be less than the yield from the General Excise Duty. It will be still less if the Commodity Excise Duties are retained for a time on a further twelve commodities. Because of this, it would be possible to proceed even a little more slowly than I have recommended. For example, the extension of the General Excise Duty to establishments with ten to twenty people working without power can be postponed by one or two years if it is considered administratively desirable to do so.

3.13 Before concluding this Section on Excise duties, I would like to refer to some aspects of the excise duties on the fourteen types of commodities the continuance of which I have recommended as necessary for quite some time to come. Besides bringing in large revenues, most of them also serve or were meant to serve some policy objectives. The rates of duty, particularly in relation to each other within a commodity group like textiles, needs to be constantly kept under review to ensure that the main policy objectives are not lost sight of. For instance, the excise duty on tea and textiles is meant, in part at least, to act as a restraint on consumption so as to make more available for export. It is necessary to ask now and again whether this purpose is being served. Further, it is quite possible that under different circumstances—which may soon prevail when more than enough cotton of all required varieties is grown in the country—the need to continue restraints on internal consumption may disappear. Different levels of incidence—such as exist now within the textile group—are bound to influence the pattern of production. It is necessary to ask in such cases whether the pattern of production is being influenced in the ways desired or in quite some other way. It is also likely that in some cases a downward revision of the rates of duty may be called for in order to encourage consumption. Such a need may perhaps arise in the not distant future in the case of iron & steel and possibly motor vehicles. I mention these points only to show that while these duties taken together will continue to be big yielders of revenue, it should not be assumed that the revenue will automatically go up at a steady rate. The administration of the Commodity Excise Duties will have to continue more or less on the established pattern. Here, there is of course scope for further streamlining. Other committees have dealt with these problems in detail and I shall do no more than emphasize that it would be desirable to extend the audit type of control as far as possible. Most of the industries concerned are well established and organised and should easily lend themselves to this treatment. It will also be desirable to restrain the tendency to use rebates, reliefs and exemptions in this field for comparatively minor policy reasons. As I have said earlier, the fiscal instrument is best not used as a means of minor or petty policies. For example, to provide that all textiles used or meant to be used in hospitals and schools should be free of duty is certain to cause administrative difficulties and enlarge loopholes disproportionately. Whether school children and patients of hospitals are benefitted will still remain extremely doubtful. There are today several exemptions and reliefs which are nearly, if not quite, of this character. They should all be reviewed and retained only if it is quite clear that they are needed as well as effective for worthwhile purposes and do not lead to disproportionate loopholes.

3.14 Excise duties of the present type—whether specific or *ad valorem*—are by their nature multipoint taxes, and therefore a certain extent of what is commonly called double taxation is unavoidable. This causes, or is claimed to cause, hardship to industries which use a number of materials or components which are already subject to excise duty. In a number of cases where this kind of hardship is accepted as deserving of some relief, the whole or part of the element of excise duty already paid on materials or components used is given back. The administration of this kind of relief is bound to be difficult, untidy and complex involving as it does a check on what is exactly used and how much, and calculation by complicated processes of something which in the last analysis will be more notional than exact. This kind of problem will just not arise in the case of the General Excise Duty because everything that is bought out will be deducted before the tax base is arrived at. But the problem will continue in the case of the Commodity Excise Duties. As I have said, it cannot be wholly solved. What can be done is to reduce the size of the problem. In the case of industries which normally use a large number or amount of products of other industries which are subject to excise duty, this problem will be felt more acutely than in others which mainly process primary raw materials. One way of dealing with this problem would be to fix the rate of excise duty itself with due regard to the excise duties that might have been paid on bought out components. By doing so, the need to give specially calculated reliefs can be avoided. For the rest, all that can be done is to intensify further the efforts which are already being made to simplify procedure and calculations.

4. Customs Duties

4.1 A major step in the direction of rationalising and simplifying the schedules of import duties was taken in 1965. I would recommend that this process should be carried to its logical conclusion. Except for a few "luxury" items like watches, jewellery, alcoholic beverages and perfumes, there is need only for three or four rates of duty. A very difficult practical problem, however, arises in applying the apparently simple and obvious principle that the rates of duty on materials and components should ordinarily be not more than the rates of duty on the related finished goods. There is no problem when the finished goods are manufactured in the country by the import of raw materials and components. But many of these raw materials and components themselves become the products of other industries which are set up in the country. This is inevitable, particularly in an economy which is at once growing and being diversified. The age old problem of how to render one man's meat no poison to another will continue to defy complete solution. Practical compromises have therefore to be sought from time to time in the future, as in the past. It will, however, be desirable to bear in mind that the first line protective wall which the present rates of customs duties on imports provide is already fairly high. The industries which make products which in turn are used by other industries should not, by and large, have any real difficulty. Only where they do really exist or arise, should there be any need for further protection, the nature and extent of which is best decided on the results of a regular enquiry by the Tariff Commission.

In the administration of Customs Duties the major problems which lead to disputes and delays spring from the interpretation of definitions or nomenclature as they are called. But many of these problems will automatically disappear if the number of rates are reduced. So long as the rate is unaffected, no one will bother much about the correct classification of an article under one head or the other. It is only when nearly like commodities can be plausibly classified under several heads some of which may attract much higher duties than others do disputes arise. With a few rates, these disputes will be confined to the border line.

4.2 As in the case of excise duties, indeed, even more so, it would be desirable not to use exemptions and rebates as economic incentives, especially of a minor character. To do so will only create and perpetuate administrative complications, still leaving the benefits very much in the area of doubt.

4.3 In calculating the amount of duty leviable on imports, complications are introduced by the wide prevalence of countervailing duties. These are almost automatically applied in addition to the "normal" import duties in the case of articles which are also produced in the country and are subjected to excise duty The implicit assumption is that the normal import duty has just about the right protective effect in the case of commodities which are not subject to internal excise. It is assumed, therefore, that when a new excise duty is introduced or the rate of an existing one increased, a corresponding increase in the import duty is automatically required to preserve the *status quo*. The validity of this sweeping assumption is open to serious doubt. It is not as if the normal rates of import duty truly and consciously reflect the degree of need for protection against imported articles. Any way, if excise duties on defined commodities are confined to the fourteen or twentysix types as recommended by me, the size of the problem becomes much less. It should be comparatively easy to apply the specific test mentioned earlier to these types of commodities and fix the rates of countervailing duty accordingly. As all other industrial production will be subject to a General Excise Duty at a uniform rate, the concept of a corresponding countervailing duty on similar imports may just as well be abolished by simply fixing the normal schedule of import duties having regard to the existence of the General Excise Duty.

4.4 I would conclude by a brief reference to "draw back" of customs duty, the administration of which is causing a great deal of dissatisfaction. "Draw back" of import duties is given to exporters of articles in the manufacture of which imported materials have been used. Because in many industries the products of which are exported, raw materials and components are both produced in the country as well as imported, the "draw back" has come to mean, and rightly so, the refund of an amount which *on the average* would represent the import duty likely to have been paid on the imported materials which have entered into the exported product. By definition, this can only be ascertained or established in a conventional way. The procedures governing "draw back", however, still suffer from a hang over of the past when it was seriously thought that a real "draw back" required exact identification of when and how the import duty was originally paid. Considerable progress has already been made in standardising "draw back", but not nearly enough. It should be frankly recognised that strict identification is just not possible and all the shackles of the past must be altogether shaken off. The "draw back" admissible on various kinds of export commodities should be determined by Government with the help of technical committees on a judgment of the best information available and announced as valid for a specified period. Changes will, of course, have to be made from time to time, but not too frequently, at any rate, not for less than a year. The exporter should be asked to produce nothing more than the evidence of export. There should be no question of enquiry into the place or the channels through which the article came into the hands of the exporter. In the case of industries which has both imported and indigenous material, the proportions in which they are used (of course, over the industry as a whole and not by each unit) and the quantity used on the average in the manufacture of a given unit etc. would already have been taken into account by the relevant authorities while fixing the "draw back" admissible. "Draw backs" however, are given not only on account of import duties but also of excise duties. There is also a widespread, and in my view legitimate, demand for taking into account other levies such as sales taxes or terminal taxes etc. A series of such separate "draw backs" would result in an impenetrable administrative jungle. I would, therefore, recommend that the Government while determining the "draw back" admissible on various types of export articles should take into account all the taxes and levies which for policy reasons are desired to be taken into account. This would emphasize the true nature of what the "draw back" has come to signify. Indeed, it would be desirable to describe it by a more suitable name, although I cannot readily think of one. I fear that so long as the expression "draw back" is used, the temptation to search for a link with what is being drawn back upon will always remain. Audit, for instance, might feel it a duty to require the establishment of these links unless the purpose of the "draw back" and the way in which it has to be determined and administered is clearly defined by or under the law. Needless to say, a conventional "draw back" determined in this way must always be prospective in its effect. It should not be changed or withdrawn retrospectively. Thus, when announcing the "draw backs" it should be stated clearly that they will apply to exports made after such and such a date.

III. DIRECT TAXES

5. Determination of Business Profits and Corporation Tax

5.1 What is generally known by the name corporation tax is governed both by the Income-tax Act and the Finance Acts. It has always been regarded as an integral part of the income tax system; in fact the expression "corporation tax" is not at present used at all in any of the tax laws, what is payable by corporations under the Income-tax Act being simply described as income-tax on companies. Corporations are, however, liable to pay two other taxes, *viz.*, the "Dividend tax" and the Sur-tax on profits. The dividend tax too is governed by the Income-tax Act and the Finance Acts, but the Sur-tax on profits is governed by a separate law. In economic terms, however, both these taxes should properly be regarded as constituents of the main Corporation tax. Taken together, these taxes constitute a needlessly complex structure. Apart from this, there are several rates of tax, depending on—

(a) whether the company is mainly engaged in industry or not;

(b) whether the company is "closely held" or not;

(c) whether the total taxable profit exceeds a certain level or not; and

(d) whether the company is foreign or domestic.

Various permutations and combinations of these factors are possible, and each such combination leads to a different effective rate. There are also additional taxes (mainly meant as deterrents) on non-distribution or insufficient distribution of profits by "closely held" companies. These additional taxes are levied at different rates depending again on whether the company is engaged in investment, trade or any other kind of activity. These classifications apply to the treatment of profits after they are determined; in other words, they determine the rates. The principles for determining taxable income are however the same whatever be the status of the tax payer, be it company, individual, partnership, Hindu undivided family or co-operative society.

5.2 These complexities in the taxation of corporations have developed over a relatively short period of about ten years. In a sense the present system of corporate taxation can be said to have begun in 1959 with the abolition of the concept that the income-tax (but not the super-tax which was commonly called corporation tax) paid by companies was treated as if it was paid on behalf of the share-holders. Until recently the only difference between income-tax on companies and other non-corporate assessees was that the principle of progression was applied only to the latter. Within the field of company taxation the closely held companies were no doubt distinguished.

Except for this, the taxation of corporations was comparatively simple until 1964. It would therefore be desirable to re-examine whether the considerations which led to the various complexities at different stages still prevail and even if they do, whether other and better means cannot be found to meet them. It is only when the reasons themselves continue to hold good and no better means are available that the continuance of the complexities has to be put up with.

5.3 Let us take the corporation tax itself first and return later to the dividend tax and the sur-tax.

The distinction between companies engaged in industry and others would seem *prima facie* valid because the nature of the economic activities can be held to differ in significant ways. It would not therefore be wise to ignore this distinction merely for the sake of elegance and simplicity. It has, however, always to be borne in mind that any differences in treatment should truly reflect—no more and no less—the reasons for which the distinctions are valid. Thus, it would be necessary to re-assess from time to time whether within the industrial field itself distinctions based on grounds of priority should continue. For some years to come, at any rate, it looks as if a distinction between industrial and other activities as well as between various types of industrial activity depending on priorities as they change from time to time will be necessary. There is, however, no need to give effect to these distinctions by differential rates of taxation. The simpler and more elegant method of a suitable straight deduction from taxable income will be much more desirable. The main tax structure can thus remain stable while still remaining responsive to changing economic policies in this field.

5.4 A distinction, *for the purpose of rates of taxation*, between closely held and other companies has *prima facie* little economic justification. In fact, the original reason for differential treatment was the desire to deter certain forms of tax avoidance. It is only later that a substantive distinction in the rate of taxation crept in. I think, therefore, that the same rates of taxation should apply to all companies, whether they are closely held or not. Whether this distinction needs to be continued for the original purpose, *viz.*, preventing certain opportunities for tax avoidance, is an entirely different question which also deserves to be re-examined in the light of conditions prevailing today. This I shall do in a later paragraph. Meanwhile, I would only emphasize that it would be highly desirable to do away with this distinction altogether for any kind of purpose for the simple reason that it not only creates innumerable and ticklish problems for the administration but leads to prolonged periods of uncertainty in the case of many companies. I understand, for example, that for nearly ten years it had not been possible for anyone to determine whether a particular company was closely held or not. The shareholdings in companies undergo changes and under the present involved definitions the tax authorities have to determine each year whether a company is closely held or not. It would therefore be well worthwhile to dispense with this arduous process.

5.5 Based on the size of the total taxable profits two types of distinctions now prevail: (i) among closely held industrial companies the rate is 55 per cent. if the taxable profit is Rs. 10 lakhs or below. But if the taxable profit is more than Rs. 10 lakhs the rate is 55 per cent. of the first ten lakhs and 60 per cent. on the rest; and (ii) among companies which are not closely held whatever be the nature of business, the rate is 45 per cent. when the taxable profits are less than Rs. 25,000 and 55 per cent. when the taxable profits are more. The underlying reasons for these distinctions seem to be different, though in both cases an element of the principle of progression is introduced, perhaps unintentionally. I have already recommended that the same rates of tax should apply to all companies irrespective of how they are held; there can therefore be no room for making distinctions among closely held companies. The second distinction, namely, favourable treatment to certain companies (not closely held) with low incomes, while it stands on a different footing, has equally little justification. The principle of progression is relevant, indeed fundamental, in the case of personal taxation but it can have no place in company taxation. Companies are only juristic personalities and it is only to the ultimate beneficiaries, *viz.*, the share-holders that the principle of progression should be applied. The distinction might have come into being owing to a vague desire to help small industries. If so, better and more appropriate means for nurturing deserving small scale industries should be devised. It should be remembered in this context that it is doubtful whether the company form of organisation is either the most prevalent or the most desirable for small scale industries which earn not more than Rs. 25,000. I would, therefore, recommend that both distinctions referred to in the opening sentences of this paragraph should be abolished.

5.6 Finally, the distinction between foreign and domestic companies stands on a different footing. It is necessary to maintain this not so much for any reasons of principle, but solely for administrative reasons. It is difficult, if not impossible, to realise personal taxes from the recipients of distributed profits. A higher rate of company taxation is therefore the only method, though a rough and ready one, of compounding the tax which would otherwise have been paid by the recipients of distributed profits.

5.7 *"Dividend Tax".*—I shall now turn to the other two taxes on corporations, *viz.*, the dividend tax and the sur-tax, The object of the dividend tax is apparently to encourage retention of profits by companies for further development. This is sought to be achieved by discouraging distribution of dividends of more than ten per cent. If this were the only or real object, the more positive method of giving tax relief related to the action desired to be encouraged, *viz.*, non-distribution of profits, would have been more logical, but it is understandable however why for good administrative reasons this method has not been adopted. Theoretically, the negative method can do equally well. But one can legitimately doubt whether the objective of the dividend tax has been realised or is even capable of realisation. For one thing, the rate of dividend is no true index either of the capacity or of the need of the company to retain profits. The rate depends mainly on the capital structure. The capacity or desire to declare and in which the scarcity of capital is likely to persist for a long time. In fact, I believe that one of the most important, if not the most important, criterion for devising or judging the merit of the corporation tax system should be whether the rate at which it is levied and even more important, the way it is done, encourages efficient, fruitful and progressive ways of utilising capital and positively discourages and even penalises inefficient, wasteful or prodigal use of what is perhaps our most scarce resource. On a consideration of all these aspects, I am convinced that the Sur-tax in its present form or in any minor variant of it cannot appropriately constitute a part of the long term tax structure. On the contrary, our objective should be to devise a corporation tax system which, while bringing in not less than what the various corporation taxes together bring in now, will have a built in potential for growth and will throughout encourage the efficient and right use of capital.

5.9 *Tax Base.*—I have so far looked into certain aspects regarding the rate of taxation. The rate has of course to be applied to a base. The determination of this base is in a sense even more important than the rates of taxation themselves. It is desirable that the base itself should remain stable for as long a period as possible, while it is in the nature of things that the rates may have to be varied more frequently in response to the needs of the situation. The principles and methods of determining the tax base constitute the essence of the main tax structure. It is this structure which should be built on a reasonably stable basis, that is to say, the main principles governing the determination of the tax base should not be lightly or frequently changed. It is, however, possible, in certain areas, to formulate the principles in such a way that there could be some flexibility in their operation from time to time. Effective rates of taxation on the one hand and changes in the application of principles which provide for changes on the other will constitute the operating levers so to say of the system. The fewer they are the better but such as they are they should be efficient. In concrete terms the principles governing and the methods of determining the tax base should be built into the structure; the effective rates and policy oriented incentives and deterrents will be the levers. Broadly speaking, the former should be incorporated in the Income Tax Act while the latter should ordinarily be introduced through the Finance Acts or through the rule-making power. It follows from this that changes of the former (which should not be too many or made too often) should be brought about only by amendments of the main Act and not through the Finance Acts.

5.10 In the language of the Income Tax Act the tax base is known as "total income". This is a somewhat misleading expression and therefore, better avoided. "Total income" is arrived at not only after exclusion from total receipts of items which do not constitute income in the ordinary or economic sense of the word, but also excluding ingredients which clearly are income but which are sought to be exempt from taxation. For the sake of convenience and clarity it would be far better to use the simple expression "tax base". This will avoid the kind of confusion which always results when a precise technical meaning is sought to be given to expressions in ordinary use. At present the tax base consists essentially of income or profits. The way of determining it has been fairly clearly defined and

and in which the scarcity of capital is likely to persist for a long time. In fact, I believe that one of the most important, if not the most important, criterion for devising or judging the merit of the corporation tax system should be whether the rate at which it is levied and even more important, the way it is done, encourages efficient, fruitful and progressive ways of utilising capital and positively discourages and even penalises inefficient, wasteful or prodigal use of what is perhaps our most scarce resource. On a consideration of all these aspects, I am convinced that the Sur-tax in its present form or in any minor variant of it cannot appropriately constitute a part of the long term tax structure. On the contrary, our objective should be to devise a corporation tax system which, while bringing in not less than what the various corporation taxes together bring in now, will have a built in potential for growth and will throughout encourage the efficient and right use of capital.

5.9 *Tax Base.*—I have so far looked into certain aspects regarding the rate of taxation. The rate has of course to be applied to a base. The determination of this base is in a sense even more important than the rates of taxation themselves. It is desirable that the base itself should remain stable for as long a period as possible, while it is in the nature of things that the rates may have to be varied more frequently in response to the needs of the situation. The principles and methods of determining the tax base constitute the essence of the main tax structure. It is this structure which should be built on a reasonably stable basis, that is to say, the main principles governing the determination of the tax base should not be lightly or frequently changed. It is, however, possible, in certain areas, to formulate the principles in such a way that there could be some flexibility in their operation from time to time. Effective rates of taxation on the one hand and changes in the application of principles which provide for changes on the other will constitute the operating levers so to say of the system. The fewer they are the better but such as they are they should be efficient. In concrete terms the principles governing and the methods of determining the tax base should be built into the structure; the effective rates and policy oriented incentives and deterrents will be the levers. Broadly speaking, the former should be incorporated in the Income Tax Act while the latter should ordinarily be introduced through the Finance Acts or through the rule-making power. It follows from this that changes of the former (which should not be too many or made too often) should be brought about only by amendments of the main Act and not through the Finance Acts.

5.10 In the language of the Income Tax Act the tax base is known as "total income". This is a somewhat misleading expression and therefore, better avoided. "Total income" is arrived at not only after exclusion from total receipts of items which do not constitute income in the ordinary or economic sense of the word, but also excluding ingredients which clearly are income but which are sought to be exempt from taxation. For the sake of convenience and clarity it would be far better to use the simple expression "tax base". This will avoid the kind of confusion which always results when a precise technical meaning is sought to be given to expressions in ordinary use. At present the tax base consists essentially of income or profits. The way of determining it has been fairly clearly defined and on the whole not much change is required. The principles of accountancy for determining commercial profits are broadly followed. Profits are arrived at by first deducting from total receipts all elements of cost. Most of these are represented by disbursements in the same year but some (*e.g.*, depreciation) while being an element of real cost in economic terms do not necessarily involve corresponding disbursements in the same year. The balance after these deductions would represent true profit or taxable income, if no other considerations were involved. But in fact further deductions before determining taxable income are consciously used as incentives or concessions. Important examples are the development rebate and straight deductions from profits allowed to certain priority industries. To complete the picture it is necessary to add that besides the various deductions referred to, some additions are also made as for example bad debts written off in a previous year but recovered thereafter, revenue expenditure allowed in an earlier year while computing profits but not actually incurred, etc. It would be clear that these are really adjustments rather than additions. Thus, if they are initially taken into account in calculating total receipts the need for additions at a further stage will not arise. There is also another type of addition, *viz*., certain elements of cost (such as for advertising or entertainment or perquisites) which though actually incurred are "disallowed" on the ground that they should not have been incurred to that extent.

5.11 It is interesting (at least to the layman) that while the expressions like gross profit and net profit which are very much in vogue are nowhere used in the Income Tax Act, nevertheless a large number of tax assessments, mainly in the field of small trade, are based in fact on assumed rates of gross profit determined on an estimate. Indeed they are generally known as "gross profit" assessments. The reason for widespread adoption of such a practice has, however, little to do with the provisions of the law or any inherent merit in the method. It has happened quite simply because in the type of cases concerned there is not enough data acceptable as valid for the computation of taxable profit as required by law. The tax authorities have, therefore, to fall back on the discretionary power given by law to make a fair assessment on the information available. It is in the exercise of this discretion that the criterion of gross profit has come to be adopted so widely. For the same reasons the tax payer in such cases prefers to accept the assessments or even when he appeals contests them only on grounds based on the same reason as that of the tax authorities, *viz.*, gross profit rate has been judged too high, etc. I am referring to this feature not merely by way of an interesting digression. I have tried to see whether some rationalisation of a process so widely adopted can yield useful ideas for application over a wider field. But I am afraid not. Gross profit as I have said, has not been defined. As accountants and Income Tax Officers understand it, it represents what may be called the first stage of profit or trading or manufacturing results, before any deduction is made for certain true elements of cost like overheads (rent, rates and taxes, salaries of head office staff, etc.) and depreciation of assets. It would be at once evident that gross profits out of which overheads of the kind described have to be met cannot possibly form a sound base for applying the tax rates without further ado. The exclusion of an appropriate amount for depreciation will be equally unsound and indefensible. It is no doubt true that at certain stages depreciation allowed or provided for may not actually be "incurred" but the fact remains that over a period of time the whole of what is allowed as provision for depreciation has not only to be actually spent but often exceeded merely in order to keep the industry or business going. The conclusion is clear that gross profit, however defined (for example, by allowing depreciation but not some overheads), cannot form a rational basis for taxation. I think, however, that the real reason underlying the suggestion that gross profit may provide a possible base is a desire to eliminate complexities in calculations or a feeling that far too many deductions are allowed. Greater simplification of the process of calculation is obviously desirable. Equally so is the objective that expenses unduly or wastefully incurred should not be recognised but discouraged. In this context standard deductions for certain types of expenditure seem *prima facie* attractive. Besides helping to simplify they may well have the incentive effect of rewarding economy and penalising extravagance. I have, therefore, carefully examined the areas in which standard deductions can be applied with advantage. The result has been largely negative. The scope for doing so is extremely limited, but wherever they appear reasonably satisfactory I have suggested them elsewhere in the report. But by and large the difficulties of prescribing norms which would not be extremely harsh and hurtful over large areas are practically insurmountable.

5.12 *Amortisation.*--I have said earlier that the ways now prescribed for determining profit are on the whole satisfactory. There is, however, one aspect in which some major improvement is not only possible but called for. There can be little doubt that in computing profit all true costs, whether immediately incurred or not, should be allowed for. Otherwise the incidence of taxation will become uneven in unintended ways and will discourage enterprise and growth. It is, therefore, necessary that all expenditure legitimately incurred for the purpose of the industry or business should be allowed as a deduction either as revenue expenditure or otherwise, mainly through depreciation. At present a number of elements of real cost fall between two stools. Even now all expenditure is rightly classified under two broad heads, revenue and capital. There is no difficulty about revenue expenditure. But not all capital expenditure qualifies for depreciation; only capital expenditure which results in physical assets (other than land) does so. But a number of types of 'capital expenditure', rightly so classified, do not result in such identifiable physical assets. Nevertheless they are in the generality of cases necessary and legitimate. I give below a list as exhaustive as I can make it:—

(1) Expenses incurred before setting up of a business—

(i) Preliminary expenses of companies including expenses on processing a foreign collaboration agreement, stamp duty thereon, etc.

(ii) Pre-operative expenses on Administrative and accounts departments and such other expenses which do not directly relate to the erection of building, plant and machinery, etc.

(iii) Expenses on issue of capital. For example, expenses incurred on printing of prospectus, payment of underwriting commission and brokerage, etc.

(iv) Expenses on market surveys before launching a new business.

(2) Expenses on shifting of a factory.

(3) Expenses on renovation of rented business premises.

(4) Payment for goodwill.

(5) Expenses for construction of railway sidings.

(6) Expenses incurred on construction of roads or for maintenance of roads on land not belonging to the tax payer (*e.g.* roads constructed in sugar factories for facilitating the movement of sugar-cane).

(7) Abortive expenses on drilling holes, developing mines, prospecting for mines, etc.

Any expenditure incurred ostensibly for these purposes but which is not germane to the business and industry (as indeed any other such expenditure) should of course be ignored. Once expenditure under any of the above heads is accepted as legitimately incurred for the purpose of the business or industry, provision should be made to deduct them over a period of years in the computation of profits. To distinguish these deductions from depreciation on physical assets, this may be called amortisation over a suitable period. Meticulous examination of each head to determine an appropriate period of amortisation is not really necessary or worthwhile. One or two broad groups, say, five years and ten years, should suffice.

5.13 *Depreciation.*—The most important element of cost which does not correspond to disbursements is depreciation. The present rates of deprecition (which are expressed as percentages of written down value) seem by and large sound. There are, however, far too many of them. Some rationalisation has recently been effected. I would suggest that this should be carried several steps further. Rates of depreciation have essentially to be derived from a judgment of the life of the assets. In the nature of things such judgment can relate only to the average and cannot possibly be true in all cases. The life of various types of capital assets which the present rates reflect can be regarded as generally adequate on the basis of stable prices. If anything, experience shows that in practice assets last longer than what is presumed in the rates. But having said this I must emphasise that there is really no need to attempt a meticulous judgment of the probable life of assets in order to build a structure consisting of numerous depreciation rates. The actual life of assets depends only in part on the nature or the use to which they are put; for the other part they vary a great deal depending upon numerous other factors including the way in which they are maintained and used. So long as it is assumed that over a period which is broadly satisfactory the cost of the asset is allowed to be deducted there is little to be gained, not even full intellectual satisfaction, by attempts at refinement. No doubt sections of industry tend to represent that such and such types of machinery are more quickly outworn than others and should, therefore, be given a rate of depreciation reflecting a short term of life. Even if such representations are accepted at face value the total result over a period of time will be exactly the same; all that will happen is that a little less tax will be paid in earlier years and correspondingly more in later years. I would recommend, therefore, that a few broad categories will be sufficient to serve the essential purpose of depreciation. I have suggested such a classification which is given in Annexure "A".

5.14 I have said earlier that the present rates of depreciation are generally adequate but the system itself is adequate only on the assumption of stable prices. During the last twenty years prices have been anything but stable and they have tended to rise at varying rates. The desire for stability in prices is very widespread, almost universal. Even so it would not be illegitimate to assume that the secular tendency, under the best of conditions, will be some rise however gradual. In modern societies a rise of 1½ or 2% per year is regarded as practically equivalent to stability and some would even go so far as to say that such a gradual rise is not only inevitable but desirable. For the purpose of legislating for a generation though not for all times to come, it would, therefore, be not only fair but prudent to accept the probability, almost certainty, of at least a small gradual rise. If so, the main objective of depreciation which is to allow for provision for replacement of the asset after its normal or average period of life, can be achieved only when the provision for replacement which depreciation allowance permits is for something more than the original cost. It is because of this that the idea of basing depreciation on replacement costs has been strongly canvassed from time to time, particularly in periods of sharply rising prices. But the administrative problems involved in determining replacement costs are so difficult to solve that no country has found it worthwhile or possible to adopt this suggestion. This, however, does not invalidate the main consideration that over an appropriate period of time the allowance for depreciation should be sufficient to replace the assets. For example, the average life of plant and machinery which our present rates reflect is about 10 to 15 years. Even with a gradual increase of near about 2% per year the provision for depreciation which present rates allow will become quite inadequate. I would, therefore, recommend that depreciation should be allowed in such a way that over a period of years 20% more than the original cost will be provided for. Administratively, the simplest way of doing so would be to increase the original cost by 20% initially at the time of inclusion in the depreciation schedule. The reasoning on which I would base this recommendation would justify that this increase should be applied not only to plant and equipment but also to all other kinds of physical assets, for the simple reason that the replacement cost of these also will increase over time. It is no doubt true that the flat rate of 20% will not correspond to actual increase in replacement costs which obviously will be more in most and less in some cases But for the reasons I have given meticulous judgment in this regard is neither necessary nor worth while.

5.15 I shall at this stage refer to some other matters connected with depreciation although they are partly of a procedural nature. Firstly, there is the question whether the present method of calculating depreciation as a percentage of written down value cannot be improved upon by adopting what is caled a straight line method or by allowing freedom to the tax payer to adopt varying sums every year according to his convenience while the total does not exceed the original cost (as adjusted according to my recommendation) There is a considerable body of opinion in favour of the straightline method. Centainly it reflects economic realities better, but the claim that it could be simpler in application is not borne out to my mind. Under the written down value method it is possible to limit depreciation schedules to the number of rates and it is unnecessary, by and large, to maintain a record of several assets separately. But if the straightline method is adopted, a new straightline will, so to say, have to be started in the case of each asset; in no other way can it be ensured that the total does not exceed the original cost. There is something to be said for the flexibility which the free methohd can provide, but this advantage will be more than wiped out by administrative difficulties. In practice, the maintenance of a separate schedule for each asset will become unavoidable if only for ensuring that deductions made do not exceed the total. Further, the somewhat excessive freedom this would provide for postponement of tax liability may result in postponement to a time when the tax may not easily be collected. I, therefore, come to the same conclusion as did the Taxation Enquiry Commission fifteen years ago, that all things considered, the present written down value method is the most suitable, but I think that the existing practice can be considerably improved upon. I have said earlier that, by and large, it is unnecessary to maintain a separate record for each asset. It, however, becomes necessary under the present method of dealing with situations arising out of the sale of assets. When an asset is sold at less than the written down value, the difference is given to the tax payer as a "terminal allowance"; similarly, when it is sold at more than the written down value the difference, called "balancing charge", is subject to tax. I think that these adjustments, which in themselves are valid and justifiable, are really necessary only when a business is completely closed or an identifiable section of it is closed and not replaced. For this purpose alone the provision in law for balancing charges and terminal allowance may continue. In all other cases, it would be enough if the sale proceeds of assets, whatever be the price, are deducted from the written down value. The effect of this, over a period, will be fair both to the tax payer and the revenue. When the sale brings in more than the written down value of the particular asset sold, the difference which today is taxed as a profit will in effect be taxed in later years as he will get correspondingly less depreciation. Similarly, an asset sold for less than the written down value will not result in an immediate tax benefit but it will be available to the same extent in later years because of increased depreciation allowance. When an asset is sold at more than the *original cost*, the difference is now subject to tax as a capital gain. Under the method I have proposed this difference will in effect be taxed at a higher rate as a profit, but cases of this type are so rare that they may be ignored. They will be even rarer when the original cost which is adopted is twenty per cent higher than the price paid for the asset.

5.16 There is another refinement in the treatment of depreciation which can with advantage be done away with. At present an attempt is made to relate depreciation to the time and intensity of its use. Thus full depreciation is not allowed when an asset is used only for part of an year. On the other hand, an additional allowance is sometimes given when an asset is used more intensively in an extra shift. In no case, however, can the total of depreciation exceed the original cost. I do not see much practical utility in continuing this refinement which only adds to the work of the tax payer and the tax authorities. The only practical result of all these complications is a slight shift in the time of tax liability, the total over a period always remaining unaffected. All this, to my mind, is not worthwhile. Depreciation should be calculated on the respective blocks at the end of each year; in other words, once an asset is installed and ready for use, it should qualify for depreciation from that year onwards, irrespective of variations in the time or intensity of use. It may seem at first sight that what I have suggested rules out any provision for accelerated depreciation but this is not really so. I am ruling out only a particular cumbrous method. As a general measure of encouragement to industry it would be desirable to allow somewhat more depreciation in earlier years than in later, I mean more than even what is inherent in the method of calculating depreciation itself on written down value. This simply means a little postponement of tax liability to a later date when an enterprise can pay with less strain. This objective, however, can be achieved by the simple method of allowing against a single assessment two years' depreciation on the accretion to the block made in that year.

5.17 *Development Rebate.*—So far I have dealt with deductions of a type which represent true costs. I shall now turn to those which are essentially in the nature of incentives. The most important of these is the development rebate which was introduced in 1955. The development rebate, as it stands, has been welcomed and appreciated by industry generally, but there is a view that it may well create a tendency to use capital a little too liaberally, even wastefully. This line of criticism deserves to be treated seriously. This was perhaps why the Government has already made it known that the development rebate should not be regarded as a permanent feature of the tax system. At the same time, it has been indicated by the Government that three years notice will be given before development rebate is withdrawn. One could argue that in the absence of development rebates of this magnitude, entrepreneurs would not have invested as much as they have done in capital equipment. By itself, however, this proves or indicates very little. The real question is whether the existence of a generous development rebate has created a tendency among entrepreneurs to invest more in capital equipment than is prudent or necessary from the point of view of economic efficiency. To this it is not easy to give a clear answer based on demonstrable evidence. One can at best attempt a judgment. *Prima facie* a generous development rebate must encourage a preference for getting a particular function performed by capital equipment (in large part imported) rather than by some other means which might have been more economical but for this particular tax incentive. To take an illustrative example: in order to move material from one place to another a choice of two ways may be available, one by using capital equipment of the kind which now qualifies for development rebate and the other involving construction, use of trucks, etc., which do not qualify for development rebate. The former will naturaly be preferred when the quantum of development rebate is more than the greater economy inherent in the alternative method. In a matter like this it is not easy to identify examples from real life. But the reduction as well as the considerable postponement of tax liability which the development rebate involves would certainly tend to the more liberal and less careful use of capital resources than otherwise. In a situation when there is considerable and widespread idle capacity, in part created by the relative facility with which capital equipment could be installed and financed, the emphasis should now shift clearly towards prudent and economic use of capital. The purpose of development rebate has been in a sense largely fulfilled and I think it is time that we now turn towards a more stable system. It appears to me therefore that the present is the most opportune moment for giving clear notice, as Government have already contemplated, that the development rebate will cease after three years.

5.18 On a superficial view, my proposal that the system of depreciation may be altered to allow for a secular increase in prices may be regarded as the kind of substitute for the development rebate. I must make it clear that conceptually and logically there is no connection between the two proposals. In other words, I would have made my proposal regarding depreciation solely for the reasons given irrespective of the existence or otherwise of the development rebate. Having said this, however, I may point out that the introduction of the change in depreciation before the development rebate is withdrawn would in practice be of particular help to industry in the years immediately following the withdrawal of the development rebate.

5.19 Having recommended the withdrawal of the development rebate, I would not ordinarily have felt it necessary to deal with aspects in which its operation could be simplified. But as it may continue for three years, I think it necessary to draw attention to one matter, *viz.* the present requirement that development rebate reserves should be shown separately in the accounts and utilised only for the purpose of the business and not for distribution of profits. I think that in practical effect nothing is gained by this stipulation which really amounts to no more than an obligation to present accounts in a particular way. The freedom of companies to use their resources as they think fit is in no way restrained in actual practice in the case of those which have other reserves. In such cases, the purpose of this requirement is not served, though no damage is caused thereby. On the other hand, in the case of less affluent companies the present requirement gives rise to disputes about the amounts which ought to have been shown in previous accounts. If this requirement is not withdrawn for any reasons, I would at least suggest that if there is any shortfall in appropriation of development reserves in any particular year according to the tax authorities, the difference should be allowed to be made up later and should not be an occasion for denying the development rebate altogether.

5.20 *Exports Incentive Rebate.*—Until last year certain tax rebates were given as an incentive for encouraging exports. I had recommended in paragraph 4.14 of my interim report that if these incentives are desired to be continued, they should be re-formulated in the shape of appropriate deductions. I, however, expressed the opinion that relief in direct taxation is not a suitable means of encouraging exports and should not be resorted to until other and better methods are exhausted. I see no reason to alter this recommendation.

5.21 *Incentives for mining industry.*—The report of the Committee on Incentives to the Mining Industry has been referred to me by the Board of Direct Taxes as well as the Ministry of Steel, Mines & Fuel. The Committee has recommended several concessions specifically for the mining industry. They consist of higher rates of depreciation and development rebate, allowance for depreciation and development rebate on development expenses and a deduction for or amortisation of expenses on development or prospecting when tangible assets are not created. The Committee has further suggested tnat certain expenses even if abortive should be allowed to be deducted from profits of other businesses owned by the mining concern. A liberalisation of the tax holiday concession is also proposed.

My recommendations regarding depreciation and amortisation of capital expenditure not resulting in tangible assets should go a long way to meet the requirements of the mining industry. Development expenses and prospecting expenses would qualify for amortisation over suitable periods. In this context prospecting expenses incurred legitimately in the normal course of business should be fully taken into account irrespective of the outcome. But there can be no question of deducting them from the profits of other businesses. It will be anomalous to perpetuate the development rebates for particular industries if it is to be generally withdrawn. The tax holiday provisions, which have already been liberalised, seem in my opinion adequate for the mining industry too.

5.22 All that I have said so far on one of the main ingredients of the tax base, namely, profits, will apply not only to corporations but to all other kinds of entities engaged in business.

5.23 *Inter-corporate dividend.*—I shall now consider another part of the tax base of corporations, namely, inter-corporate dividends, or dividends received by a company from another company. Until recently this was subject to a lower rate of tax. In accordance with my recommendation in the interim report, this rebate or lower rate was converted into a corresponding straight deduction. At that stage I had indicated that the entire question needs to be looked at again in the light of the policy intentions of Government which were by no means clear. I had also mentioned certain important considerations mainly by way of provoking thought. The drift of my reasoning was however that unless there are clear reasons of economic policy, there is no reason why dividends received by a company should be treated differently from the profits or any other income of the company. A further examination of the history of the treatment of inter-corporate dividends has not yielded any clear clue to the economic policy intentions of Government. Throughout it seems to have been implicitly accepted that such dividends should not be wholly exempt and should be taxed at least in part. So long as income tax paid by a company was supposed to have been paid on behalf of the shareholder the question did not arise in sharp focus. By and large, companies receiving dividends were treated exactly like individuals receiving dividends. That is to say, the recipient was given credit for part of the tax already paid. When this concept was given up in 1959 the logical corollary should have been that the whole of the dividend received by a company should be subject to taxation. However, the credit for tax which prevailed until then, appears to have been translated into a specific tax concession—probably with the desire to leave total tax incidence more or less unaffected. Why this was so is not quite clear. It is, therefore, necessary to look at the matter afresh and ask whether intercoporate dividends should be taxed at all or only a part should be taxed and if so, what part and why? In this connection I would refer to the last sub paragraph of paragraph 4.15 of my interim report in which I stated—"Now a corporation or a company when it has surplus funds which it wants to deploy in a particular activity has the choice of undertaking the activity itself or creating a new organisation. If in economic terms one method is better, there should be nothing in the tax laws which should discourage that particular method. In other words, the position of a company which undertakes a particular activity itself should not be different from that of a company in a like situation which prefers to undertake the same activity by organising a wholly owned subsidiary company. The profits which it derives from the wholly owned subsidiary should then be treated in the same way as its own profits, *i.e.* it should bear the appropriate rate of tax once but not more than once. In such a situation, there would be justification for excluding the whole of the dividend received from a subsidiary company from the total income, provided of course the subsidiary company has paid tax before distributing the dividend. It should be noted that on that argument there would be no case whatever for levying any tax. If this concept is accepted, then one could extend it not only to a wholly owned subsidiary but to subsidiaries which are *de facto* controlled and managed by the principal company. One could, for example consider a subsidiary in which the parent company has only a 30 per cent investment as satisfying this criterion. The test always is whether it is an alternative to the direct undertaking of the relevant activity. Even under this concept, there will be little justification for treating all dividend income in the same way as dividend received from subsidiary companies specially organised as alternatives to self-management. Odd investments, if one might call them so, should be treated exactly in the same manner as investments in Government securities or loans or deposits. While this distinction is conceptually clear and deserves introduction if it is Government's policy to permit and encourage companies to organise their economic activities in the forms in which they consider most suitable, it will not be easy administratively to distinguish between one kind of dividend and another." I still think that the subject can be meaningfully dealt with only on this line of reasoning. It is clearly the objective of Government to encourage industrial growth. All existing enterprises have a role in this regard springing from their capacity to plan and organise as well as to raise resources both internally and from outside. When an enterprise has or can command surplus funds, it has to make a choice between diversification within its own structure or the adoption of a different organisation, such as a subsidiary company. Exercise of this choice will certainly be influenced by the taxation of inter-corporate dividends. It would be desirable to create an atmosphere in which such choices are made rightly in the light of economic conditions and requirements. There is no reason to expect that influencing the choice in favour of or against any particular form of organisation will yield any better economic decisions than a free choice. The tax system should, therefore, be neutral in this regard. In other words, as far as taxation goes it should be a matter of indifference to a company whether it undertakes a particular expension activity by diversification within its own structure or by forming a subsidiary company. In either case, their surplus resources may have to be supplemented by raising additional resources from outside. Whether such additional resources can be more easily raised with diversification or through the formation of a separate company will depend on circumstances. On this line of reasoning, the right course would be to exclude from the tax base dividends from subsidiaries which are effectively controlled by the company receiving the dividends. Only such companies can be truly regarded as alternatives to diversification within the receiving company. This test, I find, has been widely adopted in several European countries like Austria, Netherlands and Switzerland, where if a company has "substantial holdings" of not less than 25% of another company, the dividends received from the latter company are wholly exempt from tax. In France, the situation is practically similar, except that the exemption is not total but slightly graduated proportionate to the holding. I would recommend the adoption of the same system as in Austria, Netherlands and Switzerland. A substantial holding may be anything beyond 25%. In my interim report I had envisaged 30%, but I think 25% would be more appropriate. It should be ordinarily enough to give the holder an effective voice in management and to ensure that Articles of Association are not changed without its concurrence. Provision may also be made, if considered necessary for Government to agree to a lower holding in special circumstances. Except for dividends received from subsidiary companies as defined above, all other inter-corporate dividends should be regarded as no different from return on investment of any other kind and fully taxed in the normal way.

5.24 *Capital as a tax base for companies.*—I shall now consider whether profit and other income as determined above should constitute the only tax base for the taxation of corporations. Historically the concept of the corporation tax has been evolved by the simple transference of the concept of income from persons to legal non-personal entities. In the case of personal taxation, there is no doubt whatever that income is the most appropriate base for taxation and further that so long as inequalities of income continue to prevail, whether as a result of or in spite of social and economic policies, the principle of progression should apply. But these considerations are not applicable to what is conventionally described as the income of corporations. What in fact we have today is a corporation profits tax. The corporation profits are determined in a manner closely resembling the determination of income in the case of persons. Beyond that, the similarity ceases to exist. The progressive principle is not applied and rightly so. What in effect corporations do is to pool together the resources of their members, augment them further by raising resources from other sources by paying the appropriate price for it, and then attempt to put these resources to the best productive and profitable use possible with the primary object of distributing profits to the participants of the association, and with the secondary object of building up internal resources to develop further. The way in which corporations raise resources and use them is of great significance to the community as a whole. This is particularly so in a developing country like India where capital is and will continue for a generation to be the most scarce of all resources. Securing the proper allocation and the most efficient use of the nation's capital resources should be one of the prime objectives of long term economic policy. It is doubtful whether a system of taxation based solely on profit (however determined) will help to serve this larger purpose adequately. For one thing, those who mobilise resources pay taxes only when profits are made. The tax system at any rate provides for no check on the inadequate or inefficient use of capital resources. No doubt, there are other forces such as the price of capital itself which would provide a motivation for its right use. I think, however, that it will be desirable to re-inforce them through a built-in element in the system of corporate taxation.

5.25 Theoretically, what I have said about capital is equally true of other resources like "land" and "labour" and the element which animates the "factors of production" which could be described as "enterprise" in the broadest sense of the word. By the taxation of enterprise, which a profits' tax ensures, the last element makes its contribution to the resources of the State which are in turn employed for the maintenance and further development of society as a whole, but it does not ensure sufficiently that "enterprise" uses the other factors in the best possible way. In order to ensure that in the long term the kind of entrepreneur (public or private or any other combination) who exhibits capacity to use the factors of production to better advantage than others should be encouraged rather than discouraged, it would be desirable, at least theoretically, for the State to make a charge on the use of the resources of the community, irrespective of the results of the use. In this context, resources naturally include only scarce resources. A charge for the use of land is already being made in one way or another. One day it would become necessary equally to introduce a charge on the use of human resources (labour) when they become scarce. Even today some part of these human resources has already become scarce and, to that extent, it would be right to levy a charge on those who compete for its use. But in practical terms, it is not yet worthwhile to do so. There is, however, no doubt that capital has become and will continue to be a scarce resource and a right tax structure should contain features which would encourage more beneficial rather than less beneficial, not to mention infructuous, uses. In concrete terms, this would mean that a tax on corporations (whose raison d'etre is to mobilise resources for productive use) should contain an element which would secure this result. In the present context this should take the form of a tax at a flat rate on all capital mobilised for use, whether in the form of equity capital and owned reserves or borrowings, long-term or short-term, and irrespective of the results produced in the shape of profits by the use of the resources so mobilised. This line of reasoning carried to the logical extreme could lead to the conclusion that there should be no tax at all on profits, until after they are transformed into the income of individuals, who will be separately taxed on the entirely different principle of their duty to shoulder the responsibilities of the State in accordance with their economic capacity. A scheme in which income will be taxed only in the hands of individuals, while corporations will pay the State only (but adequately) for the use of resources, will be wholly rational and entirely suited to a society which has reached a certain economic level and which provides for more equality in general and equality of opportunity in particular We have clearly not attained such conditions.

Therefore, while I have no doubt that this is the direction in which we should proceed, it becomes necessary to do so in stages because of other valid considerations. Incentives, which have to work through the untidy and illogical complex which is human behaviour, have not only to be rightly conceived but should have general acceptance in order to be effective. It is also necessary to see that the revenues of the State, which is engaged in the hard task of economic development, are not inconveniently diminished. Taking all these practical considerations into account, I would recommend a low rate of one per cent on all capital (owned and borrowed) and a simultaneous reduction of the general level of tax on profits of coporations by ten per cent. The standard rate of tax on the profits of corporations should then be forty-five per cent In the light of what I have already stated, different rates will have to continue only for two purposes:

(i) on royalties and technical fees received by foreign companies on which the present rate of fifty per cent, which is embodied in many agreements, should continue; and

(ii) on the other profits of foreign companies, the rate should be fixed at sixty per cent, the increase (of fifteen per cent over the standard rate) representing the element of compounding of the tax from the recipients of dividends.

The standard rate of forty-five per cent should apply equally to all priority industries; any tax concession desired to be continued or given to these industries should be by way of appropriate straight deductions from the tax base. At the rate of one per cent, the revenue from this tax on corporations will be about Rs. 50 crores. This would nearly off-set the revenue effects of a reduction of ten per cent on the profits as well as the abolition of the Surtax and the tax on dividends which I have already recommended.

Lest there be any doubt I would repeat that the capital tax will apply to all companies, foreign or Indian, irrespective of whether profits are made or not. But the tax holiday will continue to apply to both kinds of tax on corporations.

5.26 I have said that the yield from the capital tax will nearly off-set the effects of the reduction in the standard rate and the abolition of the Surtax and the dividend tax. This is a judgment based on such statistics as I have been able to study. The information available does not permit of a more accurate forecast. If, however, on better information or better interpretation of information it is considered that the revenue effects may be slightly different from what I think, I would suggest that for the first year the standard rate of tax on profits of the corporations may be fixed at forty-eight per cent or even forty-nine per cent. It is essential, however, that the rate should be below fifty per cent and the intention should be to bring it down to forty-five per cent. It is only this knowledge and expectation that will secure a better and more efficient use of capital

Some may regard these proposals as too radical, though I think that they are quite humdrum despite the introduction of one new idea. There could also be a view that even a low rate of one per cent might tend to discourage plough-back of profits. I do not share that view. If anything, it should encourage carefulness in the choice of investments. Nevertheless, on the sole ground that general acceptance also helps effectiveness, I have seriously considered whether as a transitional measure the tax on capital should not be, for the present, confined to borrowed capital. This will have one clear merit. At present the fruits of owned capital (which include an element of interest from the point of view of the investor) are taxed both in the hands of the corporation and in the hands of the shareholder. But the fruits of borrowed capital are taxed only in the hands of those who receive the interest, the payment being allowed as a deduction before determining profit. This constitutes a positive encouragement for the use of borrowed capital rather than owned capital. A tax of one per cent on borrowed capital will therefore correct this preference. Against this limited advantage, a tax on borrowed capital will yield only about Rs. 25 crores and will not, therefore, permit a significant reduction in the rate of tax on the profits of corporations. I would not therefore wholeheartedly recommend this alternative which I regard as clearly inferior.

5.27. Needless to say that all the suggestions I have made are closely inter-related and are meant to form a consistent whole. I would, therefore, urge that they should be considered and implemented together and not regarded as separate totally independent proposals.

5.28 *Additional tax on companies for not distributing profits.*—I have already said in paragraph 5.4 that the tax base having been determined there should ordinarily be no question of applying different rates depending upon the pattern of ownership of the company. In that context I had referred mainly to the different rates of taxation now applicable to certain types of closely held companies. Besides this, additional taxation is provided for when certain types of closely held companies do not make a sufficient distribution of profits. The test of sufficiency varies from ninety per cent to sixty per cent of profits after normal taxes. This additional tax has always been conceived of as a deterrent. The need for such a deterrent sprang from the opportunities open to certain tax payers with high incomes to avoid or postpone tax liability by regulating the timing and amount of the distribution of the profits of companies in which they hold shares. Tax avoidance or postponement by individuals is therefore possible if the distribution of dividend by companies could be timed in such a way that they are included in the assessment of shareholders in those years in which their income is relatively low. Obviously this path is open only to those shareholders who are in a position to control or strongly influence the policy of the company. Companies in this situation are generally known as "closely held companies" and in the language of the Income Tax Act they are negatively described as "companies in which the public are not substantially interested". The profit distribution policies of such companies are, therefore, likely to be influenced in the interests of the small body of identifiable shareholders who can in effect exercise control. This is the background of the existing provisions to ensure, by deterrent taxation, distribution of a certain minimum percentage of profits as dividends. The operation of these provisions has led to great complexity, a wide variety of disputes and much uncertainty. These start from the point of determining whether a particular company is closely held or not. It is not as if, for example, all private limited companies and no others are treated as closely held. Because of the fact that even public companies can, under certain conditions, be controlled by a small group of shareholders, the requirement of a minimum distribution and the accompanying deterrents are applied to all "companies in which the public are not substantially interested", a category which has been very elaborately defined. Detailed and often time consuming examination of several aspects are necessitated by this definition. Thus, important shareholders have to be identified, to see whether the company is controlled by five or more of such individuals or groups. Examination of groups involves going into the inter-relationship of shareholders. Often shares of one company are held by another company. The pattern of share-holding in the holding company has then to be examined. The degree of transferability of shares has to be gone into. All this provides fertile ground for many and prolonged disputes. Finally, it is not as if even after these prolonged processes these disputes are settled for good. As shares are continually changing hands, the process has to be repeated frequently, often year after year. Even after a company is judged to be closely held the tax authorities have to determine whether the actual distribution of profits had in fact been sufficient. This too can often become a difficult and complex affair. A layman would have thought that once the taxable profit is determined (upto that stage differences and disputes will be no more or no less than in other types of cases), the calculation of the amount to be distributed, *viz.*, ninety per cent for investment companies and companies where reserves exceed the paid up capital or the value of the fixed assets and sixty per cent in other cases—is a matter of arithmetic and should lead to no disputes. Curiously enough, the facts seem to be otherwise. This arises because of the fact that in many cases a management can well hold the view that it will not be prudent on ordinary commercial principles to distribute what is required to be distributed according to the legal requirements.

5.29 I have said enough to show the complexities of the law on this matter and the difficulties and delays involved in its application If the tax avoidance prevented by all this were really substantial one could well take the view that it is worthwhile to put up with it. In fact, however, the edge of this weapon has been very much blunted, consciously and by case law. Because of the desire to encourage plough back of profits for the development of industry these provisions are no longer applicable since 1964 to closely held companies engaged in industrial operations. The remaining area consists mainly of trading, investment and property, companies. Secondly, the courts have repeatedly held in effect that the adequacy of the distribution should be judged not merely from the arithmetical calculations according to the provisions of the law but mainly according to business principles. I understand that in the large majority of cases the point of view of the management of companies has been accepted. In a large measure therefore these provisions are inoperative in a direct manner even in this field. The real point, however, is whether the mere existence of the deterrent has not encouraged companies, by and large, to declare sufficient dividends. This is clearly a matter not capable of any kind of statistical proof either way. One has to rely on judgment. The fact that several other countries still consider similar provisions necessary would support a judgment that a deterrent is necessary and useful. On the other hand, it has to be remembered that many features of the present Indian tax system do not exist in those countries. These features today among themselves have made it far less worthwhile than before to desist from declaring dividends justified on business principles for the sake of postponing tax liability of individuals. Total avoidance is in any case impossible because of the provision that any kind of distribution of assets under any name including on liquidation are brought into the tax net. Thus, when profits of a company are not distributed, the value of the shares increases correspondingly and with it the net wealth of the shareholder on which wealth tax is levied. If the shares are transferred without consideration, the gift tax is attracted. If they are transferred with consideraton, capital gains tax becomes payable. On death, the value is calculated for estate duty. With all this it would be well worthwhile to consider whether the time has not come to leave distribution of profits to the judgment of the managements. On a balance of consideration, I think that the gains from the enforcement of a very intricate and complicated system of deterrents over a large area merely for the purpose of covering a comparatively small area will considerably outweigh the possible risk of some postponement of tax liability. This risk will be even less when the capital tax is introduced.

5.30 *Definition of "closely held" company and tax avoidance.*—today the need for determining whether a company is closely held or not arises not merely for the purposes already discussed but also in connection with three other matters. These are—(1) a tax concession is given to dividends received by a foreign company from a closely held Indian company; (2) a loan taken by a Director from a closely held company is deemed to be a dividend; and (3) carry forward of loss is permitted only if fifty-one per cent of the shares are held by the same shareholders as before in the case of a closely held company.

If a determination of whether a company is closely held or not becomes in any case necessary for any of these purposes, one might argue that the results may just as well be used for other purposes. We have, therefore, to ask whether the above three purposes can be served in some other way. If my proposals regarding the treatment of inter-corporate dividends are accepted, it will no longer be necessary to define a closely held company for the first purpose. For the other two, the substance of the existing provisions has to continue. But this can be achieved by applying the relevant provisions to all private companies and those public companies the shares of which are not quoted on a stock exchange under the Securities Contract Regulations Act.

Having considered all the situations, which today need the continuous identification of closely held companies on the basis of an elaborate definition, I think that if the present provisions for dealing with distribution of surplus assets in forms other than dividends are strictly enforced there will be no further need for distinguishing closely held companies from others. In that case a whole tangle of cobwebs can be swept away and the energies of the tax authorities released for more fruitful purposes.

5.31 It will be appropriate at this stage to refer to the treatment of "deemed dividends", *i.e.* the distribution by a company of its assets in forms other than dividend. Arrangements are possible by which certain benefits can thus be given to a shareholder in forms which do not readily fall under any of the recognised heads of income. Provisions have therefore been introduced to discourage tax avoidance through these means, *e.g.* taxation of perquisites of persons having substantial interests in a company and provision that certain kinds of receipts are deemed to be dividends. Broadly speaking, a dividend is considered as having been received by the shareholder if there is a constructive receipt from the assets of the company. This can happen while the company is still carrying on business or may take place at the stage of liquidation. Further, assets can be distributed in the form in which they are held by the company or by conversion into debentures, deposit certificates, etc. The provisions under which all such distribution of assets are treated as dividends are necessary and should continue, but there is one kind of notional dividend which requires some examination, *viz.* a loan taken by a shareholder with a substantial interest in the company. This could be the form in which profits are in effect transferred. The intention underlying the present law is quite clear. It is simply to prevent profits being distributed in the guise of a loan. But cases have come to notice when genuine loans are also subjected to this treatment. I would recommend that to avoid this unintended effect genuine loans should not be deemed to be dividends; the test of genuineness may be repayment within a period of one year and the payment of normal interest.

6. Taxation of Co-operative Societies

6.1 In paragraph 4.5 of my interim report, after only a limited consideration of the problem of taxation of cooperative societies, I had recommended "that all the types of income which now qualify for rebate should be excluded from the computation of total income". This has been accepted and implemented. I had also drawn attention to the fact that there is no reason why incomes earned by co-operative societies by activities which are not particularly cooperative in character and hardly dissimilar to business activity of other entities should not be taxed. I shall now proceed to consider this aspect of the matter

6.2 The present position is that apart from various rebates, which have now been converted into exemptions, the balance of income is taxed in a special way falling somewhere in between the treatment of individuals and of corporations. The first Rs. 25,000 are taxed in the same manner as individuals, the balance being subjected to a flat rate of forty-one per cent as compared to rates ranging from forty-five to sixty-five per cent for the majority of domestic companies. The types of income and the concessions relating to each were formulated as a result of the recommendations of the Taxation Enquiry Commission 1953-54. At that time the Commission had specifically recommended that safeguards may have to be provided against the abuse of some of these concessions and therefore suggested that the effect of the concessions may be reviewed after a period of about ten years. This, I believe, has not been done. During this period, however, the cooperative movement has not only spread a great deal but has extended to spheres of industrial and banking activities in a way that the organisation closely resembles those in the public and private sectors. On the view that a cooperative society is essentially the extension of the personality of weaker members of society (who are assisted by Government to come together for organising activities in the cooperative form), and the bulk of its activity relates to transactions with members, it is right and proper that cooperative societies should continue to receive special favourable treatment. But this treatment should not be automatically extended over a wider sphere. Thus, as I have stated in the interim report "there is no reason why on the face of it a factory or a spinning mill organised on the cooperative basis should not be taxed substantially in the same manner as a company....". It is well known that the cooperative form is being increasingly adopted by many who are no different from others engaged in the same type of activity, mainly because of the tax concessions and other facilities meant for truly cooperative endeavour. In medium and large industries with a cooperative form of organisation (*e.g.* sugar factories) what clearly amounts to a form of tax avoidance is widely practised by the simple method of paying more than current or market prices to members who supply material to the industrial society. On the face of it, there is no reason why preferential tax treatment should be given in such cases merely because the co-operative form is adopted. Logically, therefore, the right course would be to distinguish between the profits earned by cooperative societies by sale of goods or services to members and profits earned by sale or services to others. The former can then be wholly exempted from taxation but the latter should be subjected to taxation in the normal way. But administratively this principle is difficult to apply in a direct manner. The separation of profits by origin in a host of cases would involve an amount of work for all concerned which is just not worthwhile. I think, however, that this principle can be applied in substance by the simple method of exempting profits altogether below a certain level and taxing the whole of the balance. I would suggest a limit of Rs. 20,000 or 25,000. Even today very few at this level actually pay taxes. There could of course be cases where part or whole of the income in excess of Rs. 25,000 may be earned by sales or services to members. These cases are not likely to be very many. Special provision can, therefore, be made to exempt in addition whatever part of income, in excess of the limit, is shown to be so derived. In effect the special provision amounts to a segregation of profits by origin. In the comparatively small area which alone would be involved (and which might include some co-operative banks), this process could be undertaken without undue trouble.

6.3 The proposals I have made would in substance meet the demands made from various quarters for extension of the concessions to activities which do not specifically qualify for exemption now.

6.4 Cooperative societies are clearly distinguishable from individuals and the anomaly of taxing them like individuals upto a certain stage should disappear. It would be so automatically if the exemption limit is fixed at Rs. 25,000/-. In any case it should be clearly provided that whatever is taxed should be on a standard rate. The only question is whether this should be the same rate as for a company. As cooperative societies are subject to certain handicaps as compared with companies (restriction on shareholding limitation of dividend, prescribed minimum reserves, etc.), I think the effective rate should be ten per cent less. But this should be translated, in line with the general trend of my proposals, into the form of suitable straight deductions.

7. Taxation of firms

7.1 Firms constitute one of the important categories of non-corporate assessees. A firm is distinguished from other associations of persons by the requirement that it has to conform to the Indian Partnership Act. The essential features of a firm are unlimited liability of partners and the binding nature of actions of any partner.

A partnership constituting a firm comes into being by agreement among the members orally or in writing. In law neither a written agreement nor registration with the Registrar is obligatory, but in practice most firms are governed by written agreements; otherwise partners cannot resort to the courts if disputes arise among them. More important, without registration a firm cannot start legal action against anyone else. This form of organisation which enables individuals to pool their resources and expertise to carry on business is widely resorted to in spite of unlimited liability. The present scheme of taxation of firms recognises the basic principle that the partner is the owner of the portion of income which is his share according to the terms of the partnership. This share is added to his other income in the year in which it is receivable. The assessment of firms is therefore only a stage in the assessment of the individual partners. Therefore the assessment of a firm ordinarily means the determination of income and the apportionment of the shares of the partners. While apportioning the income, the Income Tax Officer is ordinarily guided by the terms of the partnership agreement as indicated to him, but if he finds that the real beneficial ownership is different, he is free to assess the firm as if it is a single individual. But the matter does not stop there. He can further direct that the whole or what he thinks the appropriate portion of the income should be added to the income of the various *real owners* for the purpose of determining the average rate of taxation, though not for actual taxation. A firm treated in this fashion is known as an unregistered firm. For tax purposes, a registered firm on the other hand is one in the case of which the Income Tax Officer apportions the income on acceptable evidence and then directs that the appropriate portions should be included in the incomes of the respective partners. The essential distinction between a registered and unregistered firm is therefore whether it is taxed like an individual or whether the assessment order merely determines the income and its distribution. It may appear that I have stated the obvious at some length. I have, however, done so only to emphasise the point that in actual operation the essential distinction tends to get blurred. In order to enable the income of a firm to be not only determined but apportioned, the necessary information regarding the shares of partners has to be made available to the tax authorities. This is provided for by a process of registration of firms with the income tax authorities (something quite apart from registration with the Registrar of Firms). Many procedural formalities have been introduced, all of course with a view to get correct and upto date information of the shares of partners which can and, in fact, do vary from time to time. Failure to comply with any of the procedural formalities to the satisfaction of the tax authorities results in refusal of registration and with it the inevitable consequence that the whole income of the firm is first taxed as a unit and further imported into the incomes of the real owners for rate purposes. In cases where the essential information is given to the tax authorities, but there are failures on technical or procedural matters, genuine nardship could be caused by refusal of registration. That is why there is such long standing agitation on procedures for registration of firms. There is considerable litigation on these matters. I understand that in most of the cases arising from refusal to grant registration on grounds of technical irregularity appellate authorities have generally condoned them. An incidental result of this is the "blocking" of or revision of the individual assessments of partners. The existence of this situation has been recognised by the Department and in recent years attempts have been made to remove difficulties, but these do not seem to have made much real headway. Firstly, changes have been confined to the fringe and have not approached the heart of the matter. Secondly, interpretations of even the simpler procedures have varied very widely. This, along with the effect of numerous delays, has caused a great deal of uncertainty.

7.2 I believe that most of the difficulties can be swept away by a different procedure without weakening in any way safeguards against possible abuse. A separate system of registration with the income tax authorities does not seem to be necessary at all. All that is needed is to ensure that the tax authorities do get the relevant, correct and upto date information. I would suggest that all firms should be required to get their constitution registered with the Registrar of Firms; changes as and when they occur should also be similarly recorded with him. With each return the firm should be required to furnish a declaration of the ownership of the shares in the relevant year supported by certificates from the Registrar. These should constitute sufficient evidence for the income tax authorities to treat the firm as "registered", *i.e.* income will be determined and apportioned. It will be observed that the right of the Income-Tax Officer not to accept the shares at face value when he has reason to believe that the real ownership is different will remain undiminished. In fact, it is this right and nothing else which is relevant for preventing evasion by assigning shares to benami or fictitious partners. The only difference will be that instead of treating the firm as unregistered (that is by taxing the income as a unit) the Income-Tax Officer will straightaway assess the income in the hands of those whom he has reason to believe are the real beneficial owners. I understand that this is the effect of numerous court rulings. On a superficial view it may appear that the tax authorities will lose one weapon, *viz.* taxing the firm's income as a whole. But really I think the real effect should be quite the contrary. Once the income has been taxed as one unit, the urge for going behind the benami and pursuing the real beneficiary will be considerably weakened. Under the procedure I have recommended attention will be automatically focussed on this essential point and the tax authorities will be encouraged to impose the tax on whom it should fall without delay.

7.3 Needless to say it would be essential to announce the new procedure several months before it is applied to enable those tax payers who out of ignorance or otherwise are not in the habit of registering their agreements with the Registrar of Firms. It will be evident that although such registration would be compulsory in the case of those attracting tax liability, this should cause no kind of real hardship because the new procedure will in all respects be very much simpler than the present one.

7.4 I have stated earlier that at present firms registered with the Registrar of Firms could be treated as "unregistered". Equally, in a certain type of case firms who prefer to remain unregistered are nevertheless treated as registered by the tax authorities. When the partners of a firm have large incomes from other sources, there is a temptation to leave the firm unregistered even at the cost of paying the higher tax that will result from the whole income of the firm being treated as one unit, because it will be still lower than the marginal rate which the shares will attract if added to the other income of the partners. In such cases, the Income Tax Officer is empowered to determine the income and to apportion it among those whom he regards as the real owners. In fact, in this class of case the Income Tax Officer is even now doing what I have recommended that he should do in all cases where he has reason to believe that the real owners are different. Even under the procedure I have recommended cases of this type can well arise, though they should be rarer. Those who take the risk of not registering with the Registrar of Firms at all can still attempt this course. I would recommend that this class of cases should continue to be dealt with in the same manner as other cases where the Income Tax Officer does not find that real ownership corresponds to what is stated in the agreement.

7.5 I have stated earlier that, by and large, the assessment of a firm has been regarded as only an intermediate step in the assessment of the partners. This was the exact position before 1956 since when a tax has been levied on registered firms. At present the tax is imposed at graduated rates from six to twelve per cent on incomes exceeding Rs. 25,000/-. The rate is a little less in the case of professional firms. This tax has been the subject of very wide and adverse criticism as a blatant form of double taxation. The Law Commission has expressed such views in somewhat strong language. "This is the least defensible provision of the present income tax law....... This provision for double taxation is without precedent, so far as we have been able to gather in the history of income tax legislation, either in this country or in the other countries whose laws we have examined. ....This type of legislation cannot be supported on any considerations of justice or fairness or any sound principle of taxation. It would work as a dangerous precedent etc......".

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

8. Taxation of the Hindu Undivded Family

8.1 The Hindu Undivided Family is recognised as a separate entity in the present tax system. Considering the place of this institution in Indian society its recognition for purposes of taxation was natural and legitimate. The H.U.F. is essentially an involuntary association of members of a family with specified relationships, the management and control in the widest sense of the word being in the hands of the head of the family or Karta. While the members of the H.U.F. have clearly defined rights to the property, their share in the income of the H.U.F. is quite indeterminate so long as it remains an H.U.F. For tax purposes, the H.U.F. is treated like an individual except that the exemption limit is higher. This is on the whole reasonable. There has, however, always been some scope to use the institution of the H.U.F. as a means of lowering the tax liability of individuals. This has become somewhat wider since the Supreme Court upheld the right of an individual to transfer self acquired property to an H.U.F. This enables in effect a new H.U.F. to be created even by persons who have inherited no ancestral property. In economic terms it would be justifiable to restrict or diminish the tax benefits which can thus be acquired in a perfectly legal way. There are two possible ways of doing so. One would be to treat the entire income of the H.U.F. as the income of the Karta, who will then be taxed appropriately on his whole income including the income from other sources. This would however be manifestly unfair unless provision is simultaneously made to give deductions corresponding to the obligations of the Karta. This process will by no means be easy because the customary obligations of the Karta while well known are equally imprecise. For this reason alone this otherwise sound and logical method may prove impracticable. The second way of dealing with the problem would be to treat that part of the income of an H.U.F. which arises from property transferred to it by an individual member as part of the income of the person who so transfers. This would be similar to the treatment of property transferred by the husband to a wife or by the parent to a minor child. This method will result in a different kind of administrative burden, *viz.* the need to trace and to keep track of for long periods the sources of income of H.U.Fs. Which of these methods is adopted or none at all on the ground that it may not just be worthwhile on revenue grounds is mainly a matter for administrative decision. In this context it would be well to remember that the right of partition can always be resorted to if any tax situation can be improved thereby.

9. Income from property

9.1 At present incomes are classified under six heads—interest on securities, salaries, property, business or profession, capital gains and "other sources" under which is included dividends. Few problems arise in the computation of income from salaries, interest on securities or dividends. I have already dealt with the treatment of capital gains in my interim report. The problems which arise in the determination of incomes from business are the same as those discussed in the chapter on the corporation tax and it is unnecessary to go over the ground again. There are, however, a few matters relating to income from property which deserve attention.

9.2 Income from property situated on agricultural land or ancillary to agricultural activity is not subject to central taxation, being treated like agricultural income. So long as it is not possible to consider seriously the taxation of agricultural income along with other types of income, the present position has to continue.

9.3 For all practical purposes income from property means income from buildings. When let out, the determination of income becomes mainly a matter of practical verification. At present actual expenses are allowed for insurance, interest, ground rent, etc. Actual cost of collection is allowed but only upto six per cent of the annual letting value, but curiously enough only half the municipal taxes actually paid are allowed to be deducted in the case of buildings built after 1st April, 1950. Whatever might have been the original reason for this extraordinary discrimination, there is no reason whatever why full deduction should not be allowed in all cases. For repairs and maintenance, a standard deduction of one sixth of the annual letting value is now given whether what is actually incurred is more or less. This, I think, is very sound. But there has crept in one small anomaly which needs to be removed. In the case of properties the rents of which are held down by law much below current market rents, only one sixth of the controlled rent is allowed. This is obviously inadequate and it will be fair to allow one sixth of what would be the annual letting value had there been no rent control. Many have suggested to me that an appropriate allowance should be given for depreciation. In principle this is sound but calculations as in the case of industry or business will not be worthwhile. This should be appropriately taken into account when determining the standard rate for deductions for repairs and maintenance. It will also be fair to provide for suitable administration charges and costs of maintenance of common services like lifts in the case of multi-storeyed buildings. At present, nothing at all is allowed. Here, again, a standard allowance which would do away with the need for calculations and verification would on the face of it be preferable, but without detailed investigation of the problem it is not easy to say whether a fair rate which would be appropriate to the generality of cases can be worked out. Otherwise actual expenses will have to be allowed. Being run like a business, it should not be difficult to ascertain them.

9.4 I shall now turn to income from property which is not let out but is in the occupation of the owner. Income in such cases while not actually earned is notionally determined on the basis of what the property would ordinarily fetch if it were let out. Tax on the whole of the income so calculated is rarely charged. Various concessions are in force. Income from property situated in places away from the work of the tax payer is wholly exempt. In all other cases, half the annual letting value or Rs. 1,800, whichever is less, is deducted. Deductions for repairs and maintenance etc. are allowed as for others. But all this is subject to an overall ceiling of ten per cent of the other income. This ceiling is applied even when a person has several houses which are self occupied in the sense that none is let out on rent. Such a wide concession seems unnecessary. Limiting the concession to two houses, one ordinarily occupied and the other maintained for sporadic use in the home town or elsewhere, should be quite enough. Those who desire the luxury of maintaining more should pay for it. At the other extreme there is a demand, fairly widespread, that income from self occupied property should not be taxed at all. This is supported among other things on the ground that such income is purely notional. While I would not attach undue importance to this particular reason, there is a great deal to be said on general grounds for such exemption which prevails in many countries. The exemption from wealth tax of urban house property upto Rs. 1 lakh implies a recognition that people should be encouraged to own their houses although the encouragement does not extend to large, not to mention palatial houses. In any case, the two types of concessions now prevailing seem to me inappropriate. The ceiling of one tenth of other income is unnecessarily low in the case of the larger incomes. On the other hand, the concession of half the letting value or Rs. 1,800 whichever is less, is too little in the generality of cases, if it is recognised as I think it should be that the intention underlying the exemption of Rs. 1 lakh from wealth tax should be applied in this field. I would, therefore, suggest an alternative which will also be very simple to administer. This is to allow a straight deduction, in the case of each self occupied property, of Rs. 6,000. This should be deducted not from annual letting value but from the net income, *i.e.* annual letting value minus admissible deductions determined for each of the two properties to which the concession may be applied. On the one hand, this would discourage wasteful use of houses by those with large incomes and on the other, it would do away with the need to ascertain meticulously the annual letting value in a large number of cases.

9.5 There is need to streamline and improve the methods of determining annual letting value. This is of direct importance in the case of property not let out but it is useful and necessary as a check even in the case of properties which are let out. The tax authorities have now to determine this after consideration of such data as valuation by the municipal authorities where available, the cost of the property, the rent fetched by a similar property in the locality, etc. It is common knowledge that valuation by municipal authorities is, to put it mildly, far from perfect. In connection with the wealth tax, the capital gains tax and estate duty, the correct valuation of properties has become a matter of considerable importance. The income tax authorities are not sufficiently equipped to deal with this subject which often can be quite intricate. Even now the expert opinion of valuers has often to be obtained, but usually this arises only in cases of dispute. It would help sound administration in the long run if adequate permanent arrangements are made for periodical valuations. I would, therefore, suggest the creation of special machinery for this purpose. Such machinery should not form part of the operative sections of the Ministry but should be regarded as a specialised service of the Ministry. This agency could be of great value in guiding bids by Government at auctions of property in the course of recovery of taxes. It could also be entrusted with the management of properties which Government may acquire at such auctions. In time one may expect that others may also use this agency for valuing properties in various contexts.

9.6 Low voluation of properties is resorted to for various purposes, although it is not easy to determine its extent. One possible way of discouraging it would be for the State to have the right to acquire the property at the value declared by the owner in various situations. This path (even if it is legally possible under the Constitution) is no doubt beset with various other pitfalls, but should it ever become possible or necessary to adopt some such means, a permanent and efficient machinery for correct valuation will be all the more essential.

10. Income from salary

10.1 I have said earlier that only a few problems arise in connection with the taxation of salaries and dividends. I would now turn to one or two of them because, though relatively of minor importance, they afford considerable scope for simplification and lightening of the burden on the administration.

10.2 Out of the total number of about 2·7 million tax payers, about one third are salaried people; large numbers among them have no other sources of income. Those with substantial incomes from other sources are relatively few. Collecting taxes from this class is a fairly simple task for the administration. There is, however, one feature which causes avoidable inconvenience and delay.

This concerns the deduction of expenditure incurred on the maintenance of a conveyance. As tax is deducted at source without taking this element into account, a large number of proceedings arise almost solely for the purpose of determining a refund. The calculations are also complicated and at times can be exacting. All these however are of little real significance because the major element, *viz.* the proportion of expenditure to be allocated to personal use as distinct from use for the performance of duties has necessarily to depend on broad judgment which in practice is reduced to a rule of thumb. I consider that this is a field eminently suited for a standard conventional deduction expressed as so many rupees for a few classes of conveyance. Four classes, for example, would be sufficient, *viz.* (i) Motor cars where the horse power rating does not exceed 16 and the cubic capacity 1·88 litres, (ii) other motor vehicles exceeding these limits, (iii) motor cycles, scooters, mopeds, and (iv) other forms of conveyance (which would be mainly bicycles. Few, I believe, maintain animal drawn vehicles or just animals be they horse, camel or elephant. Nor do I think any special consideration need be shown to those who choose to maintain expensive animals). An appropriate sum for each category should be fixed on a broad judgment of running costs, of the allowance necessary for depreciation and maintenance and on the presumption that half the total cost should be considered as for purely personal use. The sum so determined should be taken into account while calculating tax to be deducted at source. This will save a great deal of work both for the tax payer and the tax authorities.

11. Dividends from companies having agricultural income

11.1 In para 4·17 of my interim report I had referred to the rebates given on dividends distributed by companies subject to agricultural income tax levied by the States, but had made no final recommendation. I have considered the matter further. There is a certain confusion of thought underlying the view that dividends from companies engaged in agricultural activities should not be taxed (or taxed only at a concessional rate in the hands of the shareholder). The reasons advanced are either that tax is already paid by the company concerned or that the origin of the income (however remote) being agricultural the income should not be subject to Central income tax. Sometimes the two arguments are mixed up. The first argument is a backwash of the old system under which a part of the tax paid by a company was supposed to have been paid on behalf of the shareholder. Such a concept runs totally counter to the basic principles of the tax structure as it stands today. Whether any tax has been paid by the company or not makes no difference to the fact that in the hands of the recipient the dividend from the company is clearly income under any concept. In making his investment decision as a result of which the dividend has arisen the investor would have taken note of the situation. If such be the case of taxes paid to the Central Government, the argument that taxes have been paid to the State Government is even less valid. The second argument is that in the hands of the recipient the dividend received from a company engaged in agriculture is still agricultural income and, therefore, not subject to Central income tax.

Here, the courts have clearly ruled that while it was no doubt agricultural income in the hands of the company, it ceases to be agricultural income in the hands of the recipient of the dividend. Apart from it, the legal position represents a substantially sound economic position. If one goes back enough, many types of income can be traced to agriculture. In a scheme of direct personal taxation based essentially on the principle of capacity to pay which is a function of the total income actually at the disposal of the recipient, an enquiry into the nature of various types of income with a view to differential taxation is completely meaningless. I would, therefore, recommend that the existing rebates should be withdrawn.

12. "Tax-base", Rates of tax and Exemption limits

12.1 I have so far discussed the various types of income which are now taxable. It is necessary, for reasons which would be evident, to refer to two other types of income which are now not taxable. The less important of the two is casual income. I have given some thought to this problem as disputes may well arise on whether something is really casual or not. I understand that in practice such disputes are few and generally inconsequential. No useful purpose will, therefore, be served by changing the present position. The other type is income from agriculture. While this is par excellence income, it cannot be taxed by the Central Government as it is reserved under the Constitution for the States. Some States do in fact levy an agricultural income tax but the revenue collected is small. This division of the taxing power between the Centre and the States is, in economic terms, very unfortunate. With nearly half the total national income outside its purview, it is difficult to construct a system of direct personal taxation which can truly claim to reflect real capacity to pay. Past performance and present attitudes do not encourage even the hope that the State Governments at least will effectively use one of the most important and potentially a large and growing source of raising revenues for economic development. But even if they do, the resulting situation will be nothing as satisfactory as a proper system of progressive personal taxation which would take into account the entire income of a person which is the only factor of real economic significance. One can only entertain the hope that painful experience over some years of the consequences of neglecting a just and useful form of taxation will create conditions which will permit either an amendment of the Constitution or agreements between the Centre and the States. Meanwhile the Central Government can only note and live with the fact that there is scope for unaccounted money masquerading as agricultural income. This will unfortunately tend to increase with the increasing participation of persons with other incomes in progressive agriculture—which in itself is very much to be desired for the de-elopment of the economy as a whole. Integration of agriculture with other income tax will certainly serve to prevent this. It may, however, be asked whether such integration will not at the same time discourage the desirable trend of others engaging and investing in agriculture. I think there need be no such fears because it should be quite easy to provide for adequate incentives in the system itself.

12.2 I have discussed most of the important points concerning the determination of income of various kinds. It is the total of all this which is the real income of a person. It has been suggested that it is really not necessary to classify income under several heads as at present, and therefore it would be much simpler to do away with them. I fear that this is not really practicable, because the ways of determining various types of income have necessarily to differ and sometimes widely. In reality the present classification does no more than jog the memory, so to say, of the tax payer and draws his attention to the deductions and other benefits he can claim. Even if the classification is formally abolished, all these considerations will still have to remain. My discussions on this subject have revealed that this is quite well understood. The real reason underlying the suggestion seems to be to provide for any type of loss being set off against any kind of income. At present certain types of losses can only be set off against certain types of income, *e.g.* loss incurred in speculation can be set off only against profits from speculation and not against any other income. I have examined the present provisions for set off and find that they are, on the whole, both rational and simple. So are the provisions for carry forward of loss, generally speaking. The suggestion made by some that losses, instead of being carried forward, should be allowed to be "carried back" or set off against profits of previous years is both unsound and untidy. All that I would suggest in this area is to clarify the existing position thereby rendering their operation smoother by prescribing the priorities for set off. I would suggest the following deductions be given effect to in the first instance in the year concerned:—

(1) Depreciation;

(2) Amortisation (which I have suggested); and

(3) Development rebate.

If this results in a net loss, it should first be set off against profits of any other business or income from other sources of that year. If the whole loss is not thus absorbed, the balance has to be carried forward but separately—one part representing depreciation and amortisation which can be carried on indefinitely and the rest subject to time limitations prevailing at present. In the next year deductions may be made as follows:—

(1) Losses under other heads.

(2) Losses brought forward but excluding depreciation and amortisation.

(3) Losses brought forward on account of depreciation and amortisation.

12.3 The need for something like a carry forward or carry backward legitimately arises in the case of some classes of persons with highly variable incomes. By the very nature of their work authors, artists, musicians and actors sometimes earn very large incomes in one year and little or none at all in other years. For some of them, the active earning period during a life time is also relatively short. With progressive rates it is obviously unfair to tax such incomes in the years in which they are received. Some provisions for "spreading" is obviously called for. This has already been recognised to some extent by the existing provision that a spread over is allowed over the period during which the relevant work is done and by the facility to make larger Annuity Deposits. These provisions are halting and not very scientific. I would not recommend spread over a past period as that will involve reopening of assessments. It is far better to provide for spreading over a number of years to come. In that case, provision will have to be made for an initial deduction at a standard rate to be adjusted over the years of spread over. The disadvantage of this method lies in the need to keep careful track of adjustments over a number of years. A more flexible alternative which would at the same time practically eliminate this disadvantage would be to provide for the deposit of the entire amount with Government (in a Bank account) with complete freedom to withdraw sums as and when required. Whatever is withdrawn in any one year will become taxable in that year along with all other income. At the stage of withdrawal a deduction at a standard rate should be provided for but this will be adjusted fully in the corresponding assessment. It goes without saying that interest at a suitable rate should be paid on deposits. I would recommend the latter alternative.

12.4 Arrears of salary received at a particular time are now allowed to be spread over a number of past years. This again means reopening assessments. I would recommend instead a spread over for the same number of future years.

12.5 Before concluding, I would repeat that in the case of personal taxation, as in the field of corporate taxation, it would tend to clarity if the use of the expression "total income" with its present meaning is discontinued. In reality it does not represent either total income as commonly understood or taxable income because some further deductions are made. I would recommend the use of the neutral expression "tax base" which simply means the amount to which the tax rate will be applied.

12.6 Those who pay taxes under the Income Tax Act fall into two broad groups, corporate and non-corporate, the latter consisting of co-operative societies, firms, associations of persons, Hindu Undivided Families and individuals, who form a large majority of tax payers, at least in numbers. In all cases, the first step is to determine the tax base after providing for all deductions whether on account of costs, direct or notional, or by way of reliefs or incentives. It is thereafter that the tax rates are applied. What the rates should be is essentially a matter of economic policy. Nevertheless, it is desirable that the rates remain reasonably stable. To reconcile stability with the changing needs of the State is not so difficult as it may seem at first sight. I would, therefore, recommend that the rates to which stability is desired to be given should be incorporated in the Income Tax Act itself. Variations from year to year upto 20% either way can be made through the Finance Acts by the simple expedient of a levy (or exemption) of a percentage of the total tax liability. Variations beyond this range should not ordinarily become necessary but it is only when they do that this method becomes unsuitable in economic terms. Under those circumstances (and only under those circumstances) the rate structure itself will have to be suitably altered. It follows from this that there should be no other kind of surcharge or indeed reductions from the tax itself, (as opposed to deductions made before determining the tax base). If the economic effects of any of the existing surcharges need to be continued, they should be built into the rate structure itself. In this connection I have already recommended in the interim report that the surcharge on unearned income should be abolished and that the surcharge on earned income over Rs. 1 lakh should be replaced by appropriate changes in the structure of rates.

12.7 The main princpile governing the rate structure is progression. As far as I know, there is no truly scientific method of determining the correct degree of progression. This has to be, therefore, judged on practical and common-sense grounds. On this approach, I think that the progression reflected in the existing rates seems to me, by and large, appropriate to our present conditions and needs. I have a feeling that the rates in the middle ranges could have been pitched a little higher, but this is only a feeling. I say "could have been" because I know of no scientific way of determining a different rate which can be demonstrated to be superior. There is, therefore, some merit in leaving alone rates to which people have become accustomed. In the lower ranges of income, however, the picture is somewhat different. The first step in determining progression is the exemption limit which in law is at present Rs. 4,000. (In actual fact, it is Rs. 4,000 for a single or married individual, Rs. 4,400 for a married individual with one child and Rs. 4,800 for a married individual with more than one cnild). From 1948—1950 it was Rs. 3,000. Since then prices have doubled. On this ground alone, a considerable increase of the exemption limit is called for. It would be even more so if my main proposal regarding indirect taxes is implemented. Practical administrative considerations point even more clearly in this direction. A comparatively small amount is collected from a very large number of people. The statistics available, somewhat incomplete as they are, bring this out unmistakably. Let us take the year 1963-64. At the end of that year, there were 1,559,000 non-company assessees on the register. It is not possible to relate exactly the tax collected from each income group among the assessees on the register because all statistics of revenue yield are maintained in terms of assessments. The number of assessments generally exceed the number of assessees in the register because when a new assessee is brought into the picture, he is subjected to assessment for several past years and in the statistics each such year is counted separately. In 1963-64, however, the number of assessments was less than the number of assessees at the end of the year. This merely indicates that a large number were brought in towards the end of the year. In spite of this I am satisfied after a study of the statistics that classification by assessments indicates more or less the same position as a classification by assessees would have, any difference being immaterial in the context in which I am using the figures. Hereafter, therefore I shall use the word "assessee" instead of "assessment" as the meaning will thereby be clearer to a layman. In 1963-64, the number of non-company assessees with incomes below

Rs. 10,000 was 859,000 and that tax demand only Rs. 11·3 crores. This low figure is due to the fact that the average income per head in this class works out to about Rs. 5,600 only and the average tax per head is only Rs. 130. In the range below Rs. 7,500 the average tax is only Rs. 80. Similar figures for the range of Rs. 5,000 and below are not available, but one can easily imagine how small the contribution of this class is likely to be from the fact that with an income of Rs. 5,000 (the highest in this class), the present tax liability will be only R. 10 in the case of a married individual with two children and Rs. 125 at the other extreme in the case of a single individual. At the middle point of this range, *i.e.*, Rs. 4,500, the tax liability of a single individual will be Rs. 100, of a married person with no children Rs. 25, of a married person with one child Rs. 5 and none at all of a married person with two children or more. All this is mostly the result of the so-called family allowance which is given to all at flat deduction of tax of Rs. 125 for a single individual, Rs. 200 for a married person with no children, Rs. 220 for a married person with only one child and Rs. 240 for a married person with more than one child.

12.8 This was the situation in 1963-64. At the beginning of this year (1967) the total number of assessees had increased by nearly 1·2 million to about 2·7 million. The bulk of the increase has been in the lowest ranges of income. It is unfortunately not possible to make even a rought analysis as compared to 1963-64, but there can be little doubt about the indications. A study made by the Directorate of Inspection (Research, Statistics and Publications) of the Income tax Department on the basis of projections indicates that in 1965-66 (when the total number of assessees was slightly over 2·4 million) the total revenue from assessees with incomes upto Rs. 10,000 would have been only a little more than two years before in spite of the increase in numbers. I am not quoting the figures because these are projections of assessments rather than the number of assessees, and the conclusion indicates a much slower growth of revenue on account of the addition of more than half a million assessees than I would have imagined. Making allowances for these, I would say that a fair estimate of the revenue which may be expected from this class, as of today is not likely to be more than Rs. 12 or 13 crores. No wonder that the work load on the Department is increasing fast. In terms of assessments "for disposal", it has gone up from 2·2 million in 1962-63 to 2·7 million in 1963-64 and 4·6 million in 1965-66. Quantitatively, the assessments made each year have increased but the proportion of disposal has rapidly declined from 59 per cent. to 52 per cent. The delays that necessarily follow have affected very large numbers of people and have naturally caused widespread irritation and dissatisfaction.

12.9 It will be evident from all this that any comfort which one might have derived from the rapid increase in the number of tax payers during the last few years is largely illusory. When the statistics of the number of tax payers in each income range become available, I have little doubt that they will reveal only a slow rate of growth in the numbers of tax payers in the middle and higher ranges such as might be ordinarily expected. The drive for enrolling more and more people in the tax register has produced results which are impressive only superficially. In terms of growth of revenue, even potentially, this rather represents a diffusion of administrative effort. Some hold the view that making large numbers pay direct taxes, however small they may be, is in itself desirable in the belief that this represents a sort of participation of the people in the national effort for the mobilisation of resources for development. I fear that this too is somewhat of an illusion with a rather outdated Fabian flavour. Today even the most unsophisticated know that they are being taxed in more ways than by a direct levy. Paying direct taxes, therefore, need give no more sense of participation (not to mention satisfaction) than paying taxes in any other way. On the other hand, procedural irritations probably reduce such sense of satisfaction as a high-minded person may have when paying his taxes by buying a packet of cigarettes or going to a cinema. In any case, submission to taxation seems hardly the most fruitful field for directly evoking a sense of participation in the national economic effort; this will have immensely more validity when applied to contribution of personal work in recognisable developmental activities. If considerations of this kind are kept aside, it is very clear that it is just not worthwhile to collect small amounts by way of direct taxes even through the simplest of procedure from very large numbers of people. In fact, attempts to do so lead only to a distraction of effort from more worthwhile directions. Some Revenue officials have estimated that if work on petty assessments is cut out, the improvement in the quality and speed with which the remaining work can be done —e.g., by expeditious disposal of appeals, better investigation, etc., will lead to increase of tax collections by Rs. 100 crores for some years besides an immediate increase of about Rs. 200 crores merely by finalisation of pending assessments. I am not in a position to comment on these figures—may be they are a bit optimistic—but there is no doubt whatever that a very substantial improvement can be expected. For both economy and on practical administrative grounds I would, therefore, strongly recommend a substantial raising of the exemption limit and would suggest that the limit be fixed at Rs. 7,500 for individuals and Rs. 10,000 or 11,000 for Hindu Undivided Families. The would be justifiable merely on the increase in prices ignoring all other considerations. By doing so, the number of tax payers in the register will be reduced by about 1·7 million (on the assumption that to the 700,000 in this class in 1963-64 would have been added one million out of the increase of 1·2 million since then). The "loss of revenue" as conventionally understood will only be of the order of Rs. 7 to 8 crores. In 1963-64, the revenue from this range of tax payers below Rs. 7,500 was only Rs. 5·82 crores. But this will be very much more than made up by better administration elsewhere. The tax burden on this class will in consequence become a little lighter, but may be not to the full extent because the indirect taxes payable will be increased (not only for this class but for all classes, including those who are not subject to income tax at all) slightly under the proposals I have made for indirect taxation.

12.10 I have already expressed the view that the present structure of progressive rates is generally satisfactory and may be continued. The change in the exemption limit I have proposed can be easily and neatly fitted into this scheme. All that is required is to fix the rate for the slab Rs. 7,500 to Rs. 10,000 at seven-and-a-half per cent. (the present rate of ten per cent. for the slab 5,000 to 10,000 will be too much because, at ten per cent., the tax on Rs. 10,000 will become Rs. 1,000 which is more than the present Rs. 750). This rate will of course be subject to marginal adjustments as at present. The rate table will thus read as follows:—

Exemption limit—Rs. 7,500

(1) Where the total income exceeds Rs. 7,500 but not Rs. 10,000.	Seven-and-a-half per cent of the total income
(2) Where the total income exceeds Rs. 10,000 but not Rs. 15,000	Rs. 750 plus fifteen per cent of the amount by which the total amount exceeds Rs. 10,000 and so on for higher slabs.

An adjustment for marginal cases will be that the tax shall not exceed forty per cent of the amount by which the taxable income exceeds Rs. 7,500.

12.11 I consider that with these changes, what are now commonly known as personal or family allowances as well as the allowance recently introduced for a person who has a dependent parent or grand parent to maintain, need no longer continue. At present the personal and the family allowances take the shape of a lump sum deduction from the tax payable of Rs. 125 for a single individual, Rs. 200 for a married person, Rs. 220 for a married person with one child and Rs. 240 for a married person with more than one child. Such small lump sum deductions seem to me entirely inappropriate. A personal allowance for a single individual is obviously meaningless. This can just as well be adjusted in the exemption limit. If family allowances are meant to help the maintenance of a family, the present small lump sum deductions are clearly inappropriate. If it is desired to continue family allowances at all, I would suggest an appropriate deduction before arriving at the tax base in the case of tax payers with incomes of less than Rs. 25,000.

13. Wealth tax, Estate Duty and Gift tax

13.1 Besides income and corporate taxes, there are three other forms of direct taxation, viz., Wealth Tax, Estate Duly and the Gift Tax. The revenue arising from these taxes is very small compared to the main direct taxes. All the same, they serve important economic functions. The wealth tax should continue if for no other reason than for ensuring in the long term that income tax is properly administered. It also plays a useful role in discouraging the unproductive possession of wealth. The higher rate of tax on wealth in the form of urban property exceeding certain limits is designed to discourage concentration of highly valuable and not to easily expandable urban property. I therefore think that the wealth tax should remain as an integral part of the permanent tax structure. It is, however, necessary that this valuable instrument should be made use of properly and adequately. From the rather slow increase in the yield of this tax it seems that the administration of the tax needs improvement. The establishment of a Valuation Department which I have already recommended in another connection will be very useful for this purpose. There is also more room for using the wealth tax for improving the quality of administration of income tax. Much could be gained if the wealth tax and the income tax returns are meaningfully dealt with together. This is not usually done, although even today the same officer deals with both types of cases.

13.2 In the time at my disposal I have not been able to study in detail the problems relating to Estate Duly. I have, therefore, nothing to say on details. It seems to me, however, that an Inheritance Tax based on what a person receives rather than on what a person leaves would be both more equitable and rational. At first sight it would appear that this must result in a "loss" of revenue, but this need not be so if the rates are suitably altered. But I fear that the gains may not be substantial enough to justify a change from the Estate Duty to which, at long last, people are getting accustomed. I have not, therefore, pursued this question in depth.

13.3 The Gift Tax is primarily intended for checking the planned avoidance of Estate Duly, but it has value in other ways too. It can perform a useful function in improving the administration of the income tax itself by helping to check any tendency for unaccounted wealth to appear in the form of gifts received. On equitable grounds it can stand on its own legs as a gift clearly increases the capacity to pay of the one who receives. For these reasons as well as on practical grounds it would be more logical and convenient if the liability to pay the gift tax is formally laid on the donee rather than on the donor as at present. It follows, therefore, that all gifts received by a person in a particular year should be added up and the total subjected to gift tax at the appropriate rate. The rates of gift tax now prevalent seem appropriate. It is, however, essential that they should not be changed frequently.

At present gifts made to a spouse upto Rs. 50,000 (whether in any one year or over a period of time) are exempt from gift tax. But the income which a person earns on gifts received from a spouse is treated as forming part of the income of the doner. As it appears prima facie anomalous to treat the income of one person as the income of somebody else for the purpose of taxation, I considered whether it would not be desirable to subject gifts to a spouse also to a full gift tax and then give up the present "deeming" provisions. I have, however, come to the conclusion that the gift tax by itself will not be a sufficient deterrent to tax avoidance by transfer of wealth to a spouse. It is, therefore, necessary for the present provisions to be continued. In that case there is no need to withdraw the concession of exemption from tax on gifts upto a particular amount.

IV. PROCEDURE FOR DIRECT TAX ASSESSMENTS

14. The "Tax year" and the payment of tax in instalments

14.1 In paragraph five of my interim report I had suggested the introduction of a uniform tax year and a system of "pay as you earn" to replace the present system of advance collection of taxes. In order to facilitate the smooth working of the proposed arrangements I had also suggested a system of registration numbers to be matched by the maintenance by the Department of ledgers showing exhaustively and up-to-date the claims between the tax payer and the Department. The publication of the interim report has served to focus attention on these ideas and to elicit the reactions of those concerned. I have given further thought to these matters in the light of observations, comments and criticism received by me and numerous discussions which I have had with various groups of persons interested. The basic ideas underlying my suggestions still remain valid, but the concrete proposals which I had indicated in outline require some modification in detail.

14.2 I shall re-state the main features of this packet of proposals. These are:—

(i) There should be a uniform tax year. This need not necessarily be co-terminus with the official year of the Government, although there may be some advantages in both the official year and the tax year being the same.

(ii) Tax liability should be related, as far as possible, to the income of the tax year and not to that of any other annual period whether it is called the "previous year" or by any other name.

(iii) It should be the obligation of the tax payer to pay the bulk of his tax liability say, seventy-five per cent., during the tax year. If this obligation is laid down by law, such tax payments can no longer be correctly described as advance payments. They would rather be in the nature of provisional deposits towards meeting his tax liability of that year.

(iv) The balance of the tax liability should be discharged within a prescribed period, say, six months after the close of the tax year. This should be done by the tax payer paying the balance of his liability, as computed by him, along with the tax return.

(v) Assessment proceedings following such return will essentially continue to be what they are now, viz., determination by the tax authorities whether the income as well as the tax payable has been correctly computed.

(vi) Ordinarily, tax proposals embodied in the Finance Acts (which will normally relate to rates of taxation, reliefs, exemptions, etc.) should be prospective, that is to say, they should apply to the tax year following the Finance Act. In this way the tax payer will know in advance his rights and obligations.

Proposals already made in the interim report for a system of registration numbers for tax payers, for the maintenance of ledger accounts for all tax payers and more flexible and convenient arrangements for the actual payment of taxes are of an ancillary character, but these are necessary and desirable irrespective of the main proposals stated above.

14.3 The principle that changes in tax liability should, as far as possible, be prospective has already been largely accepted. I still believe that much of the advantage of doing so would be lost unless the prospective principle is applied to incomes earned in a uniform tax year. In the course of my discussions this has been recognised by many. However, several objections have been voiced and some of them include practical considerations which need to be met. In paragraph 5.4 of the interim report, I had envisaged that it would be possible to introduce a uniform tax year while at the same time permitting tax payers to maintain accounts for the years of their choice. I had said "Of course, they will be free to maintain the accounts for whatever period they like, but their tax liability will relate to their income arising in the tax year. Those who choose to maintain accounts for a different period will have to accept the extra burden of preparing separate accounts for presentation to the tax authorities. But it will be clearly within their hands to get rid of this burden by adopting the tax year as their accounting year. Sentiment and habit apart, I do not see why this need really be a hardship. There may of course be a few cases where because of the nature of any particular business, a different accounting year may be more suitable. If the advantages to be gained by adopting the different year outweigh the disadvantages of having to prepare accounts relating to the tax year, they would no doubt continue to do so. If the advantages are less than that, then there is no reason why the entire tax system should be distorted and many other possible benefits foregone for the sake of the marginal convenience of a relatively small, and probably dwindling proportion of people".

14.4 The discussions I have had have convinced me that this kind of choice will not be workable. For one who maintains accounts for a period different from the tax year, the return of income for the tax year will invariably have to cover two of his accounting periods, the latter of which will be incomplete. To the income of the first year can be added only an estimated income of part of the second year. One could of course provide for such estimates for a part year being accepted and later on corrected in the light of the final accounts for the whole year. But this will involve a considerable burden not only on the tax payer but on the tax authorities, besides giving rise to uncertainty about tax liability. One consequence of such uncertainty will be that it will be more difficult than otherwise for tax authorities to accept returns with a reduced degree of scrutiny in suitable cases. This will in turn cause difficulties in implementing the suggestions which are given later for extending the scope and content of what is loosely known as "self assessment". For these reasons it is necessary to formulate the proposal for a uniform tax year in a way which will avoid the need to accept estimates of income for part of an accounting year.

14.5 I shall now proceed to deal with the difficulties which some anticipate will result from the adoption of a uniform tax year by all. These fall broadly under five heads. Firstly, many people, particularly in trade, are attached by reasons of sentiment and tradition to certain years like the Diwali year or the Basantpanchmi year. Secondly, the nature of certain businesses, particularly those of a seasonal nature is said to require the adoption of an accounting year which begins at a time when inventories are low or negligible. Thirdly, it is urged that subsidiaries and branches of foreign companies would find it very difficult to adopt accounting years different from those of their principals. Fourthly, it has been pointed out that different official or accounting years have been prescribed by law for cooperative societies, banking and insurance companies, electricity undertakings, etc. Fifthly, it has been urged that a uniform tax year will entail undue strain on the part of auditors in one half of the year because of the necessity to complete audit within six months of the close of the year. Such completion is required not only for tax purposes but also for complying with the requirements of the Company Law.

14.6 If the advantages of a uniform year are fully appreciated, I am sure that objections based on sentiment and tradition will not be pressed too far. Subsidiaries and branches of foreign companies exist mainly in the organised sector and they should not experience too much difficulty in adjusting their returns to a uniform tax year. At any rate, this represents a very narrow area. It is no doubt true that the adoption of a uniform tax year will entail the amendment of other laws which prescribe different official years for banks, electricity undertakings, etc. However, the present official years have not been prescribed, to my knowledge, for any compelling economic reasons. There is, however, some substance in the view that certain seasonal industries and businesses will have genuine difficulty if their accounting year closes on a date during periods of high activity. Even these difficulties, however, should not be exaggerated. Nor do they prevail over as large an area as claimed by some. For instance, the very fact that different years are adopted by businessmen engaged in exactly the same kind of industry or trade would show that this consideration is not as important as some would like to claim. Nevertheless, it would be an advantage if the tax year is so chosen that the area of genuine difficulty is eliminated or reduced to the minimum. From this point of view, I think that if the tax year commences on the 1st of July and closes on the 30th of June most of the difficulties of this type will be eliminated. This, I think, would be actually convenient for seasonal businesses like sugar, jute and cotton and not particularly inconvenient for anybody else. There remains the question of audit. Here, again, the difficulty though real should not be exaggerated. It is not as if the auditors' work begins only after the close of the year. Much of their work is done concurrently throughout the year. It is only that part of audit which has necessarily to follow the stock-taking at the end of the year that has to be completed within a period of six months after the close of the year. Nevertheless, it would be desirable to allow for the spread of what might be called final audit work over a period longer than six months. This can be provided for by extending from six months to nine months the period for presenting final accounts. It is true that one of the consequences of such an extension might be corresponding delay in the declaration and payment of dividends by some companies. Where such delay is apprehended, it will however, always be open to the company to adopt the practice of declaring interim dividends.

On a consideration of all factors, I would therefore recommend the adoption of a uniform tax year beginning on the 1st of July. This would be convenient whether the official year of the Government remains unchanged or whether it is changed to begin on the 1st of July. In either case, the prospective principle can be fully applied. One might even say that the prospective principle becomes, if anything, even more meaningful if the tax year begins on a date after the Finance Bill is enacted into law. Difficulties will again arise only in the event of the official year of the Government beginning on a date after the 1st of July. In such an event, the whole problem will have to be thought of afresh.

14.7 While I consider that the adoption of the uniform tax year I have suggested will be in the best long term interests of everybody, I recognise that there would be opposition to the proposal and some of it might be vocal. If for any reason, whether it be the convenience of audit or difficulties in changing the official year prescribed under other laws or even a desire not to interfere with the liberty of the citizen to adopt any accounting year of his choice, it is found difficult to carry out this reform in one step, I would recommend an alternative scheme under which some at least of the benefits of the proposed change could be retained. I must, however, make it clear that this will be an inferior alternative and will have the defects inherent in any compromise.

14.8 The alternative could be somewhat as follows. As at present, everyone may be allowed to choose his accounting year. But in order to secure at least part of the benefits of the prospective principle, the tax changes embodied in the Finance Bill should apply to the incomes of accounting years which begin not more than six months before or within six months after the close of the official fiscal year. Thus, the tax proposals in the budget of February, 1968, will apply to incomes of accounting years which start after the 1st of October, 1967, and before the 30th September, 1968. This would mean that if the financial year of the Government is unchanged, the tax proposals will be fully prospective in the case of those following the present financial year, the Basantpanchami year and the Fasli year, but it will be a little retrospective in the case of those following the calendar year and nearly half retrospective in the case of those who follow the Diwali year. If the financial year of the Government is changed, the only result will be that the tax changes will be prospective or partly retrospective in the case of different sets of accounting years. Even if this inferior alternative is adopted, the long term objective should still be to encourage all tax payers to adopt the Government's financial year. Progress towards this end could be stimulated by prescribing that while existing tax payers will be allowed to continue to keep their present accounting periods and new businesses allowed to make an initial choice, subsequent changes will be permitted only to the financial year of Government. Even the inferior alternative will be much simpler and more rational than the present complicated system of previous years, although of course it will not be any thing as satisfactory as a uniform tax year for all. I would also say at this stage that under this alternative the system of payments recommended in later paragraphs will become somewhat more complicated than it would be with a uniform tax year.

14.9 At present the tax liability which arises in any official year (Called Assessment year for income tax purposes) relates to the income earned in the course of that year only in the case of salaries. In all other cases, it relates to the income earned in varying previous periods. Thus, in the case of dividends and earnings for which books are not maintained, it relates to the preceding official year. Where books are maintained, it relates to the income of the preceding accounting years of the tax payer concerned. These accounting years should end before the 30th of April, *i.e.*, a month after the opening of the official year. In the absence of any other specific provision, payment of taxes cannot be enforced before they become legally due. That is why a special provision has been made for the collection of advance taxes and for deduction of taxes at source; these are adjusted against the tax liability of the next assessment year. With the introduction of a uniform tax year it would be desirable to give up this type of arrangement and instead to provide by law that tax liability will relate to the current year, *i.e.*, the year in which the incomes are earned. If this is done, it will be no longer necessary to describe tax payments during the year as advance payments. In the case of income and corporation taxes, unlike indirect taxes, the full and correct tax liability can be known and determined only after the end of the year for the simple reason that full results can be known only after the close of the year. It will, therefore, be neither just nor practicable to require the tax payer to discharge his full liability before the end of the tax year. For ensuring a fairly even flow of revenue to the Government, to make it easier for the tax payer and to reduce avoidable difficulties in collection, it would be desirable to provide for the collection of the tax in appropriate instalments. With the tax year running from the 1st of July to the 30th of June of the next year, I would suggest the following arrangements for payment of taxes:—

Before the end of October, the tax payer will be required to pay of his own accord twenty per cent. of his likely tax liability for the year as computed by him. At this stage he will be required to submit a brief statement of his income for the year on which he has calculated his tax liability.

Before the end of February he would be required to make an additional payment which, together with what he has paid before, will be equal to forty per cent of his liability as computed by him.

at that stage. He will again be required to submit by the end of February a brief estimate of his income for the year on which he has calculated his tax liability.

Similarly, before the end of May, he will be required to pay additional amounts which will bring his total payments to seventy-five per cent. of his tax liability, together with a brief statement of his income as estimated by him at that stage.

Thereafter, before the end of September, by which time an accurate picture of true profit should be available although the final accounts may not be ready, he should be required to make an additional payment bringing up the total to ninety per cent. of the tax liability as estimated by him at that stage.

The balance of ten per cent. should be paid along with the return of income before the end of December. For reasons already explained, the period may be extended to the 31st of March for those who are unable to complete their audited final accounts.

I may clarify that payments of tax are to be made at all stages after taking into account any tax which might have been deducted at source before the income is received by the tax-payer.

14.10 It will be observed that in the earlier part of the year the tax payer will be asked to pay only a relatively small portion of his tax. On the last date by which he is required to make a payment of seventy-five per cent. nearly eleven months of the year would have elapsed and there should be no genuine difficulty either in making the payment or in estimating the income with fair accuracy. By the time the tax payer is required to complete payment of ninety per cent., he would have had ample time not only to know what his income was but also to realise it. It would have been legitimate to call for a return of income at this stage but for the fact that audited accounts are not likely to be ready. It will also be observed that full payment as computed by most of the tax payers will have been made along with the return of income before the end of December. Further collection after the returns of income are received will, therefore, relate only to changes in tax liability resulting from assessment proceedings. A greater proportion of total tax collections will therefore be accounted for by prescribed payments made on the initiative of the tax payer than at present. The proportion of collections resulting from final assessment will tend to grow substantially smaller. This will be mostly due to the fact that under the arrangements proposed regular payments will be related to the income of the current year and not to the latest completed assessment as at present under the advance payment system.

14.11 I have stated throughout that the payment of taxes before the prescribed dates should be made by the tax payer of his own accord. This means that ordinarily no notices will be issued as at present. All the same, it would be necessary for the tax authorities to watch payment and see that tax payers are in fact doing what they are expected to do. During the first few years after the introduction of the new system it would be desirable to send letters reminding tax payers of their obligations. But mere encouragement and watchfulness will not suffice. Provision will have to be made to ensure that payments are in fact made before the stipulated dates. It would, therefore, be necessary for the tax authorities to issue notices, as soon as possible after the stipulated dates, in cases where payment has not been received. In such notices the tax payer will be called upon to pay his dues as determined by the tax authorities on best information and judgment. The tax authorities will not be tied down, as at present, to pitch the demand only at a figure related to the income of the last completed assessment. On receipt of such a notice, the tax payer should either pay the sum demanded or file his own estimate together with the appropriate tax. Failure to do one or the other will constitute default and thereby attract the coercive processes of the law.

There may be a few cases where the income is earned only towards the end of the year and there may, therefore, be genuine difficulties in the earlier periods both in estimating income and in paying taxes. In such cases as well as in the case of new businesses started during the year, the tax authorities should have discretion to waive the earlier instalments, but in all cases payment upto 90 per cent. of the tax liability should be made by the due date as this date falls after the close of the year.

14.12 The main spirit underlying the proposed arrangements is that ordinarily the tax payer should be trusted to make payments according to his own estimates. At the same time, it is necessary to ensure that estimates are made in a responsible and *bona fide* manner. Otherwise, some tax payers (increasingly fewer one would hope) may seek to postpone part of their payment by pitching their estimates low. In order to encourage correct estimates, it would be necessary to prescribe fairly heavy penalties for unduly low estimates. The simplest way would be to relate the penalty to the degree of error in the estimate. In doing so, it has to be borne in mind that a larger margin of error will have to be allowed for earlier compared to later estimates. Further, even the latest of the estimates may prove false for good and valid reasons. Bearing both these aspects in mind, I would recommend that a margin of error of 50 per cent. should be allowed in the case of estimates filed with the first instalment in October, a margin of 40 per cent in the case of estimates filed with the second instalment in February, a margin of 30 per cent. in the third estimate to be filed in May and a margin of 25 per cent. regarding the fourth estimate with which 90 per cent. of the tax liability will be discharged. These margins of error would relate to the difference between the taxable income estimated and the taxable income as finally determined by the tax authorities. Of course taxable incomes which are subject to deductions at source would be ignored. In cases where the estimates filed are within the margins of error prescribed, no question of penalty will arise. Where one or more of the estimates exceeds the prescribed margin of error, a penalty will be leviable at the discretion of the tax authorities. The maximum rate of penalty should be 100 per cent. of the difference in tax based on the determined income and the estimated income. It is necessary to allow discretion to the tax authorities within the maximum rate of 100 per cent, because differences between the estimate and the actual taxable income as finally determined can arise out of a variety of reasons some of which may well be legitimate and beyond the control of the tax payer. Some may result from mere miscalculations or ignorance or different views on what is due. Such differences should obviously not attract the maximum penalty, sometimes they need not attract penalties at all if the reasons are good. It should, however, be emphasized that the onus of explaining the errors in estimates beyond the margins allowed should be clearly on the tax payer.

Hitherto, I have dealt with situations caused by insufficient payments. It is necessary, in all fairness, to provide for excessive payments even though such cases will not be very many. I have already suggested that the tax authorities should maintain an up-to-date ledger in the case of every tax payer. Excess payment at any stage will naturally be first adjusted against any other dues from the tax payer. Excess beyond this amount should be refunded without delay. The appropriate stage for such refunds will be the one at which the tax payer renders his return of income. If at this stage he claims that he has already paid, by way of previous instalments, more than what is due from him, the excess should be refunded to him as soon as possible and should not remain blocked as at present until the final assessment is over. I would suggest that the refund should be made within six months, and if it is not so made the tax payer should be entitled to interest thereafter.

14.13 The arrangements for the payment of taxes suggested in the previous paragraph need apply only to companies and all other tax payers with incomes of Rs. 15,000 and over per year. At present rates the tax payable on an income of Rs. 15,000 is about Rs. 1,500. It would not be worthwhile to collect lesser amounts in instalments. There should ordinarily be no difficulty in realising tax dues below this amount. Further, all such tax payers will be required to discharge their full liability as computed by them along with the return of income. Facilities should also be provided for such tax payers who wish to make advance payments, but the number of those tax payers will be few.

14.14 It is difficult to forecast with precision the likely effect of the proposed arrangements on the flow of revenue and the administrative effort required, but a rough assessment can be attempted. In 1966-67, total collections on account of corporation and income taxes amounted to Rs. 632·67 crores, of which Rs. 107·57 crores arose from deduction at source, Rs. 183·10 crores from payment of demands on assessments and Rs. 342 crores by way of advance payment of taxes. This last sum was realised from over 500,000 tax payers. Under the proposed arrangements, the number required to pay taxes in instalments will be reduced to about 200,000 or at the most 250,000. To that extent administrative work by way of issue of notices and watching of collections will be considerably reduced. But the postponement of collection on this account will hardly come to Rs. 20 crores. This will, however, be much more than made up by the fact that 200,000 and odd tax payers will be regularly discharging their liability upto 90 per cent. three months before the returns are filed. In other words, the amount to be collected after the filing of returns will only be a small percentage representing the difference between the estimates of the tax payers and incomes as finally determined.

14.15 The system of payments I have discussed so far assumes that a uniform tax year running from 1st July to 30th June will be, as I hope, introduced. If, however, the inferior alternative of allowing tax payers to keep accounts according to the year of their choice and continuing the present financial year is adopted, the dates of and the proportion of taxes payable with each instalment will have to be suitably modified. Following the pattern of what I recommended, the last dates for payment may run somewhat as follows:—

Instalment of tax	Accounting years commencing between 1st October and 31st January	Accounting years commencing between 1st February and 30th April	Accounting years commencing between 1st May and 30th September
Date of payment upto 20 per cent of the tax	30th April	31st August	31st December
Date of payment upto 40 per cent of the tax	31st August	31st December	30th April
Date of payment upto 75 per cent of the tax	30th November	31st March	31st July
Date of payment upto 90 per cent of the tax	31st March	31st July	30th November
Date of payment of paying 100 per cent of the tax and for filing the return—			
(*i*) When accounts are not audited	30th June	31st October	28th February
(*ii*) When accounts are audited	30th September	31st January	31st May

It would be observed that with the option given to tax payers to maintain accounts according to the year of their choice the strain on the administration in watching payments will certainly be more. It has to be remembered in this context that a tax payer having more than one business or source of income may adopt, as he often does now, different accounting years for different businesses or sources of income. Payments during the year, however, will naturally have to be related to the aggregate of all his sources of income, although the estimates on which they are based at a particular time will be subject to different margins of error. This will render calculations relatively more complicated for the tax payer and by the same token relatively more difficult for the tax authorities to ensure that dues are being paid correctly and in time. Further, the final payment will be slightly delayed in the case of those with several businesses or sources of income as obviously the aggregation of all incomes will be possible only after the close of the last of the accounting years concerned. These difficulties are unavoidable and have to be accepted as the price for giving the option to the tax payer to maintain accounts according to the year of his choice. A similar unavoidable incident of choice would be that some tax payers will be allowed a longer period than others to file returns. But the practical consequences of what may appear to be delay will not be very much. The main requirement, *viz.*, that tax liability as adjudged by the tax payer himself will be automatically discharged without calling for the initiative of the Department (whose role will only be to ensure that the automatic arrangements are in fact observed) will remain substantially unaltered. In other words, collections after the filing of returns will relate only to differences of opinion on the tax due. The bulk of payments will result from responsible estimates by tax payers themselves. Once the period of transition is over—and this should not be more than a year and a half—the rhythm of the flow of revenue will be more even than at present. This would be so under both alternatives, but as I have mentioned before, the strain on the administration will be greater under the inferior alternative.

15. Assessment Procedure

15.1 One of the essential features of the arrangements I have proposed is that full tax liability as computed by the tax payer should be discharged along with the return. In the case of those subject to the "Pay as you earn" scheme, the return will be accompanied by a payment which together with previous payments will equal the total tax due. In all other cases, along with the return of income, full payment of tax dues will be made. In both types of cases there may be claims for refund. All this pre-supposes that the tax payer is in a position not only to compute his taxable income but to calculate correctly the tax which is due. This is no problem for tax payers like companies and large businessmen who have in any case to maintain a professional staff or arrange for professional advice. However, the position of the vast majority of tax payers consisting of salaried people with some other income, people deriving income from small businesses and property and the professional classes (except tax lawyers and Chartered Accountants) is quite different. Only relatively few in this class of tax payers have the requisite knowledge. To acquire such knowledge is by no means easy. It is therefore necessary that the form of return should be made as simple as possible and should be so devised that the tax payer's attention is drawn to all relevant points. Apart from this, all tax payers should be provided with a hand-book explaining in lucid language the ways of computing income and calculating tax liability. To make the meaning clear concrete illustrations should be given. Reference should also be made to points on which the tax payer would do well to seek assistance from the Public Relations Officers of the Department or to seek professional advice. These pamphlets should be made available preferably free of charge or at least at a low cost.

15.2. Earlier this year, revised forms of return were introduced. The object was to simplify the forms and assist the tax payer. The public impression, however, is that far from achieving this object the new forms are far more complicated and exacting than the old. This criticism is perhaps too sweeping. The form intended for a tax payer with an income upto Rs. 15,000 consists of only four pages and should be easily understood at least by those for whom it is meant. It is the other forms which require revision. Even these include many features which are a distinct improvement on the old forms. But the good effect of these features has been nullified in the public eye by the requirement not only to sign a number of negative certificates but to give all kinds of detailed information which, where necessary, should ordinarily be elicited by other ways in the course of assessment. It is, in my view, unnecessary to burden the form of return with this kind of information which is really required only in a relatively small number of cases. Obscurity and complication will be the inevitable result if an attempt is made to provide in the form itself for obtaining every kind of information which may conceivably be required. I would, therefore, recommend that all the forms should be revised bearing these considerations in mind after Government have taken a decision on the recommendations in this report.

15.3 Apart from simplifying the forms of return, the public relations activity of the Department needs to be vitalised. At present there is one Public Relations Officer in all places where there is a Commissioner's office. The Income-tax Officer is also supposed to assist the tax payer, but one can easily imagine how burdened with so many duties, substantive, procedural and routine, the most conscientious and helpful of Income-tax Officers will be unable to give any attention to this aspect of his theoretical duty. The Public Relations Officers too, few as they are, are unable in practice to do little more than try to direct people to the right officers. It would, therefore, be desirable to appoint an adequate number of well trained, courteous and alert officers who will really provide guidance to ordinary tax payers and help them to fill in their forms and make their tax calculations. I realise that it will not be possible, nor indeed desirable, to ask these officers to give advice in writing or to do anything which might be construed as legally binding the Department. But there is a very wide area within these limits, in which useful assistance can be provided. The very feeling that such help is being sought to be given, not to mention the feeling that it is in fact given, will change the entire atmosphere of the relationship between the tax payer and the Department.

15.4. Once the path is thus made less thorny and unpleasant, one can legitimately hope that in a fairly short period most people will make their payments and render their returns in time. But the law has still to provide for the negligent and the recalcitrant The tax authorities should therefore continue to have the power to call for returns, for information necessary to scrutinise returns and assess tax liability, and in the event of default to take appropriate action, including *ex-parte* assessment and coercive action. In the period before the return of income is due, the initiative of the tax authorities will be called for only for ensuring the payment of tax in instalments. The next stage will consist in dealing with returns received and calling for them when not received.

15.5. Ordinarily, after a return is received the next step should be to scrutinise it without delay and accept it where suitable and to take further steps where modification seems necessary. The need for making provisional assessments should not therefore ordinarily arise. At the same time, it is necessary to retain the power to make provisional assessments on the basis of the return. This power has to be used in cases where a return is filed with no payment or with insufficient payment, but even in these cases it would be undesirable to exercise this power except in cases where the amount due is large or where there is on the face of it reason to believe that the final assessment will take some time. Unless the power is thus used sparingly, there will inevitably be a tendency to delay final assessments in the belief that the bulk of the tax has been collected on a provisional assessment. In the generality of cases the nomal practice should therefore be to proceed with the assessment itself. In law "assessment" means the determination of tax liability and would therefore technically include cases where the return is accepted in toto. It is of the essence of a good system that assessments are completed as expeditiously as possible. The benefit to the revenue is obvious; the removal of uncertainty and doubt in the mind of the tax payer is no less important. At present, not more than a small fraction of assessments is completed within the same assessment year. Even within a period of a year from the filing of the return it is doubtful if more than half the assessments are completed. Delays of over two years are quite common and much longer delays are not unknown. The prescribed period of limitation is four years beyond the assessment year. The very length of this period creates a sense of complacency, particularly after provisional assessments have been made, and encourages postponement. I would therefore recommend that both as a measure of self-discipline on the part of the Department and as an earnest of Government's intention to expedite disposal, the normal period of limitation should be reduced to three years beyond the tax year. In effect this would give a period of two years and a half to the tax authorities. This should be more than enough in the vast majority of even complicated cases. The only exception which has to be provided for is for prolonging this period to the extent necessary in cases of concealment. While the period of limitation may be two years, the objective of the tax administration should be to ensure that the maximum number of cases are disposed of within six months and the vast majority within one year. One great advantage of doing so would be to enable the tax payer to submit fuller and better returns in the light of decisions on his previous return. This, in turn, will help to create conditions in which the need and occasion for appeal will be progressively diminished. This would, of course, not be the case on disputes regarding points of substance. But in a large area, particularly in the class of cases where an element of judgment is the more important factor in determining the quantum of taxable income (*e.g.* gross profits cases in the jargon of the Department) expeditious disposal will by itself largely reduce areas of dispute and occasions for appeal.

15.6. The tax authorities will be able to make assessments expeditiously only if a sense of priority is brought to the work. Disproportionate time and effect should not be spent on relatively less important cases, whether from the point of view of revenue or of complexity. Such effort can be more fruitfully directed to more important cases. Work can be expedited and the general atmosphere improved as and when returns become more and more reliable and are accepted with little or no change. The knowledge that proper returns are likely to be accepted will in turn encourage the submission of proper returns. The whole process is so to say the opposite of a vicious circle. In order to help bring about such conditions, it would be desirable to accept returns in all suitable cases with little or no scrutiny. In some advanced countries a large proportion of returns is accepted without question, but at the same time heavy penalties are provided for and enforced when a subsequent scrutiny (mostly on a sample basis) reveals intentional omissions or concealment. Prosecutions are frequently resorted to in the case of intentional concealment. In theory the Indian law also provides such deterrents, but prosecutions are hardly ever resorted to, one reason perhaps being the extreme difficulty in proving intention to the satisfaction of a court of law. I do not think that in India conditions are yet ripe for adopting a similar system but there is little doubt that it would be desirable to move in that direction and to move as quickly as possible. As a first step, I would recommend that in the case of a progressively increasing proportion of smaller income cases, say, upto Rs. 15,000/-, the returns should be accepted without scrutiny or with only marginal scrutiny. The fact of such acceptance should be notified in the form of a simple assessment order. Even a simple letter will do if it is recognised that such a letter has the legal effect of an assessment. In the initial stages the selection of cases for such treatment will have to be left flexible having regard to the type of case, the previous record, etc. Where a return is accepted with no alteration (in the new context this will mean not only acceptance of the income as computed by the tax payer but also of the tax as computed by him), there will be no difficulty. But in the present law the elaborate procedure of notices, opportunities for hearing etc. will be attracted even if only minor errors are involved. I refer to errors of calculation of tax, errors in deductions and the like. In such cases, I would suggest that all that is required will be a letter from the Income Tax Officer that he proposes to accept the return with such and such modification and therefore to assess the tax at such and such a figure named. The tax payer's reply accepting such a letter should be deemed to be a valid revision of the return and for all intents and purposes the case should be treated as if the return was accepted without question. Assessment proceedings as understood at present will then arise only when points of substance which might lead to points of dispute are likely to be involved. In those cases it is necessary and desirable that the tax payer should have adequate opportunities to explain his position. I have just said that the selection of cases for treatment in this manner will be by sampling of a purposive character. In doing so, cases should be so selected that each one comes up for scrutiny once in three years. The tax payer himself will naturally not know whether his return for any particular year will come up for scrutiny or not. This is as it should be because only so will he be encouraged to submit his return correctly.

15.7. The return of a particular tax payer may be accepted without scrutiny for the first two years and he will have been told so.

But in the third year when it comes up for scrutiny, errors, omissions or wrong calculations may be found and this may well lead to the presumption that similar errors were contained in the previous two returns which had already been accepted. Under such conditions, the tax authorities would normally reopen the cases. If this were to be done automatically, then the whole purpose of the reform is liable to be defeated.. Acceptance of returns would then carry no authenticity. Uncertainty will, if anything, increase. The tax payer may by then have lost papers relating to the previous years. Even in the normal process of weeding, some of the relevant papers may have been destroyed and he would be put to difficulty when the cases are re-opened. Mere expedition without reasonable certainty and finality may therefore do more harm than good. In order to prevent this, it should be made clear firstly that the normal criteria for re-opening assessments will equally apply to assessments made without scrutiny or with a little scrutiny under the sampling procedure. The conditions under which assessments can be reopened are:—

(i) When the Income Tax Officer finds as a result of information (which would include information contained in subsequent returns) that some income has escaped assessment in an earlier year. Assessments can be reopened for this reason within four years, whether or not any concealment is involved.

(ii) When the Income Tax Officer has reason to believe that some income has escaped assessment in earlier years owing to concealment. Assessments can be reopened upto a period of eight years for this reason with the concurrence of the Commissoner. When the concealed income is believed to be more than Rs. 50,000/-, cases can be reopened upto sixteen years but with the previous concurrence of the Board.

There is no need to make any change for the reopening of cases in (ii) because concealment is involved. But (i) as worded and interpreted at present could enable almost every case to be reopened within a period of four years even when there is no question of concealment. Here, I think it would be necessary to make the rules for reopening a little more stringent. I would suggest that reopening should be permitted only when subsequent "information" reveals a possible under assessment of more than Rs. 200/-. The tax administration should also ensure that the expression "information" should be understood and interpreted in a reasonable manner, as the dividing line between real subsequent information and what can be inferred by a closer scrutiny of old files is rather thin. To emphasise this point, it would be desirable that the Income Tax Officer who proposes or seeks the concurrence to the reopening of a case should record how the initial under assessment happened. My proposal in effect amounts to ignoring all minor errors (involving no malafide) in the interest of certainty and finality.

15.8. I have suggested that the period of limitation for completing assessments should be three years beyond the tax year. With a three-year rotation of sampling, the period of limitation for reopening of cases (otherwise than for concealment) has to continue to be four years. At present when a case is reopened, the fresh assessment has to be completed within the same limitation as for the original assessment. With the period of limitation for initial assessment reduce to three years, it is therefore necessary to provide that the limitation for reopened cases will be at least one year from the date of reopening.

The period of limitation for setting right mistakes which are apparent from the record is at present four years. This may be also reduced to three years to give finality to the tax liability as early as possible. The only exception may be for withdrawal of development rebate when a tax payer sells the asset to a person other than Government within eight years of the year in which he gets a deduction.

I have recommended earlier that the period of limitation for making assessments should be ordinarily three years beyond the tax year. This period will not be sufficient in cases in which the tax authorities come to believe that there is concealment of income They can make enquiries and make the assessments in such cases at present upto eight years after the assessment year, *i.e.*, they get four years more than the normal period of limitation. Similar facility for making full enquiries can be given by making a provision for the Income Tax Officer to pass an order before the end of the normal period of limitation stating that it is a case of concealment and giving his reasons for coming to this conclusion. This order should be communicated to the tax payer and he should be informed that the period for making the assessment has been extended to eight years. The order would be justiciable only in the sense that if the assessment is disputed in an appeal it will be reviewed. If it is found that it is a malafide order, the entire assessment proceedings would become illegal and barred by the limitation. If it is a *bona fide* order, the assessment would not be struck down even if the addition of particular item of concealed income is not upheld in an appeal.

15.9. Before concluding my observations and recommendations on assessment procedure, it is necessary to clarify what would happen when no returns are filed at all. In such cases there is no choice but to empower the tax authorities to make an assessment on the best information available to them and on their best judgment. This is one part of what today is known as *ex-parte* assessment. A situation quite similar could also arise when having filed a return the tax payer fails to comply with notices to give further information required for the purposes of assessment. It goes without saying that *ex-parte* assessments should normally be made on a reasonable basis and should not be considered to mean an arbitrary or capricious assessment. At the same time, it cannot be overlooked that the tax payer himself would ordinarily be responsible for creating the circumstances which make an *ex-parte* assessment necessary. To that extent it would be reasonable and justifiable for the tax authorities to take a strict view. It will also be reasonable that except when there are good reasons, the tax payer should be made to pay a suitable price for necessitating an *ex-parte* assessment or best judgment assessment. If these considerations are borne in mind, it would be apparent that at present far too much latitude is allowed to those who do not file returns and by the same token far too many unnecessary procedural obstacles have to be crossed by the tax authorities while dealing with them. For example, a notice has to be issued calling for a return and giving thirty days' time for doing so. After that, further notices have to be issued for supplementary information, if any is required. It is only on the failure of one of these things that the Income Tax Officer is empowered to make an *ex-parte* assessment. I think that several of these steps can be eliminated without depriving the tax payer of reasonable opportunities to explain his position when there are good reasons. I would therefore suggest that if the return is not received within the stipulated date, the Income Tax Officer should be free to make an assessment on his best judgment after giving just one more chance to the tax payer. This could be achieved by providing for the issue of one "show cause" notice, the response to which should be not only the return but also whatever supporting data is required. In the absence of either, the Income Tax Officer will just proceed and act and make an assessment. Whether or not a penalty is imposed with such assessment should be left to the discretion of the tax authorities depending upon the circumstances of the case. Ordinarily failure to file a return even after the "show cause" notice should attract a suitable penalty.

15.10. At present when an *ex-parte* assessment is made, the tax payer has of course the right to appeal, but he has in addition the right to request the same Income Tax Officer to re-open his assessment. In view of the fact that adequate opportunities have been provided to the tax payer even before the stage of an *ex-parte* assessment, one could strictly hold the view that the provision for re-opening is redundant. But under the practical conditions prevailing today it would not be desirable to take away this right altogether. At any rate, the time is not ripe for doing so. I think the tax payer should continue to have the facility for getting an *ex-parte* assessment re-opened, but care should be taken that it does not become automatic. At present when an *ex-parte* assessment is allowed to be re-opened, the period of limitation ceases to operate. This opens the way to the temptation to make *ex-parte* assessments somewhat irresponsibly, then to re-open them on request and then to deal with them at leisure. To avoid this possibility, I would suggest that the normal period of limitation should continue to apply except for the addition of no more than the time taken to admit the re-opening. It would also be desirable to provide that the decision to reopen a case should be taken not by the Income Tax Officer who has made the *ex-parte* assessment but by the Inspecting Assistant Commissioner or some other Income Tax Officer in the Circle designated by him. These two limitations should help to ensure that *ex-parte* assessments are made in a responsible manner and at the same time avoid the possible criticism of its misuse as an instrument of coercion.

16. Collection, Recovery and Refund

16.1 Under the arrangements I have suggested the bulk of the tax due in any year would be collected in the course of the year itself and the balance of undisputed tax will become payable with the return. For the successful working of these arrangements it is necessary to give better and more convenient facilities for making payments of tax and to provide that a correct and up-to-date account of these payments is maintained in the form of a ledger for each tax payer, who should be assigned a distinctive and permanent number. The challan being an integral part of the system of Government accounts, it will not be practicable to do away with it for tax purposes. But it is not necessary to do so. All that is required is to make it possible for a tax payer to make payment with a challan but without the signature of the Income Tax Officer. Tax payers should be able to purchase challans from branches of the Reserve Bank of India, the State Bank of India and Post Offices. These may be in four perforated parts (instead of three as at present) so that the tax payer may have an extra copy which he should use to get his ledger corrected when it becomes necessary for any reason. There is also a widespread demand for easier facilities to make payments of small amounts direct to the income-tax authorities. The need for this will become less once the exemption limit is raised. All the same, it will be useful to provide this facility. By the same token, refunds of small amounts should also be paid in cash. Under the general arrangements I have recommended, arrears (except from the truly recalcitrant) should go down, but if they still persist, it is right and proper that a higher rate of interest should be charged. I find, however, that Government have recently done so by increasing the rate to nine per cent.

16.2 At present, the income tax authorities can in the last resort attach and sell property for the recovery of taxes. Sale is almost invariably by auction, but sales are often frustrated by collusive underbidding. It would, therefore, be desirable to provide for Government bidding at such auctions. The Valuation Department, establishment of which I have recommended elsewhere, will be helpful not only in determining the prices to be bid but also in the management and ultimate sale of the properties acquired in auctions. Meanwhile, the branch of a suitable Government Department accustomed to this work may be entrusted with the responsibility.

16.3 Just as there should be every facility for the State to collect taxes due, there should be arrangements for promptly refunding to the tax payer any tax which might have been collected from him in excess of what is due from him. I have already suggested that if the excess payments are not set off against any other tax which may be due as shown by the ledger account of the tax payer, and the tax is not refunded within six months, the tax payer should be entitled to interest thereafter. Such refunds may arise because excessive tax has been deposited by the tax payer while estimating his instalments of tax to be paid in the course of the tax year or because the tax withheld from payments of income exceeds the amount of tax which is found to be payable according to the assessment. Even if the assessment cannot be made in six months it is possible for the tax authorities to refund the tax on the basis of the return of income itself unless they are prepared to pay interest. Refunds also arise because of orders of appellate authorities. Here also if the tax is not refunded within one month of the receipt of the appellate order by the Income Tax Officer, interest should be paid to the tax payer.

17. Deterrents and Penalties

17.1 At present, the law provides for a variety of "penalties" to suit varying circumstances, besides the levy of interest related to all kinds of delays. The latter is commonly known as penal interest although this expression is not used in the law. Both the charging of interest or the specific levy of penalties will continue to be necessary although it would be worthwhile remembering all the time that the extent to which use is made of them is an indicator of the lack of smoothness and effectiveness of the system rather than an indicator of the energy and skill of the tax authorities. There is however a lot of room for reducing work and strain all round without in any way reducing the effectiveness of the deterrents. Interest at one or two per cent above the effective market rate should be charged on all defaults which are merely of the nature of delay but in administering the system unfruitful work can be avoided by ignoring petty matters on the one hand and confining calculations to whole months correcting shorter periods to the nearest month. Thus, interest due on amounts of less than Rs. 100 may be waived. Further, for calculating interest the base may be the tax due corrected to the nearest Rs. 100/- Again, interest and indeed tax dues of less than Rs. 10/- may be ignored.

17.2 What may be called penalties proper fall broadly under four heads:—

- (i) For giving low estimates of income in connection with advance payment under the present system or the instalment payments I have recommended.
- (ii) Failure to file a return of income within the time allowed.
- (iii) Failure to produce books of account, etc. when called upon to do so.
- (iv) Concealment of income or giving inaccurate particulars of income.

In each of these cases the minimum and maximum penalty is laid down at present. I have already dealt with (i) in para. 14.2.

In the case of (ii) and (iii) I do not think there is any need to change the scale of penalty, but there is a good deal of room for improvement in procedures. Separate proceedings are initiated regarding each type of penalty concerning the same year. While it is necessary that the tax-payer should be given an adequate opportunity to explain his case before a penalty is imposed, I do not see the need for numerous separate proceedings for this reason alone. I think that as far as possible penalties, except for deliberate concealments, should be dealt with along with the assessments. If this is done numerous unnecessary delays leading to the same evidence being repeatedly gone into by different authorities can be avoided. The theory that income-tax authorities should independently apply their mind to the question of penalty apart from the assessment itself, is being unduly stretched. This may be necessary in the case of penalties for concealment but in the other three types of cases where there is hardly any question of the tax authorities having to establish *mens rea* on the part of the tax payer, nothing will be lost if the penalties of this type are dealt with along with the assessment. On the other hand, it will result in a great deal of convenience both for the authorities and the tax payers. Cases of concealment naturally stand on a different footing. Separate proceedings may be desired by the tax payer as the issues will be, unlike other cases, wider. The tax authorities also may prefer separate proceedings for other reasons, such as the need to act within a period of limitation. Either side should have the option, therefore, to have these penalties dealt with separately. But even here there is no reason why if neither side so desires, the penalty part cannot be dealt with along with the assessment.

18. Appeals and References

18.1 There seems to be a wide spread feeling that there is inordinate delay in the disposal of appeals at all stages. While appeals are pending in this manner new decisions relating to the same tax payers necessarily continue to be taken and so long as the delays are long these must in turn swell the number of appeals. I have tried to examine whether any remedies of a general character can be applied to improve these conditions, if not end them.

18.2 I shall first outline briefly the present arrangements for appeals. The first appeal from the orders of Income Tax Officer is invariably to the Appellate Assistant Commissioner who is under the administrative control of the Department of Revenue. The second appeal lies to the Tribunal which works through Benches in different regions and is under the administrative control of the Ministry of Law. Thereafter references are permissible only on points of law to the High Court and to the Supreme Court. This line of appeal is almost invariably followed although there is provision for a reference direct from the Tribunal to the Supreme Court in certain circumstances. But I understand that this provision has not been invoked by any tax payer or by the Government. I also understand that in the case of the Gift tax even the rules have not been framed so that at present nobody can invoke it even if he wants to.

The tax payer has also an alternative line of remedy by an approach to the Commissioner on revision. He can adopt this initially or at any stage until the Tribunal gives a decision. But once he does so he forfeits the right to use the regular appellate line. Thus he can withdraw from proceedings before the Appellate Assistant Commissioner or the Tribunal and approach the Commissioner in revision, but only after such withdrawal if he has initiated action.

The jurisdiction of the High Courts in relation to Income Tax references is co-terminous with their other jurisdiction. Therefore, appellate authorities including Benches of the Tribunal working in a State are bound by the decision of the High Court having jurisdiction over that State. High Courts generally give respectful treatment to the decisions of other High Courts. All the same this has not prevented them from taking different views and these conflicts remain unresolved until occasion arises for the Supreme Court to give a decision on the matter concerned. It is no wonder, therefore, that on many points of law having a great deal of practical significance uncertainty prevails for fairly long periods. Because of this uncertainty appellate proceedings tend to remain blocked at all levels in cases where it is known that one of the points in dispute is awaiting decision by a higher authority. It is difficult to think of any remedy for such a situation. Reducing one link in the chain of appeals is not likely to help as it will merely shift delays from one level to another. A suggestion has been made by some that an Arbitration Tribunal whose decision will be binding only as between the parties and will, therefore, not serve as a precedent or guide-line, will provide a useful voluntary remedy for those who choose to adopt it. I understand that this could well be interpreted as an erosion of the jurisdiction of the Courts and might, therefore, be held as unconstitutional. There is, therefore, no way of eliminating some period of uncertainty of this type. Under the best of conditions one has to put up with it. All that is possible is to reduce the period and thus mitigate the effects of uncertainty by securing a quicker disposal of cases at all levels. Having no other remedy it has become all the more important to do whatever is possible to quicken the disposal of appeals. Alarming is not too strong a word to describe the present position. The number of appeals pending before Appellate Assistant Commissioners at the end of 1962-63 was 89,349; this has nearly doubled to 1,70,914 at the end of 1965-66. The number of appeals filed each year is steadily increasing—from 1,14,035 in 1962-63 to 1,84,004 in 1965-66. The rate of increase is obviously not unreasonably high in the light of the increase in the number of assessments over this period. The rate of disposal, however, has remained nearly constant. As against 1,23,215 in 1962-63, it rose to only 1,38,108 in 1965-66. On these figures it would appear that on an average an appeal should take about one year. But a large number do take much longer, particularly those which remain "blocked".

In the Tribunal the position is no better; in fact it is a little worse. Cases pending increased from 16,245 at the end of 1961-62 to 33,650 at the end of 1965-66. The number of appeals filed each year has been increasing only slowly from 11,007 in 1961-62 to 15,171 in 1963-64, but thereafter it has declined to 12,109 in 1965-66. But the number of disposals has increased only very slightly—from 10,105 in 1961-62 to 12,886 in 1965-66. The average time taken by the Tribunal for disposing of an appeal would thus appear to be a little over a year, but here again in practice it is longer.

18.3 The position in the High Courts is no better. From such figures of pendency of Income Tax references as are available there is no reason to think that they are disposed of appreciably quickly. It would appear that a decision from High Courts cannot be ordinarily expected in less than two years from the time of filing of a reference in most High Courts. In the more important High Courts this period is about four years.

18.4 Unless some really effective measures are taken, this state of affairs will, if anything, get worse. Delay in this field is almost assuming the proportions of denial of justice. A number of recommendations I have made on other matters should result in a substantial reduction in the number of appeals to Appellate Assistant Commissioners, but to what extent the number of appeals to the Tribunal will be reduced is difficult to forecast. I think it will be worthwhile to provide that in a certain class of cases—say assessments over Rs. 50,000 and penalties over Rs. 5,000—the tax payer will have the option to appeal direct to the Tribunal. Of course, this will not immediately help to reduce the number of appeals to be heard by the Tribunal, but over two or three years it should have that effect. When an appeal relating to a certain year is pending before the Tribunal, potential appeals relating to later years get held up not only in the same but also similar cases. When the Tribunal will deal with appeals direct from the orders of the Income Tax Officer the period of passage through Appellate Assistant Commissioner would have been eliminated. Even with the present rate of disposal, some decisions relating to a particular year will be given by the Tribunal earlier than at present and these decisions will serve to reduce the area of dispute in the same or similar cases of succeeding years. I do not expect any spectacular results from this reform, but the present delays are so great that almost anything is worth trying. I do not feel competent to suggest how the work of the Tribunal can be improved and quickened. I understand that delays hardly ever occur in the High Courts once an appeal has been heard. What is therefore needed is to get appeals heard more frequently. I would, therefore, recommend to Government to consider the possibility of constituting Benches which would continuously deal with tax appeals.

18.5 I would like to make one more observation regarding appeals. I understand that the general feeling among the administrative authorities is that the appellate authorities admit fresh evidence too freely. Restraint in this matter is very desirable as laxity will not only cause delay but provide opportunities to the recalcitrant. As it will be obviously not possible, or indeed desirable, to legislate that appellate authorities should never entertain fresh evidence, I can only suggest that they should be required to record reasons for admitting fresh evidence. Similarly, reasons should be recorded in writing when decisions are not given till long after—say more than a month—the last hearing.

18.6 Lastly, the appellate authorities should ordinarily be expected to give definite decisions, that is to say they should, bar in exceptional cases, determine the assessment and not merely give decisions on principle leaving it to the Income Tax Officer to give effect to it. This is a matter of some considerable practical importance because the translation of the principles by the Income Tax Officer may not only take time but may itself lead to further disputes. A somewhat similar situation arises when instead of giving a positive decision an appellate authority merely sets aside the assessment order. Here, again, it is clearly not possible to legislate that an appellate authority should never do so. All that is possible is to encourage and expect appellate authorities to act with discrimination. Another peculiar consequence of an assessment being set aside is that thereafter there is no limitation for making a fresh assessment. Income tax Officers, therefore, naturally tend to take their own time. This should be clearly discouraged. In these cases, a limitation of one year from the date on which the appellate authority sets aside an order should be prescribed.

V. SOME ASPECTS OF ADMINISTRATION AND PUBLIC RELATIONS

19. Language and Drafting

19.1 I have made many suggestions for the reconstruction of the tax structure and some for simplifying procedures and rendering the administrative processes smoother. If all these are adopted will the system itself become really simpler, easier to understand for the tax-payer and less difficult to administer for the tax authorities? I can only say that compared to things as they are the situation will be better all-round. Even then, what remains will be complicated enough, but this is in the nature of things. Laws which define fiscal liabilities have to be precise and unambiguous. Precision is therefore attempted even on matters which do not lend themselves easily to it. It will be difficult if not impossible to express fiscal laws in a language and style as easy to read as a good novel. It does not, however, follow that in order to be legally precise the language of the tax laws need be so involved and obscure as it has become. A citizen is supposed to know his rights and obligations. He cannot plead ignorance of the law. He must, therefore, be in a position, at least after some conscious effort, to understand the law so that he can appreciate and discharge his obligations. Today even the well educated citizen will find it difficult to find his way through the maze of our fiscal laws. It may be that other countries compete with and even surpass our own performance. Here is an exercise in precision in a British order.

> "In the Nuts (Unground) (other than Groundnuts) Order the expression Nuts shall have reference to such Nuts, other than groundnuts, as would, but for this amending Order not qualify as Nuts (Unground) (other than Groundnuts) by reason of their being Nuts (Unground)."

We have not perhaps reached these heights but short of it, our tax laws abound in similar passages on a slightly lower plane. For example, the provision for the rounding off income to the nearest ten rupees has been expressed in the Finance Act of 1966:—

> "*Rounding off of income.*—(1) Subject to the provisions of sub-section (2), the amount of total income computed in accordance with the foregoing provisions of this Act shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of paise shall be ignored and thereafter if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten; and the amount so rounded off shall be deemed to be the total income of the assessee for the purposes of this Act.

(2) If the total income of the assessee includes earned income chargeable under any head, the adjustment under sub-section (1) shall, to the extent possible, be made in computing such earned income and, as to the balance, if any, against any other income; and if there is no earned income, the adjustment shall be made in computing any other income under any head.

Explanation.—In this section, the expression "earned income" has the meaning assigned to it in the Finance Act of the relevant year."

To understand the meaning one has to read this passage slowly several times, or if better endowed, to sing it in two or three *ragas* preferably on a slow *tala*. I would, therefore, urge that the tax laws should be redrafted in a way which will make them intelligible at least to a reasonably educated person willing to make some effort. This is all the more necessary because in the future these laws will have to be translated into all the languages recognised by the Constitution. It is, therefore, necessary to ensure while redrafting to avoid archaisms and idiomatic expressions peculiar to the English language which do not easily lend themselves to accurate translation. Wherever possible and appropriate clear illustrations may be given in plain language. These explanatory illustrations should be part of the law as in the Indian Penal Code. While explaining particularly difficult points, positive as well as negative illustrations, *i.e.*, illustrations which show what it is and what it is not will be extremely useful. Plain language should be generally preferred and legal specialities or jargon resorted to only when it is not possible to convey the meaning in any other way. Thus, nothing will be lost if the expression "tax payer" is used as in other countries instead of the expression "assessee" with its suggestion of helpless passivity. Again, except where unavoidable, cross references should not be resorted to. As far as possible the meaning of every provision should be clear without the need to look at several other sections. This may involve some repetition but it would be well worthwhile. Even with the help of a suitable expert drafting committee this process may take some time. The benefits, however, will be undoubtedly large. Finally, the Income Tax Act may be re-named the "Income Tax and Corporation Tax Act", as these two taxes, though similar, are not quite the same in character

20. Assistance to the Tax-payer

20.1 Even after the tax laws are re-drafted in a more understandable way, not every one will be able to deal with all his tax problems without some assistance. It would be desirable if Government were to play a more active role in providing such assistance. In theory Income Tax Officers are supposed to help tax payers. Some Public Relation Officers have also been appointed. But, as I have said earlier, they are not able to do anything like what is needed. I would, therefore, repeat that it would be desirable to appoint a larger of alert and courteous officers and put them in a position to give more useful help to tax payers by explaining the meaning of provision, by helping to fill forms, etc. This will improve public relations generally and help the administration a great deal. It has also been suggested by some that Government should arrange for giving "advance rulings" in certain types of cases. This demand mainly comes from the organised sector of industry particularly in connection with agreements with foreign collaborators. On the face of it this would appear to be a reasonable and well intentioned demand. I appreciate, however, that it may not be possible for Government to give binding decisions on hypothetical cases. Indeed, it may not be desirable to do so in certain circumstances. Realities may turn out to be different from the initial hypothetical assumptions. I do not, however, think that for this reason alone the underlying idea should be totally abandoned. In quite a number of cases it may be possible for Government to give opinions which, while being extremely useful to industry, need not cause any embarrassment to Government if it is made clear right from the beginning that these opinions would not legally commit the Government. It may be asked whether such a reservation may not completely take away the value of the opinion. I do not think so. If tendered in a constructive spirit this kind of what may be called "weighty advice" can prove very beneficial.

20.2 Even after simplification, the appointment of an adequate number of Public Relation Officers and arrangements for "weighty advice" from Government in certain types of cases, a number of tax payers will still need professional assistance. Organisations with large or varied interests may find it necessary to employ persons with expert knowledge on taxation. This area presents no particular problems. But Government do have some responsibility for regulating the conditions under which other tax payers get professional assistance by way of advice as well as by representation before the tax authorities. For mere advice, the tax payer can of course approach anyone he likes but in practice a person who can also represent him by appearing before the income tax authorities is preferred. Besides Chartered Accountants and lawyers who constitute the 'income tax bar' proper, certain others such as Bachelors of Commerce, holders of Diploma in Commerce, etc. are also permitted to represent tax payers. The former are subject to the professional discipline of their associations, but there are no such restraints on the others. Whether in the interests of protecting the tax payers from indifferent or incompetent advisers the right of income tax practitioners (other than lawyers and Chartered Accountants) to appear before the tax authorities should be restricted is a matter which deserves some consideration. In any case, the growth of healthy conventions and the maintenance of a code of professional conduct would be of great help both to the tax payers and the State. If mutual confidence is gradually built up, there could be scope for the employment of professional Chartered Accountants to assist the tax authorities in various ways.

21. Administration

21.1 Any system, however well conceived, has to be worked by human beings. Good administration is no less important than a good tax structure and sound procedures. In a real sense, "what is best administered is best". Like justice, administration must not only be good but should be recognised and accepted as good. Again, like justice, delay is nearly as bad as denial. On these tests, our administration has a long way to go before it can claim to be really good. It has to become much more efficient, quick and responsive. For this, the administration must be adequately staffed by the right people in the right numbers. Secondly, the distribution of functions should be rightly organised so that the chain of command is clear and responsibility for judgment and actions is not diffused but clearly pin-pointed. Thirdly, checks and balances will be necessary to ensure that every one discharges his responsibility correctly and expeditiously. But great care needs to be taken to ensure that the very same well meant checks do not in turn lead to hesitations, doubt, escape from responsibility and delay. The Study Team set up by the Administrative Reforms Commission will, I am sure, deal with the problems of administration in depth. I shall content myself with a few observations on the aspects I have mentioned.

21.2 Whether the strength of the Revenue Department and the organisations under it is adequate for the efficient performance of their functions needs examination afresh. Under present conditions, I believe that it is inadequate both in numbers and in quality. What is needed, however, is a fresh assessment of what is required after the tax structure and procedures are changed after considering my recommendations. If the law is expressed clearly and unambiguously and if procedures are "streamlined", the demands on the administration will be less to that extent. In particular, the elimination of more than a million and half income tax assessments by the raising of the exemption limit and the extension of the "audit type of control" in the administration of Commodity Excise Duties will release a considerable amount of manpower for re-deployment for more worthwhile purposes. I think that, by and large, the administration of the General Excise Duty can be provided for by such re-deployment. This means of course much freer inter-change of officers between the two wings of the Revenue Service and some amount of re-training. Only experience will show the nature of further requirements both in numbers and in quality. In any case, it would be desirable to recruit in the future a certain number of Chartered Accountants, if necessary by offering a higher starting salary. But however recruited, officers of the Revenue Service should be given not only initial training, as now, but periodical re-training designed to widen both their knowledge and their outlook.

21.3 On the organisation of the Department, which I consider generally sound, I have only two suggestions to offer. Firstly, I think the Boards would be better able to discharge their wider responsibilities if they function more as a Board, *i.e.* a collective group, than they do at present. This is particularly so in shaping policy or assisting Government to do so. Collection and maintenance of up-to-date statistics on all relevant matters and continuous interpretation of those statistics is vital both for formulation of policies and for seeing that policy decisions already taken bring about the intended effects. A great deal needs to be done in this field. At present most of the statistics are designed and used (when used) for routine administrative purposes. Thus, classification of income-tax assessments are more related to the "work-load" involved than any meaningful economic information they can reveal. Needless to state, the statistics are also very much out of date. Quick reporting of the right information and quick organisation of this information by modern methods are essential both for policy formulation and good administration. Secondly, I would suggest that the need for the appointment of more Commissioners of Income Tax should be examined. Most Commissioners are over-loaded and therefore find it difficult to perform their duties in the spirit in which they are intended to be performed. Thus, revision petitions (which are specifically designed as a quicker and cheaper alternative to regular appeals) are supposed to be heard and disposed of personally by the Commissioner. I understand that in practice they have to lean heavily on Headquarters Income Tax Officers. Even so, revision petitions take nearly one year for disposal. More important, the knowledge that the Commissioner gives only limited personal attention reduces the utility of this procedure by reducing the confidence which otherwise would have been reposed in it.

21.4 However well staffed and organised the working of an agency charged with the administration of taxes may be it will be beset with many difficulties mostly inherent in the relationship between the tax payer and tax collector. Checks and balances have to be built into the system and procedures. These are equally necessary to protect the tax payer from arbitrary action or harassment and to prevent laxity and collusion. It is the duty of the higher echelons of the administration to give attention to both these aspects. Provisions for appeal, revision and references to the highest judicial tribunal are mainly designed to protect the tax payer. To prevent laxity and inefficiency is the main function of administrative supervision and independent audit. In their actual operation these very processes practised without sufficient imagination tend to produce opposite results. Thus, the facilities provided for appeals and revision could be turned into instruments of delay and avoidance by recalcitrant tax payers. Similarly, supervision and audit can sometimes sap the morale of officers and hamper their initiative and make them seek refuge and escape by passing on responsibility. There is a widespread feeling that the fixation of targets of collection and disposal of cases lead many officers knowingly to take incomplete, haphazard and even unfair decisions, their conscience being satisfied by the belief that correction would be provided in due course by different or higher authorities. Equally widespread is the impression that the well meant efforts of Audit to protect revenue and ensure strict compliance with the law have the unintended effect of influencing many officers to act more with an eye on what Audit might say later than on a fair and independent exercise of their own judgment. Supervision and Audit both partake of the nature of potent medicines; in the right doses they are highly beneficial but are apt to turn toxic in the wrong doses. These factors have to be constantly borne in mind to secure good administration. In concrete terms, I would suggest that higher supervision should generally be by way of general instructions and guidance than by specific interference which should be carefully confined to matters clearly calling for disciplinary action. I would also recommend that the assistance and co-operation of the Comptroller and Auditor General should be invoked to secure the most beneficial use of audit. In the main, the comments and observations of Audit should be applied for corrective action of a preventive nature. Retrospective action should be resorted to only with great care. This should be equally so whether it involves disciplinary action against officers or re-opening of assessments. Just as the former should arise only when there is reasonable indication of negligence or collusion, the latter, namely, the re-opening of assessments should not be resorted to automatically, but only on the conscious application of the normal requirements for re-opening of cases. I believe that a broad understanding between the Government and the Comptroller and Auditor General on these lines will at once secure greater usefulness of audit and improvement in administration.

21.5 I shall now conclude my report by recalling that while the measures I have suggested may make the Central tax system a little simpler, more rational and more stable than now, they will not add up to anything like the kind of fundamental reform which is needed for a modern society such as India wants to become. The management of the economy and its development to provide higher standards of living for growing numbers of people has become the major function of the State. In this context the division, prescribed by the Constitution, of functions and responsibilities between the Centre and the States and the corresponding division of the means of raising them, has already become unreal and outmoded. Taxation itself is no longer the principal means of mobilising resources for development. Other means of inducing and mobilising the savings of the community have assumed greater importance. Fiscal policies must therefore be co-related more and more intimately to economic policies in all other fields. For this very purpose, however, it is more important than ever that the mechanisms through which fiscal policies are given effect must be made and kept simple and efficient.

 S. BHOOTHALINGAM)

NEW DELHI,
26th December, 1967.

ANNEXURE A

Depreciation Allowance

There will be four rates of depreciation, *viz.* five per cent, ten per cent, fifteen per cent and twenty per cent; but the cost of renewals, replacements or actual consumption, as the case may be, may be allowed as revenue expenditure for the following assets:—

(1) Flour mills—rollers . .	Cost of replacements.
(2) Iron and steel industry—rolling mill rolls . . .	Cost of replacements.
(3) Match factories—wooden match frames	Cost of replacements.
(4) Sugar works—rollers . . .	Cost of replacements.
(5) Artificial Silk Manufacturing machiery—wooden parts . .	Cost of replacements.
(6) Cinematograph films—bulbs of studio lights	Cost of renewals.
(7) Glass Manufacturing concerns—Direct Fire Glass melting furnaces	Cost of replacements.
(8) Minral oil concerns—field operations distribution (above ground)—returnabe packages . . .	Cost of packages actually used up.
(9) Mines and quarries—	
(*a*) Coal tubs, winding ropes, haulage ropes and sand stowing pipes	Cost of renewals.
(*b*) Safety lamps . . .	Cost of lamps actually used up.
(10) Salt works—salt pans, reservoirs and condensers etc., made of impervious clay	Cost of renewals.
(11) Rubber and Plastic goods factores—Moulds	Cost of renewals.
(12) Mineral oil concerns—plant used in field operations (below ground)	Cost of renewals.

2. The rates of depreciation will be as follows:

A. *Buildings.*

(1) First class substantial buildings of selected materials (whether factory or other types).	5%
(2) Second and third class buildings other than factory buildings and offices, godowns, officers' and employees' quarters	5%
(3) Second class factory buildings other than offices, godowns, officers' and employees' quarters	10%
(4) Third class factory buildings of inferior construction other than offices, godowns, officers' and employees' quarters	15%

(The whole of the expenditure on temporary erections will be allowed as a revenue deduction).

B. *Furniture and fittings*	10%
C. *Ships*:	
(1) Ocean going vessels (Depreciation to be computed on the "straightline" basis as at present) . . .	5%
(2) Vessels ordinarily operating on inland waters, but other than speed-boats	10%
(3) Speed-boats	15%

D. *Machinery and plant*

The rates of depreciation prescribed for machinery and plant will fall under the following three categories:—

(a) "Group rates" which are applied to the entire machinery and plant used in specified industries, with an option to the tax-payer to elect the "special rates" prescribed separately for particular machinery or plant, *vide* item (b) below.

(b) "Special rates" which are applied to specified items of machinery and plant.

(c) A general (residuary) rate of 5 per cent., which will be applicable to machinery and plant for which no "group" or "special" rate has been prescribed.

(i) *Depreciation at* 10 *per cent*

(a) Industries in which the entire machinery and plant qualifies for depreciation at the 'Group rate'.

(1) Aerating Gas Factories.

(2) Bone Mills.

(3) Coffee Manufacturing concerns.

(4) Cork Manufacturing Works.

(5) Distilleries.

(6) Flour Mills—machinery and plant other than Rollers.

(7) Ice factories.

(8) Match factories—machinery and plant other than wooden match frames.

(9) Rice Mills.

(10) Shoe and other leather goods factories—machinery and plant other than wooden lasts used in the manufacture of shoes.

(11) Starch factories.

(12) Sugar Works—machinery and plant other than Rollers.

(13) Tea factories.

(14) Aluminium Factories.

(15) Battery manufacture.

(16) Brick and Tile manufacture—Plant and Machinery other than wooden shelves and pallets.

(17) Calcium Carbide manufacture.

(18) Cement Works using rotary kilns.

(19) Chemical Works—Machinery and plant like boilers filtera- tion plant, etc. other than machinery and plant coming into contact with corrosive chemicals.

(20) Coke manufacture.

(21) Concrete Pipes manufacture—Machinery and plant other than moulds.

(22) Confectionary manufacture including biscuit and pepper- mints.

(23) Cycle manufacture works.

(24) Dyeing and bleaching works.

(25) Dairies.

(26) Electrical engineering works.

(27) Galvanising works.

(28) Healds and Reeds manufacture (knitting, reed-making, varnishing, doubling, winding and polishing machines).

(29) Hydraulic presses.

(30) Internal combustion engines repairing works.

(31) Iron and steel industry—machinery and plant (Blast fur- nace plant, steel making plant, steel rolling plant, forges, generators, boilers and sheet mills) other than rolling mill rolls.

(32) Iron and brass foundries.

(33) Motor car repairing works.

(34) Oil extraction factories.

(35) Optical instruments manufactur

(36) Paper mills.

(37) Patent stone works

(38) Pottery and other clay products manufacture.

(39) Rod mills.

(40) Saw mills.

(41) Ship building and engineering works.

(42) Soap and candle works.

(43) Straw Board Mills.

(44) Tanneries.

(45) Telephone operating concerns.

(46) Tin and Can making works.

(47) Vegetable Ghee manufacture.

(48) Wire and nail making mills.

(49) Lime Works.

(50) Rubber and Plastic goods factories—General Machinery and plant.

(51) Silk manufacturing—weaving machinery worked by electric motors, including winding machines, twisting frames, doubling machines, pirn winding machines, warping machines, looms, stentering machines and hydro-extractors.

(b) Specific items of machinery and plant qualifying for depreciation at the 'Special rate'.

(1) Mines and quarries—boilers and headgears excluding moving parts.

(2) Ginning and Pressing machinery.

(3) Textile machinery (excluding silk manufacturing machinery)--Jute (excluding generating plant).

(4) Electric Tramways and Tramways run by internal combustion engines—Permanent way not exceeding 50,000 car miles per mile of track per annum.

(5) Electric Tramways—general plant, machinery and tools.

(6) Air Compressors and pneumatic machinery.

(7) Electric Supply Undertakings—electric plant, machinery boilers.

(8) Electrical Machinery (other than batteries) including electric generators and motors (other than tramway motors).

(9) Electrical machinery—Switchgear and instruments, transformers and other stationary plant and wiring and fittings of electric light and fan installations.

(10) Electro-plating and electro-welding plant.

(11) Glass manufacturing concerns except Direct Fire Glass melting furnaces—machinery and plant including machinery for the manufacture of vacuum tubes and vacuum bulbs other than (a) Recuperative and Regenerative glass melting furnaces and (b) Moulds.

(12) Locomotives, Rolling stock tramways and Railways used by concerns, excluding Railway concerns.

(13) Mineral oil concerns—Refineries—

(a) Boilers, (b) Prime Movers.

(14) Mineral oil concerns—Field operations—

(a) Boilers, (b) Prime Movers, (c) Storage tanks (above ground), (d) Pipe-line (above ground), (e) Fixed Boilers (above ground).

(15) Mines and quarries—Tramways on the surface.

(16) Newspaper Production plant and machinery.

(17) Rope-way structures—Driving and tension gearing.

(18) Salt Works—(i) Barges and Floating Plant, (ii) General Plant and machinery used in engineering shops.

(19) Textile Machinery (excluding silk manufacturing machinery)—(a) cotton, (b) woollen and worsted, (c) carpet.

(20) Electric Tramways and tramways run by internal combustion engines—Permanent way exceeding 50,000 and not exceeding 75,000 car miles per mile of track p.a.

(21) Electric tramways—cars—car trucks, car bodies, electrical equipment and motors.

(22) Tramways run by internal combustion engines—tram cars including engines and gears.

(23) Zip Fasteners manufacturing machinery.

(24) Concrete pile driving machines.

(25) Machine Tools—(a) Automatic and Semi-automatic; (b) Precision machine tools *e.g.* grinding machines.

(26) Mineral oil concerns—Refineries—Process Plant.

(27) Mineral Oil concerns—Field Operations—Process Plant; Prime Movers forming part of pipelines (above ground).

(28) Mineral Oil Concerns—Jetties and dry docks constructed entirely or mainly of wood.

(29) Ropeway structures—Carriers.

(30) Salt Works—piers, quays and jetties constructed entirely or mainly of wood; pipelines for conveying brine if constructed of masonry, concrete, cement, asphalt or similar materials.

(31) Electric tramways and tramways run by internal combustion engines—Permanent way exceeding 75,000 and not exceeding 1,25,000 car miles per mile of track p.a.

(32) Tube well boring plant.

(33) Weighing machines.

(34) Works instruments.

(ii) *Depreciation at* 15 *per cent*

(a) Industries in which the entire machinery and plant qualifies for depreciation at the 'Group rate'.

(1) Brick and Tile Manufacture—wooden shelves and pallets.

(2) Chemical Works—Machinery and plant coming into contact with corrosive chemicals.

(b) Specific items of machinery and plant qualifying for depreciation at the 'Special rate'.

(1) Accounting Machines.

(2) Air Conditioning Machinery.

(3) Artificial Silk Manufacturing machinery and plant except wooden parts.

(4) Building Contractors' Machinery.

(5) Calculating Machine.

(6) Earth Moving Machinery employed in heavy construction works such as dams, tunnels, canals, etc.—Motors, Graders, Tourapul scrapers, Excavators, Rooter, Tourna Dozer.

(7) Embroidary machines (hand or automatic) and their accessories.

(8) Mineral oil concerns—Field operations—Distribution—Kerbside pumps including underground tanks and fittings.

(9) Mines and Quarries—Surface and underground machinery (other than electrical machinery, boilers and portable underground machinery), head gear, moving parts and rails.

(10) Neo-post Franking Machines.

(11) Office Machinery including calculating machines, typewriters, neo-post franking machines and accounting machines.

(12) Refrigeration Plant Containers etc. (other than racks).

(13) Road making plant and machinery.

(14) Salt works—Machinery, plant, Locomotives, wagons and rolling stock.

(15) Sewing and knitting machines employed in the manufacture of Hosiery and woollen goods.

(16) Sewing and stitching machines for canvas or leather.

(17) Surgical instruments.

(18) Electric tramways and tramways run by internal combustion engines—Permanent way exceeding 1,25,000 car miles per mile of track p.a.

(19) Typewriters.

(20) Wireless apparatus and gear, wireless appliances and accessories.

(21) Sugar Cane crushers indigenous (Kolhus and belans).

(22) Juice boiling pans (Karhais).

(23) Cinematograph films—Machinery used in the production and exhibition of cinematograph films—(a) Recording equipment, reproducing equipment, developing machines, printing machines, editing machines, synchronisers and studio lights except bulbs, (b) projecting equipment of film exhibiting concerns.

(24) Cycles.

(25) Earth moving machinery employed in heavy construction work such as dams, tunnels, canals etc.—Dumpers.

(26) Electrical machinery—Batteries; X-Ray and Electro-therapeutic apparatus and accessories thereto.

(27) Glass manufacturing concerns except Direct. Fire Glass melting furnaces—Recuperative and Regenerative Glass melting furnaces.

(28) Motor cars.

(iii) *Depreciation at 20 per cent*

(a) Industries in which the entire machinery and plant qualifies **for** depreciation at the 'Group rate'.

(1) Concrete Pipes manufacture—Moulds.

(2) Shoe and other leather goods factories—wooden lasts used in the manufacture of shoes.

(b) Specific items of machinery and plant qualifying for depreci**ation** at the 'Special rate'.

(1) Aeroplanes—Aero-engines.

(2) Aeroplanes—Aerial photographic apparatus.

(3) Earth moving machinery employed in heavy construction works, such as dams, tunnels, canals etc.—Tractors.

(4) Mines and quarries—Portable underground machinery.

(5) Motor buses, motor lorries, motor taxis, motor tractors.

(6) Aeroplanes—Aircraft.

(7) Glass manufacturing concerns except Direct Fire Glass melting furnaces—Moulds.

(8) Mineral oil concerns—Field operations (above ground)—Portable boilers, drilling tools, wellhead tanks, rigs etc.

(9) Ropeway structures—Ropeways ropes and trestle sheaves and connected parts.

सत्यमेव जयते